Mexico | Should the corporate income tax rate be reduced?

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21 Aug 2017

A few days ago Coparmex presented a document containing a series of tax policy proposals. I believe that some of them are right, while others require more discussion. Here, I refer to one in particular: Coparmex proposes a gradual reduction of the corporate income tax rate from its present level of 30% to 24.6%, which is the average rate applied in the OECD countries. Theoretically, lowering this tax may have benefits. It is a difficult tax to collect. There are a number of studies in other countries that suggest that companies end up passing it on to consumers. Therefore, I think the matter should be discussed the next time when taxes are next reformed (which should be when the next government is formed). However, this measure should not be considered without first proposing other ways to increase tax revenues to compensate for the decrease in corporate income tax. One could, for example, reduce this tax and increase VAT at the same time or apply it to articles now exempt. But adopting Coparmex's proposal without any other tax collection policy would be a serious mistake. Coparmex proposes some measures to increase tax revenues, but none of them would compensate the loss caused by lowering the corporate rate. Coparmex also proposes that it is necessary to increase the number of taxpayers by reducing the rate of non-compliance. Of course, this is desirable. But it is somewhat complicated and time-consuming. Tax rate reductions should not be proposed before tangible results in reduction of tax evasion are achieved. The order is important.

First because Mexico does not have the fiscal space to reduce its tax income. Debt as a percentage of GDP has shown a significant upward trend in recent years: public debt as a percentage of GDP has increased by about 20 percentage points over the last seven years, from roughly 30% in 2010 to 50% at the end of 2017. Because of that increase, the rating agencies had narrowed the outlook for Mexican sovereign debt rating from stable to negative. This year will be the first in a decade in which, thanks to fiscal consolidation measures and the Bank of Mexico's operating remnant, debt as a percentage of GDP is going to decline. Thanks to this, the rating agencies have once again raised the outlook on debt to stable. If Coparmex's proposal were adopted, even gradually, the debt-to-GDP ratio would grow again and we would very likely see reductions in the country's sovereign rating. This would mean increases in financing costs for government, businesses and families.

Moreover, Mexico must increase, rather than reduce, tax revenue. It is true that the country’s corporate income tax rate is higher than the OECD average. But what is relevant to this analysis is that Mexico has the lowest tax collection of the countries that make up that organization. While the average tax collection of OECD countries is 34.3% of GDP, in Mexico it is only 17.4%. In this context proposing a reduction in taxes on corporate income, without proposing other tax policies would be irresponsible.

Some people say that reducing tax rates would not lower tax revenues. They rely on a so-called theory that has arisen in the United States called "supply-side economics." According to proponents of this theory, lower tax rates will generate such economic growth that the effect on revenue would be neutral or even positive: you have a lower rate, but a wider base due to economic expansion. This theory was behind the tax cuts of President Reagan and Presidents Bush. Evidence shows, without a shadow of a doubt, that this theory does not work. Today only charlatans defend it. No serious academic economist does. In the Reagan and Bush father and son cases, the reductions cited increased the United States' fiscal deficit and, therefore, debt as a percentage of GDP.

It is pertinent to discuss whether Mexico has an optimal combination of tax rates. But proposing reductions in a source of revenue in isolation is dangerous and irresponsible.

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