Mexico addresses United States Tax Reform

Carlos Serrano
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In the United States a reduction is envisaged in the federal tax rate on companies from 35 to 20%. In Mexico there are voices saying this would be more serious for the country's economy than the breakdown of the North American Free Trade Agreement (NAFTA). This is nonsense.

The concern is that, since this rate is 30% in Mexico, the country will no longer be competitive in relation to the United States and, therefore, will begin to lose Foreign Direct Investment. I think these fears are ill-founded. The tax rate is not the only determining factor regarding decisions about where to invest. Of course, if this tax reform is carried out in the United States, Mexico will lose some of its competitive advantage in the production of manufactures vis-à-vis the US, but in absolute terms it will remain more competitive. This is due to several factors.

Firstly, in Mexico, labour costs in the manufacturing sector are, unfortunately, much lower than in the United States: only one-sixth as high. And labour costs account for 22% of revenues for manufacturing companies in the United States. This factor alone would more than compensate for the aforementioned tax cuts. Secondly, it must be considered that in the United States, in addition to federal corporate tax, there are state taxes: they are applied in 45 states. On average the state tax rate is 6%. For most of the states (82%), the total corporate rate, if the change I talked about comes to pass, would be similar to that of Mexico.

I estimate that even if the tax reduction is approved in the United States, the costs of producing manufactures in Mexico would be at least 20% lower than in that country. Thirdly, the flexible exchange rate is a mechanism that helps to absorb this type of shock: with the depreciation of the last two years, Mexico is more competitive than the United States, even with the change in the rate to 20%.

It is short-sighted to think that the tax rate is the only or even the main factor determining where investments are made. If that were the case, why haven't all US companies moved to the five states that do not have income taxes? Why are there many more companies in California, where the rate is 9%, than in Wyoming, where the rate is 0%?

In recent days, different analysts have said that Mexico should reduce its corporate tax rate in reaction to the possible change in the United States. It is said that our country is uncompetitive due to having one of the highest corporate tax rates in the OECD. However, to analyse the differences in tax burdens, we need to consider the rates that are actually paid, not just the statutory rates.

According to the United States Congress Budget Office (CBO), the corporate income tax rate actually paid by companies in the United States is 18.6%, while in Mexico it is 11.9%. When looking at the effective rate, Mexico is not among the countries at the top of the table. It is necessary to look for other factors that explain our low levels of investment.

Mexico's main fiscal problem is that revenue collection is very low. It is the lowest in the OECD and lower than most countries with similar levels of development. Therefore, it would be irresponsible to think about reducing the rate of corporate income tax, without first designing compensatory measures. That said, it is possible to consider changing the composition of taxes by lowering the tax burden on investment and raising it on consumption, the latter as part of a new fiscal overhaul needed by the country to increase revenue. But it is not a decision that should be taken in haste and even less as a reaction to what is being done in the United States. As I said, it does not need to be done.

Finally, I repeat that comparing this possible tax reform in the United States to the breakdown of NAFTA has no logic whatsoever. The breakdown of NAFTA, while generally not affecting trade flows, since it would be possible to continue to trade with the World Trade Organisation's most-favoured-nation tariffs, would indeed have negative impacts on investment and on targeted sectors such as the production of vehicles for transporting goods.

The tax reform in the United States, as I explained, would not have such negative impacts. the markets perceive it this way. That's why every time there is news about NAFTA, big exchange rate reactions are seen, which does not occur when debates take place on reducing the corporate tax rate in the United States. Exaggerating and making sterile comparisons does not help when discussing the policies that the country should adopt.