

The Tax System and Tax Institutions in Mexico

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Mexico

**THE MIRRLEES REVIEW:
TAX REFORM FOR A MODERN ECONOMY**

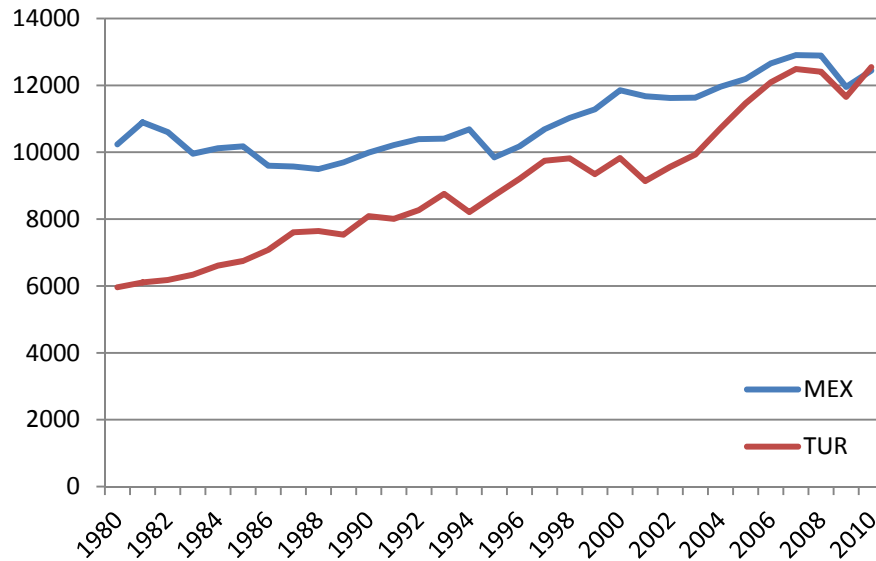
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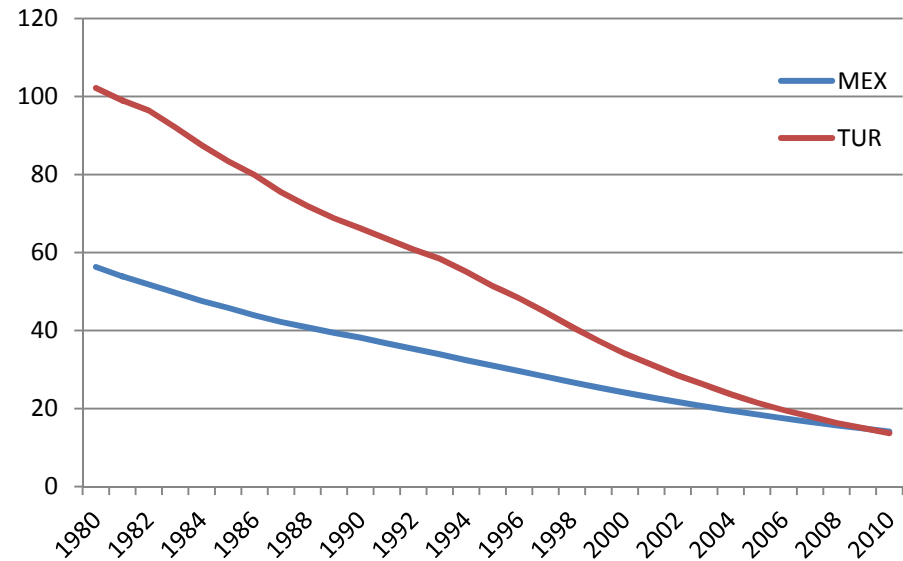
- Tax-benefit reform issues: renewing the social contract
- Recent reform initiatives
- The tax-benefit system: ¿who pays? ¿who benefits?
- Lessons for tax-benefit reforms (in high-inequality, middle income, low-revenue economies)

Mexico and Turkey: growth & distribution

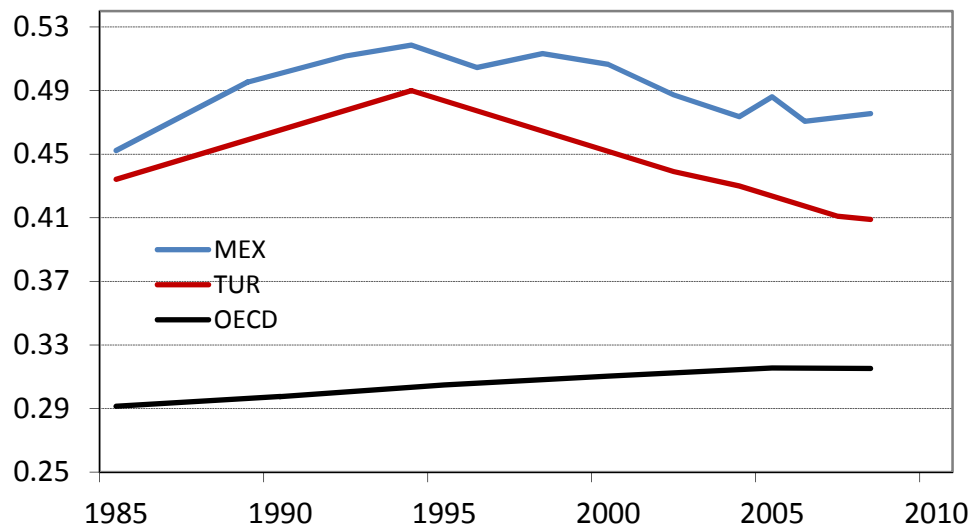
GDP per capita, PPP (constant 2005 international \$)



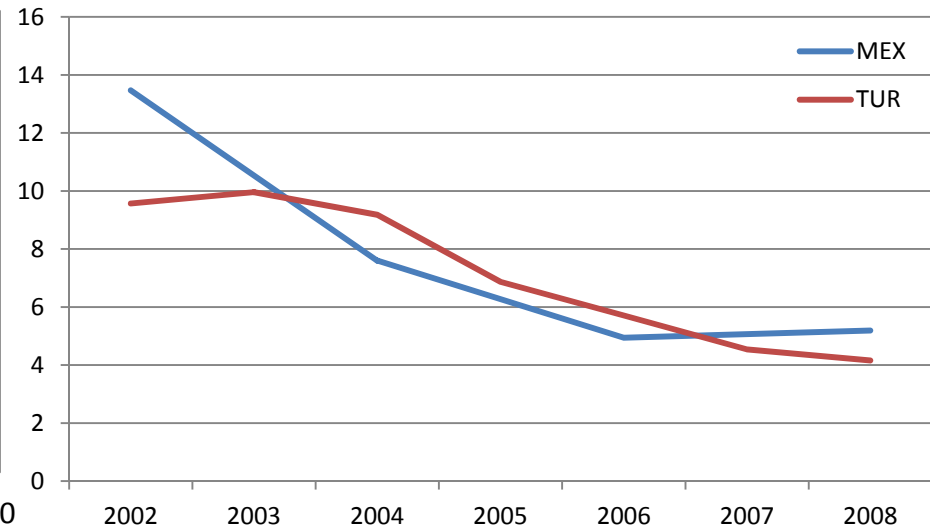
IMR (per 1000 live births)



Gini coefficient of income inequality

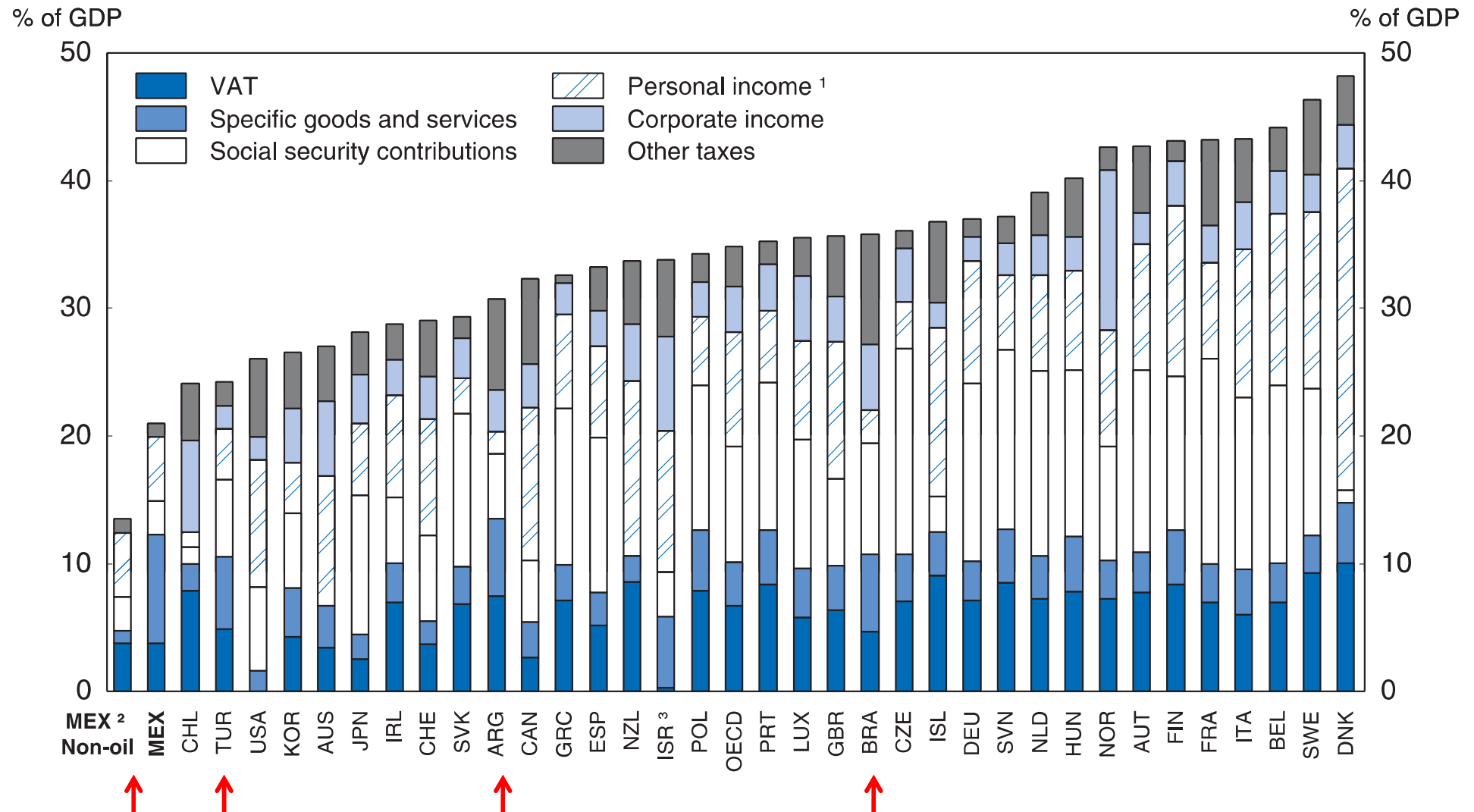


Poverty headcount ratio at \$2 a day (PPP)



Mexico and Turkey: tax revenue & structure

2008



Tax-benefit reform issues

- Low tax revenues: lowest *non-oil* revenues in OECD and LAC
- “Oil curse”:
 - unstable and uncertain oil-revenues (1982 debt crisis)
 - used to finance growing current spending (00’s)
 - Large, distortionary, regressive petrol subsidies (06-)
- Low tax efficiency, complex, narrow base: costly and inequitable tax expenditures
- Quality and equity of public transfers: tax compliance, net incidence

Tax-benefit reform issues

- Public spending requirements:
 - Growing, unfunded public pension deficits
 - Public goods: infrastructural investment, public security,
 - Increasing coverage and quality of social services
 - Universalizing social protection/security.
- Constraints on labor markets, growth and equity from dual social security/protection system

Tax-benefit reform issues

- **High inequality traps/equilibria** require broad and deep reform efforts: high inequality limits growth, but also fiscal/redistributive capacity.
- ***New Social Contract*: broad-based taxes, universal benefits**, towards a more “inclusive”, equitable & pro-growth equilibrium (Acemoglu & Robinson 2012)

Recent reforms and reform initiatives

- Broad tax/benefit reforms in 90's and 00's
 - Fiscal discipline (vs. 80s): eliminating inflation tax
 - Increasing share of public spending allocated to social services: from 30% to 60%
 - Increasing equity of social spending: eliminating urban bias, increasing coverage & progressivity of basic education and health services, CCT (Oportunidades)
- Recent reform initiatives
 - VAT: 1% increase in 2010 (proposal: 2% generalized), following decade of failed initiatives to reduce exemptions.
 - Direct: minimum tax on business income (IETU, 2008), tax on cash deposits, temporary increase of top rate corporate & personal income tax (28 to 30%).

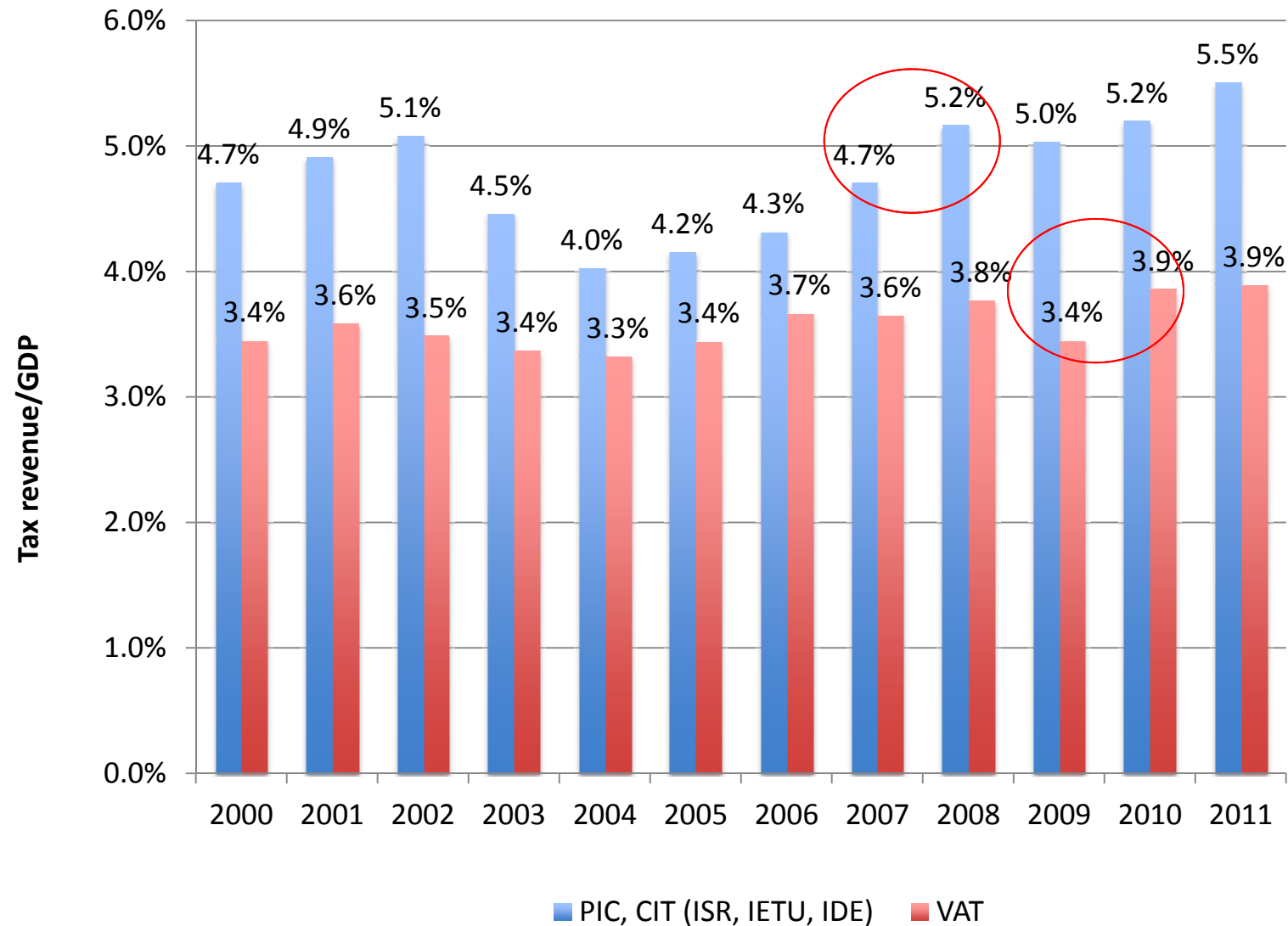
Recent reforms and reform initiatives

- Institutional (post-2000)
 - Transparency, accountability: political culture & legislation
 - *National Evaluation Council for Social Policy* (CONEVAL), National Institute for Educational Evaluation
 - Tax/benefit incidence, fiscal expenditure estimates, and individual program evaluations mandated as inputs for the budgetary process
 - Tax incidence simulator: Center of public finance studies (CEFP), Lower Chamber (eliminated with change of political leadership).
- 2012 electoral platform of leading (PRI) candidate:
 - Universal social protection financed through generalized VAT 16% (following Levy, 2008).

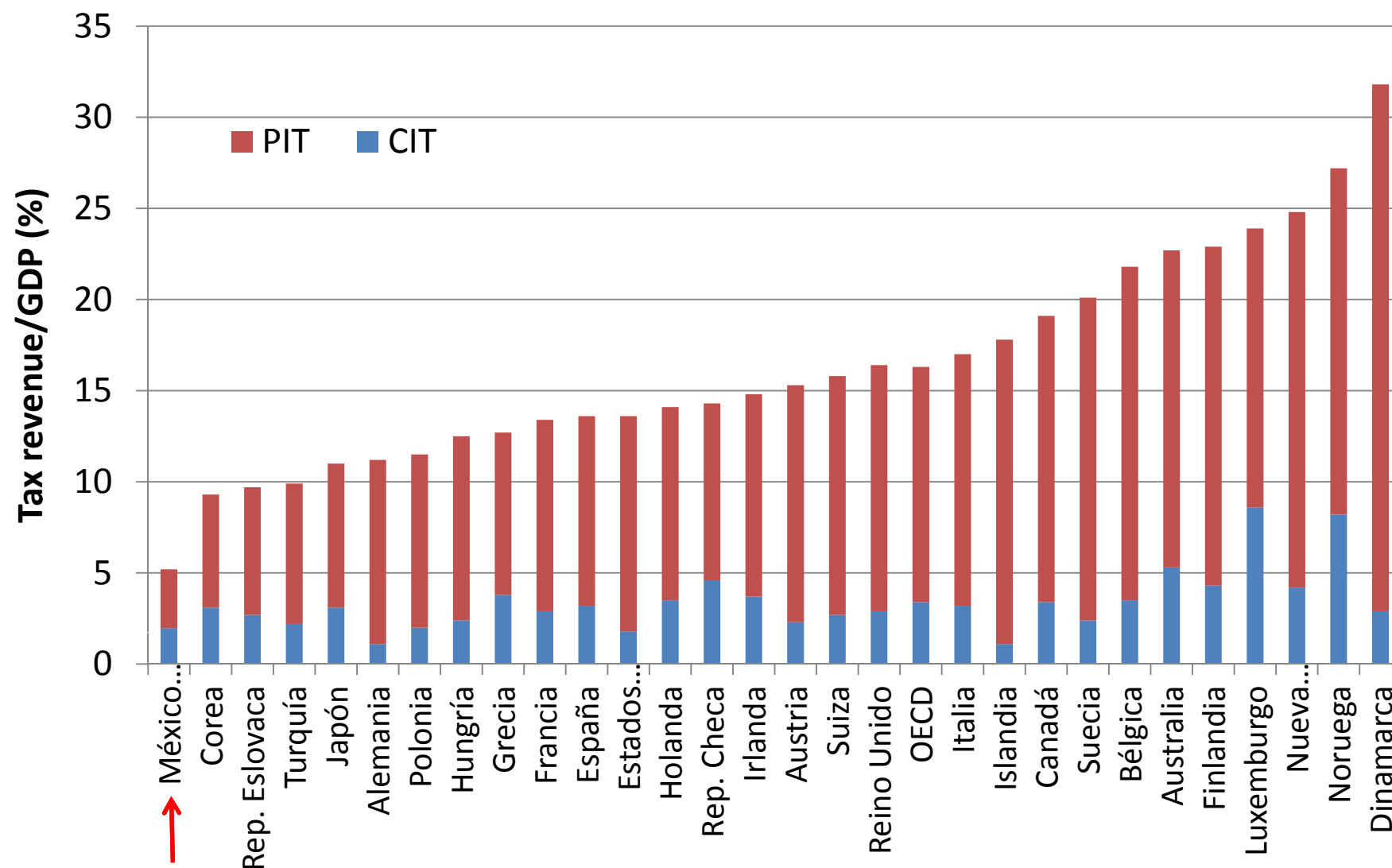
“Redistributive fiscal illusions”

- Tax progressivity vs. redistributive impact of tax-benefit system
 - Under conditions of high inequality, **tax revenue/efficiency** more important for redistributive impact than tax progressivity
 - the share in national income of the poorest decile is 1%, so a 10% flat tax financing a neutral transfer almost *doubles* income of poorest decile: $-0.1\% + 1\%$
- **Redistributive intentions and rethoric vs. redistributive impact:** regressive transfers (in absolute terms) defended on progressive agendas: generalized consumption subsidies, public sector subsidies and agricultural subsidies...

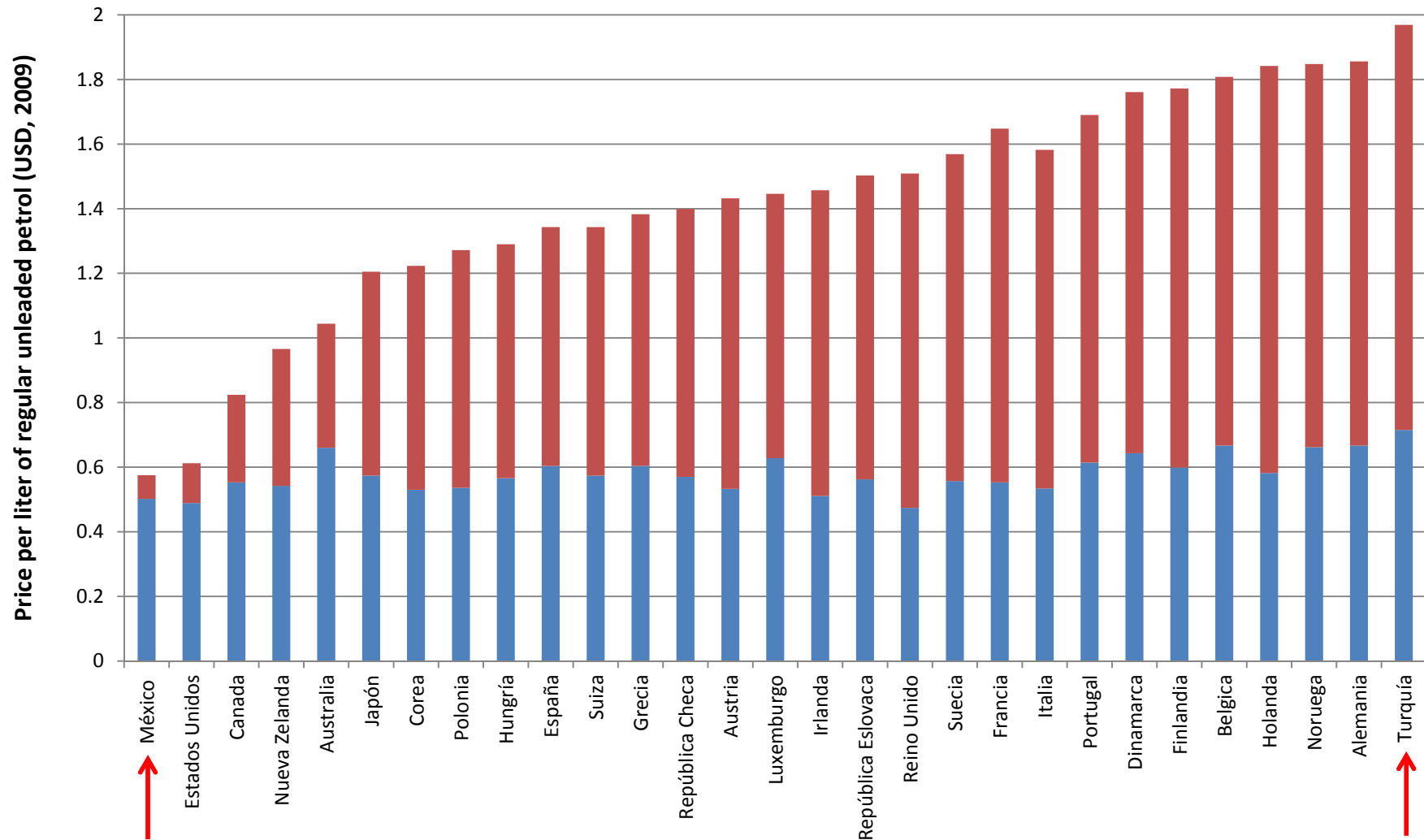
Direct taxes and VAT: 2000-2011



PIC revenue: from 3.23 to 28.9 % GDP

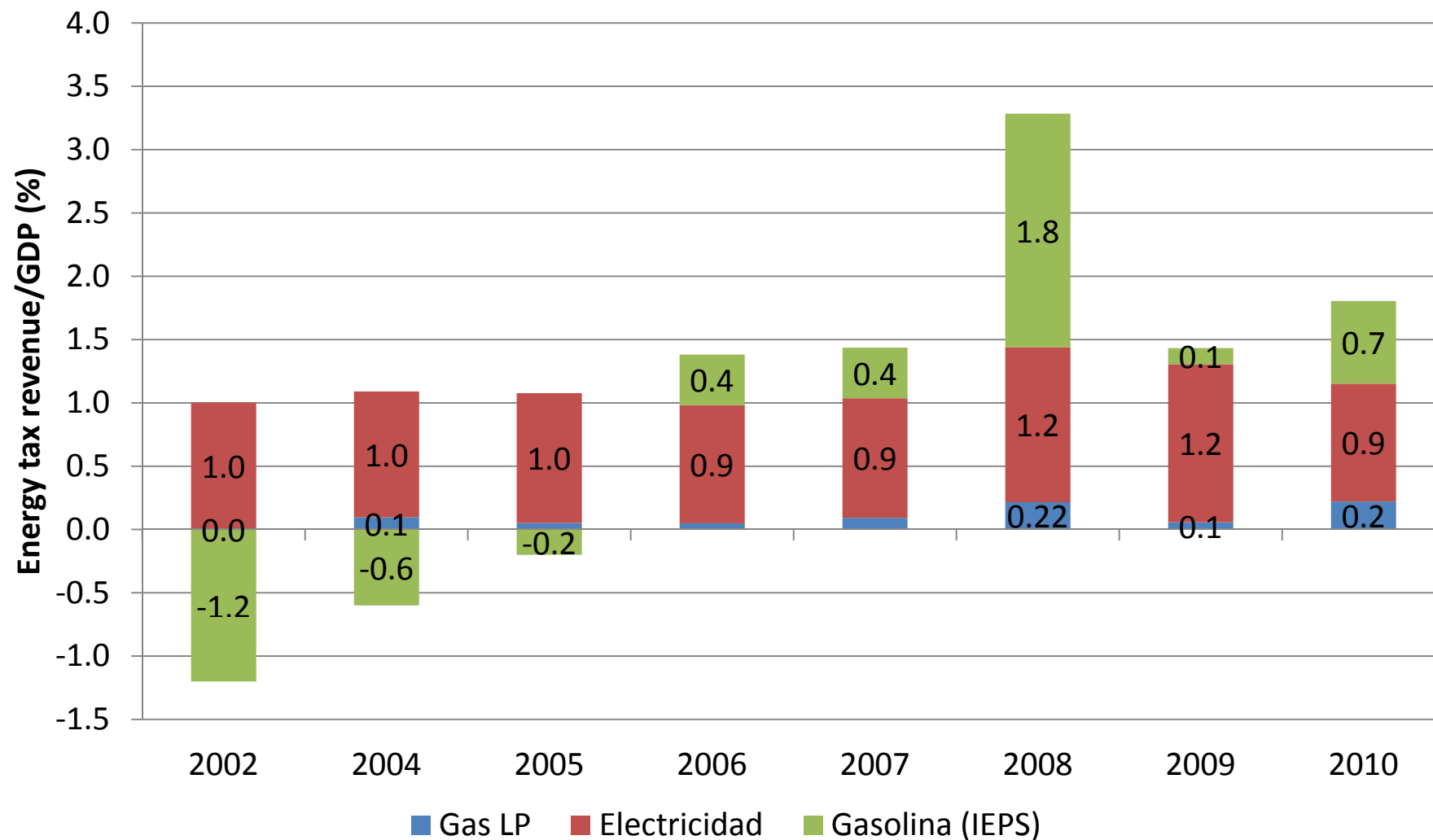


Petrol taxes



OCDE-IEA, Energy Price and Taxes, Quarterly Statistics: 3rd Quarter, 2009.

Generalized energy subsidies: 10% of GDP in 2005-2010 (cummulative)



Tax expenditures reduce tax revenues by a third

Table 5. The size of tax expenditures in terms of lost revenues

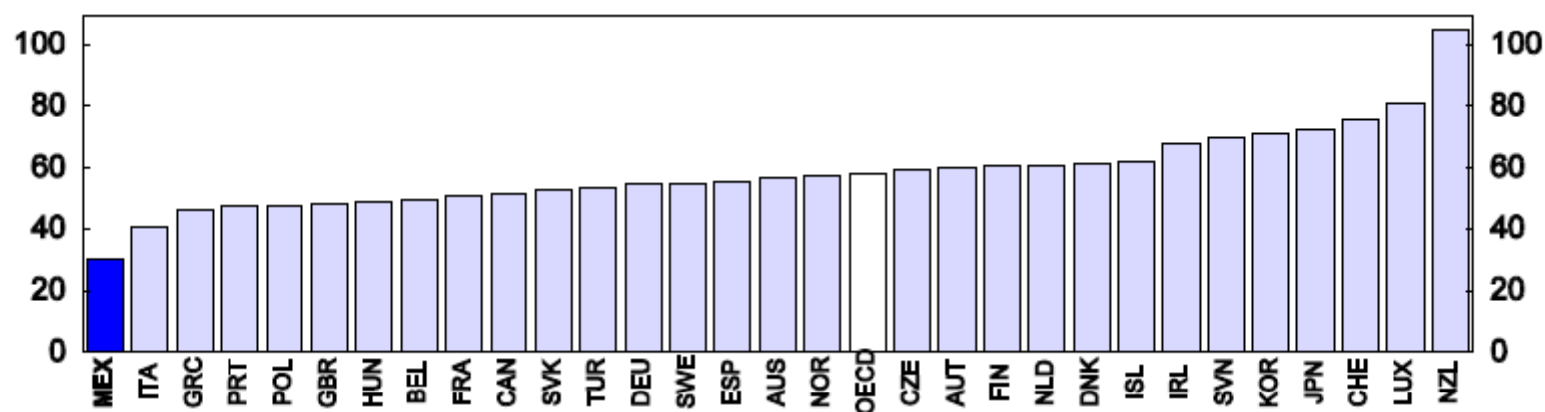
in % of GDP unless indicated otherwise

	2003	2004	2005	2006	2007	2008	2009	2010
Income tax	2.85	2.65	3.64	2.85	2.64	2.09	2.30	1.76
a) corporate income tax	1.35	1.38	2.32	1.71	1.27	1.31	1.44	1.09
b) personal income tax	1.49	1.27	1.32	1.14	1.37	0.77	0.85	0.66
business flat tax						0.79	0.75	0.55
VAT	1.65	1.66	1.72	1.68	1.88	1.73	1.91	1.51
Specific consumption taxes	0.71	0.27	0.16	0.16	0.42	1.64	1.12	0.56
Various tax reliefs	0.32	0.17	0.21	0.14	0.24	0.11	0.12	0.06
Total	5.52	4.75	5.72	4.84	5.19	5.47	5.32	3.79
Total in % of tax revenues	32	28	32	27	29	27	32	

Source: Servicio de Administración Tributaria and Ministry of Finance, Presupuesto de Gastos Fiscales

Figure 12. Effectiveness of value added taxes as measured by the VAT revenue ratio ¹

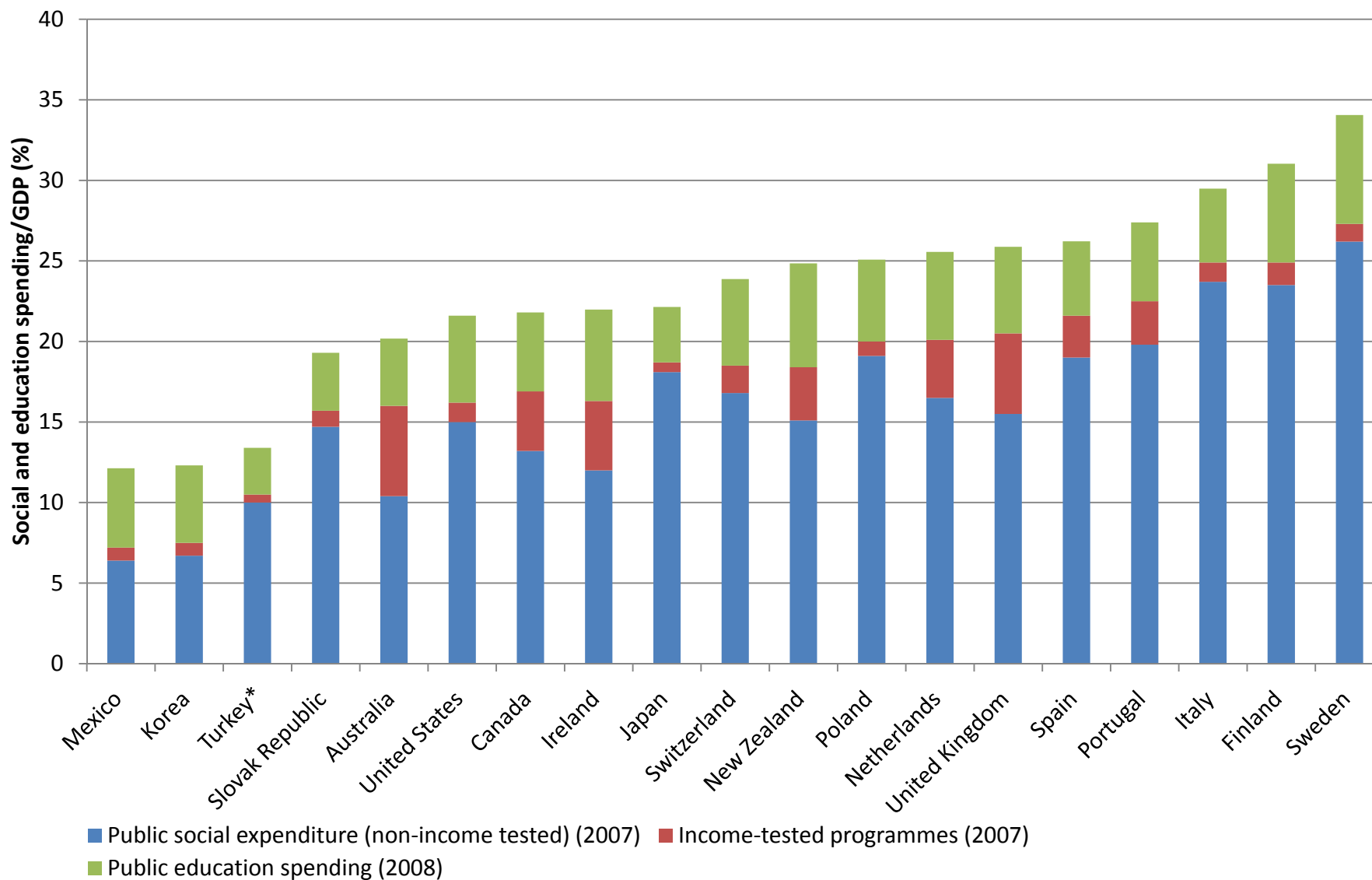
2005 ²



1. The VAT revenue ratio (VRR) is defined as the ratio between the actual value added tax (VAT) revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. This ratio gives an indication of the efficiency of the VAT regime in a country compared to a standard norm. The calculation for Canada is for federal VAT only and the OECD aggregate is an unweighted average of data for the countries shown.
2. 2009 estimates for Mexico and 2007 for Slovenia.

Source: OECD, Consumption Tax Trends; OECD Revenue Statistics database and Ministry of Finance of Slovenia.

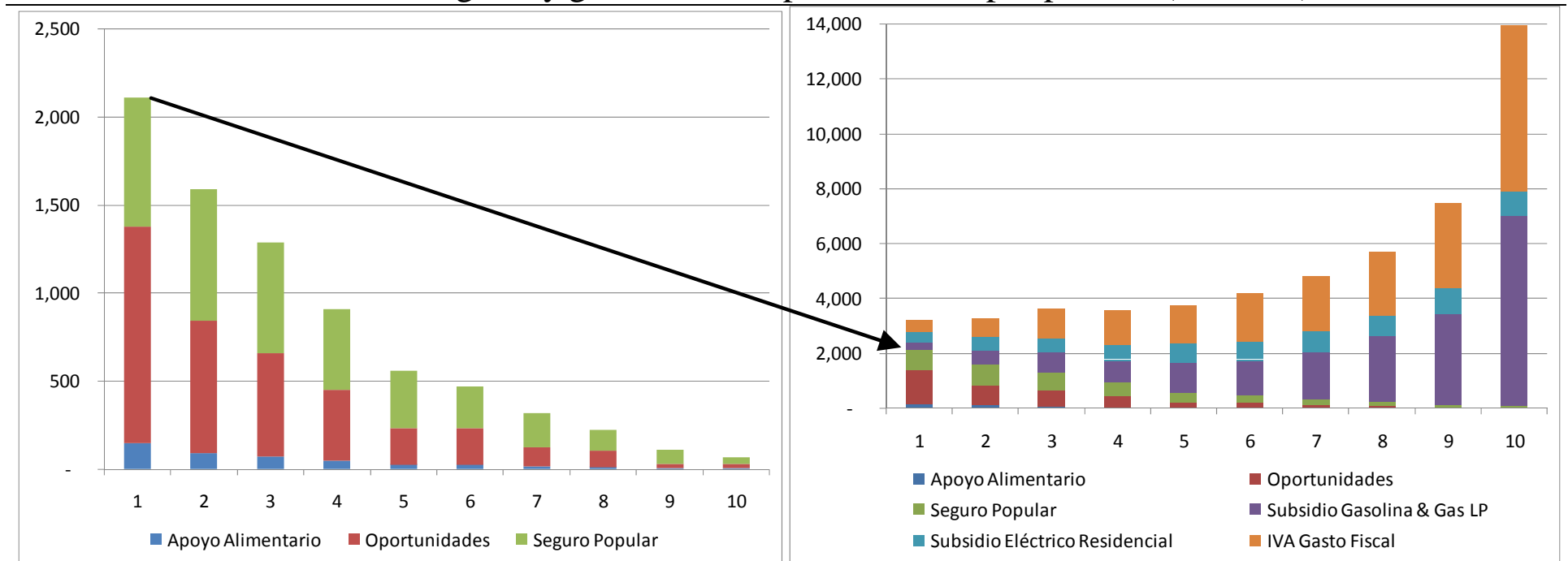
Public social and education expenditure: 12-30+ (%GDP)



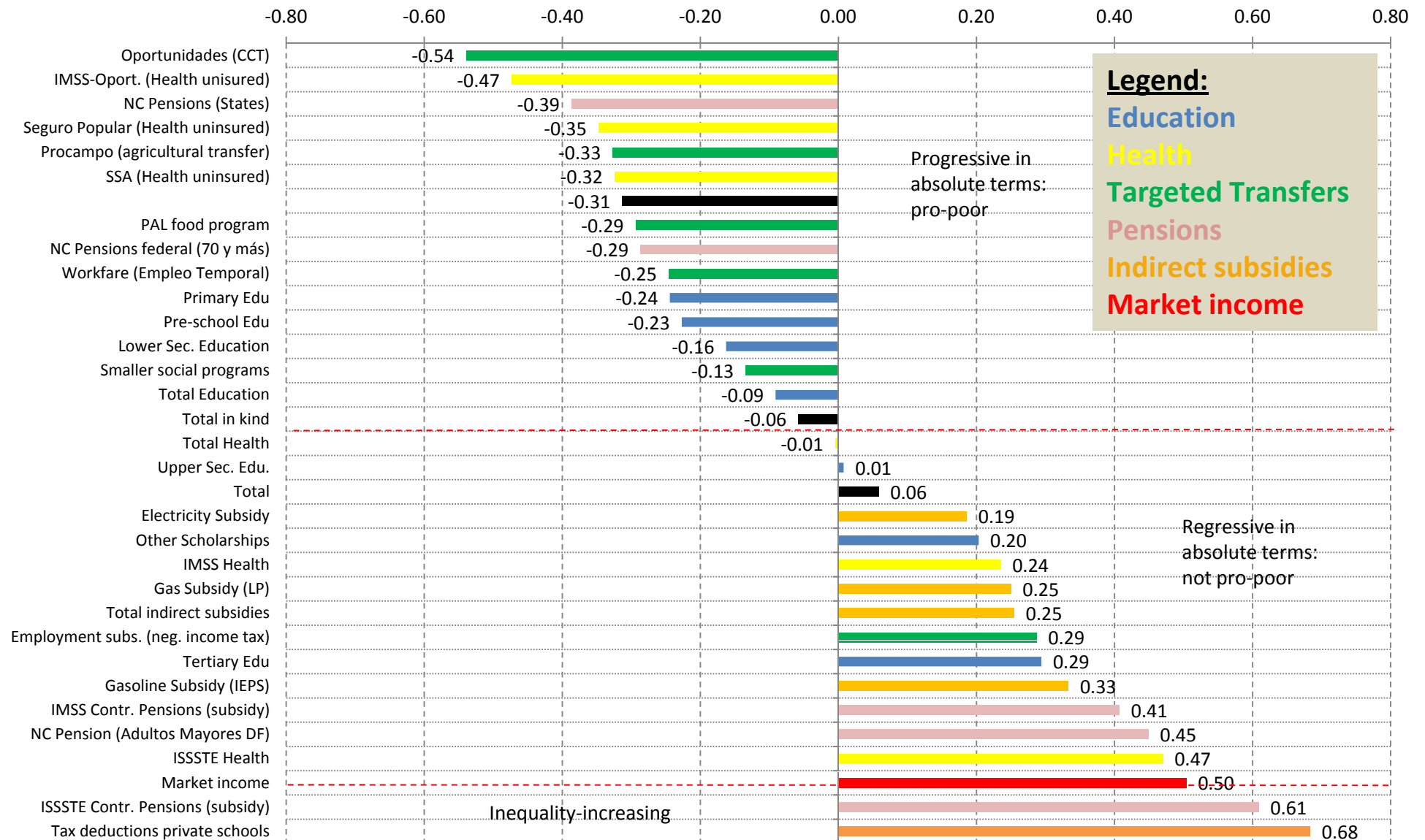
*Turkey education spending: 2006

Generalized subsidies cancel out the redistributive effect of targeted transfers...

Subsidios dirigidos y generalizados: pesos anuales por persona (GP 2008)



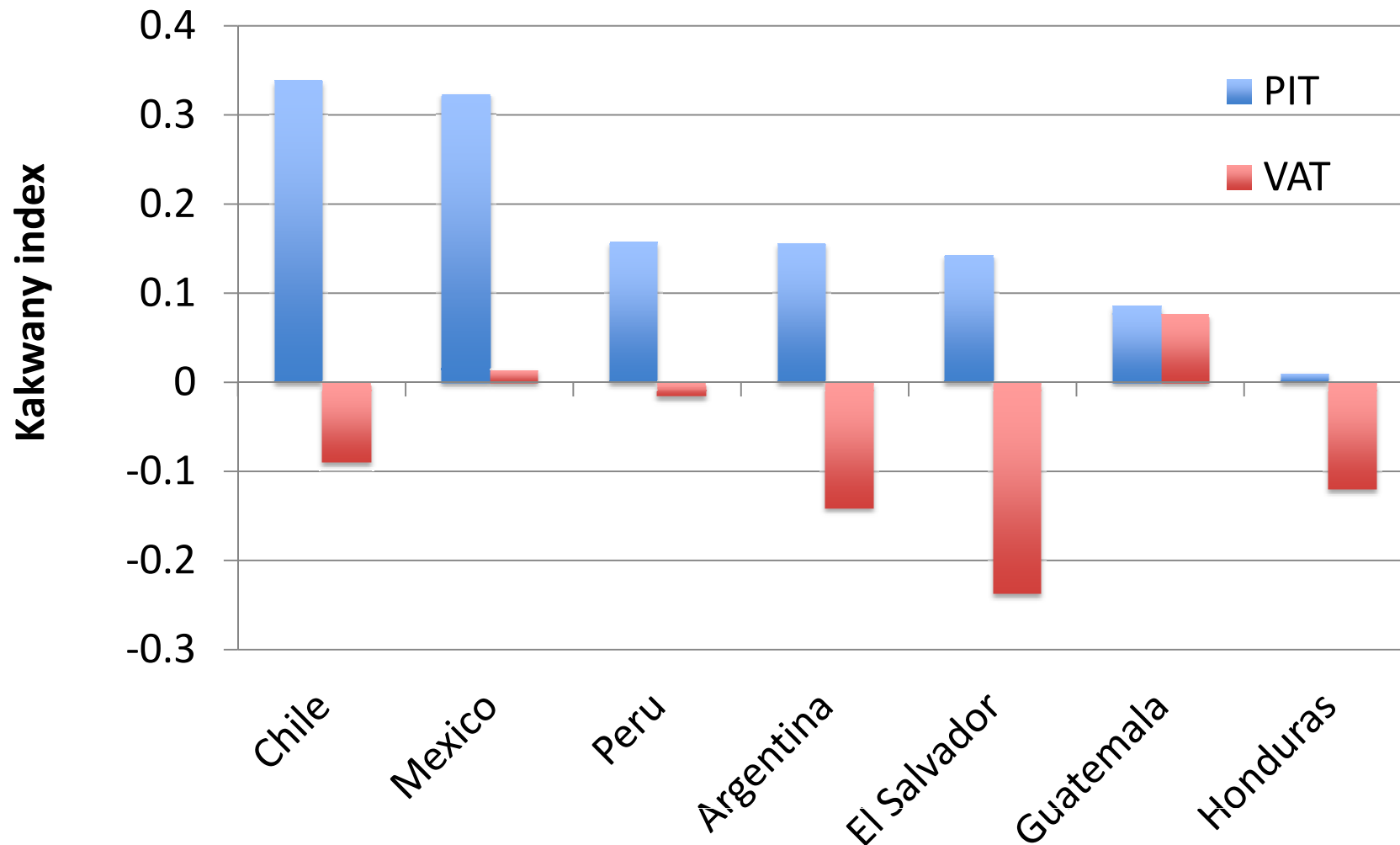
Wide range of redistributive efficiency of public benefits: Concentration/Gini coefficients, 2010



Progressive but inefficient taxes, neutral transfers:
direct taxes/transfers very progressive, but small

	Deciles	Taxes			Transfers				
		Total	Direct	Indirect	Total	Direct monetary	Indirect Subsidies	In-kind	
								Education	Health
Concentration shares	1	0.8%	-0.1%	1.1%	9.9%	22.2%	3.6%	11.5%	10.4%
	2	1.5%	-0.3%	2.2%	9.5%	13.7%	4.9%	11.3%	9.8%
	3	2.1%	-0.7%	3.3%	9.5%	10.6%	6.2%	11.2%	9.7%
	4	2.8%	-1.2%	4.5%	9.8%	9.5%	7.7%	11.2%	9.7%
	5	3.6%	-1.5%	5.8%	9.5%	8.0%	8.4%	10.4%	9.6%
	6	4.6%	-0.6%	6.8%	9.8%	6.9%	9.7%	10.1%	10.0%
	7	6.8%	1.8%	9.0%	9.9%	6.5%	11.0%	9.7%	10.1%
	8	10.2%	6.7%	11.7%	10.0%	5.3%	12.3%	9.3%	10.3%
	9	17.6%	18.4%	17.2%	10.4%	5.5%	14.6%	8.6%	10.6%
	10	50.1%	77.4%	38.4%	11.7%	11.6%	21.6%	6.8%	9.9%
	Total	100%	100%	100%	100%	100%	100%	100%	100%
Incidence (% NMI)	1	-6.28%	0.19%	-6.47%	145.09%	22.30%	13.53%	72.07%	37.20%
	2	-5.78%	0.35%	-6.12%	64.50%	6.42%	8.65%	33.16%	16.27%
	3	-5.65%	0.58%	-6.23%	44.41%	3.41%	7.47%	22.49%	11.04%
	4	-5.74%	0.71%	-6.45%	35.11%	2.32%	7.10%	17.24%	8.44%
	5	-5.84%	0.73%	-6.57%	27.00%	1.55%	6.19%	12.61%	6.65%
	6	-5.92%	0.22%	-6.13%	22.11%	1.07%	5.68%	9.86%	5.50%
	7	-7.01%	-0.56%	-6.45%	17.79%	0.81%	5.08%	7.50%	4.40%
	8	-7.96%	-1.56%	-6.40%	13.72%	0.50%	4.36%	5.44%	3.42%
	9	-9.53%	-2.98%	-6.55%	9.87%	0.36%	3.58%	3.49%	2.44%
	10	-10.71%	-4.96%	-5.75%	4.37%	0.30%	2.09%	1.09%	0.90%
	Total	-8.77%	-2.62%	-6.15%	15.34%	1.05%	3.97%	6.59%	3.73%

Tax progressivity vs. redistributive impact: Kakwani index (C-G) for PIT and VAT



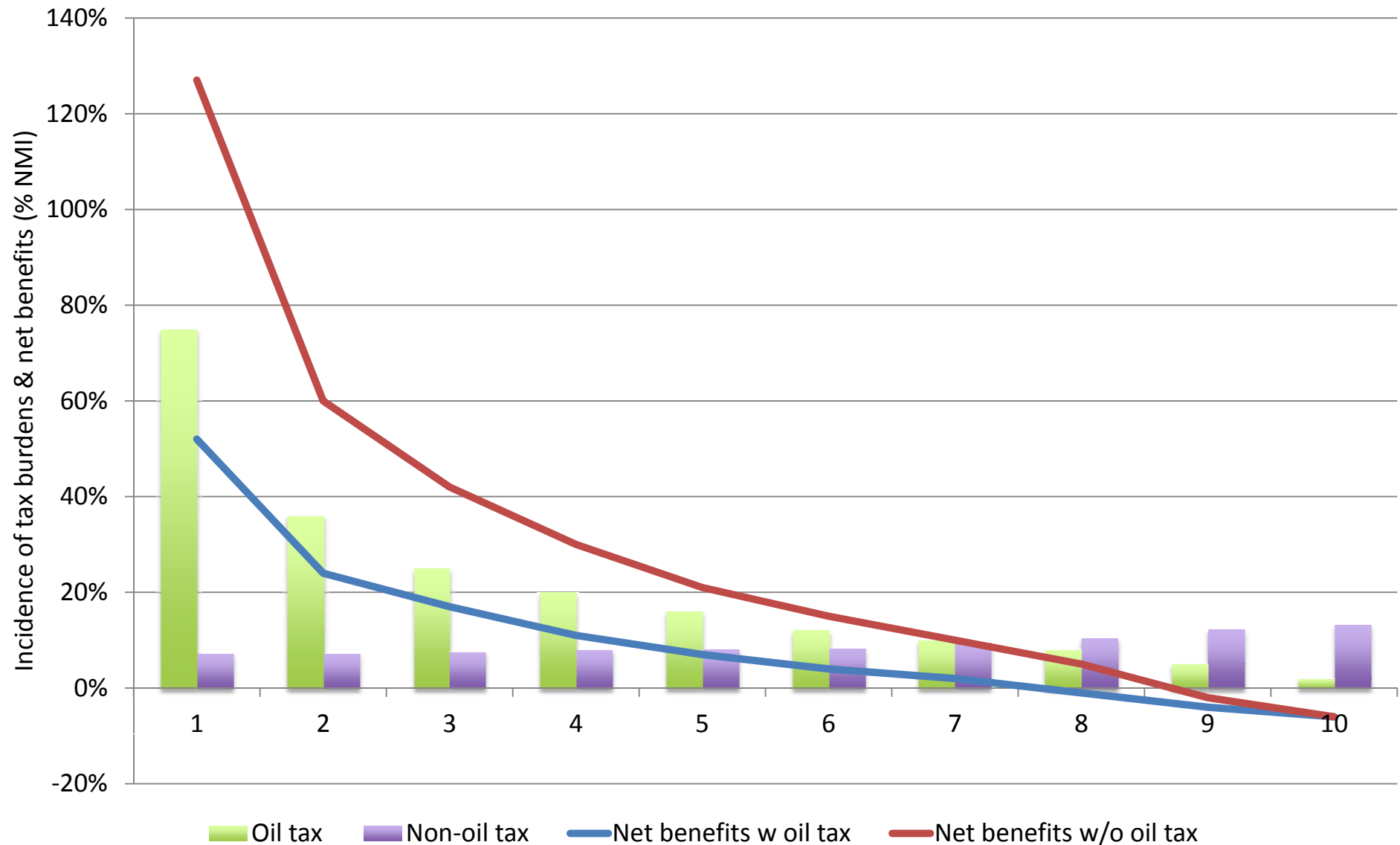
Source: Mexico 2008 (Scott), rest 1989-2000 (Lora, 2007, "Trends and Outcomes of Tax Reform," in *The State of State Reform in Latin America* (Table 6.8, p. 204).

Tax progressivity vs. redistributive impact: generalized 2% VAT, vs. 1% VAT with exemptions

	2 % generalized VAT, Targeted transfer			1% VAT with exemptions, Targeted transfer			2% generalized VAT, Neutral transfer	
HH deciles	VAT	Net transfer		VAT	Net transfer		Net transfer	
		MP hh month	Incidence (% DI)		MP hh month	Incidence (% DI)	MP hh month	Incidence (% DI)
1	-\$50	\$451	15.9%	-\$10	\$125	4.4%	\$74	2.6%
2	-\$65	\$240	5.2%	-\$13	\$69	1.5%	\$59	1.3%
3	-\$75	\$101	1.7%	-\$16	\$32	0.5%	\$48	0.8%
4	-\$85	\$13	0.2%	-\$18	\$8	0.1%	\$38	0.5%
5	-\$96	-\$24	-0.3%	-\$22	-\$3	0.0%	\$28	0.3%
6	-\$105	-\$69	-0.7%	-\$26	-\$16	-0.2%	\$18	0.2%
7	-\$122	-\$96	-0.8%	-\$32	-\$25	-0.2%	\$2	0.0%
8	-\$143	-\$133	-0.9%	-\$39	-\$37	-0.3%	-\$19	-0.1%
9	-\$183	-\$176	-1.0%	-\$54	-\$52	-0.3%	-\$60	-0.3%
10	-\$306	-\$302	-0.8%	-\$101	-\$99	-0.3%	-\$183	-0.5%
Nacional	-\$123			-\$33				

Sources: own calculations using ENIGH 2008, and CEFPI tax incidence simulator.

The incidence of **net benefits** is highly progressive,
but much less so if oil taxes are included:
oil taxes are equivalent to “poll” taxes



Redistributive effect of taxes and transfers in LAC and OECD: monetary transfers vs. social services

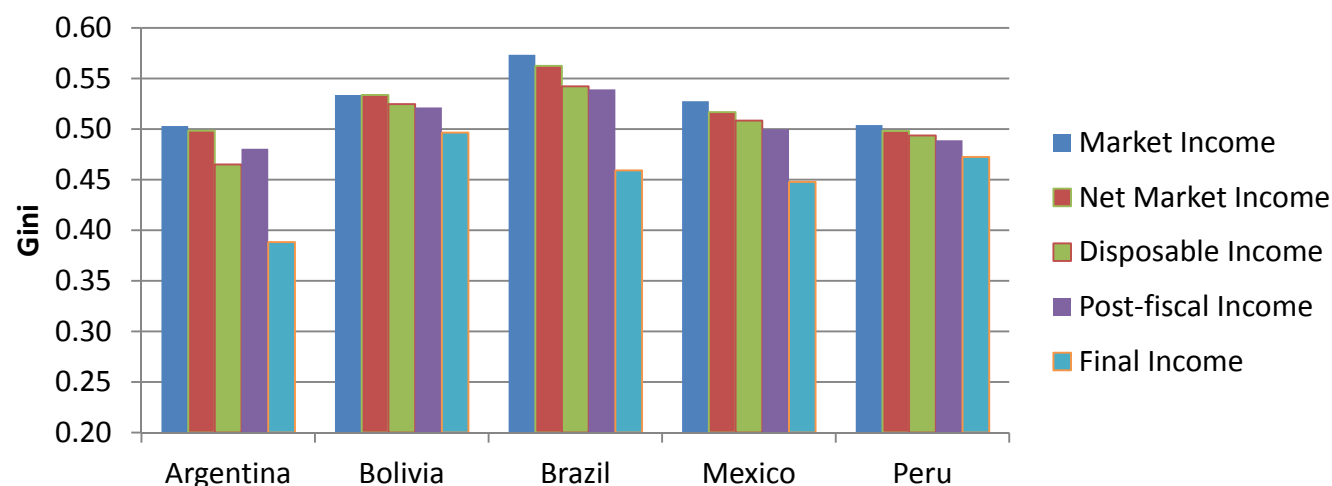
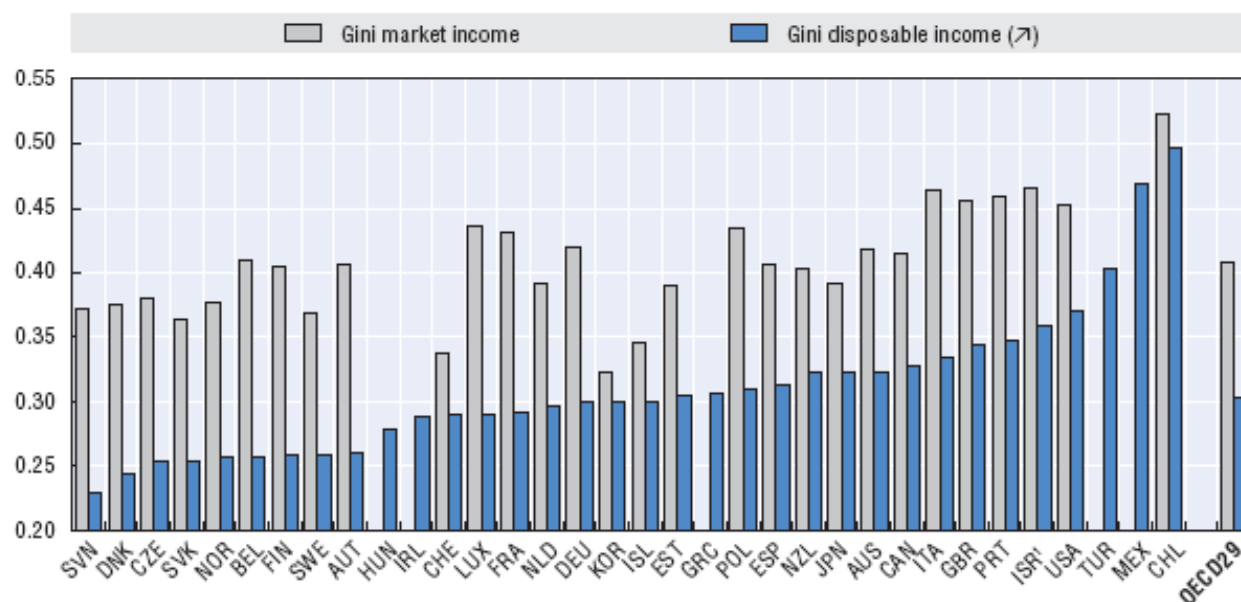


Figure 6.1. **Gini coefficients of inequality of market and disposable incomes, persons of working age, late 2000s**



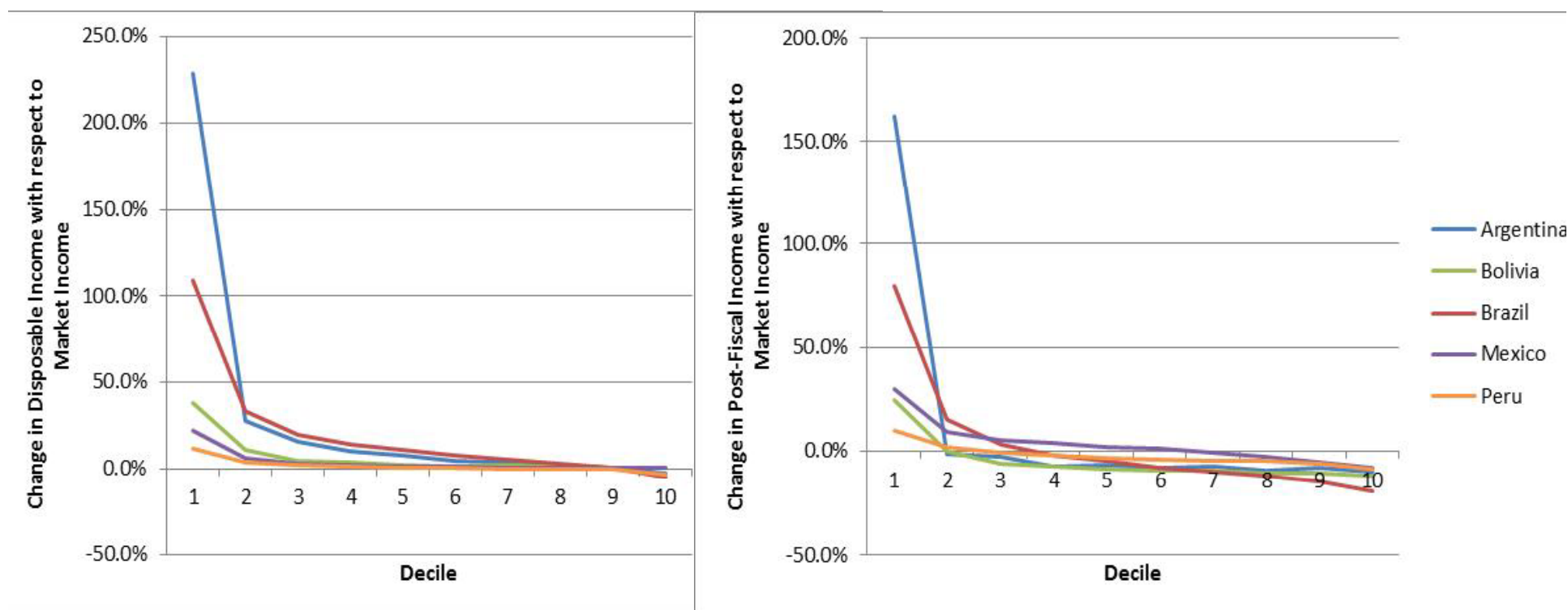
Evidence-based tax/benefit reforms requires comparable/standardized tax-benefit incidence methodologies...

Commitment to Equity (CEQ) LAC project (coordinated by Nora Lustig)

World Bank: long tradition of Benefit Incidence Analysis but no standardized base

OECD, 2011, *Divided We Stand: Why Inequality Keeps Rising*.

In countries with large indirect taxes, these may cancel the benefits received from direct transfers and indirect subsidies even for the poor...



Lessons for tax-benefit reforms

- **Growth of fiscal capacity is endogenous to** the construction of universal and effective public services, not viceversa (history of welfare states: Lindert 2004, *Growing Public*).
- **Tax capacity and efficiency, and the quality and coverage of public benefits** more important for redistributive impact than **tax progressivity**.
- **Generalized consumption subsidies** (VAT exemptions or energy subsidies) are distortionary and **inefficient redistributive instruments compared to targeted or even universal benefits**.

Lessons for tax-benefit reforms

- **Universal social security**, financed through general taxation: dual contributive/contributive social security/protection systems distort labour markets and harm growth.
- More generally, **basic universal benefits/flat tax** (Atkinson, 1995), can be efficient & equitable in high inequality settings