

**The Political Economy of Tax Collection in Mexico: The
Constraints on Reform, 1970-2000**

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Abstract

This thesis aims at explaining the reasons behind Mexico's tax revenue stagnation, by exploring the structural weaknesses of the tax system, identifying the main actors in the tax policy making process, and studying the tax reforms attempts and the role policy actors played to shape them in the last thirty years.

The dissertation first shows Mexico's low tax collection yield and its stagnation for more than thirty years. The analysis portrays an inefficient tax collection system, with a tax structure plagued with a plethora of privileges and exemptions that dilute collection. A large number of interviews with public authorities, politicians, intellectual, representatives of businesses, social and international organizations showed a common concern over Mexico's low tax effort. An issue, which surprisingly has always been in the rhetoric of the political agenda, but has received very little political, social or scholarly attention.

The thesis rises a puzzling paradox. By looking at the dynamics of tax reform, the evidence seems to suggest that even in a strongly centralized and hierarchical state like Mexico, frequently depicted as authoritarian, policy makers have been constrained to shape tax policy. Government's policy objectives and the "uniqueness" of the relationship with socio-economic actors, principally the business community, have affected the nature, profile and outcome of the tax reforms. I argue that the Mexican political system has been upheld by a very fragile political coalition with socio-economic actors, which has become the most important constraint on reform.

The historical analysis shows that a substantial tax reform has been avoided, despite that increasing government revenue is crucial for the long-term economic development of the country. Instead, the government pursued other less politically troublesome means for financing the State. However, these alternative revenues-raising policies exacted a very high social and economic cost in the long run.

The study of the tax policy decision making highlights the dominant role of politics in the policy making process, concluding the clientelism best describes the politics of

tax policy making. As a result, the current shape of the Mexican tax system responds largely to the political accommodation of powerful vested interests. Economic policies have been subordinates to political stability, as well as upholding the fragile coalitions that support the Mexican political regime.

To my father with love.

**I did not become the medical doctor
he wanted me to be, however as he
says, I still can try to cure some
of my country's social diseases.**

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London, May 1st 2000

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Introduction

In the last three decades, Mexico has experienced a profound economic and political transformation. The government has experimented with different development strategies that range from Import Substitution Industrialisation (ISI) to an outward oriented model. Independent of the strategy, the rhetoric has always considered taxation a top priority for sustainable economic development. However, taxation is probably the area that has lagged furthest behind in the process of economic reform, which has been taking place in Mexico since the early 1980s. Mexico's tax burden is surprisingly low compared to other OECD member countries and advanced Latin American nations. More striking is the fact that the total burden of taxation in GDP terms in 1970 was 8.2%, and almost thirty years later and after numerous reforms, the state collects just around 10% of its GDP from taxes. The stagnation in tax revenues is inconsistent with the profound programme of structural reforms undertaken by Mexico in the last 18 years. A structural adjustment process, highly praised by International Financial Institutions (IFIs),¹ included the implementation of substantial tax reforms to strengthen revenues as one of the core policies,² but did not actually improve the rate of tax collection.

¹ See Sebastian Edwards ed., Latin America and the Caribbean: A Decade After the Debt Crisis (Washington, DC: World Bank, 1993); "IMF Approves US\$ 17.8bn Stand-by Credit for Mexico," International Monetary Fund, Press Release No. 95/10, February 1, 1995; Structural and Sectorial Adjustments: World Bank Experience, 1980-92 (Washington, DC: World Bank, 1995); Peter Kenne, "The Use of IMF Credit," in The International Monetary Fund in a Multipolar World (Washington, DC: Transactions Books, 1990); Eduardo Lora, "A Decade of Structural Reforms in Latin America: What has Been Reformed and How to Measure it?," Washington, DC: Inter-American Development Bank, 1997. Mimeo; John Williamson ed., Latin American Adjustment: How Much has Happened? (Washington, DC: Institute of International Economics, 1990).

² Tax reform is one of the 10 policies of what is known as the "Washington Consensus." See Williamson, 1990.

The inability of the Mexican State to raise taxes highlights an ironic paradox. The Mexican State, usually depicted by the literature as strong and authoritarian, has shown to be weak and vulnerable regarding tax collection, the most essential function for the survival of any state. It is difficult to understand how a country like Mexico, with such huge social and infrastructure needs, still collects less than 50% of its total income through taxation. This weakness is evident since the country has faced recurrent liquidity crises at the end of every presidential term, since 1976.

This thesis explores whether selecting tax instruments and defining fiscal policies has been a process of choices made on rational calculations of economic cost and benefits, or the by-product of accommodating policies in a corporatist political system. I argue that the development of the tax system has been based on political expediency rather than economic or administrative logic. Tax policy has been to a large extent the by-product of constant tension among economic and political groups trying to push for the implementation of tax instruments that will produce policies biased in the direction they prefer. The ability of these groups to resist policies that would affect their well-being or could remove their privileges is highly relevant. Although rent-seeking is present in any capitalist economy, the unique characteristics of the Mexican political system have exacerbated its negative effects.³

The historical analysis shows that a substantial tax reform has been avoided; despite the fact that increasing government revenues is crucial for the long-

³ These "unique" characteristics include an authoritarian presidential regime and a corporate political system, where the economic elite enjoys a high degree of control over the country's economy.

term economic development of the country. The most plausible answer to why taxation as the main source of revenue has long been disregarded lies in the politics of tax policy making itself. The unique nature of the Mexican political system has largely contributed to the stagnation of the tax system, since assuring the support of most powerful interest groups became essential for maintaining a fragile coalition that legitimised the political regime.

The various presidents in the last thirty years have opted to pursue alternative means of financing the state, in an attempt to avoid political confrontation with powerful interest groups, especially large investors, empowered with their ability to transfer capital abroad with devastating effects on the economy. The love-hate relationship between the state and the economic elite has been governed by a tacit agreement with the business sector, which secured low tax rates and government support to businesses in exchange for them keeping away from politics.⁴ The official argument in favour of policies of low taxation has been the unsubstantiated belief that an increase in the tax burden would reduce investment and induce capital flight, thus diminishing economic growth. Mexico's powerful economic elite has taken advantage of the government's insufficient resources, using their capacity to transfer capital assets abroad as a powerful instrument to oppose adverse economic policies, particularly taxation. As Prof. Philip states, Mexico has been a victim of globalisation and the mobility of capital since the 1970s, long before the term was even invented.⁵ Another influential force resisting tax reform has been privileged corporate

⁴ For authors that refer to this implicit agreement between the economic elite and the state, see Dan A. Cothran, Political Stability and Democracy in Mexico: the Perfect Dictatorship? (Westport, Conn: Praeger, 1994) and John J. Bailey, Governing Mexico: the State Craft of Crisis Management (Basingstoke: Macmillan, 1988).

⁵ See George Philip, "The Lawless Presidency: Economic Crisis and Democratic Accountability in Mexico, 1970-1994," Democratization, Vol. 5 No. 1 Spring, 1998: 23-41.

actors. Although there has been a clear decline in their influence since the early 1980s, they have remained influential in policy making, being capable of resisting the withdrawal of multiple privileges and exemptions that could have affected their interests.

A key element behind the government's evasive attitude towards a radical tax reform has been the fact that resources could be obtained by less politically troublesome means in the short term. However, these have exacted a very high social and economic cost in the long run. Such revenue-raising policies are: running up budget deficits; inflation; contracting foreign and internal debt; increasing the price of goods and services supplied by the state; relying on oil revenues; privatising state owned companies; or recycling foreign investment; frequently in the form of volatile portfolio investment. In many cases these revenue maximising policies are not very reliable and may create economic distortions. Privatisation is finite while other means, such as increasing the price of goods and services supplied by the public sector, involve a very high social cost. In addition, by relying on these alternative means of financing, the Mexican economy has become very vulnerable to external shocks. External factors such as the lack of foreign credit, the collapse of oil prices, the volatile flows of capital and the rise of international interest rates greatly affect the economy as well as government spending.

The absence of an efficient tax collection system and the subsequent abuse of these mechanisms has produced profound distortions in the economy, which have required the implementation of deeper and costlier structural adjustments to correct. The government has traditionally solved the chronic malaise of the

country's poor revenue collection by reducing government expenditure, lowering subsidies and cutting public investment. Such measures have exacted an extremely high cost on the population, making them politically and socially almost unsustainable. These structural adjustments have been extremely harsh on Mexican society, even affecting areas that the World Bank recognises as spending priorities, such as health and education.⁶

The central question of this thesis is: if increasing revenues from taxes is so important for the long-term development of the country, why has the government failed to increase significantly the collection of taxes in the past thirty years? Analysis of the literature offers four possible hypotheses that could explain the Mexican case. The first is structural weaknesses embedded in the economy. The second is exogenous factors determining the direction and nature of domestic tax policy making. The third is the lack of an efficient administrative structure, limiting the potential for collection and reform, and the fourth is that domestic politics are the reason behind the evasive government attitude towards tax reform.

The analysis of the four hypotheses during my research led me to conclude that each one of them is important and complementary in understanding Mexico's inefficient tax collection system. Nevertheless, I consider the political variable to be the most important factor shaping the tax structure and inhibiting its development and I will test this assumption throughout this dissertation. My hypothesis is that beyond the limits posed by structural weaknesses,

⁶ The World Bank acknowledges that the Mexican may be under-spending on health care, see Adjustment Lending Policies for Sustainable Growth (Washington, DC: World Bank, 1990).

administrative deficiencies and international influences, the accommodation of political interests (both domestic and international) has played the main role in determining the outcome of tax policies in Mexico, and the vested interest of these groups represents the main constraint on reform. /

At first glance, the stagnation of tax revenues during the past thirty years could suggest that the most important structural weakness of the Mexican State, its inability to finance itself, has been largely ignored. In fact, taxation has always been at the top of the government agenda. The highest-ranking public officials have always openly recognised that the fragility of public finances, due to the low tax yield, hinders the country's prospects for development. One after another, authorities have promised to strengthen the country's tax income. Neither could it be argued that there has been little awareness of the importance of strengthening tax revenues on the Mexican society. Public authorities, academics, intellectuals, businessmen, social groups, and international organisations have all expressed their concern and understanding of the grievous implications of an inefficient tax system. But despite the political rhetoric, its perennial presence in the political agenda and a seeming societal awareness of the problem, the fact is that in the last thirty years only lukewarm measures have been implemented to correct the low revenue yield.

Aims and Conceptual Synopsis

This dissertation aims to explain the reasons behind Mexico's tax revenue stagnation, by exploring structural weaknesses and identifying the main actors within the tax-policy making process, and studying the tax reform attempts of the last thirty years and the role that policy actors have played.

This thesis makes the following arguments: politics is the most important factor influencing tax policy-making, although the other variables mentioned should also be taken into account. Tax policies have been shaped by the struggle between the state and vested interests. Tax policy-makers, particularly those of the economic elite, have accommodated the interests of political groups to maintain their loyalty to the status quo. No serious attempts have been made to reform the system because this would jeopardise the fragile political coalition, which sustains the political regime. The highly restricted capacity of the state to extract resources from socio-economic actors portrays a rather weak Mexican State in frank contradiction to the authoritarian depiction used in the specialised literature.

This hypothesis draws from basic assumptions in tax literature: from Peters, Hansen, Rose and Karran, Bird, Elizondo, Kaldor and Reithckmen comes the idea that the process of tax policy-making is a system with political actors, articulated and aggregated into a policy proposals.⁷ The nature of tax policy-making is to reconcile conflicting interests in order to bring about acceptable and workable solutions.⁸ It also takes from a basic premise widely accepted by scholars, which states that all governments act under the same paradigm: any tax reform strategy must involve a minimum political cost, by avoiding political

⁷ Richard Rose and Terence Karran, Increasing Taxes, Stable Taxes or Both? the Dynamics of United Kingdom Tax Revenues since 1948 (Glasgow: University of Strathclyde, 1983); Richard M. Bird, Tax Policy and Economic Development (Baltimore: John Hopkins University Press, 1992); Carlos Elizondo, "In Search of Revenue: Tax Reform in Mexico," Journal of Latin American Studies Vol. 26, 1994: 162; Nicholas Kaldor, Reports on Taxation II (London: Duckworth, 1980); Benjamin Retchkiman, Política Fiscal Mexicana (México: UNAM, 1983).

⁸ Richard Bird, Optimal Tax Policy fo a Developing Country: the Case of Colombia (Toronto: Toronto University Press, 1969): 37.

confrontation as much as possible.⁹ In order to bring these premises into the Mexican context, it takes from Needler the argument that the Mexican political system is supported by a fragile political coalition of societal groups whose unity helps to legitimise the government.¹⁰ I take this argument further, suggesting that such a coalition is so fragile that multiple political and economic benefits need to be given by the state to hold together these self-interested factions. Thus, a profound tax reform that removes tax privileges, particularly from the business community, would undermine this tacit agreement holding together the political system. Due to the absence of a full democracy,¹¹ the state needed to legitimise the political regime by holding together the most important societal forces. As result the state was faced with a dilemma: whether to extract the necessary taxes to finance government expenditure at the risk of breaking the political coalition; or to seek alternative means of financing, therefore avoiding political confrontation, while protecting vested interest groups. The state chose to keep the fragile coalition, which proved to be very efficient in maintaining a stable and civilised political system that allowed rapid and almost continuous economic development. However, it became a major constraint on the modernisation of the country's public finances.

⁹ See Richard Bird and Oliver Oldman ed., Readings on Taxation in Developing Countries (Baltimore: Johns Hopkins University Press, 1975), Richard Bird and Oliver Oldman ed., Taxation in Developing Countries (Baltimore: Johns Hopkins University Press, 1990), Bird, Tax Policy; Rose and Karan; Guy B. Peters, The Development of the Tax State (Glasgow: University of Strathclyde, 1895), Guy B. Peters, The Politics of Taxation: A Comparative Perspective (Oxford: B. Blackwell, 1991) and Susan B. Hansen, The Politics of Taxation: Revenue without Representation (New York: Praeger, 1983).

¹⁰ Martin C. Needler, Mexican Politics: the Containment of Conflict (New York: Praeger, 1990).

¹¹ Although elections were held routinely they were controlled by a single party in government, in what is described by Sartori as an hegemonic party. See Giovanni Sartori, Parties and Party Systems: A Framework for Analysis (Cambridge: Cambridge University Press, 1976).

Synopsis of the thesis

The thesis is divided into three sections. The first one explores Mexico's low tax collection problem, its stagnation for more than thirty years and the attempts made to explain it. The second is the structural analysis, unveiling the anatomy of tax policy making, deconstructing the tax system and exploring the effects on the tax structure of vested interests. The third section makes a historical review of tax reforms during the past thirty years, analysing the main tax reforms, the evolution of the policy actors and the conditioning factors influencing the path of these reforms.

a) The Problem and Review of the Literature

The first chapter examines Mexico's poor tax collection yield, using country comparisons with OECD and Latin American nations, demonstrating that Mexico lags far behind. In terms of the tax ratio compared to GDP, Mexico stands as one of the lowest in the world compared to countries with similar development. It also draws some conclusions on the consequences of an insufficient flow of tax revenues. Secondly, it shows how the tax yield has remained stagnant over the past thirty years, despite a profound programme of structural reforms implemented in the past two decades. Interviews with the most important policy actors clearly demonstrate a common concern for the country's low tax ratio. But despite the authorities' and societal concern there is little awareness of its consequences, and even less support for sharing the burden of increasing the tax effort.

The review of the literature shows that the issue of tax reform in Mexico and the country's low revenue yield has received very little academic attention.

Surprisingly, in Mexico very few books and academic articles have been written on the subject in the span of thirty years. In their absence, reviewing the international literature on the topic of taxation helps to draw four possible hypotheses, of which, after careful analysis, the variable of domestic politics is selected as the underlying factor, not just shaping but holding back the development of the tax system and its collection potential. A major contribution of the thesis is that it raises a puzzling paradox on the nature of the Mexican State, which is frequently portrayed as authoritarian, here will be shown to be weak in response to vested interests, and particularly to the influence of capital. Such argument attempts to contribute not just to the economic but also to the political debate on the nature and limits of the Mexican political regime. The elucidation of the anatomy of tax policy-making and the analysis of the tax structure will show the reader clear evidence of the power of vested interests. A tax system crowned with exemptions and privileges, but perceived by the political elite as necessary to maintain a fragile political coalition that legitimised the regime itself. Chapter two brings to light Mexico's greatest paradox: an apparently strong state unable to extract sufficient resources from its socio-economic actors. The various positions taken by scholars on the autonomy of the Mexican State are reviewed and summarised in support of this argument.

b) Structural Analysis

To understand the impact of policy actors in the tax system, the third chapter identifies the principal actors involved in the process of tax policy making, adjusting the theoretical model proposed by Peacock and Forte on tax planning

to the Mexican context.¹² This section identifies the main actors, their influence and leverage, and examines how these actors interact to shape policy. It also explores how the process of tax policy-making, as well as those actors that shape the tax system, have been transformed by the evolving political and economic conditions in Mexico.

This dissertation recognises that the very complex problem of the country's low tax collection and stagnated development cannot be explained solely by political factors. That endogenous and exogenous forces, as well as structural weaknesses, also play a major role and cannot be disregarded by a political-economy analysis, but it will not be possible to explore them in greater detail due to the required thesis extension.

The fourth chapter demonstrates how the pressure of vested interests plays a major role in explaining why loopholes and tax expenditures have developed and still persist. Deconstructing the tax structure and studying its principal tax instruments helps to understand how these policy actors have shaped the structure while seeking to maximise their benefits. The current profile of the tax system shows past struggles of vested interests to secure benefits and exemptions. Tax authorities and specialists agree on the fact that the erosive effects of harmful preferential tax regimes and multiple exemptions are largely accountable for the country's low tax collection yield and constitute evidence of political trade-offs.

¹² See Alan Peacock and Francesco Forte, The Political Economy of Taxation (Oxford: Basil Blackwell Oxford, 1981).

c) Historical Analysis

For academic purposes the historical analysis of tax reforms and their conditioning factors is divided in three distinct periods based on the last five presidential administrations. The three periods are: *Macroeconomic Populism (1970-82)*, which studies in chapter five the periods of President Echeverría and López Portillo. Chapter six explores a period that I have called *Economic Openness (1982-94)* and covers the sexenios of Presidents De la Madrid and Salinas.¹³ Chapter seven, titled *Democratic Openness (1995-2000)* encompasses the reforms made during President Zedillo's administration and the new political framework where the reforms took place. The empirical evidence will show that the context in which decisions are made and the nature of the Mexican political system ultimately determine the development of tax policies. The examination of the more important tax initiatives during the past five presidential administrations and of the prevailing political and economic conditions will shed light on how politics has affected the fate of the tax reform process.¹⁴

The historical analysis encompassing the last five presidential terms, divided in three distinct periods, will help me to demonstrate that tax policy making has been governed by political expediency rather than economic or administrative logic. The wish to accommodate political interest, rather than the limits posed by structural deficiencies, has played the main role in the design and outcome of tax policies.

¹³Hereafter I will use the word "sexenio" to describe the six years span that constitutes a presidential term. Note that job titles reflect the position the interviewees held at the time of the interview.

¹⁴ It is important to note that this dissertation makes no judgment on the economic advisability of the changes, neither does it make an evaluation of their technical quality.

Chapter I

Mexico's Low Tax Collection: Lagging Behind After Thirty Years of Reform

"I am not saying that people in Mexico do not pay taxes, some may even pay quite a lot. The truth remains, however, that by looking at the overall national scope, total tax collection is relatively low and certainly insufficient to address our nation's needs."

*President E. Zedillo.*¹⁵

This chapter highlights Mexico's very low tax collection yield in a cross-country comparison, stressing how after a process of profound economic transformation tax reform has lagged far behind other structural adjustments. After more than thirty years of tax reforms, tax revenues as a percentage of GDP have stagnated with adverse consequences for economic development.

This chapter raises the question of whether Mexico's tax fragility has been ignored by society and authorities, only to find out after intensive interviewing that the issue has been at the top of the government agenda in the last three decades and representatives from every corner of society seem to be aware of the problem and its consequences. Surprisingly, despite the relevance of this matter, very few scholarly works have attempted to explain the factors that have constrained the development of the tax system. I explored four possible hypotheses in this regard, coming to the conclusion that although each one is relevant, it is politics the main constraint to reform.

¹⁵ See Presidente Zedillo's speech on Apodaca, Nuevo León, September 23rd, 1999, Comunicación Social Presidencia de la República, stenographic copy.

1.1.- Mexico's Tax Collection Effort in a Comparative Perspective

President Zedillo has repeatedly expressed to business representatives his concern over the country's fragile finances, stating that "Mexico's tax burden is extremely low compared to countries with a similar level of development."¹⁶

Mexico has one of the lowest yields of tax collection in the world as a percentage of GDP, about 16% if one takes into account revenues from oil, or just around 10% when only revenues from tax sources are considered.¹⁷

Mexican Public Finance has traditionally suffered from a small stream of revenue through taxation.¹⁸ In 1960, a study commissioned by the Secretary of Finance, Ortiz Mena to an internationally recognised tax expert, Nicholas Kaldor, found that Mexico's revenue from taxation, amounted to just 9% of GDP, one of the lowest in the world at the time. Kaldor stated four decades ago that "the public revenue of Mexico is too small not only absolutely, but relative to its stage of underdevelopment."¹⁹ By the 1970s, despite a slight improvement, Mexico still suffered from one of the lowest tax burden in Latin America, only ahead of Argentina.²⁰ By the 1980s Tanzi's quantitative analysis of the tax systems in developing countries, found again that Mexico had a very small tax collection yield when compared with other countries with similar per

¹⁶ President Zedillo's quotation during a meeting with the country's business elite, including the leaders of Coparmex, the umbrella organisation representative of the country's employers. See Rosa Elvira Vargas, "Cambiarán las Metas Económicas: Zedillo," La Jornada March 14th, 1998:1.

¹⁷ The OECD uses the 16% figure while the Secretariat of Finance reports use a figure close to 10% of GDP.

¹⁸ According to the quotations in Elizondo, Mexico had the third lowest level of tax income in the world in the 1960s. By the early 1970s it still had the second lowest in Latin America after Argentina. Carlos Elizondo, "In Search": 162.

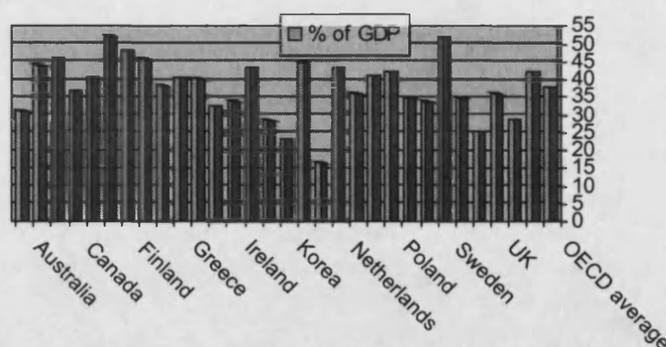
¹⁹ Kaldor, Reports: 215.

²⁰ Quoted by Elizondo "In Search," 162.

capita income.²¹ Total tax revenues as a percentage of GDP has changed very little since 1970, by the end of the 1990s Mexico still had the lowest level of tax collection among OECD countries and the third lowest in Latin America.²²

The average tax revenue as percentage of GDP in OECD countries is 38%.²³ Using OECD's data that includes taxes from oil, Mexico's total tax revenues account for only 16% of its GDP. On the opposite end of the spectrum, the OECD countries with the highest tax/ GDP ratio are Denmark, Sweden, Finland, Belgium and France with over 45% of GDP. Based on Mexico's poor tax ratio figure, the OECD has made an urgent call to increase its tax revenue generating capacity, since more financial resources are required to make up for the country's lags in human development and infrastructure.²⁴

Graphic 1.1.- Tax Revenue as % of GDP in OECD countries



Source: Tax Revenue Statistics OECD, 1999.

²¹ See Victor Tanzi, "Quantitative Characteristics of the Tax Systems of Developing Countries," in D. Newbery and N. Stern, eds., *The Theory of Taxation for Developing Countries* (Oxford: Oxford University, 1987):221.

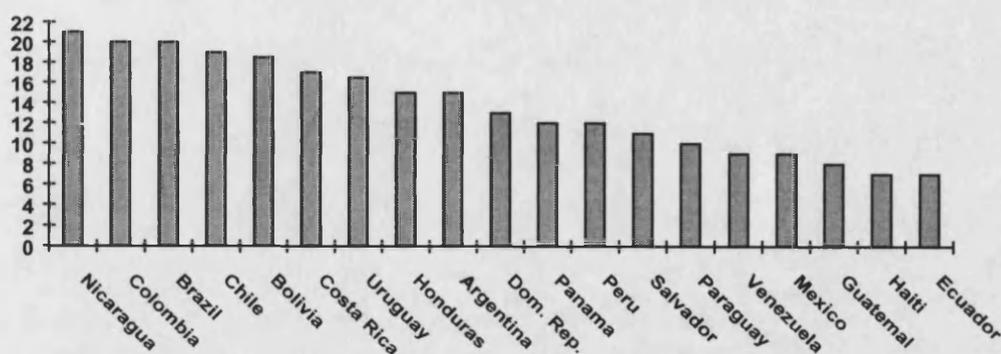
²² See *OECD Statistical Revenues* (Paris: OECD, 1999) and *The Fiscal Covenant: Strengths, Weaknesses, Challenges* LC/ G 204 (Santiago: ECLAC, 1998).

²³ See *OECD Statistical Revenues* for an IMF analysis on the share of tax revenue/GDP in the world between 1986 and 1992, or Janet Stotsky, "Summary of IMF Tax Policy Advice," in Parthasarathi Shome, *Tax Policy Hand Book* (Washington, DC: IMF, 1995): 279-284.

²⁴ See *Mexico: Economic Survey, 1999* (Paris: OECD, 1999).

A comparative analysis with Latin American nations shows similar results. Based on a study made by the Under-Secretariat of Revenues, in 1994 tax collection as percentage of GDP in Mexico was 14%, including revenues from oil. A tax burden ratio smaller than the average 16.7% of GDP in South America and 15.1% in Central America.²⁵ CEPAL data, which do not include revenues from oil, shows an even gloomier picture. Mexico stands as the third lowest country in terms of central government tax receipts, with 9% of GDP (a figure also used by government statistics). The national government tax take (excluding social security contributions) represents 13.6% of GDP in Latin America and 27.2% in the Caribbean countries.²⁶

Graphic 1.2.- Central Government Tax Receipts in Latin America, 1996 (as percentage of GDP)



Source: Figure I-2, Central Government Tax Receipts in The Fiscal Covenant, ECLACL, 1998. The figures include social security contributions, but not oil.

Comparative cross-national tax data shows that Mexico's tax collection lags behind other countries with a similar level of development or per capita

²⁵ Ruíz, "Hacia," 4.

²⁶ See Fiscal Consolidation in The Fiscal Covenant.

income.²⁷ The following table compares Mexico with other countries grouped under “upper middle income” as defined by the World Bank. Turkey is included, despite the fact it is being classified as a low middle-income country, because per capita income is quite similar to the Mexican one. In addition, it is often used in cross-country comparison with Mexico as is the case with Korea, Spain and Portugal, although per capita income in these countries is far greater than in Mexico.

In every case, Mexico’s tax burden is lower than their counterparts, and dependent to a higher degree on non-tax revenues. It is noteworthy to mention that the figure used by the World Bank for Mexico includes oil revenues, if it did not, then Mexico’s position would be even worse. The data on selected high-income economies sheds further light on the existing differences in terms of tax and non-tax revenues with these countries. The conclusion is that countries with similar level of per capita income have developed their tax systems much better than Mexico, since they developed a better revenue generating capacity. The empirical evidence suggests that there is a correlation between the tax burden and per capita income, those countries with a per capita income of less than \$5,000 had a tax burden below 20%.²⁸ Again, Mexico performed poorly even when this variable is taken into account.

²⁷ Elizondo argues that comparisons ought to be made with countries with similar GNP per capita, since countries with higher GNP per capita tend to raise and spend more as percentage of GNP. Thus, I used for the comparison those countries classified by the World Bank under a similar GDP per capita income. However, Kodrzycki argues that among OECD there is no general relationship between a country’s GDP per capita and its overall level of taxation, explaining that more affluent countries rely more heavily for their revenues on income and profits taxes. See Yolanda Kodrzycki Henderson “A Second Word About Taxing Affluence,” in Herbert Stein ed., Tax Policy in the Twenty First Century (London: John Wiley & Sons, 1988): 248-252.

²⁸ See Graphic 1 titled Recaudación Total como Porcentaje del PIB, promedio 1994-1996 in Carlos Elizondo, “La Fragilidad Tributaria del Estado Mexicano: Una Explicación Política,” El Mercado de Valores Nacional Financiera, July 1999.

Table 1.1.- Tax Revenues: Comparative Perspective

Upper Middle Income Countries				
Country	Income per capita in USD	Total Tax Revenues as % GDP	Non Tax Revenues (% of GDP)	GDP in USD (millions 1995)
Turkey	2,780	14.3	7.3	164,789
México	3,320	14.8	8.0	250,038
Brazil	3,640	18.6	4.9	688,085
Czech Republic	3,870	37.5	13.0	44,772
Malaysia	3,890	20.6	6.6	85,311
Hungary	4,120	44.9*	20.5*	43,712
Chile	4,160	17.8	9.7	67,297
Argentina	8,030	28.9 **	2.6*	281,060
Greece	8,210	26.0	17.8	90,560
High Income Economies				
Korea	9,700	17.7	6.5	455,476
Portugal	9,740	30.9	12.8	102,337
Spain	13,580	28.7	6.5	558,617
United States	26,980	19.0	0.8	2,708,150

Own Elaboration with data from: Selected World Development Indicators, World Development Report, 1997 from the World Bank.

* 1980, **From Elizondo's data in "la Fragilidad."

IFIs have expressed deep concern for the limited capacity of the Mexican State to extract resource to undertake its fundamental tasks, including public spending for social programmes and infrastructure. This restrained revenue generating capacity is shown by Mexico's low tax collection yield as a percentage of GDP. As result, the OECD has called the Mexican government to boost its tax-collection abilities to ease reliance on oil revenues and increase social spending. This organisation states that the low level of tax collection represents a debilitating factor in Mexico's economic strategy, urging the country to increase its revenue generating capacity.²⁹ In the same lines, the IMF has stressed the negative effect of weak flows of tax revenues on macroeconomic stability and development in Latin America. In the case of Mexico, increasing tax collection was one of the most important conditions

²⁹ The OECD recommended in a recent study to reinforce the tax system and accelerate the process of structural reform. See Mexico: Economic Survey, 1999 and "Recomienda la OECD a México, Reforzar el Sistema Tributario y Agilizar Reformas Estructurales, Financiero April 29th, 1999:1; "Mexico Told to Boost Tax Take," The Financial Times April 30th, 1999, 3.

required by the IMF 1995 stand by credit agreement.³⁰ A view shared by the World Bank, its chief economist, William Perry, stated that in order to achieve a sustainable strategy of development Mexico should increase its fiscal effort, arguing that progress lies in making collection more effective and broadening the tax base.³¹

Inter-American Development Bank studies stress that “in most countries in Latin America the effectiveness of taxes remains weak,”³² concluding that in the realm of taxation progress has been limited, despite multiple tax reforms that have been implemented in the region. The data show in particular Mexico’s poor performance.³³ For IADB’s president, Enrique Iglesias, the low level of tax collection in Mexico is worrying, adding that tax reform is a top priority for the Bank. He pointed out the vast resources channelled to Latin American countries for this task.³⁴ In the context of Latin America, Mexico stands as one of the weakest tax system in the region. This has moved ECLAC to call for a new fiscal pact, explaining that recent improvements in Latin America’s tax systems (including Mexico) represent just a marginal improvement in terms of revenue adequacy. The basic assumption of the proposal is that the State cannot systematically and efficiently carry out its functions with limited tax revenues. Thus, the international organisation calls for a renewed fiscal

³⁰ Teresa Ter-Minassian and Gerd Schwartz, “The Role of Fiscal Policy in Sustainable Stabilization: Evidence from Latin America,” *IMF Working Paper No. 94*, August 1997 and Vito Tanzi, “The Impact of Macroeconomic Policies on the Level of Taxation and the Fiscal Balance in Developing Countries,” *IMF Staff Papers*, Vol. 36, num. 3 September, 1989. The 1995 IMF Standby Agreement with the Mexican government also called for a review on tax policies for the 1996 budget.

³¹ Interview, Barcelona, Spain, March 16th, 1997.

³² Lora, “A Decade”: 16.

³³ Ibid.

³⁴ Interview Barcelona, Spain, March 17th, 1997. See IADB loans to Latin American countries to improve tax administration.

covenant that strengthens public finance and legitimises the role of the State, and the scope of government responsibilities in the economic and social spheres.³⁵

1.2.- The Consequences of an Inefficient Tax System

The tax system has failed to provide its main objective, a constant and stable flow of revenues to finance public spending. Now, limited tax revenues threaten fiscal equilibrium. The State's difficulty in meeting its revenue targets, mainly because of a decrease in non-tax income, whether in the form of capital revenues, lower oil prices or lower sales volumes of products and services provided by the state, has led frequently to budget deficits and even to financial crisis.³⁶ The OECD states that Mexico requires strengthening of its tax revenues to allow the funding of key spending programmes. For the country to improve equity through public spending, it is fundamental to enlarge the low capacity for raising revenues.³⁷ The government has solved the recurrent public finance imbalances by reducing public investment, lowering subsidies and cutting the budget in social programmes. However, in the words of the Under-Secretary of Finance it is unsustainable to follow this strategy, and ultimately could undermine the State's capacity to address the basic social demands and the infrastructure required for sustainable development.³⁸

³⁵ The objectives of the pact include strengthening tax revenues, raising the productivity of public expenditure, enhance transparency on tax expenditures and promoting social equity through the fiscal covenant. See El Pacto Fiscal: Fortalezas, Debilidades, Desafios, CEPAL, LC/G 1997/ Rev. 1, July 3rd, 1998, and Eugenia Lahera, "El Pacto Fiscal en América Latina: una Propuesta de la Cepal," Comercio Exterior Vol. 49 no. 6, Mexico, June 1999.

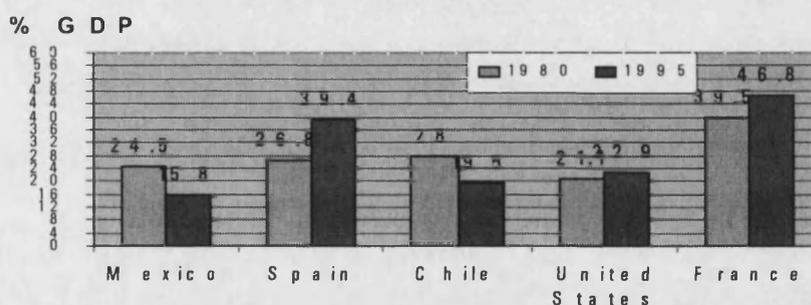
³⁶ To Easterly, Rodríguez and Schmidt, large fiscal deficits are largely explained by conscious policy choices not by external shocks or by feedback from domestic economic conditions. For Macroeconomic consequences of public deficits, see William Easterly, Carlos A. Rodríguez, Klaus Schmidt-Habbel, Public Sector Deficits and Macroeconomic Performance (Oxford: Oxford University Press, 1994), see also Vito Tanzi, The Political Economy of Fiscal Deficit Reduction (Oxford: World Bank and Oxford University Press, 1994).

³⁷ See Mexico Economic Survey 1999.

³⁸ Interview Tomás Ruíz, September 21st, 1999 and Ruíz, "Hacia": 9.

The size of the government has been drastically cut in the last two decades seeking to compensate for the lack of resources.³⁹ In 1982, Mexico's government total expenditure represented 44% of GDP, by 1998 it had declined to just 22%.⁴⁰ While the federal budget (programmable expenditure) has drastically decreased in Mexico, in other countries it has increased significantly.⁴¹ In a period of ten years, programmable expenditures per capita shrank from 11.05 thousand pesos 1988 to 6.0 thousand in 1998.⁴² This helps to explain much of the increase in inequality in Mexico, which observers have noted since 1982.⁴³

Graphic 1.3.- Government Expenditure (Programmable Expenditure as % GDP)



Source: Secretariat of Finance and Public Debt, 1998.

In conclusion, the economic development of the country is threatened by a low yield in tax revenues. This handicap limits the resources the government can

³⁹ For a good debate on the new role of the state see Luiz Carlos Bresser Pereira, State Reform in the 1990s: Logic and Control Mechanisms (Brasilia: MARE, 1997).

⁴⁰ This figure includes the cost of financing public debt, see Ruíz, "Hacia," 7.

⁴¹ According to ECLAC in the 1990s there was a marked resumption on social spending in Latin America. See Fiscal Covenant. In Mexico social spending has increased proportionally to the budget, in 1997 it was about 65% of the federal budget, proportionally above those budgets from Brazil or the US, however smaller in GDP terms. See Ingresos y Gestión Pública, official document by the Secretariat of Finance and Public Debt, 1998.

⁴² See Revisión Sistema Fiscal Integral, official document by the Secretariat of Finance and Public Debt, 1998: 25.

⁴³ See Economic Survey of Latin America and the Caribbean (Santiago: ECLAC, various years) and Economic and Social Progress in Latin America (Washington, DC: IDE, 1997).

appropriate to promote its social agenda and maintain a macroeconomic balance. Current resources from taxation are insufficient to finance public spending, since tax revenues represent less than 50% of total government income. Putting together all revenues from the main tax sources, they contribute with only 74% of the total budget or 88% of the resources destined for social spending.⁴⁴ In 1998, public spending reached the lowest level in 18 years, despite the growing size of the population.

The government claims that it has succeeded in reducing the size of the government apparatus as well as improving its efficiency.⁴⁵ However, the small tax revenue yield threatens the state capacity to address the growing social demands.⁴⁶ International organisations such as the OECD and CEPAL, have remarked on the low level of public spending in Mexico, compared to other countries surveyed. Both highlight the declining trend in public spending at a time when the country is clearly lacking modern infrastructure and is lagging badly behind in regards to social investment.⁴⁷

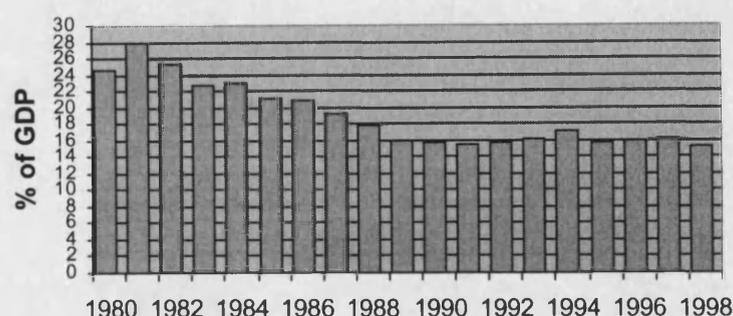
⁴⁴ Ruíz, "Hacia," 8.

⁴⁵ In a period of ten years almost a thousand state companies were privatised, decreasing from 1155 in 1982 to 217 in 1992. For the process of divestiture of public companies see Jacques Rogozinski and Francisco J. Casas, "The Restructuring Process in Mexico," in Public Administration in Mexico Today (México: Secretaría de la Contraloría General de la Federación and Fondo de Cultura Económica, 1993) 21-48.

⁴⁶ Speech delivered by Secretary of Finance, José Angel Gurría, on the opening of the forum "La Reforma Fiscal que Mexico Requiere," Mexico city, November 5, 1998.

⁴⁷ CEPAL figures show that Mexico's public spending is one of the lowest in the Latin American region, with 7.8% in 1997, the OECD rise the same concern but their figure is around 10%. See graphic 12, titled Gasto Público Social como Porcentaje del PIB, in Economic Survey of Latin America and the Caribbean 1997-1998; and Bénédicte Larre, "Mexico: Looking Forward with Caution," Observer, OECD magazine, October 1st, 1999: 14-17.

Graphic 1.4.- Declining Trend in Government Expenditures



Source: Revisión Integral del Sistema Fiscal, SHCP, 1998.

The consequences of weak public finances spread to the political, social and economic arenas. The scarcity of resources spreads far beyond public finances. Economically, the lack of sustainable resources has led to underinvestment in public services and infrastructure. Additionally, weak public finances have left Mexico quite vulnerable to external shocks and the influences of foreign actors.⁴⁸ Politically, the state's inability to finance itself raises the peril of inoperability.⁴⁹ In addition, it has promoted the progressive and widespread erosion of trust in the government and the promises of economic reform. In electoral terms, the inability of the government to deliver expected benefits of the economic reform has affected significantly the level of incumbents support. Socially, sinking revenues have taken a huge toll in society, by requiring a reduction in social spending. They have forced the sequestration of budget spending, in many of the basic programmes with a devastating social impact. The limited revenues are not sufficient to provide

⁴⁸ A recent OECD survey on Mexico highlighted that relying to heavily on oil revenues made Mexico highly vulnerable to exogenous shocks, mainly short-term fluctuations on oil prices. At the same time the low capacity for raising revenue translated in low levels of public spending with a high social cost, see Mexico: Economic Survey, 1999.

⁴⁹ Presentation made by Laurence Whitehead, "The Governability of the Mexican System since 1970," Oxford University Seminar on Mexico, January 1998.

well-funded government programmes to fully address the great social needs in the country, particularly on education, health and poverty alleviation.⁵⁰

As a result of low tax revenues, the government has increasingly relied on alternative means for financing spending, an unsustainable strategy in the long run and one that involves a huge social cost. Among those strategies used by the last five administrations are: internal and external borrowing, running government deficits, cutting social spending, inflationary financing, privatising state-owned companies, and relying on volatile capital flows.⁵¹ Directly or indirectly all of them have had a negative impact on the society, debilitating the reliance on tax revenues. As stated by Bird taxation is the lesser evil among the various means of financing the State.⁵² Printing money translates into inflation, affecting adversely the poorer groups of society. Borrowing is limited and carries big dangers as instability and international dependency. Although it is the most frequently used, the commitment to repay interest limits the capacity to undertake new programmes, and when resources dry up the consequences are devastating. Selling goods and services can rationalise access to facilities, they could also alienate poor people to use the facilities.⁵³ These policies have delayed the process of fiscal reform, moving the government away from a more autonomous and reliable way of financing itself.

⁵⁰ A World Bank staff appraisal report found that Mexico might be under-spending in health care and education, see Adjustment Lending Policies for Sustainable Growth (Washington, DC: World Bank, 1990).

⁵¹ For the great variety of ways in which government finance their deficits see Easterly, Rodriguez, Schmidt-Habbel, Public Sector Deficits, and Tanzi, The Political Economy of Fiscal Deficit Reduction.

⁵² See Bird, Tax Policy and Economic Development.

⁵³ For the discussion on alternative means for financing the State, see A. Shick, "Controlling Non Conventional Expenditure: Tax Expenditures and Loans, " no. 6 Public Budgeting and Finance, 1986: 3-19. Financing Public Expenditure Through User Charges (Paris: Occasional Paper in Public Management, OECD, 1990).

The insufficient stream of revenue from taxation has increased the number and the social cost of structural adjustments. In general, the alternative strategies for government financing have been based on cutting expenditures, instead of raising income. If instead, the government had focused in increasing a stable tax stream of revenues, most structural adjustment policies would have been less stringent on the population. The most important aim under structural reform was balancing the budget. This was achieved by dramatic spending cuts, primarily in public spending and social programmes. Those strategies focused on increasing revenues have been either temporal, as privatisation or too costly in social terms, as increasing the price of goods and services provided by the public sector (which further contributed to inflationary pressures). Relying on foreign volatile capital flows had devastating consequences for the economy, resulting in the countries worst economic crisis in contemporary history.⁵⁴

By looking at Mexico's low generating tax revenue capacity, it would be easy to assume that government and society have largely ignored the tax issue. However, the record shows that a large number of changes and reforms have been implemented but without any significant maximisation of revenues.

1.3.- Neutral Reforms: No Revenue Gains after Thirty Years

Mexico's tax revenue yield is not just very low by international standards but it has remained stagnated for the past 30 years, while around the world the tax

⁵⁴ See Sebastian Edwards, *Crisis and Reform in Latin America* (Oxford: Oxford University, 1995) or Armando Jiménez S.V. "Mexico's 1994 Financial Crisis," Masters degree thesis for the L.LM in Georgetown University, 1995.

effort has significantly increased. It is stunning that after almost 30 years of tax reforms, tax collection as a percentage of GDP in 1997 was just 9.8%, about the same amount (8.2%) that was collected in 1970. It is notable as well that in 1970, as much as 90.3% of total revenues came from taxation, compared to just 74% in 1998.⁵⁵ Tax reforms have failed to increase the tax effort, despite of high IFIs' executives, including the President of IADB, Enrique Iglesias and the Chief Economist of the World Bank, William Perry, have praised them.⁵⁶ Studies supported by the World Bank, as the one made by Das-Gupta and Mookherjee on administrative reform in Mexico during the Salinas' term are used as case models.⁵⁷

According to Goode, tax reforms should provide improvements on the tax structure plus additional revenue. In the case of Mexico, they have concentrated just in the former. Mexican reforms have had neutral or negative effects in terms of revenues, notwithstanding the urgent need for fresh resources. To Goode it is incoherent that countries that need more revenues seek to implement neutral tax reforms.⁵⁸ This contradiction applies to the Mexican case, where reforms have failed to generate more revenues despite the growing social requirements. The graph shows total tax collection as percentage of GDP, excluding special taxes from oil.⁵⁹

⁵⁵ See table VI.2 Ingresos del Gobierno Federal, 1959-1970, Antonio Ortiz Mena, El Desarrollo Estabilizador: Reflexiones sobre una Epoca (FCE and Colegio de México: México, 1998):165.

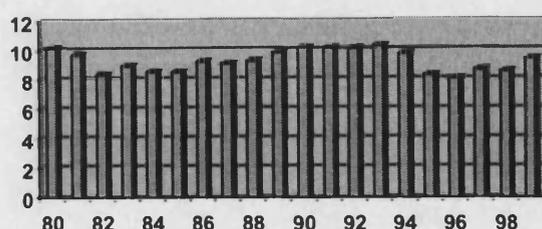
⁵⁶ Interviews, Barcelona, March 17th and 16th, 1997.

⁵⁷ Arindam Das Gupta and Dilip Mookherjee, Incentives and Institution Reform in Tax Enforcement (Oxford: Oxford University Press, 1998): 304-332.

⁵⁸ Richard Goode, "Obstacles to Tax Reform in Developing Countries," in Bird and Oldman 121.

⁵⁹ According to tax authorities special taxes on gasoline (IEPS) distort tax revenue estimates. See Revisión Fiscal Integral, 18.

Graphic 1.5.- 1980-1999 Tax Collection as % of GDP



Source: Revisión Integral Fiscal, SHCP, 1999

The data from OECD Revenue Statistics shows that in the past thirty years the average tax burden has risen in almost every OECD country, especially in industrialised countries where higher tax levels increased from 29% in 1970 to 38% in 1996. In very few exceptions, as the case of Mexico, the tax burden measured as percentage of GDP has fallen.⁶⁰ However, none of these countries suffers from such a poor yield of tax revenue as Mexico does.

In contrast with other Latin American countries, the process of reforms in Mexico has not translate in greater tax revenues. By the end of the 1980s an international wave of tax reform moved countries all over the world to undertake a full review of their tax systems. Latin America experienced a substantial increase in revenues in both income and add-valorem taxes after the implementation of reforms.⁶¹ Asian economies also improved slightly after the reform, particularly in income tax. In Latin America, the reforms implemented improved tax collection significantly.

⁶⁰ Other countries where the tax level has declined are: Belgium, Ireland, Luxembourg, Netherlands, Norway and the United Kingdom. See Steven Clarck and Flip Kam, Taxes Revisited (Paris: OECD, 1998).

⁶¹ For the process of reform see Elizondo, "The Politics of Tax Reform in Latin America," Dossier No. 32 (México: CIDE, 1997) and Parthasarathi Shome "Recent Tax Policy Trends and Issues in Latin America," in Andres Lara Resendez, ed., Policies for Growth: Latin American Experience (Washington, DC: IMF and the World Bank, 1995).

The following table shows how between 1990 and 1994, Central America increased its tax revenue collection by 50%, moving from 10.5% to 15.1 % of GDP, while on South America's percentage of collection increased by 25%, from 13.6 to 16.7% of GDP. It is noteworthy that Latin American countries improved collection almost on every front, income and consumption taxes. The improvements achieved by some countries in the region are remarkable.⁶² Peru increased its share of tax revenues coming from VAT from 1.1% of GDP in 1990 to 5.6% by 1994.⁶³ In comparison, Mexico's VAT revenue decreased from 3.6% to 2.7% of GDP, in the same period.

**Table 1.2.- Sources of Tax Revenue
(as percentage of GDP)**

	Total		Income tax		VAT	
	1990	1994	1990	1994	1990	1994
OECD	28.0	28.2	14.0	13.6	6.4	6.5
Asia	25.9	27.7	6.5	7.4	3.0	3.2
Central America	10.5	15.1	2.0	3.5	2.7	3.3
South America	13.6	16.7	1.1	4.2	3.5	5.4
México ⁶⁴	13.7	14.0	4.7	5.1	3.6	2.7

Source: Evolución del Sistema Fiscal, SHCP, 1999.

Despite significant reforms in the 1970s, such as the elimination of a cedular system, and introducing computerised mechanisms for the administration of taxes, revenues decreased. Similarly, the reforms implemented between 1980-87, including the introduction of VAT and indexing taxes to inflation had no substantial effects on tax collection, it decreased again from 10.7% to 9.1% of GDP. During Salinas' far reaching administrative and auditing reforms, income

⁶² See *El Pacto Fiscal*.

⁶³ For a complete overview of Peru's process of modernisation see Francisco Durand, "State Institutional Development: Assessing the Success of the Peruvian Tax Reform," University of Texas at San Antonio, 1998. Mimeo.

⁶⁴ Total tax collection, differ from other figures here because the Secretariat of Finance includes special levies on gasoline (IEPs) and what would constitute the corporate income of Pemex.

revenues increased just slightly from 9.2% to 9.77% of GDP, while during Zedillo's term revenues plunged further to 8.67% in 1997. Although this was attributable partly to the economic crisis, it was to a large extent also the result of a set of fiscal incentives introduced to foster investment and job creation.

The studies of the Secretariat of Finance estimated that fiscal reforms undertaken from 1980 to 1996, cost in government revenues approximately 5.61% of GDP.⁶⁵ Many of the revenue maximising reforms, including administrative and auditing measures, were introduced to compensate for the expected revenue loss. Tax authorities claim that they were conscious that transforming the fiscal system would not lead to increasing tax revenues.⁶⁶ According to the Secretary of Finance, "the government fully assumed the revenue cost, assessing that it was a fair price to pay for the modernisation of the economy."⁶⁷

Table 1.3.- Cost of the tax reforms in the last 20 years

Structural Reform up to 1994	2.90%
Additional Tax Reforms 1995-96	1.21%
Immediate deductions for small companies ⁶⁸	0.10%
Negative Tax on wage earners	0.34%
VAT	0.21%
Tax on Assets ⁶⁹	0.25%
Tax Tariffs	0.31%
Social Security Reform	1.50%
Total	5.61%

Source: Evolución Sistema Fiscal, Official Document of the Secretariat of Finance, 1999.

⁶⁵ See Tomás Ruíz speech at the national consultations for a full scale fiscal reform: "La Reforma Fiscal que México Requiere," Mexico, November 5th, 1998.

⁶⁶ Interviews with tax authorities like Pedro Aspe, Alma Rosa Moreno and Tomás Ruíz.

⁶⁷ Speech delivered by Secretary of Finance, José Angel Gurría, on the inauguration of the forum "La Reforma Fiscal que México Requiere," November 5, 1998.

⁶⁸ A reform in 1995, allowed small companies within the three large metropolitan areas the opportunity to make immediate deductions on investments.

⁶⁹ The rate on the assets tax was reduced from 2% to 1.8%, and small companies were exempted from it.

The decline in Mexico's tax income is explained by the policy objectives pursued by tax authorities under the programme of economic modernisation. Tax authorities argue that the reforms implemented since the mid-1970s responded to a comprehensive process of profound economic change.⁷⁰ After the mid 1980s, the objectives pursued by reformers included fiscal neutrality, reducing tax distortions that affected the economy, improving administrative efficiency and facilitating the economic transformation of the country. Tomás Ruíz argues that without such reforms, which included the elimination of special taxes and the reductions of the marginal rates, the Mexican economy would have not been prepared to successfully compete in a globalised world.⁷¹

1.4.- Has the Fragility of the Tax System Been Ignored the Past Three Decades?

At first glance, the stalemate of tax revenues and the consequently fragility of the public finances in the past three decades could suggest that the issue has been largely disregarded by public officials. It may be that Mexico's tax system inefficiency in terms of revenue has generated little awareness among its socio-economic groups. However, the evidence gathered in interviews with many of the most influential actors suggests the contrary. The low tax revenue yield has traditionally been a major concern for Secretaries of Finance, as well as socio-economic leaders.⁷² Paradoxically, it appears at the top of the public agenda, even at times of abundant alternative resources.⁷³

⁷⁰ Interview, Tomás Ruíz and Ruíz speech "Hacia, 1998.

⁷¹ Ibid.

⁷² Please note that job titles reflect the position the interviewees held at the time of the interview.

⁷³ A review of the presidential addresses to the nation, shows that the issue of fragile public finance and the urgent need for revenues has been at the top of the public agenda. It is particularly important during presidents Echeverría's and Salinas' speeches, and the first

In the words of Revenue under-secretary, Tomás Ruíz, there is no serious specialist who has not recognised the low level of tax collection in Mexico.⁷⁴ The evidence gathered here, shows that the concern for the country's low tax collection level is not only recognised by specialists but also extends to the whole political and economic spectrum of the Mexican society.

Public officials at the Secretariat of Finance openly recognise the fragility of the government's finance and the need to strengthen tax revenues, since the 1970s. President Zedillo has repeatedly stressed that "tax collection in Mexico is very low and insufficient to address the great economic needs of the country."⁷⁵ Currently, tax revenues pay just three-quarters of total social spending; the rest is financed with oil revenues.⁷⁶ Secretaries of Finance, from Ortiz Mena in the 1960s to the current Secretary José Angel Gurría, all have complained about the government's insufficient tax capacity to address social development and infrastructure in the country.⁷⁷ Strengthening tax revenues come up as a national priority on interviews with some former Secretaries of Finance in the past three decades, vgr. Ibarra (López Portillo), Aspe (Salinas) and Ortiz and Gurría (Zedillo). Likewise, representatives from the socio-economic spectrum all agree on the government's need to boost tax revenues in order to increase stalemated social spending.

address to the nation given by President Zedillo. See various Informes de Gobierno, Presidencia de la República, various years.

⁷⁴ Tomás Ruíz, "El Sistema Fiscal Mexicano: Avances y Retos," El Mercado de Valores, Nacional Financiera, July 7, 1999:4.

⁷⁵ In interview with Mr. Arizmendi one of the members of President Zedillo's media pool, he said that the president usually addresses this issue on his presidential tours to the provinces. For example, see Juan Arvizu and Gustavo Chavolla, "Rechaza EZ Exigencia de NL por Más Dinero," El Universal, March 24th, 1999:1.

⁷⁶ See José Angel Gurría's "La Reforma que México Requiere."

⁷⁷ See Ortiz Mena.

The need to raise tax revenues is a growing issue in the agenda of political parties. From the left of the political spectrum to the right, senior opposition politicians coincide on the need to increase revenues through taxation.⁷⁸ From the right, former presidents of the PAN, Luis H. Alvarez, Castillo Peraza and Felipe Calderón have called for a tax system that fosters investment and growth, as well as one that is efficient in collection terms.⁷⁹ Fiscal Federalism understood mostly as increasing revenue shares is among their core policies.⁸⁰ Vicente Fox, as PAN governor demanded greater tax powers and increasing federal revenue shares to states and municipalities. As presidential candidate for the same party, he campaigned on the need to increase tax collection to 15% of GDP (not including oil revenues) and moving further to consumption taxes.⁸¹

On the other end of the political spectrum, former Mexico's city mayor and three times presidential hopeful for the PRD, Cuauhtemoc Cárdenas, also complained on the grim resources channelled to the country's capital, and the need to enhance tax revenues. He argued that a profound fiscal reform was needed to provide the state with urgent resources to address lagged social demands, plus a reform that would emancipate the country's tax collection from

⁷⁸ See article published by one of the leading PRD's deputies, Ricardo García Sainz, "Reforma Fiscal Integral para Fortalecer los Ingresos Públicos," El Mercado de Valores Nacional Financiera, July 1999:42-48.

⁷⁹ Interview Luis H. Alvarez in London, May 1997; and Felipe Calderón in Aguascalientes, June 11th, 2000. In similar terms Carlos Castillo Peraza, another former president of the PAN strongly supported the idea of expanding the tax capacity of sub national governments. See Elisa Robledo, "Reforma Fiscal Callejera Propone Castillo Peraza," Epoca June 23rd 1997: 23.

⁸⁰ See PAN's political platform, and Vicente Fox, "Federalismo Fiscal" in Compromisos por la Nación. See also chronicles of the two presidential debates, were one of the issues proposed was tax reform.

⁸¹ Comments made as governor in an interview in London in June 5th, 1997, as presidential candidate see Fox's pledge made at ITAM university, Mexico, January 11th, 2000.

PEMEX's revenues. He vaguely suggested an overhaul to tax privileges for large companies and capital gains.⁸² Porfirio Muñoz Ledo, bitterly complained as well, about the lack of resources for social programmes, and called for a new fiscal convention to re-design the tax system, involving fiscal authorities from the 31 states.⁸³ PRD former president, López Obrador stood for eliminating the government support programmes, including Fobaproa, in order to cut VAT rates.⁸⁴ Others PRD members have proposed an overhaul of the tax system to make it more efficient and equitable.⁸⁵

The President of the PRI, Dulce María Sauri and former President, Santiago Oñate, recognise that the official party lacks a proper tax agenda.⁸⁶ Reforms are imposed from above, and little analysis has been made to discuss this issue. As Oñate put it "the president orders the party and legislative leaders to vote in favour of the tax reforms. In exchange, all sorts of privileges were granted to interest groups. It is difficult to develop a tax agenda in such a clientelistic political system." Nevertheless, there were attempts by the PRI to discuss this issue and proposed possible solutions to the country's tax problems.⁸⁷ PRI Presidential candidate, Francisco Labastida also stressed

⁸² In an interview in London he was very cautious by stating that this was not an attack to the powerful financial elite, but a mechanism to ensure greater equity among tax payers and recapture the distributional role of taxation. As presidential candidate, he continued to support these arguments, see conferences at ITAM on January 11th, 1999.

⁸³ Interview in London, February 19th, 1998.

⁸⁴ "Anular Apoyo Federal a IP para Compensar la Reducción del IVA, pide López Obrador," La Afición August 15, 1997:9.

⁸⁵ Influential PRD members have made tax reform proposals, for example Ifigenia Martínez H., "Cambiar la Forma de Cobrar el IVA para Aumentar la Recaudación," Nuevo Consultorio Fiscal, N.222, June, 1999.

⁸⁶ Interview Dulce María Sauri, President of the PRI, London, February 28th, 2000, and former president Santiago Oñate, London, March 8th, 2000.

⁸⁷ See PRI: Plataforma Electoral 2000-2006 (Mexico: Fundación Colosio, 2000) and interview with Sen. Oscar López Velarde, President of the Fundación Colosio, the PRI's think-tank, Mexico city, May 12th, 2000. Within the Fundación Colosio there was a large working group specialised in taxation. For the names see Agenda Electoral (México: Fundación Colosio, 1999).

repeatedly the need to increase the country's tax revenue generating capacity.⁸⁸

The idea of strengthening revenues appealed to all political denominations, but none has laid down how it should be achieved. The issue is absent in their party's political platforms, but it became a very important issue in the 2000 presidential campaign. Although, the issue frequently came up, possible solutions were addressed very vaguely. In interviews with the presidents of the three major political parties -PRD President, Amalia Garcia; PRI President, Dulce Maria Sauri and PAN president, Felipe Bravo- all proposed to broaden the tax base, but avoided saying which privileges should be eliminated.⁸⁹ They also defended the preferential treatment for agriculture, describing it as a national priority. None of them seem truly familiar with the topic, using arguments commonly put forward by public rhetoric. Bravo Mena demanded less taxes and more incentives to business, even accepted that such proposal represented a blunt contradiction to the policies seeking to eliminate tax privileges.⁹⁰ All agree on the fact that tax policy making process has become highly politicised issue and on the need to review special tax privileges.

Representatives of the private sector, including leaders of business organisations and large business tycoons have highlighted the problem as well. Eduardo Bours, the president of the most important business organisation, the Businesses Co-ordinating Council (CCE), stated that the tax system is

⁸⁸ See Francisco Labastida, Que el Poder Sirva a la Gente (México: Oceano, 2000).

⁸⁹ Interview, Amalia García, President of the PRD, London February 27th, 2000; Dulce María Sauri, President PRI, London February 28th, 2000, and Felipe Bravo, PAN's President, London February 28th, 2000.

⁹⁰ Interview Felipe Bravo Mena, PAN President , London February 28th, 2000.

inefficient, lacks the capacity to provide sufficient resources to finance public expenditure programmes adequately. He adds that revenues should be sufficient to run government programmes, without relying on mounting deficits, excessive borrowing or oil revenues.⁹¹ Jorge Marín Santillán the leader of CONCAMIN, expressed that the industrial sector “recognises that the main objective of an overall fiscal reform should be strengthening the income of the public sector, but at the same time it should foster economic growth, investment and savings.”⁹² In the same context, Carlos Slim, the richest Mexican businessmen, concedes that tax changes in the last decade implied a noteworthy administrative progress, but a significant potential remains to be realised in terms of collection.⁹³ While Gutiérrez Prieto another of the few Mexican billionaires expressed the need to consolidate a stable source of fiscal revenues to improve social conditions, public infrastructure and services.⁹⁴ For the director of ICI, head of one of the large multinational companies in the country, there is potential to increase revenues without increasing tax rates, by improving the administration of taxes.⁹⁵

The impelling need to raise government revenues has reached even Mexican intellectuals, who recognising the fragility of public finances have expressed concern on the way the tax system is structured and managed. Aguilar Camín has described the tax system as the “nation’s invisible villain,” responsible for

⁹¹ Eduardo Bours Castello, “Hacia una Reforma Fiscal Integral,” Mercado de Valores July, 1999:10-17. Interviews London October 13th and 14th, 1998.

⁹² “Lo que Sea Mejor para México, es la Misión de CONCAMIN: Lic. Jorge Marín Santillán,” Industria CONCAMIN, Vol. 12 March 1999: 7, and interview London, October 14th, 1998.

⁹³ Interview, London, October 14th, 1998.

⁹⁴ Interview London, June 9th, 1998.

⁹⁵ Interview Ing. Manuel Díaz, President ICI Group Mexico, Canning House, February 1997 London.

recurrent economic crisis.⁹⁶ With a similar position, Jorge Castañeda has depicted the system as unjust, unequal and inefficient, highlighting its limited revenue potential and the structural distortions caused by politics.⁹⁷ Carlos Fuentes, focused his comments on the distributive side of tax reform, arguing that globalisation and the current economic strategy (neo-liberalism) has spread poverty excluding large sectors of the Mexican society. He also states how insufficient revenues have failed to respond to the economic demands of millions of Mexicans.⁹⁸ For Carlos Monsiváis attempts to redistribute wealth using taxation have been corrupted by political interests,⁹⁹ while Rolando Cordera believes on a more progressive taxes system to prevent further concentration of wealth in few hands.¹⁰⁰

The empirical evidence indicates that the pressing need to increase the low level of tax collection has always been in the official rhetoric, however little has been done to increase the yield of revenues. Most revenue maximising reforms were implemented to compensate for those reforms that have reduced public income. As stated before, the reason that partially explains the limited revenue maximising policies, is that less conflicting means for financing the state have always been at the disposal of the government. However, this would be a simplistic answer to a very complex problem, since it fails to explain why some of the most important revenue maximising tax reforms were implemented at periods of abundant alternative resources.

⁹⁶ Aguilar Camín, Proceso, 11th April, 1999: 41.

⁹⁷ Interview Madrid, March 11th, 1998.

⁹⁸ Interview London, July 7th, 1999.

⁹⁹ Interview London, November 19th, 1997.

¹⁰⁰ Interview Madrid, March 10th, 1998.

During López Portillo's term the government arcades were flooded with revenues from the oil boom, nonetheless the government implemented important revenue maximising reforms, including the introduction of VAT. The Salinas administration also pursued significant reforms to strengthen tax receipts, regardless the fact that for the first time in two decades, the government experienced a surplus in public finances, thanks to the large proceeds coming from privatisation and volatile capital flows.

1.5.- Academic Attempts to Explain the Fragility of the Mexican Tax System and Factors that have Constrained its Development

The studies of the Mexican tax system and particularly the factors that have inhibited its development have received very little scholarly attention.¹⁰¹ In the last thirty years very few authors (Kaldor, Retchkiman, Aspe, Gil Díaz, Elizondo, Latapí) have examined Mexico's fiscal fragility, epitomised by a tax system that has failed to provide the resources needed for the sustainable development of the country. These academics have predominantly sought to explain Mexico's poor tax collection effort, but avoid explaining the reason hindering reform. Their analysis shows a complex set of social, economic and political factors shaping the tax system and inhibiting its development.

¹⁰¹ Important research has been made on the tax systems of selected Latin American countries, which has been enlightening for understanding of the Mexican tax system. See Shoups analysis of Venezuela, Musgrave of Colombia and Bolivia, and on Colombia the separate works by Bird and MacLure on Colombia. See Carl Shoup, "Taxes and Economic Development," in Bird and Oldman, 37-45. Richard Bird, Taxation and Development: Lesson from Colombian Experience (Cambridge, M.A.: Harvard University Press, 1970); Bird, Optimal; Richard Musgrave, Fiscal Reform for Colombia: Final Report and Staff Papers (Colombia: Commission on Tax Reform, 1971); Richard A. Musgrave, Reforma Fiscal en Bolivia: El Marco Económico General (La Paz: Secretaría de Finanzas, 1978); Richard A. Musgrave, Fiscal Reform in Bolivia: Final Report of the Bolivian Mission on Tax Reform (Cambridge: The Law School of Harvard University, 1980); Charles E. MacLure Tax Policy Lessons for LDC's and Eastern Europe (San Francisco, Calif: ICS Press, 1992); Charles E. McLure The Taxation of Income from Business and Capital in Colombia (Durham: Duke, U.P., 1990).

Commissioned by the Secretariat of Finance Kaldor made a very comprehensive study of Mexico's tax structure, in the early 1960s. Then, he stated that there was "an urgent need for a radical and comprehensive reform of the tax system," due to the fact that revenue from taxation was "inadequate for development needs and escalating population growth."¹⁰² The large number of privileges given to specific sectors and activities, and particularly the numerous exemptions and deductions embedded in the tax legislation astonished him.¹⁰³ In the 1970s, Tanzi looked at the quantitative characteristics of the tax mix in Mexico as a way to explain the low revenue yield,¹⁰⁴ while in the 1980s Solís examined the underperformance of the tax structure, highlighting the great number of tax havens and the preferential treatment.¹⁰⁵

More recently, research done by Pedro Aspe and Francisco Gil Díaz has exposed the shortfalls of the tax system, after analysing the tax structure and the reforms implemented in the last two decades. The main conditioning variables studied by these authors have been economics and the model of development pursued by the different administrations.¹⁰⁶ Maykanosky used an economic model to study the revenue and social impact of the 1983 fiscal

¹⁰² Kaldor, Reports, 214.

¹⁰³ Nicholas Kaldor, "Las Reformas al Sistema Fiscal en México," in Leopoldo Solís, La Economía Mexicana (México: Fondo de Cultura Económica, 1973).

¹⁰⁴ See Vito Tanzi, "Quantitative Characteristics of the Tax System of Developing Countries," in David Newbery and Nicholas Stern, The Theory of Taxation in Developing Countries (Oxford: Oxford University Press, 1987): 206-211.

¹⁰⁵ Leopoldo Solís, Economic Policy in Mexico: A Case Study for Developing Countries (New York: Pergamon Press, 1981).

¹⁰⁶ Pedro Aspe and Paul Sigmund, The Political Economy of Income Distribution in Mexico (New York: Holmes and Meier, 1984), Francisco Gil Díaz, "The Incidence of Taxes in Mexico: A Before and After Comparison," in Aspe and Sigmund, 59-98. Francisco Gil Díaz, "Some Lessons for Mexico's Tax Reform," in Newbery and Stern.

reforms. In the late 1990s, Latapí explored the weaknesses of the tax system and its negative socio-economic effects.¹⁰⁷ These authors concentrated on examining the shortfalls of the tax system but little attempts was made to understand the forces that have inhibited reform.

Some authors explain the fragility of the tax system based in the process of economic policy making, arguing that it is subordinated to competing socio-economic forces seeking selfish benefits.¹⁰⁸ From a Marxist approach involving class struggle, Retchkiman asserts that it is the economic elite, the one who has hindered the development of the tax structure in Mexico. He argues that the Mexican State is subordinated to large businesses' interests, and tax legislation depicts the way the State looks after the interests of property holders, while it disregards those of "the miserable mobs of Mexicans."¹⁰⁹ Other authors recognise the influence of the economic elite but include other powerful players. Cothran underlines the role of corporate actors within the PRI and their influence on fiscal policies,¹¹⁰ though most analysts argue that since the early 1980s corporate actors' influence has been rapidly declining.¹¹¹

Elizondo gives the bureaucracy greater autonomy, but takes into account interest groups' influence over tax policy making. He suggests that politics has

¹⁰⁷ Mariano Latapí, La Realidad de los Impuestos en México: 30 Años de Perversión Fiscal (México: Sistemas de Información Contable y Administrativa Computarizados, 1998).

¹⁰⁸ For the dynamics of socio-economic groups in struggle during economic reform in Latin America see Joan M. Nelson ed., Fragile Coalitions: the Politics of Economic Adjustment (New Brunswick; Oxford: Transactions, 1989) and S. Haggard and R. Kaufman, "The Politics of Stabilization and Structural Adjustment," in J. Sachs ed., Developing Country Debt and Economic Performance: The International Financial System (Chicago: Chicago U.P., 1989).

¹⁰⁹ Retchkiman:18-19.

¹¹⁰ See Cothran.

¹¹¹ Interview John Womack, Harvard University, July 15th, 1998. For a general view of those competing forces see interview with Womack in "Mexico: Un Diagnóstico," Nexos February 1996:41-47.

been the most important conditioning factor explaining the shape and limited attempts to reform the tax system.¹¹² This author draws main three causes, which have constrained the reform process in Latin American tax systems, particularly in Mexico. First, the nature of the state, where three elements are considered: elite divisions within the state over taxation, the role of interest groups and the limited administrative capacity of the Latin American States. Secondly, government's search of several policy objectives additional to raising revenues. Lastly, the use of alternative sources available to the State to finance its expenditures.¹¹³ Similarly, De La Garza concludes in his research that political factors predominantly explain the tax structure and its evolution.¹¹⁴

In the absence of a specialised tax literature on Mexico, the research turns to review international literature on the topic, to shed some light on the Mexican case. Sandford made a comparative analysis of the different aspects that influence tax reform in developed countries. Among the most resilient features were: the country's constitution and political practices, macroeconomic and tax reform background, the process of tax policy formulation and implementation, external influences, political will, the role of personalities and personal relationships.¹¹⁵ Peters places special attention to politics as the main driving force shaping the tax system, but he also highlights the role of institutions and international influences.¹¹⁶ Similarly, Bates and Hansen emphasise politics as

¹¹² Elizondo, "In Search of Revenue": 159-190. Elizondo, "La Fragilidad": 18-29, and Carlos Elizondo, The Politics of Tax Reform.

¹¹³ Elizondo, The Politics, 3.

¹¹⁴ José María de la Garza Serna, "The Politics of Tax Reform in Mexico," PhD. Thesis, University of Essex, 1996.

¹¹⁵ Cedric Sandford, Successful Tax Reform, Lessons from an Analysis of Tax Reform in Six Countries (Bath: Fiscal Publication, 1993).

¹¹⁶ B. Guy Peters, The Politics of Taxation: A Comparative Perspective (Blackwell: Oxford University, 1991).

the driving force behind tax policy making.¹¹⁷ From a different approach, Tanzi puts forwards the relationship between economic structures and taxation, and how the earlier conditions tax policy.¹¹⁸ To Musgrave economic, political and social factors affect a country's tax structure.¹¹⁹ While the importance of institutional and political variables in the formation of optimal taxation, is foregone by Geleotti and Marrelli.¹²⁰ In general, though to a different degree, all authors seem to place special emphasis on politics as the main force shaping and holding back tax policy.

Regarding those forces that constrain the process of reform the literature shows a wide range of factors. Goode has laid down some of the obstacles to tax reform in developing countries, including analytical difficulties, administrative and compliance weaknesses, the shortage of local fiscal experts, unsuitable foreign advice, and political obstacles.¹²¹ The World Bank has examined some of the impediments to reform, signalling administrative capacity and political opposition as the most important constraint.¹²² Bird highlights in particular the difficulties to reform posed by a weak administration, but recognises the obstacles posed by domestic politics.¹²³ Retchkiman and Elizondo have concentrated on the study of the political obstacles. Their analysis is supported in Rose and Karran argument that tax reform is usually avoided because it implies a very high political cost, so politicians prefer to

¹¹⁷ Robert Bates, "Apolitical Scientist's View," in Malcolm Gillis ed. Tax Reform in Developing Countries (Durham: Duke University Press, 1989) and B. Hansen.

¹¹⁸ Vito Tanzi, "Forces that Shape Tax Policy," in Herbert Stein ed., Tax Policy in the Twenty-First Century (New York: John Wiley & Sons, 1988):267-277.

¹¹⁹ Musgrave, Fiscal Reform.

¹²⁰ G. Geleotti and M. Marrelli, Design and Reform of Taxation Policy (Netherlands: Kluwer Academic Publishers, 1992).

¹²¹ Goode, "Obstacles to Tax Reform": 121-131.

¹²² World Development Report, 1997, (Washington DC: World Bank, 1997):144.

¹²³ Bird, Tax Policy and Economic Development.

make only marginal changes than significant reforms.¹²⁴ However, the literature review does not explain why a full-scale overhaul of the tax structure has been evaded for more than three decades in Mexico. Although Elizondo's work provides valuable insights to this issue it requires to be studied in greater depth.

1.6.- Four Possible Explanations to the Constraints on Reform

After a detailed survey of the specialised tax literature, there are four possible hypotheses that may be put forward as the main constraints on reform in the past three decades in Mexico.

The first hypothesis proposes that structural weaknesses embedded in the economy and deeply rooted social attitudes have inhibited the potential for strengthening tax receipts. Among the economic factors are Mexico's young population, extended poverty and low per capita income, which lead to small number of registered taxpayers. Other bounding factors include large income and regional disparities, tax evasion and avoidance, a large informal economy and heavy reliance on income from oil. Additionally, harmful practices deeply rooted in the Mexican society such as rampant corruption and very weak voluntary tax compliance adds to the structural deficiencies hindering collection.

Secondly, are those exogenous variables that determine, constrain or at least influence domestic tax policies. Tax reforms have been shaped by a worldwide tax reform movement, designed in industrialised countries to comply with global

¹²⁴ Rose and Karran.

interests rather than domestic ones. Globalisation has had a profound impact on the world's tax systems, particularly in developing countries where fierce competition has developed to attract foreign investment. In addition, it has spread a style of tax reform shaped by a trend of thinking about tax policy in the world at large, not just locally.¹²⁵ The economic crisis in Latin America during the 1980s reinforced the spread of this world trend. Due to the financial needs of many developing countries in the region, international agencies like the IMF and the World Bank become very influential in shaping the nature and direction of tax policy design. This has been done in various ways, either by the conditions attached to structural adjustment loans, by training hundreds of officials, providing technical assistance or simply by spreading a "universal" model of tax reform, applicable to all countries. Some policy actors claim that IFIs have promoted a tax reform receipt based on a "neo-liberal" model, which may not match Mexico's true needs.¹²⁶

The third hypothesis contends that countries are constrained to implement novel tax reforms proposals due to their limited administrative capacity. Some tax instruments may seem attractive in theory, but risk being inapplicable in reality due to the lack of institutional capacity.

Last but not least, politics is attributable to a considerable extent for the structural weaknesses in the tax system and best explains the elusive government attitude towards tax reform. Powerful vested interests explain the current shape of the tax system and constitute the main constraint to a

¹²⁵ Bird and Oldman, 37-45.

¹²⁶ Interview with Cuauhtémoc Cárdenas, London, March 25th, 1999 and Porfirio Muñoz Ledo, London February 19th, 1998.

through fiscal reform. Mexico's unique political system has been traditionally upheld by a fragile political coalition with the main socio-economic actors. This political agreement has for a long time has preserved the status quo and maintained a stable political regime, but at the same time it has hindered the reform process. Political authorities still fear that any attempts to extract further resources from socio-economic actors, especially large businesses, could break the fragile socio-political coalition that upholds the regime.

This thesis argues that politics best explains the configuration of the tax system and contributes as no other hypothesis to understand the thrust behind the constraints on reform. Thus, the political variable is the main reason behinds Mexico's inefficient tax structure, being the uniqueness of the Mexican political system the most powerful constraint on tax reform. The remaining three hypotheses, however, cannot be disregarded, since they also play an important role. Any study that fails to recognise their influence would most likely be incomplete. These three alternative explanations would be examined throughout the thesis as complementary factors to the political hypothesis.

Chapter II

Tax Fragility and State Autonomy: A Puzzling Paradox

"It is notable that a supposedly authoritarian regime such as Mexico, would have had such a difficulty in carrying out (tax) reforms that more democratic governments enact routinely."
Cothran.¹²⁷

This chapter explores the hypothesis of politics as the main constraint on tax reform questioning traditional paradigms about the Mexican State. I argue that tax policy making understood as a clientelistic process of political accommodation raises a conceptual paradox about the nature of the Mexican state. Assuming that tax reforms are not just the product of independent decisions of autonomous policy-makers, but the result of political accommodation resulting from pressures exercised by vested interests, then the limited reforms in the past 30 years and its inefficient revenue generating capacity portrays a rather weak Mexican state. Such argument contradicts the traditional literature that depicts it as autocratic and authoritarian. A thorough analysis of the literature on the autonomy of the Mexican state is presented here, concluding that the need to maintain a fragile political coalition largely limited the leverage of the State.

2.1.- Domestic Politics as the Main Constraint on Reform

The political hypothesis rests on the idea that tax policy making is imminently a political issue, dominated by interest groups competing to shape government policy design and outcome. Several scholars stress that politics is the key variable influencing tax policy making, since no other criterion carries so much weight. Peters argues that "political considerations will always dominate the

¹²⁷ Cothran, 123.

selection of tax policies, since all tax decisions are policy decisions, and therefore political ones. Therefore, the design and implementation of a tax policy are political actions.”¹²⁸ He uses two other reasons to support his stance: first, by stating that the mere question of how the government will raise its taxes, and how it will spend the money are central political issues, and should therefore be addressed politically. Secondly, he underlines that tax proposals do not become policies unless government is willing to accept them and enact them into law through the political process.¹²⁹ Peters acknowledges that economic and legal considerations may be used to initiate a discussion of tax policy, but it is politics that decides the outcome of the discussion and the final shape of the tax laws.¹³⁰ In his words “economists may have dominated the academic discussion of taxation, but political criterion appear to dominate tax policy making in the real world.”¹³¹

The supremacy of politics over economics, ethics and administration in the tax policy making process, has been addressed by several scholars like Hansen, Steinmo, Robinson and Sandford, Hadenius, Goode, Peters, Rose and Karran, Atkinson.¹³² Even Bird who has concentrated on the constraints at the administrative front admits that “the administration of taxes is a political issue, and its resolution must be political not just technical.”¹³³

¹²⁸ Peters, 21.

¹²⁹ Peters, 3.

¹³⁰ Peters, xiii.

¹³¹ Peters, 53.

¹³² Hansen; Seven Steinmo, ed., Tax Policy (Northampton, MA: Edward Elgar Pub., 1998); Ann Robinson and Cedric Sandford Tax Policy Making in the United Kingdom: A Study of Rationality, Ideology and Politics (London Heinemann Educational, 1983); Axel Hadenius A Crisis of the Welfare State?: Opinions About Taxes and Public Expenditure in Sweden (Stockholm: Almqvist & Wiksell International, 1986); Goode; Rose and Karran; A. B. Atkinson, Public Economics in Action (Oxford: Oxford University Press, 1996).

¹³³ Bird, Optimal, 41.

2.2.- Political Forces Opposing Reform

According to Atkinson politics frequently impedes tax reforms.¹³⁴ This view is supported by IFIs, which argues that politics frequently represent the most important barrier to reform. The World Bank accurately points out that obstacles to reform may be embedded in the political regime itself.¹³⁵ These include a clash of values or objectives among policy-makers, the desire of government leaders to remain in power, the activities of interest groups and the efforts of bureaucrats elite to retain and enhance their power and perquisites.¹³⁶ The empirical analysis in different periods will show that all these obstacles have risen in multiple occasions over the last three decades. More significant to our case, are the efforts made by government leaders to prolong the tenure of the PRI system by favouring their actual or potential supporters, or at least not alienating them.

Opposition to reform can be deeply rooted in the country's institution too. At any given time, the forces favouring the status quo are more likely to prevail, since it is easier for opponents to maintain the existing system.¹³⁷ The experience shows that reformers usually have to face opposition from within, from both the bureaucratic and political elite. To the World Bank, conflicts exist among economic objectives and the stance of individual political leaders, these differences in priorities or disagreement about policies may derail tax reform efforts.¹³⁸ This can be seen through Mexico's recent history. David Ibarra, Former Secretary of Finance recognises differences with President López

¹³⁴ See arguments about how a single reform can meet very different objectives of diverse supporters and why politics impedes reform on Atkinson.

¹³⁵ World Development Report, 1997, 149.

¹³⁶ Goode, 124

¹³⁷ World Development Report, 1997, 144.

¹³⁸ *Ibid.*

Portillo over some tax policy decisions, including VAT.¹³⁹ Carlos Tello, one of the economic key members of Echeverría's sexenio recalls similar differences with the cabinet on tax and other related issues.¹⁴⁰ More recently President Zedillo faced unprecedented overt opposition from his own party deputies over the proposal to increase the rate of VAT.¹⁴¹

Opposition can arise from the administrative front as well. Ascher brings to light the uncertainty caused by reform on tax administrators.¹⁴² In many cases, the World Bank observes "bureaucrats that run the risk of unemployment or losing prerogatives can thwart reform."¹⁴³ The very initiative of tax reform typically puts bureaucrats responsible for tax administration on the defensive, because it usually represents additional burdens to them.¹⁴⁴ When the institutions are corrupted the opposition is even greater, because changes may expose illegal practices.¹⁴⁵ Former Finance Secretary Pedro Aspe, recalls the efforts undertaken to dismantle the administrative "mafia" within the Secretariat.¹⁴⁶ In contrast the leader of the government unions, Deputy Carlos Jiménez argues that bureaucrats at the Secretary were not just co-operative in implementing reforms but the major force behind the policies aimed at "cleaning the

¹³⁹ Interview with Ibarra and Gil Díaz over the struggles within the members of the economic cabinet. Both in Mexico City on September 25th, 1999 and March 25th, 1999 respectively.

¹⁴⁰ Carlos Tello, La Política Económica en México: 1970-1976 (México: Siglo XXI editores, 1979) and interview Mexico, October 12th, 2000.

¹⁴¹ Former PRI's President Santiago Oñate recalls the discontent of PRI deputies over the increase of VAT rate, tax authorities failed to explain and persuade PRI deputies over the true benefits of enacting the law authorising the reforms.

¹⁴² William Ascher, "Risk, Politics, and Tax Reform: Lessons from Some Latin American Experiences," in Malcom Gillis ed., Tax Reform in Developing Countries: Fiscal Reform in the Developing World (Durham: Duke University Press, 1989): 420.

¹⁴³ World Development Report, 1997, 146.

¹⁴⁴ Ascher, 421.

¹⁴⁵ See Francisco Durand, State Institutional Development: Assessing the Success of the Peruvian Tax Reform, San Antonio: University of Texas, 1997. Mimeo

¹⁴⁶ Interview Pedro Aspe, September 20th, 2000.

house.”¹⁴⁷ However, despite the positive results in cracking down on corruption during Salinas term, the impetus to fight corruption from within faded away during Zedillo’s presidency.¹⁴⁸

The heftier obstacle to tax reform is vested interests represented by highly organised groups. These groups are powerful enough to stop attempts to reform. In consequence, non decision making occurs because existing interests prevent changes from being debated or put into effect because that would be harmful to their material well being.¹⁴⁹

The usual stereotype of tax politics is a process dominated by special interest groups seeking concessions and preferences for their members.¹⁵⁰ To Bird tax reforms are not just the product of independent decisions of autonomous policy-makers, they reflect the pressure exercised by groups and vested interests.¹⁵¹ The role of interest groups -regional and sectional as well as economic and social- is present in the design of tax policies and ultimately play a significant role in shaping the tax system.¹⁵² Due to its technical nature, interest groups have more chances to influence tax policy than in other policy areas because its complex, technical character makes it easier for them to disguise their real influence in legal and economic jargon.¹⁵³

¹⁴⁷ Interview Deputy Carlos Jiménez, July 28th, 2000.

¹⁴⁸ Interview Diego Yrribarren, January 11th, 1998.

¹⁴⁹ Rose and Karran, 11.

¹⁵⁰ Alvin Rabushka, The Tax Revolt (Stanford, Calif.: Hoover Institution, 1982): 88.

¹⁵¹ Bird, Optimal, 36.

¹⁵² Robert Dahl, Size and Democracy (Stanford, Calif.: Stanford University Press, 1973).

¹⁵³ Peters, 12.

However, it is not easy to identify the vested interests of political actors. These actors have strong incentives to disguise their goals and strategies with regard to taxation behind a facade of ideology over broad statements about equity, fairness, and the public interests, because much of their work diverges from public preferences.¹⁵⁴ Even when political actors show their true interest in tax policies, they may conflict with what the authorities consider to be in the public interest.

2.3.- Taxation and State Autonomy a Puzzling Paradox

The general perception around the world is that tax policy making is designed by a small and well-trained group of technocrats, versed in the models of cost-benefit analysis.¹⁵⁵ Due its technical nature it would be easy to assume that decision-makers use analytical and rational process to decide which is the most appropriate alternative that best meets their goal based on the highest benefits to costs ratio. However, in reality the policies are contaminated in the design process by multiple political factors that change the nature and outcome of supposed rational policies.¹⁵⁶

Rent seeking interest groups exercise a pernicious influence over government to shape tax policy, since they are oriented towards obtaining self-interested objectives rather than productive ones.¹⁵⁷ The analysis of the Mexican system

¹⁵⁴ Hansen, viii.

¹⁵⁵ Goode.

¹⁵⁶ For key forces shaping what the governments chooses to levy see J. Cullis and P. Jones, Public Finance and Public Choice (London: McGraw Hill, 1992) and F. Cowell, Cheating the Government (Cambridge, Mass.: MIT Press, 1988).

¹⁵⁷ The process by which interest groups appropriate monopoly rents is called rent seeking. See D. Mueller Public Choice II (Cambridge: Cambridge University Press, 1989), 229. Interest groups appropriate monopoly rents, at the expense of other competing groups due to their monopoly position, in many cases artificially sustained by government officials. On literature on

shows that in the end tax policy is more the reflection of the pressure of vested interests than rational decisions based on economic and administrative assessment. Tax policy becomes not the result of policy planning, but a series of small adjustments involving a process of accommodation and coalition building.¹⁵⁸

This assumption raises a puzzling paradox, if tax policy in Mexico is the reflection of the pressure of vested interests and not the decision of autonomous policy-makers, then the Mexican State must be surprisingly weak. Contrary to the authoritarian depiction of the Mexican State, the evidence pictures a state ineffectual in extracting resources from the economic actors and feeble to resist the pressures of corporate actors, particularly before domestic and international capital.

Based on the literature, the Mexican case is characterised by a close decision making process with the president and the top bureaucracy as key actors.¹⁵⁹ Most students of Mexico have described the Mexican policy making process as authoritarian and corporate in nature,¹⁶⁰ a system where the political power is

rent seeking and interest groups see G. Tullock, The Economics of Special Privilege and Rent Seeking (Boston: Kluwer, 1989); G. Rowley, R. Tollison and G. Tullock eds., The Political Economy of Rent-Seeking (Boston: Kluwer, 1988); T. Persson, Political Economic: Explaining Economic Policy (Cambridge Mass: MIT Press, 1999); P.A. McNutt, The Economics of Public Choice (Cheltenham: Edward Elgar, 1996). The influence of these groups depends largely on the number of members and total political expenditures. See W. Mitchell and M. Munger "Economic Theories of Interest Groups," American Journal of Political Science, No. 35, 512-546.

¹⁵⁸ Charles E. Lindblom, Politics and Markets: the World's Political and Economic Systems (New York: Basic Books, 1977), Rose and Karran for the incrementalist approach in tax matters.

¹⁵⁹ For the process of policy making in Mexico, see J. Teichman, Policy Making in Mexico from Boom to Crisis (London: Allen and Unwin, 1988).

¹⁶⁰ Laurence Whitehead, "An Elusive Transition: The Slow Motion Demise of Authoritarian Dominant Party Rule in Mexico," Democratization Vol. 2, No. 3, Autumn 1995: 246-269; Giovanni Sartori, "Parties"; George Philip, The Presidency in Mexican Politics (London: Macmillan in Association with St. Anthony's College, Oxford, 1991); George Philip,

centralised in the office of the presidency: other fundamental parts of government such as the judicial and legislative branches are almost powerless regarding policymaking. According to Kaufman, public policy in Mexico has been dominated by three features of the Mexican state: 1) Centralisation of decision making in the presidency, 2) Big businesses and their capacity to create major economic disruptions through capital flight, 3) The PRI as a social control mechanism.¹⁶¹

For many students of Mexico, a centralised policy making process was almost “insulated” from interest groups, which if any, they had a very limited influence in the formulation of policy. Large business groups have been traditionally the most successful in bargaining with the State, been capable of eluding or changing the intent of government policymaking than those organisations representing peasants or labour.¹⁶² Clientelism and patronage characterise the relationship between state and society. Additionally, the absence of a professional bureaucracy has largely contributed to the development of rent-seeking policy making, politicising the process and wide spread corruption.

Democratisation and Social Conflict in Mexico (London: Research Institute for the Study of Conflict and Terrorism, 1999); George Philip, Politics in Mexico (London: Croom Helm, 1985). According to Purcell the basic elements of authoritarian politics are: centralisation of power, elite consensus, limited pluralism, low levels of political mobilisation and participation and patrimonial style of rulership, see Purcell Susan Kaufman, The Mexican Profit-Sharing Decision: Politics in an Authoritarian Regime (Berkeley: University of California Press, 1975). For the corporatist nature of the Mexican system see Howard J. Wiarda, Corporatism and National Development in Latin America (Boulder Colo.: Westview Press, 1981) and Howard J. Wiarda, Corporatism and Comparative Politics: the other great “ism” (Armonk, NY: M.E. Sharpe, 1997). Wayne, Cornelius, Todd Eisenstadt & Jane Hindley eds., Subnational Politics and Democratization in Mexico (San Diego: University of California, 1999).

¹⁶¹ Kaufman, 100.

¹⁶² See Steve W. Hughes and Kenneth J. Mijeski, Politics and Public Policy in Latin America (London: Westview Press, 1984).

This widely accepted view of the process of policy making in the literature fails to explain the frequent failures of presidential-inspired policies. In contrast to the popular view that saw almost no limits to the almighty power of the presidency, former President Miguel de la Madrid referred to the numerous constraints to presidential power, including those of a constitutional and of a political character, according to the former President “the role of the president was that of a mediator among conflicting interests.”¹⁶³ Vernon also argues that Mexican presidents were constrained by the institutionalisation of power in the Mexican political system and public policy choices emerged as a result of conflicting interests within the official party.¹⁶⁴

Some intellectuals state that the autonomy of interest groups in Mexico is severely circumscribed by government power. Among them, the most autonomous are business groups because they enjoy independent resources and organisational skills. Nevertheless, the government still had means to control businesses. Some of the most important business organisations like CONCANACO or CONCAMIN were created by the government and compulsory registration was required by law until very recently. But the most efficient way to keep businesses checked was through the control exercised by government over labour organisations and tax audits. González Casanova signalled that other groups like peasants, urban labour, teachers, bureaucrats and middle class groups were less autonomous, being controlled by their affiliation to the PRI structure.¹⁶⁵ However, these supposedly “restrained” policy

¹⁶³ Interview, Mexico, November 3rd, 2000.

¹⁶⁴ Raymond Vernon, The Dilemma of Mexico's Development: The Roles of the Private and Public Sector (Cambridge: Harvard University Press, 1963).

¹⁶⁵ Pablo González Casanova, Democracy in Mexico (Mexico: Ediciones Era, 1970): 169-178.

actors have been able to introduce a plethora of privileges to the tax legislation benefiting them. In my opinion the bureaucracy is far less autonomous than scholars believe. Confronted with the menace of capital flight the state is very vulnerable before domestic and international capital. However, corporate actors like peasants and labour, must not be disregarded since they have been able to maintain a preferential tax treatment.

If politics is considered as the main force shaping the tax system and tax policy as the reflection of the pressure of vested interests, then it is fundamental to determine the degree of autonomy enjoyed by the state.

2.4.- A Survey of the Literature on the Autonomy of the Mexican State in Policy Making

Determining the autonomy of the Mexican State is not an easy task, as has been pointed out by Geddes.¹⁶⁶ She observed the difficulties faced by those attempting to do so.¹⁶⁷ Authors such as Stepan, Linz, Grindle, Vernon, Bazañez, Hamilton, Haggard, Rueschemeyer, Evans, Lee, Maxfield and Kaufman have discussed this topic extensively.¹⁶⁸ Kaufman summarises the position taken by the scholars trying to determine the autonomy of the Mexican government in the process of policy making.¹⁶⁹ 1) Grindle argues that the state

¹⁶⁶For an excellent debate on the difficulty for determining the state autonomy see Barbara Geddes, Politician's Dilemma, Building State Capacity in Latin America (Berkeley, CA: University of California Press, 1994).

¹⁶⁷The Political autonomy of the state is defined here in Bird terms, as the capacity to make decisions independent of the wishes of groups and interests in the society. See Bird, 24.

¹⁶⁸ Juan J. Linz and Alfred Stepan, The Breakdown of Democratic Regimes (Baltimore: John Hopkins University Press, 1978); Hamilton 1982; Stephan Haggard, Chung H. Lee and Sylvia Maxfield, The Politics of Finance in Developing Countries (Ithaca: Cornell University Press, 1993); Peter Evans and Dietrich Rueschemeyer, States Versus Markets in the World Systems (Beverly Hills, Calif.: Sage Publications, 1985); Susan Kaufman Purcell, Mexico in Transition: Implications for US Policy (New York: Council on Foreign Relations, 1988).

¹⁶⁹Kaufman, 1975:120.

is autonomous in making economic policy, based on the political control exercised by the bureaucracy in Mexico.¹⁷⁰ 2) Vernon and Basañez believe that the state is constrained due to the competing forces of business and popular sector interests.¹⁷¹ 3) Hamilton asserts that the state is capable of deflecting the pressures of popular constituency but it is vulnerable to pressures from the business sectors and IFIs.¹⁷² It is noteworthy that none of the scholars envisioned the Mexican state weak or seriously constrained in its ability to push his own agenda. In general there are two approaches those who believe the Mexican State to be autonomous and those who consider it “relatively autonomous.”

a) An Autonomous State

Scholars like Grindle, Purcell and Purcell, Bennett and Sharpe have stressed that the Mexican State is noted for its strong capacity to set rules for economic and political interaction and interest groups severely circumscribed by government power.¹⁷³ Grindle has written that the state is autonomous in making economic policy, due to the political control exercised by the bureaucracy.¹⁷⁴ This author argues that the fact that a single party has

¹⁷⁰ See Merilee S. Grindle, Bureaucrats, Politicians and Peasants in Mexico: A Case Study in Public Policy (Berkeley, CA.: University of California Press, 1977) and Merilee S. Grindle, “Building Sustainable Capacity in the Public Sector: What Can be Done?” Public Administration and Development Vol. 15, 1995: 441-463.

¹⁷¹ Vernon, or Miguel Basañez, “20 Years of Crisis in Mexico, 1968-1988,” PhD thesis, London School of Economics, 1991 and Miguel Basañez, La Lucha por la Hegemonía en México 1968-1990 (México: Siglo XXI Editores, 1990).

¹⁷² Hamilton.

¹⁷³ Grindle, Bureaucrats; Purcell; Douglas C. Bennett and Kenneth E. Sharpe, Transnational Corporations Versus the State: The Political Economy of the Mexican Auto Industry (Princeton, N.J.: Princeton University Press, 1985). Even Hamilton recognises the ample autonomy of the bureaucracy.

¹⁷⁴ Merilee S. Grindle, “Sustaining Economic Recovery in Latin America: State Capacity, Markets, and Politics,” in Graham Bird and Anna Helwege, Latin America’s Economic Future (Washington, DC: Academic Press, 1994): 303-323, and Merilee S. Grindle, Challenging the State: Crisis and Innovation in Latin America and Africa (Cambridge: Cambridge University Press, 1996).

dominated elections expanded the power of the state to control social mobilisation and organisation.¹⁷⁵ A study by Grindle and Thomas shows decision makers have the independence to define the public policies, accordingly to their ideology, professional training and experiences, although they have to shape the policies to make them politically and bureaucratically acceptable for the various interests groups in the system.¹⁷⁶

Other authors like Findlay have also stressed the independence of the Mexican State from social forces.¹⁷⁷ Anglade and Fortin state that although the influence of private capital is paramount in the Mexican political system, it allows a considerable degree of autonomy to the state as it was clearly shown by the country's bank nationalisation.¹⁷⁸ Camp states that the Mexican government is committed to capitalist development but it does not appear to be dominated by the capitalist class, although it has considerable influence over it.¹⁷⁹ For Callaghy Mexico had traditionally enjoyed high levels of bureaucratic state capability and insulation from political forces. This was achieved by a strong executive authority, which insulated the PRI from making significant contributions to policies.¹⁸⁰

¹⁷⁵ Grindle, Challenging the State, 11.

¹⁷⁶ Merilee S. Grindle and John W. Thomas, Public Choices and Policy Change: The Political Economy of Reform in Developing Countries (Baltimore: John Hopkins University Press, 1991).

¹⁷⁷ Findlay's common conditions associated with "States' independence from social forces" easily apply to the Mexican case: 1) low degree of organisation within society 2) authoritarian nature of existing political regime 3) control of the state by small elite. Ronald Findlay, The Roots of Divergence: Western Economic History in Comparative Perspective (New York: Columbia University, 1991):18.

¹⁷⁸ Anglade and Fortin, 271.

¹⁷⁹ Roderic Camp, Entrepreneurs and Politics in Twentieth-Century Mexico (New York: Oxford University Press, 1989): 7-8.

¹⁸⁰ Thomas M. Callaghy, "Toward State Capability and Embedded Liberalism in the Third World: Lessons for Adjustment," in Nelson ed. Fragile Coalitions.

Mexico is frequently described by political scientists as corporatist.¹⁸¹ Under such an assumption, PRI's corporate actors (labour, peasants and small businesses and professionals) should play an important role in the government's policy making. Nevertheless, several scholars question the influence of the corporate system in policy making. Story argues that the PRI was not a dominant actor in the process of policy decision making. To him the official party was more like an institution serving the executive branch.¹⁸² Bailey places bureaucrats with a large degree of autonomy from the PRI's corporate structure and its patronage role. He highlights the dominance of the bureaucracy on public policy, resulting from of a highly centralised presidential system.¹⁸³ Philip also stresses that the presidential system allowed greater autonomy to the bureaucrats responsible for policy making, since a strong executive is less exposed to influence from interest groups.¹⁸⁴ Likewise, Centeno states that the corporatist sectors did not play a major role in policy making; their role was limited to supporting the legitimacy of decisions made in the bureaucracy.¹⁸⁵

The state bureaucracy was free from the constraints placed by the political machine, because the PRI and its predecessor never function as a political party but rather as a political control secretariat within the governing

¹⁸¹ See Wiarda or Wayne Cornelieus, Judith Gentleman, and Peter H. Smith eds. Mexico's Alternative Political Futures, (San Diego, Calif.: University of California, 1989)

¹⁸² Dale Story, Industry, the State and Public Policy in Mexico (Austin: University of Texas Press, 1986): 131-132.

¹⁸³ John Bailey, Governing Mexico.

¹⁸⁴ Philip, The Presidency in Mexican Politics.

¹⁸⁵ The CTM was conformed to maintain labour acquiescence to government policies, and their influence declined with the replacement of Fidel Velazquez over the more independent union leader Vicente Lombardo Toledano. The incorporation of the National Confederation of Popular Organisations (CNOP) balanced the power of the two major sectors.

bureaucracy.¹⁸⁶ To Needler interest groups like small entrepreneurs, workers and peasant organisations were relegated from the decision making process. Plus labour and agrarian rules allow the government a great deal of latitude against uncooperative labour and peasant leaders.¹⁸⁷

For Kaufman the bargaining power of corporate sectors, especially the National Confederation of Peasants (CNC), was very limited in the process of policy making.¹⁸⁸ Grindle who studied in great detail the process of policy making involving bureaucrats, peasants and representatives from the CNC, came to a similar understanding, concluding that bureaucrats were the dominant actor in the policy process, despite been the peasant sector, one of the pillars of the party-government structure.¹⁸⁹ For Middlebrook labour organisations have a minor role in policy making because they were largely dependent on state subsidies. He argues that the development of neo-liberal policies since the early 1980s have further weakened the power of labour to influence policies.¹⁹⁰

In relation with the business sector, Smith believes that the Mexican state is autonomous and does not serve the interest of international and domestic capital.¹⁹¹ Camp, a student of the relationship between the state and the private sector in Mexico, argues that the government bureaucracy has traditionally

¹⁸⁶ Miguel Angel Centeno, Democracy with in Reason, Technocratic Revolution in Mexico (Pennsylvania: Pennsylvania University Press, 1994) 51.

¹⁸⁷ Needler, 70-71.

¹⁸⁸ Susan Kaufman Purcell, "Mexico: Clientelism, Corporatism, and Political Stability," in Samuel N. Eisenstadt and Rener Lemarchand, eds., Political Clientelism, Patronage, and Development (Beverly Hills: Sage, 1981):199.

¹⁸⁹ Grindle, Bureaucrats.

¹⁹⁰ Kevin J. Middlebrook, The Paradox of Revolution (Baltimore: The Johns Hopkins University Press, 1995).

¹⁹¹ Peter H. Smith, Labyrinths of Power: Political Recruitment in Twentieth-Century Mexico (Princeton, N.J.: Princeton University Press, 1979).

dominated the relationship, and therefore the policy agenda.¹⁹² Elizondo attributes to the economic elite a strong influence over the tax policy making process but believes that the bureaucracy still dominates the agenda. He makes the case that those emphasising the role of the economic elite as the governing force, underestimate the autonomy of the Mexican bureaucracy, in particular that of the President.¹⁹³ Kaufman, Badrezch and Heredia have written about the important role of national and foreign capital during the Salinas term, but attributed to the technocrats the dominant role in policy making.

b) A Relatively Autonomous State

From an opposing stance, various other scholars believe that the bureaucracy is constrained by internal actors such as corporatist and business interest groups, and external actors such as IFIs, foreign business and capital. Wiarda describes Mexico as an open corporatist system, largely constrained by socio-economic actors.¹⁹⁴ To Maxfield, macroeconomic policy patterns are shaped by interest coalitions, formed by particular state agents, sectors of the bourgeoisie, labour and other economic actors. These competing coalitions extend across state and society including both state actors and representatives of social groups.¹⁹⁵ Cothran states that the Mexican political system is often called authoritarian, but is usually flexible in its response to group interests,

¹⁹² Camp, 239.

¹⁹³ See Elizondo, "In Search," 165.

¹⁹⁴ Wiarda, Corporation and National Development.

¹⁹⁵ Sylvia Maxfield, "International Finance, The State and Capital Accumulation: Mexico in Comparative Perspective," PhD thesis, Harvard University, 1988.

especially business and to a lesser extent labour.¹⁹⁶ To Philip, economic policy in Mexico after 1982 has been constrained by politics.¹⁹⁷

Centeno believes in the "relative autonomy" of the bureaucrats in designing and implementing public policies without the intervention of interest groups. But since the opening of the economy, the degree of autonomy has been constrained by domestic and international capital.¹⁹⁸ The PRI's main function was to manage the patronage machine that compensated corporatist sectors for their support to the system.¹⁹⁹ Fortin and Anglade have studied in depth the autonomy of the Latin American countries, given Mexico a degree of "relative autonomy."²⁰⁰ To these authors the Mexican political system is based on a "symbiotic relationship between business and the state, with the ruling party playing the role of broker."²⁰¹ They argue that the influence of private capital remains paramount, allowing some degree of autonomy. Additionally, they place great importance on international financial centres.²⁰²

For Evans, policy reform in Mexico has been the result of a relative autonomous state. He argues that the phenomenon of policy change is usually the combination of internal autonomy and external dependency.²⁰³ In order to make policy reform possible, the state must have a significant degree of autonomy from social forces. He highlights the importance of a coherent

¹⁹⁶ Cothran, 112.

¹⁹⁷ Philip. "Democratisation".

¹⁹⁸ Centeno, Democracy within Reason.

¹⁹⁹ After 1946 the Party function increasingly focused in managing the patronage machine on which political stability depended. Centeno, 54.

²⁰⁰ Anglade and Fortin, The State.

²⁰¹ Anglade and Fortin, Vol. II, 271.

²⁰² Ibid.

²⁰³ Evans 1992, 176.

bureaucracy, strong enough to prevent rent seeking from defining policies and with the necessary contacts with the international policy structures.²⁰⁴ Internal autonomy allows the state to break the alliances that maintain the status quo, whereas the external actors and their actions become a stimulus for the reform. Haggard concurs with the idea that external influence provides the initial stimulus to both the flow of capital and ideas across borders.²⁰⁵

Multiple scholarly works have been written on the relationship between the state and capital. They can be classified in three groups, according to the limits posed by national and international capital on policy makers: (1) Mexican public policy has largely reflected the interest of international and national capital. (2) Two different factions of a dominating elite, one responsible of government institutions and the other for the control of national capital, where neither one dominates, albeit the interest of these groups often conflict. (3) That of “relative autonomy” which recognises the importance of capital, but gives the state a leeway of independence. The state and the private sector interact but the state is dominant in the process of policy making.²⁰⁶

It is generally agreed that business groups are the most influential actors in the process of policy making. To Hamilton the state seeks to exercise as much control as possible but it is constrained by the reactions and expectations of capital, adding that the business class enjoys powerful weapons to sabotage

²⁰⁴ Evans 1992, 163-165.

²⁰⁵ Haggard 1990, 28.

²⁰⁶ Nora Hamilton, The Limits of State Autonomy: Post Revolutionary Mexico, (Princeton, N.J.: Princeton University Press, 1982); Jorge Carrión and Alonso Aguilar, La Burguesía, la Oligarquía y el Estado (México: Nuestro Tiempo, 1972); Roger Hansen, The Politics of Mexican Development (London: John Hopkins Press, 1980); Kaufman, The Mexican Profit-Sharing Decisions; Teichman, Policy Making from Boom to Crisis; James M. Cypher, State and Capital in Mexico: Development Policy since 1940 (Boulder: Westview Press, 1990); Maxfield, 1988.

the policies it opposes.²⁰⁷ Other authors such as Frieden and Maxfield highlight the leading role of domestic and international capital in the design of economic policies.²⁰⁸ Maxfield describes an alliance between bureaucrats and bankers, and how this has influenced economic policy.²⁰⁹ Lindblom stresses that that economic forces shape the balance of power in politics, and the organisational capacity of interest groups depends on their control upon economic resources.

The business elites have the capacity of economic disruption through capital flight, thus the possibility to alter the economic agenda. Political leaders translate the demands of capital into concrete policy actions under the threat of capital flight.²¹⁰ Reitchkman goes much further to argue that the tax system in Mexico reflects the interests of domestic capital and their influence to resist taxation.²¹¹

Haggard, Stallings and Maxfield emphasise the importance of international forces in the process of policy making.²¹² The state is constrained by the leverage of international capital and interest groups in the political arena.²¹³ Concurring with this view, Stallings argues that international actors are crucial

²⁰⁷ Hamilton.

²⁰⁸ Frieden stresses that business political influence lies in their ability to influence directly policy making, organise lobbying and upset the economy through capital flight. The capacity to leave the domestic economy through the stock market, provide an important leverage to influences the state public polices. See Jeffrey A. Frieden, Debt Development, and Democracy: Modern Political Economy and Latin America, 1965-1985 (Princeton, N.J.: Princeton University Press, 1991): 29.

²⁰⁹ Maxfield, Governing Capital international Finance and Mexican Politics.

²¹⁰ Lindblom.

²¹¹ Retchkiman.

²¹² Maxfield Governing Capital; S.Haggard, Chung Lee and S. Maxfield, The Politcs of Finance in Developing Countries (Ithaca: Cornell Universtiy Press, 1993); B. Stallings, "International Influence on Economic Policy: Debt Stabilization and Structural Reform," in S. Haggard and R. Kaufman, eds, The Politics of Economic Adjustment (Princeton, N.J.: Princeton University Press, 1992).

²¹³ Haggard, Lee and Maxfield, 312.

in explaining the changes in policies during the 1980s.²¹⁴ According to Lipson] international capital has become one of the major policy actors in setting the policy agenda and imposing the policies upon the governments.²¹⁵ This academic describes international capital as a coherent organisation composed by interdependent and co-ordinated structures of financial institutions, which allows them to influence the policies undertaken by the debtor states.²¹⁶

Even Grindle a defender of an autonomous bureaucracy contends that the state can not ignore the implicit demands of international capital when making public decisions.²¹⁷ Levi estimates that the globalisation of the economy increased the power of Transnational Corporations reducing the relative bargaining power of national states over corporate tax levels.²¹⁸ Furthermore, many authors (Pastor, Williamson, Sachs, Mosley, Haggard, Kahler, Kaufman, Remmer, Edwards, Durnsbuch, Thorp and Whitehead, Vietmeyer) have pointed out the significant leverage that IFIs exercise in debtor countries' agendas through the conditionality attached to structural adjustment loans.²¹⁹

2.5.- State Autonomy in the Light of Tax Policy Making

The tax literature seems to support the assumption that tax policies are the outcome of political bargaining of interested groups, although there are a few

²¹⁴ Stalling.

²¹⁵ Lipson 1988, 44.

²¹⁶ Ibid.

²¹⁷ Maxfield, *Governing Capital*, 53.

²¹⁸ Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1988).

²¹⁹ See Manuel Pastor, *The International Monetary Fund and Latin America* (Boulder, Colo: Westview Press, 1987); *Adjustment Lending: An Evaluation of Ten Years of Experience* (Washington, DC: The World Bank, 1988); Joan Nelson, ed. *Economic Crisis and Policy Choice: The Politics of Adjustment in Developing Countries* (Princeton, N.J.: Princeton University Press, 1990); Stephan Haggard and Robert Kaufman, "The Politics of Stabilization and Adjustment," in Jeffrey D. Sachs, ed. *Developing Country Debt and Economic Performance* (Chicago: University of Chicago Press, 1989): 209-254.

who argue that tax policy making is an independent and rational process undertaken by a very compact elite bureaucracy.²²⁰ In general, authors following the pluralist and rent seeking traditions maintain that tax policy decisions are the result of the competition of interest groups, which try to influence policy making in order to extract benefits from the state.²²¹ This hypothesis has been used to explain tax policy making in developed countries. To Peters and Mucciaroni the tax structure in the US reflects a classic case of "client politics" with a pattern of concentrated benefits and diffused costs.²²² The benefits are concentrated on those who pressure tax policy-makers.

Lindblom's incremental approach states that policy is made not by planning, but by a series of small adjustments to the tax structure, involving a process of mutual accommodation and coalition-building. This theory also shows the power on tax policy making of pressure groups and vested interests.²²³ Aron and Gulper also refer to the "forces" which shape the tax structure, causing tax favouritism in the US. These forces concentrate the benefits on a small minority of all taxpayers, while diffuse costs on the general taxpayers.²²⁴

Galeotti and Marrelli argue that fiscal variables are determined by the political machinery in the decision making process.²²⁵ But according to Haggard this theory is not very useful for developing countries, because the political elite

²²⁰ See David Good, The Politics of Anticipation: Making Canadian Federal Tax Policy (Ottawa: Carleton University, 1980).

²²¹ See Dahl; Peter Evans and Dietrich Rueschmeyer and Theda Skocpol, Bringing the State Back In (Cambridge: Cambridge University Press, 1985), Frieden.

²²² Peters, Gary Mucciaroni, "Public Policy and the Politics of Comprehensive Tax Reform," Governance vol. 3, 1990.

²²³ Lindblom.

²²⁴ "The Politics of Tax Reform" in Henry J. Aaron and Harvey Gulper, Assessing Tax Reform (Washington, DC: The Brookings Institution, 1985): 129-139.

²²⁵ Galeotti and Marrelli.

usually has built these organisational structures.²²⁶ The best way to explain the political influence of social and political forces in policy making is to weigh their power to resist change.²²⁷ Levi believes that rulers act as rational self-interested actors, although there are constraints to their relative bargaining power from international actors and capital.²²⁸ Similarly, Peters believes that the growing power of international corporations reduced the bargaining power of national governments in tax matters.²²⁹

The few authors who have studied the Mexican tax policy making process, like Solis, Reitchkmen, Gil Díaz, Elizondo and Aspe give the dominant role to the bureaucracy, but they also assign significant influence to other attemptive actors who try to influences the process, like capital, corporate groups and international actors. It has been argued in this thesis, that such actors' role and influence has experienced important changes in the last thirty years, thus any generalisation which does not differentiate dissimilar periods could be misleading. Hence, the importance in dividing the thesis into periods looking at the particular economic and political conditions, plus those fundamental variables that have determine the shape and nature of the tax policies.

The evidence shows that the influence of corporate actors has plummeted in the last three decades, but I argue that they are still influential. The best example of their prevailing influences is better understood not in terms of the changes they made to tax policy in the past decades, but in how these powerful

²²⁶ Haggard, 3.

²²⁷ For a view on the weight of social forces see Skocpol, 9.

²²⁸ M. Levi.

²²⁹ Peters.

interest groups have been able to resist changes in the tax system that may affect their interests. Tax bureaucrats have been unable to break powerful resistance to policy changes organised by these interest groups and the force to be reckoned with is the economic elite and their ability to move capital abroad.

For Cothran the causes of Mexico's economic problems are found partly in its position as a relatively poor country that is highly dependent on world and domestic capital that can easily find outlets elsewhere, thus the government must be careful about frightening capitalists.²³⁰ Policy positions unacceptable to domestic and international capital can lead to a sudden loss of needed investment. This limits the policies that Mexican government can pursue.

2.6.- The Power of the Economic Elite and Taxation

Elizondo proposes four reasons why the government has implemented only mild reforms until the Salinas administration. First, the collusion between some members of the government and those groups benefiting from fiscal privileges, usually politically important and capable to mobilise large groups. Political support was secured in exchange for tax exemptions. Secondly, the government philosophy of industrialisation implied giving tax privileges to induce capitalists to invest in Mexico. Thirdly, the threat of large businesses starting a speculative attack against the peso, by pulling their capital out of the country if taxes were raised. Fourthly, the financial power of the economic elite and the need to seduce capital holders, in order to maintain their voluntary

²³⁰ Cothran, 122-123.

savings deposited in the Mexican financial system to continue to finance the public deficit in a non-inflationary way.²³¹

Elizondo seems to underscore the power of interest groups, but brings to light the huge political power of the economic elite, mainly through their ability to transfer capital abroad. He draws attention to the ample autonomy of the Mexican bureaucracy and in particular to the power of the President in order to make reform possible. Other scholars like Maxfield contest this view, emphasising the power of the economic elite,²³² or Reitchkman who goes further to state that the economic oligarchy has traditionally controlled the process of tax policy making. There are two resilient characteristics in the symbiotic relationship between the government and the country's economic elite: a tacit agreement that governs the economic and political relationship and the enormous power of the economic elite to mobilise their capital.

Several scholars refer to a such tacit agreement between the state and the business elite.²³³ Such agreement assured the business elite guaranteed profits secured by a captive market, high subsidies, ample resources through industrial development programmes and more importantly low taxes. In return business organisations had to stay away from politics.²³⁴ Though business could defend their professional interests, they lack the political freedom to express their views on the state or its development strategy.²³⁵

²³¹ Elizondo, "In Search," 163-165.

²³² Maxfield, Governing Capital.

²³³ Cothran, 125.

²³⁴ See Rolando Cordera and Carlos Tello, México, la Disputa por la Nación: Perspectivas y Opciones del Desarrollo (Mexico: Siglo XXI editores, 1981)

²³⁵ Carlos Arriola, "Las Organizaciones Empresariales Contemporáneas," in Lecturas de Política Económica (México: El Colegio de México, 1977).

Tax privileges and incentives were used as a political tool for maintaining a fragile political coalition with the business community. Cothran argues that the government fostered economic growth, largely through policies designed to favour business and avoiding policies that would have alienated business support. He highlights that the continuity of the regime in power depended largely on the support from businesses, thus the government kept the business sector happy with preferential tax, subsidy and tariff policies to ensure them predictable profits.²³⁶ In addition, government feared that a higher tax burden would diminish incentives to invest, therefore affecting growth.

This agreement allowed the economic elite to enjoy phenomenal profits, in a market secured by the ISI strategy. The economic elite benefited with the arrangement accumulating great capital. But soon their vast resources became strategic for funding Mexico's public finance. The excessive dependence on the savings of the economic elite has been raised by Maxfield.²³⁷ This dependency created a vicious circle, where the government's inability to strengthen its fiscal income made it rely increasingly on voluntary savings deposited in the Mexican financial system. The greater the government depends on these savings the more difficult it became to impose taxation that would affect holders of capital in Mexico.

Capital flight has become the key constraint for government policies designed to limit the privileges of capital holders. Since the early 1970s, the menace of

²³⁶ Cothran, 82.

²³⁷ Maxfield, Governing.

capital flight has been used by the economic elite as a political lever for influencing economic policy. The vehicles used to transfer resources include the purchasing of foreign currency, authorised capital transfers and misinvoicing.²³⁸ In the last two decades, globalisation increased these means to relocate capital abroad further empowering capital holders' influence over tax policies.

The proclivity to send capital assets abroad has proved to have devastating effects in the economy, as shown by the recurrent economic crisis. According to Dornbusch there are three types of costs of capital flight. First, capital flight destabilises macroeconomic management. Second, it undermines tax morality, a common practice as underinvoicing of exports invariably reflects in reduced tax payments. Third, when a certain percentage of GNP is transferred abroad year after year, fewer resources are available for domestic investment. This means that savings are not available for domestic capital formation and reduced capital formation implies slower growth and less rapid increase in the standard of living.²³⁹ The Mexican economy has experienced these types of costs, made worse by the absence of a stable source of tax income.

Several authors, including Dornbusch, Solís, Zedillo, Gurría and Fadl, Cumby, and Williamson have estimated the magnitude of the resources legally transferred abroad, as well as the motives and vehicles behind capital flight in

²³⁸ See Rudiger Dornbusch, Capital Flight: Theory, Measurement, and Policy Issues, Occasional Papers 2, (Washington, DC: Inter-American Development Bank, 1990); see also José A. Gurría and Ricardo S. Fadl, Estimación de la Fuga de Capitales en México, 1970-1990 (Washington, DC: Banco Interamericano de Desarrollo, 1991): 9-11.

²³⁹ See Dornbusch, Capital Flight, 19-20.

Mexico.²⁴⁰ Different methods to quantify the total amount of capital flight have been used providing contrasting results, which nevertheless disclose the magnitude of the problem. In 1991, Williamson estimated that around USD \$ 80 billion had flown from Mexico since the early 1980s.²⁴¹ During 1994 alone, an estimated USD \$ 29 billion dollars fled out from the Mexican economy in just one year.²⁴² The following table, elaborated by Gurría and Fadl presents a summary of the principal studies on this issue.

**Table 2.1.- Estimates of Capital Flight from Mexico
(millions of dollars)**

Source	1970-1985	1976-1984	1981-1987	1977-1987
Gurría & Fadl	27,095	26,223	19,616	20,460
Alvárez & Guzmán			22,048	
World Bank		53,564		
Cline		25,618		
Cuddington		36,197		
Erbe		53,600		
Morgan G.T.		53,392		
Zedillo	28,558			

Source: Gurría and Fadl, 7.

Regarding the motives behind capital flight, these range from the legitimate concern of entrepreneurs to diversify asset holdings, to protect capital in expectation of major changes in the exchange rate or political risk, to financial repression or tax considerations, including tax fraud. These authors have studied the political issues that induced capital flight, particularly in the case of

²⁴⁰ See Dornbusch, Capital Flight; D. Lessard and John J. Williamson eds., Capital Flight: The Problem and Policy Response (Washington, DC: Institute for International Economics, 1987); Leopoldo Solís and Ernesto Zedillo, "The Foreign Debt of Mexico," in G. Smith and J. Cuddington eds., International Debt and Developing Countries (Washington, DC: World Bank, 1985); Ernesto Zedillo, "The Mexican Case," in D. Lessard and John Williamson, eds., Capital Flight and Third World Debt (Washington, DC: Institute of International Economics, 1987); Gurría and Fadl; R. Cumby and R. Levich, On the Definition and Magnitude of Recent Capital Flight (Cambridge, MA: National Bureau of Economic Research, 1987); Morgan Guaranty Trust. LDC Debt Reduction: A Critical Appraisal, World Financial Markets December 1988: 1-12.

²⁴¹ Williamson, How Much has Happened, 63.

²⁴² Mark Fineman, "Some Fear Zedillo Can't Pull Mexico from Mire," Los Angeles Times January 11th, 1995: A6.

changes in the regime or shifts in the economic orientation of the home country. In all the cases, capital holders act in response to uncertainty to protect their assets.

None of these authors mentioned have risen the argument I put forward here, that the transfer of capital abroad can be used as a powerful political tool to manipulate economic policy making, in particular tax policies. In Mexico, the menace of capital flight has been a major deterrent on government policies aimed at reforming the tax system.

Conclusion

Mexico is a typical case where politics has shaped the tax system. Based on Peters' study of the patterns of taxation in OECD countries, Mexico's tax system closely resembles those where the tax pattern is not selected consciously by the government, but appears rather to emerge from the political and economic systems within, which the policy choices are being made. He argues that these types of countries adopted certain tax strategies in part because of the impact of corporatist political structures, and the consequent need to raise revenue without offending major social interests.²⁴³

Political accommodation limited the possibilities of reforming the tax system. Due to the high political cost involved in tax reform, politicians prefer to make only marginal changes rather than significant reforms that would affect their political position. The absence of an overall tax reform in the past three decades could be explained by the Rose and Karran theory of political inertia,

²⁴³ Peters, 62.

where tax reforms stagnated due to the fear of negative political effects. These authors argue that politicians follow the basic axiom of politics of taxation which states that non decision-making is preferred to decision-making.²⁴⁴ The theory builds on the idea that keeping out of trouble is one of the basic rules of politics and increasing taxation is likely to invite political trouble. Ascher unveils two intrinsic political risks rooted in any tax reform in Latin America; the sacrifice of political capital to gather support for the reform and the fact that it may led to adverse economic reactions from non-governmental actors, the most significant being capital flight.²⁴⁵ In the Mexican case the risk was much higher, breaking the social pact that legitimised the political regime.

The government has shown to lack the autonomy necessary to increase the fiscal burden on certain groups, continuously been confronted by political resistance and threats to boycott the economy and break up the fragile political pact. The analysis will show a constrained State, particularly vis-à-vis domestic and international capital. The menace of capital flight has given the economic elite the most powerful instrument to oppose and sometimes reverse government's economic policies. Paradoxically, the economic elite's ability to transfer capital abroad represents such a powerful weapon, only because Mexico lacks a stable and sufficient flow of tax revenues. Ironically, the devastating effect of capital flight in the economy could only be reduced if Mexico strengthens its tax revenue income.

²⁴⁴Rose and Karran, 5.

²⁴⁵Ascher, 470.

Chapter III

The Anatomy of Tax Policy Making: Main Actors and their Influence

"It is not an easy task to identify the main tax policy actors, usually they operate secretive and in a disarticulated manner. However, they remain very effective in maximising tax benefits."

*José Luis Medina Guiar,
President of the Public Finance Committee of the Senate*

In this chapter my objective is to disclose the anatomy of tax policy making by identifying the main actors in the process as well as how they interact with each other to shape tax policy. This thesis follows the argument that tax policy making is a combination of rational economic calculations, incremental adjustments to existing policies, and attempts by interest groups to maximise political gains. Thus, the outcome of tax policy-making arises from the maximising efforts of political and social actors rather than just economics. On this issue, Peters argues that tax policy outcomes are not entirely the product of conscious economic considerations, rather they are the result of a highly politicised bargaining process.²⁴⁶ For Bird the tax structure reflects the past equilibration of political forces, as constrained by economic structure and scarce administrative resources.²⁴⁷ Tax policy decisions must satisfy both political and economic constraints, and politics is most likely to be the dominant consideration in the formulation of tax policy.²⁴⁸

In addition tax policy is like any other public policy: a mixture of political choices and older inheritances.²⁴⁹ The result is that most national tax policies have not been planned or designed, they have just grown over time through the

²⁴⁶Peters, 70.

²⁴⁷Bird, Tax Policy and Economic, 22.

²⁴⁸Peters, 70.

²⁴⁹Ibid.

accumulation of historical happenstance and passing political expediency.²⁵⁰ Rose and Karran claim that tax policy is driven by "inertia," stressing the forces of continuity in the policy making process. Policy is made not by any process of synoptic planning but by a series of small adjustments to the status quo, involving mutual accommodation and coalition-building.²⁵¹

Analysis of the process of tax policy-making requires a clear identification of the bargaining units.²⁵² However, it is not a simple task to identify the interest groups likely to have a common interest in influencing the tax structure,²⁵³ since those most visible in policy-making may not be the most influential. Due to the technical and specialised nature of this field, the process usually takes place within a small circle of specialists or behind closed doors. In this chapter, I have followed the model offered by Forte and Peacock for understanding the anatomy of tax policy-making. However, I have adjusted it to conform to the Mexican situation.

The anatomy of tax policy-making helps to identify the principal actors in political bargaining. This is relevant to tax reform because the empirical evidence suggests that there has been a transformation in the actors as well as in the environment surrounding the process of tax policy-making in Mexico. Changes in economic and political conditions affecting Mexico in the last three decades have reshaped the system. Clearly, there has been a new configuration of actors, as well as a changing pattern in their relations and their

²⁵⁰ Bird, Tax Policy and Economic.

²⁵¹ Rose and Karran.

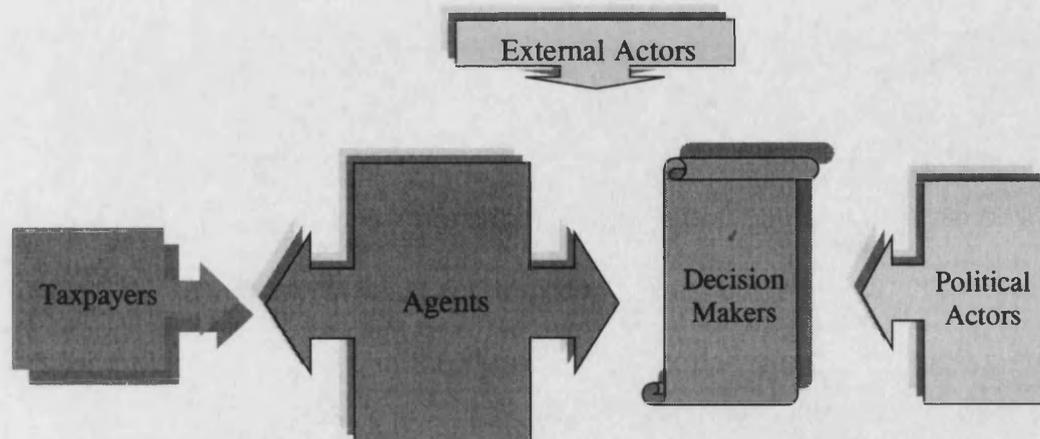
²⁵² Peacock and Forte, 12.

²⁵³ Ibid.

capacity to influence the tax system. New and powerful actors have emerged while others have lost their bargaining power. Thus, in order to understand the process and the changes that have taken place, it is necessary to identify the various actors and their roles.

Peacock and Forte have proposed a useful model for understanding the dynamic of tax structure on what they call the process of "tax planning." This model classified the actors involved as the "planners": interest groups representing the personal and corporate interests of tax payers; the "agents" as those whom the tax payers employed to promote their tax interests, and the "suppliers" of tax decisions makers as legislators, bureaucrats and the judiciary.²⁵⁴ This model, at least for Mexico, leaves out other very important actors who play a major role in the dynamics of tax policy-making process, like external and political actors. Although these actors do not represent a tax group per se, they also seek to influence the tax system, and further analysis will show they have been able to influence it.

Graphic 3.1.- Dynamics of Tax Planning



²⁵⁴ Peacock and Forte, 5.

3.1.- The Planners

Tax payers are divided into personal and corporate. Personal tax payers are categorised as working and self-employed.²⁵⁵ Corporate groups include private sector companies, public sector companies and international companies. In Mexico the total number of taxpayers included in the 1999 census numbered approximately 17.2 million entries, most of them salaried workers.²⁵⁶ However, as indicated in Chapter 1, the great majority do not pay taxes. Of the 2.5 million businesses identified in the census only one fifth are registered tax payers. The organization of taxpayers' interests for collective action poses great difficulties, mainly because "tax payers" is a very broad classification. Olson was the first to point out the difficulties of organising tax payers, due to the fact that their individual tax situations make each one have different campaign priorities.²⁵⁷

3.1.1.- Personal Tax Payers

a) *Workers*

This includes captive wage earners. Less than a quarter of those employed pay income taxes. Workers are obliged to contribute to the fiscus in two ways: direct and indirect taxation. Wage earners pay direct taxes (income taxes) only when their income is above 3.2 times the monthly minimum wage. But, only one in four salaried workers has an income above this threshold. Income tax is withheld by employers and then paid directly to the Treasury. On the other hand, all workers pay indirect taxes such as VAT and excise taxes on tobacco

²⁵⁵ Peacock and Forte also include non-working tax payer, but since there is not a social security pension for those unemployed in Mexico, this category is not applicable.

²⁵⁶ Francisco Gil Díaz, "Rehabilitation of Public Finance and the New Tax System," in Public Administration Today in Mexico Today (México: Secretaría de la Contraloría General de la Federación y el Fondo de Cultura Económica, 1993): 189.

²⁵⁷ M. Olson, The Logic of Collective Action (Cambridge, Mass.: Harvard University, 1965).

and liquor. Thus, wage earners can be affected by changes in tax composition, especially cuts in the products exempt from VAT or increases in rates of indirect taxes. Salaried workers are organised through their unions, and use their legislative representatives to fight for their tax interests. Collective action is reactive, responding to changes that they consider a threat. The actions of salaried workers' representatives are usually directed to obtain tax privileges or maintain the current conditions by opposing to changes in the tax system that may affect them.

b) Self- Employed

This group is classified by working activity. In 1993 the tax register counted approximately 4,200,000 self employed.²⁵⁸ This classification of tax payers covers a wide range of activities that range from professional groups such as doctors, accountants, lawyers, etc., to private individuals engaged in entrepreneurial activities such as salesmen, peasants and farmers. This group is not well regulated and it is very difficult to tax; many remain out of the tax net and their income is difficult to register or calculate. In this group, the professionals are those easier to tax, however Fitzgerald asserts that professional groups have always been lightly taxed in Latin America.²⁵⁹ These groups are mostly represented by a variety of professional associations of lawyers, doctors, engineers, etc., whose activities are sometimes difficult to measure.

²⁵⁸ Carlos Rojas Gutiérrez, "The National Solidarity and the Restructuring of Participative Social Management," in Public Administration in Mexico Today (México: Secretaría de la Contraloría General de la Federación y el Fondo de Cultura Económica, 1993): 161.

²⁵⁹ E.V.K Fitzgerald, "The Fiscal Crisis of the Latin American State," in Jhon F.J. Toye ed., Taxation and Economic Development (London: F. Cass, 1978): 133.

Among the self-employed, there are some sectors identified as being almost off-limits for the tax net, usually due to their traditional political power and/or the difficulty of collection. Among these are the "sacred cows" of taxation, they enjoy preferential treatment and usually cannot be touched for political reasons. These groups raise strong resistance to any tax reform that could affect their privileged status. One such group is the agricultural sector. This sector contributes very little to the tax indices, but as in many other countries the agricultural sector enjoys big privileges. Large farmers have benefited from the privilege that most peasants and farmers do not pay taxes, and very few efforts have been made to collect taxes from them. The privileged tax position enjoyed by some of these organizations reflects their real power in the political structure. Peasants and farmers are organized through the National Confederation of Peasants (CNC), one of the three pillars of the PRI, and probably the most important one, since the rural vote constitutes around 60% of total presidential votes for the PRI.²⁶⁰

Agricultural sector influence is felt in the public policy making process. Grindle has made an excellent analysis of the organisational alliance between bureaucrats and the agricultural sector.²⁶¹ The alliance with the party structure has developed via large subsidies and tax exemptions for the agricultural sector. Another group which enjoys a privileged tax position is the fishery sector.²⁶² These two sectors enjoy special treatment, which includes large

²⁶⁰ Interview former national leader of CNC, Hector Hugo Olivares Ventura, March 14th, 1998.

²⁶¹ For a detailed study of the peasant sector, how its organise and how it interact with bureaucrats, see Grindle, Bureaucrats.

²⁶² Interview with former Under-Secretary of Fishery, Oscar González Rodríguez, Aguascalientes April 18th, 1999.

subsidies and tax exemptions to encourage investment in these areas considered fundamental for the country's development.

Another very important group outside the tax net is the informal economy. The most obvious consequence of the existence of the informal economy is that income goes untaxed, plus other indirect taxes such as VAT and excise duties are evaded.²⁶³ This ultimately translates into large revenue losses for the state. In addition, the black economy distorts information about measured output, unemployment and inflation.²⁶⁴ According to the INEGI, 30% of the economically active population (EAP) is under-employed.²⁶⁵ These groups do not pay taxes but are politically well organised. They exercise collective action to maintain their privileged status by pressuring politicians, bureaucrats and party leaders.²⁶⁶ Programmes to incorporate a million street vendors into the tax net have failed and raised political turmoil.²⁶⁷

3.1.2.- Corporate Taxpayers

To organise corporations according to their tax interest is not an easy task either. Corporations are typically organised "functionally" within industries and aggregated through an umbrella organisation. This includes functional sectors such as manufacturing, agriculture, banking, mining, etc. The difficulties for

²⁶³ David J. Pyle, Tax Evasion and the Black Economy (London : Macmillan, 1989): 131.

²⁶⁴ Pyle, 141.

²⁶⁵ Estadísticas Generales del Empleo (Aguascalientes: INEGI, 1994): 34.

²⁶⁶ Cuauhtémoc Cárdenas argues that these are political arms of the PRI, politically motivated in their collective action. But PRI officials accuse these groups to be clientelistic structures tied to the PRD structure. Interview Dulce María Sauri, London, February 28th, 2000.

²⁶⁷ In 1993 attempts were made to demand street vendors the introduction of cash registers certified by the revenue office, the program did not succeed due to the political resistance of these highly politicised groups.

effective collection action arise because these numerous groups could be affected very differently by a tax policy.

In general, these groups petition for more favourable tax treatment, and particularly an increase in fiscal incentives for the reduction of rates, red tape and particular tax regulations.²⁶⁸ Corporate taxpayers rarely fight for a fundamental change in tax policy, since they pursue different interests according to their particular circumstances. The business sector is not homogeneous, and it does not act as a block. Even within the same sector there could be differing priorities depending on size or their relationship with the government. However, despite the differences in its constituency it has a strong interest in pursuing a common strategy to reinforce its position.

a) Private Businesses

Businesses participate through their existing trade and industrial associations and have a common interest in promoting tax advantages for their members. In Mexico, micro, small and medium companies compromise 98% of the total companies in the country, numbering about 1,316,952 in 1993. Surprisingly, according to Nafinsa, micro-companies constituted 97% of the total.²⁶⁹ In Mexico there are approximately 2.2 million businesses registered in the tax census.²⁷⁰ But just 2000 large companies account for almost 64% of the total

²⁶⁸ Propuesta Final de Reforma Fiscal Integral (México: CANACO, 1999).

²⁶⁹ Red de Apoyos Públicos y Privados Hacia la Competitividad de las PYMES (México: Nacional Financiera, 1995), 151.

²⁷⁰ Anuario Estadístico de los Estados Unidos Mexicanos (Aguascalientes: INEGI, 1998).

corporate income tax,²⁷¹ whereas small and micro businesses contribute very little to total corporate income tax receipts.

Due to the large contribution made by big businesses to state revenues, they stand in a better position to demand improved or preferential tax treatment.²⁷²

There are multiple accounts of abuses and preferential treatment.²⁷³ Small and micro businesses, although large in numbers are less well organised. They have been traditionally constrained by government created corporate organisations. The large diversity of functions and sizes makes it very difficult for them to join together in a common cause.²⁷⁴ To Loeza, small entrepreneurs groups began to mobilise politically after the nationalisation of the banks in 1982, an expropriation which directly affected them. They sought to enhance their influence and voice their protest against the intrusion of the government into the private sector domain, using the political structure of the PAN to empower their demands and agenda.²⁷⁵ In contrast, large businesses rapidly came to terms with the nationalisation, quickly building new bridges with the State.²⁷⁶

²⁷¹ Interview Tomás Ruíz, Under Secretary of Finance March 25th, 1999.

²⁷² Interview Gutiérrez Prieto, owner of one of the 10 largest conglomerate of business in Mexico, London, August 22nd, 1999.

²⁷³ Recently businessmen complained that a media mogul was given exemptions for the import of two planes and 6 luxury armoured cars, see Miguel Badillo, "La Facultad descrecional de Gurría para Condonar Deudas", *El Universal* February 28th, 2000. Similarly, a group of popular artists complained because tax authorities cancelled fines of up to USD \$ 1.25 million for Juan Gabriel, a famous singer. See Juan Ruíz Healy, "A Fondo," *Novedades* 10th February, 2000

²⁷⁴ Interview Eduardo Garcia, General Director, CANACO, Mexico September 23rd, 1999.

²⁷⁵ This boosted the vote of PAN votes during the 1980s. See Soledad Loeza, Seminar on Mexico at the LSE, February 8th, 2000 and Soledad Loeza, *El Partido Acción Nacional: La Larga Marcha, 1939-1994* (México: Fondo de Cultura Económica, 1999).

²⁷⁶ See Carlos Elizondo, "Property Rights in Mexico: Government and Business After the 1982 Bank Nationalisation," PhD Dissertation, Nuffield College, Oxford, December 1992.

There has been an evolving relationship between the private sector and the government. The private sector had traditionally relied on the state for cheap services supplied by the state-owned companies, low tariffs, tax exemptions, subsidies and government assistance in moderating labour demands, creating an interest driven coalition that benefited both parties. In exchange for government patronage, business political activism was to a large extent constrained. In addition, a large proportion of big businesses presented no threat to the government since they had close ties with the political structure,²⁷⁷ and some even developed close relationships at the personal level.²⁷⁸ However, there have been many strains in the relationship between the economic and political elite in Mexico.

Many of the large Mexican conglomerates have developed to a large extent thanks to government-personalised support and official licenses.²⁷⁹ Derossi, Luna, Tirado, Valdés, Cordero, Santin and Tirado have studied the avenues of development of Mexican business groups.²⁸⁰ Particularly illustrative is Matilde Luna's insight into relations and struggles between entrepreneurial and political interests. The literature on this topic divides the business sector into segments, according to their relationship with the government. The Northern segment or

²⁷⁷ See Roderic A. Camp, Entrepreneurs and René Millán, Los Empresarios ante el Estado y la Sociedad (México: Siglo Veintiuno, 1988).

²⁷⁸ See Camp, Entrepreneurs, 229.

²⁷⁹ Bailey.

²⁸⁰ Flavia Derossi, The Mexican Entrepreneur (Paris: Development Centre of the Organization for Economic Co-operation and Development, 1971); Salvador Cordero, Rafael Santín and Ricardo Tirado, El Poder Empresarial en México (México: Terra Nova, 1983); Matilde Luna, Ricardo Tirado and Francisco Valdés, "Business and Politics in Mexico, 1982-1986," in Ricardo Anzaldúa Montoya and Silvia Maxfield, eds., Government and Private Sector in Contemporary Mexico (California: Center for US Mexican Studies, 1987):13-44; Matilde Luna, Los Empresarios y el Cambio Político: México 1970-1980 (México: Era and IIS-UNAM, 1992); Matilde Luna "Entrepreneurial Interests and Political Action in Mexico: Facing the Demands of Economic Modernization," in Riordan Roett ed., The Challenge of Institutional Reform in Mexico (London: Lynner Reinner, 1995): 77-94.

Monterrey group is distant from the power elite, the central segment closely related to power and the Alemán segment was itself once part of the political group in power. Some include a Salinas segment, a new group of entrepreneurs that accumulated unprecedented capital and power during president Salinas' administration.²⁸¹ However, Vernon has rightly pointed out that the relationship between the private sector and the state varies significantly between one public organisation and another and from one presidential administration to the next.²⁸²

There are elite organisations with a very limited membership, usually including the most powerful business groups. The Consejo Mexicano de Hombres de Negocios (CMHN) is part of the CCE structure, embracing 30 or so of the most influential Mexican entrepreneurs. However, big businesses prefer to lobby individually rather than in groups; their comments and complaints are made personally to high-ranking tax authorities, or even directly to the President.²⁸³ Camp argues that decision-makers listen to demands from business groups more through informal internal channels than through formal public channels.²⁸⁴ The elite organisations have the economic means and the organisational capacity to mobilise their members and public opinion to effectively influence policy decisions at the bureaucratic level.

²⁸¹ For an overview of Mexican business clusters and evolution see Alejandra Salas, "The Mexican Business Class and the Process of Globalisation: Trends and Counter Trends, PhD thesis, London School of Economics, 1998.

²⁸² Vernon, 26.

²⁸³ Interview A. Gutiérrez Prieto, August 22nd, 1999 and Carlos Slim, October 14th, 1998.

²⁸⁴ Camp, 143. Camp also provides examples on the process of consultation of fiscal authorities with the business sector. See former Secretary of Finance Ortiz Mena in Camp 1987:116.

During the period of liberalisation of the economy the power of large companies grew enormously. The opening up of the economy was accompanied by an improving relationship with the business sector, especially during the Salinas administration (88-94). Representatives of large companies had close ties with government technocrats. This close relationship with the government allowed them to enjoy personalised support, as is the case of FICORCA and FOBAPROA, two public bail out programmes. ²⁸⁵

b) Public corporations

Revenues from state owned companies constitute an important part of the country's total income. In 1996 Pemex contributed 2.9% of GDP, the Social Security Institute (IMSS) 1.9%, the Federal Electricity Commission (CFE) 1.6% and others like ISSSTE, FERRONALES, CONASUPO, ASA, CAPUFE, PIPSA, LyFC, and LOTENAL together supplied another 1.3 % of GDP.²⁸⁶ However, public enterprises' role and influence has lessened in the last two decades. The overwhelming role of the state as producer was one of the most salient characteristics of Mexico's development strategy and as result, state owned companies played a major political and economic role. But the new development strategy based on the principle of reducing the role of the

²⁸⁵ A small committee of technocrats enjoyed almost full discretion in deciding the beneficiaries of government support programmes to businesses. At the beginning of the 1980s FICORCA (Fideicomiso para la Cobertura del Riesgo Cambiario) provided resources of USD\$ 12bn to bail out large companies in risk of bankruptcy after the devaluation. In the mid 1990s FOBAPROA (Fondo Bancario de Protección al Ahorro) provided more than USD\$ 50bn to bail out 14 banks after the 1995 liquidity crisis. President Zedillo was the head of the first programme and authorised the second scheme as President. Some of the large entrepreneurs have benefited twice, like Eugenio Garza Lagüera and Adrian Sada González, first with Visa and Vitro and later with Bancomer and Serfin. Other beneficiaries are Marcelo and Lorenzo Zambrano from Cemex, and Imesa owned by Eugenio Clariond. See Antonio Jáquez, "Hace 15 años con Ficorca, Zedillo Salvó de la Quiebra a Industriales que, convertidos en Banqueros son otra vez Salvados por él con el Fobaproa," *Proceso* May 24th 1998, 7-10.

²⁸⁶ See Política de Ingresos, Secretaría de Hacienda y Crédito Público, México, 1997.

government in the economy plus the divestiture programme, reduced significantly the government influence.²⁸⁷ The number of State Owned Enterprises (SOE) was curtailed from 1,155 in 1982 to 204 in 1995.²⁸⁸

Despite the divestiture efforts SOE continue to provide an important flow of revenue to the state. But their contribution to taxation is very limited, with the exception of the Mexican Oil Company (Pemex) which has such a heavy tax load that some years has to borrow in the market just to pay taxes. By law nearly 75% of Pemex's annual profits are relinquished to the revenue office as levies. It contributes alone 37% of the country's total tax income. Since the 1980s oil is the most important source of tax revenue for the State.²⁸⁹ According to Pemex former Director General, Adrian Lajous, the companies influence in the design of tax policies is very limited, and they were rarely consulted despite shifts on policy which had a direct impact on the company's finance.²⁹⁰

c) *Foreign firms*

The majority of the largest 100 companies in Mexico are partly owned by foreign firms; about half of them are almost 100% foreign owned.²⁹¹ It is logical to suppose that the foreign companies may have a common interest to influence their tax treatment and pressure the government to sign favourable

²⁸⁷ See Jacques Rogozinski and Francisco Javier Casas Guzmán, "The Restructuring Process in Mexico," in *Public Administration in Mexico Today* (Mexico: SECODAM and FCE, 1993):21-48.

²⁸⁸ *The Mexican Economy 1996* (México: Banco de México, 1997): 84

²⁸⁹ See George Philip, "The Political Constraints on Economic Policy in Post-1982 Mexico: The Case of Pemex," *Bulletin of Latin American Research* Vol. 18 No.1, 1999; 35-50.

²⁹⁰ Interview in London March 3rd, 2000.

²⁹¹ Interview Luis Felipe Vilches, Director of Foreign Investment, Bancomext, November 11th, 1999.

tax treaties with their host country. They demand at least the same favourable tax conditions that they would receive in the developed world.²⁹² In Mexico, foreigners are forbidden to enter politics, so their executives, when not nationals, would operate through representatives. In general they would be very discreet regarding dealings with government authorities. These large actors, either executives or representatives, may bargain directly with tax policy-makers at the Secretariat of Finance.²⁹³ However, they usually lobby through their business organisations. According to Lindblom, the major US corporations use their economic power to influence public policies. During the 1960s and 1970s Multinational Corporations (MNC) were extremely powerful in shaping policy in developing countries, through their direct investment.²⁹⁴ In the 1980s, MNC actively participated in making the world tax reform wave possible.²⁹⁵ At the beginning of the third millennium, 75% of the world's total trade occurs through the 100 largest MNC.²⁹⁶ Many of these companies had subsidiaries in Mexico and may have pressured the government to adopt similar measures as those undertaken in their own countries.

Some MNCs have played an important role in Mexico, for example the automobile companies, but in general their influence on policy is variable and very difficult to determine because they operate behind closed doors, dealing directly with top policy-makers. Former Secretary of Finance, Pedro Aspe,

²⁹² Interview Anthony Westnedge, former representative of Johny Walkers in Mexico, London, October 13th, 1999.

²⁹³ Interview Mexico September 13th, 1999 with an official at the Secretary of Finance who asked no to be quoted.

²⁹⁴ Bates, 7.

²⁹⁵ Peters.

²⁹⁶ See Roberto González Amador, "Equivalen a 75.5% del Comercio Global Ventas de 100 Transnacionales," La Jornada February 6th 2000: 1.

insists that MNC were treated in the same way as national companies.²⁹⁷ However, tax authorities recognise that sometimes “special” treatment is given to large companies, as a means of facilitating their activities.²⁹⁸ Unfortunately, there are not many studies on the pressure exercised by multinational corporations in the process of tax policy making in Mexico. But as an example, car manufacturers were successful in abolishing the tax on the purchase of new vehicles to induce demand after the crisis of 1995.²⁹⁹

Taxation is a very important factor in determining foreign investment, and remains a very powerful hook to lure investors. Changes in taxation may push foreign investment out of the country, thus countries must be cautious in the design of their policies. Foreign investment is a very sensitive issue for a government like Mexico, which relies so heavily on both direct and portfolio investment to finance its current account. Due to the financial liberalisation of the last two decades, private financial institutions like investment banks and management funds have taken the place of multinational industries as the most influential exogenous actor. A few private financial institutions control the huge flow of portfolio investment around the world. As an example, in 1998, assets under the management of Merrill Lynch surpassed US\$ 501 billion, while its private client assets are estimated at around USD\$1.4 trillion (the total Mexican GDP is about a third of the latter figure). As an example, private financial institutions have been able to deter governments from taxing a variety of financial instruments.

²⁹⁷ Interview Aspe, September 20th, 1999.

²⁹⁸ Interview Ruíz, March 22nd, 1999 .

²⁹⁹ The levy on the purchase of new cars was cancelled for the 1996 fiscal year. See "Política de Ingresos," Secretaría de Hacienda y Crédito Público, 1996, 5. Mimeo.

3.2.- The Agents

Taxpayers recruit “agents” to protect their individual interests and campaign in favour of those whom they represent. They have many different means of influencing the government, from studies detailing the pros and cons of tax reforms to lobbying and political pressure. Agents provide information on a certain group’s tax position and on how to use the tax structure to the fullest advantage. At other times, they organise lobbying and political action aimed at pressuring tax authorities for favourable changes in tax legislation.

There are three types of agents entrusted with the task of obtaining tax advantages: Professional Associations (lawyers, accountants and economists), Unions, and Industrial and Trade Associations.³⁰⁰ The latter groups usually have specialised individuals or groups to defend their associates’ interests in tax matters.

a) Professional Associations

Professionals specialised in tax matters assist their clients by informing them of how to take the best advantage of the current tax structure or warning them of the risks of reforms. At other times they act by voicing the demands of the tax payers. Professionals organisations’ technical expertise allows them to anticipate the effects of reforms and suggest possible alternatives. Their input and influence has been very limited, though by law they have to be consulted by the government on matters concerning their members. Professional

³⁰⁰ Forte and Peacock only include trade associations.

associations' main role is that of advisors, but due to the recent political changes new opportunities for consultancy and lobbying have developed.³⁰¹ These groups organise forums for discussion of tax matters, and elaborate studies usually in coordination with trade and industrial organisations.³⁰² The more influential professional associations are the Mexican Institute of Finance Executives (IMEF) and the Mexican Institute of Public Accountants (IMPC).³⁰³

According to Good, tax professionals rarely influence tax policies but have a considerable effect on technical provisions.³⁰⁴ This argument applies to IMCP, since this organisation issues the guidelines on accounting principles and auditing standards in accordance with the accounting requirements of tax authorities. There are other groups such as lawyers specialised in public finances and taxes who are also active players.³⁰⁵

b) Unions

Industrialised countries' unions may act only as intermediaries between workers and independent consultants, but in corporatist systems such as Mexico they play a greater role. Ascher asserts that due to the complexity and

³⁰¹ See interview with Antonio Gómez Espinera, President of the Mexican Institute of Public Accountants, on the new role of the organisation in Silvia Meave Avila, "El Burocratismo Causa la Evasión Fiscal," *Siempre* December 10th, 1998: 14-16.

³⁰² The IMEF holds an annual meeting where many of the tax issues of the moment are debated.

³⁰³ These two organisations had a very active role in the VAT debate. For some examples of these two outspoken groups see Guadalupe Hernández and Juan Arvizu " Piden a EZ Ampliar IVA a Alimentos y Medicina," *El Universal* November 19th 1999: 1; Adolfo Sánchez, " Enfrentan las Finanzas Públicas Debilidad en Ingresos y Rigidez en Egresos: IMEF," *Excelsior* February 8th 1999: 1. For IMCP see Héctor Rendón, Alicia Díaz and Jorge Thomas, "Endurece Hacienda Cobro de Impuestos, Antonio Gómez, Presidente IMCP," *Reforma* January 7th, 1999: 1. For a harsh criticism to the tax system from IMCP see Silvia Meave, "El Burocratismo Causa la Evasión Fiscal," *Siempre* December 10th, 1998: 14-15.

³⁰⁴ Good, xv.

³⁰⁵ See comments made by the President of tax legislation at the Lawyers-Bar Association, Cuahtémoc Reséndez, Leonor Flores and Luis Fabre, "Arrecia Polémica en Torno al Sistema Fiscal, es Corto Placista," *El Financero* January 11th, 1999.

the apparent indirectness of impact, organised labour in Latin America exerts little effort over tax issues unless there is a clear danger, as opposed to an opportunity.³⁰⁶ This was the case in Mexico; changes in the tax structure were usually seen by unions as a high political risk that jeopardised their privileges and tax exemptions.³⁰⁷

Unions were closely linked to the government structure. According to Needler, in most Latin American countries, unions have generally been organised under government guidance in order to provide the ruling regime with a base of support and control over the labour movement. Over half of all industrial workers in Mexico are unionised and belong to one of the nine large labour federations. Approximately 85% of union workers belong to nation-wide organizations; the other 15% belong to single company unions.³⁰⁸ Most labour unions have traditionally been affiliated with the official party (PRI) through the Mexican Confederation of Workers (CTM). The CTM is associated with some smaller independent unions and federations in an organisation known as Labour Congress (CT), which constitutes the labour sector of the PRI.³⁰⁹ The CT claimed to represent 90% of Mexico's organised labour force, however their numbers have declined significantly after the death of the long-standing CTM leader, Fidel Velázquez.³¹⁰ The CT includes the CTM, the Regional

³⁰⁶ William Ascher and Malcom Gillis ed. Tax Reform in Developing Countries (London: Durham & London, 1989): 463.

³⁰⁷ Rodríguez stated "you can not raise the profile of the tax exemptions too much because you could raise unwanted attention, and end up losing some of the privileges you already have." Interview with Senator Jorge Rodríguez regional CTM leader, Aguascalientes, September 29th, 1999.

³⁰⁸ Doing Business in Mexico (Mexico: Nafinsa, 1998): 29

³⁰⁹ Needler, 58-59.

³¹⁰ In November 1997, two hundred unions with more than a million and a half members, created the National Union of Workers (UNT), separating from the CT structure. See Guillermo Correa, "Los Foristas Crean su Propia Central Obrera, Bajo el Compromiso de Hernández

Confederation of Mexican Workers (CROM), the oldest labour organisation in Mexico, and several other union groups. *The Workers and Peasants Revolutionary Confederation*, the leading opposition faction, is made up predominantly by unions in the textile, restaurant and shoe industries. The *Federación de Sindicatos de Trabajadores del Estado* (FSTSE) is the major association of government workers. This is affiliated to the PRI through the popular sector (CNOP) which is supposed to represent the middle class and small business.

Traditionally, unions did not present a threat to tax policies or the tax structure, since there was a symbiotic relationship of mutual dependency between the government and unions. The government needed the political support of union leaders during elections as well as their unconditional commitment to control workers' demands for wage increases. Successive rise and fall of union leaders was closely connected with government favour. A combination of political favours, payment of union leaders, quotas for administrative and political positions and coercion have achieved Mexico's relatively peaceful labour relations.³¹¹ However, "quotas" for political positions (governorships and legislative posts) offered to union leaders were the most effective and frequent way to secure unions support.³¹²

Juárez: "Nacemos sin Patrocinio Gubernamental ni Empresarial," *Proceso* November 23rd, 1997: 32.

³¹¹ See Middlebrook, *The Paradox of Revolution* and K. Middlebrook ed., *Unions, Workers and the State in Mexico* (San Diego: University of California, 1991).

³¹² Interview with former federal deputy and union leader Alfredo González, September 28th, 1999.

CTM representatives had different ways of influencing the tax structure and approaching tax policy decision-makers for this end. However, labour has suffered from an acute decline in policy influence. One way to voice their demands was by using the PRI's leadership or during the negotiations of the "Pactos". Through the leadership of the PRI, union leaders expressed their concerns on tax matters, expecting the PRI president to discuss these issues on their behalf with the President or the member of the economic cabinet.³¹³ Another way to discuss tax concerns was through Labour Secretary, or alternatively by asking their elected representatives such as deputies, senators and governors to discuss tax changes directly with tax authorities.³¹⁴ When the "Pactos" were introduced they became a new mechanism for socio-economic actors to voice their tax demands, but the open nature of the debate and negotiations, limited corporate groups' ability to demand special treatment.³¹⁵ According to Aspe those regular meetings to evaluate the "pactos" were a good time for social representatives to express their concerns over tax matters. Prior to the negotiations, the actors would usually try to put forward their tax proposals.³¹⁶ With time, this important forum for economic policy "bargaining" become more a formality than a true space for negotiations.

We can include within the corporate organisations, the National Peasants Confederation, a corporate group with hefty leverage during the time of the inward development model. According to former Secretary for Agricultural

³¹³ Interview with former PRI's president Santiago Oñate, London March 8th, 2000 as well as PRI president Dulce María Sauri, London February 28th, 2000, on how union leaders used to express their concerns.

³¹⁴ Interview Alfredo González, February 28th, 1999.

³¹⁵ To learn about the "pactos" see Aspe in the Mexican Way or Lustig, The Remaking of an Economy.

³¹⁶ Interview Aspe September 20th, 1999; see also Aspe in the Mexican Way.

Reform, the agrarian movement was the political force that propelled Echeverría to the presidency, "in those times rural leaders were very influential."³¹⁷ The evidence shows that rural leaders' political clout has declined; however, they have managed to maintain much of their privileged tax treatment.³¹⁸

c) *Trade and Industrial Associations*

They are organised by activity, not by economic sector. Among their objectives is the acquisition tax advantages for members as a whole, rather than for individual companies.³¹⁹ These associations are recognised by law as formal consultants regarding economic policy. They make public statements, making their views known and their influence felt on matters affecting them economically. They provide data about economic and political trends, as well as ideological guidance for their members. Representatives from the trade and industrial associations periodically have public and private meetings with government officials.

The power of entrepreneurial associations has traditionally been far greater than other functional corporate groups such as labour and peasants.³²⁰ For some authors, businesses are a countervailing force to authoritarian policy making.³²¹ However, as expressed by Bailey, it is difficult for the top

³¹⁷ Former Secretary of Agricultural Land Reform, Deputy Gómez Villanueva, Mexico, September 26th, 1999.

³¹⁸ Maximiliano Silerio, current president of CNC, and former president Beatriz Paredes agreed that the National Peasant Confederation influence in policy-making has declined in the last two decades.

³¹⁹ Bates, 482.

³²⁰ Story, 1986.

³²¹ See Camp, Entrepreneurs.

associations to reach a clear-cut position on specific issues, due to their diversity, and some concerns such as tax incentives.³²² Some of these business organisations have sections that study the impact of taxation on their members, such as the Fiscal Commission in COPARMEX and CONCAMIN, and the Centre of Economic Studies of the Private Sector at the CCE. The lack of official data regarding tax issues accounts for the limited extent and depth of these organisations' studies in fiscal matters.³²³

These are some of the most important business organisations in Mexico:

- 1.-**CCE**-(Entrepreneurs Co-ordinating Council),
- 2.-**CONCAI** (National Confederation of Chambers of Industry)
- 3.-**CONCANACO** (National Confederation of Chambers of Commerce)*
- 4.-**COPARMEX** (Association of Mexican Employers)
- 5.-**CANACINTRA** (National Chambers of Transformation Industries)
- 6.-**CONCAMIN** (National Confederation of Chambers of Industry, Manufacturers Associations)*
- 7.- **CMHN** (Mexican Council of Businessman)
- 8.-**ABM** (Mexican Banks Association)
- 9.- **AMIS** (Mexican Association of Insurance Companies)
- 10.- **CNG** (Nation Confederation of Cattlemen).
- 11.-**CNPP** (National Confederation of Small Farmers)
- 12.-**CNPC** (National Confederation of Small Merchants)

*Until 1998 these required mandatory enrolment.

³²² Bailey, 133-137.

³²³ Interview with Rubén González, technical secretary of the Fiscal Commission CONCAMIN, Mexico, September 22nd, 1999.

According to Grindle, business groups lobby formally and informally outside the structure of political parties.³²⁴ Business associations strictly observe a policy of non-partisanship, but there are some marked tendencies in their relations with the government. Bailey provides an interesting analysis of the general lines of their relationship with the government. CONCAMIN and CANACINTRA³²⁵ have a moderately critical stance towards the government, while a hard-line criticism characterises COPARMEX and CANACO. Other organisations such as CCE, CMHN, AMIS, CNG oscillate between moderate and hard criticism, while the CNPP and the CNPC both belong to the popular sector of the PRI and typically support the government.³²⁶

The government tends to exercise greater influence in the leadership selection of what until recently were obligatory bodies (CONCAMIN, CANACINTRA, CONCANACO). COPARMEX frequently takes a harder line in government-business relations, being funded as a voluntary association embracing all fields of enterprise, including finance. It is legally organised under labour legislation as an employers' union. The members belong to one or other of the bodies. Another very influential organisation is CCE, the chief spokesman of the private sector. The Business Council Coordination was created in 1975 to orchestrate a business response to Echeverría's anti-business rhetoric and actions. It is comprised of the top associations, and it has become the major entrepreneurial organisation used for state consultations on economic policy. The CMHN is part of the CCE structure; it embraces 30 or so of the most influential Mexican entrepreneurs and was founded in 1962 as a reaction to the reforms introduced

³²⁴ Grindle, *Challenging the State*: 49.

³²⁵ CANACINTRA belongs to the structure of CONCAMIN.

³²⁶ Bailey, 133-137.

by President López Mateos. These organisations' relative independence is clear; COPARMEX even helped to fund the PAN, and a former CCE president, Manuel Clouthier, ran as the PAN's presidential candidate in 1988.³²⁷

CONCANACO, and particularly those delegations in Mexico City, Monterrey and Guadalajara, are quite powerful in influencing or at least raising the debate over tax issues that have a direct effect on them. CANACO Monterrey was at the forefront of the national mobilisation for the overhaul of the tax system in 1999.³²⁸ Mexico City's CANACO is the largest business organisation in the country at the state level, with more than 1 million members, most of them small companies. This business representation has strongly advocated a policy of incorporation of the informal economy into the tax net. They can be credited with the policies of cracking down on tax evaders in the informal economy, implemented by the Secretariat of Finance, and Mexico City's government's attempts to relocate street vendors and regulate this illegal activity. Other smaller business organisations complain that their concerns are not taken into account by authorities.³²⁹

³²⁷ Since 1988 entrepreneurs have expanded their action to political participation, mostly as members and candidates of the PAN. Examples of entrepreneurs involved in politics are the Pan Governors: Jalisco-Cardenas Jiménez, Guanajuato-Vicente Fox, Aguascalientes-Felipe González, Nuevo León-Canales Clariond.

³²⁸ Juan Carlos Pérez Góngora, President of CANACO Monterrey, was behind the first national effort to open a public debate on fiscal matters, during a national consultation for the overhaul of the fiscal system. See Propuesta de Reforma Fiscal Integral 1999.

³²⁹ Interview Refael Escudero, President of Small Businesses in Mexico City, May 4th, 2000.

3.3.- The Suppliers or Decision Makers

The decision-makers in tax matters are public servants, the legislature and the courts, but the executive has dominated the process.³³⁰ The Mexican political system, as no other, was for many decades an executive-dominated system. Political power was highly concentrated in the presidency. The Mexican presidential system was institutionalised by depersonalising the office from the holder, while the Constitution prohibits re-election. In the absence of a civil service, the president appoints all the top positions in the bureaucracy.³³¹ Moreover, as leader of the party, he used to select all the candidates for electoral positions, giving him extraordinary power, in a country governed by an hegemonic party. Thus, upward political mobility within the system depended on the president. Mexican historian Daniel Cosío Villegas described the Presidency as a "six year dictatorship,"³³² Krauze as "imperial presidentialism"³³³. Other political analysts like, Philip or Whitehead, have taken a more moderate approach, stating that the power of the presidency is also constrained by the written and unwritten rules of the political system.³³⁴ Whatever the description, the President is the key decision maker and sets the tone for policy direction. Policy-making flows from the top down and the

³³⁰ Forte and Peacock include Central and State legislature, as well as Central and State Public Servants. They also include the Supra national organisations, which in the Mexican case does not apply.

³³¹ Smith, Labyrinths of Power.

³³² Daniel Cosío Villegas, El Sistema Político Mexicano las Posibilidades de Cambio (México: Joaquín Mortiz, 1972).

³³³ Krauze, La Presidencia.

³³⁴ George Philip, The Presidency. Another author studying the role of the presidency are César Cansino, "Mexico: the Challenge of Democracy," Government and Opposition Vol. 30, No.1, 60-73.

process is closed to very few actors. However, 1997 Congressional elections changed the way policy is made.³³⁵

The executive branch has often been portrayed as the principal legislator of the country, despite the fact that legislation allows bills to be introduced by either the Executive, both chambers of Congress and the states' legislatures. For almost seven decades the President had total control of the production of the Federal Budget, vis-à-vis Congress, which operated more in a rubber stamping capacity, than as a separate entity.³³⁶ Since its foundation in 1929, the PRI has dominated both the Chamber of Deputies and the Senate. Practically all bills proposed by the Executive to Congress were approved by an overwhelming majority of PRI legislators in both chambers. Legislators cast their votes as the PRI leadership told them to. But the traditional pattern of hegemonic party rule in Congress was broken in July 1997 when the PRI lost its absolute majority of the lower Chamber, with only 39.1% of the votes.³³⁷ This event, drastically altered the traditional formula of policy-making and substantially eroded the extraordinary power of the presidential office.³³⁸

³³⁵ The leaders of the LVII Legislature called 1997 a watershed that put an end to the domination of presidential control of the legislative branch. See Carlos Acosta and Francisco Ortíz, "Legisladores de Oposición Advierten : En Política Económica se Acabo el Absolutismo Presidencial," *Proceso* August 31st 1997: 12-16, and in the same issue see Gerardo Albarrán, "En la Cámara el Choque entre Oposición y Régimen se Convirtió ya en Auténtica Disputa por el Poder," 6-10.

³³⁶ Some authors believe in the relative autonomy of Congress, emphasising a process of consensus building, see Alicia Hernández Chávez and María Luna Argudín, *La Nueva Relación Entre Legislativo y Ejecutivo: La Política Económica 1982-1997* (México: El Colegio de México, Instituto de Investigaciones Legislativas de la Cámara de Diputados, Instituto Politécnico Nacional and Fondo de Cultura Económica, 1998).

³³⁷ The right-wing PAN obtained 26.6%, the left wing PRD 25.7% and the remaining 8.6% was divided between minority parties including PVEM and PT.

³³⁸ For the declining power of the presidential office see Samuel Schmidt, *The Deterioration of the Mexican Presidency: The Years of Luis Echeverría* (Tucson: University of Arizona Press, 1991) and George Philip, "The Lawless Presidency", or Whitehead.

a) Public Servants (Bureaucrats)

Grindle argues that in developing countries policy-making is centred in the executive branch of the state, which includes political leaders and high-level administrators.³³⁹ For Haggard, bureaucrats in developing countries are the most active actors in shaping policy making, not legislators.³⁴⁰ Most analysis of tax policy-making give bureaucrats the leading role in the development of tax policies. There are excellent works done in this field, like: Wilkies who analyses tax policy making in Australia,³⁴¹ Hansen, Peachman and Tanzi in the US,³⁴² Robinson and Sandford in the United Kingdom,³⁴³ and Good in Canada.³⁴⁴ Only broad studies have included the cases of developing countries.³⁴⁵ But, regardless of the country, all scholars agree that politics play a fundamental role in the process of tax policy making.

Bureaucrats are powerful forces in the policy process, particularly in a highly centralised presidential system like Mexico. The economic bureaucracy is important in the formulation and implementation of economic policies.³⁴⁶ Grindle suggests that public policy in Mexico is the product of the bureaucratic elite and political interaction.³⁴⁷ The bureaucracy is highly politicised; and will frequently use their position to advance their political careers and individual interests.

³³⁹ Grindle and Thomas, 52.

³⁴⁰ Haggard, 238.

³⁴¹ J. Wilkies, The Politics of Taxation (Sydney: Hodder and Stoughton, 1980).

³⁴² Hansen, The Politics of Taxation. Tanzi, "Forces that Shape Tax": 266-278. Matrio S. Brodersohn, "Developing Countries' Delicate Balances," in Herbert Stein ed., Tax Policy in the 21 Century, 118-125. Joseph A. Peachman, Federal Tax Policy (Washington, DC: Brookings Institution, 1971).

³⁴³ Robinson and Sandford, Tax Policy Making in the United Kingdom.

³⁴⁴ Good.

³⁴⁵ Gerald M. Meier, Politics and Policy Making in Developing Countries (San Francisco: International Center for Economic Growth, 1991).

³⁴⁶ Benent and Sharpe, Grindle, Challenging the State, Vernon.

³⁴⁷ Grindle, Challenging the State.

Their wide range of discretionary powers has allowed the top bureaucracy to build strong ties with political and interest groups, particularly the economic elite. Evans supports the idea of a bureaucracy in close connection with the productive sector of the society (industrialists) in order to enhance development, however warns over close ties between bureaucracy and the private sector since can develop into corruption.³⁴⁸

According to Good, tax policy-making is an internal and private affair. A handful of economic and tax advisors operate in a tight community, who share similar perceptions about what is a tax issue, how it should be conceptualised, what alternatives and consequences are to be considered, and how decisions should be taken.³⁴⁹ Because taxation is a highly technical subject experts in the public bureaucracy dominate the policy making process. They apply their own particular vision of the world to tax policy, at least in theory with some input from different sectors of the economy. However, politics end up governing it, the tax community ultimately relies upon the assessment of "political climate" to determine what tax changes interest groups and tax payers would accept with a minimum reaction.³⁵⁰

³⁴⁸ Evans, Embedded.

³⁴⁹ Good, x.

³⁵⁰ According to Williamson the first precondition for good economic policy is that technocrats be in charge of making it. But Bates argues that technocrats are generally academics and normally lack the prerequisites of political influence: wealth and power. Usually the power they possess is given to them by politicians. The relationship between good policy and technocratic power is the result of the decision of politicians to delegate political power to otherwise powerless experts so as to secure economically superior public policy. See Bates, The Political Economy of Policy Reform, 11-33.

b) Legislative Branch

Traditionally, the legislative power did not play a significant role in the process of policy making in Mexico. The legislative power's role in the process of policy making was until very recently almost symbolic. Mexico's presidential system, together with the continuous hegemonic control of the PRI over the two chambers, enormously facilitated the passing of any tax law without opposition.

The overwhelming majority of PRI representatives at the Chamber of Deputies allowed tax authorities to pass tax legislation easily with almost no debate or opposition. Party discipline assured that no PRI representatives would oppose the suggested tax policies, even when these policies affect their constituencies' interest or contradicted their own views on the matter. Party discipline was reinforced by a centralised party system, where the President as the leader of the party had the power to decide the party's nominations. Other means like clientelism and patronage also helped to secure the legislators support.³⁵¹

c) The Courts

The Judicial Power has also been subordinated to the executive, although in 1995 constitutional reforms were made to strengthen the independence and autonomy of the federal judiciary. In Mexico, a Supreme Court ruling only applies to those cases which have been put into its consideration. When tax payers believe that an administrative decision from tax authorities is contrary to their rights, they may file an administrative appeal with the Treasury

³⁵¹ See Scott Mainwaring and Arturo Valenzuela Politics, Society and Democracy: Latin America (Boulder, Colo.: Westview, 1998).

Department, or appeal to the Federal Tax Court or the Supreme Court as their last resort.

The role of the Judicial Power as a decision maker in the tax policy making process is only occasional, but is evolving rapidly. A good example is the 2% tax on assets. The Supreme Court has ruled five consecutive times declaring this to be unconstitutional. According to the constitution, a ruling from the Supreme Court the same way five consecutive times becomes law, and it applies to all cases which fit the same circumstances. The problem is that the taxpayer would only benefit from this ruling if they undergo through a lengthy trial. As a result not many businesses have benefited from such Supreme Court ruling.³⁵²

3.4.-Other Attemptive Actors

In order to adjust this model to the Mexican case, Good's classification of "attemptive actors" is used. Under this category, the author includes all other actors interested in participating in the tax policy-making process, beside the bureaucracy.

Deep changes in the Mexican political system in recent years have altered the configuration of actors involved in the process of policy-making. The process of democratisation has incorporated new political players, that pledge to represent the interests of taxpayers. Among these actors previously dormant are political parties, independent legislators and state governors. In addition, there are

³⁵²For recent Supreme Court rulings over tax matters, see Agustín Ambriz, "Dotada de un Autoridad Desmedida, Hacienda Aplica Disposiciones Fiscales Inconstitucionales Según Fallos de la Suprema Corte," *Proceso* November 22nd, 1998:10.

exogenous actors that operate outside the taxpayer framework, but that have become closely involved with the process, including those of the IFIs and the US government.

3.4.1.- Political Actors

a) Political Parties

Political Parties are the organisational representatives of voters and they play an important role in defending their constituents tax agenda. Individuals who are not part of the organisation can voice their main concerns by casting their votes. Political parties seeking office may design their electoral campaigns to include programs and promises related to the payment of taxes. Such strategies are aimed at gaining the vote of taxpayers. In the industrialised world during the 1980s, many successful candidates campaigned on tax issues.³⁵³ In Mexico taxation did not dominate the campaign debate until 1997. Opposition parties won congressional elections with the pledge to cut the VAT rate. There was no precedent in previous political campaigns of such heated tax debate.

One of the characteristics of Mexico's regime was the political monopoly of a hegemonic party system. Sartori characterises Mexico's political system as one governed by an hegemonic party system, in which moderate dissension and political competition were tolerated as long as it did not threaten the PRI hegemony.³⁵⁴

³⁵³ In the 1980s, tax reform was an important item on the political agenda on many conservatives parties. Candidates campaigned vigorously with tax reform as part of their political agenda, examples are Ronald Reagan in US, Helmut Kohl in Germany and Margaret Thatcher in the U.K. or Mulroney in Canada.

³⁵⁴ Sartori, 236.

The role of the PRI in the policy-making process is very controversial. There is disagreement as to whether the PRI was an autonomous actor or an extension of the government itself. To some, it was difficult to separate the President's policy-making role from concerns over the stance of the official party. In a corporate structure, where the main social actors are agglutinated in a political party, such institution in theory should be very influential in policy making. To others the PRI is just a control device for facilitating acquiescence in government decisions, and a tool to achieve compliance with government policy initiatives.

It also can be argued that the partnership between government and PRI, was an effective mechanism to legitimise and provide flexibility to accommodate changing political circumstances. Political control was based on the Presidents' written and unwritten powers and on the party's machinery as the mechanism to organise electoral process and provide patronage and clientelism. However, since the last three administrations the PRI has experienced a rapid demise of its hegemony.³⁵⁵

The empirical evidence suggests that despite the PRI's role as a melting pot, where all political forces amalgamated together, it only exercised a negligible role in the policy making process. The analysis suggests it is far from being a key actor in the process of policymaking, not even in the consultation stage. Grindle found in her study of agricultural policies during the Echeverría administration that neither the legislature nor officials of the PRI, even at high

³⁵⁵ Francisco E. González, "Mexico's Political Liberalization: the Demise of an Hegemonic Party System," Paper for the Seminar on Mexico at the Latin American Centre in Oxford University, 1998:18.

levels, were directly involved or consulted in the formulation of agricultural policies.³⁵⁶ In recent years, the PRI experienced a rapid power decline, not only in the electoral arena but also in its relation with the technocratic governing elite, reducing further their indirect influence. However, PRI leaders insisted that they still provided relevant input in the process of economic policy making.³⁵⁷

The power of opposition parties to influence the policy making process was even less significant. This condition changed in 1997, when opposition conquered the control of the majority of the seats at the Chamber of Deputies, becoming active policymakers, but this new role is evolving slowly. Not until the 2000 budget, were they able to reshape those policy proposals presented by the executive.

b) Legislators

Legislators are seen as "constituency delegates" ensuring that those they represent receive a fair share of the tax benefits and burdens. They have a strong interest in tax provisions when the effects are regionally concentrated.³⁵⁸ Electoral reforms and more recently democratisation have substantially increased the number of legislators from opposition parties. One of the issues widely debated on the floor of the lower chamber is taxation and the allocation of the budget. Every year congressmen have to debate the nature of the tax structure in the Revenue Law, as well as how federal resources are going to be spent and distributed in the Budget. The increased participation of

³⁵⁶ Grindle, *Bureaucrats*, 548.

³⁵⁷ Interview Dulce María Sauri, February 28th, 2000.

³⁵⁸ Good, xv.

legislators in the tax debate has not been limited just to opposition representatives, a clusters of congressmen in the lower chamber formed as common cause to push for policy reforms including taxation. The so called "Reflexión Group" has taken a different position to the PRI's guidelines over taxation.³⁵⁹ While in the Senate another group of PRI members was formed, calling themselves the "Galileo Group," with an independent policy proposal to those of the PRI's hierarchy.³⁶⁰

c) Governors

Governors represent the interests of those tax payers within the state. In a period of ten years the power of governors has changed dramatically, having been previously subordinated to the federal government. In 1989, the PAN won the first governorship election. By 1998, seven PAN governors had been elected and one arrived in office due to negotiations between the PRI and PAN.³⁶¹ There were also two elected governors from the PRD, including the powerful governor of Mexico city. PAN governors began to demand changes in the system of tax collection, and specially on the allocation of revenues to the states. A loud campaigner for a new distribution of resources under the framework of New Federalism had been Guanajuato's Governor Vicente Fox.³⁶² The Governor of the State of Nuevo León, Fernando Canales Clarión, entered into a fight with the federal government demanding more resources for

³⁵⁹ Interview Oscar González, on Reflexión proposals for tax reform, Aguascalientes April 18th, 1999. See also "Propuestas Sobre la Reforma Fiscal del Grupo Reflexión," Cámara de Diputados, 1999. Mimeo.

³⁶⁰ Interview with one of their leaders Senator Eloy Cantú, London, January 6th, 2000.

³⁶¹ Median Plascencia, former mayor of Leon was chosen as provisional governor after the dispute over the electoral result between the PRI and the PAN.

³⁶² Fox stressed the need to change the tax structure and redesigned the redistribution of financial resources to the state. He considered the system highly centralised and unfair. London, June 5th, 1997.

his state, the richest in the country. To Governor Canales revenue shares should match more closely the states tax collection ratio.

PRI governors have also expressed their interest in redefining the rules for the distribution of resources, complaining that Canales' formula would affect the poorest states.³⁶³ From the Left, Zacatecas' Governor Ricardo Monreal became the new champion of federalism, trying to organise the 11 opposition governors to form a common front in tax matters. Monreal argued that the federalist model only exists in the letter of the Constitution, and governors should demand more political and economic freedoms, including the powers to manage some of the federal taxes.³⁶⁴ The richer states, many governed by the PAN, proposed a new formula based on regional collection, but the governors of poorer states argued it would accentuate regional economic disparities further.

3.4.2.- External Actors

External actors have been very influential particularly during the so called neo-liberal period. The US dominates IFIs in the sense that it controls the decision making process within these organisations. Voting power in multilateral institutions is directly related to the contribution made by members to the provision of funds. The US domination of international lending organisations translates in tangible influence to change recipient country's economic policy. Although in theory the IFIs provide only advice to countries in matters related to

³⁶³ Oaxaca's Governor José Murat has been campaigning for a new formula for the the distribution of resources.

³⁶⁴ Interview Zacatecas' Governor Ricardo Monreal, London, February 4th, 2000.

their fiscal affairs, in practice these institutions have played a major role in the design and implementation of tax reforms.³⁶⁵

a) The US Government

The US government has always been an influential actor in Mexico's economy.³⁶⁶ It is, by far Mexico's most important trade partner, with 83% of Mexico's exports going to the US market. It is the origin of 70% of the country's foreign investment and its first creditor. Authors like Kaufman have highlighted the importance of the US government in Mexican stability, and its influence over domestic policy making.³⁶⁷

In tax matters this influence is evident, the Mexican government followed the US tax reform recipe to the letter, implementing all its main features, such as broadening the tax base, cutting the income and corporate tax rates, etc. Although the Salinas' tax reform process began almost five years before the implementation of the NAFTA,³⁶⁸ the potential of the treaty provided the impetus for the tax reforms. Globalisation and the possibility of economic integration convinced Mexican authorities of the need to homogenise tax legislation as much as possible, in order to meet international standards, particularly those of the USA.

³⁶⁵ In November 1996, IMF officials visited the Treasury to learn more about the SAT programme, the official visit was chaired by Dr. Carlos Silvani from the Fiscal Affairs Office. See "La Reunión De Validación y Evaluación: SAT", Secretaría de Hacienda y Crédito Público, internal document, September 12th, 1996.

³⁶⁶ For the new relationship under NAFTA, see Victor Bulmer –Thomas and James Dunkerley, The US and Latin America: The New Agenda (Cambridge, MA: David Rockefeller Centre for Latin American Studies, ILAS, and Harvard University Press, 2000).

³⁶⁷ Kaufman, 109.

³⁶⁸ To learn more about NAFTA and its impact in Mexico see Georgina Kessel, ed. Lo Negociado del TLC (MacGraw Hill and ITAM, 1994). For its impact in US companies see Nora Lustig, Barry P. Bosworth and Robert Z. Lawrence, ed. Assessing the Impact: North American Free Trade (Washington, D.C. : The Brooking Institutions, 1992).

Tax authorities accept they received policy advice and suggestions regarding the use of tax instruments after the 1994 crisis.³⁶⁹ Despite its notorious influence the USA seldom acts directly, rather it uses the advisory and negotiating power of IFIs.

b) International Financial Institutions

IFIs have played an important role in spreading economic ideas into domestic policy decisions. In theory, IFIs play just an advisory role regarding tax matters. Foreign tax missions contribute by preparing domestic experts, and background analysis, to be available when the domestic political and economic conditions are favourable for reform.³⁷⁰ But in reality, tax reform was at the top of Latin American's government agenda because it was a "must" for obtaining fresh loans, attached to financial packages. These clauses required policy reforms in exchange for fresh resources to debtor countries.³⁷¹

To Maxfield and Stallings the need for international capital after the 1980s debt crisis, provided IFIs with the power to shape policy reforms in countries heavily reliant on foreign capital.³⁷² The conditionality attached to stand-by credits shows that IFIs pushed tax reform as one of the core policies of structural adjustments into the developing countries' agenda. According to World Bank data, about 250 structural and sectorial adjustment loans to 86 countries

³⁶⁹ Interview with Diego Yrribarren economic advisor to the Under-Secretary of Revenue, September 24th, 1999.

³⁷⁰ Stotsky, 279-284.

³⁷¹ According to the World Bank structural adjustment loans (SALs) and sectorial adjustment loans (SECALs) are both instrument for policy reform, in which tax reform was included. See Structural and Sectorial Adjustment: World Bank Experience, 1980-92, 107.

³⁷² Maxfield Governing Capital, Stallings 1992.

between 1979 and 1994, included fiscal reform components.³⁷³ The World Bank clearly states that tax reform is at the "heart of stabilisation and adjustment process."³⁷⁴ The first World Bank paper dealing with issues of general tax policy, reviews the Bank's growing provisions of advice on tax reform and the increasing use of loan conditions related to tax reform.³⁷⁵

The official objectives of tax reform according to the document were: to increase insufficient government revenues, reduce the distortions and inequities caused by taxation, and eliminate administrative problems facing developing countries.³⁷⁶ Specifically, the World Bank recipe for tax reform in four specific semi-industrial countries (Colombia, Korea, Mexico and Thailand) includes the following policy actions: 1) Lower marginal tax rates, would not necessarily produce lower revenues, since the tax base may be expanded to compensate for the lower rates. 2) Broadening and consolidating the tax base. 3) Exempting savings from the tax base to eliminate bias of income taxes in favour of current consumption. 4) Bring down the rate of inflation but if it's politically infeasible try to index the tax system and limit the distortions introduced by high inflation. 5) Restructure (reduce rates) corporate taxes and improve the nature of incentives for investments. 6) Eliminate tax preferences. 7) Replace turnover taxes with taxes with a rational base as VAT; where VAT is implemented exemptions should be granted to investment goods generally, and replace domestic taxes with excise taxes. 8) Full tax rebates and duty

³⁷³ About 48% of conditions stipulated specific statutory changes in the tax legislation. For a review of the tax conditionality by IFIs and their mechanisms for monitoring and evaluation see *Fiscal Management in Adjustment Lending* (Washington, DC: World Bank, 1996).

³⁷⁴ *Adjustment Lending Policies for Sustainable Growth*.

³⁷⁵ See *World Bank Advice and Adjustment Lending, Lessons of Tax Reform* (Washington, DC: World Bank, 1991): 64-75.

³⁷⁶ *Lessons of Tax Reform*, 3-4.

drawbacks for exporters to compensate them for the increase in the cost of purchased inputs.³⁷⁷ Each one of these policies was implemented to the letter by the Mexican authorities.³⁷⁸

Similarly, the IMF's Fiscal Affairs Department offers technical assistance on tax policy linked to structural adjustment programs.³⁷⁹ Among the typical IMF recommendations are that taxes on consumption (VAT) must be kept to a single rate from 10 to 20% and exemptions kept to a minimum. It also advised the use of excise taxes, and against the reliance on import and export taxes. In relation to income taxes, the emphasis has been on reducing the marginal rates and broadening the base, while corporation tax is held within 30-40% to enhance the efficient allocation of capital.³⁸⁰

According to the World Bank, the IMF tends to take the lead on issues relating to taxes and the aggregate level of spending, whereas the World Bank leads on sectorial spending issues.³⁸¹ Former Secretary of Finance Pedro Aspe argues that the World Bank had a much more active role in providing advice during the Salinas term, while Martin Werner referred to the IMF, particularly the Fiscal Affairs Unit as the most important external influence during the Zedillo's administration.³⁸² The difference may be explained, by the fact that at the start

³⁷⁷ Chad Leechor, Tax Policy and Tax Reform in Semi-industrial Countries (Washington, DC: World Bank, 1986): 7-8.

³⁷⁸ Pedro Aspe, "Balance de la Transformación Económica Durante la Administración del Presidente Carlos Salinas de Gortari," Informe Hacendario, July-Septiembre 1994 Vol.2 No7.))))

³⁷⁹ Stotsky, 279-284.

³⁸⁰ Stotsky, 281-282.

³⁸¹ Fiscal Management in Adjustment Lending. As a matter of fact, the World Bank's Policy Research Analysis, moved from tax analysis in October 1994 to concentrate on expenditure issues.

³⁸² Interview Aspe September 20th, 2000, Martin Werner, Undersecretary of Finance, London, May 15th, 1998.

Zedillo's administration it faced financial turmoil. To cope with it the IMF offered a loan in excess of USD\$ 17.5 bn, the largest ever given to that date, while during the Salinas term the IMF mostly renewed loans previously committed. Complying with such assumption is the fact that IMF loans are for countries with fiscal equilibrium problems, while World Bank loans are for fostering development.

Conclusion

Tax policy is a political activity that involves negotiations among interested actors. The task of politics is to reconcile these conflicting interests in order to bring about acceptable and workable solutions for the interested parties. In tax matters, rent seeking activities of individual citizens are directed towards exploiting what opportunities are available to influence the decision makers, meaning those who apply the law, the bureaucracy and the courts.

This chapter identified within the Mexican context, the "planners" or interest groups representing personal and corporate interest of tax payers, the "agents" or those used by tax payers promoting their proposal or acting in their behalf as representatives. We also identified the suppliers, or those who ultimately make the tax policy decisions. I have included in the research "other attemptive actors," which I consider to be of great influence in the tax policy making process in Mexico, without them the analysis would have been incomplete. Analysing each one gives the reader a sense of their political influences. In the next chapter, I will show some examples of how these vested interests have influenced the tax structure.

There is a well-known tradition in the analysis of tax structure that employs the concept of group interest as a vital element in the determination of tax policy. For Forte and Peacock the individual taxpayer is just a passive adjuster to changes in the tax structure. Since the range of options open to individual tax payers are narrow, so they recourse to organising pressure groups.³⁸³ Interest groups know that the tax system can be altered as a result of pressure on decision makers.³⁸⁴ This assumption attracts interest groups to organise themselves and seek to alter the system in order to maximise their welfare.

In this context, client politics best describes the politics of tax policy-making.³⁸⁵ Interest groups seek special concessions for their members trying to pass on the cost of taxation to other groups, or among all tax payers. The process is dominated by selfish interest in a zero-sum game. Usually the group obtaining substantial tax concession does at the cost of other groups.

³⁸³ Peacock and Forte, 11

³⁸⁴ Ibid.

³⁸⁵ James Q. Wilson ed., The Politics of Regulation (New York: Basic Books, 1980).

Chapter IV

Deconstructing the Tax Structure in Search of the Loopholes and Benefits

Created by Vested Interests

“The Mexican tax code is full of holes like in a gruyere cheese, draining away all tax collection efforts.”³⁸⁶

Secretary of Finance, José Angel Gurría

This chapter discloses how the influence of interest groups plays a major role in explaining how loopholes and tax expenditures have developed in the Mexican tax system. The erosive effects of preferential tax regimes and exemptions built up over the years are responsible for the low level of tax collection. Such harmful preferences constitute the greatest obstacle to reform, since changes would take away vested interests' privileges. These harmful preferential tax practices are deeply rooted in the tax legislation (the amount of tax collected is invariably affected not just by changes in tax rates, but by the statutory definition of tax bases). These perverse incentives are the result of political trade offs that unfairly differentiate among taxpayers.

4.1.- Tax Expenditure: the Erosive Effects of Harmful Preferential Tax Regimes and Exemptions

Tax expenditures represent the way governments spend through concessions that are embedded in the tax system. These tax incentives and benefits constitute subsidies with lower visibility, which dilute tax revenues and create economic

³⁸⁶ See Secretary of Finance, José A. Gurría's speech to the Businessmen's Co-ordinating Council, Mexico City on November 4th, 1999.

distortions. Tax expenditures distort consumption, savings and investment decisions, and introduce added complexity to the tax system. Furthermore, their efficiency is difficult to determine because of their lack of transparency or regular evaluation of the fulfilment of their original objectives.³⁸⁷

To ECLAC tax expenditures introduce opacity into the design and implementation of fiscal policy, since governments lack estimates of the volume of tax revenue they are forgoing and the true extent of the benefits. Moreover, tax concessions tend to become vehicles for rent-seeking and corruption. They conclude that the use of tax incentives not only undercuts revenue adequacy, but jeopardises the principle of equity.³⁸⁸

In the Mexican tax system there are a vast number of exemptions and preferential treatments for certain sectors. Kaldor in the 1960s wrote that “partial or full exemption for profit taxation was an inappropriate instrument for promoting industrial growth and its efficiency doubtful, thus should be terminated as soon as possible.”³⁸⁹ Four decades later many of those exemptions still embedded in the tax legislation.

The tax system confines special tax treatment to some taxpayers depending on the economic sector, the type of income, or in the case of indirect taxes, according

³⁸⁷ New accounting procedures have been incorporated in OECD countries to estimate revenues forgone from tax concessions. See Spending Via the Tax System (Paris: OECD, 1997).

³⁸⁸ See Fiscal Convent.

³⁸⁹ Kaldor, Reports.

to the kind of product. The latest OECD report on Mexico states that "the tax system contains several major deficiencies, which make the system inequitable in terms of incidence across different types of income and activities and contribute to keeping tax revenues low."³⁹⁰ Among the large number of preferential regimes is the vast number of exempt goods and services in the VAT regime, specific sectors with preferential treatment in the taxation of corporate income, and the exemption of fringe benefits in the taxation of individual incomes. The document stresses that the main priority in a reform of the tax system must be to broaden the tax base by reducing to a minimum these major preferential regimes. The ill effects they cause, besides diluting revenue and complicating tax administration, include horizontal inequity and loopholes, and they also help to facilitate evasion.³⁹¹

Tax authorities are well aware of the negative effects of preferential regimes. To the president of the SAT, all the exemptions, including those special regimes and the preferential treatment of sectors described in the tax legislation, represent the greatest constraint to strengthening tax revenues.³⁹² Finance Secretary José Gurría has pointed out that the tax code is plagued with benefits and exemptions, draining revenues.³⁹³ For Tomás Ruíz, Under-Secretary of Finance, Mexico's low percentage of tax collection effort has resulted from the slow but continuous incorporation of fiscal benefits in the legislation through time. He adds that "preferential treatment has ultimately ended up eating the positive benefits of

³⁹⁰ Economic Survey.

³⁹¹ Economic Survey.

³⁹² Alma Rosa Moreno, interview, Mexico City, September 25th, 1999.

³⁹³ See Gurría's speech 4th November.

reforms and now it represents an obstacle to strengthening tax revenues and the modernisation of the tax system.”³⁹⁴

Special regimes in the legislation have created unjustified benefits among the various economic sectors, ultimately creating major problems of horizontal inequity. These policies were conceived under a different strategy of economic development in vogue three decades ago, policies that contradict the philosophy of the current economic model. Such policies do not match the logic of a competitive and open economy. The Secretary of Finance has declared “it is impossible to justify (abroad) the large number of exemptions embedded in the tax system.”³⁹⁵ Cross comparative studies from 32 countries show that Mexico has the largest range of sectors and products receiving special tax treatment. Among those areas benefited are the financial, medical and educational services, plus whole sectors such as newspapers and publishing, agriculture, fishery and livestock. With regard to consumption taxes, Mexico stands out internationally for the vast number of products exempted.³⁹⁶

Privileged treatment, when extended to various sectors, is considered to have negative effects on the tax system, both in administratively and in terms of collection. Treating the same kind of income differently causes inequality and reduces the taxable base, forcing authorities to maintain high rates on medium income levels. This practice tends to cause economic distortion in the composition

³⁹⁴ Interview Ruíz, Mexico City, September 25th, 1999.

³⁹⁵ See Gurría 4th of November speech.

³⁹⁶ Interview Ruíz, Mexico City, September 25th, 1999.

of wages.³⁹⁷ Tax authorities recognise that differential treatment of income in Mexico has created heavy marginal tax rates on middle income levels.³⁹⁸

International studies show that a tax system with a large number of exceptions, fiscal incentives and privileged regimes offers more opportunities for tax evasion and avoidance than a broadly applied system. Evasion increases if taxpayers perceive the system to be unequal. Voluntary tax compliance decreases when taxpayers with similar income receive different treatment, or those with greater economic capacity receive a more favourable treatment.³⁹⁹ With regard to tax avoidance, a differentiated treatment may induce companies with investment in multiple sectors to translate profits to the company under the preferential tax regime.⁴⁰⁰

In addition, there are numerous fiscal incentives to businesses and individuals, which have an additional erosive effect on revenues. Contrary to the perception of Mexican business,⁴⁰¹ a plethora of fiscal incentives for companies exist in the tax legislation, despite the fact that OECD studies have shown that fiscal incentives have a very limited impact on investment.⁴⁰² For SAT president, Alma Rosa

³⁹⁷ Ruíz, "El Sistema Fiscal Mexicano, 55.

³⁹⁸ Interview Ruíz, Mexico City, September 25th, 1999.

³⁹⁹ Ruíz, "El Sistema Fiscal," 5.

⁴⁰⁰ Ibid.

⁴⁰¹ Business organisations frequently claim that there are not sufficient tax incentives in the legislation, See Memorias Foros de Consulta Regionales CANACO, Monterrey, 1998 (various issues). Particularly, Memorias: Primer Foro Regional Zona Noreste: Consulta Nacional Sobre La Reforma Fiscal Integral, CANACO, Monterrey, 1998, and Propuesta Final: Reforma Fiscal Integral, 1999.

⁴⁰² To see the vast number of incentives see Estudios Económicos de la OECD (México: OECD, 1999): 179-188.

Moreno, it is “ironic” that the private sector still perceives that the tax system does not offer enough incentives despite so many of them being included in the tax code. Businesses’ misleading perception may be explained by the fact that those enjoying these types of benefits are usually large companies. Small companies usually lack sufficient information or expertise to take advantage of such incentives.⁴⁰³ Paradoxically, despite tax officials acute criticism to the so called fiscal incentives and preferential regimes, a significant number of new fiscal incentives were introduced during the last administration, while the world’s trend seems to go in the opposite direction.⁴⁰⁴

The next section looks at the profile of the tax base for traces of rent-seeking effects in the process of tax policy making. It then explores the main tax instruments in order to determine the effect of vested interests on their tax base. The analysis clearly shows the influence of interested groups.

4.2.- Deconstructing the Tax Structure

Of the various reasons put forward to explain Mexico’s low tax yield, international studies place particular emphasis on the tax structure and the composition of the tax profile.⁴⁰⁵ A country’s tax mix shows the difficulties governments face in collecting taxes directly from their citizens. In countries where the population is

⁴⁰³ Alma Rosa Moreno, “Promoción de las Actividades Productivas y el Ahorro Interno,” La Reforma Fiscal que México Requiere, speech delivered November 5th 1998.

⁴⁰⁴ See the example of Sweden or the policy reversal towards fiscal incentives during President Reagan’s administration in the US.

⁴⁰⁵ See World Bank country studies, such as Argentina: Política Tributaria para la Estabilización y la Recuperación Económica (Washington DC: Banco Mundial, 1990).

uncooperative in paying direct taxes and the pattern of tax administration facilitates evasion, governments are forced to find other means of collecting the revenues they need. Using Peters' study on the influence of politics in policy choices, the Mexican tax profile reflects a "broad based" tax system.⁴⁰⁶ This type of system shows the impact of corporatist political structures and the need to raise revenue without offending major economic or social interests. The policy outcome reflects the bargaining process amongst interest groups.

Mexico's federal tax structure includes both indirect and direct taxes. Direct taxes represent the largest source of income, and include corporate and personal income tax. The corporate tax is levied at a flat rate of 34% (30% if reinvested) and the global individual tax is levied at a progressive rate, escalating from a negative tax to a marginal tax rate of 35%.

Indirect taxes include specific consumption taxes for fuel, tobacco and beverages, as well as the value-added tax, which is levied at a rate of 15% (10% on the border) on the sales of goods and services. There are a large number of exemptions and reduced rates for consumer goods. After tax sharing, income taxes and VAT constitute 80% of total tax revenues, but the total tax income only amounts to about 45.5% of the total net income.⁴⁰⁷

⁴⁰⁶ Peters, 64.

⁴⁰⁷ These figures contrast sharply with those of the private sector, made by the Centro de Estudios Economicos del Sector Privado (CEESP) See Bours, "Hacia una Reforma Fiscal Integral", 10-17.

**Table 4.1.- Composition of Tax Revenues
(Percentage of total)**

	1991	1995	1998
Income Tax	47.6	52.3	52.1
<i>Value Added Tax</i>	31.2	28.9	37.8
Excise Taxes	6.3	5.1	3.8
Foreign Trade	11.0	7.8	6.4
Other	3.9	5.9	

Source: SHCP for 1991, 1995 and Vinculación entre Ingresos y Gasto, SHCP for 1998.

Tax literature has been dominated by the desire to define an optimal tax structure.⁴⁰⁸ In Mexico, Jaime Serra Puche and Ernesto Maykanosky have proposed economic models comprising particular tax mixtures and optimal rates.⁴⁰⁹ Although Bird argues there is no such thing as an optimal tax structure that fits all countries,⁴¹⁰ developed countries share some general characteristics in their tax structures. The analysis of the tax mixture or tax profile has helped academics to determine the modernity of the tax system.⁴¹¹ The tax structure profile of developed countries has evolved, moving from heavy reliance on traditional direct taxes on land, through taxes on trade, to reliance on modern direct tax on income.⁴¹² In the last decade there has been a rapid increase in

⁴⁰⁸ See Richard Musgrave, The Theory of Public Finance (New York: McGraw Hill, 1959).

⁴⁰⁹ Ernesto Maykanosky, Diseño de una Reforma Fiscal Optima: el Caso de México (México: Colegio de México, 1985).

⁴¹⁰ Bird, Optimal.

⁴¹¹ See Enrique Mendoza, Assaf Razin and Linda L. Tesar, "A Comparative Analysis of the Structure of Tax Systems in Industrial Countries," IMF Working Paper No.14 (Washington, DC: IMF, 1993); Eric Sidgwick, "Tax Revenue Structures: Across Sectional Statistical Analysis for 1980-1988," Fiscal Affairs Department Working Paper, No.1 (Washington, DC: IMF, 1991) and Tanzi, "Quantitative."

⁴¹² For the evolution of the tax structures during development see Harley H. Hinrichs, A General Theory of Tax Structure: Change During Economic Development (Cambridge MA; Harvard Law School, International Tax Programme, 1968). For hard data see Revenue Statistics 1965/1998 (Paris: OECD, 1999).

consumption taxes.⁴¹³ However, Kaldor argued that the tax structure that existed in developing countries was inappropriate, because it did not rely sufficiently on income tax.⁴¹⁴

A recent analysis by OECD of trends in taxation concluded that some important changes have taken place in its countries' tax mixture (share of main taxes in total revenues). Affected by globalisation, tax burdens on profits fell, excises and import duties halved and general consumption taxes have been the fastest growing revenue source.⁴¹⁵ World Bank data shows a dramatic growth in countries using VAT in the last two decades. The wave of tax reform pushed countries to rely further on consumption taxes.⁴¹⁶ The World Bank's 1997 Report states that increased global integration has affected the way developing countries raise tax revenues. On the one hand, the internationalisation of businesses and the relentless competition for foreign investment have curtailed the marginal tax rates on individuals and corporations. In addition economic liberalisation has reduced the collection of border taxes. Faced with these constraints many have turned towards consumption taxes.⁴¹⁷ Mexico's tax profile corresponds to one of a modern tax system, since the largest portion of income originates from income and

⁴¹³ Consumption taxes are easily collected plus indirectly through consumption levy (those in the informal sector). But they disproportionately hit lower-income households, which consume a larger part of their disposable income.

⁴¹⁴ Kaldor, Taxation.

⁴¹⁵ See A World of Taxes (Paris: OECD, 1997).

⁴¹⁶ See Vito Tanzi, Taxation in an Integrating World (Washington DC: Brookings Institution, 1995)

⁴¹⁷ World Development Report, 1997: 48.

value added taxes.⁴¹⁸ The following table sets forth the composition of the government's tax revenues for the periods indicated.⁴¹⁹

**Table 4.2.- Evolution of Tax Mix 1925-1999
(Percentage of Total Tax Revenues)**

Taxes	1925-40	1941-50	1951-60	1961-70	1971-80	1981-90
Natural Resources	7.61%	4.72%	2.59%	2.58%	2.85%	
Industry	26.22%	14.06%				
Production			16.85%	18.56%	17.66%	16.11%
International Trade	35.94%	27.22%	30.30%	18.47%	15.42%	23.85%
Income Tax	12.05%	21.04%	35.81%	42.24%	43.03%	33.76%
Pay Rolls				1.93%	0.98%	0.77%
Stamps	9.73%	1.15%	2.06%	0.16%		
Commerce	2.11%	9.67%	9.60%			
Mercantile Income				13.33%	18.66%	
VAT						21.6%
Lottery			1.20%	0.11%	0.36%	
Immigration			0.27%	0.27%	0.06%	
Other	6.34%	22.14%	1.31%	2.35%	1.86%	1.01%

Source: Own elaboration with data from the Secretariat of Finance

The table shows the evolution of the tax profile in the post-revolutionary period. In the last thirty years, the number of taxes has been curtailed. The significance of income tax has declined considerably, but it was compensated for by the introduction of VAT and the elimination of some excise taxes. As in the rest of the world, VAT has become one of the main sources of revenue. Taxes on trade declined very rapidly after the mid 1980s, when the country moved towards an open economy.

⁴¹⁸ ECLAC has praised Mexico's tax structure as one of the three most balanced among Latin American nations, with direct taxes accounting between 40 and 50 % of all tax revenues. See Fiscal Covert. In other developing countries excises and import duties are prominent in the revenue systems.

⁴¹⁹ For an interesting overview of 22 OECD countries and their patterns of taxation and main characteristics see Peters. For the evolution of the tax systems in Latin America see Shome and Elizondo, The Politics of Tax Reform, Rodríguez and Richard Bird, "Tax Reform in Latin America: A Review of some Recent Experiences," Latin American Research Review Vol. 27. No. 3.

The OECD's review of Mexico's tax structure depicts the Mexican tax system as relatively neutral in terms of its impact on investment, savings and work. It shows a system where average effective tax rates on consumption, labour and capital are low compared with other OECD countries; moreover, statutory marginal tax wedges on labour income are modest for most wage levels and family types.⁴²⁰ Marginal tax rates are very competitive, and the tax legislation offers special schemes for deduction of some categories of investment and corporate consolidation rules. Additionally, personal and corporate income taxes are integrated so as to avoid double taxation of dividends and distributed profits. The study also underlines that major preferential regimes make the system inequitable in terms of incidence across different types of income and activities, creating horizontal inequity. The OECD recommends eliminating exemptions and preferential regimes from the VAT regime. In the corporate tax system, it contends that favourable regimes for certain sectors, including agriculture, fisheries, land transportation and publishing should be abolished, plus a further tightening of consolidation rules would limit tax avoidance. Regarding income tax on individuals, the suggestion is to eliminate the fiscal subsidy and tax fringe benefits. If these reforms are implemented altogether, these initiatives could raise tax revenue by some 3% of GDP.⁴²¹

A study from the Secretary of Finance concludes that the country's low tax collection problem is explained by the composition of the tax structure itself, and

⁴²⁰ See Mexico Economic Survey 1999.

⁴²¹ Mexico Economic Survey, 1999.

particularly by the reduced taxable base of the main tax instruments.⁴²² The reduced real tax rates for corporate and individual income tax show the power to resist taxation of businesses and those better off.

4.3.- Income Tax

Mexico's tax system compares very favourably with the tax rates of most industrialised and developing countries. The marginal tax rate on individuals at 40% is considered competitive internationally. For the low wage earner there is a fiscal subsidy. On the other hand, Mexico has a tax system that taxes corporate earnings at a flat rate of 34%, and if profits are re-invested the rate is as low as 30%, and the difference deferred until the time of profit-sharing. A rate of 30% on retained earnings, starting in the year 2000, was a move harshly criticised by the OECD, which stated that the "lowering of corporate statutory rates did not seem strictly necessary in light of Mexico's low taxation of capital and the need to raise revenues."⁴²³ This is the total rate paid by companies, since the federal legislation restricts state and municipal taxes on income. The tax laws do not impose a tax on undistributed profits,⁴²⁴ and allow the remittances of dividends and other distributions to shareholders without further taxation.⁴²⁵

⁴²² Evaluación del Impuesto al Valor Agregado, Secretaria de Hacienda y Crédito Público, November 1998. (internal document).

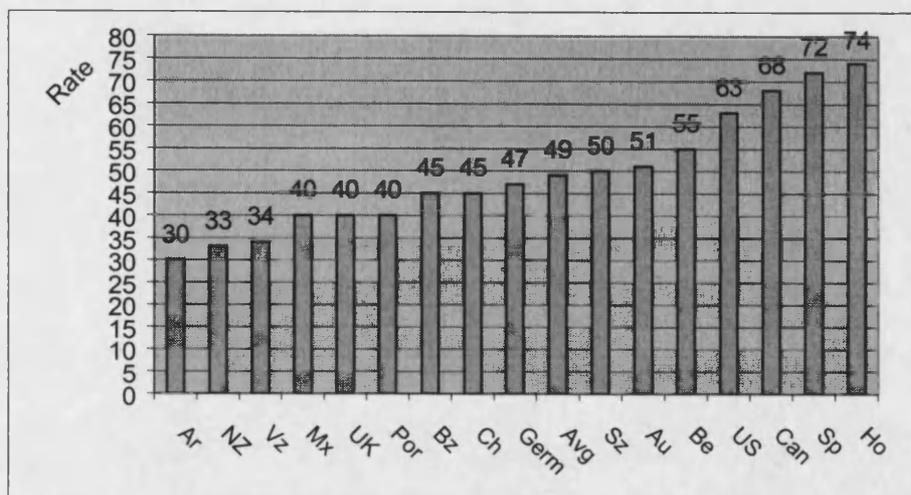
⁴²³ Mexico Economic Survey, 1999.

⁴²⁴ In a 1995 cross country comparison with some developed countries made by an accounting firm showed that Mexico stands quite competitive on the taxation of dividends, interests, royalties, rental payment and capital gains. See "Tax and Financial Aspects of Doing Business in Mexico 1995," Mexico, Arthur Andersen, 1996:22.

⁴²⁵ In principal, those companies that distribute dividends must pay a tax on such distributions at a rate in excess of 34%. But if such company maintains a tax free Net Fiscal Profit Account (Cuenta de Utilidad Fiscal Neta) the tax on such distributions will be zero.

The following graphic shows that Mexico has one of the most competitive corporate tax rates in the world.

Graphic 4.1.- Corporate Tax Rate International Comparison



Source: Ingresos Gestión Pública, SHCP and OECD Revenue Statistics 1998

In addition, Mexico has integrated its personal and corporate tax system to avoid double taxation on income from capital organised in corporate form. This has increased the appeal for foreign investment. However, it has resulted in a very large loss in tax revenues.⁴²⁶

The multiplicity of special regimes, seen in the following table, accounts for one of the most erosive effects on revenues. The legislation provides tax breaks for taxpayers in the agricultural and forestry sectors, under a *simplified regime*. This benefit is also granted to taxpayers whose business activity is land transportation

⁴²⁶ Interview Alma Rosa Moreno, Mexico City March 25th, 1999.

of persons and goods.⁴²⁷ The *consolidated regime* allows corporate groups to be taxed on a consolidated basis, giving a significant advantage to large businesses. Losses of some groups' companies can be offset against the profits made by other companies, significantly reducing the taxes paid by the group as a whole.⁴²⁸ The *small tax payers* regime enjoys a very simplified accounting system, together with an extremely low tax rate, at a maximum rate of 2.5% on total income.⁴²⁹ Unfortunately, many companies improperly contribute under these regimes, unfairly seeking to appropriate the benefits.⁴³⁰ Nevertheless, even when preferential regimes are not abused, they still exact a large toll on revenues.

Table 4.3.- Types of Fiscal Regimes According to Activity

<i>General Regime</i>	Corporate entities	Individuals involved in entrepreneurial activities
General Regime by Law	Mexican and foreign companies operating in the country	Those with income above 2.3 million pesos, including commission-agents and those involved with administration
Special Regimes		
a) Simplified Regime	Those companies involved in activities such as agriculture, livestock, fishery, forestry, Land transport including people and cargo. Empresas Integradoras (some kind of holdings)	Those involved in activities such as agriculture, livestock, fishery, forestry land transport including people and cargo. Optionally craftsmen

⁴²⁷ There are proposals to extend this regime to micro, small and medium companies. See José Alarcón, Guillermo Castillo and Octavio Pérez, "Régimen Simplificado en Empresas Micros, Pequeñas y Medianas," No 222, June, *Nuevo Consultorio Fiscal*: 21-24, 1998.

⁴²⁸ At least 10 out of the 42 largest companies in Mexico are holdings operating under the consolidated regime. See Carlos A. de Juan and Joshua Chaffin, "The Top Companies Shaping Business in Mexico Today," *Mexico Business* July-August 1996: 48-55. There are around 9,500 companies (300 large holdings) under this fiscal regime; together they produce nearly 80% of the national output. See Mariano Latapi, "Nuevo Régimen de Consolidación Fiscal," in *PaF*, Vol 19, 19 April, 1999: 103-106.

⁴²⁹ The income in Mexican pesos for 1999 are: From 0 to 132,276 (0%), 132,276-250,000 (0.25%), 250,000-350,000 (0.50%), 350,000-500,000 (0.50%), 500,000-750,000 (1.50%), 750,000-1,000,000 (2.50%).

⁴³⁰ See Jorge Santamaría García, "Pequeños Contribuyentes: Simulaciones Jurídicas y Defraudación Fiscal," *PaF*, No. 239, October 13th, 1999:37-40.

b) Fiscal Consolidation Regime	Large Corporate Holdings	
c) Small Taxpayers Regime		Individuals involved in entrepreneurial activities with income smaller than 2.3 million pesos

Source: Ley de Impuesto Sobre la Renta, 1999.

a) Tax Incentives for Companies

There are a considerable number of fiscal incentives granted by the Secretariat of Finance to companies and individuals. According to the tax authorities, Mexican corporate taxpayers enjoy one of the highest deductible depreciation schemes in the world. In 1992, the maximum deductibility for capital investment in the first year was 91% in Mexico, compared with 33.3% in the US and 35% in Canada.⁴³¹ Tax law allows deductions of nearly the total amount of the investment depreciation, either in the year in which the investment is made or when the new fixed asset is placed in service. A programme of immediate deduction of investments is also applicable.

Tax incentives for companies include:

- Allowance for adjustment of initial investment cost on real estate and shares of a Mexican corporation that will reduce or eliminate the impact of capital gains taxes,
- Low withholding taxes on royalties and technical assistance,
- Allowance for accelerated deductions on inventory purchases and production costs as they are acquired or incurred;

⁴³¹ Aspe, El Camino Mexicano, 99.

- Optional lump-sum depreciation deductions for new fixed assets
- A ten year net operating loss carry-over is allowed with a five year extension available if such losses are not used to the extent the loss was recognised for financial purposes.
- Environment deductions to research, development and implementation of pollution abatement, energy saving and alternative fuel technology, sustainable water use and pollution prevention, relocation of industries and the establishment, administration and oversight of natural protected areas.
- To promote investment in areas of research and technological development, there are fiscal credits for investment in Research and Development.
- Employee profit sharing is also deductible.
- The tax legislation allows deferment of the payment of corporate taxes for up to two years for future investments in training and technology.

In addition there are a number of programmes designed to support export activities and to provide fiscal incentives to investors to establish companies in Mexico. In general tax incentives include deductibility of expenses from imports of machinery for producing export goods and a zero VAT rate for equipment and goods used for the maintenance of such machinery. Among the specific export programmes are:

- The Temporary Import Programme to Produce Export Goods (PITEX), allows companies to import duty-free goods provided that the merchandise imported

will be directly or indirectly exported later. Some of the benefits include no import duties, no value added taxes, lower customs fees.

- The Inbound Industry Programme, known as “Maquiladora”, also permits the temporary duty-free import of raw materials, parts components and accessories for basic production. Under certain conditions PITEX and “Maquiladora” companies can purchase products from national suppliers without paying VAT.
- Temporary Imports Programmes for Integrated Services to Exports, where export related services can temporarily import machinery and equipment.⁴³²
- The drawback of ad-valorem duty paid on goods which are later incorporated into export products.⁴³³

b) Tax Incentives for Individuals

Individuals are entitled to a personal tax credit, which diminishes as their level of income increases.⁴³⁴ In addition, there is a tax subsidy against their tax liability,⁴³⁵ which as well marginally diminishes as their income increases. Some types of income are exempted from individual taxation, including pension, disability and death benefits,⁴³⁵ and fringe benefits (provided to all employees on a non-discriminatory basis if they do not exceed specified levels). In addition, payments received at the time of termination of employment, if they do not exceed 90 times

⁴³² Official Gazette, Mexico April 11th, 1997.

⁴³³ Drawback is a mechanism by which the ad valorem duty paid on certain imported goods can be refunded.

⁴³⁴ The 1994 is by agreement on wage policy included a 3% increase through an income tax credit for workers with incomes not more than two minimum salaries. Employers were allowed to supplement wages of those earning up to twice the minimum wage and claim corresponding credit. See “IMF Approves US\$ 17.8 Billion”.

⁴³⁵ Unless they exceed nine times the daily minimum salary.

the daily minimum wage each year of service rendered, are also exempt. Among the deductions for individuals are medical, dental fees and hospital expenses; charitable contributions to public institutions, teaching, research and religious establishments; or deposits in special interest bearing savings accounts. Those who earn the most enjoy the tax benefits designed to promote savings. There are no taxes for gains in the stock market, or for interest earned on instruments which take over a year to mature. There is only a low rate of interest on banking accounts or debt instruments which mature in under a year. Many authors believe there is no reason to suppose that the exemptions effectively promote the process of investment and savings. To Kaldor "the exemption of capital gains from taxation is the single most glaring feature of one law for the rich and another law for the poor," being no less objectionable because it is widespread among western nations.⁴³⁶

As a result of the exemptions and various incentives, the effective tax rate on capital income in Mexico is the lowest in the world, after Switzerland.⁴³⁷ The table number shows the effective income-tax rate, opposed to the statutory one. Mexico's effective rate is less than one third of the average rate in Asia, and half of that of Latin America. Many of the tax reforms were justified as necessary to maintain a competitive effective tax rate, but they have had a devastating effect on the government income. While our NAFTA trade partners Canada and the US,

⁴³⁶ Kaldor, 247.

⁴³⁷ The effective rate on income taxes includes the corporate income tax, taxable base, including immediate deductions on investments, purchases, an inflationary adjustments, and desgravation of dividends.

respond to an effective income tax rate on capital of 56.6% and 51.7% respectively, in Mexico it amounts to only 12.1%.

Table 4.4.- Effective Income Tax on Capital

Country	Rate (%)
Average OECD	39.9
Average Asia	38.2
Average Latin America	24.9
Canada	56.6
United States	51.7
México	12.1
Chile	42.6
Argentina	19.9
Japan	43.8
Singapore	35.7
Australia	21.1

Source: Ruíz, Evolución del Sistema Fiscal, 1999.

4.4.- Value Added Tax

The value added tax is the second most important source of income. However, it finances just 38% of the budget for social spending, while in Spain it pays as much as 95% of the budget and in Chile 91%.⁴³⁸ The general statutory tax rate is 15% (10% on borders), but due to the multiple exemptions, the effective tax rate is reduced to just 8%.⁴³⁹ Multiple preferential rates have caused economic distortions

⁴³⁸ See *Vinculación entre Ingresos y Gasto*, 50

⁴³⁹ Interview Alma Rosa Moreno, Mexico City September 25th, 1999.

and brought about a high administrative cost.⁴⁴⁰ In addition, VAT has proved to be an inefficient tool for redistributing income.⁴⁴¹ Because income is highly concentrated in Mexico, VAT represents an inefficient mechanism to foster equality. In order to benefit those groups with limited income, the state has to subsidise those with higher income.⁴⁴²

A cross-country comparison shows that Mexico has a low marginal VAT rate, but the large number of tax exemptions has deteriorated its taxable base. The table shows numerous exemptions, compared to other countries. The OECD has suggested broadening the VAT base, by eliminating the zero rating on agriculture and fisheries, as well as the exemption on land transportation. In addition, the border rate of 10% should be brought into line with the standard rate. Zero-rated goods should be limited to at most a few basic staples. The OECD argues that selecting exempting goods and services from consumption is not an efficient way to achieve equity objectives, but dilutes revenues.⁴⁴³

Table 4.5.- International Comparisons: VAT base

	Financial Services	Medical Attention	Education	News-papers	Inter. Transfers	Agriculture Fishing,	Food staffs	Medicines
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⁴⁴⁰ See Mario Calderón Dannel, "Estudio Sobre el IVA", Internal Document of the Secretary of Finance, 1998.

⁴⁴¹ According to Green, VAT is regressive, costing the poor more than the rich since they spend a larger portion of their income on buying goods and services. Green, The Silent Revolution.

⁴⁴² See "Evaluación del Impuesto al Valor Agregado," SHCP, 1998. Boltkvinik made a quantitative analysis of how VAT affects economic groups. The 10% of the population with the lowest income pay 1.1% of the VAT collected, versus 41.21% paid by the 10% with the highest income. However, approximately 43% of the highest income group is exempted from VAT. See Julio Boltvinik, El Impacto del IVA, La Jornada August 2nd, 1997: 16.

⁴⁴³ The OECD recommends that lower income groups should be compensated for the cuts in exemptions through specific targeted transfers at a much lower cost. See Mexico Economic Survey, 1999.

						livestock		
Argentina							EX	EX
Canada	EX	EX	EX		0 %	0%	0%	0%
Chile								
Spain	EX	EX						
France	EX	EX	EX					
Mexico	EX	EX	EX	EX	0%	0%	0%	0%
Switzerland	EX	EX	EX					
Venezuela		EX	EX				EX	EX

Source: Evaluación al Impuesto Agregado, Secretariat of Finance, 1998.

International comparisons indicate that Mexico is one of the countries which extracts the least from value added taxes. Contrary to the world trend in the 1990s, VAT revenues decreased in Mexico. In comparison to South America revenues from this source increased from 3.5% of GDP in 1990 to 5.4% in 1994. The statistics from a comparative study of VAT made by the Under-Secretary of Finance show that VAT has increased as a percentage of total tax collection in the last two decades in OECD countries. It also shows that in most OECD countries tax rates are above 20%, while in Latin America the average is 15%.⁴⁴⁴

**Table 4.6.- International Comparison of VAT
(As percentage of GDP)**

Average	1990	1994
OECD	6.4	6.5
Asia	3.0	3.2
Central America	2.7	3.3
South America	3.5	5.4
Peru	1.1	5.6
Chile	7.0	7.9
Mexico	3.6	2.7

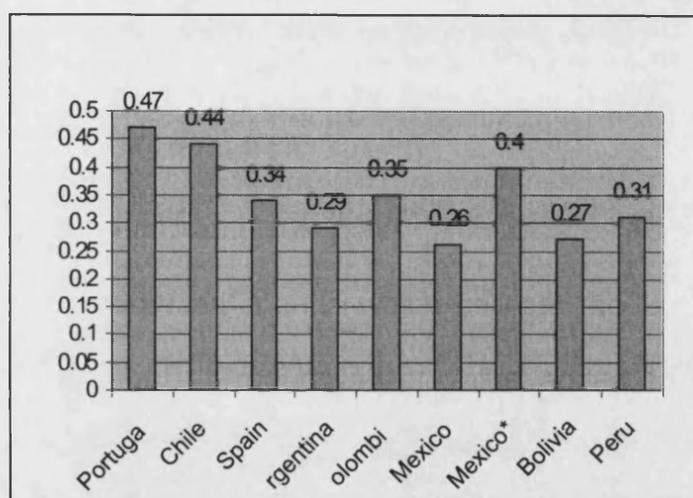
Source: Evaluación al Impuesto al Valor Agregado, SPF, 1998

Limited revenues from VAT respond to its low productivity, which is attributable to the fact that Mexico has a small tax base, resulting from a large number of goods

⁴⁴⁴ See "Evaluación del Impuesto al Valor Agregado," 85-86.

and services being either exempt or having a zero rate. According to the IADB, Mexico is the country in Latin America which collects the least for each point of VAT rate (0.2% of GDP).⁴⁴⁵ Productivity of value added tax is defined as the relationship between the basic tax and the amount collected expressed as a percentage of GDP.⁴⁴⁶

Graphic 4.2.- Productivity of VAT



Source: Evaluación al Impuesto al Valor Agregado, SHCP, 1998.

Tax evasion has also been put forward as one of the main reasons behind the country's low tax collection level. Although tax authorities do not deny that tax evasion represents one of the most important structural weakness of the tax system, by itself this does not explain the country's low VAT collection. To support

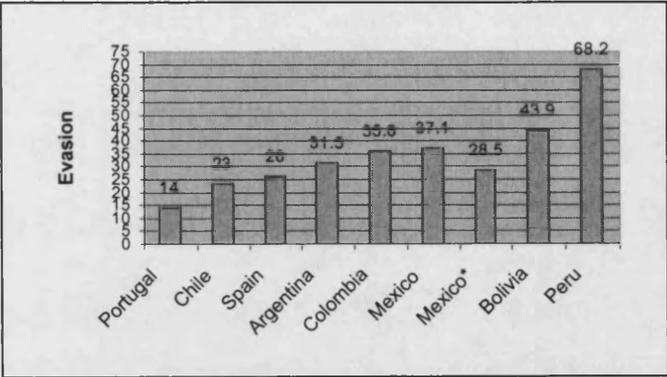
⁴⁴⁵ This indicator is used to measure the effectiveness of VAT tax systems.

⁴⁴⁶ Lora, "A Decade of Structural Reforms," 15.

this argument they present a comparative analysis on the rates of VAT evasion in Latin America.⁴⁴⁷

The graph below shows that Mexico’s tax evasion of 37% is about average in the region. However but collects the least for each base point in the tax rate in the whole of Latin America. Even countries like Peru with almost double the rate of tax evasion (68%) collect more for each point base. As stated previously, the reason is that Mexico has the least inclusive tax base, leaving entire sectors and large numbers of goods and services out.⁴⁴⁸

Graphic 4.3.- VAT Evasion



Source: Ingresos y Gestión Pública, SHCP, 1998

According to IADB, VAT’s real collection rates are far lower than their statutory rates, “due to exclusion of many final goods and services from the tax base and problems with management and control.”⁴⁴⁹ VAT is levied differently accordingly to the product and to where consumption takes place (e.g. 10% the rate at the border). The unequal treatment of products and services has eroded the tax

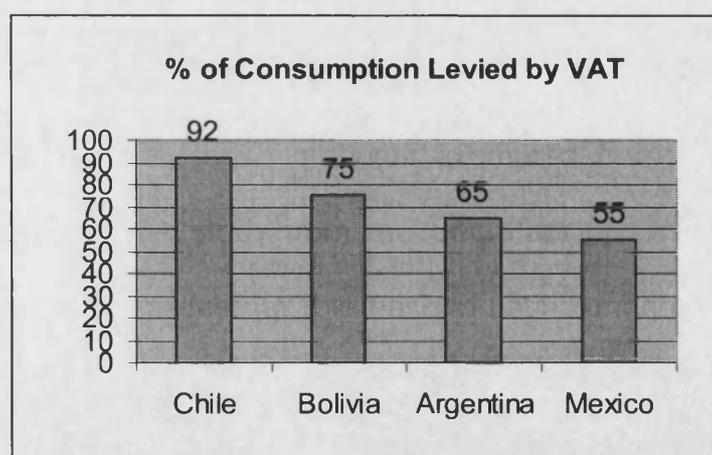
⁴⁴⁷ See Evaluación del Impuesto al Valor Agregado.

⁴⁴⁸ Ruíz, “La Reforma que México,” 39-40.

⁴⁴⁹ Lora, “A Decade Reforms.”

system revenue potential, its administrative simplicity and economic efficiency. Originally there were few items exempted from VAT, and only exports enjoyed a 0% rate.⁴⁵⁰ Nowadays, as many as 40% of domestic activities have a 0% VAT rate. Among many others, those products exempted from VAT are basic food stuffs and medicines.⁴⁵¹ A study from the Secretary of Finance concluded that Mexico has one of the smallest taxable base in Latin America, while the tax base in Chile includes 92% of total consumption, in Mexico it is just 55%.⁴⁵²

Graph 4.4.- Taxable Base of VAT



Source: Ingresos y Gestión Pública, SHCP, 1998

⁴⁵⁰ In 1980 those products exempted were basic products, agricultural equipment, machinery and fertilisers. According to Ibarra, when the tax was introduced it contained only a few exemptions.

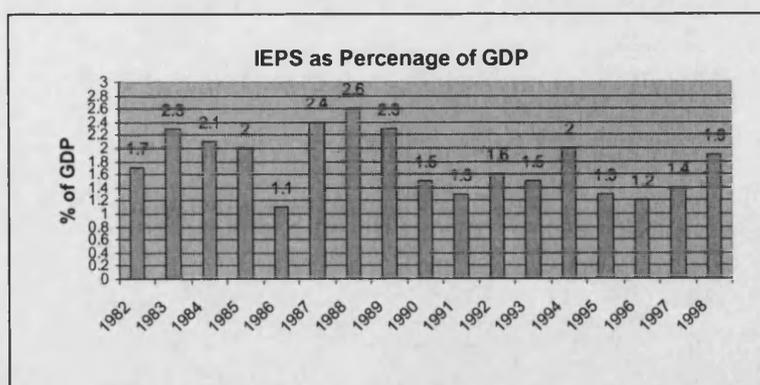
⁴⁵¹ For a detailed account of those activities exempted and those with a zero tax rate see Ley de Impuesto al IVA, (Mexico: SHCP, 1998).

⁴⁵² See "Evaluación del Impuesto de IVA," 90.

4.5.- Special Taxes: IEPS

Special taxes are levied on alcohol and alcoholic beverages, beer, manufactured tobacco and some fuels. Other special taxes include the tax on the sale of new vehicles (ISAN). Green taxes are not fully developed in Mexico, but as shown before there are some fiscal incentives tied to investment in anti-pollution equipment. To Quadri, director of the Center for Economic Studies at the Coordinative Council, green taxes could substitute income taxes. As mentioned by the ECLAC, expanding the use of green taxes offers a lot of potential for development in Latin American countries.⁴⁵³

Graphic 4.5.- IEPES as percentage of GDP



Source: Ingresos, Secretaría de Hacienda, 1999.

⁴⁵³ The Fiscal Covenant.

In total, special taxes represent only about 4 % of total revenues, if taxes on gasoline are not included. The fact that there is a relatively small revenue yield is because these taxes affect well organised groups able to resist taxation. They affect the economic interests of usually large transnational companies, like the car manufacturers, brewers and telephone companies. After the 1995 crisis the Association of Car Makers negotiated with the government to eliminate the tax on new vehicles for a year in order to stimulate car sales, since then it has lobbied strongly to remove the levy permanently, but failed to succeed.⁴⁵⁴ They argued that the levy was a major obstacle to car sales.⁴⁵⁵ Another battle they lost was the legalisation of illegally imported USA used cars.⁴⁵⁶ Initially tax authorities strongly opposed the proposal supporting car manufactures, since there were more than two million illegal cars in the country. At the end, after much political pressure they accepted the registration of those cars with more than ten years of use.

Another example of effective lobbying is that of the beverage industry which opposes successfully to the sharp increase in levies to beer and alcoholic beverages from 15% to 30%.⁴⁵⁷ National and international companies campaigned together to reduce the levy, arguing that it would boost counterfeiting and thus tax

⁴⁵⁴ Sergio Ramírez, "Piden a Hacienda Anular el Impuesto sobre Autos Nuevos," Diario de México, July 22nd, 1997: 11; Mario Cappi, "Quitar Impuestos a los Autos Nuevos, Exigen Industriales," El Financiero June 22nd, 1997: 10; "GM" Pide Reducir el ISAN," Novedades June 26th, 1997: 6; Victor Sánchez, "Ford Demanda Dsiminución de Impuestos al Gobierno," El Herald July 15th, 1997, 2; José Antonio Durán, "Solicitan las Automotrices Reducción de Impuestos para Reactivar las Ventas," El Financiero July 15th, 1997: 21.

⁴⁵⁵ See Isabel Becerril, "ISAN: El Mayor Obstáculo para la Venta de Automóviles," El Financiero July 21st, 1997: 36 and Omar Zuñiga, "Propone Eliminar el Impuesto Sobre Autos Nuevos para Permitir el Repunte de Ventas," El Sol de México June 25th, 1997: 8.

⁴⁵⁶ "Se Oponen a la Legalización de Autos Extranjeros," Infoel Service, December 7th, 1999.

⁴⁵⁷ For the lobby of this industry at the Chamber of Deputies see Hector Rendón, "Reconocen El Error en Impuestos," El Universal December 30th, 1997: 12.

evasion.⁴⁵⁸ Most recent, is the case of a new tax on telephone companies which few proposed for the 1999 Revenue Law. After fierce opposition by large telephone companies, it was withdrawn from the revenue law.

a) Import Duties

Revenues from levies and duties on international trade are declining rapidly with the growing process of integration and economic liberalisation, despite a huge increase in foreign trade registered in the last two decades. In a period of 10 years, Mexico moved from been the 15th largest exporter world-wide in 1987 to the 7th largest in 1999.⁴⁵⁹ Foreign trade grew from 22 billion in 1986 to an estimated 145 billion by 2000. Imports increased seven fold from USD \$19.3 billion in 1980 to almost USD\$ 145 billion by 2000.⁴⁶⁰ Tax revenues from import levies have not increased proportionally due to the fact that Mexico has entered into various trade agreements aimed at reducing tariffs and customs duties. In 1986 Mexico joined GATT, unilaterally reducing up to 80% of its tariffs. On January 1st 1994, the North American Free Trade Agreement (NAFTA) with the US and Canada came into force, in a phased programme of cuts on duties on imports and tariffs, which ranged from immediate reductions to reductions after periods of five or ten years for sensitive sectors.⁴⁶¹ NAFTA is particularly important because 83% of Mexico's foreign trade is concentrated with just one of its NAFTA partners, the US. In addition, Mexico has entered into bilateral trade agreements with duty preference

⁴⁵⁸ Interview Arturo Astaburuaga, Moctezuma Beer's representative in Europe, London March 27th, 2000.

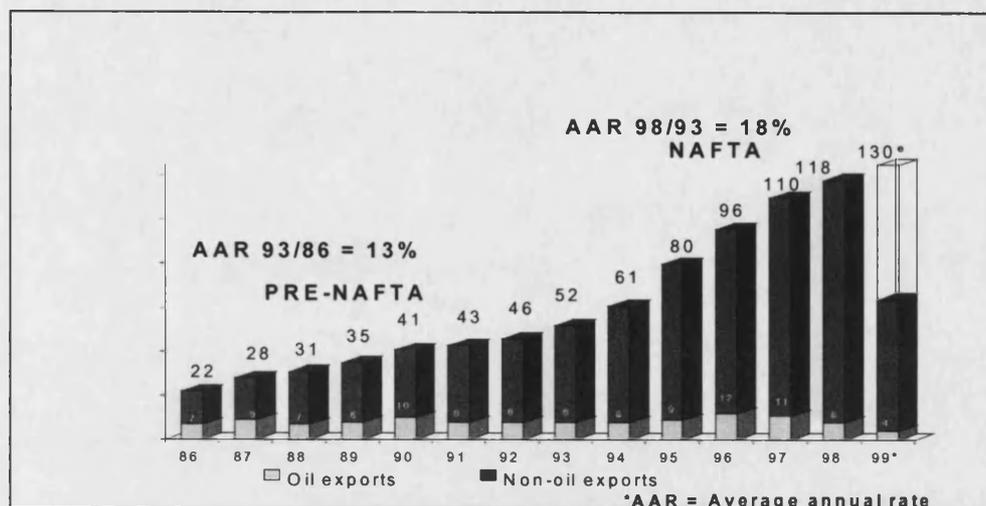
⁴⁵⁹ Interview Pérez Mota, representative SECOFI in Europe, London February 29th, 2000.

⁴⁶⁰ Bancomext estimates, from its office in London.

⁴⁶¹ See Georgina Kessel, ed., Lo Negociado del TLC (México: ITAM and McGraw-Hill, 1994).

for goods coming from Bolivia, Chile, Columbia, Costa Rica, Ecuador, Venezuela, Nicaragua and recently the European Union.⁴⁶² The following table shows the large increase of exports as result of NAFTA.

Graphic 4.6.- Mexico Exports Growth

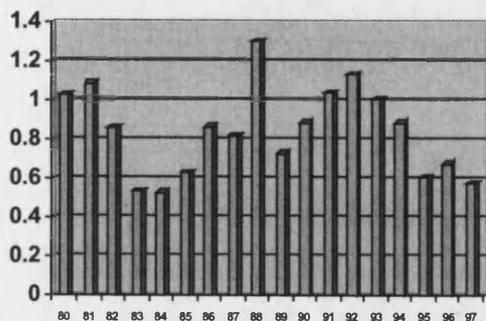


Source: Banco de México and SECOFI

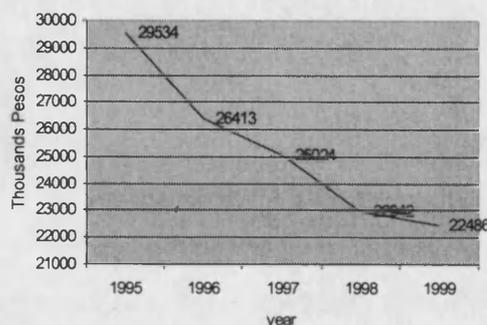
The following graphic shows the fluctuation of tax revenues from international trade as a result of trade liberalisation after entering GATT in 1986. In addition, foreign trade was affected by distortions in consumption caused by sharp devaluations of the peso aimed balancing budgets, especially during 1982, 1988 and 1994. Internal data from the Secretary of Finance shows how in peso terms tax revenues from import duties declined sharply, both as a result of the reduced consumption of imports because of the “end of sexenio crisis” and because NAFTA came into effect reducing government income in the form of tariffs.

⁴⁶² By 1999 Mexico was negotiating trade treaties with a group composed by El Salvador, Guatemala and Honduras, and bilateral agreements with Panama, Peru, Belize, Trinidad y Tobago, Dominican Republic and Israel.

Graphic 4.7.- Foreign Trade Revenues



Graphic 4.8.- Revenue from Taxes on Exports



Source: Elaborated with data from Revisión Fiscal Integral.

b) Tax on Fixed Assets (TA)

There is a federal tax on corporate assets, of 1.8% of the annual average value of the fixed and financial assets of the company. This has been one of the most contested taxes ever, although very few have to pay it. This tax only applies if the total amount exceeds the amount of the tax on profits, in which case the corresponding difference must be paid. The Tax on Assets law offers a credit for income tax that allows carry forward and carry back. The decreasing rate of tax and the large sectors exempted show the concessions that the government had to make to industrial organisations. First the rate was reduced from 2% to 1.8%, and later small and medium companies were exempted from this levy.⁴⁶³

⁴⁶³ On January 1st, 1995, the tax on assets was reduced from 2% to 1.8%.

This tax produces little revenues and was originally introduced as a mechanism to expose and deter income tax evasion. According to Former Secretary of Finance, Pedro Aspe, the TA was envisaged as such a mechanism, after many companies managed to avoid paying taxes by reporting losses for more than 10 years.⁴⁶⁴

c) Payroll taxes

The federal government taxes corporations with social security fees that amount to a minimum of 8.95% of the payroll to be paid by the employer to provide for old age, death, child care, retirement and disability. In addition, the employer must contribute 5% of each worker's salary to the National Fund for Worker Housing. The payroll tax is lower than most OECD countries, but for the benefit of Mexican employers, payroll taxes and fees are deductible for corporate income tax purposes.

Conclusion

Analysis of the most important tax instruments shows that the tax system is plagued with exemption and tax privileges reducing the taxable base and thus eroding tax revenues. The composition of the Mexican tax mix fits Peters' description of a tax system heavily influenced by corporate actors and seriously concern with not offending the interests of politically worthy groups. The country's tax mix shows the impact of corporatist political structures and the result of the bargaining process between the State and interest groups. The influence of

⁴⁶⁴ Interview Pedro Aspe, September, 20th, 1999.

interest groups is shown by the multiple loopholes and tax exemption in the tax system.

The low income tax rates for corporate and high-income earners show their success in maintaining a low burden of taxation and their influence to move the system towards indirect taxes. Similarly, the low burden on special taxes shows the capacity of large national and international corporations to resist taxation. On the other hand, “special regimes” for those in rural activities and transport industry show the power of corporatist actors, as well as the numerous products exempted from the VAT reflect the concessions given to organised labour and the working classes. Finally, it is noteworthy that despite the vehement rhetoric by public officials against tax exemptions and privileges, no serious public action has been taken to reduce these unfair privileges.

Chapter V

Macroeconomic Populism

“Large capital holders do not wish to invest and pay taxes in Mexico, they distrust the government and the country’s future.”⁴⁶⁵

Former President Luis Echeverría

This chapter examines tax reforms during the span of two presidential terms: President Luis Echeverría (1970-1976) and President José López Portillo (1976-1982). Evans argues that although the cumulative effects caused by incremental tax reforms between 1970 and 1982 are significant, they have been largely underestimated, particularly those undertaken by the López Portillo administration.⁴⁶⁶ For analytical purposes, I have drawn upon common characteristics from both presidential terms, as well as those ones that differentiate them. The resilient characteristics of this period are: 1) An economic agenda dominated by political concerns, in what has been described by the literature as “macroeconomic populism” 2) Both Presidents shared a common view of the strategy of economic development where the State is the main engine of development and growth. 3) A period of easy alternative means for the state to finance itself. 4) A relationship of patronage between the state and socio-economic actors, where the corporate actors are influential in economic policy making, while

⁴⁶⁵ Interview, Former President, Luis Echeverría, Mexico City, October 12th, 2000.

⁴⁶⁶ See John S. Evans, The Evolution of the Mexican Tax System since 1970, Technical Paper Series, No. 34 (Austin: Office for Public Sector Studies, Institute of Latin American Studies, University of Texas, 1982).

the business elite is largely alienated; and 5) A period of bonanz, with high rates of economic growth for a sustained period of time.

5.1.- Characteristics of this Period

a) Macroeconomic Populism

During this period politics dominated the economic policy agenda and tax reforms were largely influenced by corporate actors. The ultimate objective was to preserve the political system, using the economy as an instrument for this goal. Bazdresch and Levy has classified this period as one of “populist macroeconomic policies,” since economic polices concentrated on political goals at the expense of economic equilibrium.⁴⁶⁷ Both administrations pursued a set of economic policies designed to achieve specific political goals, while disregarding the economic disequilibrium they may cause.⁴⁶⁸ For Krauze these years show an unprecedented politicisation of economic policies which ultimately ended in catastrophic economic outcomes.⁴⁶⁹

Those political aims range from mobilising support within organised labour and lower middle class groups, to politically alienating rural oligarchy, foreign enterprises, and large scale domestic industrial elites. To Kaufman and Stalling, the typical economic policies pursued by these kind of regimes are: 1) a budget deficit to stimulate domestic demand, 2) nominal wage increases, plus

⁴⁶⁷ Carlos Bazdresch and Santiago Levy, "Populism and Economic Policy in Mexico," 1970-82, in Dornbusch and Edwards, The Macroeconomics of Populism in Latin America (Chicago: The University of Chicago Press, 1991) :223.

⁴⁶⁸ Dornbusch and Edwards define populism in economic terms as an approach to economics that emphasises growth and income redistribution and demphasises the risk of inflation and deficit finance, external constraints and the reaction of economic agents to aggressive non-market policies. Dornbusch and Edwards, The Macroeconomics of Populism in Latin America.

⁴⁶⁹ Enrique Krauze, La Presidencia Imperial (México: Tusquest ed., 1997) and Enrique Krauze, Por una Democracia sin Adjetivos (Mexico: Joaquín Mortiz-Planetta, 1986).

price controls to effect income distribution, and 3) exchange rate controls or appreciation to cut inflation and to raise wages and profits in non traded-goods sectors.⁴⁷⁰ Historical evidence confirms that each one of these policy actions was pursued during this period. Sheahan also outlines the common features of populist policy-makers, which seem to apply to our subject. Populist governments committed, at least in the public rhetoric, to protection of workers and wages, to industrialisation, to nationalism, to policies of subsidised food for urban consumers and to favours for groups with political influence.⁴⁷¹

The origins of macroeconomic populism are found in the crisis of legitimacy that the Mexican state suffered at the end of the 1960s. The political events that preceded Echeverría's term drastically shifted the direction of government policies, given an unequivocal "populist" hallmark to the following two presidential administrations. The 1968 movement reshaped the following administrations' political style and social approach.

For the first time in the post war period, Mexico experienced political instability by the end of the 1960s, jeopardising the existence of this long-lived political regime. On the 2nd of October 1968 the government suppressed with brutal force a student demonstration in Tlatelolco, an event that would have future political implications in policy making.⁴⁷² This sad episode in Mexican history

⁴⁷⁰ Robert P. Kaufman and Barbara Stallings, "The Political Economy of Latin American Populism," in Dornbusch and Edwards.

⁴⁷¹ See J. Sheahan, Patterns of Development in Latin America: Poverty, Repression and Economic Strategy (Princeton, N.J.: Princeton University Press, 1987): 316.

⁴⁷² For a brief analysis of the Tlatelolco crisis, and the political and economic response from government see Cothran, 91-129. See also Samuel Schmidt, The Deterioration of the Mexican Presidency: The Years of Luis Echeverría (Tucson: University of Arizona Press, 1991).

suddenly broke the image of the “Mexican miracle” and, according to multiple scholars, disrupted the traditionally stable Mexican political system.⁴⁷³ For Federico Reyes Heróles the government’s brutal repression to silence the student movement shook the nation’s political conscience, triggering changes that would have an important effect in future social policies.⁴⁷⁴ Because the challenge came from leftist groups, public policies moved towards the left of the political spectrum. Echeverría decided to counteract the public anger against the state, pursuing a “populist” style of patronage and paternalism in an attempt to legitimise his administration.⁴⁷⁵

b) Expansionary Strategy

Both Presidents believed in increasing the sphere of action of the government in the economy. They were strongly committed to the expansion of the public sector in strategic areas, and chose an inward bias of industrialisation focused in developing local industry. The ultimate aim was to become economically independent. Both presidents shared the dislike of the traditional dominance economic elite and the influence of foreign investment. Interviews with key policy actors of the period and the relevant literature shows that the government sought to become financially independent and consequently more autonomous in economic decision making. Paradoxically, the economic

⁴⁷³ For Helman president Echeverría was well aware of the political crisis that his government was facing at the beginning of his term and acted in response. See Judith Adler Helman, *Mexico in Crisis* (New York: Holmes and Meier, 1978) : 187-188. Garrido also agrees that the presidential system was in crisis, see Luis Javier Garrido, “The Crisis of Presidentialism,” in Cornellius, Gentleman and Smith. 417-434.

⁴⁷⁴ Federico Reyes Heróles, *El Poder: La Democracia Difícil* (México: Grijalbo, 1991):148.

⁴⁷⁵ For an overview of populism in Mexico, see Alan Knight, “Populism and Neo-Populism in Latin America, especially Mexico,” *Journal of Latin American Studies* Vol. 13, no.2, 303-312.

strategy they pursued made the Mexican state economically vulnerable and more dependent on international and domestic capital.

Expansionary policies were aimed at raising social expenditure and general levels of income. In a departure from the previous economic policies of conservatism,⁴⁷⁶ the government embarked in a relentless spending spree. As a result of the lack of fiscal discipline, large deficits developed leading to a loss the fiscal equilibrium. During Echeverría's term the fiscal deficit reached 10% of GDP, while during López Portillo it reached almost 17%.⁴⁷⁷

c) Easier Financial Means than Taxation

During most of the twelve year period, Mexico enjoyed access to ample international resources, giving the government easier means to finance the state than through taxation. International events had a considerable effect in Mexico. The most notable factor was the steep rise in oil prices, especially significant after the discovery of vast oil reserves in Mexican territory in the mid 1970s. Another, relevant international event that had a large impact on Mexico was the abundant availability of foreign resources to developing countries in the early 1970s. Commercial banks were flush with petrodollars deposits from oil exporting Arab nations. These banks in turn recycled their dollars to developing countries like Mexico, South Korea or Brazil, countries that enjoyed high growth rates in those years.⁴⁷⁸ As a result of these ample and inexpensive resources, Mexico's international indebtedness expanded. Mexico was an especially

⁴⁷⁶ For the fiscal austerity followed during stabilising development period, see Antonio Ortiz Mena, El Desarrollo Estabilizador: Reflexiones Sobre una Epoca.

⁴⁷⁷ See Banco de México, yearly statistics.

⁴⁷⁸ Jaime Ross, "Mexico from the Oil Boom to the Debt Crisis An Analysis of Policy Response to External Shocks " Rose Mary Thorp and Laurence Whitehead, eds., The Latin American Debt Crisis. (London: Macmillan, 1986).

attractive borrower to commercial banks, because in addition to the growing expansion of the Mexican economy it became a major oil-exporting nation. The government also pursued alternative means to finance the state like printing money, running deficits and inflation, all with devastating effects on the economy.

d) Redefining the Relationship among Policy Actors

The set of macroeconomic policies implemented by President Echeverría polarised the fragile and symbiotic relationship between the state and the business sector. Both governments supported the idea that economic growth and development could only be reached via state intervention of the market. The greater government incursion into the economy strained the relationship with the private sector, which saw it as an invasion to their domain. An antagonistic relationship developed with the business community and although it improved at the beginning of the López Portillo administration, it ended with the nationalisation of the banking system in response to massive capital flight. After 40 years of supporting the government's economic policies, the business elite began to challenge their nature and direction. The financial fragility of the Mexican state made the economic elite realise the enormous power behind their ability to move capital abroad and its possible use as an instrument to resist policies that would affect them. The large dependency on private capital and the government's inability to implement some of the desired tax reforms shows a rather weak state, in direct contradiction to the literature that depicts it as an authoritarian and almost omnipotent state.

During this period the Mexican state was not only responsive to the economic elite, but had to deal with a strong corporatist legacy, particularly organised labour. The large expansion of the public sector in the economy reinforced further the power of organised labour. In order to rally political support from corporate actors, both governments adopted populist economic policies and clientelism, through the use of subsidies to agricultural development, water, transportation, food stuffs and many public services provided by the state. For Middlebrook, during the Echeverría and López Portillo terms, clientelism, patronage, subsidies and coercion governed the relations between organised groups and the state.⁴⁷⁹

The state sought to consolidate its political power by undertaking an interventionist and paternalistic role. Corporatist groups, pillars of the hegemonic party, consolidated and expanded their influence during this period. Handouts and privileges (various kinds of subsidies) were given to all sectors and groups in exchange for loyalty to the regime. The role of the corporatist sectors was particularly important for the system because they provided the “bedrock vote” needed to legitimise the government.⁴⁸⁰ This paternalistic attitude expanded during most of López Portillo’s administration, fuelled thanks to the abundant oil revenues during his term.

⁴⁷⁹ For an excellent review of labour development and its role with the state see Middlebrook, The Paradox of Revolution.

⁴⁸⁰ According to Middlebrook, government-allied unions constituted a base of mass support for ruling party candidates in urban and industrial areas. Organised labour political discipline during presidential elections was a crucial element in the survival of a closed presidential succession process. Middlebrook, The Paradox of Revolution, 153.

e) High Rates of Economic Growth

Both presidents were well aware that in order to legitimise the regime they needed big economic growth rates. Although growth rates only dropped slightly compared to the previous development period known as “stabilising development” (Desarrollo Estabilizador), economic expansion continued to remain noticeably high.⁴⁸¹ During the Echeverría’s administration the average growth rate for the sexenio was 8.7%, while for López Portillo’s term it was 6%.⁴⁸² This high trend of economic growth was maintained at the expense of macroeconomic disequilibrium, caused by failing to match growing expenditures with income. Ultimately, divorcing income from expenditure had a devastating effect on the economy. Both presidents ended their respective terms facing acute economic crisis, resulting from the macroeconomic instability that had been triggered by the accumulation of huge fiscal deficits and the stampede of capital flight.

Among the most significant differences is the fact that Echeverría’s tax reforms ended up as mere adjustments, while López Portillo’s reforms were carried out successfully. Notable are the differences in approach, scope and direction of the proposed tax reforms. Also significant are the abundant oil revenues during the López Portillo term, which provided for a short period of time, the long desired financial self-sufficiency of the state. It is clear that the motives behind the style of economic populism varied while Echeverría’s underlying objective was to solve a political crisis, López Portillo sought to please various sectors of society and achieve financial self-sufficiency. At last, the relationship with the

⁴⁸¹ See Ortiz Mena.

⁴⁸² Banco de Mexico various issues.

private sector and the official rhetoric differed substantially between these two presidents. Echeverría's term was characterised by harsh criticism of entrepreneurs, while López Portillo tried to co-opt them with subsidies. But when the economic crisis erupted at the end of the sexenio, López Portillo's rhetoric changed dramatically, to resembling that of his predecessor.

5.2.- Echeverría (1970-76): The Pursuit of Equity through Deficit Spending

"A feud between the President and the economic elite developed over the role of the state and the strategy of development. Neither of them won."⁴⁸³

Ernesto Gil, Echeverría's Private Secretary

Echeverría came to power with the objective of legitimising the government after the political crisis that originated with the massacre at Tlatelolco⁴⁸⁴. As a result, political objectives overshadowed the economic ones. He attempted to win popular support by promising a better distribution of wealth. His team believed that this could be achieved by increasing the role of the state in the economy and through the tax system.⁴⁸⁵ Populist macro-economic policies created large public sector deficits, while inflation and foreign borrowing provided easy ways to finance the expansionary policies of the state.

These populist policies and the government's contentious rhetoric against the private sector rapidly deteriorated the relationship, which soon escalated from antagonistic to confrontational. Not only did the private sector oppose the

⁴⁸³ Interview, Ernesto Gil Elourdy former, Private secretary to President Echeverría, Manila, Philipines, July 28th, 2000.

⁴⁸⁴ It is important to remember that during the late 1960s and early during the 1970s a wave of political unrest swept the world. Young people, usually students demonstrated against their governments in France, US, Italy and Germany.

⁴⁸⁵ Interview Ernesto Gil Elourdy, Manila, Philipines July 28th, 2000.

populist policies but it openly challenged the nature and direction of economic policy.

Most relevant to our case are Echeverría's attempts to increase revenue through failed fiscal reforms, which further enhanced the conflict with capital holders. Fitzgerald argues that the tax reform proposals in 1972 broke the tacit agreement between the financial sector and the Mexican Treasury to finance the modest fiscal deficits in return for no tax reform.⁴⁸⁶ Echeverría's ambitious tax proposals ended up as mere adjustments, with only a slight increase in tax revenues, but at the expense of further eroding the confidence of the private sector, who opted for reallocating their capital out of the Mexican economy. The Echeverría sexenio culminated with a sharp devaluation of the peso, large public debt, and a huge and inefficient para-statal sector. Overall very little income redistribution was achieved.

5.2.1.- Economic and Political Conditions: When Politics takes precedent

a) Responding to Political Instability

Cothran states that by 1970 support for the Mexican regime had weakened considerably.⁴⁸⁷ The 1968 student-led protest and its brutal repression by the government brought the erosion of the government's legitimacy.⁴⁸⁸ This incident triggered a profound change in the political priorities at the top of government's agenda. As a result, the final aim was preserving the political

⁴⁸⁶ E.V.K. Fitzgerald "Stabilization Policy in Mexico: The Fiscal Deficit and Macroeconomic Equilibrium," in Rosemary Thorp and Laurence Whitehead, Inflation and Stabilisation in Latin America (Oxford: Macmillan and Oxford University Press, 1979): 39.

⁴⁸⁷ Cothran, 100.

⁴⁸⁸ Echeverría believed that the fundamental problem of the government was the loss of legitimacy that the regime has suffered after Tlatelolco. Cothran, 101.

system, using the economy as an instrument for this goal.⁴⁸⁹ Economic policy was directed to strengthen the financial autonomy of the state and gain scarce popular support. Many authors follow this reasoning. According to Looney, the economic strategy adopted by Echeverría responded to a number of urgent political pressures rather than economic concerns. Similarly, Bazdresch and Levy argue that political concerns dominated the agenda, while the economic ones became subordinated to the government's attempt to legitimise itself.⁴⁹⁰

The consensus within government was that the political crisis should be tackled by more state activism.⁴⁹¹ The state would expand its participation in the economy, in order to reduce poverty and the influence of foreign firms in the economy. Towards this objective, the state would increase public investment in areas where private investment was not forthcoming.⁴⁹² To rally political support, Echeverría's government extensively expanded state subsidies in general, and specific subsidies were tailored to politically worthy groups. The largest general subsidies were concentrated on reducing the price of oil, electricity and fuel, operating the railroad system and lowering food prices.⁴⁹³ Subsidies to specific sectors usually included tax exemptions.

Because the challenge to the regime came from the left, Echeverría took a pro-labour, pro-agrarian policy line, accompanied by a belligerent political rhetoric

⁴⁸⁹ Cothran argues that Echeverría's major concern was political stability and like previous presidents he looked at the economy as the solution of the problem. Cothran, 106.

⁴⁹⁰ Bazdresch and Levy, 237-238.

⁴⁹¹ Confirmed by Gil Elourdy in an interview, Manila, 28th of July 2000 and Jorge Nuño, close collaborator to President Echeverría.

⁴⁹² Bazdresch and Levy, 237-238.

⁴⁹³ The operations of CONASUPO (National Staple Products Corporation) expanded significantly bringing agricultural products at guaranteed prices and the marketing of such products extended through the enlargement of the number of retail stores that sold goods at subsidised prices.

against the private sector that was aimed to win the support of the leaders of the left wing movement.⁴⁹⁴ To complicate things further, his attempts to increase revenues through taxation caused the relationship between Echeverría and the private sector to be at odds, forcing him to look for political support within the system's corporate actors. At the end of his term, the deterioration of the economic conditions was so bad that the support of those groups eroded as well.

b) Using the Economy as a Political Tool

The economic strategy adopted during Echeverría's term responded to urgent political concerns rather than economic ones. This term is characterised by the large role of the state in the economy and the full use of the state apparatus as a political tool. Echeverría's cabinet saw the public sector as the main vehicle for economic growth. The role of the state was to improve income distribution, orient industrial production and develop the national infant industry throughout an inward industrialisation strategy. This was attempted by the expansion of the state in the economy. The goals of the administration were increasing job creation capacity, decreasing external dependency by improving local industry capacity to substitute imports, and reorienting industrial production towards the needs of the great majority of the population.⁴⁹⁵

In his last presidential address to the nation, Echeverría stated that his presidency has been devoted to improving Mexico's inequitable income

⁴⁹⁴ Needler, 34.

⁴⁹⁵ Robert E. Looney, Bulletin of Latin American Research, Oxford: May 1993: 57

distribution.⁴⁹⁶ The paramount goal of public policies was the pursuit of equality, through distributional policies (including taxation). The sexenio economic development strategy was called "shared development" and it was largely focused on rectifying income distribution disparities, using the state to correct economic deficiencies. By the end of this term little change had been achieved. However, it is important to bring into light the pursuit of a more equal distribution of income, because it helps to explain the orientation of tax reform attempts during his government.

The main features of Echeverría's term were: the massive expansion of the public sector in the economy, a public spending spree and an outburst in state owned enterprises (SOE), as well as the proliferation of large subsidies to SOEs, the general public and corporate sectors. The spending spree soon translated into large public sector deficits and escalating foreign debts, ending in severe economic turmoil. Solís has very accurately described Echeverría's term as "the pursuit of equity through deficit spending."⁴⁹⁷

c) Massive expansion of the public sector in economic activity

The political objectives of Echeverría's sexenio called for a larger role of the state in the economy. The number of state owned companies grew from 84 in 1970 to 845 in 1976, and the number of employees doubled to more than a

⁴⁹⁶ See "Sexto Informe de Gobierno," México, Presidencia de la República, 1976. For a good overview of Echeverría's Policies see Leopoldo Solís, Economic Policy Reform in Mexico In his inaugural address President Echeverría promised to reduce poverty and income inequality. See Primer Informe de Gobierno, México, Presidencia de la República 1970. Aspe and Sigmund show that President Echeverría's efforts to improve Mexico's inequitable income distribution achieved very little. See Aspe and Sigmund.

⁴⁹⁷ See Solís, Economic.

million.⁴⁹⁸ The government expanded to areas such as electricity, oil, banking, transportation, communications, steel and petrochemicals. The expansion of the state was justified as being necessary for correcting the deficiencies in the provision of services to lower income groups, and compensating for the shortfalls of private sector investment. However, ISI created an over protected and inefficient domestic industry with an anti-export bias, with national products overpriced compared to international standards. By the end of the Echeverría's sexenio, the state had become obese and inefficient, public sector accounted for as much of 45% of GDP.⁴⁹⁹

d) Increase in Public Spending

Government spending increased with the expansion of the state in the economy⁵⁰⁰ and the desire to appease mounting political unrest. Public sector expenditure increased from less than 6% of GDP during the second half of the 1960s to 17% of GDP in the last two years of Echeverría's sexenio. The current capital expenditure of the public sector rose from 22% in 1968 to 29% in 1976, without a parallel increase in income.⁵⁰¹ Although public sector revenues increased, they lagged far behind the increase in expenditure. The ratio of current expenditures to current revenue, which averaged 84% in the 1965 to 1970 period, jumped to 90% between 1971 and 1976. Public sector investment became the engine of growth. Public expenditure rose from an annual average of 6% in 1971 to more than 12% by 1976, while private sector investment remained almost stagnated from 12% of GDP in 1971 to 13% of GDP for 1976.

⁴⁹⁸ Cothran, 109.

⁴⁹⁹ Looney, 59.

⁵⁰⁰ Pedro Aspe and J. Beristain, "The Evolution of Income Distribution Policies during the Post-Revolutionary Period in Mexico," in Aspe and Sigmund. ✓

⁵⁰¹ Fitzgerald, 30.

⁵⁰² The expansion of public expenditure generated an enormous fiscal deficit, due to the absence of a tax reform that increased revenues or price adjustments of publicly owned enterprises.⁵⁰³

e) Growing Public Sector Deficit

Price controls on key commodities provided by public enterprises fuelled the fiscal deficit. Central government subsidies both to public sector enterprises, and to private sector through reduced public prices, averaged 5.3% of GDP in the 1973-1976. The philosophy of the time was to keep the price of goods and services supplied by the government at very low levels in order to make them affordable to the masses.⁵⁰⁴ Between 1971-76, public sector deficit increased to an average of 5.7% of GDP, reaching a 9.5% GDP deficit in 1976, compared to an average of 2.5% of GDP between 1965-1970. During Echeverría's administration, the federal government's budget deficit rose from 1% to 3.8% GDP.⁵⁰⁵

State revenues proved to be insufficient for the grandeur of the government's schemes. Faced with the spending-revenue disparity, the government looked for alternative means of financing the state. The first option was raising revenue throughout taxation, but this proved to be more difficult than anticipated. In the absence of an increase in taxation the budgetary deficit expanded as current income rose less rapidly than the total expenditure in the government and the

⁵⁰² Looney, 58.

⁵⁰³ Fitzgerald, 39.

⁵⁰⁴ Interview Adrian Lajous former Director General PEMEX, London, March 3rd, 1999.

⁵⁰⁵ Looney, 59.

SOEs.⁵⁰⁶ To finance the deficit the government followed a path of mixed foreign borrowing and inflationary financing.⁵⁰⁷ The other alternative was external debt, which was widely used causing a rapid escalation in public debt.

f) Escalating Public Debt

The inability to finance the expansion of the industry with internal resources rapidly increased the amount of foreign debt.⁵⁰⁸ Between 1961 and 1965, foreign loans financed only 7% of the industrial deficit; by 1975 the figure was nearly 66%. As a result, the net income paid abroad in the current account deficit increased to more than 50% between 1970-74, compared to 29% between 1960-64.⁵⁰⁹ The expansion of state investment pushed its Public Sector Borrowing Requirement as % GDP from 2% in 1971, to 6% in 1973, to 10% in 1975.⁵¹⁰⁵¹¹ In monetary terms foreign public debt grew from USD \$4 to 22 billions in the span of the sexenio.⁵¹² By 1976 Mexico owed nearly one quarter of all third world debt to private multinational banks.⁵¹³

The availability of foreign borrowing increased because of OPEC's dollar surpluses. The government had easy access to international borrowing, mostly due to the petrodollars from oil exporting nations recycled by private banks.

⁵⁰⁶ Fitzgerald, 30.

⁵⁰⁷ Bazdresch and Levy, 242. Luke argues that the government chose inflation over taxation to finance itself, see Luke, 45.

⁵⁰⁸ Sidney Weintraub "Case Study of Stabilization: Mexico," in William Cline and Sidney Weintraub eds., Economic Stabilization in Developing Countries (Washington, DC: Brookings Institution, 1981): 281-83.

⁵⁰⁹ Looney, 65.

⁵¹⁰ *Ibid*

⁵¹¹ Fitzgerald, 33. The annual borrowing requirement average rose from 3% of GDP in the previous sexenio to 8 % at the final years of Echeverría's administration. See Looney, 59.

⁵¹² Enriquez, 31.

⁵¹³ *Ibid*.

⁵¹³ Fitzgerald, 35.

The 1973 oil boom enhanced Mexico's access to international resources, as the international financial markets needed to recycle these large petrodollar deposits. As a result, commercial banks increased their lending to developing countries substantially.⁵¹⁴ In 1975, the announcement of the discovery of large oil deposits in the south improved Mexico's already easy access to foreign borrowing. For government officials, foreign borrowing offered an easy alternative to finance government expansion. External borrowing was perceived by the political elite as an opportunity to be taken advantage of.⁵¹⁵ This was a source of relative cheap resources that did not entail the high political cost of taxation.⁵¹⁶

g) Capital flight

By the end of Echeverría's term, after large budget deficit and increasing devaluation expectations, businesses and the middle class slowed their investment in Mexico and sent much of their money abroad. The trust in the currency eroded and dollar deposits increased from 17% of total deposits in 1970 to 40% in 1976.⁵¹⁷ The general economic situation worsened, as a result of the capital outflows that began in mid 1974. The decline in private sector confidence was reflected in the large amounts of capital flying out of the Mexican economy. An estimated US\$ 4bn fled the country during the 18 months preceding the devaluation.⁵¹⁸ The combination of under-investment and

⁵¹⁴ Most borrowing came from private banks rather than multilateral organisations, charging variable interest rates at shorter maturities.

⁵¹⁵ See Tello, also interview Adrian Lajous, former director PEMEX, London March 3rd 1999.

⁵¹⁶ Luke argues that the large sums of money raised in the private banks merely financed capital flight, especially during 1975 and 1976. See Luke, 45.

⁵¹⁷ Solís, Economic

⁵¹⁸ Looney, 62.

capital flight, plus a notorious worsening of the balance of payments,⁵¹⁹ contributed to a decline in the economic growth rate from 8% to 4% in the last year of the *sexenio*.⁵²⁰ In September 1976, with no more alternatives left the peso was devalued by 59%, after depleting the country's foreign reserves attempting to defend its value. The inflation rate was 22% and foreign debt amounted to \$29.5bn. Echeverría's term ended in a liquidity crisis and the need for an agreement with the IMF to stabilise the economy after the 1976 devaluation.⁵²¹

5.2.2.- Policy Actors and their Influence: Struggle at the top

The literature describes in detail the influence of corporate actors in Mexico during this period. Representatives of these social organizations have described this period as the "golden days," when they considered themselves to be influential in policy making.⁵²² Determining the degree of influence of the corporate actors is without doubt a difficult task. Nevertheless there are indirect means that help to evaluate the true leverage of organised groups, such the number of subsidies and privileges received, the scope of political autonomy and, most evident, the political positions occupied by their representatives. The former is particularly significant in a system where the executive assigned congressional seats according to negotiated "quotas."⁵²³

⁵¹⁹ Enriquez, 31.

⁵²⁰ Cothran, 11.

⁵²¹ For a detail description in the stabilization strategy followed by Mexico and the IMF requirements see Fitzgerald, 24-63.

⁵²² Interview with Deputy Augusto Gómez Villanueva, Mexico, March 20th 1999.

⁵²³ This is a good way to visualise the power exercised by corporate groups in a given *sexenio*, since the government usually compensated their political support through congressional seats. In an interview, Santiago Oñate, former PRI's president confirmed this assumption, London March 8th, 2000. Camp shows that very few administrative positions were given to the leaders of the corporate organisations. See Roderic A. Camp, "El Tecnócrata en México," Revista Mexicana de Sociología Mexico, UNAM, num. 2-3, April-June, 1983.

a) Labour: rebuilding the support base

Economic and political subsidies to labour increased in exchange for support to government policies during Echeverría's term. According to Middlebrook, President Echeverría promoted a democratic opening of organised labour by permitting greater freedom of action for opposition labour and political groups. There was more tolerance of labour politics, and the number of applications for union registration increased greatly; 327 applications were received just in the first year.⁵²⁴ He also expanded government subsidised worker housing, granted government employees a forty-hour working week, and enacted several emergency wage hikes to compensate workers for price increases. In addition, the prices of goods and services provided by the state were kept low to support the working class.⁵²⁵

As state owned enterprises expanded so did the numbers and consequently the bargaining power of organised labour. Labour's "political quotas" increased in both chambers during the Echeverría's administration.⁵²⁶ Table 7.1 shows a large rise in organised labour's seats in Congress during Echeverría's term, up from 20% to 30% of the PRI's total representation. Similarly, in the lower Chamber, the number of deputies representing labour increased from 11% to 22% of the total number of deputies (See table 5.2).

⁵²⁴ Middlebrook, 175.

⁵²⁵ See Middlebrook, 160 and Paulina Fernandez Chistlieb and Octavio Rodríguez Araujo, "En el Sexenio de Tlatelolco," in Pablo González Casanova, La Clase Obrera en la Historia de México (Mexico: Siglo Veintiuno, 1985).

⁵²⁶ According to Rendón, President Echeverría tried to manipulate internal opposition rather than suppressing it by force. Heavily relying on corporate organisations within the official party, Echeverría expanded their seats in Congress. To see a detail account of the governors, and seats in Congress occupied for labour leaders see Armando Rendón Corona, La Renovación de la Clase Política en México, 1940-1977 (Mexico: Universidad Autónoma Metropolitana, 1990): 93.

Table 5.1.- PRI's Sectorial Representation before Congress

Year/ Total	Agrarian %	Labour %	Popular %
1970 (177)	26.6	20.3	53.1
1973 (192)	27.1	19.8	53.1
1976 (196)	28.6	29.6	41.8

Source: Rendón, 258

Table 5.2.- Chamber of Deputies: percentage in relation to the total number of deputies

	Agrarian		Popular		Labour	
Year	Number	%	Number	%	Number	%
1970	41	18	72	34	22	11
1973	42	18	83	36	27	12
1976	33	17	77	40	42	22

Source: Rendón, 257

b) Peasants: consolidating their strong hold

The agricultural agenda was at the top of Echeverría's programme. In an interview with Gómez Villanueva, former Secretary for the Distribution of Rural Land, he stated "Echeverría's top priority was developing the rural sector, he used to called me every single day to learn how things were progressing."⁵²⁷ Echeverría was personally committed to accelerate the distribution of communal land called "ejidos," even to a degree that effected many large

⁵²⁷ Interview with Augusto Gómez Villanueva, former Secretary of Land Tenure, Mexico, March 20th 1999. According to Echeverría's probably his closest collaborator in his cabinet. See Castañeda, *la Herencia*.

landowners.⁵²⁸ According to Needler, at the end of his term the President was supporting even illegal land seizures by peasants.⁵²⁹ The evidence clearly suggests that the agricultural agenda was a priority for this president. This could be explained either because the CNC was the main corporate force behind his presidential nomination or because he was really committed to it. Mexico had suffered a profound decline in agricultural growth since the 1960s.⁵³⁰ The fundamental reason was the potential of political unrest in rural areas, due to the unequal inequities of distribution of wealth in the countryside.⁵³¹

In the 1970s, there was evidence of a declining trend in agricultural production and in public investment in the rural sector. Per capita agricultural production decreased from 12% during 1965-1970 to 8% from 1970-75. To reverse this trend Echeverría increased federal investment in agriculture from 15% in 1971 to 20% in 1976.⁵³² In 1971, Mexico began to import significant amount of food stuff and grains. This caused strident complaints from the rural representatives. To compensate for the agricultural decline, Echeverría extended subsidies and further tax privileges to this sector.⁵³³ The statistical data shows that proportionately the agricultural sector contributed much less to tax receipts than this sector's overall contribution to GDP.⁵³⁴ Curiously, the number of

⁵²⁸ Interview Gómez Villanueva, Mexico, March 20th 1999.

⁵²⁹ Needler, 36.

⁵³⁰ To learn about the forces behind Echeverría's nomination see Castañeda, La Herencia.

⁵³¹ Merillee S. Grindle, "Policy Change in an Authoritarian Regime," Journal of Interamerican Studies and World Affairs, N. 4/ 19, 531.

⁵³² Cothran, 107.

⁵³³ See David Barkin, Distorted Development: Mexico in the World Economy (London: Westview Press, 1990).

⁵³⁴ See Información Sobre los Ingresos Gubernamentales 1970-80 (México: Secretaría de Programación y Presupuesto y Secretaría de Hacienda y Crédito Público, 1982).

political appointments offered to peasants and farm leaders, either in the form of governorships or congress seats, did not increase considerably.

c) Business sector: confrontation and struggle

During Echeverría's period, the business elite felt alienated from the process of economic decision making. As early as 1970, Coparmex accused the government of not consulting business organisations for the design of economic policy.⁵³⁵ The relationship between the government and the state deteriorated because of Echeverría's economic policies and his anti-business rhetoric.⁵³⁶

The economic elite felt so alienated that it confronted the government, by openly challenging its strategy on economic development. The process of confrontation rapidly escalated to conflict. At the beginning, business organisations adopted a very critical position over the government's economic policy, but as this strategy failed to provide results they organised themselves into a common front. The Monterrey conglomerate formed a national pressure group called the Co-ordinating Council of Businessmen (CCE). This group was constituted by a very select group of the 30 or so largest companies in the country. To Tello and Cordera, the CCE was born in reaction to state policies that might remove their prerogatives.⁵³⁷ But to its leader, Eduardo Bours it was

⁵³⁵ Luke, 46

⁵³⁶ For a detailed account of the origins of the conflict with the private sector see Roberto Newall and Luis Rubio, Mexico's Dilemma: The Political Origins of Economic Crisis (Boulder, Colo.: Westview, 1981) for an account on the war of words see pages 126-127.

⁵³⁷ Tello and Cordero, 65.

simply a natural response of the big entrepreneurs who felt that these economic policies were affecting their interests.⁵³⁸

The conflicting relationship between the state and the business community is summarised with two articles of the time.⁵³⁹ The first article by Lorenzo Servitje, one of the most important entrepreneurs in Mexico, shows the stern struggle with the private sector over the management of the economy, particularly inflation and those policies aimed at redistributing income. He fiercely attacks the government's monetary policies and its inflationary effects. Furthermore, although he acknowledges the large income disparities, he harshly criticises the policies implemented by Echeverría's government, suggesting they could be depicted as "dictatorial." The discourse also shows the confrontation with labour organisations calling them a "working aristocracy."⁵⁴⁰

At the core of the dispute was the role of the state and the proposed tax reform. Bernardo Pacheco, President of the Studies Committee of the Social Union of Mexican Empresarios (USEM), demanded a greater autonomy and participation of the business community in the planning of economic development. Openly he asked for tax privileges for those who co-operate with the state and suggested coercion, either by business organisations or the state, for those business men reluctant to participate in the shared development plan. Although Pacheco accepts that the deficiencies of the private sector should be compensated by state participation in the economy, he stands for clear rules of

⁵³⁸ Interview Eduardo Bours, London, October 13th 1998.

⁵³⁹ These articles show the profound struggle between the private sector, the state and labour organisations over the strategy of economic development.

⁵⁴⁰ Lorenzo Servitje, "La Inflación, la Distribución del Ingreso y los Empresarios," Revista USEM No 29, January and February 1975, 20-24.

the game that draw up the boundaries of the public and private sectors sphere of influence.⁵⁴¹

Soon the verbal confrontation escalated into a political struggle over the country's economic strategy of development.⁵⁴² Echeverría's economic policies were seen as a threat to businesses interests, in particularly to the northern Monterrey fraction, which saw these policies almost as a declaration of war against the business community.⁵⁴³ Ultimately, the struggle caused the rupture between the entrepreneurial class and state elites.⁵⁴⁴ For the economic elite the tacit agreement between the state and entrepreneurs had been broken with the expansion of the state and the proposed tax reform.⁵⁴⁵ Three public policies, in particular, caused acute problems between the state and the business elite: the tax reform proposal, the strategy for international trade and the one for agricultural development. The government policy reversal in these three areas shows the power of the business elite. The distributional tax reform was ultimately aborted; the strategy of international trade culminated by postponing Mexico's entrance to GATT and the agricultural development strategy, was timidly implemented with the SAM (Mexican Food System) programme.⁵⁴⁶

⁵⁴¹ See Bernardo Pacheco, "Dinámica del Desarrollo," *Revista USEM* No 29, January and February 1975, 3-7.

⁵⁴² See Carlos Tello and Rolando Cordera on the struggle over the strategy of economic development.

⁵⁴³ Conversation with Othón Ruíz, director of one of the large Monterrey companies, after a conference at the Harvard Business School over the relationship between government and the private sector, May 18th, 1994.

⁵⁴⁴ For more information on the confrontation of the state and the economic elites see Hamilton.

⁵⁴⁵ This was the perception of the business community in Monterrey, according to Nuevo León Senator Eloy Cantú, interview London November 12th, 1999.

⁵⁴⁶ See Tello and Cordera, 63.

Capital holders soon realised the powerful leverage embedded in their ability to move their capital abroad, and began to use it as political instrument to oppose unfavourable economic policies. One of Echeverría's cabinet members, Carlos Tello, stresses in particular the power of the Banking community.⁵⁴⁷ In his book, Tello harshly criticises the ample benefits given to financial groups, like free convertibility of the peso, anonymity of property, special tax treatment, ample guarantees to their investments and deposits, high yields and profits, and no problems with unions.⁵⁴⁸ He goes even further, to place the blame of the 1976 crisis on President Echeverría, and his lack of courage to remove the system of privileges given to the financial sector.⁵⁴⁹

d) External Actors: distant relations

Exogenous actors did not play a prominent role in shaping the government's economic policies during Echeverría's term.⁵⁵⁰ In spite of this, the government ended up signing a loan agreement with the IMF after the economic crisis of 1976. The conditions required by the loan were very limited and its surveillance lax. The only specific commitment that was demanded by the IMF stabilisation programme was cutting its public sector deficit from 9.9% in 1976 to 2.5% of

⁵⁴⁷ See Tello, *La Política Económica de México*.

⁵⁴⁸ Tello and Cordera, 105. According to Jean Moorhouse, the Bank of England supervisor of Latin America, Mexico more than any other country of the world enjoys the high degree of protection of investments and deposits by the state. Interview, London, February 29th, 2000.

⁵⁴⁹ See Tello, 208. This author was a prominent member in the Echeverría and López Portillo economic cabinet. According to Tello a restrictive monetary policy and the worldwide crisis of capitalism were the main factors behind the crisis of confidence in 1976. He argues that there was not commitment from the President to re-define the way the economy was financed. He criticises the state's excessive protection to the financial sector and its "unlimited" privileges. Interview, Carlos Tello, México City, feb 29, 2000.

⁵⁵⁰ According to Gil Elourdy, Echeverría's private secretary, he concentrated on political institutions rather financial ones. Echeverría distanced his agenda from that of the US, by embracing the cause of so called not allineated countries. Interview, Philippines, July 28th 2000.

GDP by 1980. Nor even a drastic cut in public spending was required by the IMF, just an expenditure cut of 0.5% GDP was recommended.⁵⁵¹

During his term Echeverría was strongly committed in breaking Mexico's dependence on foreign investment and markets.⁵⁵² In an attempt to reduce the influence of foreign companies in the Mexican economy, he tightened the legal requirements for the majority of Mexican ownership and exposed those companies owned by Mexicans just on "paper" (*prestanombres*).⁵⁵³

5.2.3.- President Echeverría's Tax Reform: In Pursuit of Revenues and Equity

Right from the start of his period Echeverría stressed the need for a radical tax reform that would increase revenues. According to one of his economic Secretaries, a fiscal reform that would increase revenue seemed the logical option for the expansionary plans of the government.⁵⁵⁴ Echeverría originally planned to finance increasing spending through a progressive tax reform, which at the same time would help to redistribute income by increasing the tax burden on those better off. Nevertheless, the ambitious plans for a fiscal reform ended up just as fiscal adjustments (*adecuaciones*) due to the opposition from the private sector and the perceived political cost of implementing the desired reforms.⁵⁵⁵

⁵⁵¹ Luke, 47.

⁵⁵² Interview, Ernesto Gil Elourdy, Philippines, July 28th 2000.

⁵⁵³ Cothran, 109.

⁵⁵⁴ Tello.

⁵⁵⁵ For an excellent overview see Elizondo, "In Search."

The first attempt to increase government revenue was made in 1970, but it had a small impact in revenue terms.⁵⁵⁶ The business community opposed the tax reform on the grounds that they had not been consulted. By 1972, the executive tried to revive a 1964 tax proposal for an increased tax burden for companies, previously blocked by business interests during Díaz Ordaz's term.⁵⁵⁷ This second tax proposal faced strong opposition from within the government, particularly from the Central Bank and the Secretary of Finance.⁵⁵⁸ The proposed changes included direct taxation of property income, as well as the aggregation of personal incomes from different sources of income in a single tax base, plus the abolition of anonymous forms of wealth holding.

These proposals largely affected the interests of the better off. The studies at the Secretariat of Finance, revealed that the tax rate in some categories was not only very low, but as income was fractionalised it was impossible to impose progressive taxation. Income could be moved to another category to avoid higher tax rates, and it was very easy to deduct personal expenses. The anonymity of wealth represented a big fiscal issue, since income was taxed according to income categories or source of income. Taxpayers were not obliged to disclose their wealth assets, so property holders remained largely anonymous.⁵⁵⁹ Hence, income tax was borne principally by wage earners, the

⁵⁵⁶ To see more details Elizondo, "In Search," 166.

⁵⁵⁷ See Ortiz Mena for the 1964 proposal that was rejected.

⁵⁵⁸ See F. H. Purcell and S. Kaufman, El Estado y la Empresa Privada, Nueva Política Col 1, No 2 (1976), 230 and Elizondo, "In Search," 167.

⁵⁵⁹ See Elizondo, "In Search."

only ones that faced a progressive tax scale.⁵⁶⁰ The statistics show that wage earners contributed most of the tax receipts.⁵⁶¹

Tax authorities saw the elimination of the anonymity of wealth more as a control mechanism than a way to raise revenues significantly.⁵⁶² The government expected to provide relevant data on capital flows and the wealth position of rich Mexicans.⁵⁶³

Businesses, particularly big ones opposed the reform, arguing that the government had over-reached its traditional economic boundaries. The bill never reached Congress, having been dropped by President Echeverría under pressure from business groups and the Central Bank, arguing that would lead to capital flight.⁵⁶⁴ In addition, the adjustments to tariffs and prices of public services were delayed in an attempt to curb inflation, and to avoid alienating the support of popular sectors. At the end, fearing that the reforms would affect the corporatist groups, only minor changes were implemented, in the form of increases in tax rates.

After a long struggle, in 1974 the government introduced the so called "adecuaciones fiscales," or mild modifications to the tax structure to increase revenue, which did not alter the nature or composition of the fiscal system. The

⁵⁶⁰ The direct tax burden shifted towards earned salaries See Fitzgerald in Thorp and Whitehead Inflation and Stabilization, 31.

⁵⁶¹ Información sobre los Ingresos Gubernamentales.

⁵⁶² See Solís, Economic Policy Reform, 72-73 and Maxfield, Governing Capital 88-92.

⁵⁶³ Elizondo, "In Search," 167. Elizondo argues there was great concern among businessmen of the government knowing who owned what, since the state would be in a better position to impose other kind of controls in the future. Elizondo, "In Search," 168. Solís argues that the private sector saw the proposal as the first step to impose foreign exchange controls. Solís, Economy Policy Reform, 76.

⁵⁶⁴ Fitzgerald, 31.

increase in revenue was based on indirect taxation, higher rates of personal income and the reclassification of wage earners' tax brackets due to inflation. The reforms had some distributional effects. The maximum marginal tax rate for individuals was raised from a 35% to 50%. For companies, the tax rate was a flat 42%, despite a progressive schedule for corporate income. There were also important reforms in indirect taxation, increasing taxes on items consumed by the rich and higher excises. As a result, federal tax revenues were augmented thanks to the increased rates of the turnover Sales Tax (TST) and in excise taxes on goods such as beer, soft drinks, alcoholic beverages, telephones, cigarettes, and electricity. Tax rates remained low, compared to international standards and both the TST and the excises stood at extremely low levels. The only exception where Mexico was conspicuous was luxury rates of 30%.⁵⁶⁵ However, tax increases were not restricted to the better off. Taxes on popular consumed goods such as beer and petrol were increased as well, showing that Echeverría's commitment to increase tax revenues was beyond his populist stance.

On the administrative front, significant changes were made in terms of co-ordination between federal and state fiscal authorities. The introduction of a new turnover sales tax led to the co-ordination of federal and states sales taxes and helped to eliminate the multiplicity of rates and treatments that had spread over time across the thirty-two federal entities. The reform of the revenue sharing scheme provided a unified tax system that paved the way for the introduction of VAT some years later.

⁵⁶⁵ Gil Díaz, "Tax Reform." 262 –265.

Two other important reforms in Echeverría's period were the inclusion of financial interest income from rented property in the tax base and the changes to taxation of financial interest income. The first reform was largely cosmetic, but tax increases on financial interest had profound effects. According to Gil Díaz such policy raised very little revenue, but affected the main internal sources of funding for the government and private sector; the deposits made to domestic financial intermediaries. The government was a prime borrower of internal funds, so the higher tax was reflected in the higher cost in its internal debt. As a result, both the private and the public sector enhanced the level of foreign borrowing.⁵⁶⁶ This reform affected the bankers and holders of capital, enhancing their proclivity to transfer their resources abroad.

The results of the adecuaciones were that total tax revenue went up from 8.15% of GDP in 1971 to 9.78% in 1974, 11.25% in 1975, and then down to 10.97% in 1976. The three most important indirect taxes went up even faster: from 4.22% of GDP in 1971, to 5.18% in 1974, 6.18% in 1975, then down in 1976 to 5.72%. Income tax revenues rose from 3.44% of GDP in 1971, to 4.05% in 1974, 4.47% in 1975 and 4.82% in 1976.⁵⁶⁷

⁵⁶⁶ Gil Díaz, "Tax Reform," 263.

⁵⁶⁷ Elizondo, "In Search," 172.

5.3.- López Portillo (1976-1982): Management of Abundance

"I want to inform the Mexican people that as a result of the discovery of abundant oil reserves in the south, Mexico has become finally financially self-sufficient. From now on, the country's only economic problem is how to manage our wealth."

President López Portillo, 1979

As a candidate López Portillo talked about the financial needs of the State, the lack of adequate means of financing it and the urgent demand for a tax reform. Such reform included greater faculties to states and municipalities so they could increase their tax collection share.⁵⁶⁸ López Portillo implemented far reaching tax policies in some of these fronts, but the promised deep tax reforms that would improve Mexico's financing capacity never arrived.

President López Portillo shared the same strategy of economic development as his predecessor, undertaking a large expansionary role of the state in the economy. Regarding taxation, however, López Portillo's approach to reforming the tax system was different. According to his Secretary of Finance, David Ibarra, a distinctive change of tactics took place, moving towards a consensus building strategy, which helped to pass important reforms, above all, the introduction of VAT.⁵⁶⁹ Noticeable is the fact that tax reform proposals began to move away from the hefty distributional agenda of the previous government. Nevertheless, tax authorities still believed that the real income of low-income people could be improved through tax-rate tailoring.⁵⁷⁰ Also significant is the

⁵⁶⁸ See El Pensamiento Político de José López Portillo: La Campaña Presidencial (México, IEPES, PRI, 1979) 361, 369, 372 and 376.

⁵⁶⁹ Interview David Ibarra, México, September 25th, 1999.

⁵⁷⁰ Gil Díaz, 264.

fact that the tax reforms moved away from instruments that could clash with the interests of capital and big business.

The literature has been consistent in asserting that the Mexican government always opted for alternative means of financing the state that would avoid political conflict, in particular taxation. However, López Portillo's successful reform seems to contradict this argument, since significant tax reforms were implemented during a period of plentiful revenues from oil. Undoubtedly, the new approach of extensive negotiations and the avoidance of conflict with capital through anticipatory tactics were fundamental for the success of the reforms, but they alone cannot explain it. Hence, the answer may rest on the fact that the oil resources gave the state greater autonomy before the economic elite; a financial and thus political autonomy sought by all presidents. Reinforcing this argument, former Secretary of Finance David Ibarra states that oil revenues provided an unprecedented leeway to the government in dealing with the private sector over economic policy.⁵⁷¹

According to Luke, after the 1976 crisis the immediate priorities for the López Portillo administration were to stabilise the economy and restore confidence to large sections of the populace, especially the middle classes and the private sector.⁵⁷² López Portillo's private secretary Roberto Casillas agrees with this argument, highlighting the priority given by President López Portillo to rebuilding the relationship with the private sector, describing it as "a

⁵⁷¹ Interview Ibarra, September 25th, 1999.

⁵⁷² Paul Luke, "Debt and Oil-led Development: The Economy Under López Portillo," (177-82) in Philip, The Mexican Economy.

fundamental state policy”.⁵⁷³ This President tried to win the people’s support with more privileges and subsidies, both in the form of open and covert transfers from the public sector, rather than confronting the private sector. During this administration all sorts of subsidies increased, like artificially low public sector tariffs and tax exemptions.⁵⁷⁴ Luke has cleverly described this period as “oil fired populism.”⁵⁷⁵

López Portillo populism included extensive subsidies to all sectors of the society, not just businesses, ranging from inexpensive public goods and services to cheap dollars. This administration has been described as one “obsessed with pleasing all groups” and oil revenues provided the necessary means to do so, at least for a short time. Unfavourable external conditions added to the destabilising internal factors affecting the economy, culminating in the financial crash of the economy in 1982. One year before the sexenio ended the price of oil began to decline rapidly, while world interest rates increased. The government resorted to foreign borrowing to finance the growing deficits, but such funds rapidly dried up, leaving the country’s public finance in chaos.

⁵⁷³ Interview Roberto Casillas, President López Portillo’s private secretary, Mexico, April 28th 2000.

⁵⁷⁴ A policy of price contention was established with controls of nominal wages and the price of public services. The contention of the price of public services resulted in huge subsidies to state owned enterprises. A large social programme by the name of the Mexican Food System (Sistema Alimentario Mexicano) was implemented. It was aimed to reduce poverty and improve nutrition of lower income group as well as raising incomes of the rural poor through guaranteed prices for basic grains. Badrezch and Levy , 249.

⁵⁷⁵ Luke, 59.

5.3.1.- Economic and Political Conditions: Handling the Oil Boom

a) In search of financial independence

At the centre of the discussion is the search for the financial autonomy of the Mexican State. Gil Díaz argues that the favourable revenue environment made it politically difficult to sell an increase in the tax load or a "structural" tax reform.⁵⁷⁶ However, it can be argued that oil revenues gave the government more independence to pursue a reform on its public finances. Most actors interviewed for this thesis agree that vast oil resources postponed the much needed tax reform. Yet the evidence shows that some of the most important reforms in the last three decades took place during this period, including the introduction of VAT and the Fiscal Co-ordination Agreement, as well as important reforms to direct taxation which affected those with higher incomes. This apparent contradiction reinforces one of the main arguments in the thesis, that the Mexican state has been largely constrained to impose tax reforms because it is largely dependent on capital not generated by the state.⁵⁷⁷

López Portillo shared Echeverría's belief in the strategic role of the public sector in the economy, and the state as the guiding force in the economy (Rectoría del Estado). Since the post-revolutionary period the state had been searching for greater financial autonomy and oil revenues seem to provide such desired self-sufficiency. According to Bazdresch and Levy, López Portillo wanted a large public sector and an economy immune to the will of the private sector. This meant a government capable of producing its own inputs or at least

⁵⁷⁶ Gil Díaz, "Tax Reform". 261.

⁵⁷⁷ President Zedillo in his PhD thesis has argued that the Mexican State was financially constrained by lack of savings, tax revenues and oil income. Maxfield has shed some light on the large dependency of the state on the savings of the capital holders in Mexico, see Maxfield.

capable of generating the foreign exchange required to buy these inputs, without running the risk of being blackmailed by the private sector with capital flight.⁵⁷⁸ All presidents have been constrained in economic policy making, particularly in taxation by the menace of the transfer of large private resources abroad. Not even López Portillo who enjoyed vast oil revenues, was immune to the devastating effects of capital flight.

During López Portillo's period oil resources offered the necessary resources to carry out an extensive government programme which included the development of industry, infrastructure, the tourist sector and simultaneously could eliminate poverty and malnutrition while achieving self sufficiency in energy and basic grains.⁵⁷⁹ To Anglade and Fortin oil revenues dramatically eased external constraints and allowed the resumption of growth at an average rate of 8.4% between 1978 and 1981.⁵⁸⁰ For Cothran, thanks to the oil wealth, Mexico appeared less bound by the financial constraints than previous governments.⁵⁸¹ Confirming this argument, David Ibarra, López Portillo's Secretary of Finance, stated that "oil revenues gave the State the confidence necessary to pursue the tax reforms."⁵⁸²

b) From Economic Boom to Boost

López Portillo's sexenio shows three distinctive periods: In 1977 the government attempted to restore economic stability through fiscal discipline after the economic crisis inherited from the Echeverría administration. Then, in

⁵⁷⁸ Bazdresch and Levy, 248

⁵⁷⁹ Bazdresch and Levy, 246.

⁵⁸⁰ Anglade and Fortin, 270.

⁵⁸¹ Cothran, 119.

⁵⁸² Interview David Ibarra September 25th, 1999.

1979, the oil bonanza translated in a renewed spree of government spending and foreign indebtedness. The oil boom provided an enormous inflow of foreign exchange to finance the expensive public expenditure programmes. Lastly, when the oil boom waned in 1981, macro-economic disequilibrium reappeared, ending in an acute financial crisis. Like his predecessor, López Portillo concluded his term amidst a financial crisis and by signing a stabilisation program with the IMF. This time, however, the Mexican economic crisis had international repercussions, leading to a painful decade of economic stagnation in Latin America.

c) The Oil Bonanza and Growing Government Spending

In the first two years of his administration, President López Portillo tried to maintain fiscal prudence in government finance. But the discovery of large oil reserves, returned the government to the expansionary policies of the past and the postponement of much needed structural reforms, including taxation.⁵⁸³ During 1978 and 1979, the price of oil skyrocketed multiplying government revenues. The new oil revenues triggered government spending, which increased from 13.7% in 1978 to 14.1% in 1979 in real terms.⁵⁸⁴ Oil revenues also had a positive effect on taxation.⁵⁸⁵ The private sector responded positively to large economic growth and the change in the official rhetoric, and private investment rose from 5.1% of GDP during 1978 and by 22% in 1979. The risk of devaluation was perceived as minimal given the expected volume of

⁵⁸³ To Solis the abundant supply of new resources turned the government's attention away from structural reforms. Solis, *Economic Policy Reform in Mexico*, 59-72.

⁵⁸⁴ Bazdresh and Levy, 248

⁵⁸⁵ According to Baillet tax revenues as percentage of GDP rose with the oil boom from 11.3% in 1976 to 15.1% in 1982. After the effects of the oil bonanza, the ratio drastically fell to 11.4% in 1983 and 10.3% in 1984. See Alvaro Baillet, *The Mexican Fiscal System* (México: El Colegio de México, 1986): 7.

foreign exchange earnings coming from oil.⁵⁸⁶ According to Gil Díaz and contrary to some widespread notions, the economy on the whole had been adequately managed up to the end of 1980. The increase in public expenditures had been matched by even faster increases in revenues, thus permitting regardless of ever-increasing foreign debt financing of the fiscal gaps an improvement in the external and internal public debt ratios to GDP.⁵⁸⁷ As a result the Mexican economy was strong and growing, and foreign bankers were eager to lend money to the Mexican government. Few years later, it became clear that oil revenues were not sufficient to pay for the ambitious government agenda, and the government recurred to external borrowing once again.

Although government revenues largely increased thanks to oil income, expenditures increased further during the second period, as the state undertook large projects in infrastructure, health and nutrition, as well as productive public enterprises. Large amounts were channelled to the development of state owned enterprises, with heavy investment to the petrochemical and energy sectors, and large subsidies on energy prices.⁵⁸⁸ The large range of sectors where the government intervened and the vast resources coming from oil generated large inefficiencies in state owned enterprises. A statement by former Secretary of Finance Jesús Silva Herzog clearly illustrates the scope of the inefficiencies when he said “we were so inefficient in managing state owned companies, that the Mexican government

⁵⁸⁶ Bazdresh and Levy, 249.

⁵⁸⁷ Gil Díaz, 261.

⁵⁸⁸ In the interview Ibarra complained that a large portion of oil revenues went to subsidise energy prices and invest in the development of PEMEX.

was the only proprietor in the world that ran a cabaret club in red numbers.⁵⁸⁹

In addition to inefficiency, the lack of control in the allocation of resources stimulated the spread of corruption. Oil revenues helped to expand the scope and depth of public works, but the abundance of resources triggered rampant corruption and mismanagement. Corruption flourished as a result of massive spending without control, accountability or professional bureaucracy.⁵⁹⁰

d) Losing the Handles of the Economy

Large government projects, subsidies to the population and state owned companies generated huge deficits in the current and fiscal account. The current account deficit increased from \$2.7billion in 1978 to \$16 bn in 1981. In spite of the ample revenues from oil, the deficit in the current account was met with foreign borrowing. Foreign debt increased dramatically from \$ 36.4bn in 1978 to \$74.4billion in 1981, most of which was contracted with private banks at short maturities and variable interest rates. In 1982 the total external debt represented, 51.7% of the country's GDP.⁵⁹¹ The ratio of public external debt as a percentage of total external debt jumped from 73.1% in 1975 to 83.2% in 1982. According to Ibarra, the vast oil revenues led the economic cabinet to believe that the government could undertake large development projects financed with relatively inexpensive international loans.⁵⁹²

⁵⁸⁹ Conversation in Georgetown University in November 12th, 1994.

⁵⁹⁰ The magnitude of corruption during López Portillo administration shocked the nation, see Juan Miguel de More, Esto nos Dió López Portillo (México: Anaya Editores, 1982) and Julio Scherer García, Los Presidentes (Mexico: Editorial Grijalbo, 1986). Corruption spread to such extent that in his presidential campaign Miguel de la Madrid tried to disassociate himself from it by calling for a national crusade against corruption.

⁵⁹¹ The Mexican Economy, 1985 (México: Banco de Mexico, 1985).

⁵⁹² Interview David Ibarra September 25th, 1999.

In 1981, the price of oil plummeted and subsequently so did government revenues. As a result the government had to turn to foreign borrowing to finance spending. The external debt increased from USD\$49bn to almost \$75bn in 1981 alone. After the oil boom was over, foreign commercial banks continued to lend money to Mexico, probably because they felt that the fall in oil prices was just a temporary phenomenon, and there was hope that the American government would come to the rescue if needed.⁵⁹³ In 1982 Mexico owed \$16.5 billion to the 13 major US banks. This amount accounted for almost half of the US's largest banks' capital.⁵⁹⁴ There was fear that if Mexico defaulted other major debtor nations in Latin America could follow, unleashing an international economic crisis that, according to Green, could be at the scale of the 1930s crash.⁵⁹⁵ By the end of López Portillo administration foreign debt totalled \$92.4 bn.⁵⁹⁶

The government's first response was to implement a small devaluation and a contractionary package, which included cuts in public investment and in food subsidies, as well as increases in public energy prices, but this failed to stop the stampede of resources. In a second attempt the prices of public services were raised, all imports were subject to control and the rate of growth of public expenditure was reduced from 25% in 1981 to just 3.7% in 1982. But the government lost control, inflation reached almost 100% and the public sector

⁵⁹³ Bazdresch and Levy, 251.

⁵⁹⁴ For more information on the issue check Adhip Cahuhuri, The Mexican Debt Crisis, 1982. (Washington, DC: Institute for International Studies of Diplomacy, Georgetown University School of Foreign Service, case 204).

⁵⁹⁵ Green, Silent Revolution, 60.

⁵⁹⁶ Badrezch and Levy, 252.

deficit nearly 18% of GDP.⁵⁹⁷ Suddenly the flow of external borrowing halted, while the defence of the peso drained foreign reserves further. By August 1982, the government announced a moratorium in payments and a large devaluation (the peso devalued 470% from December to December) that year.⁵⁹⁸

The private sector responded to economic uncertainty and the lack of economic adjustments to government's fiscal disparities with massive capital flight. To Anglade and Fortin the escalation of capital flight generated confrontation between the financial sector and López Portillo's administration. The president blamed the crisis on financial speculators.⁵⁹⁹ This developed in an intensely acrimonious relationship that culminated in the nationalisation of the banking sector.⁶⁰⁰ Badrezch and Levy argue that President López Portillo nationalised the banking industry and introduced exchange controls, probably as means to punish the private sector for taking their capital abroad or to reassert the primacy of the government in the economy.⁶⁰¹

**Table 5.3.- Capital Flight
(billions of dollars)**

1978	1979	1980	1981	1982
1.88	2.67	7.36	8.22	4.07

Source: Dornbusch in Williamson.

⁵⁹⁷ Badrezch and Levy, 252.

⁵⁹⁸ Anglade and Fortin, 270.

⁵⁹⁹ Anglade and Fortin, 271.

⁶⁰⁰ See Elizondo, interview February 19th, 2000.

⁶⁰¹ Badrezch and Levy.

5.3.2.- Policy Actors and their Influence: In search of reconciliation

According to Bazdresch and Levy, during the López Portillo sexenio economic policy was characterised by an attempt to “please all.” The populist economic policies tried to please urban workers by providing more jobs, middle classes with price subsidies and an overvalued exchange rate, the bureaucracy with greater influence due to larger involvement of the government in the economy, the private sector with an overvalued exchange rate and sizeable profits in the domestic market, and rural Mexico to an increase in employment, infrastructure investment, and the subsidies of the Mexican Food System (SAM).⁶⁰² The primary task was to restore the legitimacy of the regime that had been tarnished by Echeverría, and in particular restore business confidence in the regime.⁶⁰³

Luke asserts that the strategy adopted by López Portillo was to use “political reform” to acquire legitimacy with the left and liberals and “corporatism” to marshal the support of the private sector.⁶⁰⁴ With the use of abundant resources, the government sought to buy the support of corporatist groups. Economic subsidies were distributed indiscriminately, and political subsidies in the form of electoral posts were also assigned discreetly amongst PRI’s corporate organisations.

The multiple exemptions and privileges in VAT and other tax instruments shows that corporate actors remained very influential in economic policy. The business sector maintained its predominant influence over economic policy, but

⁶⁰² Badrezch and Levy.

⁶⁰³ Cothran, 116.

⁶⁰⁴ Luke, 50.

the nationalisation of the banking industry represented a strong blow to their traditional dominant position. International actors exercised just a marginal influence on policy making, even the IFIs. The US did not become involved in Mexico's financial difficulties until 1982, when they realised that Mexico's defaulting on its payment could have a large impact on large American Banks.

a) Labour: accommodating Union's interests

In addition to the subsidies established by his predecessor, López Portillo increased the "political subsidies" to labour, trying to consolidate their support. Labour leaders were uneasy with the high rates of inflation experienced during 1976 and demanded more political positions for their representatives in exchange for the economic sacrifices made by workers.⁶⁰⁵ In 1976 the number of seats "assigned" to labour representatives at the chamber of deputies augmented, as recognition of their influence and support for the government's economic policies.⁶⁰⁶ Labour's quota expanded further between 1979-1982, to reach almost a third of total PRI's deputies.⁶⁰⁷ In addition, López Portillo strengthened his personal ties with long lasting labour leader Fidel Velázquez, and other union leaders from state owned companies.⁶⁰⁸ Gil Díaz recalls the power of union leaders in the input to the design of tax policies, remembering that a famous union leader bluffed that "the exemptions in VAT had cost blood," referring to the pressure put into government to include these amendments that

⁶⁰⁵ Interview with Angel Aceves, three times President of the Treasury Committee at the Lower Chamber and economic advisor to labour's leader Fidel Velázquez, London, October 14th, 1999. See also Middlebrook, *The paradox*.

⁶⁰⁶ *Ibid.*

⁶⁰⁷ Forty four deputies belonged to the CTM.

⁶⁰⁸ Interview Angel Aceves, London, October 14th, 1999.

would benefit workers the most.⁶⁰⁹ Mr. Ibarra states that as Secretary of Finance he had the presidential mandate to “take care of the interests of workers in the design of the VAT reforms.”⁶¹⁰ Thus, extensive negotiations took place to accommodate the interest of labour.

b) Peasants: fighting for survival

Large subsidies went to the rural sector during this period. In 1980, the government introduced the SAM, the objective of which was to make the country self-sufficient in seven basic crops by 1985.⁶¹¹ The scheme aimed to help improve farm incomes and increase the demand for domestic products. Large investment went to modernise the state owned company producing fertilisers (FERTIMEX). The funding of agricultural production increased during López Portillo’s term to an annual average of 4.5% compared to Echeverría’s 2.6%.⁶¹² In political terms, quotas to agricultural representatives via the National Confederation of Peasants (CNC) increased from 20% of Congress seats in 1950 to almost 30% during the 1976-1979.⁶¹³

c) Business: rebuilding a deteriorated relationship

One of the top political objectives was to re-establish the strained relationship with the private sector. According to Roberto Casillas, President López Portillo’s private secretary, the first government priority was to rebuild business confidence in the regime, stating that “the President and his cabinet went out

⁶⁰⁹ Interview Francisco Gil Díaz, former Under-Secretary of Finance, during Salinas term, Mexico, September 21st 1999.

⁶¹⁰ Interview Ibarra September 25th, 1999.

⁶¹¹ Luke, 62.

⁶¹² Badrezch and Levy, 248.

⁶¹³ Rendón, 259.

to re-establish the channels of communication and rebuild the deteriorated relationships with diverse interest groups, in particular the private sector.”⁶¹⁴

Another clue that it was fundamental to re-erect the relationship with the private sector, is the fact that acting President Echeverría decided on López Portillo as his successor as a way to build bridges of understanding and cooperation with financiers, since as Secretary of Finance López Portillo enjoyed a good relationship with the private sector.⁶¹⁵

President López Portillo’s rhetoric towards the private sector changed drastically, compared with that of the previous administration. In the first couple years of his presidency, López Portillo embarked on making conciliatory gestures to the private sector. Among these new attitudes was active consultation of economic matters with business and professional organisation, particularly issues related to tax policy making.

In order to win back the support of the private sector, López Portillo’s government introduced a number of general and particularised subsidies. The reasoning behind the subsidies was to create instruments that would encourage business to invest in selective sectors considered key areas for the development of the country.⁶¹⁶ Towards this aim, many subsidies in the form of tax exemptions or privileges were instituted under government programmes. One of the most important efforts was the “Alliance for Production,” an agreement where the private and public sector jointly committed to increase investment and productivity. In exchange the president offered tax relief on

⁶¹⁴ Interview Roberto Casillas, Mexico April 28th, 2000.

⁶¹⁵ Interview Casillas, Mexico April 28th, 2000 and JorgeCastañeda, Spain, March 11th, 1998.

⁶¹⁶ Retckiman, 35.

invested profits. The Alliance for Production was an important attempt to improve the relationship with the government, giving a prominent role to business in the development strategy, though detractors understood the scheme as an excuse to hand over privileges unilaterally.⁶¹⁷

There were many other schemes aimed to seduce the private sector using fresh resources and tax incentives. In 1978, a large programme to support small and medium size companies was launched, offering assistance for pre-investment studies, credit lines and different investment incentives, including those of a fiscal nature.

Other programmes supporting industry reduced duties on imported inputs and offered various tax incentives, including accelerating depreciation. Moreover, the Industrial Development Plan established a system of “fiscal promotion certificates” applicable against any federal tax, issued in support of new investments, new sources of employment and the purchase of domestic machinery and equipment.⁶¹⁸ But despite the numerous subsidies and incentives, by the end of the sexenio the relationship between the government and the private sector had deteriorated due to capital expatriation. In return, López Portillo retaliated with the nationalisation of the banking sector.⁶¹⁹

⁶¹⁷ Luke, 51.

⁶¹⁸ Luke, 54.

⁶¹⁹ Many scholars see the nationalisation of the banking sector as an expression of the power of the state over capital. See Anglade and Fortin, 271. I see it more like a personal vendetta than a properly thought state policy. According to an interview with Ibarra it was made secretly and unexpectedly, since he found out very shortly before the announcement. In my opinion it was driven by the President's frustration and anger against those whom he thought responsible for the collapse of the economy in 1982, the so called “sacadólares” or those super-rich who had moved their capital assets abroad.

The Secretary of Finance of the time, David Ibarra, complained about “businesses blackmailing the government over whether to invest and keeping their capital assets in Mexico.”⁶²⁰ He was particularly bitter about the way the bankers had triggered capital flight with “false accusations over the handling of the economy.” To the Secretary of Finance during López Portillo presidency, “the massive stampede of capital abroad orchestrated by the banking community caused the breaking-off between the state and the business community.”⁶²¹

d) Foreign actors: just a marginal role

International actors played a limited role during the López Portillo administration. Former Finance Secretary, Ibarra, recalls that “their (IMF and World Bank) input in tax policy was largely technical and only marginal.”⁶²² The fact that the economic collapse took place at the end of the presidential term, put all the burden of adjusting and implementing stabilisation programmes on the next administration. However, this time important stabilisation measures were required.⁶²³ According to Tello and Cordera, the US had become more tolerant to Mexico’s policies because it was one of its largest oil providers.⁶²⁴ The US government did not become involved in the country’s economic policies until the liquidity of the major US banks was put in jeopardy with the possibility of Mexico declaring a debt moratorium.⁶²⁵

⁶²⁰ Interview David Ibarra September 25th, 1999.

⁶²¹ Ibid.

⁶²² Ibid.

⁶²³ See the vast literature before quoted on the 1982 debt crisis and the conditionality clauses. For an overall review see Lustig in the Remaking of the Economy.

⁶²⁴ See Cordera and Tello.

⁶²⁵ See Maxfield.

It is important to highlight that state governors emerged as influential actors as a result of extensive tax negotiations. The Secretariat of Finance spent a long time persuading state governors of the benefits of the introduction of VAT and the new fiscal co-ordination agreement. David Ibarra, describes the negotiations as “very difficult” and remembers “the huge task involved in lobbying state governors for their support.”⁶²⁶ He stresses the difficulties faced in removing well-established clientelism, since mutual benefits between companies and state or municipal authorities had developed at the cost of collection.

5.3.3.- López Portillo’s Tax Reforms : A Consensual Approach

President López Portillo took a different approach to fiscal reform: by favouring consensus over confrontation, and instead of clashing with the private sector over who will carry the burden of the taxes, his administration improved indirect taxation spreading the cost over consumers. There are three very significant reforms implemented during the López Portillo term, amendments to income taxes, the improvement of indirect taxation through the introduction of the VAT and a new fiscal co-ordination agreement that brought uniformity and improved the revenue sharing system.

The reforms were carried out in various stages from 1978 to 1982. Some important changes to the income tax of individuals and corporations were introduced in the 1977 income tax law, such as the differentiation between cumulative and non-cumulative incomes. The objective was to make taxation

⁶²⁶ Interview Ibarra September 25th, 1999.

more progressive, by adding all the sources of income of an individual into only one taxable base.⁶²⁷ The law also established a distinction between enterprises as major and minor taxpayers according to their yearly gross income. For minor taxpayers the law stipulated a flat rate of 5% on gross income and for major taxpayers the average corporation income tax rate was 40%.

There was a gradual change in the income tax. The three objectives of income tax reform were to increase its scope, reduce its distortive effects on resource allocation and adjust it to inflation. With regards to base broadening, dividends were made cumulative to personal income with the introduction of an integration scheme that allowed full credit for the corporate income tax. Some important reductions to tax privileges were implemented. Capital gains were included in the individual income tax base, with the exception of gains on stock-listed shares. The reforms were able to bring under the normal tax rules the construction industry, previously among the "areas of special treatment" such as agriculture, newspapers and trucking. This was an important accomplishment because it ended the possibility of over-invoicing through construction industry receipts.

In the individual income tax, the elimination of itemised personal deductions in favour of a single personal deduction equal to an annual minimum wage also introduced the indexation of deductions. More importantly, the income tax schedule was adjusted every year to account for inflation. According to Gil Díaz although the inflation adjustments were incomplete, especially in the corporate

⁶²⁷ Baillet, 5.

income tax, they prepared the way for full indexation in 1987.⁶²⁸ However, the reforms to accumulate income were ineffective, since multiple loopholes in the legislation and lax surveillance allowed large income earners to evade the higher marginal rates.⁶²⁹ López Portillo was firmly committed to implementing an inheritance tax since he was Secretary of Finance during Echeverría's presidential term. However, he failed to do so even as President due to the stern opposition of the economic elite.⁶³⁰

a) The Introduction of VAT

The most important reform was the introduction of the Value Added Tax (VAT) in substitution for the purchase tax and multiple other levies.⁶³¹ It was a remarkable achievement since it involved the elimination of the 4% TST, a 30% luxury rate and 25 federal and 300 state excises.⁶³² To achieve this task important administrative changes were made in order to simplify and facilitate the incorporation of local taxes into the VAT system. But most significant were the extensive negotiations needed to pass the law enacting VAT.

At the beginning, the private sector and professional groups were opposed to the VAT, because they felt it would trigger inflation.⁶³³ Nevertheless the administration was convinced that the effect of VAT would be at most a slight

⁶²⁸ Gil Díaz, 265-266.

⁶²⁹ See Información sobre los Ingresos Gubernamentales.

⁶³⁰ His son José Ramón López Portillo, then Under-Secretary of State during his father's sexenio, described the conversations with his father on this matter and how committed he was to the idea, which never became reality due to the powerful opposition of the "very rich" in México. Interview José Ramón López Portillo, London February 17th, 1998.

⁶³¹ For a statistic overview of VAT see Mario Calderón Daniel, "Evolución del IVA," Secretaría de Hacienda y Crédito Público, November, 1998. Mimeo.

⁶³² According to David Ibarra, the reforms eliminated 600 local taxes and 36 federal ones, Interview September 25th, 1999.

⁶³³ This was the same argument presented by the private sector during Echeverría's term.

once-and-for-all increase in the price level.⁶³⁴ A feature that increased public resistance was the visibility of the levy. Unlike other countries, the Mexican law requires the tax to be shown separately from the price on sales slips.

Gil Díaz argues that the VAT proposal almost fell through due to the opposition both from within and outside government.⁶³⁵ To persuade different socio-economic actors and non-supporters within the government, the Secretary of Finance presented position papers, international evidence, and comparisons on the benefits of the proposal. In a departure from the previous administration, extensive consultation took place, taking into account the various points of view to make the necessary amendments.⁶³⁶ Diverse groups were interested in how the new tax would affect them, and separate negotiations were conducted before the law was enacted and in the year before it went into effect.⁶³⁷

Extensive negotiations were needed to build consensus. Secretary of Finance, David Ibarra, recalls that “the benefits of the new indirect taxes were clear both in terms of revenue and as an evasion control mechanism. But it was a difficult endeavour to convince sceptics both outside and inside the government.”⁶³⁸ Among those sceptics was President López Portillo himself.⁶³⁹ Gil Díaz

⁶³⁴ Stated by Gil Díaz and confirmed during the interview with Ibarra.

⁶³⁵ Interview Gil Díaz, Mexico, September 21st, 2000 and Gutiérrez Prieto June 5th, 1999 over opposition to the VAT.

⁶³⁶ According to David Ibarra, the Secretary of Finance used tax experts to convince the private sector and political intermediaries, and frequently deputies to convince labour organisations. Interview September 25th, 1999.

⁶³⁷ Gil Daiz, 264. Former Secretary Ibarra explained how the new tax system altered the burden of taxation causing new winners and losers. In particular he recalls the stern opposition posed by the radio and television companies, which without a productive chain were not able to deduct the VAT tax. Interview Gil Diaz, September 21st, 1999.

⁶³⁸ Interview Ibarra September 25th, 1999.

⁶³⁹ In an TV interview President López Portillo stated that he regrets to this day introducing the VAT mechanism.

highlights that in the end it was all due to the Secretary of Finance's ability to persuade the president and the different socio-economic groups that the inconveniences were outweighed by the advantages that the VAT scheme was carried.⁶⁴⁰

The rapid evolution of VAT exemptions shows how the government had to accommodate its tax policies to the pressures of interest groups. Current Secretary of Finance Gurría, recalled in a recent speech that from the day the VAT was born multiple exemptions began to appear.⁶⁴¹ Union stores came first; not much later a cascade of products were exempted from value added tax, demonstrating the influence of corporatist sectors.

Two distinctive stages of the VAT rate structure during López Portillo term illustrate the influence of the corporate actors:⁶⁴² In 1980, a 10% general rate was introduced with a special rate of 6% for the northern border. This special rate was an effort to standardise the level of sales taxation at that of neighbouring U.S cities.⁶⁴³ A zero rate was given to some agricultural goods and some basic foodstuffs, demonstrating the influence of labour leaders and unions. In addition to the products given zero rating, exemptions were given to sales through union stores. In the interview David Ibarra, bitterly complained

⁶⁴⁰ Gil Díaz.

⁶⁴¹ In a speech to the CCE, Secretary Gurría recalled the night when VAT was introduced at the Chamber of Deputies, particularly how representatives from labour and other organisation began to demand exemptions for foodstuffs. See José Angel Gurría speech to the Business Coordinating Council, in Mexico city on November 4th 1999.

⁶⁴² Gil Díaz, 265.

⁶⁴³ Gil Díaz states that it is impossible to have a tax for purchases much higher than that of the US, taking into account that more than 200 million people cross the border every year. Interview, Mexico, September 21st, 1999. See "Evolución del IVA."

about weakening the original VAT scheme with such exemptions, stating that it has been “contaminated by politics.”⁶⁴⁴

A year later, the VAT zero rate was extended to include more foodstuffs.⁶⁴⁵ With this action, the government responded to political pressures and to those who argued that VAT had fuelled inflation.⁶⁴⁶ A shift, to expand the items under preferential tax treatment, shows the pressures exercised from business organisations and corporate groups, who attributed the rise in inflation to this new indirect tax.

The two most important issues in the VAT debate involved the general rate and the revenue sharing formula. The Secretary of Finance estimated that the general VAT rate should be at 12.7%, to compensate for the revenue that was going to be lost through the elimination of the plethora of federal and state taxes. Meanwhile the business sector demanded the general rate be set at 10%. In order to eliminate the biggest obstacle for the negotiation, the Secretary of Finance agreed to lower the rate to 10% to avoid the main obstacle to the consensus.⁶⁴⁷ The other central issue in the negotiation with the states was the formula for sharing revenues.

The administrative changes for the implementation of VAT required intense negotiations with state fiscal authorities regarding the new revenue formula.

⁶⁴⁴ Interview David Ibarra September 25th, 1999.

⁶⁴⁵ This largely affected the overall tax collection yield of VAT from 2.8% of GDP in 1981 to 2.2% in 1982. See data Calderón, 103.

⁶⁴⁶ The rise of inflation from 18.2% in 1979 to 26.3% in 1980 was attributed to the introduction of VAT.

⁶⁴⁷ Gil Díaz, 260.

The old formula for revenue sharing was based on a portion of the amount they collected, which was nearly impossible to calculate under the VAT.⁶⁴⁸ A new formula based on rewarding with a large coefficient to those states that produced a greater percentage increase with respect to the average percentage, did not work. To keep all the states content, tax authorities proposed raising the overall percentage while maintaining the system's constant coefficient, which unfortunately led to a complacent administrative attitude in most states and an increasing haemorrhage of federal funds.⁶⁴⁹

b) Fiscal Co-ordination Agreement

In 1980, the government introduced a programme of Fiscal Co-ordination aimed to eliminate overlapping tax competencies among tiers of government, give uniformity to the tax system, avoid competition for investment amongst provincial states and to introduce a mechanism for the distribution of federal resources. The National System of Fiscal Co-ordination (NSFC), was integrated by two agreements: the NSFC and the Administrative Collaboration for Fiscal Federal Issues.⁶⁵⁰ The Secretary of Finance, David Ibarra, recalls the difficulties of building consensus among the governors, since more developed states, and those with oil revenues refused to relinquish part of their resources to those less well off.⁶⁵¹ At the end, the NSFC programme was so contaminated by politics that ended by enhancing the process of centralisation.

⁶⁴⁸ Gil Díaz, 263.

⁶⁴⁹ Ibid.

⁶⁵⁰ For more information on fiscal coordination, see Diagnóstico del Sistema de Contribución y Distribución de Hacienda Pública Estatal y Municipal (Mexico: Instituto Nacional de Administración Pública, 1996), María Emilia Janetti Díaz, "La Coordinación Fiscal y los Ingresos Estatales," Comercio Exterior Vol. 39, no.9, September 1989, 769-774. Managing Across Levels of Government: Mexico (Paris: OECD, 1997).

⁶⁵¹ Interview, David Ibarra, México, September 25th, 1999.

Conclusion

The analysis of Echeverría's period highlights the consequences of divorcing spending from income, it also shows the government's concern over the lack of sufficient tax resources to finance the state. This is an issue widely discussed in the literature. For Cothran, Echeverría's problem was that "he tried to redistribute more (resources) than those that were sustainable by the revenues available."⁶⁵² Enriquez, taking a similar position argues that it was a "government that tried to do too much and too fast without the necessary resources to succeed."⁶⁵³ Fitzgerald also believes that the great mistake of President Echeverría was that public expenditure expanded without having attained reforms on the financing side.⁶⁵⁴ Ultimately, the absence of a tax reform that would boost revenue contributed to the loss of control of the economy in 1976.

The evidence demonstrates that Echeverría's policies responded more to political than to economic concerns. He and his cabinet tried to adjust the system in the direction they thought necessary to maintain political stability.⁶⁵⁵ As cleverly stated by Looney, "Echeverría's economic strategy is best evaluated not as a mere product of arbitrary and irresponsible personal leadership, but as a reasonable rational attempt to reinvigorate the political

⁶⁵² Cothran, 112.

⁶⁵³ Enriquez, 30.

⁶⁵⁴ Fitzgerald, "Stabilisation Policy in Mexico," 25.

⁶⁵⁵ Cothran, 116.

system, accepting a certain loss of short term economic equilibrium as the price.”⁶⁵⁶

In the end, Echeverría's government was ultimately unsuccessful in undertaking a fiscal reform that would provide the necessary funds to redistribute wealth and finance and the enlargement of the state. Two great deterrents were capital flight and the possibility of disrupting the fragile socio-political coalition that supported the regime. It was the resistance of the business class and particularly the threat of capital flight which inhibited the type of tax reform Echeverría dearly wanted.⁶⁵⁷ Purcell and Kaufman speculate that Echeverría did not seek the support of popular sectors or the middle classes to pass the tax reform because it would have politicised the issue to such an extent that it would have provoked a greater flow out of capital from the economy.⁶⁵⁸

The government's tax policy reversal shows a weak state, highly responsive to the pressures of the corporate groups. In the view of the participating actors, the government could not introduce the desired tax reforms without causing major economic and political disruptions. This shows a state largely constrained by the influence of socio-economic actors, particularly the business community and their ability to move their capital abroad, which largely constrained the leeway of economic policy-makers. He confirmed that “the state was constrained in economic policy, any reform required negotiations and compensate those affected”. Soon, the economic elite discovered that the

⁶⁵⁶ Looney.

⁶⁵⁷ Fitzgerald, 263-282.

⁶⁵⁸ Purcell and Kaufman, 245

menace of capital flight could act as a powerful deterrent in opposing government economic policies and began to make full use of it. This was particularly worrisome for a country with such “borrowing requirements” as Mexico.

Echeverría's tax reform, land distribution and social welfare policies threatened the economic interests of business and the wealthy. However, it is notable that the social bias of the reforms were targeted to extract resources mainly from big business and the better off the accumulation of income in one taxable base, the tax on property and the end to wealth anonymity). No reform efforts were made to eliminate tax privileges benefiting corporate actors.

In conclusion, those aborted tax reforms during President Echeverría's administration generated a negative precedent over the capacity of the state to extract resources from the private domain. Surprisingly, despite vehemently defending the tax reform, Echeverría made a policy reversal aborting the intended tax policy changes. This was considered by the business elite as a victory against “intrusive government policies,” boosting their confidence to oppose further tax attempts that could affect them.⁶⁵⁹ This precedent, plus recurrent fiscal imbalance and the state's growing need of funds gave the holders of capital a powerful leverage to influence economic policy making from then on. Ironically, the tax proposals sought financial self-sufficiency but increased its dependence on domestic and international capital.

⁶⁵⁹ Interview Gutiérrez Prieto, August 22nd, 2000.

In contrast, President López Portillo and his team took a different approach in how to operate the proposed tax reforms. Extensive consultations and lobbying was undertaken to avoid possible confrontation with powerful interest groups. Negotiations and premiums (subsidies and tax holidays), given to economic sectors allowed the government to implement important reforms. The introduction on VAT exemptions shows how interest groups were able to secure additional tax privileges. Nevertheless, sensitive tax policies which affected the interest of powerful political groups, such as the construction sector (which had enjoyed a privileged tax treatment for a long time), were implemented as well.

Elizondo stresses that the relatively low opposition to tax change during López Portillo's term is largely attributable to the gradual implementation of the reforms, the lack of anti-business rhetoric by the government, plus the existence of loopholes to avoid payments of taxes and the oil boom.⁶⁶⁰

However, another relevant reasoning behind the success of López Portillo's reforms is that they did not affect to a large extent the interests of the economic elite. The burden of the tax reform was passed on to consumers, setting a trend that would be followed by the next Presidents. As oil prices waned the Mexican State lost power and the momentum to push for further tax reforms, suggesting the plausibility of constrained autonomy of the state.

Baillets suggests that the designers of any tax reform must take into consideration the type of tax payers their proposals are designed to affect, as

⁶⁶⁰ Elizondo, "In Search," 175.

well as discriminate in order to maximise efficiency.⁶⁶¹ Following this reasoning, López Portillo's administration took a different approach to reform, aware of the conflicts with the private sector brought about by the attempted tax reforms during Echeverría's period. This time the fiscal reform emphasised indirect taxation, affecting consumers and not taxpayers with large incomes and holders of wealth.

Oil revenues provided the trust behind the tax reforms, as the state found itself with almost no financial constraints. For a few years López Portillo was able to reach the highest level of autonomy enjoyed by any of his predecessors. Unfortunately this comfortable situation did not last. Badrezch and Levy argue that López Portillo's populism failed to reach its political objectives, as the huge debt built up, the bank nationalisation and the exchange controls did not strengthen but instead further weakened the government.⁶⁶²

As a general conclusion, the evidence provided in this chapter reinforces the main hypotheses of this thesis, that politics dominated the tax policy-making process. Both populist policies ended in the need for macroeconomic stabilisation after recurrent liquidity crisis. In each term policies seem to have been introduced as a response to inadequacies or errors in previous approaches.⁶⁶³ The tax exemptions introduced into VAT legislation demonstrate the power of corporate actors to shape policy. In both administrations the volatility of domestic capital was a major source of concern. Business confidence developed after what they considered a successful

⁶⁶¹ Baillet, 77.

⁶⁶² Badrezch and Levy, 265.

⁶⁶³ Philip ed., The Mexican Economy, 4.

attempt to reverse tax policy. As the financial position of the state deteriorated the economic elite confirmed that capital flight represented an important deterrent to adverse economic policies.

The conflict generated by Echeverría's tax reform proposals confirms the sensitivity of the issue of taxation in the relationship between the state and the business elite. It supports the idea that a tacit agreement between the state and private sector over the load of taxation existed. The failure of the state to implement the tax reform reinforces the argument of a rather weak state, contradicting the popular depiction of the Mexican State as a strong and authoritarian regime.⁶⁶⁴

The evidence suggests that the policies of Both presidents represent clear attempts to obtain greater financial independence for the State. However, as has been stated by Professor Philip, "foreign borrowing during Echeverría and a combination of borrowing and oil revenues under López Portillo, led policy-makers into the dangerous illusion that Mexico had become a constraint-free economy; the result of this illusion was economic crisis in 1976 and far more severely in 1982."⁶⁶⁵

⁶⁶⁴ In analysing the Echeverría period Cothran questions the authoritarian depiction of the Mexican political system. He highlights the weak position shown by the state to impose the necessary tax reform. Cothran, 112.

⁶⁶⁵ Philip, The Mexican Economy, 3.

Chapter VI

Economic Openness

"Taxation was a tool, just a part of our greater strategy of modernisation of the economy. Our true objective was opening the Mexican economy to the world."⁶⁶⁶

Pedro Aspe, Salinas' Finance Secretary

6.1 .- Characteristics of this Period

a) *Economic Transformation Triggered by the Debt Crisis*

The presidencies of Miguel de la Madrid (1982-88) and that of Carlos Salinas (1988-94) undertook an unprecedented programme of economic transformation. The implementation of these policies shifted Mexico's economic strategy from inward looking to export oriented. This process of transformation was triggered by the Mexican debt crisis.⁶⁶⁷ In 1982, the supply of foreign resources to Mexico stopped as creditors realised the magnitude of Mexico's debt and the unstable economic situation. Mexico's debt stood at approximately \$80 billion (51.7% of GDP).⁶⁶⁸ If Mexico defaulted then other major debtor nations in Latin America could follow, unleashing an international economic crisis, that according to Green, could be of the scale of the 1930s crash.⁶⁶⁹

⁶⁶⁶ Interview Pedro Aspe, September 20th, 1999.

⁶⁶⁷ To learn about the third world debt, see Thomas D. Lairson and David Skidmore, International Political Economy: The Struggle for Power and Wealth (Florida: Harcourt Brace College Pub, 1993): 275-313.

⁶⁶⁸ A large part of the debt was contracted with commercial banks from OECD countries, US financial institutions being the largest creditors. Mexico owed \$16.5 billion to the 13 major US banks. This amount accounted for almost half of the bank's capital. To learn about Mexico's 1982 debt crisis see Rosario Green, Lecciones de la Deuda Externa de México, de 1973 a 1997 (Mexico: Fundación Colosio y Fondo de Cultura Económica, 1998) or Cahuhuri, The Mexican Debt Crisis, 1982.

⁶⁶⁹ Green, Silent Revolution, 60.

The debt crisis spread to other Latin American countries, which like Mexico were unable to service their international debt. As a result IFIs decided to tackle the mounting problem with macroeconomic adjustment programmes, debt rescheduling agreements and structural reforms. Creditors decided that these types of programmes were the only viable strategy to solve debtor countries' economic crises.⁶⁷⁰

As a condition for new financing, IFIs demanded a set of structural adjustment policies. Multilateral organisations promised medium term credit facilities for assisting debtor countries to gain economic self-sufficiency if debtor governments implemented a recipe of structural economic reforms⁶⁷¹ and stabilisation programmes.⁶⁷² The set of policies required by IFIs and the US Treasury in order for debtors countries to renegotiate their international debt, is known as the "Washington Consensus."⁶⁷³ The ten policy instruments are: fiscal balance, reducing public expenditure, tax reform, interest rates, exchange rates, trade liberalisation, foreign investment, privatisation, deregulation and property rights.⁶⁷⁴ However, after years of implementing these policies, they failed to restore growth⁶⁷⁵ while inflicting an enormous social cost.⁶⁷⁶

⁶⁷⁰ See Edwards, The Latin American Debt Crisis.

⁶⁷¹ For information about structural adjustments see: Adjustment Lending Policies for Sustainable Growth; Structural and Sectorial Adjustments: World Bank Experience, 1980-92. Peter Kenne, "The Use of IMGF Credit" and Edwards, Crisis and Reform.

⁶⁷² Stabilisation programmes are designed to reduce demand by cutting government expenditure, controlling money supply and rising interest rates, devaluating to correct currency overvaluation, restricting imports and expanding exports. For information on stabilisation programmes in Mexico see Fitzgerald, "Stabilisation Policy in Mexico," and Lustig, Mexico: The Remaking of the Economy and Jiménez "The Social and Economic Cost of Structural Adjustments." Masters' thesis, Harvard University, 1999.

⁶⁷³ See Williamson, Latin American Structural Adjustments.

⁶⁷⁴ To look at the record of implementation of policy reforms in Latin America, including Mexico see Williamson, Latin American Adjustment; Edwards, Latin America and the Caribbean and Lora, "A Decade of Structural Reforms in Latin America".

⁶⁷⁵ According to the World Bank, the aim of structural adjustments loans (SALS) is to support programmes of policy and institutional change necessary to modify the economy, so debtor

Right at the core of the structural reform programme was the opening of the economy, which constituted a departure from the ISI development strategy followed since the 1930s in the region.⁶⁷⁷ External factors played a major role in the countries' economic transformation, IFIs being the key factor in the shift of the region's economic development strategy towards an outward-market economy.⁶⁷⁸ Another contributing factor was the process of globalisation, which greatly facilitated the worldwide expansion of IFIs recipe for economic adjustment.⁶⁷⁹

As a result of the country's economic opening, Mexico became more vulnerable to external shocks and the influence of international actors. In particular, policy-makers became more responsive to international conditions and foreign influences. A greater autonomy of market forces meant reducing the government's influence in political and economic terms. In general, the

countries implementing such reforms could restore growth as well as maintain the viability of its balance of payments in the medium term. However, they have only been successful in the second objective, since economic growth stalled for more a decade. See Structural and Sectorial Adjustment, 107.

⁶⁷⁶ To learn about the social cost of structural adjustments see Mohsin Khan, "The Macroeconomic Effects of Fund Supported Adjustment Programs," IMF Staff Paper, 37.2 (Washington DC: IMF, 1990); Tony Killick, Moazzam Malik, and Marcus Manuel in "What Can We Know About the Effects of IMF Programme?" World Economy 15 (1992): 212-234; Victor Bulmer Thomas ed., The New Economic Model in Latin America and Its Impact on Income Distribution and Poverty (London: Macmillan, 1996); David Barkin, Distorted Development; D. Woodward, The Impact of Debt Adjustment at the Household Level in Developing Countries (London: Printing Publishers, 1992); Nelson, "The IMF and the Impact of Structural Adjustments on the Poor," in The IMF in a Multipolar World; Green, The Silent Revolution; Watkins, The Oxfam Report; David Ibarra, Transición ó Crisis? Las Contradicciones de la Política Económica y Bienestar Social (México: Nuevo Siglo, 1996).

⁶⁷⁷ The import substitution model was based heavily on public sector spending as the primary engine of growth in a highly protected inward looking industry. CEPAL's model of ISI included state interventionism, inward orientation and disregard for a macro economic balance. X

⁶⁷⁸ The World Bank recognises the increasing insistence of IFIs economists to shift Latin American development strategy towards market based policies. See Edwards, Latin America and the Caribbean, 23

⁶⁷⁹ Harvard Professor Dani Roderick believes that globalisation has helped to spread the neo-liberal model around the world, Spain March 17th, 1997.

profound economic transformation, as well as the sharp decline in economic growth during this period had a large impact on tax collection in Mexico.

A common pattern emerges in the political economy of tax collection. Like their previous nationalistic governments, these outward oriented presidents share the same weakness, and small tax capacity. De La Madrid and Salinas governments continued to avoid a substantial tax reform, relying instead on alternative means of financing the state. Although some important reforms were made during the Salinas' term, they fell short of substantially increasing the rate of tax collection, more as a response to IFIs influence than a maximising revenue policy. The analysis of each administration's tax reforms shows that politics continued to shape taxation policies, reflecting the bargaining power of interest groups.

During this period the sharp re-configuration of influential actors in the process of economic policy making is noteworthy. While the power of the private sector increased significantly, the influence of those traditionally strong corporatist sectors, such as organised peasants and labour, decreased. Due to the large financial obligations, external actors such as global business and IFIs gained substantial leverage. Economic transformation expanded the business elite's policy making influence, strengthening their capability to resist taxation efforts. Trade and financial liberalisation facilitated their capability to transfer capital abroad, increasing their leverage over economic policy-makers. The influence of policy actors changed the tax system and the direction in which public policy actions were taken. In an attempt to avoid confrontation with interest groups, particularly with the business elite, these governments moved to less conflicting

ways of increasing revenues, such as indirect taxes or improving the administrative process of tax collection.

Especially significant is that during the neo-liberal era the underlying problems of the Mexican fiscal system were accentuated. The declining economic conditions further reduced an already low tax revenue capacity. In addition, the country's income distribution gap worsened, increasing the number of people living under poverty and the size of the informal sector. Economic austerity measures had an impact on wages and income, eroding both, the small tax payer base and the yield of collection. At the same time wealth concentrated further in fewer hands, making it more difficult for the state to tax the economic elite.

b) Different Development Strategies, Same Weakness

Despite a radically different approach between the nationalist and neo-liberal development strategy, a similar pattern emerges. Both administrations continued to avoid a substantial tax reform, focusing instead on alternative means of financing the state. During the 1980s, external financing dried up and oil revenues plunged, compelling the government to seek new ways of financing itself.⁶⁸⁰ Neo-liberal governments, like their predecessors, avoided a substantial tax reform, forcing their respective governments to rely on alternative means. Traditional methods included borrowing, printing money, raising the price of goods and services provided by the public sector and recycling direct foreign investment. Novel ways were incorporated such as privatising state owned companies or recycling volatile capital flows, but these

⁶⁸⁰ The Mexican 1980s debt crisis triggered a period of economic reform in the whole Latin American region.

alternative means made government finance more vulnerable to economic changes and external shocks. In the end revenue maximising policies were either a one-time income as privatisation or socially too costly as often increasing the price of goods and services supplied by the public sector.

The primary alternative for balancing the government finance was cutting expenditures rather than raising revenues. This policy approach aimed at balancing the budget has a devastating effect on the economy and the population. Due to the insufficient stream of revenue from taxation, the severity and number of structural adjustments increased. If instead the Mexican government had focused on increasing a stable stream of revenues from taxation, not just reducing expenditures, structural adjustment policies would have been less stringent for the population.

c) The Neo-liberal Strategy Aggravated Structural Weakness of the Tax System: Increased Marginality

Fiscal adjustment fell on expenditure reducing policies rather than a serious attempt to increase revenues. The orthodox programmes for reducing inflation, the current account deficit and the fiscal deficit, were achieved through a squeeze on popular consumption and living standards.⁶⁸¹ Structural reforms brought the stagnation of the economy and the drastic contraction of public investment, greatly reducing the income levels of the population and worsening the income distribution gap. In the end, this economic approach impoverished

⁶⁸¹ Anglade and Fortin, 292-293 and Lustig, Mexico the Remarking of the Economy.

the population since the main government targets were cuts in social spending and public investment.

As result of the recession and limited expansion of employment, wages declined in real terms. They lost about 50% of their value between 1983-1989.⁶⁸² Although they slightly improved between 1989-1993, due to the control of inflation,⁶⁸³ this was a short-lived phenomenon and proved to be unsustainable.⁶⁸⁴ The table below shows the real depreciation of minimum wages since 1972. The minimum wage in 1999 represents about one third of the value of 1972. The sharp decline in wages affected labour contributions, personal income taxes, and consumption taxes such as VAT and excise taxes.

Graphic 6.1.- Variation of Minimum Salary



Source: Salarios Mnimos, Secretara del Trabajo, 1999.

Sharp economic contraction reduced government revenues and increased evasion. The contractionary policies plunged the rate of economic growth to negative figures. The 1980s are known in Latin America as the “lost decade” for

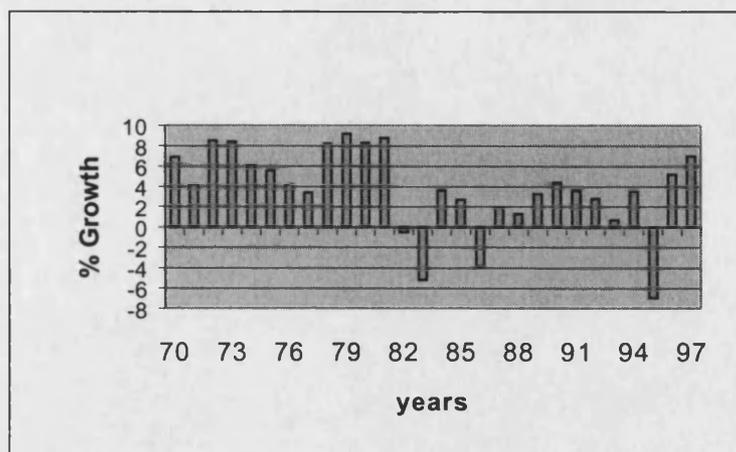
⁶⁸² Barkin, 101.

⁶⁸³ See Reporte Social Sobre America Latina y el Caribe (Santiago: CEPAL, 1996).

⁶⁸⁴ Such improvement did not reflect the real conditions of the economy, since foreign investment, an overvalued peso and revenues from privatisation artificially boosted wages.

the lack of economic expansion in the region. Mexico was one of those countries hard hit by the adjustment process. The average GDP growth rate under De la Madrid was 1%, and under Salinas only 3%, very low compared to the historical growth ratio of the 1960s and 1970s.⁶⁸⁵

Graphic 6.2.- GDP Growth (1970-1997)



Source: Banco de México

The stringent contraction of the economy had a large impact on taxation. The shrinking of economic activity, and the process of economic transformation forced many small and medium companies to close down, unable to compete with foreign competitors and a squeezed domestic market. Sector output changed enormously while revenues from corporate taxation plunged from 2.6% in 1981 to 1.6% in 1998 as percentage of GDP.

Public and private lay offs pushed millions of people to look for jobs in the informal sector. On top of those sacked during the recession and rationalisation, more than a million young Mexicans entered the labour market

⁶⁸⁵ It is worth noticing that De la Madrid term was largely affected by the drop of 50% in oil prices, a galloping inflation that reach to 160% in 1997, a large net outflow of resources of about 6.8% of GDP. While During Salinas' term the average inflation was about 16%, they enjoyed large revenues from the privatisation of banks and other state owned entities, and a total inflow to the economy of 5.6% of GDP. See Lustig, The Remaking of the Economy.

each year for the first time. In the absence of job opportunities, those alienated from the labour force found their way into the informal sector, outside the taxpayers net. Large numbers moved into the informal sector, amounting to more than 10 million people.⁶⁸⁶ By 2000, a forecast estimated up to 2.5 million street vendors in Mexico City.⁶⁸⁷ To Mexico City mayor Cuauhtémoc Cardenas one the greatest concerns of his administration was dealing with street vendors in downtown. The Mayor blamed the alarming number of people in the informal economy on the “erroneous policies implemented by neo-liberal governments, which generated armies of unemployed workers.”⁶⁸⁸

The spectacular growth of the informal sector during this period has contributed to the expansion of the black economy, which escapes all types of taxation, from corporate to personal income taxes, import taxes, excises and VAT. To the Deputy Fiscal Attorney “the problem is not just the people in the informal economy outside the tax register, but all the evasion that evolves around it.”⁶⁸⁹

Personal income contributions from the 11 million people or so would only amount about .006% of GDP of income taxes, due to the fact that in general these people earn a very low income. But if the estimates by the private sector are correct, that the underground economy constitutes a third of the formal economy, as much as USD \$150 bn a year escapes any form of taxation. Thousands of unregistered companies operate within the underground economy avoiding the payment of any kind of taxes, while many registered

⁶⁸⁶ El Sector Informal, INEGI.

⁶⁸⁷ A study from Mexico’s College of Architects found that there were more than 1.5million street vendors in 1996. See “En el Año 2000 Podría haber mas de 2.5 Millones de Vendedores Informales: Colegio de Arquitectos,” La Jornada February 19th, 1997: 2A.

⁶⁸⁸ Interview Cuauhtémoc Cárdenas London, March 25th, 2000.

⁶⁸⁹ Interview Rafael Estrada, Deputy Fiscal Attorney, Mexico, November 12th, 2000.

ones do not report their business transactions when undertaken in this sector. Very little efforts have been directed towards bringing accountability to the companies working in the underground economy or the informal sector. Tax authorities argue that bringing them into the tax net would yield very little revenues, while the administrative cost would be very large.⁶⁹⁰ Some others argue, that these tax havens are tolerated due to political motives. Cardenas pointed out that “street vendors in particular represented a stronghold for the PRI’s mobilisation groups, therefore any attempts to call them into order would cause political conflict. During the Priistas’ government, officials tolerated such groups because of their electoral support to the PRI.”⁶⁹¹

Tax evasion became widely practised during the De la Madrid term, while voluntary compliance declined as a result of political disillusion. In addition the stagnation of the economy and the official rhetoric against corruption discouraged individuals and companies from paying taxes. According to a businessman “the economic crisis was the result of corrupt politicians stealing the resources from tax payments.”⁶⁹² The Salinas administration made very significant efforts to eliminate certain group privileges and reduce evasion. Nonetheless, such efforts were targeted mostly at current taxpayers, and not by trying to incorporate those in the black economy. In the end, fiscalisation and

⁶⁹⁰ The Secretary of Finance argued that the efforts to reduced evasion in the informal sector have not gone further due to the fact that they offered very little retribution in revenue terms. In addition, it was very difficult to discover large tax evaders in this sector, since they operate almost anonymous, always in cash and they tend to protect each others. Interview former Secretary Aspe. In the same context, projections done by the Tax Collection Under Secretariat showed that a broad fiscalisation scheme would bring a very small increase in collection, while at the same time it implied a very large administrative cost. See Economía Informal.

⁶⁹¹ Interview, Cuahutémoc Cárdenas, London, March 25th, 1999.

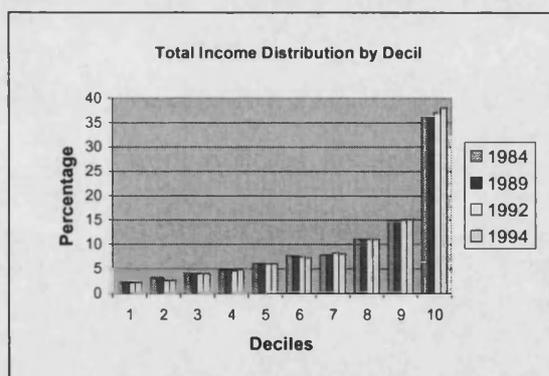
⁶⁹² De la Madrid campaigned for the moral renovation of society, promising a war against corruption. Although not real change was achieved, the campaign brought the issue to the national debate. During the economic crisis many in the opposition argued that corruption was to blame for the lack of growth. This changed the taxpayers mood over voluntary compliance.

firm enforcement of the fiscal law during the Salinas period changed public perceptions increasing voluntary compliance.⁶⁹³

d) Polarising Further Income Distribution Disparities

Neo-liberal structural adjustment policies accentuated the income distribution gap in the country, a topic which has been widely explored by authors such as Lustig, Bulmer-Thomas, Meller, Londono, Heredia, Green and others.⁶⁹⁴ These authors agree that economic transformation during this period further polarised the unequal Mexican society, as wealth was concentrated in few hands. Government statistics show that in 1984 the richest 20% of the population received 49.5% of the national income; by 1994 it was 54.5%. On the other hand the poorest 20% fell from 4.83% in 1984 to 4.35 % in 1994.⁶⁹⁵

Graphic 6.3.- Income Distribution Disparities



Source: Own elaboration with data from INEGI

⁶⁹³ Solidaridad was the government programme for social development, it channelled large resource to various social sectors. This program largely improved the popularity of government policies. See survey on the popularity of government policies in Robert R. Kaufman and Leo Zuckermann, "Attitudes toward Economic Reform in Mexico: The Role of Political Orientations," *American Political Science Review*, Vol. 92, No 2, June 1998.

⁶⁹⁴ To learn more see Edwards, *Crisis and Reform in Latin America*; Juan Luis Londono and Miguel Seakely, "Distributional Surprises After a Decade of Reforms: Latin American in the Nineties" (Washington, DC: Inter-American Development Bank, 1997) Mimeo; Lustig, *Mexico the Remaking of the Economy*; Nora Lustig, *Coping with Austerity: Poverty and Inequality in Latin America* (Washington, DC: Brooking Institute, 1995); Patricio Meyer, *Economic Adjustment and Its Distributive Impact* (Paris: OECD, 1998); Victor Bulmer-Thomas ed., *The New Economic Model in Latin America and Its Impact on Income Distribution and Poverty*.

⁶⁹⁵ *Encuesta Nacional del Ingreso-Gasto de los Hogares* (Aguascalientes: INEGI, 1984, 1989, 1992 and 1994).

However, the official data does not show the real extent of the polarisation of the Mexican economy. During this period the number of dollar billionaires passed from 2 in 1982 to 24 in 1993.⁶⁹⁶ In 1997 the assets of the 100 richest Mexicans constituted 49% of that year GDP. The astonishing accumulation of wealth in few hands has made taxing these groups extremely difficult.

In interviews with three of these billionaires (Carlos Slim, Antonio Gutiérrez, Eduardo Bours), all tried to avoid talking about taxation. They described the tax system as unfair because it punished those who create capital and pointed out the need for an integral tax reform, which would promote growth, employment and private investment. All cautiously hinted that the state has traditionally abused its taxing powers although none would elaborate further. In the same context, in a public lecture, Othón Ruíz, general manager of one of the largest Mexican companies, gave a detailed account of the relationship between the government and the private sector since the days of Díaz Ordaz. He bitterly complained about the continuous shifts in government policies and how the President's broad discretionary faculties had affected business interests. Later in private, he argued that the "business sector had been a victim of the unlimited power of the president" and accepted that capital flight has been a way to show private sector discontent with certain government policies.⁶⁹⁷

Authorities recognise the difficulties in taxing those at the top of the economic elite. In his speech at IADB Bank meeting in Spain, Guillermo Ortíz, then Secretary of Finance, commented on the fierce opposition by some powerful

⁶⁹⁶ Forbes Magazine July 18th, 1994: 19.

⁶⁹⁷ Conversation Othón Ruíz, Cambridge MA., June 14th, 1994.

groups to the process of structural reform in Mexico -including taxation. When I questioned him later whether this included some members of the economic elite, he hesitantly accepted, but immediately added that business organisations have been supportive of tax reforms.⁶⁹⁸ Salinas' Finance Secretary, Pedro Aspe, also commented on the large companies' resistance to taxation. He stated that when he took office "only a handful of the 300 largest companies registered at the stock market paid taxes." He even mentioned a large car manufacturing company that in the past 25 years had failed to report any profits. According to Aspe, this was the reason why they implemented the 2% tax on companies assets, "more as a mechanism for assisting authorities to fight tax avoidance, than as a means for increasing revenues."⁶⁹⁹

The huge concentration of capital in a very small group empowered them to strongly oppose any taxation efforts. Those getting richer were paying less and less taxes proportionally to their wealth. Corporate and income taxes were cut, and gains made at the stock market the transfers of capital abroad or inheritances were left untaxed.

e) The Reconfiguration of the Main Actors in Tax Policy Making

A major realignment of the main influential actors in the process of economic policy making took place during this period, with large consequences for the tax system. The economic elite and international actors such as the World Bank, the IMF and IADB sharply increased their influence in the process of economic

⁶⁹⁸ Guillermo Ortiz was Under-Secretary of Finance during Salinas' administration, interview March 15th, 1997.

⁶⁹⁹ Interview Pedro Aspe, September 25th, 1999.

policy making, while the corporatist sector influence significantly decreased as the technocracy rose to power.

f) The Rise of the Technocratic Elite and the Fall of Corporatist Sector Influence

The new economic model facilitated the rise and consolidation of an ambitious technocratic elite.⁷⁰⁰ The implementation of structural reforms required a technically qualified team of policy-makers.⁷⁰¹ As the technocratic elite held on power, the influence of the corporatist sector languished. Both the De la Madrid and Salinas administrations sought to reduce the influence of labour.⁷⁰² To Middlebrook, most labour organisations emerged from the 1980s in a substantially weaker position vis-à-vis both private enterprise and the state.⁷⁰³ The economic developments during the 1980s weakened labour organisations and seriously eroded the bases for the social pact that had existed since the 1950s. Economic transformation affected the size, composition, organisational strength, and bargaining effectiveness of labour organisations. Economic stagnation and subsequently high unemployment, reduced labour's sector bargaining power. Industrial restructuring, privatisation and the closure of state owned enterprises created massive lay offs, sapping the strength of the most important industrial unions.⁷⁰⁴

⁷⁰⁰ See Centeno, *Democracy Within Reason*.

⁷⁰¹ See Smith and Acuña on the need for a strong executive branch in order to implement the structural reforms agenda.

⁷⁰² Salinas even tried to dismantle the regional corporate structure by introducing a territorial division within the PRI instead of the traditional peasants, labour and popular sector groups.

⁷⁰³ Middlebrook, 287.

⁷⁰⁴ Economic stagnation reduced union's market-based bargaining leverage with employers. Privatisation of state owned companies undermined major national unions' ability to use their political influence to achieve economic goals, as well as their capacity to mobilise organised protest. Industrial reorganisation affected unions, which lost part of their control in hiring and firing.

Organised labour lost influence in economic policy making, despite the fact that workers had borne much of the sacrifice in the economic adjustments programme. Workers economic welfare declined enormously, as wages plunged and inflation skyrocketed during the De la Madrid period.⁷⁰⁵ Additionally, the economic stagnation in most of the 1980s included the dismantling of subsidies and the increase in public service supplied by the state, worsening workers' economic conditions.

g) New Economic Conditions Enhanced the Influence of the Economic Elite

In sharp contrast to the fate of organised labour, the influence of the economic elite grew enormously. According to a high-ranking government official during the De la Madrid and Salinas' administrations, "the relationship with the private sector was right at the top of the government agenda."⁷⁰⁶ The De la Madrid task was to re-build the relationship with the private sector, which had largely deteriorated during Echeverría term.

Salinas inherited a very favourable relationship with the private sector and improved it. A close relationship between the economic and technocratic elite developed and translated into direct subsidies to domestic productive capital.⁷⁰⁷ According to Muñoz Ledo not only were economically dominant classes safeguarded through specific, targeted measures aimed at compensating them for

⁷⁰⁵ According to former Labour Secretary worker's purchasing power lost nearly 65% between 1982-1996. Interview Santiago Oñate, London June 11th, 1998. To Roxborough the massive drop in real wages affected the leadership of labour leaders, since they were unable to deliver jobs for their members. Roxborough, 117-118.

⁷⁰⁶ Interview Suárez Dávila, Chairman of the Treasury Committee at the Lower Chamber and former Under-Secretary of Finance, London, May 23rd, 1997.

⁷⁰⁷ Anglade and Fortin, 312-313.

the impact of the economic policies, but the economic transformation largely benefited them.⁷⁰⁸

Many of the economic reform policies favoured the economic elite. *The Economist* stated that “stabilisation and structural adjustments brought magnificent returns to the rich.”⁷⁰⁹ A greater autonomy of market forces meant reducing the government’s influence in political and economic terms. The dismantling of the state economic apparatus translated into great opportunities for a small domestic elite to enrich themselves with the divestiture programmes. In general the decrease in employment strengthened the bargaining power of employers. Trade liberalisation facilitated the outflow of capital throughout misinvoicing international trade,⁷¹⁰ and financial liberalisation allowed the free transfer of resources.

A sensational rise in the influence of domestic and international capital decreased the state’s autonomy in economic policy making. This reached such a level that many relevant political decisions were made to please capital holders and investors. The underlying factor behind the sharp rise to power of the domestic economic elite was their ability to transfer their capital abroad. In a time of the government’s limited resources, the threat of capital flight had become a very powerful weapon for the economic elite. According to a public

⁷⁰⁸ See FICORCA programmes. Interview London, February 19th, 1999.

⁷⁰⁹ “A Survey of Latin America,” *The Economist*, November 13th, 1993.

⁷¹⁰ See Fitzgerald or Dornsbuch Transfer Pricing.

official at the Treasury, "capital flight was constantly used or at least threatened to do so, in order to advance their policy agenda."⁷¹¹

h) The Growing Influence of International Actors

The role and influence of international actors increased substantially, as a result of the economic world changes and the profound opening up of the economy in the country. Exogenous factors, including those ideological, political and economic, played a major role in reshaping the Mexican economy and the process of economic policy making. Globalisation of the economy, economic opening, the expansion of the neo-liberal ideology throughout; the Washington Consensus' receipt of structural reform, the consolidation of conservative governments in industrialised countries and the 1980s world wave of tax reform, all had a significant impact on Mexico. In particular, these exogenous events opened the door to greater participation of international actors in the Mexican economy.⁷¹²

⁷¹¹ This is particularly evident with the presidential nominations in the official party in 1982, 1988 and 1994. The active president, chose his successor not based in his popularity or grass-roots support, but by assessing if such candidate would be "accepted" by domestic and international capital. J.R. López Portillo points out that "the main concern of former Presidents López Portillo, De la Madrid and Salinas was to avoid sending the wrong message to international markets by choosing the wrong candidate. Both López Portillo and De la Madrid took care in selecting a candidate that would be popular with the financial sector. José Ramón López Portillo, interview 17 September 1997. In the same context, Castañeda points out that president Salinas was seen by the De la Madrid as the candidate who most likely would appease international markets. See Castañeda, *la Herencia*. During the unvailing process ("destapes") of de la Madrid and Salinas, organised labour and the traditional political groups opposed their nomination, on the grounds that they did not represent the interest of the corporate sectors of the PRI.

⁷¹² The globalisation of the economy spread "Neo-liberalism" as the only feasible model of economic development. IFIs contributed to spread the neo-liberal recipe to developing countries, through the conditions attached to fresh resources and debt restructuring. The transformation of economic thinking, was a drastic change, moving from protectionism to liberalisation in a very short span. During the 1980s, both developing and developed countries experienced drastic economic policy reversals. Christopher Hood, *Explaining Economic Policy Reversals* (Buckingham: Open University Press, 1994).

IFIs influence became so important, that they constituted the thrust behind Mexico's shift in the model of economic development.⁷¹³ In the early 1980s, when the priority was to stabilise the economy, the IMF played a larger influence, taking advantage of the government's need for emergency credit. Conditional policies were mostly aimed at maximising revenue. However, according to Salinas' Secretary of Finance in his term "the pressure to reform the tax system came from the World Bank, rather than from the IMF."⁷¹⁴ In spite of the fact that taxation was part of the structural agenda promoted by IFIs and the great need for revenues in debtor countries, the World Bank tax reform agenda was not aimed at increasing revenues. Instead it tried to harmonise corporate and income taxes with international levels and emphasised policies aimed at reforming the system of tax administration.

According to W. Perry, Chief Economist of the World Bank "in the 1980s it became clear that in order to increase tax collection, it was necessary first to improve the tax administration."⁷¹⁵ Once IFIs recognised that tax reform required further development than just cutting corporate and personal income rates, multilateral institutions began to pour resources to member countries to develop their administrative and tax collection systems. Inter-American Development Bank President, Enrique Iglesias, pointed out that the reform of Latin America's administrative tax systems had become one of the priorities of

⁷¹³ A World Bank's publication states that as the 1980s unfolded, leading economists in Latin America including those in the IMF and the World Bank insisted in a shift of the economic development strategy to market-based policies. *Latin America and the Caribbean*, 23.

⁷¹⁴ During the Salinas term there was no need for emergency credit facilities from the IMF, therefore IMF presence was less common than during the De La Madrid sexenio. Interview Aspe September 20th, 1999.

⁷¹⁵ Interview William Perry, Spain, March 16th, 1997.

IFIs, making references to the large number of loans given to member countries to develop their tax system.⁷¹⁶

Another relevant international event, was the 1980s' world wave of tax reform, which set the issues of fiscal reform at the top of the political agenda. According to former under-secretary of Finance, Suárez Dávila "Mexico's tax cuts and the modernisation of the fiscal system were heavily influenced by the international trends in taxation during the 1980s; particularly, because tax reform was one of the ten policies of the Washington consensus policies."⁷¹⁷ Salinas' Secretary of Finance, Pedro Aspe, insisted on the importance of remaining internationally competitive, keeping tax rates and administrative procedures in accordance with international standards.⁷¹⁸ The new trend of tax reform was aimed towards increasing indirect taxation and improving the efficiency of the tax administration.

i) Moving Towards Indirect Taxation and the Streamlined Tax Administration

During this period, economic policy making became more responsive to economic issues than political ones. Compared with "nationalist" governments, the agenda was less dominated by political concerns. Facing a contracted economy, a largely eroded tax base and an increasingly powerful economic elite opposing new taxes, both administrations moved towards less conflictive grounds, such as indirect taxation and administrative reform. In a period of 10 years the burden of indirect taxes almost doubled, from 6.3 % of GDP in 1978

⁷¹⁶ Interview, Enrique Iglesias, Barcelona, March 17th, 1997.

⁷¹⁷ Interview Suárez Davila, London May 23rd, 1997.

⁷¹⁸ Interview Pedro Aspe, Mexico, September 23th, 1999.

to 13.6 % in 1988.⁷¹⁹ The De la Madrid administration focused on indirect taxes and raised the price of goods and services provided by the state; while Salinas' tax reform efforts focused on correcting flaws in the fiscal structure, improving collection and the administration of taxes. Fiscal authorities during Salinas' term were modestly successful in expanding the tax payers base and closing legal loopholes, increasing revenues considerably.

6.2.- De la Madrid (1982-1988): Economic Realism

"After living in opulence during López Portillo's presidency, we learned to live in austerity"

President Miguel de la Madrid

De la Madrid's administration had to adjust to unfavourable factors such as a crunch in foreign credit and high inflation. Tax collection substantially declined as result of the erosive effect of inflation and the lack of growth (see graphic 8.2). The average rate of inflation during the sexenio was 91%, while the average annual rate of growth was just above 1%. Expenditures largely exceeded revenues, thus increasing the financial deficit. To finance the state, De la Madrid's government used oil revenues, increased the price of services provided by the state, internal borrowing and through inflation. More than a third of the budget was financed by borrowing.⁷²⁰ As the presidential terms passed the burden of debt became an impediment to growth.⁷²¹ Faced with the

⁷¹⁹ Gil Díaz, "Tax Reform Issues in Mexico," 255.

⁷²⁰ Armen Kouyoumdjian, "The Miguel de la Madrid Sexenio: Major Reforms or Foundation for Disaster?" in Philip, The Mexican Economy, 83.

⁷²¹ From 1983 through 1988 Mexico was a net exporter of capital transferring billions of US dollars in debt services every year (approximately an average of 4.5% of GDP). The transfer of resources drained the economy of savings and investment creating a major impediment to growth.

scarcity of foreign funds and pressured by IFIs, De la Madrid administration slashed government expenditure and increased taxes.

Minor tax reforms were made, but their impact in terms of revenue were minimal. In 1987, in response to high inflation, this administration extended the process of indexation to corporate income tax. Fearing further conflict with the private sector, De la Madrid's administration avoided restructuring the fiscal system "in a way that could re-open the old wounds created by the nationalisation of the banking sector."⁷²²

Table 6.1.- Economic Indicators During De la Madrid's Term

	1982	1983	1984	1985	1986	1987	1988
GDP%	-0.6	-4.2	3.6	2.6	-3.8	1.7	1.2
Revenue (%GDP)	28.9	32.9	32.2	31.2	30.3	30.5	30.2
Expenditure	33.4	33.0	32.1	32.6	37.9	39.1	35.0
Fin. Balance	16.9	8.6	8.5	9.6	15.9	16.0	12.4
Exports	21.2	22.3	24.2	21.7	16.0	20.7	20.6
Imports	14.4	8.6	11.3	13.2	11.4	12.2	18.9
Trade	6.8	13.8	13.0	8.5	4.6	8.4	1.7
Disb. Debt (bn)	86.0	93.0	94.8	96.9	100.9	109.5	100.8
Inflation %	99	81	59	64	106	159	52

Sources: Inter-American Development Bank, Economic and Social Progress in Latin America, Reports 1992 and 1993.

De la Madrid implemented a set of policy responses to cope with the economic crisis. Unfavourable international events which took place during his administration ended up deteriorating an already stringent economic situation. The two main economic priorities of this government were: reducing the huge government deficit and fighting high levels of inflation (see table above). Both circumstances had an impact on the policies related to taxation. To balance the

⁷²² Interview Jesús Silva-Herzog, former Secretary of Finance, Mexico June 12th, 2000.

budget De la Madrid faced two options: either increase taxes or cut down on expenses; he choose the later, implementing a stringent austerity programme. To some analysts this was a perfect time for implementing a profound tax reform, to others the prevailing political cleavage could have escalated into a political crisis with such reform.

6.2.1.- Economic and Political Conditions

During De la Madrid's term two significant political events took place, events that would prove to have far-reaching political and economic implications in the country's future. First was a cleavage within the PRI elite, caused by the split over the economic strategy followed by the technocratic elite.⁷²³ Secondly significant was the continuous growth of the PAN at local and state level, triggered by the discontent of small and medium business with the banking nationalisation and the stringent economic conditions suffered by the people.⁷²⁴

De la Madrid began his term with great impetus towards an overall tax reform, but soon the impetus faded away.⁷²⁵ During his presidential campaign he committed himself to fight evasion and increase the number of tax incentives to

⁷²³ The shift in the economic strategy caused an abrupt split in the ruling class. Led by Cuauhtémoc Cárdenas and Porfirio Muñoz Ledo, a sector in the official party, left the PRI to form a new party. Both Cárdenas and Muñoz Ledo, confirmed that they left the official party in protest to the orthodox economic strategy, although Muñoz Ledo insisted in the lack of democracy as the main reason. Interviews Cárdenas and Porfirio Muñoz Ledo, both in London March 25th, 1997 and February 19th, 1998 respectively. To learn about the cleavage see Manuel Pastor, Whirpool: US Foreign Policy Towards Latin America and the Caribbean (New Jersey: Princeton University Press, 1997). To learn about the political struggle during Salinas term see Cothran: 177 -208.

⁷²⁴ Comments made by Soledad Loeza in the Seminar on Mexico at the London School of Economics, February 12th, 2000. See also Soledad Loeza, El Partido Accion Nacional.

⁷²⁵ See Miguel de la Madrid: Tres Informes de Gobierno, 1983-1985 (México: Presidencia de la República, 1985).

companies.⁷²⁶ Among the key policies put forward in his campaign, De la Madrid highlighted the need to increase public income. He promised a fiscal reform that would ensure equity on the levy of direct taxes, to harmonise the rates of indirect taxes, to increase the tax collection rate, to improve the administration of taxes, and to overhaul all tax incentives in order to keep only those that promote employment, industrial output and exports. He also pledged to increase tariffs for goods and services consumed by those better off and committed to raise the standard of efficiency and productivity of state owned enterprises.⁷²⁷ The highlights of this administration include an extensive programme of municipal reform, which included the reform to article 115 of the Federal Constitution.⁷²⁸ In tandem with the municipal reform, this presidency embarked on programmes of decentralisation,⁷²⁹ federalism and administrative simplification.⁷³⁰

a) Balancing the Budget through an Austerity Programme

When president De la Madrid entered office in 1982 the economy was in a big mess. According to former Under-Secretary of Planning, José Ramón López Portillo, beside the lack of external credit, the state faced a record fiscal deficit

⁷²⁶ Miguel de la Madrid, Pensamiento Político (México: Coordinación General de Documentación y Análisis, PRI, 1982) and Miguel de la Madrid H: Campaña Presidencial Sexta Etapa 5-16 de Enero (México: Presidencia de la República, 1982).

⁷²⁷ See Puntos Programáticos: Programa Inmediato de Reordenación Económica (México: Presidencia de la República, 1982).

⁷²⁸ See "Miguel de la Madrid H: Campaña Presidencial, 145.

⁷²⁹ The terrible 1985 earthquake triggered the process of decentralisation. On October 10th 1985, in the presidential house President De la Madrid instituted the "Committee for Decentralisation." See "Comité de Descentralización," México, Presidencia de la República, October 9th, 1985. Rodolfo Landeros, then governor of the state of Aguascalientes recalls the efforts made by then Secretary Salinas and President De la Madrid to agree on the allocation of government agencies in provincial cities. Interview Rodolfo Landeros, April 22nd, 2000.

⁷³⁰ To strengthen federalism, President De la Madrid instituted a new system of coordination for the allocation of federal resources between the states and the federal government, known as "Convenio Unico de Desarrollo." He also passed a Presidential Decree to encourage decentralisation called "Decreto para la Descentralización Pública Federal, Junio 1983." See Miguel De la Madrid: Tres Informes de Gobierno, 1983-1985.

of the order of 17% of GDP.⁷³¹ To José Angel Gurría, “the most urgent priority in 1983 was putting public finances on a sound footing and ensuring that fiscal discipline would be a guiding principle in the future.”⁷³² To do so the government implemented large cuts to keep the financing gap under control.

To reduce the fiscal deficit, President De la Madrid called for a programme of economic austerity, which drastically cut subsidies for basic commodities such as transportation, electricity, natural gas, and gasoline,⁷³³ and imposed stringent controls on wage increases, cut public sector employment and social spending. The stringent orthodox policies which included cuts in subsidies translated into higher prices for state-controlled goods and services, increasing the already rocketing inflation.⁷³⁴ Reduction in public spending was a critical element of the administration’s fiscal programme. Expenditure was cut from 31.5% to 26.75% of GDP, allowing the deficit to fall from 17.1% in 1982 to 8.9% in 1983.⁷³⁵ In order to strengthen revenues during 1983 and 1984, the government increased further the prices of public services. VAT rates also went up, as well as the progressive stages of individual income tax rates.

These policies had positive effects on the government’s income, but it was much less than expected.⁷³⁶ By 1986, the austerity programme had caused a

⁷³¹ Interview José Ramón López Portillo, Under-Secretary of Planning during De la Madrid’s term, London, February 17th, 1998.

⁷³² José Angel Gurría, *The Modernisation of the Mexican Economy*, Mercado de Valores (June, 1994):18.

⁷³³ Middlebrook, 161.

⁷³⁴ Kouyoumdjian, 79.

⁷³⁵ Kouyoumdjian, 81.

⁷³⁶ Ernesto Estrada González, El Impuesto Sobre la Renta de las Empresas y la Reforma Fiscal: Un Análisis del Equilibrio General Aplicado (México; Colegio de México, 1987): 2-3.

dramatical decline in real wages and cut down living standards.⁷³⁷ In the mid 1980s, adverse international events altered the performance of the economy. In 1986 the international price of oil plunged to around one third of the previous year's value. When oil prices collapsed export earnings declined from about \$16 bn in 1985 to an estimated \$9bn in 1986. To balance the budget, the government introduced massive rises in the prices of goods and services provided by the state. The public sector balance returned to a large deficit of 16.% of GDP while the economy contracted by 3.8% of GDP.⁷³⁸ To make up for the loss of oil revenues, the government went to the market for more internal borrowing, but it reached alarming proportions. Interest payments represented 18.5% of GDP, absorbing a large proportion of federal government revenues. Servicing the debt accounted for as much as 86% of the states revenues.⁷³⁹

In November 1987, the New York stock market crashed affecting the Mexican stock market whose index lost nearly 75%.⁷⁴⁰ The stock market crash and the rising inflation triggered a large devaluation of the peso, losing more than one third of its value. Frequent currency devaluations ignited a devaluation-inflation-devaluation cycle. The disappointing performance of the economy and the adverse exogenous events pushed the government to move towards deeper economic transformation. The first steps of economic restructuring were taken during the De la Madrid period in the mid 1980s. The government embarked on a process of privatisation⁷⁴¹ and trade liberalisation. In order to cut subsidies, the government tried to divest loss making public sector companies responsible

⁷³⁷ See Lustig, The Remaking.

⁷³⁸ Kouyoumdjian, 84.

⁷³⁹ Ibid.

⁷⁴⁰ To learn about the unrealistic growth of the market see Kouyoumdjian 90-91.

⁷⁴¹ See The Mexican Economy 1995 (Mexico: Banco de Mexico, 1995).

for a large part of the deficit. The number of public enterprises declined from 1,155 in 1982 to 412 in 1988. However, no major state companies were sold during De la Madrid's period. Regarding trade liberalisation, the government signed up in 1986 for membership to the GATT after long-standing internal opposition, and reduced unilaterally by 95% the number of products subject to import licences.⁷⁴²

b) Economic Stagnation and its Impact on Taxation

Tax revenues were hit hard by a sharp slowdown in economic activity. Corporate income tax revenue lost considerable ground from 2.6% of GDP in 1981 to around 1.6 % in 1987. The fall in corporate taxes further weakened public finance, which already had to face the suspension of foreign credit and the precipitous economic opening.⁷⁴³ High inflation, lower imports, and higher exports, also contributed to the relative loss of value added taxation. Tax authorities reacted by increasing considerably the level of taxation. Income and indirect taxes rates had to be increased to compensate for the Treasury

⁷⁴² The purpose of opening the economy was to boost non-traditional exports (non oil exports grew from \$5.6bn in 1982 to \$12bn in 1987). Opening of the economy was done unilaterally despite stern resistance from nationalist and protected industries. Economic opening was viewed by most businessmen with great trepidation, since many companies, after so many years of inefficiency and protectionism, were incapable of competing with international standards of efficiency and productivity. According to Bailey the groups that favour a gradual opening of the economy and the entry into GATT were: the bureaucracy (Treasury, SPP, Bank of Mexico, SECOFI) and a minority of business organisations ANIERM, CANACO, COPARMEX and the large-scale firms of CONCAMIN. Opposing: were at the bureaucracy (Foreign Relations, SEMIP) the majority of small and medium sized industries represented specially by CANACINTRA, as well as unions. Bailey, *Governing*, 142. An interview with Fernando Solana, former Secretary of Foreign Affairs during Salinas' administration confirmed that many powerful groups opposed to the opening of the economy. Mr Solana fiercely criticised the process of economic opening, stating that it was done abruptly, adding that it should have been done gradually and included safeguards similar to those governing the European Union. Interview, London, February 16th, 1997.

⁷⁴³ Gil Díaz, 268.

forecast loss.⁷⁴⁴ The significance of indirect taxes rose from 9.2% to 13.2%, while collection from corporate taxes declined (See table 8.2). However, higher rates made evasion extremely profitable.

Table 6.2.- The Impact of the Economic Contraction on Taxes

	1982	1983	1984	1985	1986	1987	1988
Indirect Taxes (% GDP)	9.2	12.6	11.7	11.6	9.7	10.6	13.2
Revenue VAT (million pesos)	72,877	87,200	93,026	92,612	84,245	90,763	96,123
Year increase	-12.4	19.7	6.7	-0.4	-9.0	7.7	5.9
Corporate Tax	1.7	1.5	1.6	1.6	1.7	1.6	n.a.
Loss Revenue Due to Inflation (% GDP)	1.04	0.88	0.68	0.73	0.78	0.82	0.40

Source: Gil Díaz various tables in Tax Reforms Issues in Mexico, in The World Tax Reform. Indirect taxes do not include trade taxes. The amount of Revenue from VAT is in real receipts in millions of 1978 pesos. The year increase is in relation to the previous year.

6.2.2.- Policy Actors and their Influence: The Decline of Corporatism

The balance of power among policy actors began to shift during De la Madrid's term. The government envisaged new mechanisms to control interest groups economic and political demands. While the power of corporate actors rapidly waned, the technocratic wing of the government rose to power. In the mean time the influence of both domestic and international capital reached unprecedented leverage.

a) Corporate Actors: Controlled with the "Pactos"

After failed attempts to halt inflation the government implemented a different approach which included the participation of all socio-economic actors. Such strategy not only proved to be successful in reducing inflation, but provided an efficient mechanism of political control over corporate actors. In December

⁷⁴⁴ They forecasted huge losses in tax collection as result of economic contraction, September 20th, 1999.

1987, the government called for an economic alliance to halt hyperinflation, the instrument was called “pactos.” The social pact provided a forum where different sectors of the society (workers, farmers, employers and government) could examine the national economic problems and those problems faced by the participants. The “pactos” also provided an exceptional environment for dealing with the demands of the socio-economic actors. This is particularly relevant for our case, because pactos changed the traditional bargaining process, since they provided a forum where proposals and concerns were openly negotiated.⁷⁴⁵ Finance Secretary, Pedro Aspe, states that the pactos became “the natural channel to address most of the tax concerns of the various economic sectors represented in the accord.”⁷⁴⁶ For corporate sectors, such open economic debates weakened their bargaining power.⁷⁴⁷

b) Business: Rebuilding the Relationship with the Government

The first issue confronting De la Madrid’s administration was to overcome mutual distrust and to rebuild the government-business relationship. He had to work to alleviate business class resentment against the government’s nationalisation of the banking sector. De la Madrid opened the channels of communication and largely improved the relationship with the private sector.

⁷⁴⁵ Important tax concessions were made to the corporate sector under the “pactos” framework. Organised labour obtained some important concessions such as the elimination of income taxes for workers earning less than three minimum salaries VAT rate for some basic products, while large agro-industries retained most of their privileged tax status.

⁷⁴⁶ Interview Aspe September 20th, 1999. According to a former Secretary of Labour, this open bargaining system benefited the government. The fact that each interest group operated with a conflicting agenda constrained their bargaining capacity at the negotiations table. Interview Oñate, June 11th, 1998. Agricultural representative, CNC president Hector Hugo Olivares complained that many of the accords between the private sector and government, were made behind closed doors, usually before the general pacto meetings. Interview, Aguascalientes, January 13th, 1998.

⁷⁴⁷ Interview, Rodríguez León, former Senator and union leader, who complained that in the “pactos”, business did not comply with their the end of the deal, increasing prices while salaries remained frozen, México July 23rd, 1998.

The new model of economic development, that included privatisation and deregulation, pleased the business elite. The relationship was improved further with actions such as subsidies to big business and a swift compensation to the expropriated bankers. De la Madrid arranged quick compensations and divestiture of corporate shares held by banks as loan collateral. Despite the previous disillusionment with the competence of the political class, the foreign debts of many large companies made them increasingly dependent upon government assistance.⁷⁴⁸

c) International Financial Institutions: Get Back on the Scene

The contraction of the economy plus greater borrowing requirements of the Mexican government made it largely dependent on IMF resources to stabilise the economy. Such resources were subject to hard conditions that must be obeyed in order to keep the fresh resources flowing. This provided a leverage over economic policy to any international financial institution supporting Mexico, particularly the IMF as largest sponsor.

6.2.3.- Tax Reform During de la Madrid's Term: Copying with Adversity

a) Increasing Indirect Taxation

Due to the poor performance of the economy and its impact on taxation, the government moved towards indirect taxation, as the simplest and quickest way to increase revenues. State revenues from indirect tax increased significantly from 9.2% of GDP in 1982 to 13.2% in 1988. VAT introduced in 1980, prevented a substantial loss in revenues, but rates had to be increased

⁷⁴⁸ Bailey, *Governing Mexico*, 123.

because the percentage of collection declined. The adjustments to VAT rates in 1983 improved collection to 19.7 %, after falling to 14.2% in 1982. The VAT tax rate rose from 10% to 15%, but it grew more complicated as the number of rates proliferated to meet political demands, showing that the influence of interest groups shapes the tax structure. These rates ranged from zero rate for foodstuffs and medicines to a 20% rate for luxury items. Gil Díaz, a former Under-Secretary of Finance, recognised the influence of political actors in the tax policy making process, stating that due to political arrangements original simplicity of the ad valorem tax soon disappeared.⁷⁴⁹ He also stresses how these multiple rates complicated the administration of the tax. Political negotiations were not just limited to representatives of the economic sectors, but included the authorities of the states as well. Problems with the collection sharing formula for the states contributed to the laggard performance of VAT during this term. But in 1987 the VAT formula was corrected bringing new stimulus to collection. The reforms gave states 30% of the VAT they collected without holding this part of their share to a ceiling.⁷⁵⁰

The rates of excise taxes were substantially raised as well. In spite of the reforms, excise revenue ratios fell far behind international standards. The substantial increases in the rates of excise did not increase revenues considerably. The ratio of excise to GDP was 1.81% in 1982 and increased to only 2.39% in 1983. The figures from 1984 to 1987 averaged 2.41%.⁷⁵¹ The openness of the economy had a negative impact on excise taxes, since they are not generally paid on exports, and there is a full rebate on them and on

⁷⁴⁹ Gil Díaz, 267. Interview September 21st, 1999.

⁷⁵⁰ Gil Díaz, 264.

⁷⁵¹ Gil Díaz, 267

VAT paid in previous stages. Non oil exports increased from 2.4% of GDP in 1982 to 8.49% percent in 1987; with imports lagging behind, the taxable base of excises and the VAT contracted.

b) Struggling Against Inflation

Inflation had a major negative effect on tax collection; income taxes declined 26.6% between 1982 and 1986, and just in 1983 alone they fall by 19.7%. Corporation taxes accounted for most part of this drop (about 70%).⁷⁵² The high rate of inflation during the De la Madrid administration 1982-87, caused a large loss in revenue, before fully inflationary corrections were made in the tax base.

The decline in the collection of corporate income tax was partly attributable to the fact that such tax was collected in three payments annually. To correct the distortions created by inflation, in 1987 the government implemented a fiscal reform indexing corporate taxes to inflation.⁷⁵³ Tax brackets were indexed and assets were valued on an inflation adjustment basis. Advance monthly payments replaced quarterly tax payments. Unfortunately, these reforms further complicated the administration of taxes.⁷⁵⁴

⁷⁵² Ernesto Estrada González, El Impuesto Sobre la Renta: 4.

⁷⁵³ For a detail account of the complexities involved in indexing corporate income tax see Gil Díaz, 268-270.

⁷⁵⁴ Inflation had an impact on the administration of taxes. It created an extremely complicated set of rules that have to be calculated every month, together with the ever more complex VAT and in some cases monthly excises. To see the impact of inflation in taxation see Gil Díaz and Kaldor, 1973.

Table 6.3.- Collection of Corporate Income, and the Effect of Inflation

Year	Inflation %	Inflationary Effect	Total Effect on Tax Collection
1981	28.9	0.3	0.40
1982	98.8	0.76	1.04
1983	80.7	0.76	0.88
1984	59.1	0.56	0.68
1985	53.3	0.64	0.73
1986	05.7	0.77	0.78
1987	159.1	n.a	0.82
1988	51.7	n.a	0.44

Source: Own elaboration with data from Banco de México, Gil Díaz, Estrada and Elizondo.

The transition period was characterised by extremely complex procedures. Corporations were required to use two different accounting systems to calculate their taxable income and still another method to calculate the profits to be shared with workers.⁷⁵⁵ Other significant reform in the 1987 fiscal law was that corporations were allowed only to deduct real interest rates, eliminating the subsidy to capital financing. The measure was aimed to induce companies to use healthier financing mechanisms such as the issue of stock.⁷⁵⁶

⁷⁵⁵ Gil Díaz, 251.

⁷⁵⁶ Estrada, 5-10.

6.3. Carlos Salinas de Gortari (1988-1994): Modernising the Economy

*"Our greatest achievement on the tax front was to increase tax revenues while reducing tax rates."*⁷⁵⁷

President Carlos Salinas

In a gradual tax reform, the Salinas administration increased the tax base, enlarged the number of taxpayers, lowered taxation rates, simplified procedures and improved collection by implementing tax evasion control mechanisms. Additionally, tax havens, subsidies and exemption were reduced and loopholes were eliminated. During the Salinas' government more than half of the 18 federal taxes that existed in 1988 were cut. The VAT was reduced from 20% and 15 % to 10%, as well as personal income tax rates from 50% to 35%, and corporate income tax from 42% to 34%. Fiscal authorities broadened the tax base, by eliminating unjustified fiscal privileges, and enlarging the number of taxpayers. A noticeable decline in tax evasion came as a result of tougher application of fiscal laws and fiscalisation. All these factors contributed to an increase in tax collection of 35% in real terms, between 1988 and 1993.⁷⁵⁸

Salinas' tax reform's most notable stroke was the expeditious modernisation of the tax system, with far-reaching changes in tax administration. These include a large investment in information technology to process more adequately a large volume of information and reducing the auditors discretion. New computerised auditing systems were installed, together with a system of

⁷⁵⁷ See Carlos Salinas de Gortari, *México: Un Paso Difícil a la Modernidad* (Madrid: Ed. Plaza Jane, 2000): 386. Non-oil tax revenues increased by 34% in real terms from 1989 to 1993 and Gurría, "The Modernisation of the Economy," 18.

⁷⁵⁸ See Gil Díaz, Rojas, Arindam Das-Gupta, and Dilip Mookherjee, *Incentives and Institutional Reform in Tax Enforcement* (Oxford: Oxford University, 1998) and Elizondo, "In Search."

economic incentives for auditors. But the greatest achievement was in policy enforcement, directed to the deterrence of tax evasion, tax avoidance and corruption. Penalty policies were revised and tax offenders were prosecuted for the first time in 60 years. A presumptive tax on real assets on companies was implemented mostly as a deterrent of tax avoidance. The enforcement measures largely helped to an increase in voluntary tax compliance.⁷⁵⁹

However, despite all the administrative improvements and reforms made to the tax system, Mexico's tax collection yield remained very low when compared with other OECD countries. It moved from 11.6% in 1988 to 9.3% in 1995, lagging far behind a desirable 20% tax collection rate.⁷⁶⁰

Nevertheless, the evidence seems to suggest that tax reform responded more to international pressures to homogenise tax rates and practices around the world, than to a real attempt by the authorities to increase badly needed revenues. Broadening the tax base and enlarging the number of registered tax payers was made to compensate for the losses incurred when cutting tax rates.

6.3.1.- Economic and Political Conditions: Putting the House in Order

President Salinas came to power in 1988 with a clear reform agenda, among popular discontent after years of hardship and economic austerity. The 1988 Presidential election was questioned by opposition leaders and academics.⁷⁶¹ De la Madrid's decision to hand pick Salinas de Gortari as his successor (to

⁷⁵⁹ See Das-Gupta.

⁷⁶⁰ See Ingresos Ordinarios del Sector Público Federal y Total de Contribuyentes Activos, Anexo del Tercer Informe de Gobierno, Poder Ejecutivo Federal, September 1997: 64.

⁷⁶¹ For those academics who questioned the election see Pastor. Cuahutemoc Cárdenas claimed Salinas stole the presidency from him. Interview, London, March 25th, 1999.

ensure the continuity of the neo-liberal model) brought important divisions within the PRI. A powerful fraction of the ruling party broke away, forming a new party with its own presidential candidate, Cuauhtémoc Cárdenas, the son of a popular former president. The cleavage in the PRI, plus the popular discontent for the years of economic hardship resulted in a substantial decline in the share of the PRI's vote, from 74 % to 50%. Salinas arrived to the presidential office under allegations of electoral fraud, after the inexplicable break down of the computerised counting system in the 1988 federal election. However, President Salinas grew from weak political legitimacy to huge popularity. He was able to win popular support by improving Mexican's economic conditions resulting from savings in the external debt, privatisation, financial flows and by allowing a huge increase in the current account deficit, but most significantly thanks to the hand over of discretionary government resources distributed through the implementation of this social programme for low-income groups known as "Solidarity."⁷⁶²

During his campaign Carlos Salinas paid little attention to the need of reforming the tax system⁷⁶³ but briefly addressed the issue in the National Development Plan 1989-1994. In this document, that serves as the guideline for public policies during each presidential term, President Salinas offered to decrease the number of special tax regimes, fight tax avoidance and tax evasion and to improve the fiscal relations between federal, state and local governments.⁷⁶⁴

⁷⁶² See Presidential Decree that creates "The Commission for the National Solidarity Programme," *Official Gazette*, Tuesday 6th of December 1988: 7-9.

⁷⁶³ Salinas makes no comments on the need of a tax reform in his campaign policy proposals, see Carlos Salinas de Gortari, *El Reto* (México: Diana, 1989).

⁷⁶⁴ See *Plan Nacional de Desarrollo 1989-1994* (México: Presidencia de la República, 1989): 58.

The issue of Federalism appears early in the agenda as a key concern of Salinas' government.⁷⁶⁵

Salinas' reforms sought to modernise the tax system so it would conform with the new economic environment and better respond to the development objectives of the country. The new strategy of development required rules compatible with a market-oriented economy.⁷⁶⁶ According to Pedro Aspe, Finance Secretary, the government objective was to modernise the economy by opening it to the world.⁷⁶⁷

a) Deepening Economic Reform

The Salinas administration inherited favourable political conditions for the introduction of tax reforms. De la Madrid had improved the relationships between the government and businessmen. The government was able to reduce inflation and renegotiate very favourable conditions for the country's international debt.⁷⁶⁸ Overall it had embarked on a profound programme of structural adjustments highly praised by IFIs.⁷⁶⁹ Salinas' administration

⁷⁶⁵ See David Colmenares Páramo, El Federalismo Fiscal en México 1989-1994 Volumes I, II, III (Oaxaca: Gobierno del Estado, 1995).

⁷⁶⁶ Pedro Aspe, Economic Transformation the Mexican Way (Cambridge, MA: The MIT Press, 1993): 96.

⁷⁶⁷ Aspe argues that they were well aware of the large losses incurred by cutting up tax rates (it had been carefully evaluated by specialised economists at the Treasury Department). However, the priority was to remain internationally competitive, and get rid of the obstacles to foreign investment. In addition, measures taken, as increasing the tax base, and the number of taxpayers registered among others, helped to compensate for the loss of revenue. Interview Aspe September 20th, 2000.

⁷⁶⁸ Smaller debt services free budgeted resources that were then channelled into social investment and development infrastructure.

⁷⁶⁹ According to the World Bank, Mexico and Chile were the only countries in Latin America that had reached mature consolidation in their reform programmes. Latin America and the Caribbean. In the same context, the IMF stated that "Mexico has achieved a remarkable economic transformation since the late 1980s on the basis of prudent macroeconomic policies and far reaching structural reforms." See IMF Press Release No.95/10.

commitment to market oriented reforms increased flows of foreign investment, financing the Mexican economy for a few years.⁷⁷⁰

The first problem that the Salinas' administration faced was a heavy burden of debt service, which had become an impediment to growth.⁷⁷¹ A condition for the re-negotiation of credits was a programme of structural reforms, which led the country to experience a substantial transformation of the economy. Mexico followed step by step the structural adjustment policies recommended by IFIs and the US government known as "the Washington Consensus."⁷⁷² But the Salinas' administration went beyond the original set of policies, achieving very significant macroeconomic results. These included: reducing inflation from almost 160% in 1987 to 8% in 1993, without a sharp decline in national

⁷⁷⁰ See net flows of capital in Foreign Direct Investment in Developing Countries: The Case of Latin America (Madrid: IRELA, 1994) and Inversión Extranjera Directa en América Latina en los Años 90s (Madrid: IRELA, 1996).

⁷⁷¹ From 1983 through 1988, Mexico was a net exporter of capital, transferring billions of US dollars in debt services every year (approximately in 4.5% average) This transfer of resources drained the economy of savings and investment and created a major impediment to growth. Between 1989-92, the Salinas' administration negotiated a financing package for Mexico, together with a subsequent debt reduction operation. To learn more about the rescheduling of the external debt during the Salinas' administration see José A. Gurría, La Política de la Deuda Externa: Una Visión de la Modernización de México (México: Fondo de Cultura Económica, 1994) and Green. In addition, a substantial programme of structural reforms reduced the Mexican economy's reliance on borrowed funds as well as GDP ratio of external debt. Total public sector debt as percentage of nominal GDP fell from a high of 124.4 % of GDP at the end of 1987 to 32.8% of GDP at the end of 1993. Later reflecting the sharp devaluation of the peso at the end of 1994, it increased to 49.8% of nominal GDP at December 31, 1994. Banco de Mexico various issues.

⁷⁷² Noteworthy are the similarities between the IFIs recipe and Salinas' government agenda. According to the 1988-94 National Development Plan, the top priorities in the Salinas administration agenda were: 1) Control wage and price instability through an agreement among labour, business and government, the Pact for Economic Stability and Growth (PECE); 2) Renegotiate the foreign debt so as to eliminate its excessive drag on economic growth; 3) Open the country to world trade flows, in order to stimulate the Mexican economy's competitiveness, encouraging exports; 4) Attract foreign and national investment; 5) Privatising state owned companies, freeing resources for social programmes; 6) Implement a social program to combat poverty; 7) Reform the fiscal system; 8) Maintain strict fiscal discipline; Mexican Agenda, 13th edition, (México: Presidencia de la República, Dirección de Comunicación Social, 1992): 72. See Williamson ed. Latin American Adjustment.

productivity. A successful re-negotiation of the foreign debt⁷⁷³ reduced the total external debt from 47% of GDP in 1988 to only 19% in 1993 (Public sector debt passed from 28% of GDP to 11%).⁷⁷⁴ Public social expenditure increased from 6.3 % of GDP in 1988 to 10.2% in 1994. In addition up to 50% more resources went to local and provincial governments. There was a reduction of the number of people living in extreme poverty from 14.1% in 1989 to 11.8% in 1992. Government finance moved from a fiscal deficit of 12.4% of GDP in 1982 to a public sector surplus of 1% in 1993. Also significant, was a programme of disincorporating hundreds of state owned companies. Such achievements were possible thanks to the reduction and rationalisation of public expenditure, a tax reform, the privatisation of public enterprises,⁷⁷⁵ and priced adjustments for goods and services supplied by the public sector.

Nevertheless, the greatest change took place with trade and financial liberalisation. Trade liberalisation was at the core of the economic programme; the objective was to move away from traditional oil exports. In 1982 oil represented 78% of total exports, while manufacturing exports represented only 14%. By 1993 manufacturing exports amounted to 80%, while oil exports

⁷⁷³ The 1989-92 Financing Package for Mexico, implemented in March 1990 was intended to reduce the principal amount of and the debt services burden associated with Mexico's commercial bank debt, and to secure sufficient future financing to allow Mexico to resume sustained economic growth. Of the approximately \$48 billion of external debt held by Mexico's commercial bank creditors in 1989, approximately \$ 43 billion participated in the principal and interest reduction options; approximately \$ 20.6 billion was exchanged for Discount Bonds and the balance was exchanged for Par Bonds. Thus, Mexico was able to reduce the principal amount of its external debt by approximately \$ 7 billion. The balance of Mexico's commercial bank creditors agreed to participate in the new money option and to lend Mexico approximately \$ 1.07 billion in new credits over four years. Since the 1946 rescheduling of debt incurred prior to the revolution in 1910, Mexico has not defaulted in the payment of principal of interest on any of its external indebtedness. See *Mexico's Agenda*.

⁷⁷⁴ Total consolidated internal and external debt of the Mexican government, diminished from 68% of the GDP in 1988 to 22% in 1993.

⁷⁷⁵ Total revenues from privatisation between December 1988 and December 1993 amounted to \$23 bn. But privatisation revenues are one-time income only.

decline to 14% of the total export output. During the Salinas administration Mexico expanded and diversified its commercial relations through regional and multilateral agreements; specially significant was the Free Trade Agreement signed with Canada and the US (NAFTA).⁷⁷⁶ Likewise, a broad legal and institutional reform took place to open the financial system to local and foreign investors.⁷⁷⁷ Financial liberalisation attracted capital, Mexico received a major inflow of capital of more than US\$90 billion dollars from 1988 to 1994. According to Banco de Mexico, \$71,731 million were in portfolio and only \$23,185 million were in the form of foreign direct investment.⁷⁷⁸ The financial opening has caused the country to become very vulnerable to international events and susceptible to the influences of foreign actors.⁷⁷⁹

6.3.2.- Policy Actors and their Influence: The Growing Influence of Capital

As stated before in this chapter, the power of corporate actors continued to decline in an effort by the Salinas' administration to diminish their political influence. Once the relationship with the business sector was restored to amicable levels, Salinas made sure that the interests of business were protected and opened the door for new juicy business. President Salinas was

⁷⁷⁶ In 1993 it joined the OECD and APEC, and in 1994 the North American Free Trade Agreement with the US and Canada entered into effect. Additional trade agreements were signed with Chile, Venezuela, Colombia, Costa Rica y Central America. To learn about NAFTA see Lustig, Bosworth and Lawrence eds., Assesing the Impact of the North American Free Trade Agreement.

⁷⁷⁷ In 1988 there were a total of 19 banks, by 1994 there were more than 50, among another 300 other financial institutions. To learn about the modernisation of the stock market see Luis Miguel Moreno, "The Internationalisation of the Mexican Stock Market," El Mercado de Valores, Nacional Financiera, January-February 1994: 2632.

⁷⁷⁸ See Banco de Mexico, various issues.

⁷⁷⁹ In the late 1980s and early 1990s the providers of foreign capital shifted from institutional funds to capital from private investors. This expensive and highly volatile capital fled after a year of uncertainty and political turmoil causing a severe liquidity crisis at the end of 1994.

obsessed with the idea of taking Mexico into the first world, further deepening the policies of structural adjustments. Detractors accused the government of following a neo-liberal agenda that increased the leverage of external actors, both financially and ideologically.

a) Exogenous Influences: Reform from Abroad

The tax reform policies came into Salinas government agenda propelled by the IFIs and the worldwide wave of tax reform. While Suárez Dávila, Under-Secretary of Finance during De la Madrid's term recognised the powerful influence exercised by the IFIs through the Washington Consensus policies. Pedro Aspe, Salinas' Finance Secretary, played down their influence, pointing only to their advisory role. The evidence shows surprising similarities between the Mexican tax reform agenda and that of the World Bank.⁷⁸⁰

As noted earlier, during the Salinas presidency the pressure to reform the tax system came from The World Bank, rather than from the IMF. The Mexican government closely followed World Bank's tax reform policy recommendations, implementing them almost to the letter. Tax reform policies included broadening the tax base, increasing incentives to investment through a lower marginal base and improving the administration of taxes.⁷⁸¹

⁷⁸⁰ Aspe's lessons of tax reform in Mexico are almost identical to those policy recommendation made by the World Bank to developing countries reforming their tax system. See Aspe, Economic Transformation the Mexican Way, 96.

⁷⁸¹ The World Bank recommendation on fiscal reform, are summarised in Lessons of Tax Reform. The book discusses the issues that must be addressed when reforming taxes. It summarises current best practices in tax reform, including examples of countries that have adopted these measures and it reports on the tax advice that the World Bank has been giving in this topic. The study concludes with recommendations on future Bank operational and research work in the field of taxation.

The most important policies favoured by the World Bank are: a) limiting the use of fiscal incentives⁷⁸² that could lead to distortions in resource allocation across sectors and b) generating revenue by widening the tax base rather than by raising rates.⁷⁸³ Broadening the base generally involved eliminating or reducing exemptions, plus related deductions, allowances and loopholes.⁷⁸⁴ The World Bank strongly encouraged countries to cut income tax rates, arguing that in developing countries, "personal income taxes tend to have high rates on narrow bases, and generate little revenue. The low yields reflect limited coverage and poor design."⁷⁸⁵ The general objective according to the World Bank was to increase revenue while minimising the distortions and inequities in the existing tax system. World Bank officials recommended paying particular attention to efficiency, horizontal equity, and administration.

In a similar tone, the world-wide wave of tax reform that took place during the 1980s and early 1990s, focused on improving efficiency to minimise the distortions created by taxation. The trend included lower marginal tax rates, a response to international pressures, and a consideration of the value added tax as a broad-based source of revenue.⁷⁸⁶ The objective was to make taxes interfere as little as possible with the free working of the markets.⁷⁸⁷ New emphasis was placed on improving efficiency of the tax administration, tax simplification and voluntary compliance. However, the wave of tax reform that

⁷⁸² The World Bank tax reform study, is particularly critical of the fiscal incentives scheme used by the Mexican government to promote investment in the early 1980s. The incentive (CEPROFIS) was given in the form of a tax credit based on a special certificate that was used to pay the beneficiary's tax liabilities. See Lessons of Tax Reform, 37

⁷⁸³ The World Bank's new attitudes for the design of tax reforms in Lessons of Tax Reform, 37.

⁷⁸⁴ Lessons of Tax Reform, 38.

⁷⁸⁵ *Ibid.*

⁷⁸⁶ Boskin and McLure.

⁷⁸⁷ See Boskin and McLure. For a detailed record in the developed world see Sandford, Successful Tax Reform, see also Taxation and International Capital Flows.

swept the world in the 1980s was largely revenue “neutral” (some countries like Germany even lost income).⁷⁸⁸ In addition, the reform neglected vertical equity, (a more progressive tax schedule) and instead emphasised horizontal equity (known as levelling the field). This was a marked contrast to earlier reform attempts, where vertical equity was dominant, taxing heavier those better off to reduce income inequalities. According to Sandford a negative by-product of the world wave of tax reform was that it significantly accentuated inequalities of income distribution.⁷⁸⁹

6.3.3.- Salinas Tax Reforms: Harmonising the Tax System with the First World

Studies show the huge influence of IFIs, but is important to recognise that enforcement and administrative reforms went far beyond international guidelines. The reforms included cutting income tax rates to persons and corporations, and eliminating some exemptions and deductions. Administrative change and the commitment to enforcement and surveillance was highly prized by the international community.

a) Cutting tax rates

The objective was to reduce income tax rates from individuals and corporations, to international standards. The fiscal reform included large cuts in tax rates, which had the explicit aim of making Mexico’s tax rates similar to those in the US, and Canada, as well as reducing the incentives for tax evasion. The top personal rate went down from 50% in 1988 to 35% in 1989.

⁷⁸⁸ Taxation and International Capital Flows, 45.

⁷⁸⁹ Sandford, Successful Tax Reform, 71.

The corporate tax rate also went down, from 42% in 1988 to 35% in 1990. Simultaneously, personal income tax was indexed to the consumer price index and corporate income tax was adjusted to inflation.⁷⁹⁰

Indirect tax rates were also reduced. In the framework of the “pactos” negotiations in 1991 the general rate for the VAT was reduced from 20% and 15% to a common rate of 10%. In addition, in 1992 VAT rates at the border zone (6,15, 20%) changed to a general rate of 10%.⁷⁹¹ To maintain similar tax revenues, the tax base was broadened and the number of taxpayers increased. The number of registered taxpayers other than workers, increased from 1.7million in 1988 to 5.6 million in 1994.⁷⁹²

Table 6.4.- Total Number of Taxpayers

	1988	1989	1990	1991	1992	1993	1994
Individual	1,457	1,604	2,741	3,042	4,461	5,066	5,264
Corporate	301	325	336	332	351	354	382
Total	1,759	1,929	3,077	3,374	4,812	5,421	5,647

Source: Ingresos Ordinarios del Sector Público Federal y Total de Contribuyentes Activos, Anexo 3 Informe de Gobierno, Poder Ejecutivo Federal, September 1997: 64.

Tax officials carefully forecast the potential losses in tax revenues, resulting from the reduction of tax rates. Former Secretary Aspe signalled that they were “perfectly conscious of the probable loss in revenue, but it was considered a necessary step in moving towards a free trade agreement with the United

⁷⁹⁰ Aspe, Economic Transformation, 99

⁷⁹¹ Gil Díaz, “Rehabilitation of Public Finance”: 51 and Aspe, Economic Transformation, 100.

⁷⁹² Gil Díaz, “Rehabilitation of Public Finance,” 53.

States.”⁷⁹³ Ultimately, revenue figures tend to increase despite the reduction on the tax rates, showing the importance of tax evasion. This shows the effect caused by the pressure exercised by IFIs. In order to compensate for the losses a programme of enforcement and collection was implemented (see table on revenue yields from different taxes). Aspe accepted that without enhancing the number of taxpayers and a strict programme of enforcement, the country would have experienced a much greater loss of tax revenues.⁷⁹⁴

b) Eliminating Exemptions and Deductions

According to former Finance Secretary Pedro Aspe, the burden of taxes lay largely on individual tax payers. Regarding corporate income it was concentrated only in a few sectors of the economy with tax rates usually higher than international standards. Some privileged sectors of the economy enjoyed tax exemptions despite the lack of social or economic justification for it. These tax system structural weakness and inequalities were one of the reasons behind the 1989 and 1991 tax reforms.⁷⁹⁵ The reform included a detailed survey of exemptions and deductions of previous tax laws, as well as an assessment of those fiscal privileges that were not truly justified according to economic rationale. Two examples are the elimination of deductions in restaurant consumption and expensive cars for executives.⁷⁹⁶ For Secretary Aspe the tax system was contaminated by a system of fiscal credits, conceived } in an strategy of industrialisation in vogue 25 years before.⁷⁹⁷ Eliminating

⁷⁹³ Interview Aspe, September 20th, 2000.

⁷⁹⁴ Ibid.

⁷⁹⁵ Aspe, Economic Transformation, 97.

⁷⁹⁶ Aspe, Economic Transformation, 101.

⁷⁹⁷ Aspe, Economic Transformation, 96.

exemptions and cutting the number of items that could be deducted helped broaden the tax base.

An unprecedented move was a stringent treatment of hard-to-tax-groups. In December 1989, special provisions for so-called minor taxpayers (MTP) and the special tax basis (STB) were eliminated.⁷⁹⁸ These had covered around a million and a half firms (compared with 250,000 registered as normal taxpayers) that each paid a specific quota depending on their activity, and did not pay VAT. These two taxes were designed as a means of taxing hard-to-tax groups, but end up unjustifiably subsidising many taxpayers. Tax exemptions enjoyed by artists were also eliminated. Through this legal change the government took away fiscal privileges enjoyed by 17% of all Mexicans, who had legally paid no taxes or enjoyed special treatment. As no accounting was required the authority did not know how much they were making, leading to the manipulation of profits and evasion. Many special groups were well organised and exercised political pressure by mobilising mobs and lobbying government officials as well as PRI leaders. The taxpayers that prospered enough to fall outside the special scheme, were able to resist this pressure supported by the political organisation that acted as their tax agents, lobbying in their favour. These schemes provided a legal cover up for many companies in the informal sector. A new scheme of cash tax flow was introduced, substituting the previous ones. An amnesty on all past obligations was granted if the taxpayers completed a declaration of assets owned. The taxpayers were required to maintain daily records and issue receipts to all customers. Concessions

⁷⁹⁸ Minor Taxpayers Regime (Contribuyentes Menores) and Special Basis Taxpayers (Bases Especiales de Tributación).

remained for peasants and truckers, who complained about the difficulty of getting receipts.⁷⁹⁹ Some minor privileges granted to areas such as agriculture, fishing, forestry, livestock, transport, banks and publishing industry were eliminated. Agriculture, fishing and cattle remained in a special regime with a reduction of 50% in the tax rate, but they were obligated to maintain a record of all the transactions in cash.⁸⁰⁰

To broaden the tax base fiscal subsidies to income tax were cancelled, companies were paying about one third of their employees' salaries on tax-exempt fringe benefits. The subsidy consisted in a tax reduction that was steeper for employees receiving a higher proportion of their income in the form of cash.⁸⁰¹ This is a practice that is commonly abused. The Mexican government itself is the first to fail to report to tax authorities full salaries; its employees receive up to 30% of their salary on tax-exempt income known as "compensación." This is a practice commonly used in both federal and local governments.

To fight tax avoidance a 2% levy on enterprise assets was introduced in 1989.⁸⁰² The Tax on Real Assets (TAR) was designed to stop tax manipulations, which had previously enabled up to 70% of business to avoid paying any profits. For many years, large companies in particular declared

⁷⁹⁹ Das-Gupta, 313-314 and interview Beatriz Paredes former peasant leader, Mexico September 25th, 1999.

⁸⁰⁰ Aspe, Economic Transformation, 93.

⁸⁰¹ Das-Gupta, 308.

⁸⁰² In 1989, Mexico introduced the Ley de Impuesto al Activo, (Asset Tax Law) an alternative form of minimum income tax on corporations and individuals engaged in business activities, the new tax was aimed at reducing tax evasion. The tax on real asset is assessed at a rate of 1.8% on the aggregate book value of the assets owned by a company in each fiscal year. Income tax payment may be credited against the Asset Tax. Tax authorities strongly believe that the TAR has been helpful in increasing tax collection.

continuous losses, but with the implementation of a new tax they had to pay at least 2% of the value of their assets each year. The tax was envisaged to curb widespread use of paper losses by companies, mostly in the form of transfer pricing by multinationals trying to avoid paying any income tax.⁸⁰³ According to Pedro Aspe, TAR was credited towards the payment of income tax, thus only affecting those which had no profits or had devised ways to avoid the payment of income tax.⁸⁰⁴ However, the tax caused great trepidation among the business community, who were opposed to the idea that they had to pay taxes when experiencing losses and accused the TRA of being unconstitutional.⁸⁰⁵ Thousands of *habeas corpus writ*, (Injunctions) were filed in the courts. Since then the Supreme Court has declared this levy unconstitutional, on the grounds of proportionality and ability to pay. Nevertheless, in order for a company to benefit from the Supreme Court ruling it must file itself a suit.

c) Administrative Reform

The modernisation of the tax system required a complete revision of administrative procedures.⁸⁰⁶ Tax authorities came to the conclusion that the problem with low collection was to a large extent structural, meaning weak tax infrastructure and administration, plus the handicap of widely spread corruption and evasion.⁸⁰⁷ To address these problems they proposed a package of measures that included the revision of administrative procedures and the

⁸⁰³ See Durnsbusch on Transfer Pricing.

⁸⁰⁴ Interview Aspe, September 20th, 1999.

⁸⁰⁵ Interview Raúl Picard, President of CANACINTRA, Mexico, September 25th, 2000.

⁸⁰⁶ Aspe, Economic Transformation, 97.

⁸⁰⁷ Esperanza Durán, "Mexico's 1986 Financial Rescue: Palliative or Cure?" in Philip The Mexican Economy, 98.

expansion of human and capital resources.⁸⁰⁸ There were partial attempts to decentralise the collection of taxes, by allowing the collection of taxes through commercial banks. The customs warehouses were opened to the administration of private companies, where private customs agents managed the information and the tax calculations. The special regime was replaced by a simplified one, in an attempt by the government to abandon the paternalistic approach, and introduce new conditions and incentives to gradually incorporate these companies to a competitive economy. A simple accounting system was required for the smallest companies, with simpler rules to calculate depreciation of assets, no obligation to pay total asset taxes nor to maintain a record of all the expenses.⁸⁰⁹

A new system of invoices was introduced with special forms to be printed by authorised printing establishments, with all the details of the selling establishment as well as those of the printer to avoid duplication. Sanctions on invoice irregularities were strongly enforced in 1993, when 2985 business were shut down and 24,871 fines were imposed.⁸¹⁰ Fiscal cash registers were also introduced to automatically record all sales; however, surrendering to political pressure they were withdrawn under the Zedillo's administration.

Important administrative reforms to the organisational structure took place during the Salinas term.⁸¹¹ Many of these reforms had the objective of making the system more efficient and reducing petty corruption. The authorities

⁸⁰⁸ Durán, 97

⁸⁰⁹ Aspe, Economic Transformation, 100.

⁸¹⁰ Des-Gupta, 314.

⁸¹¹ Des-Gupta, 317-326.

reduced the number of manpower from 46,000 in 1988 to 36,000 in 1991,⁸¹² eliminating a large part of the bureaucracy that resisted to the changes. Banks acted also as collector agencies, largely increasing the number of tax collection windows, reducing queues and improving services. To maximise collection they minimised direct contact with taxpayers and incorporated the use of computers and a new system of issuing and printing forms. The process of computerisation allowed collectors to increase the number of collection notices from 250,000 in 1988 to a staggering 2 million a year in 1993. To get around the bureaucratic obstacles of a fully computerised operation, the Tax Collection Agency privatised the entire computerisation process, using pre-programmed laptop audits.

d) Enforcement and Surveillance

One of the main objectives of the Salinas administration's fiscal policy was to fight tax evasion by improving the fulfilment of tax payers' obligations.⁸¹³ The Finance Secretary justified the fiscal reforms on the grounds that the capacity of the tax system to support the permanent expenditure of the government, the social infrastructure and the system's ability to correct the problems of inequality was greatly threatened by general evasion and tax avoidance.⁸¹⁴ Many legal changes were made to strengthen enforcement and firm actions were taken to enforce fiscal laws. The objective was to make an exemplary punishment that would induce other tax evaders to regulate their fiscal situation. Penalties for tax evasion were augmented, and the law was amended to close loopholes, and facilitate enforcement. Prior to the Salinas

⁸¹² Des-Gupta, 319.

⁸¹³ Gil Díaz, "Rehabilitation", 49.

⁸¹⁴ Interview Aspe, September 20th, 1999.

administration, a tax evader was not prosecuted if they paid what was owed plus a fine and charges. Fiscal laws were reformed to enhance the grounds on which government could imprison tax evaders. Before the legal reform only those who presented a fraudulent declaration could be prosecuted and those not registered as taxpayers could not.⁸¹⁵ The number of prosecutions increased from only two registered cases between 1929 and 1988, to more than 600 tax evasion prosecutions by 1994, of which more than 250 included imprisonment.⁸¹⁶ According to the deputy fiscal prosecutor, the legal department decided to pursue only those cases with a large public impact, using them as exemplary punishment to increase deterrence.⁸¹⁷ The amount of the fraud should be around US\$3 million for targeted personalities.⁸¹⁸

The number of active taxpayers grew sharply as a result of the improved tax enforcement.

Table 6.5.- Number of Active Tax Payers (in millions)

Year	Salaried Employees	Tax Payers	Total
1988	11.14	1.76	12.90
1989	11.87	1.93	13.80
1990	12.70	3.08	15.78
1991	13.60	3.38	16.98
1992	13.94	4.81	18.75
1993	14.01	5.42	19.43
1994	14.50	5.65	20.15

Source: Director General of Revenue Policy and International Fiscal Affairs, Secretary of Finance, 1998.

e) *The Auditing Programme*

⁸¹⁵ Elizondo, "In Search."

Interview Aspe, September 20th, 1999 and Aspe, *Economic Transformation*, 100.

⁸¹⁷ Interview Enrique Hernández, Deputy Fiscal Attorney, Mexico, October 24th, 2000.

⁸¹⁸ Among those prosecuted were a world boxing champion, some soap stars, couple of singers, a large banker, the owner of a foot ball team, and some prominent businessmen.

A large fiscalisation programme meant that 10% of taxpayers were subject to random audits. In 1988, only 14% of the 54,000 audits carried out showed credit balances favouring fiscal authorities. By 1991, out of the 156,00 audits, 90% favoured the treasury.⁸¹⁹ The benefit-cost ratio of the audits increased ten fold during a very short period of time, due to a programme of incentives for tax auditors. Bonuses were given according to the number of penalties realised by tax auditors, and as a result their salaries went up more than 100%. This method increased by 60% the total revenues collected from penalties. Although the incentives scheme was largely attributable for improving the effectiveness of audits, other policies like the dismissal of corrupt officials, changes in the audit procedures, rotating periodically auditor involved in different stages of the auditing process contributed to the rise in collection-effectiveness ratio. Reducing the contact between taxpayers and auditors to curb collusion proved to be a huge success. According to the leader of the bureaucracy, Deputy Jiménez, the bureaucracy posed no resistance to the reform process; in his words "our open support to the reforms in public management was the key element in the successful implementation of the new policies."⁸²⁰

Another innovative scheme was the introduction of private sector auditors for large taxpayers.⁸²¹ The auditor, a certified public accountant, was liable for criminal penalties if there were proven irregularities in the tax return. The number of taxpayers subject to private audits grew from around 25,000 in 1988

⁸¹⁹ Gil Díaz, "Rehabilitation," 50.

⁸²⁰ Interview FTSE leader, Deputy Carlos Jiménez, Philipines, July 28th, 2000.

⁸²¹ The system was mandatory for those with annual income of around US\$2 million (N\$5.8) or real assets of at least US\$3.9m (N\$11.7m).

to 65,000 in 1993.⁸²² As a result, tax officials in the auditing department focused on middle and small taxpayers, increasing the auditing pressures on these taxpayers. Despite the good relations between the private sector and government, the efforts to prosecute tax evaders for exemplary punishment and increase auditing were described by business organisations as "fiscal terrorism."⁸²³ Business representatives complained that they were harassed with unlawful practices. The audits were accused of being politically motivated, while the government continuously assured every one that audits were drawn at random.⁸²⁴

f) The Results of the Tax Crusade in Revenue Terms

These were the most important tax reforms in thirty years. Although the increase of the tax collection ratio was not very large, the administrative reforms put Mexico in the vanguard in Latin America. As a result of the adopted fiscal policies, tax receipts of the federal government (excluding oil related taxes) increased from 9.7 % of GDP in 1987 to 11.3 % by 1994. In real terms, tax receipts grew 30% between 1988 to 1991, whereas the economy, during the same period, grew just 11.8%.⁸²⁵ In 1987, 43.2% of the resources of the Federal Government came from the oil industry; and resources extraneous to oil, including revenues not derived from taxes, represented 56.8%. This situation changed considerably by 1991, when figures from said sources

⁸²² Audits Statistics, Administración General de Auditoría Fiscal Federal, Secretary of Finance, 1996.

⁸²³ Carlos Abascal, President of COPARMEX, Mexico, September 26th, 1998, various newspapers.

⁸²⁴ However, the method looks at the history of the taxpayer, such as recurrent losses, large changes in the reported profits of income, or constant credits. The crossing of information, as well as complains are taken into account.

⁸²⁵ Gil Díaz, "Rehabilitation," 50.

reached 28.8% and 71.2% respectively.⁸²⁶ Between 1989 and 1991, real non-oil tax revenues increased 29.5%, that is 1.5% of GDP. An increase of nearly 60% was the result of more revenue from a broader income tax base and a growing number of taxpayers. The rest came from an increase above 12% in the collection of the value-added tax and indirect taxes from international commerce.⁸²⁷

Income tax rose from 3.9% of GDP in 1987 to 5.1% in 1992. VAT income grew from 2.7% in 1987 to 2.9% in 1988, 3.1% in 1990 and 3.3% in 1991.⁸²⁸ In 1988, the taxpayer census numbered 13.1 million, this figure went up to 17.2 million in 1991 (31.7% higher than the previous one).⁸²⁹ With regard to private individuals engaged in entrepreneurial activities, the number grew by 106% during the above period.⁸³⁰

Table 6.6.- Tax Collection as % of GDP

1988	1989	1990	1991	1992	1993	1994
11.6	11.7	11.1	10.6	11.3	11.4	11.3

Source: Ingresos Ordinarios del Sector Público Federal y Total de Contribuyentes Activos, Anexos Tercer Informe de Gobierno, Poder Ejecutivo Federal, Septiembre 1997:64.

Conclusion

As seen here, Salinas' reforms have been praised by academics and international institutions. The success is largely due to the fact that the policy shift was accompanied by profound changes in the administration and the

⁸²⁶ Ibid.

⁸²⁷ Aspe, *Economic Transformation*, 102.

⁸²⁸ See figures in Elizondo, "In Search," which may differ with other official sources.

⁸²⁹ This include all kind of workers.

⁸³⁰ Gil Díaz, "Rehabilitation," 50.

enforcement mechanisms. This confirms Bird's theories that a legal tax reform is futile without an administrative change. Undoubtedly, the most important administrative tax reforms in the last three decades took place during Salinas' term. But despite its administrative success, tax collection yield increased little and many of his tax policies were abandoned by the next president.

According to Salinas, his greatest achievement on the tax front was enhancing tax collection efficiency without raising new taxes. In his memoirs, he praises himself for cutting taxes while increasing tax collection and social spending. He highlights his commitment towards tougher enforcement of fiscal laws, from 3 to 700 tax convictions during his term and broadening the number of register taxpayers three fold.⁸³¹ But, in the same text he recognises that he could have done more; what he calls in his book "an additional effort to enhance collection." However, political difficulties during the first year of his administration inhibited the possibilities of implementing a profound tax reform.⁸³²

According to Salinas there were three reforms missing that needed to be introduced:

- 1.-Improve the surveillance on the management of VAT by the states, since many provincial governments made not even one VAT audit.
- 2.-Improve taxes on land ownership (Predial), increasing its collection yield from 2 to 4% of GDP, like the yield in Chile.

⁸³¹ See Carlos Salinas, Mexico : Un Paso Difícil a la Modernidad, 389.

⁸³² Ibid.

3.-Implement a general VAT rate and eliminate the zero rate, since it prompted evasion representing up to 3% of GDP.⁸³³

The origins of Salinas' tax reforms lies in the deep fiscal disequilibrium of the country and the need to rapidly adapt to globalisation. The depth of the fiscal problems in the early 1980s was the force that triggered the need for a comprehensive tax reform. The economic crisis and the crunch of resources pushed the government to have recourse to new ways for raising revenue. Traditional sources of finance such as inflation and borrowing were not possible any more, so new ways such as privatisation were envisaged. Once again the state ended up using alternative means for financing itself while avoiding taxation as much as possible.

The concentration of economic power with the wave of globalisation and privatisations complicated further the ability of the state to extract resources from the economic elite. Their financial mobility increased their economic leverage, in a time of great demand for financial resources. Globalisation enabled IFIs to push their ideological agenda forward. In addition, the conditions attached to the loans allowed them to get directly involved in economic policy making. The drift of reform came from outside while the Mexican technocracy welcomed it. The political leadership clearly understood the need to move forward by opening the economy to a globalised world and the cost of ignoring it.

⁸³³ Ibid.

The large transformation of the tax system affected all sorts of taxpayers differently. Large and medium size businesses benefited the most, from the reduction of tax rates, investment write offs, inflation accounting procedures, as well as the institution of private auditors which led to quicker refunds. The only major cost was the new tax on real assets, which nevertheless could be credited to the payment of income taxes. Industries with special political clout such as agro-industries and the transport industry continued to enjoy a large number of special concessions.

The greatest burden of the tax policy reforms fell on small business, with the elimination of special treatment, stricter tax enforcement and the implementation of new rules for accounting and issuing invoices. For the middle classes the tax services improved but many deductions were eliminated, increasing their tax burden, they also benefited from the lower tax rates. Salaried employees benefited with the introduction of fiscal subsidies for the poorest taxpayers and the reduction of VAT.⁸³⁴ Defending himself against his detractors, who accuse him of benefiting the richest. Salinas argues in his memoirs, that his tax policies favoured mostly the poorest, since tax increases concentrated on gasoline levies (80% increase during his term) which are paid by only 10% of the population with higher income, while he reduced the general VAT benefiting those less well off.⁸³⁵

Noteworthy, is that these reforms were possible thanks to the *sui generis* nature of the Mexican political system. According to Das-Gupta the scope and

⁸³⁴ See Das Gupta, 328-332.

⁸³⁵ See Carlos Salinas de Gortari, Mexico: Un Paso Difícil a la Modernidad.

span of the reforms was possible because of the willingness of the President and the new team of technocrats in economic policy making sphere, but more importantly thanks to the unique political conditions that existed in Mexico. He highlights the virtual absence of political resistance and the lack of inertia from within that could have constituted an obstacle to administrative reorganisation, to the unique character of the Mexican state, with the hegemonic role of the PRI and great presidential power, acting as a manager of conflict among interest groups. He also points out that the legislature has acted as a rubber stamp to executive initiatives because of the weak power of the opposition. In a few words, the autocratic regime facilitated the implementation of policy reforms.⁸³⁶ Nevertheless, these political conditions dramatically changed after 1994, changing the framework and bringing new actors into the process of policy making. The democratic opening would have an impact on taxation, and the next chapter examines Zedillo's tax reforms within a new framework of democratisation.

⁸³⁶ See Smith, Acuña and Gamarra on the authoritarian technocratic leaders in Latin American countries following the neo-liberal paradigm. William C. Smith, Carlos H. Acuña and Eduardo A. Gamarra, eds. Democracy, Markets and Structural Reform in Latin America: Argentina, Bolivia, Brazil, Chile and Mexico (Miami: North-South Center University of Miami, 1993).

Chapter VII

Democratic Openness

"I will not make false promises over tax cuts. We will review our tax system and I will make sure to undertake all the necessary steps to become fully competitive at the international level."

Ernesto Zedillo as presidential candidate.⁸³⁷

After more than 70 years of hegemonic control by a single political party, the country has gradually opened up, becoming a democratic regime. The resilient characteristics of the Mexican political system, identified by Das-Gupta as the main reasons behind the successful implementation of the tax reforms during the Salinas' period are quickly disappearing. The new political framework is changing some of the most important variables, and these include the rapid deterioration of the PRI's hegemonic role, the weakening of the presidential office and the emancipation of the legislative branch. These changes have taken place in the short span of time of six years. Political turmoil and the unexpected crisis in 1994 cracked the fundamentals of the long lasting political regime, opening the door to democracy.

7.1.- Characteristics of this Period

The 1994 crisis largely redefined the geopolitical face of the country. Popular discontent over the grievous political events at the end of the Salinas term, and the devastating financial crisis in 1995, changed electoral preferences benefiting opposition parties. The official results gave President Zedillo victory

⁸³⁷ Campaign speech before private sector representatives in Manzanillo, Colima, May 14th 1994. See Ernesto Zedillo, *Una Propuesta en Campaña*, PRI: Coordinación General de Campaña, 1994: 75. To learn more about Zedillo's campaign tax proposals see speech given on June 6th, 1994 "Crecimiento Económico para el Bienestar Familiar," Ernesto Zedillo, *Propuestas y Compromisos* (México: Editorial Noriega, 1994): 68-70.

with only 50.2%, a tight victory, if one takes into account that before 1982 the official party has rarely announced victories of less than 95%.⁸³⁸ From the mid 1980s opposition parties increasingly began to conquer numerous elective posts at state and municipal level.⁸³⁹ The rapid growth of opposition victories, both from the left and right, encouraged opposition parties (mostly PAN) to call for an overhaul of the relationship between the state and municipal governments with the central government. The government responded, incorporating a scheme called “new federalism,” a priority for President Zedillo’s government programme.⁸⁴⁰

The issue of federalism was a very important part of the public rhetoric of Zedillo’s presidential campaign.⁸⁴¹ As a candidate, he stated that “in federalism we have a legal, political and social instrument to take fully advantage of. We are going to reform our federal transfer system in order to strengthen the fiscal resources transferred to state and municipalities.”⁸⁴² The pressure of opposition parties put the issues related to federal transfers and fiscal coordination at the top of the agenda.⁸⁴³ However, as soon as the growth of opposition at state level lost steam, at its mid-term elections so did the impetus of the new federal

⁸³⁸ “Mexico: Country Profile 1995-1996.” Economist Intelligence Unit, United Kingdom, 1996: 4.

⁸³⁹ See Loeza on the growth of PAN since mid 1980’s.

⁸⁴⁰ Federalism was one of the main issues during the 1994 presidential campaign, see Zedillo’s campaign records in Una Propuesta en Campaña and Propuestas y Compromisos.

⁸⁴¹ For further information on the relevance of federalism see Miguel Osorio Zedillo Frente a su Pueblo (México: Coordinación Nacional de Estudios Históricos Políticos y Sociales, PRI, 1994) and Una Propuesta en Campaña and Propuestas y Compromisos.

⁸⁴² Speech given in Netzahualcoyotl, Mexico State on April 15th, 1994.

⁸⁴³ For interesting efforts made to strengthen the system of fiscal coordination, the transfers of federal funds to municipalities and their powers to collect local taxes, see Foros Regionales de Presidentes Municipales (México: Federación Nacional de Municipios en México, 1999). On the issue of Federalism and Municipal reform see “Reunión Nacional de Legisladores Locales Priistas,” Cancún, Quintana Roo, October, 1999.

scheme. At the end, only limited reforms were achieved on the fiscal coordination front.⁸⁴⁴

The Zedillo term's tax reforms responded mostly to the devastating economic effects of the 1994 financial crisis and the international plunge in oil prices in 1998. Small improvements were made to streamline the tax system as well as cracking down on evasion and corruption. Despite these efforts, however, tax collection remained very low. Not even the economic buoyancy experienced in the last few years (more than 5% GDP growth from 1996-2000) translated into an increase in the tax revenue capacity. The reason rests to a certain degree on the stiff adjustment measures implemented to counteract the 1995 economic crisis. These measures and the contraction of the economy had a harsh toll on tax collection. Unfortunately, despite the loud campaign, what stands out is Zedillo's lack of political commitment towards reform.

The economic crisis at the start of Zedillo's term and the democratic conditions reshaped not just the forces involved in the tax policymaking process, but the process itself. The executive branch had lost sole control of the tax policymaking process. New influential actors have been incorporated into the process, particularly the legislative branch, which has regained its role as decision-maker. In addition, the scarcity of credit brought back the powerful influence of domestic capital and IFIs, specially the IMF.

⁸⁴⁴ See "Reformas a la Ley de Coordinación Fiscal 1998-2000," LVII Legislatura, Comisión de Fortalecimiento Municipal, January 2000.

The new political framework, characterised by greater political competition and “alternancia” (shift of power among political contenders), had a far-reaching impact on public policies. It also affected the way tax policy is designed and implemented. However, the full impact of democracy on the political economy of taxation remains uncertain due to the fact that the democratic process is just beginning.

7.2.- Economic and Political Conditions

a) Economic Policies Ridden by the 1995 Crisis

The fiscal policies during Zedillo’s sexenio had to respond to the devastating effects of the 1995 economic crisis.⁸⁴⁵ From the first day in office, President Ernesto Zedillo had to face huge macroeconomic disequilibrium, as well as pressing international financial requirements in the short term. A large current account deficit of US\$ 29.4 bn, equivalent to 8% to GDP, and US\$ 28 bn in short term maturity debt instruments known as “tesobonos.”⁸⁴⁶ There were growing doubts among investors that the Mexican government could honour the US\$28 billion short-term dollar-linked debt due in 1995. In addition, the Mexican economy suffered other structural weaknesses such as a reduced level of domestic savings and an overvalued peso, reducing its capacity to withstand internal and external political and economic shocks that was those occurred in 1994.⁸⁴⁷ These economic difficulties plus unprecedented political turmoil increased the lack of confidence of portfolio investors who took their

⁸⁴⁵ José Angel Gurría, interview Mexico city, September 23rd, 1999.

⁸⁴⁶ See Jiménez, “The Mexican Financial Crisis.”

⁸⁴⁷ While during 1975-1985 the average domestic savings was 20% of GDP, by 1995 it had fallen to 15% of GDP. “The Alliance for Economic Growth,” Under Secretariat of Finance and Public Credit, October 26th, 1996.

investment out of the economy resulting in the 1994 liquidity crisis.⁸⁴⁸ An interest rates like in the US also had a negative impact on financial flows to Mexico.

On the first of January, the day that NAFTA come into effect, a group of armed indigenous peasants in the southern state of Chiapas declared war on the federal government. Although the insurgent "Zapatista Army" entered negotiations with the government a couple of months later, civil unrest and political uncertainty remained. Politics became violent as never before, and in March 1994, Luis Donaldo Colosio, PRI's presidential candidate was assassinated. During the same year, the PRI's former secretary general, Francisco Ruíz Massieu was also killed. The kidnappings of prominent businessmen added fuel to rampant uncertainty and political instability. These unfortunate events made investors very nervous, specially with the Presidential and congressional elections to be held in August that year, pushing further the outflow of foreign capital that traditionally precedes elections.

The economic uncertainties and the political turmoil caused first a sudden interruption of foreign capital flows into Mexico, and later a reversal of capital flow.⁸⁴⁹ In response, president Zedillo devalued the currency and later adopted a floating exchange rate. The US financial sector felt betrayed by the devaluation. Besides, the mismanagement of the devaluation added fuel to the

⁸⁴⁸ For a review of the causes of the 1994 liquidity crisis see Fieldstain. See "To Mexico Rescue," The Economist February 4th, 1995 and Jiménez.

⁸⁴⁹ See "Under the Volcano".

prevailing uncertainty,⁸⁵⁰ triggering probably the worst economic crisis in Mexico's contemporary history.⁸⁵¹ The vicious cycle of devaluation-inflation led to extremely high interest rates in real terms, contributing to a severe contraction in aggregate demand. As a result, countless companies and households were unable to carry their debt burden, the economic activity shrank and unemployment rose to unprecedented levels.⁸⁵² In 1995 the economy plunged into a deep recession, and GDP contracted by 6.9%. In the end, the Mexican government was able to weather the liquidity crisis with a syndicate of loans and loan guarantees put together by the US government for an unprecedented US\$50bn.⁸⁵³

b) The 1998 Plunge in Oil Prices

Tax policy responded once again to exogenous events with the international plunge in oil prices.⁸⁵⁴ Confronting a sharp decline in revenues, the government decided to drastically cut expenditures to balance the budget. The Finance Secretary announced three budgetary adjustments to absorb oil revenue losses, which amounted by the end of 1998 to US\$ 7,300 million (1.9% of

⁸⁵⁰ Newspapers editorials reflected the general mood in the US over the Mexican devaluation and the loss of confidence in Zedillo's policies. The Wall Street Journal stated that with the devaluation, the Mexican government sacrificed its most valuable forward moving asset "market confidence," Review and Outlook, Mexico: Policy Matter," The Wall Street Journal, February 1st, 1995 and Colin McMahon, "Peso, Stock and Confidence Fall in Mexico," The Chicago Tribune January 11th, 1995. Investors harshly criticised President Zedillo who has promised he would not devalue the Mexican currency. Few days earlier Many experts also criticised the mishandling of the devaluation, labeling it as the "December error." Tanzi in The Political Economy of Fiscal Deficit Reduction, highlights the importance of credibility, were being perceived as sincere is as important as believed competent, 514.

⁸⁵¹ See Sidney Weintraub, Mexico's Devaluation: Why and What Next? (Washington, DC: Center for Strategic International Studies, 1995).

⁸⁵² Unemployment rose to 5-6% and the number of bad loans rose to 70% of the total loans.

⁸⁵³ See, Jiménez, Edwards, "to Mexico's Rescue" and "Rescuing the Sombrero".

⁸⁵⁴ See "Sexophobia," The Economist October 31st, 1998 an "Mexico's Economy. Miracle or Mirage?" The Economist April 11th, 1998.

GDP).⁸⁵⁵ For every dollar the price of oil fell, Pemex lost about US\$1.1bn per year.⁸⁵⁶ When the price of oil plunged to 25 year record lows, Luis Téllez, Secretary of Energy, highlighted the importance of a tax reform in order to increase tax collection from 11% to 20% of GDP. He stated that “ it was no longer possible to finance the budget, primarily on oil revenues.”⁸⁵⁷ As a result of the international collapse of oil prices, the country reached an 18 year low record in total revenues.⁸⁵⁸

To compensate for the loss of revenues, the Secretary of Finance proposed in the 1999 budget new taxes and tax rate increases to Congress. Among the new taxes suggested was a telephone service tax.⁸⁵⁹ However, the powerful lobbying of the telephone companies, owned by Mexico’s largest billionaires, blocked the entry of the new levy.⁸⁶⁰ Curiously, the highly passionate debate over the VAT rate in 1998 did not resurface in the 1999 budget. According to an opposition congressman, “it was inappropriate to suggest tax cuts at a time when government revenues had been considerably squeezed by large losses in oil revenues.”⁸⁶¹

⁸⁵⁵ In 1998, the average price of the Mexican oil mix was 10.20 dollars per barrel, 38% below the 16.46 dpb in 1997; such a fall represented losses for more than 1% of GDP. To offset the losses, the government implemented three fiscal adjustments during the year amounting to 29,775 million pesos and an increase in non- oil revenues of 6,472 million pesos. “Mexico Implements a Third Budgetary Adjustment,” Press Release, Hacienda, July 8th, 1998. To learn about the plunge of oil prices, see “Nueva Proyección para el Precio de la Mezcla de Exportación del Petróleo Mexicano,” Secretaría de Energía, México, July 8th, 1998, or “Sagging Oil Prices Complicate Pemex Future,” Petroleum Economist June 1998.

⁸⁵⁶ See Henry Tricks, “Mexico Faces Oil Price Crunch,” Financial Times March 20th, 1998 and interview Pablo Espresate, Pemex representative in Europe, London, May 16th, 1999.

⁸⁵⁷ Yadira Mena, “Debe Aumentar a 20% la Recaudación Fiscal,” El Economista December 8th, 1998:1.

⁸⁵⁸ Victor Ballinas and Mireya Cuellar, “ En 98, los Menores Ingresos de 18 años, señala Hacienda,” La Jornada July 1st, 1998: 12.

⁸⁵⁹ See “Economic Policy Guidelines for 1999,” Secretariat of Finance, November 13th, 1998.

⁸⁶⁰ Some of the tycoons behind the large telephone companies are Carlos Slim, Telmex’s owner; Carlos Peralta Iusacell’s owner and Roberto Hernández owner of Avantel.

⁸⁶¹ Interview, Senator Enrique Franco from PAN, Mexico City, September 2erd, 1999.

c) Export Growth Boom

A resilient characteristic of this period is that Mexico experienced a remarkable recovery in GDP growth, thanks to the astonishing growth in exports. During Zedillo's term, Mexico had become one of the most successful export countries in the world, ranking number seven world-wide. Thanks to the implementation of the North American Free Trade Agreement (NAFTA), international trade was boosted from US\$ 51.9bn in 1993 to US\$ 160 bn for the year 2000. The average annual growth rate in exports growth since 1993 was 18%.⁸⁶² Exports had been the most dynamic component of aggregate demand, contributing to growth and employment creation.⁸⁶³ However, despite the blossoming of the export sector it had only generated a limited impact on the income of the State. Trade agreements reduced tariffs and therefore revenues.⁸⁶⁴

Exports also contributed very little to the tax receipt due to the preferential tax treatment enjoyed by the in-bond industry. The number of maquiladoras⁸⁶⁵ in Mexico had grown from 2, 047 in 1993 to 4, 367 in 1998, in total they contributed US\$ 45,500 million in 1998, almost half of total exports.⁸⁶⁶ Maquilas were exempt from VAT and import tariffs, since they paid a safe harbour tax equivalent to 5% on assets. Their status changed from temporary assembly plants to permanent establishments in the year 2000, and with that they lost some privileges like the tariff waiver (eliminated on January 1st, 2001). The

⁸⁶² "Report on International Trade," SECOFI, 2000. Mimeo

⁸⁶³ For the recent statistics on international trade see "Mexico's Achievements in Export Activity," Bancomext, 1999. Mimeo.

⁸⁶⁴ Interview Secretary of Trade and Industry, Hermino Blanco, London, February 11th, 1997. See also Mayela Vazquez, "Golpea TLC Recaudación," *Reforma* July 10th, 1998, 1.

⁸⁶⁵ Maquiladoras are engaged generally in assembly activities and combine Mexican labour and material with foreign technology, components and capital.

⁸⁶⁶ See "NAFTA Update," Report by the SECOFI-NAFTA Office, Mexican Embassy in the US, Washington DC, 1998.

proposal to collect income tax from maquiladoras encountered heavy opposition, even from the US Treasury whose representatives argued that these measures could provoke double taxation.⁸⁶⁷

In order to meet the large expansion of trade, the government had undergone a process of modernising the customs agency, one of the busiest in the world. Nevertheless, corruption and deficiencies in this agency prevailed despite the new policies.⁸⁶⁸ A document from the Secretariat of Finance reports that an internal programme for auditing customs officers, ended up in many agents being prosecuted for corruption.⁸⁶⁹ To the Vice-president of the Association of Customs Agencies, what has been found only represents the tip of the iceberg.⁸⁷⁰

Very significant, is the fact that the economic crisis accelerated the process of democratisation; bringing politicians from opposition parties to numerous elected posts and offices of influence in decision-making. This has changed the way tax decisions have been made in Mexico for seventy years.

d) Political Openness: Changing the Way Tax Policy is Made

Challenges both from the left and right began to render electoral fruit to opposition parties by the end of the 1980s. In this decade there was a rapid

⁸⁶⁷ See Andrea Mandel-Campbell, "Shipping Mexico: To Raise Harbour Taxes," *Financial Times* October 29th, 1999: 13 and Christopher Parkes, "Free Trade Zone May be Victim of its Own Suces," *Financial Times* May 14th, 1999, 11; Andrea Mandel-Campbell, "Maquilas Prepare for Tax Shake-Up," *Financial Times* May 13th, 1999:8.

⁸⁶⁸ "Corrupción, Fraude y Deficiencias en el Sistema de Aduanas: Omar Fayad," *Novedades*, March 11th, 1999 and interview with a customs agent at Mexico city international airport, on September 19th 1999.

⁸⁶⁹ Reporte interno Dirección General de Aduanas, Secretariat of Finance, 1998.

⁸⁷⁰ Interview Jorge Rivera, Vice-president Private Customs Agents, September 28th, 2000.

decline in the hegemonic role of the PRI, as well as a significant fall in the previously omnipotent power of the president.⁸⁷¹ A wave of democratisation in the late 1990s brought a more plural political system to the country, to such degree that Krauze has claimed that “the age of politics has begun in Mexico.”⁸⁷²

Political openness during Zedillo's term had far-reaching effects in tax policy making, incorporating new actors while opening the economic debate for the first time in seven decades. However, it is important to note that these were not presidential initiatives but political victories by opposition parties.

In tax policy terms the main effects of democratisation were:

- a) The growth of opposition has translated into greater demand for a new meaning to federalism, aimed at regulating a more equal relationship among the tiers of government.
- b) Opening the tax debate to new actors, including business representatives as well as legislators from the official party who have become outspoken as presidential power declines.
- c) Most important reinstating the role of the Legislative power as tax policy maker, bringing to an end the role of the Executive as a sole tax policy maker.

⁸⁷¹ Krauze has described the Mexican Presidency as an “imperial Presidency” due to the great powers enjoyed by the chief of the executive. Krauze, La Presidencia Imperial.

⁸⁷² “Mexico Enters the Era of Politics,” The Economist July 12th, 1997:32.

a) *The Growth of Opposition: the Impetus Behind the New Framework of Federalism*

The growing number of electoral victories achieved by opposition parties at state and municipal level translated into new demands for administrative decentralisation as well as redefining the relationships amongst tiers of government. Such demands were channelled by the government via a new framework for inter-governmental relations known as “new federalism.”⁸⁷³

Esteban Moctezuma, former presidential appointee for leading the programme of federalism, argued that “Mexico enjoys a *de jure* federalism but suffers the burden of *de facto* centralism,”⁸⁷⁴ despite the fact that in the Constitution Mexico is a Federal government.⁸⁷⁵

Centralism has caused subnational governments to become largely depended on federal revenue shares.⁸⁷⁶ At present, the federal government raises most revenues and then distributes them among states and municipalities. The tax sharing agreement represents about 80% of states’ revenues, with 20% going to the municipalities. In addition, there is an unequal allocation of revenue shares, since a small group of states (the Federal District, Jalisco, Mexico, Nuevo León, Tabasco and Veracruz), account for 59% of the government’s

⁸⁷³ This was one of the main issues during Zedillo’s campaign.

⁸⁷⁴ Esteban Moctezuma, Conference on Federalism, The North American Institute, June 7th, 1996.

⁸⁷⁵ To learn more about Mexico’s Federalism, see Alicia Hernández Chávez, “Federalismo y Gobernabilidad en México,” in Marcello Carmagnani Ed. Federalismos Latinoamericanos: México, Brasil, Argentina (México: Colegio de México 1993): 263-74.

⁸⁷⁶ See Marcela Astudillo Moya, México la Distribución de los Ingresos Públicos, la Federación y los Estados (México: UNAM, 1989). Federalism has been one of the central demands of the PAN, interview with PAN President Bravo Mena, London, 24th February, 2000, see also Victor González, “Busca el PAN Terminar con el Exacerbado Centralismo Económico,” El Financiero August 20th 1997, 9.

grants know as "participaciones," and 44.2% of the total public investment.⁸⁷⁷

For Francisco Suárez, these large regional inequalities called for a new framework for revenue sharing.⁸⁷⁸

Many governors from both the official and opposition parties, began to question the revenue sharing formula demanding more resources for their governments. Richer states complained that they were unfairly shouldering the burden for the less developed states in the south and subsidising the Federal District. Competing this view, governors from less developed states demanded an equitable formula for the distribution of resources, one which recognised regional inequalities.⁸⁷⁹ The State's governors also complained about the wide discretionary faculties given to tax officials when distributing the budget.⁸⁸⁰

To deal with this problem Zedillo's administration implemented a federal scheme that sought to delineate the scope of authority in the hierarchy of governments and redefine the decision of fiscal functions among levels of government. The objectives included redesigning the formulas for revenue sharing among levels of government and sharing responsibilities not just passing greater tax powers and more resources. The reform extended to

⁸⁷⁷ See Astudillo Moya.

⁸⁷⁸ Interview, Suárez Dávila, Chairman of the Treasury Committee at the Chamber of Deputies, London, May 23rd, 1997.

⁸⁷⁹ César Camacho, Governor of the State of Mexico, argued that the distribution of resources should be clearly based on the law, not in the discretion of tax authorities. Oaxaca's governor, Diodoro Carrasco and Rigoberto Ochoa governor from Nayarit asked to allocate the federal resources based on the state's needs, benefitting the poorest states, while Nuevo León's governor Canales demanded an end to the subsidies to the federal district and a distribution of resources according to their contribution to the tax receipt. See "Se Fortalecerá el Federalismo Sí Hay Trato Equitativo en la Reforma Fiscal," *El Hidrocálido* September 6th, 1995: 4.

⁸⁸⁰ Interviews with Aguascalientes' governors, (PRI) Otto Granados, Aguascalientes, Marh 3rd 1997 and (PAN) Felipe González, México, September 19th, 1999; Guanajuato's Governors (PAN) Medina Plascencia, León, October 2nd, 1998 and Fox Quezada, London, June 5th, 1997.

institutional restructuring, enhancing the autonomy and welfare of the local governments, and at the same time preserving their sovereignty.⁸⁸¹

Traditionally, the federal government had transferred resources through the revenue sharing agreement and the programmable budget. Zedillo's government introduced a third mechanism for transferring resources to the states and municipalities known as "*aportaciones*" or "*Ramo 33*," These entitlement grants were additional to the revenue sharing allocations known as "*participaciones*." However, they were tied to a specific purpose, and certain provisions with a clear set of responsibilities for each level of government, monitoring and accountability.⁸⁸²

b) Democracy Incorporated New Actors to the Economic Policy Debate

The July 1997 Congressional election was a watershed in Mexico's political history.⁸⁸³ After seven decades of congressional monopoly, the official party (PRI) lost control of the majority at the lower house as well as Mexico City's first elected mayor.⁸⁸⁴ Opposition victories fundamentally altered the balance of power in economic policy making and led to an unprecedented dispute over

⁸⁸¹ Interview Esteban Moctezuma, Mexico, May 4th, 2000.

⁸⁸² The 1998 budget made a reform to the Fiscal Coordination Act, institutionalising federal contributions to state and municipal governments via the creation of three funds: primary education and teacher training, health services, and investment in basic social infrastructure at the municipal level. See also *Avances en el Federalismo* (México: Presidencia de la República, November 25th, 1997).

⁸⁸³ See "A Watershed in Mexico," *The Financial Times* July 8th, 1997: 39. Mexico emerged as a new political system after the mid-term 1997 elections. See "Mexican Voters Abandon PRI After Seven Decades," *Financial Times* July 8th, 1997:39.

⁸⁸⁴ See "Mexican Voters Abandon PRI After Seven Decades" and "Mexicans Vote for a Peaceful Revolution: In an Historic Switch the Opposition May Have Won 255 of 300 Directly Elected Seats," *Financial Times* July 8th, 1997: 39.

the power of decision making.⁸⁸⁵ To Krauze, the election was a historical event “forcing the government/PRI to negotiate with opposition parties over the passage of important legislation through Congress, resulting in a greater balance of power between the legislature and the presidency.”⁸⁸⁶ Deputies from opposition vowed to transform a rubber-stamp Congress into an independent branch of government, ending sixty eight years of legislative subordination to the President.⁸⁸⁷ They proclaimed the end of “presidential absolutism” in economic affairs.⁸⁸⁸

The results of the elections brought for the first time in seven decades co-habitation in Congress, and the need for the official party to negotiate economic policy. Opposition parties have built support for their causes on popular discontent with austerity measures and declining living standards. They campaigned blaming the neo-liberal economic model for the harsh situation, promising to change economic policy if they were elected. Once in control of Congress, they even announced that PAN, PRD and PT had reached a consensus to change the economic model.⁸⁸⁹ Two opposition leaders López Obrador from PRD and Calderón Hinojosa from PAN called Congressmen to overhaul the country’s economic policy. Both agreed that it was no longer the

⁸⁸⁵ Gerardo Albarrán de Alba, “En la Cámara, el Choque entre Oposición y Régimen se Convirtió ya en Una Auténtica Disputa por el Poder,” Proceso August 31st, 1997: 6-10.

⁸⁸⁶ “Mexicans Vote for a Peaceful Revolution.”

⁸⁸⁷ See Santiago Creel comments on “Mexico’s New Congressmen Mount Challenge,” Financial Times July 9th, 1997:37.

⁸⁸⁸ Carlos Acosta Córdova and Francisco Ortiz Pardo, “Legisladores de Oposición Advierten: en Política Económica, se Acabó el Absolutismo Presidencial,” Proceso August 31st 1997:12-16.

⁸⁸⁹ Statement made in conjunction by Porfirio Muñoz Ledo, Francisco Paoli Bolio and Gonzálo Yañez See José Luis Galán, “Logran Consenso PRD, PAN y PT para Modificar la Política Económica,” El Economista August 1st 1997:34. “A Discusión Progama Económico,” El Heraldó September 5th, 1997:5.

President's role to decide the country's economic path alone.⁸⁹⁰ Porfirio Muñoz Ledo warned "the President does not decide the economic policy by himself any more. Now he has to share that responsibility with Congress."⁸⁹¹

The opposition electoral victories brought great expectations over Congress' economic role. In interviews with the leaders of the two main opposition fractions at the lower house, Porfirio Muñoz Ledo (PRD) and Medina Plascencia (PAN), both stated that top that their priority was to re-orient the economic model of development.⁸⁹² This issue was seriously considered, despite the loud opposition by President Zedillo, who warned deputies of the dangers of a drastic shift in the country's economic model.⁸⁹³ Zedillo promised that "political interests will not change the path of economic development."⁸⁹⁴ Academics and business leaders supported Zedillo's warning over the risks of drastic shifts in economic policy.⁸⁹⁵ Fearing it would suffer a historic reverse over economic policy, Zedillo instructed key Secretaries to set up special Congressional liaison offices to negotiate economic policies with opposition congressmen.⁸⁹⁶

⁸⁹⁰Roberto Morales y Rolando Ramos, "No es Facultad del Presidente Decidir el Rumbo Económico del País: Oposición," *El Economista* August 1st, 1997: 34.

⁸⁹¹ Interview Porfirio Muñoz, London, February 19th, 1999.

⁸⁹² See Xóchitl Rodríguez and Adriana Contreras, "Insisten el PAN y el PRD en Revisar la Política Económica," *Diario de México* August 1st, 1997: 25.

⁸⁹³ "Plantea PRD Modificar Política Económica," *La Afición* August 29th, 1997: 1. Ricardo Platt García President of the Cámara Mexicana de la Industria de la Construcción considered as "disastrous" any attempt to change the economic model. See Antonio Gutiérrez, "Desastroso Modificar el Modelo Económico: CMIC," *Novedades* August 14th, 1997:6-F.

⁸⁹⁴ Manuel Moreno, "EZPL: Ningún Interés Político Cambiaría el Rumbo Económico," *El Financiero* July 31st, 1997: 34.

⁸⁹⁵ See Ricardo Gutiérrez and Ana Rosas, "Alteraría la Recuperación Politizar Debate sobre el Modelo Económico, Estima IP," *El Universal* August 11th, 1997:1.

⁸⁹⁶ Interview Federico Rubli, liaison officer between Banco de Mexico and Congress, London, June 4th, 1999.

The new conditions in Congress woke up Mexico's business associations.⁸⁹⁷ A plural Congress required greater negotiations with the various economic actors. A new form of dialogue between tax authorities and business leaders was born. Particularly significant were unprecedented negotiations between the various political parties represented in Congress and the private sector. As soon as they were elected PRD and PAN deputies approached private sector leaders to discuss changes in economic policy as well as the programme of fiscal reform.⁸⁹⁸ Eduardo Bours leader of the Coordinating Businessmen's Council stated that "in the past, all negotiations were conducted only with the PRI. Under a plural Congress, the business sector should have to interact extensively with legislators from all parties."⁸⁹⁹

Tax authorities, anticipating a heated debate after the 1997 congressional elections, offered to open a debate on tax matters with the private sector.⁹⁰⁰ In the first round of meetings, each one of the business organisations tried to put forward their self-centred agenda. The President of the Confederación Nacional de Cámaras de Comercio (Concanaco), Armando Araujo, demanded tax deductibility, fiscal simplification and reducing penalties for tax violations, plus the elimination of the official cash register machines, and the 2% tax on assets.

⁸⁹⁷ See Crawford, "Political Troubles Stir Mexican Business," Financial Times August 1ST, 1997: 3.

⁸⁹⁸ Lourdes Martínez González, Felipe de Jesús González and Guadalupe Baez, "Negocían los Empresarios con PRD y PAN un Proyecto de Reforma Fiscal," August 8th, 1997: 1.

⁸⁹⁹ Crawford, "Political Troubles Stir Mexican Business", 3.

⁹⁰⁰ The negotiations meetings between private sector (Concamin, Canacintra, Concanaco, CEE) and tax authorities, included ways to simplify procedures in order to facilitate the compliance of fiscal obligations, deregulation and expanding the tax payers base. The representative of the private sector called for a new tax framework that would foster investment, savings and employment and could offer legal security to taxpayers. See Alinda Archundia, "Pláticas Para Conformar Nuevo Marco," 1. Interview Carlos Gutiérrez, former CANACINTRA President, Mexico, October 25th, 2000.

Additionally, he called for the elimination of privileged tax sectors.⁹⁰¹ Cámara de la Industria de la Transformación (Canacintra) leader Carlos Gutiérrez, asked for fiscal simplification as well, and for the implementation of a fiscal stamp schemes for those operating in the informal economy.⁹⁰² CEE leader Eduardo Bours' petitions concentrated on a new fiscal framework and reducing tax rates.⁹⁰³ The Confederation of Mexican Employers (Coparmex), in the voice of its President Gerardo Aranda Orozco, supported the idea of a fiscal reform that would foster the creation of new enterprises and employment.⁹⁰⁴ Groups representing specialised sectors like the auto makers or the large brewing companies lobbied to eliminate or reduce taxes affecting them, trying to diffuse the cost into other sectors.⁹⁰⁵

The leaders of the business organisations responded favourably to the debate on tax issues stating that they welcomed any initiative which would take into account their proposals and concerns, however they expected specific results.⁹⁰⁶ Zedillo's team claims that they instituted for the first time an "open dialogue" between the different economic sectors and tax authorities.⁹⁰⁷

⁹⁰¹ Antonio Castellanos, Patricia Muñoz and Humberto Ortiz, "Gobierno y Empresarios Negocian Propuesta de Reforma Tributaria," *La Jornada*, June 27th, 1997: 17

⁹⁰² Ibid.

⁹⁰³ Ibid.

⁹⁰⁴ Ibid.

⁹⁰⁵ See Sergio Nogueira, Director of the US Pan American Car Industry, demanding the elimination of the tax in new cars but warning that the reduction of VAT would generate the productive industrial sector. See Fernando Pedrero, "La Reducción del IVA Podría Perjudicar la Planta Productiva," *El Herald* August 22nd, 1997: 3.

⁹⁰⁶ Interview Eduardo Bours, President CCE, London, October, 13th, 1999 and Jorge Marín Santillán, President CONCAMIN, London, October 14th, 1999.

⁹⁰⁷ Anticipating tensions on the economic debate after the congressional elections, the Secretary of Finance offered a forum to "debate openly" with the private sector tax matters. See Tiburcio Cadena, "El Titular de la SHCP Aseguro que Dialogará con Empresarios para Analizar la Legislación Fiscal", *El Sol de México* July 11th, 1997: 1-F. The issues that would not be negotiable were a) cuts in tax rates, b) fiscal incentives to specific sectors, c) deductibility in restaurant bills, school fees and mortgage payments. See Andrea Ornelas, "Deberá Mantener la Reforma Fiscal Finanzas Públicas Sanas: CCE," *El Economista* June 27th, 1997: 31.

However, the consultation group only lasted a single year, after tax authorities (SAT) were unable to provide the highly publicised “overhaul fiscal reform.”⁹⁰⁸ There had been previous consultation exercises during the Salinas administration, which one of the most important businessmen Antonio Gutiérrez described as “mere shows” to keep the private sector calmed.⁹⁰⁹ Similarly, other participants such as the professional association of accountants and the representatives of small business have complained that their proposals have not been taken into account.⁹¹⁰ A former economic advisor to the Under-secretary of Revenue confirmed that private sector proposals were not considered very seriously when the authorities were designing tax policies. In the end, political pressure was the decisive factor in tax policy changes.⁹¹¹

New Freedom Among Official Ranks

The demise of the presidential power opened the door for a greater debate of politics and economic policy making in the whole political spectrum, including the official ranks. Governors, senators and deputies belonging to the official party found new opportunities to express their views openly, even when their beliefs did not conform with the presidential rhetoric. This was a breakthrough from the previously unquestionable and hierarchical party discipline, though this process was still in its infant stages. The PRI groups such as *Galileo* at the Senate and *Reflexión* in the Chamber of Deputies stood to confront the “línea”

⁹⁰⁸ See Alima Archundia, “Pláticas Para Conformar Nuevo Marco Tributario en 6 Mesas de Trabajo, Inician SHCP y Organismos Cúpula,” *El Sol de México*, June 26th 1997: 1.

⁹⁰⁹ Interview Antonio Gutiérrez Prieto, London, August 22nd, 1999.

⁹¹⁰ Interview Rafael Escudero, President Small Businessmen in Mexico city, May 12th, 2000.

⁹¹¹ Interview Javier Sánchez, former economic advisor to Under-Secretary of Revenues, London, June 12th, 1998.

or the imposition of the party line.⁹¹² Leaders of these groups, Senator Eloy Cantú and Deputy Oscar González, agree about the welcomed unprecedented freedom of speech within party ranks; however González insists that their members still faced even repression when they did not follow the party line.⁹¹³ Unfortunately, President Zedillo did not take criticism kindly from within his own party, neither demands for more transparent and democratic practices within the PRI, raising serious doubts about his true commitment to democracy.

Many see such political openness as a by-product of the decline in presidential power. Both scholars and politicians have reported a demise in presidential power, attributing it to President Zedillo's lack of leadership.⁹¹⁴ To his detractors Zedillo has been a weak President with no control over the political forces in the country or his party. They criticised his apathy towards political and party matters and questioned his commitment to democracy, since he took no actions towards democratising his own party. In an unprecedented move, President Zedillo distanced the government from the PRI calling it "a healthy distance." This caused disorientation among party members and a political vacuum. Suddenly the official party found itself without political leadership. To his supporters President Zedillo was a modern democratic leader, arguing that

⁹¹² Carlos Velasco, "Acuerdan Trabajo Contra la "Línea" los Priistas Inconformes," El Universal October 23rd 1998, 1 and Fabiola Guarneros and Jorge Teherán, "Fin a los Acuerdos "Cupulares" con el Gobierno, Demandan Diputados," El Universal October 22nd, 1998: 1.

⁹¹³ Interviews Eloy Cantú January 6th, 2000 and Oscar González September 14th, 1999. Members of these groups have been accused of traitors. González recalls that he was punished for voting against Fobaproa. The party leadership immediately after the vote removed him from the presidency of the Development Committee at the Lower House. To learn about the attempts to silence them see Isidro Chavez, "Instruyen a Diputados del PRI no Comentar Más Sobre el IVA" Novedades August 1st. 1997, 5. See also "No Más Sumisión Legislativa: Los Priistas ya no Somos Incodicionales del Presidente, Afirma Oscar González," El Herald August 26th, 1998:1.

⁹¹⁴ Lucy Conger, "Cautious Zedillo Shies from Fraught Issues" Financial Times September 31st, 1998.

gone are the days of authoritarianism of strong and unaccountable “caudillos”, and highlighting that the strength of Zedillo’s leadership rested on the rule of law and the separation of powers.

7.3.- Policy Actors and their Influence

a) Reinstating the Role of the Legislative Power as a Policy Maker

New found democracy’s most significant impact on taxation was the sudden transformation of the legislative power from a merely “rubber stamp branch” to a full tax policy maker. Up until 1997, the official party had controlled both chambers in Congress,⁹¹⁵ constraining the original check and balance function of the legislative branch. Nowadays, legislative proposals have to be negotiated among political fractions within Congress and coalition building governs the tax policy making process.⁹¹⁶ This new situation has created explosive confrontations among Congressmen, to such a degree that Zedillo’s Secretary Gurría labelled the Congress floor “the circus.”⁹¹⁷

During the first months of the new plural congress, opposition parties put aside their differences and voted against the PRI to get control of important committees within the lower house. But when the budget debate began, the two major parties, the leftist PRD and the right-wing PAN, split. The PAN ended up voting together with the PRI to pass the budget, which included both tax

⁹¹⁵ In 1994, the PRI lost the 3/4 majority needed for Constitutional reforms but maintained the simple majority until the 1997 elections.

⁹¹⁶ On the works studying the policies of coalition building to pass legal reforms, see Amparo Casar “ La LVII Legislatura de la Cámara de Diputados en México. Coaliciones y Cohesión Partidaria en un Cámara sin Mayoría,” Política y Gobierno Primer Semestre, 2000.

⁹¹⁷ For the conflicts on the floor with Guillermo Ortiz see Oscar Camacho, Ciro Pérez and Roberto González “Se Centró la Comparecencia de Ortiz Martínez en un Forcejeo en Torno al IVA,” La Jornada November 19th, 1997:1, and for those taking place during José Angel Gurría, see Henry Tricks, “ Congress’ Blow to Mexican Budget,” Finacial Times November 28th, 1998:13.

revenue and spending laws. Although PAN and PRD voted together to reduce the VAT rate from 15% to 12%, the measure was blocked in the Senate that was still controlled by the PRI.⁹¹⁸ Open dissent became the hall-mark in Congress, not only among the executive and legislative branch, or the political parties represented in the lower chamber but also among parliamentarians from the official party themselves.⁹¹⁹ The VAT debate in Congress showed that in the end, tax measures were raised for their electoral potential rather than their economic soundness.

b) Corporate Actors: Weak and Divided

Corporatist structures lost political influence with the consolidation in power of the technocracy. President Zedillo distanced himself from this group. Labour organisations had grown more fractious since the death of their leader Fidel Velázquez. A group of more than 100 unions representing one million members broke away from the official union CTM. The chief organiser, the leader of TELMEX, Francisco Hernández, announced his opposition to the government's economic policy as a whole. Private sector organisations supporting the government were also weakened. Businesses no longer had to be full members of the pro-government chambers of commerce and industry.⁹²⁰

⁹¹⁸ See "The Sour Fruits of Victory," The Economist December 20th, 1997; "Watershade in Mexico," Financial Times; "A Lesson in Mexico: Open Dissent is the Hall-mark of Democracy," The Economist September 28th, 1996.

⁹²⁰ See Alonso Urrutia, Fabiola Martínez and Martha García, "Hoy la Formal Integración de la UNT: Agrupará a 1.5 Millones de Trabajadores," La Jornada November 28th, 1997: 1; and "Mexican Unions in a Breakaway Group," Financial Times August 25th, 1997: 16.

c) Foreign Influence Returns

The need for foreign resources to cope with demanding financial requirements made the Mexican government once again vulnerable to the influence of international financial actors. Unable to cope with the financial requirements in 1995, Zedillo's administration turned to the IFIs and US Government for help. Fearing that economic instability could spread to the whole region by a "domino effect," the US government put together a very large bail-out package for Mexico to refinance the public sector's short-term debt, (primarily tesobonos), as well as to restore the country's international reserves and to support the banking sector reform. The rescue package amounted to US\$ 48 billion in credit facilities, including: US\$20 billion from the US, \$1.5 billion Canadian dollars from the Bank of Canada, US\$10bn from monetary authorities of several countries coordinated by the Bank of International Settlements (BIS) and \$18 billion from the IMF.⁹²¹ These resources allowed the government to roll over its financial obligations under longer payment schedules.

The large amount of resources directed to Mexico, gave foreign actors a powerful leverage on the country's economic policy making. A good example on how influential they became, is given by the *Draft of the Law Accompanying the American Bailout Package for Mexico*. The original Draft of "the Mexican Economic Stabilization Act of 1995" required Mexico to consult with the US on the country's economic policy.⁹²² Mexican politicians were outraged by such

⁹²¹ See Jiménez, "The Mexican Financial Crisis," and R.W. Apple, "Risky Course for Clinton," *The New York Times* February 1st, 1995: 1; David A. Singer, "International Package Aid Could Reach Almost \$ 50Billion," *The New York Times* February 1st, 1995. See also "IMF Approves US\$17.8 billion Stand-by Credit for Mexico."

⁹²² This draft proposed that the Mexican government should engage in consultations to address monetary and budget policies, privatisation, NAFTA, and other policies with respect to financial,

proposals. The Mexican Ambassador to the US at the time, Jesús Silva Herzog, stated that such a clause was like “rendering Mexico’s economic sovereignty to the US.”⁹²³ In the end, thanks to stiff opposition the law was rejected. The IMF, a major provider of funds, played a very important role in advising the government about the means to boost public sector revenues.⁹²⁴ The credit facilities agreement with the IMF required the Mexican government to undertake large budget cuts and increase taxation,⁹²⁵ (instructions that the Mexican authorities followed up to the letter). Despite their active role, IFIs strongly deny that they had dictated Mexico’s economic policies during the financial crisis. Chief Economist from the World Bank, William Perry claimed that IFIs provided just “advisory support” to the Mexican government in the design of the 1995 economic plan to increase public sector revenues, but had no power to impose such policies.⁹²⁶

d) Business: The Influences of Capital (Fobaproa)

The influence of the economic elite is evident with the banking rescue programme. This deposit insurance vehicle put by the government to hold all these bad debts is known by its Spanish acronym, Fobaproa. The problems of the financial sector go back to the privatisation scheme in 1991, when a new breed of industrialists converted to bankers made loans anxious to recoup the

capital markets and deregulation. See “Draft of the Mexican Economic Stabilization Act of 1995,” at House/Senate Discussion Draft of Mexico Loan Guarantee Bill, dated January 20th, 1995.

⁹²³ Conversation with Ambassador Silva Herzog in the Mexican Embassy in Washington D.C., February 11th, 1995.

⁹²⁴ Interview with an official from the Secretary of Finance who actively participated in the negotiations and asked not to be quoted.

⁹²⁵ See IMF agreement in the rescue package. See also how the SAT re-engineering programme was presented to IMF Fiscal Affairs Office for review on the 11-12 of November, representing the IMF was Carlos Silbani.

⁹²⁶ Interview William Perry, Spain, March 18th, 1997.

price paid for the privatised financial institutions. The 1995 crisis put the banks in the brink of collapse and exposed the poor quality of their loans. In response to the banking community, the government took over poorly managed banks and acquired thousands of delinquent loans.⁹²⁷ Bank shareholders (mostly large private investors) only collaborated with US\$11bn, while the large cost of the bail out programme, approximately US\$70bn, come from taxpayer's money.

The government insisted that it was of the most importance to maintain the banks alive,⁹²⁸ adding that state intervention would have been a more expensive alternative. Nevertheless, Michael Mackey the Canadian auditor hired by the Mexican Congress to audit Fobaproa, concluded that there was no evidence that an early intervention was the most expensive alternative as the authorities have argued. In contrast, he stressed that keeping the weak banks operating for several years ended up being more expensive than intervening in them immediately after the 1994 financial crisis.⁹²⁹ According to the legislative committee evaluating the scheme, not only financial institutions benefited, but also large companies and some state governments received huge debt cuts, some even up to 60% or more.⁹³⁰ Despite the large inflows of capital from taxpayer money to the wobbly financial institutions, they still required huge quantities of money for recapitalisation. Ironically, while huge resources were

⁹²⁷ Jean Morhouse, supervisor for Latin America at the Bank of England, argues that in no other country in the world she has seen such ample protection to banks' investment as in Mexico. Interview, London, February 24th, 2000.

⁹²⁸ Conference to UK investors at the HSBC office in London, March 17th, 1999.

⁹²⁹ See Sergio Martín, "Mexico: Fobaproa Initial Findings Constructive for Longer-Term Bank Reform," *Chase Emerging Markets Today*, July 21st, 1999: 11. "Mexican Banks, Debts to Society," *The Economist* February 6th, 1999: 31.

⁹³⁰ Among those are Grupo Mexicano de Desarrollo, belonging to the Ballesteros family, Hermes Group owned by Hank Rhon's family, K 2 owned by Abel Vazquez Raña, Salinas y Rocha owned by Salinas Pliego and the Newspaper Excelsior and ICA. See Fabiola Guarneros and Osiel Cruz, "Dió Fobaproa Apoyos Ilimitados; Mutilan el Informe," *El Universal* July 23rd, 1999:1.

given to bankers throughout Fobaproa, the government pledged to reduce general subsidies benefiting the lower strata, further eroding the living standards of Mexicans already affected by the crisis.⁹³¹ While the government was allocating huge resources to “save the banks, the social budget reached record lows in twenty-five years.”⁹³² The unbelievably large amount of resources channelled to the banking sector during hard economic times shows the mighty power of Mexico’s economic elite.

The debate over Fobaproa caused a legislative deadlock, postponing much needed tax reform.⁹³³ Opposition parties, particularly PRD, refused for months to authorise the cost of the rescue programme as public debt. They demanded that the cost of the bail-out should be shared more equally among bankers, corporations that defaulted and taxpayers. Meanwhile, Mexican banks were expecting the government to help them again; therefore they were reluctant to put more pressure on shareholders to build capital adequacy levels.⁹³⁴ In the end, Fobaproa passed with the support of the PAN, which shows again the power of the economic elite. PAN deputies voted in favour of the law despite the measure being largely unpopular.⁹³⁵

⁹³¹ “Reducir Subsidios, Meta del Presupuesto para 1999,” El Heraldo de Mexico November 16th, 1998. In total there were 225% more resources to bail out financial institutions than to fight poverty. See Roberto González and César Martínez, “Para Sanear Bancos, 225% Más Recursos que Contra la Pobreza,” La Jornada November 13th 1998. The elimination of tortilla’s price controls and corn subsidies, caused upheaval in the population. See Elisabeth Malkin “Who’ll Flatten Whom in the Tortilla Wars? Business Week November 16, 1998, 42. The government spend as much as 7.5% of GDP in subsidies, see “Canaliza el Gobierno Subsidios por 7.% dle PIB en 1998,” El Economista February 18th, 1999: 2.

⁹³² Interview Eloy Cantú, London, January 16th, 2000.

⁹³³ See Yolanda Morales, “Reforma Fiscal Integral: Nuevamente Condicionada por Intereses Políticos,” El Economista March 9th, 1999: 3.

⁹³⁴ See Tricks, “Banking System’s Problems.”

⁹³⁵ See Henry Tricks. “Accord on Bank Bail Out fund Passed in Mexico,” Financial Times December 14th, 1998: 3.

7.4.- Zedillo's Tax Reforms: Crisis Ridden Adjustments

Zedillo's fiscal policies responded largely to the effects of the economic shocks, first the 1994 crisis and later the collapse of the price of oil during 1998. The economic crisis limited the leeway of the government's tax policies. The Finance Secretariat had to deal with the terrible effects of a severe recession in 1995, which had a large impact on the fiscal account.⁹³⁶ Tax revenues suffered a fall of 2% of GDP after the economic crisis.⁹³⁷ Collection dropped in real terms and thousands of taxpayers incurred arrears. The sharp devaluation of the peso, and the consequent up-turn in interest rates, together with the decline in economic activity, seriously affected domestic firms, specially small and medium size companies unable to fulfil their fiscal obligation.⁹³⁸ The Treasury's taxpayers monthly census showed a step decline in the number of taxpayers.⁹³⁹ In addition, industrial production shrank, reducing companies' sales and utilities, largely affecting corporate taxes. Very weak domestic demand reduced consumption taxes such as VAT and excises.

⁹³⁶ For the policies in response to the economic crisis see "Unity Agreement and Program to Overcome Economic Emergency," Presidencia de la República, 1995.

⁹³⁷ Internal data from the Dirección General Adjunta de Análisis de Indicadores de la Administración Tributaria, such as "Comparativo de Recaudación Nacional 1996-1999," "Comparativo de Ingresos Tributarios," y "Recaudación Bruta y Neta de las Administraciones Locales de Recaudación," various years. See also the statements made by the Secretary of Finance in "Ortiz Plans to Boost Spending on Public Works," Financial Times September 26th, 1996.

⁹³⁸ Ironically a select number of firms prospered amongst the economic adversity see Noll Scott, "Mexico Winners in Adversity," and Victor Bulmer Thomas, "Mexico The Peso Crisis One Year On," in World Link Magazine January-February, 1996.

⁹³⁹ See "Universo de Contribuyentes," Estadísticas Mensuales. Internal Document from the Secretariat of Finance.

To increase state revenues the government adopted a number of so called emergency measures. Such measures were outlined in the 1995 Programme to Overcome the Economic Emergency which included:⁹⁴⁰

- i) An increase in the general value added tax (VAT) rate from 10% to 15%, effective on April 1st 1995, except in Mexico-US border region and in duty-free zones, where VAT rate remained at 10%. With respect to pharmaceutical products and food, they continued to be subject to a VAT rate of 0%.
- ii) Prices of gasoline and diesel fuel increased by 58.5 % in 1995. Residential natural gas and electricity increased by 20% in March 1995, and increased each month thereafter by 0.8%, resulting in an aggregate increase of 40.98% by the end of 1995.
- iii) Prices of other public services, such as railroads, airports and highways, were also gradually increased by an average of 2.5% per month, with aggregate annual increases limited to 30%. The prices of all other goods provided by the public sector were adjusted to eliminate subsidies. Such adjustments plus the lingering effects of inflation, hit harshly the income of working classes and consequently taxpayers receipts.

The Secretary of Finance, Guillermo Ortiz explained that due to the contraction of the economy and the loss of income of the population, the Secretariat of Finance projected a massive decline in tax collection, specially income tax.

⁹⁴⁰ For an overview of the programme see "Joint Program to Overcome the Economic Emergency," El Mercado de Valores March-April, 1995, 5-11.

This forced the government to increase consumption taxes (VAT) and tariffs in an attempt to raise revenues.⁹⁴¹ To William Perry from the World Bank, the Mexican government had no other alternative but to increase taxes, stating “the massive reversal of foreign capital flows, pushed the (Mexican) government to look for domestic means to increase its revenues.”⁹⁴²

The economic crisis boosted the share of non-performing taxpayers. In response, the Secretary of Finance announced on July 3rd 1996 a support programme for firms and individual taxpayers with tax arrears, called “Programa de Apoyo a Deudores del Fisco Federal” (PROAFI). The statistics show that about 10% of individual taxpayers and nearly a quarter of corporations, benefited with Proafi I and II. See table below on the number of taxpayers who benefited and the arrears forgiven.

Table 7.1.- PROAFI PROGRAMME

Period	Non performing tax payers		
	Individuals	Corporations	Total
August-December 1996	319,462	76,956	369,418
February-December 1997	143,588	39,186	182,774
January-September 1998	21,922	6,609	28,531
Total	484,972	122,751	607,723

Tax paid			Amount Forgiven			
Individuals	Corporations	Total	Individual	Corporations	Total	
816,686	2,607,979	3,424,665	313,973	544,140	858,113	25.10%
930,407	5,800,873	6,731,280	524,041	2,434,982	2,959,023	44.00%
262,328	1,465,331	1,727,659	134,973	736,099	871,072	50.40%
2,009,421	9,874,183	11,883,604	972,987	3,715,221	4,688,208	39.50%

Source :Proafi, Internal Memo, SHCP and tables from the Administración del Centro Contable, SAT and Proafi Reuniones Mensuales de Evaluación Regional, Administración General de Recaudación, (various reviews) SAT, SHCP, 1998.

⁹⁴¹ Interview Guillermo Ortiz, Spain, March 17th, 1997.

⁹⁴² Interview William Perry, Spain, March 18th, 1997.

The 1996 and 1997 reforms to the Revenue Laws contained a vast number of tax breaks to stimulate the economy's growth,⁹⁴³ like tax cuts on the Asset Tax for companies with income less than 8.9 million pesos, immediate deductions on corporate income tax, a 71% deduction on new cars, a reduction from 6.5% to 2.5% on the levy on new cars, the introduction of the programme for taxpayers arrears and tax credits for companies opening new job opportunities.⁹⁴⁴

As a presidential candidate President Zedillo pledged to overhaul the tax system.⁹⁴⁵ Then as President, in his inaugural address he confirmed his commitment to a simpler and an equal tax system,⁹⁴⁶ plus a priority to simplify the tax system,⁹⁴⁷ and the elimination of what he described as "stifling" centralism.⁹⁴⁸ But among business organisations scepticism remained on the political commitment and true extent of the reforms.⁹⁴⁹ At the end, only minor reforms were made during Zedillo's term. The overall reform was postponed in 1996 by the economic crisis, although many argue that it was the right time to implement it. Then, it was put off by the debate over VAT in 1997, while in 1998

⁹⁴³ See Salvador Rotter, "Comentarios a la Iniciativa de Reformas Fiscales para 1996 del Código Fiscal de la Federación," Nuevo Consultorio Fiscal December, 1995: 9-11.

⁹⁴⁴ Tercer Informe de Gobierno del Presidente Ernesto Zedillo México: Presidencia de la República, October, 1997.

⁹⁴⁵ A new tax policy to impulse investment was one of the ten campaigning flags. See Zedillo in Propuestas y Compromisos and Una Propuesta en Campaña.

⁹⁴⁶ See "Inaugural Address of Mexican President, Ernesto Zedillo Ponce de León," Presidencia de la República, Comunicación Social, December 1st, 1994.

⁹⁴⁷ Rosa Elvira Vargas, "La Simplificación Tributaria, un Esfuerzo Proirritario: Zedillo," La Jornada August 21st, 1997: 21. Armando Alcantara, "Simplificación Tributaria con Estricta Responsabilidad Fiscal: Ernesto Zedillo," El Nacional . August 21st, 1997, 3.

⁹⁴⁸ "Eliminar el Centralismo Asfixiante Acelerara el Desarrollo, Dice Zedillo," El Sol de México August 13th, 1999: 1.

⁹⁴⁹ Mariel Zuñiga, "Habrà Reforma Fiscal hasta Dentro de 8 años," Reforma September 5th, 1997: 7.

the Fobaproa feud paralysed the legislative agenda.⁹⁵⁰ By 1999 the politicisation of the presidential succession made it impossible according to tax authorities.⁹⁵¹ The year 2000 was Zedillo's last year in office, making it almost impossible to push any important reform. Nevertheless, PAN president Bravo Mena, perceived a window of opportunity after the election had taken place.⁹⁵² But, Zedillo's had lost his grip and influence, and besides his supposed political commitment was never strong enough to pass the promised tax reforms.

No spectacular tax reforms took place during Zedillo's term. The set of measures that characterised Zedillo's term included policies aimed at modernising the fiscal system, improving administration, combating tax evasion and strengthening the federal pact. As shown here, most policies responded to the impact of the crisis on state revenues. Zedillo's tax team argue that they went further than its predecessors on improving the tax administration, improving the efficiency of the system and reducing corruption.⁹⁵³ But their overall impact was very modest. Some improvements were made on information systems and computerised technology, making records more difficult to tamper with. Some interesting efforts were made towards redistributing federal resources to municipalities and states, but failed to widen

⁹⁵⁰ President Zedillo, in a speech to the Civil Engineers Association stated that the tension generated over the financial reform in Congress and the contraction of the economy due to the plunge in oil prices, impeded the reform to the tax system. See President Ernesto Zedillo speech to the Civil Engineers Council in the President's Official Residence, November 11th, 1998.

⁹⁵¹ José Gurría, Secretary of Finance stated during a presentation organised by HSBC for UK investors satated, that the idea of a tax reform previous to the elections was certainly impossible, London, March 17th, 1999.

⁹⁵² Interview Bravo Mena, London, February 24th, 2000.

⁹⁵³ In Peru comprehensive administrative reforms, particularly improving quality personnel and a programme of incentives largely increased revenues, from 5.4% of GDP in 1990 to 9.0% of GDP in 1991. See Dilip Mookherjee, "Incentives Reforms in Developing Country Bureaucracies: Lesson from Tax Administration, Annual World Bank Conference on Development Economics", 1997. Mimeo.

their faculties to rise taxes.⁹⁵⁴ At the beginning of President Zedillo's administration a special working group was formed with the objective to explore new ways to increase tax faculties.⁹⁵⁵ However, these programmes soon faded away, leaving little results. The early impetus and support disappeared as the PRI began to consolidate its hegemonic position, winning back most state elections.

Experts from the Secretariat of Finance have concluded that in order to improve tax collection the reform should focus on the administrative process.⁹⁵⁶ For this task a new administrative body with technical autonomy was created: the Tax Administrative System (SAT).⁹⁵⁷ This new agency was part of the campaign proposal, although it had been conceived and structurally drawn during the previous administration.⁹⁵⁸ The SAT substituted on the 1st of July 1996 the Under-Secretary of Income,⁹⁵⁹ in order to ensure greater autonomy for the new agency. Less than two years later, however, the policy was reversed, and currently SAT is again subordinated to the Under-Secretary of

⁹⁵⁴ For the views of Provincial Finance Secretaries see Hugo A. Michel, "Avance en los Trabajos del Grupo de Expertos en Materia de la Fórmula de Participaciones," Revista Indetec October-November 1996, 50-54. Interview Guillermo Huizar, Secretary of Finance of the State of Zacatecas, London, February 4th, 2000.

⁹⁵⁵ The Working group was chaired by Miguel Rubiano, Secretary of Finance from the State of Tamaulipas, see a summary report in "Actividades del Grupo de Trabajo de Fuentes del Ingreso Local y Potestades Tributarias," Revista Indetec October-November 1996, 96-100.

⁹⁵⁶ Interview Under-Secretary of Revenue, Tomás Ruíz, México, September 25th, 1999.

⁹⁵⁷ To learn about the nature, objectives and faculties of the New Tax Collection Agency, see "Ley del Servicio de Administración Tributaria, Diario Oficial, 15 de Diciembre de 1995. See also "Descripción Plan de Trabajo del SAT, ITAM, April 2nd 1996. The new agency draws experiences from Spain, US, New Zealand, Puerto Rico, Australia, Colombia and Chile, see "Estructuras de Modelos Tributarios," a study prepared by ITAM for SAT (ITAMC11). To learn about the implementation stages see "Plan Estratégico del ITAM para la Reactivación del Proyecto SAT," ITAM México, 1996.

⁹⁵⁸ Zedillo proposed an autonomous agency for the collection of taxes at the Forum "Crecimiento Económico para el Bienestar Familiar," Mexico, June 7th, 1994.

⁹⁵⁹ Fernando Pescador, "Ley de Ingresos Afectada por Resultados Electorales," El Financiero July 10th, 1997:10.

Revenue.⁹⁶⁰ Tax authorities hoped that by partly privatising the rights to collect taxes (awarded by auction-like procedures), accountability would rise and efficiency and voluntary compliance would increase. In addition, fiscal control would be enhanced through auxiliary activities.

a) Cracking Down on Corruption and Evasion

According to Tomás Ruíz, the tributary strategy is based on reinforcing the battle against tax evasion and the informal economy, as well as eliminating bureaucratic obstacles to economic activity.⁹⁶¹ Tax authorities believe that in order to increase tax revenues the answer lies in cracking down on evasion and fighting internal corruption. Under-Secretary of Revenues and Tax Affairs, Tomás Ruíz estimated that cracking down on evasion could raise tax revenues.⁹⁶² For this task, a scheme with two fronts, which included internal and external approaches, was developed.

Fighting corruption from within. Under-Secretary Ruíz stressed that “one of the biggest obstacles to improve tax collection lies in corruption within the government itself.”⁹⁶³ In the same context, Guillermo Ortiz, as Secretary of Finance acknowledged that corruption prevailed among tax personnel. He also underlined that the SAT was an appropriate vehicle to eliminate corruption

⁹⁶⁰ Interviews with top tax authorities defend their argument in the fact that they wanted to give to the Under-Secretary of Revenue full powers to design policy. Interviews Javier Treviño, Oficial Mayor, Secretariat of Finance, Mexico, September 23rd, 1999, separate interviews with Tomás Ruíz, Under-Secretariat of Finance and Alma Rosa Moreno, President of the SAT, in Mexico city on September 25th, 1999.

⁹⁶¹ Interview Ruíz, Mexico city, September 25th, 1999.

⁹⁶² “Mexico Puts Inspectors Overtime,” Financial Times September 20th, 1996.

⁹⁶³ Ibid

among tax collectors, improving the quality of the tax bureaucracy.⁹⁶⁴ SAT focused on improving the quality of tax administration personnel by raising wage levels, instituting stricter screening and promotion and recruitment criteria and through incentive schemes.⁹⁶⁵ Policy actions to fight corruption included measures for “cleaning up the house” where incompetent or dishonest officials were induced to leave. More than 200 corrupt tax inspectors were fired just in 1996. More than 1,800 customs police officers were placed under military control, and army intelligence officers were used to root out contraband networks and corruption rings within the tax agency.⁹⁶⁶

The government implemented legal changes to simplify the tax system, closed loopholes and make prosecution of tax evaders easier. The authorities stiffened sentences for tax evasion, in an attempt to prompt compliance, but the results were meagre in the first couple years. The private sector opposed plans to classify tax evasion above a certain threshold as a “serious crime” in the penal code.⁹⁶⁷ But, in 1999 Congress passed a new law that did classified tax evasion as such. Authorities emphasise the new commitment to fight evasion.

⁹⁶⁴ Antonio González Vázquez, “Cientos de Casos de Corrupción en Hacienda: Ortiz,” La Jornada July 11th, 1997:18. SAT seeks to decrease corruption among tax collectors through the professionalisation of its personnel. For the first time, the new agency would provide officials in the Secretary at Finance the opportunity to pursue a civil service carrier within this federal institution.

⁹⁶⁵ Zedillo's team reduced tax collectors' incentive mechanisms implemented during the Salinas term, because according to the economic advisor to the Under-Secretary of Revenue they did not eliminate corruption, but increased harassment to honest taxpayers. Additionally, it created huge wage inequalities among the tax collection personnel. Interview Diego Yribarren, Economic Advisor to Under-Secretary of Revenue, Mexico city, January 11th, 1998. For information on incentive mechanisms see Dilip Mookherjee, “Incentives Reforms.”

⁹⁶⁶ “Mexico Puts Inspectors Overtime”.

⁹⁶⁷ Gerardo Aranda, President Coparmex, believed that it would increase tax harassment (terrorismo fiscal). However on December the 31st the Higher Chamber approved the bill which classified tax evasion for more than 700,000 pesos (almost \$US 70,000) as a serious crime.

According to Mr. Ruíz, where fraud is detected the government would no longer drop charges if fines and arrears were paid.⁹⁶⁸

There was also an increase in tax audits for recent years: in 1997 tax officials audited more than 400,000 companies and individual tax payers,⁹⁶⁹ and about 650,00 audits were planned for 1999.⁹⁷⁰ In 1998 nearly 8,000 industrial and commercial establishments were closed because they were not registered with tax authorities.⁹⁷¹ Business representatives complained that these auditing policies constituted "tax harassment" (terrorismo fiscal).⁹⁷² Defending auditing policies, Tomás Ruíz argued that every time tax authorities enforced the fiscal law to fight evasion, they were accused of harassing taxpayers.⁹⁷³

The crackdown scheme included an audit programme directed to street vendors called "sweeping the streets." This programme responded to the mounting pressures from the private sector to fight the informal economy.⁹⁷⁴ The Secretariat of Finance promised to incorporate in the tax net 1.2 million street vendors by the year 2000, with very poor results.⁹⁷⁵ Carlos Gutiérrez Ruíz, *Canacintra's* President believed that the first step towards solving the complex tax problems was to incorporate the informal economy and those

⁹⁶⁸ "Mexico Puts Inspectors Overtime."

⁹⁶⁹ Ibid.

⁹⁷⁰ Yolanda Morales, "Realizará Hacienda 650,000 Actos de Fiscalización para Coptar Evasores en 1999," *El Economista* January 12th, 1999:1. In the first half of 1999, the SAT reported 403,419 fiscalisation.

⁹⁷¹ See data on "Evaluación de Actos de Fiscalización," Centro Contable de la Administración General de Recaudación, SHCP, 1999.

⁹⁷² See Fernando Ortega "Los Empresarios se Quejan: Las Medidas Intimidatorias de Hacienda no Propician Más Recaudación y Sí Mayor Corrupción," *Proceso* January 5th, 1997: 12.

⁹⁷³ Interview Ruíz, Mexico, September 25th, 1999.

⁹⁷⁴ Interview Eduardo García, General Director Mexico's city Chamber of Commerce, Mexico City, September 23rd, 1999 and Rubén González, CONCAMIN Secretary for the Tax Reform Committee, Mexico City, September 19th, 1999.

⁹⁷⁵ Interview Ruíz and Moreno, Mexico city, March 25th, 1999.

street vendors into the tax system, thus increasing the tax payers registered and as result tax revenues.⁹⁷⁶ Nevertheless, Tomás Ruíz argued that incorporating those in the informal economy to the tax register would not solve the financial problems of the country, since they earned very little. In addition, it is difficult to incorporate the vast number of illegal street vendors, since they constitute a strong political force that has resisted regulation.⁹⁷⁷

Fighting Evasion from Above. President Zedillo promised to end privileged sectors, and to reform the tax code, closing loopholes that allowed companies to legally evade taxes.⁹⁷⁸ Following this policy line, tax authorities highlight that their campaigns for cracking down evasion included auditing powerful and influential businessmen. Other measures that have affected powerful vested interests are: taxing offshore investments and eliminating special tax regimes that unfairly benefit large taxpayers.⁹⁷⁹ Tax authorities launched a tax evasion crusade hunting down selected tax offenders. The Fiscal Attorney issued arrest warrants against construction magnates, newspapers owners and even a world's boxing champion.⁹⁸⁰ But more surprisingly, tax audits were ordered against economic tycoons such as Ricardo Salinas Pliego, owner of Televisión

⁹⁷⁶ Leticia Rodríguez, "Timbre Fiscal para Pago de Impuestos Propone Cancintra," *El Financiero* July 11th, 1997: 8; Interview Carlos Gutiérrez, former President CANACINTRA, Mexico, October 25th, 2000.

⁹⁷⁷ Interview Ruíz, Mexico city, March 25th, 1999.

⁹⁷⁸ K.Casillas, A. Asalgado, G. Flores, V. González, "Alza de 15% a Bienes y Servicios Públicos," *El Financiero* November 12th, 1998:1.

⁹⁷⁹ Interview Ruíz, Mexico, March 25th, 1999.

⁹⁸⁰ Entrepreneur Alfredo Hakim, *El Universal Journal*' owner Ealy Ortiz and World Champion boxer Julio Chávez. Interview, Enrique Hernández, Deputy Fiscal Attorney, Mexico, October 24th, 2000.

Azteca; Adrian Sada Blanco, owner of Serfín, Mexico's third largest bank; and Carlos Peralta, owner of Iusacell, a large telecommunications company.⁹⁸¹

Sceptics dismissed the tax evasion crusade as the traditional "circus" performed once every *sexenio* to boost collection, using highly publicised cases to intimidate delinquent tax payers. In response, Revenue Under-secretary, Tomás Ruíz, accepted that the crackdown programme was prompted by the sharp drop in tax receipts since the 1994 devaluation,⁹⁸² and the fiscal prosecutor confirmed that none of the cases mentioned above end up in conviction.⁹⁸³ Authorities defend an improved record of enforcement, but convictions have largely declined during this period.

The government also directed its crusade against tax havens, obliging Mexicans to declare investments held abroad. These include income generated by foreign holdings, including undistributed profits or dividends. The penalty for failing to disclose offshore income is from 3 to 5 years in prison. The list includes 87 countries considered as tax havens.⁹⁸⁴ However, the enforcement in this issue has been quite lax.

The 1999 budget provoked howls of protest from the private sector, since the government proposed increases in both gasoline prices and taxes. Business

⁹⁸¹ Many saw the audits as political vendettas, since these three billionaires had strong business links to President Carlos Salinas' older brother, Raúl Salinas who is currently in jail.

⁹⁸² In the first months of 1996, tax receipts fell to less than 7% of GDP compared with 9.4% in 1994. See "Comparativo de Recaudación," Dirección General Adjunta de Análisis de Indicadores de la Administración Tributaria, SHCP, 1997.

⁹⁸³ Interview, Enrique Hernández, Deputy Fiscal Attorney, Mexico, October 24th, 2000. The attorney stated that there are more than 25,000 million pesos in dispute over tax claims.

⁹⁸⁴ Leslie Crawford, "Mexico Plans Tax Crackdown," *Financial Times* January 16th, 1997. See also Carlos Acosta "Toda Inversión Mexicana en los Parasos Fiscales Deberá Ser Reportada y Pagará Impuestos," *Proceso* January 5th, 1997.

argued that the burden of reform has fallen on them.⁹⁸⁵ Despite the obvious need to increase revenues, the government abandoned its proposal of extending the value added tax to foodstuffs and medicines, showing the muscle of corporatist groups.⁹⁸⁶ In particular the pharmaceutical industry mobilized their 20,000 members or so to oppose the levy on medicines.⁹⁸⁷ Convinced by the leadership of the PRI that the intended proposal to extend VAT to food and medicine (currently exempt) would be politically disastrous, the Treasury had to abandon this move.⁹⁸⁸ Instead the reforms concentrated on high wage earners and eliminated some tax brakes for companies. For the 1999 Revenue Law a new tax on telephone services was submitted but rejected,⁹⁸⁹ plus the traditional increase on gasoline prices. Also proposed was a reduction in the income tax for firms and the elimination of tax deductions for new investment.⁹⁹⁰

Probably the most significant reform was reducing the span of the consolidated status (by 30%). Mexican tax laws allow corporate groups to be taxed on a

⁹⁸⁵ Interview, Raúl Picard, CANACINTRA President, Mexico city, September 26th, 2000.

⁹⁸⁶ The VAT on food and medicine generated heated debate among the different political groups and social representatives, see Guadalupe Hernández and Juan Arvizu, "Piden a EZ Aplicar IVA a Alimentos y Medicinas," El Universal November 19th, 1999: 1.

⁹⁸⁷ Antonio Pascual, leader of National Association of Pharmacies in Mexico, successfully lobbied Congressmen, tax authorities and business leaders to gather support in opposition to the levy of VAT on medicines, arguing that it will generate closures and thousands of lay-offs in this industry.

⁹⁸⁸ Jaime Contrearras, "Ningún Alza al IVA: Seguirán Exentos Alimentos y Medicinas: SH," Excelsior November 6th, 1998: 1 and Ana María Rosas y Gustavo Talavera, "Sin Cambios en 1999, El IVA Anuncia Gurría," El Universal November 6th, 1998: 1.

⁹⁸⁹ See Jorge Hildalgo and Wilbert Torre, "Pasa Ley de Ingresos sin Impuesto Telefónico," Reforma December 11th, 1998: 1. Francisco Gil Díaz, as president of Avantel, saw such measure as political maneuvering by TELMEX, aimed at eliminating competition. Interview, Francisco Gil, Mexico, September 21st, 1999.

⁹⁹⁰ These included: a new tax of 15% on telephone services, a reduction of income tax for corporation from 34% to 30% so long as profits were reinvested, the elimination of immediate deductions for new investments, and increase in the income tax for individuals from 35% to 37.5% for those earning more than 1.5 million pesos and 40% for those with more than 2 million pesos.

consolidated basis. The filing of a consolidated return had significant advantages for corporate groups, since losses of some of the groups companies could be offset against the profits of others. About 300 very large companies benefit from this programme. The government eliminated the 100% immediate deduction rate for new investments, since only 400 companies concentrated 70% of the tax benefit.⁹⁹¹

Despite the official rhetoric promising to redistribute resources throughout the tax system, it failed to take from the richest tax payers as was promised.⁹⁹² Gurría went to the extreme of trying to sell to the deputies the idea that the telephone tax and the hike on gasoline prices were examples of equity.⁹⁹³ As always, the government has recourse instead to cutting spending, including the subsidy on salaries. In the words of Secretary Gurría the “1999 budget was the leanest in Mexico’s modern history.”⁹⁹⁴ In the end, not even businesses were happy with the reforms.⁹⁹⁵

The VAT

However, the 1997 VAT debate opened for the first time in Mexico’s contemporary history a tax policy debate between the executive and legislative

⁹⁹¹ Interview SAT President, Alma Rosa, Mexico City, September 25th, 2000.

⁹⁹² Gurría promised that for the 1999 budget, 82% of additional revenues would come from the 10% higher economic strata, see Jorge Camargo, “No Pasará, Gritan Panistas a Gurría,” Reforma November 25th, 1998 and “Busca Fisco Cancelar Privelegios; Elevará las Tasas,” El Universal November 4th, 1998.

⁹⁹³ See Angelina Mejía, “Impuesto Telefónico y Alza en Gasolinas Ejemplo de Equidad, Afirma Gurría,” La Crónica November 25th, 1998: 1.

⁹⁹⁴ Angelina Mejía and Ma. Isabel Melchor, “El Gasto Público de 1999, el Menor en la Historia Moderna de México,” La Crónica November 10th 1998: 1. For information on the budget see “The Mexican Congress Approves the 1999 Budget and Revenue Law,” Secretariat of Finance, Press Release, January 4th, 1999.

⁹⁹⁵ Fernando Ortega, “Ni a los Empresarios Dejó Contentos el Gobierno,” Proceso January 11th 1999:11.

as equals. A study of the change in VAT rates, sheds some light in the secretive process of political tax bargaining. It also helps to identify the main actors and their vested interests. The policy outcome also shows the political influence of certain interest groups and how politics end up shaping tax policies.

Multiple stances of business organisations demonstrates the variety of interests in policy matters and the difficulties in co-ordinating a common front. Sector or industry interest may shift considerably in tax matters. The arguments are similar, always complaining about the heavy tax burden they shoulder, but vested interests vary enormously. The very rich never supported the cut in VAT because it would have translated into less resources for programmes in which they benefit like Fobaproa or the highways bail out scheme.⁹⁹⁶ The shift in positions of some actors after secret negotiations took place, gives us a hint on the trade-offs made with the authorities in exchange for support for the official policy.

The reduction of VAT became a political banner, rather than a true commitment to modify the tax system or its redistributive effects. But the negotiations were not all political gains. There was a growing concern among party members from the PAN that they had been penalised at the polls because of the alliance with the official party on economic reforms, and therefore they wanted to distance themselves from the VAT cut although many in this party supported it. The

⁹⁹⁶ The cost of the highway scheme in 1997 was 18,800 million pesos but across the span of 17 years it would amount to 33,741 million pesos at 1997 value. A figure greater than the 22,000 million pesos lost in revenue per year if VAT rate was cut to 10%. See Mauricio Flores, "Bajar el IVA o Rescatar las Carreteras?" *El Economista* August 25th, 1997:41.

members of the PRI also complained that they were penalised for voting in favour of neo-liberal reforms, and particularly the 1997 VAT hike.

The struggle between the Executive and the legislative over the VAT rate shows the inauguration of the legislative branch as a tax policy decision maker. The analysis shows that the VAT debate was born more of a political issue than an economic one, every policy actor jumped onto the wagon of the debate looking for self-interested gains.

The opposition block that dominated early decision making in Congress came to an end when the PRI and the PAN voted in favour of the Revenue Law. PAN's leaders had agreed to exchange its support to the Executive's bills in exchange for greater municipal decentralisation and autonomy, as well as better terms for revenue sharing. Congress learnt to build consensus. By the 2000 budget, the revenue law was passed with the support of all parties, after agreement was reached with those less expected. The small parties signed up with the PRI, despite they declined their presidential candidate in favour of the two largest opposition parties, PRD and PAN.⁹⁹⁷ This shows a new threshold for coalition building in Mexico, where the legislative is the true centre of politics.

Conclusions

In the early 1990s, the bitter clash between the old guard and the technocrats, together with the economic crisis, broke up the distinctive political

⁹⁹⁷ See "Aprueba Congreso Presupuesto de Ingresos 2000," December 15th 1999, Infosel services or Francisco Arroyo, Mayra Aguirre, Ion Teherán, "Amarra Pro Apoyo Verde y Petista para Presupuesto," El Nacional December 15th, 1999: 1.

characteristics of the Mexican system. Special characteristics such as the hegemonic role of the PRI, the dominance of the executive over the other branches of government and the large concentration of power in the office of the presidency, are all in the process of profound change; even Mexico's corporatist past is rapidly disappearing.

This period also shows a substantial erosion of the extraordinary power of the Executive, in the office of the Presidency. For the first time in 70 years the new political conditions weakened PRI discipline, and authorities had to learn to build consensus even with those within the official party. The evidence suggests that policies have not been ideologically motivated, but governed by pragmatism and political gain. The diverse number of coalitions shows the intense negotiations taking place in Congress, highlighting a successful working alliance between the PRI and PAN on fiscal matters.

The case sheds light on how the process became highly politicised, after each party wanted to make political gains from the proposal to cut rates. Business leaders denounced it, arguing that the opposition had become more interested in political gains than on the redistributive impact of the tax reforms.⁹⁹⁸ But business representatives also took advantage of the situation and tried to push their own agenda. The debate became so heated, that the President had to call for the depoliticisation of the tax reform proposals.⁹⁹⁹

⁹⁹⁸ See Adolfo Sánchez, "La Reducción del IVA es Bandera Política de la Oposición: Concamin," Excelsior August 25th, 1997:1.

⁹⁹⁹ "Habrà Reforma Tributaria, Pero con Responsabilidad Fiscal: Zedillo," El Economista, August 20th, 1997: 29.

The contentious and highly politicised environment in Congress made any kind of tax reforms difficult. But dissent was not only the hallmark among political parties, revolt arose internally. Disagreement between the leadership and the rank-and-file arose to the surface frequently. The lack of a common and coherent tax policy stance within the parties was evident, shown by the discrepancies and conflicting arguments posed by the members of the same party.

In the end, Zedillo's tax reform proposals en up as his predecessors: just in public rethoric. He probably did less than the others Presidents, despite it hat to face a huge economic crunch and had greater control over capital holders with FOBAPROA.

Conclusion

This thesis demonstrates that tax policy making is a combination of rational economic calculations, incremental adjustments of functioning policies, and attempts by interest groups to maximise political gains. The outcome of tax policy making arises from the struggle of political and social actors rather than just economics. This is a highly politicised bargaining process that reflects the equilibration of political forces, economic, and administrative constraints. A process driven by “inertia,” inheritances as well as political accommodation and coalition building, allowing me to conclude that client politics best describes the process.

This dissertation first indicated Mexico's low tax collection yield and its stagnation for more than thirty years. The analysis portrays an inefficient tax collection system, with a tax structure plagued with a plethora of privileges and exemptions that dilute collection. A large number of interviews with public authorities, politicians, intellectuals, representatives of business, social and international organisations showed a common concern for Mexico's low tax effort. An issue which surprisingly has been always in the rhetoric of the political agenda, but has received very little political, social or scholarly attention.

The study of tax policy decision making highlights the dominant role of politics in the policy making process. The evidence put forward in the empirical analysis shows that political considerations have become the fundamental

factor in considering any attempt to transform extant tax structure and its instruments.

The thesis raises a puzzling paradox; the dynamics of tax reform seem to suggest that even in a strongly centralised and hierarchical state like Mexico (frequently depicted as authoritarian), policy-makers have been constrained in shaping tax policy. Government's policy objectives and the "uniqueness" of the relationship with socio-economic actors, principally the business community, have affected the nature, profile and outcome of the tax reforms. I argue that the unique nature of the Mexican political system has been upheld by a very fragile political coalition with socio-economic actors, which has become the most important constraint on reform.

The profile of the Mexican tax structure reflects a system shaped by the government's need to co-opt interest groups, despite the fact that by doing so, it has put in jeopardy the most important and stable source of economic stability: tax income. The vast number of exemptions and privileges can only be explained as a result of political bargaining in a state, whose main priority has been to maintain a fragile political coalition that legitimises the political regime.

A) Tax structure

The analysis of the tax structure showed loopholes and tax expenditures, which have developed in the tax system. Preferential tax regimes and exemptions built over the years are responsible for the low level of tax collection. These harmful preferential tax practices are deeply rooted in the tax legislation

eroding tax revenues. Interest groups have accumulated ample benefits over the years and now constitute the strongest obstacle to reform.

The tax structure is a mixture of older accommodation inherence, and measures to compensate gaps and new privileges. Although the individual taxpayer is a passive actor, rent-seeking groups pressure decision makers seeking to maximise their welfare. By deconstructing the tax system, I have shown the impact of vested interest on the tax legislation.

I have also addressed the many structural weaknesses that help to explain why the tax revenue yield in Mexico is small compared with countries with a similar level of development. Among these are: a low number of taxpayers, large disparities in income and between regions, low wages and per capita income and social attitudes towards taxation. However, concurring with tax authorities, Mexico's low tax collection effort is best explained by the number of harmful tax practices embedded in the tax structure that give preferential treatment to some sectors, services and products.

The plethora of tax exemptions and privileges for some sectors as well as the large number of fiscal incentives to companies (an issue frequently overlooked) dilute the raising capacity of tax instruments. Tax expenditures do not only dilute revenue but facilitate evasion and complicate tax administration, arguing that the tax system is horizontally inequitable in terms of incidence across different types of income activities. Treating the same kind of income

differently causes inequality and reduces the taxable base, forcing authorities to keep high rates for medium income levels.

There is extensive empirical evidence that suggests that the lack of significant tax reforms in Mexico is closely tied to political interests. The government has not been free to bring about substantial change in taxation due to political compromises with “privileged” social groups and to business elite. These privileged sectors have been successful in blocking moves to tax them more effectively, particularly the business elite. The government feared that any significant change in the tax system would damage the privileges of certain groups putting at risk their political support and loyalty. A profound tax reform could put in jeopardy the loyalty of social sectors (CNOP, CTM, CNC) or damage the fragile relationship with the business elite. These actors were indispensable to maintain the corporatist political system. Elected politicians in Mexico were not so concerned with being re-elected, as Rose and Karran’s theory suggests, but they were concern with preserving the PRI’s hegemony in the political system.

In the Mexican case, economic policies and tax policy in particular have been subordinated to the attainment of political stability. Policies were guided towards maintaining a fragile corporate political system. The historical analysis shows that the government could have done more to reform the tax system even in the face of structural, administrative, political and economic constraints, but attempts lack sufficient political will by political actors. None of the last five administrations risked implementing a profound change that would have

eliminated privileges or preferential treatment to some sectors, despite the fact that tax reform has been considered a high priority in their public agendas. Efforts have concentrated on the administrative front to avoid confrontation with members of the fragile socio-economic coalition.

The historical analysis showed that a substantial tax reform has been avoided, despite the fact that increasing government revenue is crucial for the long term economic development of the country. Instead, the government pursued other less politically troublesome means for financing the State. Nonetheless, these alternative revenue raising policies exacted a very high social and economic cost in the long run. An overview of thirty years of tax reforms showed that they have been mostly revenue neutral and politically oriented. In the light of the historical analysis, actors that shape the tax system have been transformed by the evolving political and economic conditions in Mexico.

B) Macroeconomic Populism

These two governments have been described as "populist," since they pursued a set of economic policies designed to achieve specific political goals, disregarding the economic disequilibrium they caused. According to Bazdresch and Levy, the economic policies were designed to please political groups, not to meet economic concerns. The populist policies and the continuous anti-business rhetoric during Echeverría's term and the later nationalisation of the banking system during the López Portillo presidency, damaged the fragile relationship with the private sector. Orchestrated by the business elite, Echeverría's government experienced for the first time in post

revolutionary Mexico an open challenge to the direction of the country's economic policy. The strategy of development and the attempts to raise taxes seriously damaged the tacit agreement of mutual co-operation between the state and the business elite.

Under the strategy of import substitution and industrialisation, Echeverría and López Portillo's administrations expanded the role of the state in the economy. Both administrations enjoyed easy means for financing the state, largely increasing government expenditures. Both governments undertook a spending spree and ignoring fiscal deficits which ultimately ended in a liquidity crisis. Echeverría benefited from the 1973 world oil boom, which enhanced Mexico's access to international resources, as the financial markets need to recycle the large petrodollar deposits. The discovery of large oil reserves in the mid 1970s, pushed López Portillo's government into an expansionary spree. But when the oil boom waned in 1981, macroeconomic disequilibrium reappeared ending in an acute financial crisis.

It was during this period that the economic elite discovered the powerful leverage of capital flight. Since then, it has used its ability to mobilise capital to push its own agenda. Thus, since the 1970s the fear of capital flight has constrained the autonomy of the state in policy making. The analysis of the tax reforms during Echeverría's term shows the futile attempts of the administration to increase tax collection from the better off. Echeverría's tax reforms ended just as mere adjustments to the tax system, since the president was not willing to invest much political capital in support of the tax reform. López Portillo took a

different approach to fiscal reform. Instead of confronting the private sector with proposals to reform tax income, his administration focused on improving indirect taxation, best exemplified with the introduction of the Value Added Tax. This time the economic elite did not tackle López Portillo's tax reform because the burden of the reform was passed to consumers, not large income earners or companies. In the end, López Portillo was not able to attain the desired "financial autonomy" he preached, diverting to other means for financing the state, particularly reverting to the vast resources coming from the oil boom.

C) Economic Openness

These two presidential terms are characterised by a profound process of economic transformation and the stagnation of economic activity. In this period, the economy's expansion plunged to less than 2% on average compared with the historical ratio of 7% of GDP growth. Most significant is the process of economic liberalisation that radically shifted the strategy of development to an outward oriented economy. This period of stabilisation, adjustment and economic transformation had a large impact on taxation. Many argue that this could have been an excellent time for undertaking a far-reaching tax reform that would have strengthened revenues. Despite the shift in the development strategy however, the state suffered from the same old weakness: insufficient tax revenues.

As with the previous administrations, these "neo-liberal" presidents avoided taxation and pursued alternative means for financing the state, heavily relying on privatisation and the recycling of foreign investment, usually in the form of

portfolio investment. The precipitous liberalisation of trade sharply reduced income from imports and the financial liberalisation made the economy very vulnerable to external shocks and the influences of foreign actors. The new strategy pursued by the neo-liberal governments aggravated the structural deficiencies of the tax system, increasing poverty and widening an already very large income distribution gap. The implementation of IFIs programmes induced structural adjustments and enlarged the numbers of people unemployed, pushing them into the informal economy.

The changing economic conditions caused a re-configuration of the main actors in the tax policy making process. The technocratic elite achieved control over the state, while the influence of the traditional corporatist sectors decreased rapidly. The process of economic transformation enhanced the power of the economic elite and the influence of international actors. Following the lines recommended by IFIs, tax reforms moved further to indirect taxation and the pursuit of revenues by streamlining tax administration. De la Madrid's limited tax reforms responded to the heavy burden of the economic crisis. Most economic policies, including taxation, were geared to cope with a severe economic contraction and skyrocketing inflation. An austerity programme for economic stabilisation was implemented at the cost of a huge plunge in economic growth. To make matters worse hyperinflation was not curbed until very late in De la Madrid's term.

On the other hand, the Salinas administration embarked on a far-reaching programme of economic reform that included taxation. Between 1989-1991 tax

rates in direct and indirect taxes were cut to emulate the international wave of tax reform that took place during the 1980s and harmonise the tax system with that of those, soon to be, commercial partners. Tax authorities closely followed the World Bank's tax reform recommendations, putting special emphasis on reforming the administrative system to increase efficiency and fight evasion. To compensate for the loss of revenues from cuts of rates and trade tariffs, the Salinas team increased the tax base, enlarged the number of taxpayers, simplified procedures and improved collection by implementing tax evasion control mechanisms. Some exemptions and deductions were eliminated and a new system of invoicing and auditing was successfully introduced. Stringent enforcement policies were implemented improving voluntary tax compliance. The number of registered taxpayers rose from 1.7 million in 1988 to more than 5 million by 1994. Despite the reform, tax collection increased only modestly, and in reality it was more a response to the loss of revenues from the cuts on rates and trade tariffs than a serious attempt to increase revenue. At the end of the day the thrust behind the adjustments on the tax front was to remain competitive in order to attract foreign investment.

D) Democratic Openness

This chapter focused on Zedillo's administration, which although it had closely followed the neo-liberal economic model pursued by the previous two governments, the new conditions provided by a newly found democracy had transformed the process of tax policy making. Democracy brought a fundamental shift in the unique political system in Mexico, reducing the power of the presidential office, and the hegemonic role of the PRI. It also provided a

new framework for tax policymaking, brought new actors, such as state governors and political parties, to the bargaining table. Most significant is how the legislature regained its constitutional role as decision-maker.

The electoral achievements of the left and the right in recent years developed in a multiparty political system and a plural Congress since 1997, after the official party lost the majority in the lower chamber. In addition, an increasing number of governorships had gone to opposition parties, which began to demand an overhaul in the tax system as well as redefining the financial relations between the tiers of government. The so called new federalism became a priority on Zedillo's government agenda, largely because of the growing electoral achievements of opposition parties. But it did not last very long; as soon as opposition victories waned in 1998 and 1999, so did the thrust behind the programme. The demise of the power of the president also brought more freedom and debate among members of Congress belonging to the official party; groups like "Galileos" and "Reflexión" voiced their political and economic concerns, which included among others the design and implementation of taxes. State governors also began to demand more freedom to levy taxes and called for a careful review of the Fiscal Co-ordination Agreement.

Tax reforms during Zedillo's term focused on improving efficiency, through streamlining the administration of taxes. For this purpose a new entity, called the System of Tax Administration (SAT), was instituted, though it was designed during Salinas' term. Originally it was supposed to be independent from the

government to reduce favouritism and clientelism, but it has not delivered the expected results yet. Zedillo's tax reforms are best described as crisis-driven changes, since they responded to the economic debacle of 1995. Among the most important are the increase of VAT from 10% to 15% and the programme of fiscal incentives to stimulate employment and investment. Other reforms for fighting evasion were merely cosmetic, and there was even a backward step in auditing policies.

A detailed analysis of how VAT rates were increased in 1995 and how the state has managed to keep the high marginal rate, despite opposition parties pledges to reduce them, disclosed the struggle and bargaining among the different actors involved in the tax policy making process in Mexico. It also displayed how different actors voice their proposals and concerns, and revealed that if successful, tax authorities would try to accommodate vested interests into tax policies.

At last, the conclusion is that the empirical evidence of the various periods shows that the government has been largely constrained in manoeuvring within the tax policy making process, trying to maintain a fragile political coalition that legitimises the political system. The evidence shows a weak state, constrained by corporate actors and the business community. I argue that the unique nature of the Mexican political system has been upheld by a very fragile political coalition with the socio-economic sectors. Traditionally, such a coalition has contributed to legitimising the governing elite and securing political stability, but now it has become the most important constraint on reform.

The government became almost powerless to increase the fiscal burden on certain groups, continuously confronted by their political resistance and threats to boycott the economy and break the political pact. The study shows the autonomy of the State is constrained, particularly vis-à-vis domestic and international capital. The examination of the main actors and their evolving role and degree of influence provides substantial evidence of the deteriorating ability of the state to control economic policy making. The menace of capital flight has given the economic elite the most powerful instrument to oppose and sometimes reverse the government's economic policies. Paradoxically, the economic elite's ability to transfer capital abroad represents a powerful weapon only because Mexico lacks a sufficient and stable flow of tax revenues. The devastating effect of capital flight on the economy could only be reduced if Mexico strengthens its tax revenue sources.

The thesis examined many changes in the tax legislation, in the role and influences of policy actors, on the economic conditions, tax policy objectives and strategies. However, tax collection has remained extremely low, because the state has been not able to make people pay taxes.

In 2000, after seventy one years in power, the PRI lost the presidency. This is a threshold of a new political era in Mexico, raising great expectations of change amongst Mexicans. The newly elected president from the PAN, Vicente Fox, loudly campaigned his commitment to reform profound political and economic changes. At the top of his agenda has been tax reform, as demonstrated by his campaign speeches. However, he rapidly confronted reality. As presidente elect

even before he took office, he and his team proposed to expand the VAT base to include medicines and basic consumption products. The proposal aroused upheaval among business organisations (particularly pharmacy associations) and social representatives, forcing them to withdraw it in the meantime.

This shows that although, the new political system has detached itself from the corporatist actors of the PRI era, increasing tax collection will continue to pose great problems to whoever is in power. In addition, Mr. Fox still has to deal with the powerful economic elite, some members of which strongly supported his political campaign. An economic elite that has been able to successfully oppose significant tax reforms for more than thirty years, and is likely to continue doing so, suggests that newly found democracy may not make the difference in taxation, and tax inertia will prevail.

Nevertheless, this is an historic opportunity to change Mexico's most worrisome structural deficiency, as never before the government enjoys the freedom and legitimacy necessary to make change possible. Taking advantage of the synergy given by popular support and willingness to change, tax reform seems possible. After all, if political change were achieved, then economic reform should be easier.

Appendix I

Methodology

I began this dissertation with an open mind on the possible explanations to the constraints to tax reform. From the specialised literature, I identified four possible hypotheses in response. They range from structural weaknesses embedded in the Mexican economy and society, limited administrative capacity, exogenous influences to domestic politics. It soon became clear, after a dozen interviews or so with primary actors that the political hypothesis was the most influential variable. As the research progressed, however, I realised that the other three hypotheses were also crucial in explaining this very complex issue. Thus, across the dissertation the other alternative answers are discussed as contributing factors.

a) The Difficulties faced for the research

As Mexico's low tax collection is one of the country's most serious weaknesses, the limited academic work analysing this topic is surprising. This can be attributable to the difficulty of gathering data. Taxation was, until very recently, considered one of the great "taboos" surrounding the relationship between the state and the business community. Neither side was open to discuss it, considering it to be a "sensitive" matter, most of all they feared being quoted. In one of the interviews with a high ranking public official at the Revenue Office, I was even searched (although with the outmost discretion) and asked if I had a hidden recorder. Despite these difficulties, I was able to interview an incredible sample of nearly a hundred policy actors, who, kindly offered to share their

experiences and views on the topic with me for which I am deeply grateful. The level and variety of those interviewed is particularly notable, offering the reader a very wide view of the profile, perception and stance of the wide spectrum of policy actors involved in taxation.

The collection of data was even more difficult since it is considered “confidential” and only rough statistics are published occasionally in official documents, often contradicting each other. Fortunately, I was able to gather nearly seventy “classified” internal documents and “confidential” documents, providing information not publicly available, much less published. Some times papers were shown to me, but i was not allowed to quote or photocopy them. Such data are not presented here, however, they helped me to understand the trends and conditions that led policy-makers to make the reforms. In addition, I made a very extensive search of documents published by international organisations as well as newspaper library sources (particularly in the case of the VAT debate), totalling around 400 national and international newspaper articles.

b) Research Aims and Methodology

This research makes a cross-examination of several sources of data to analyse the complex factors that have inhibited the development of the Mexican tax system. Note that the thesis does not seek to explain Mexico's poor tax performance in revenue terms, although indirectly the research sheds some light on this issue. The data analysed include both primary and secondary

sources. It relies primarily on qualitative methods, although some basic quantitative instruments of analysis were used to interpret statistical data.

The research draws upon a set of theories and analytical methods that provide a theoretical framework where the data is codified, processed, typified, examined and interpreted. My basic unit of analysis is tax policy actors, identified in chapter three, though their role and influence is examined across the dissertation as well as the political and economic conditions motivating the reforms. Part of the analysis is a historical overview of the primary attempts to reform the tax system in the past thirty years, divided into three periods. For academic purposes, I have divided the last thirty years in three distinctive periods, subcategorised based on their resilient characteristics as well as the economic and political conditions prevailing at the time.

c) Qualitative Analysis

Selective Interviewing was undertaken to discover the logic of the process behind tax reform. Particular attention has been given to policy actors, their role in tax reform and their interpretation of events. The core of the research questions, its structure and objectives are discussed in this part. A general guide was used for the interviews with three distinctive sections. A common set of questions about the tax system and the forces that have shaped it and inhibited its development were directed to the subjects. Secondly, the policy actors and their role. Lastly, a specific section design for each interviewee was used, taking into consideration their position or role in the tax reform process.

d) Quantitative Analysis

Most of the analysis is qualitative, although quantitative methods have been used to assess the evolution of some tax instruments in terms of revenue yields, the evolution of taxes in relation to GDP or simply to evaluate the performance of taxes compared to other tax instruments or previous years. It is noteworthy that the thesis does not attempt to evaluate the reforms in terms of their success in revenue yields or applicability.

The basic data has been taken from primary sources:

1. -Primary Sources

- *Documentary Sources*
- *Official and Non-Official Publications and Documents*

- **Data from the Secretariat of Finance**

The thesis heavily draws on different sources of information from the Secretariat of Finance. I divide this information in five subcategories: published data, data for public presentations, internal documents for the use only of high ranking officials, internal memos, and monthly and yearly evaluations. The last three sources are in particular, “highly confidential” and will be quoted only when authorised; please note that most of them can not be quoted for legal reasons. Nevertheless, they gave me an invaluable insight into the tax system, its evolution, the tax structure and its main actors.

- **Studies and documents from Businesses Organisations, including leaflets, brochures, magazines, declaration of principles, etc.**

- Studies and documents from Political Parties, including leaflets brochures, magazines, and declaration of principles, documents on party ideology.
- Studies and documents from Professional Organisations
- Data from academic institutions
- Data from International Organisations like the World Bank, IMF, OECD, and ECLA.

2. - Secondary Sources

- Bibliography on Taxation, Structural Reform and the Political System in Mexico.
- Specialised journals
- National and international newspapers and magazines
- Providers of Economic and Political analysis like Chase Manhattan Bank and the Economist Intelligence Unit country Report.
- Electronic Data: Computer Services like Reuters and Infotel.

3.- Interviews

- Selecting Non-structured Interviews

Data generated through open-ended, semi-structured interviews. Selecting interview included key tax policy actors and representatives of interested groups. The interviews expanded to include a vast scope of subjects ranging from public officials (especially former and current tax authorities), state governors, entrepreneurs, business executives, representatives from business associations, political leaders, deputies and senators, leaders and representatives of corporatist organisations within the PRI structure,

intellectuals, academics, representatives from IFIs and journalists among others. The subjects were selected after identifying the policy actors using the Forte and Peacock model.

Research Questions

The questions were divided in three sections. The first part was geared to the structural level, inquiring about the characteristics of the tax system and the possible reasons for its shape and stalemate. The second part was centred on the operative level, asking about the process of tax policy making, the influence of policy actors and the interpretation of the interviewee of tax reforms and the role of policy actors. This was with the purpose of learning about the process, the actors, their relative influence, and their overt objectives and if co-operative, about the vested interests of the group represented by the subject. The third section asked about specialised information based on the subject profile. A specific set of questions for each interviewee was used, designed to take advantage of their expertise, personal view or perceptions of historical tax reforms or failed attempts. Interviews with academics and intellectuals did not contemplate the second section, but focused on their field of specialisation. For the representatives of international institutions the emphasis was on a comparative perspective.

Guide for interviews with policy actors' representatives

A. The Problems with the Tax System

1. Structural Problems

2. Possible Explanations

3.The Effect of Exogenous and Indigenous Conditions

4. The Effect of Politics

B. Operative Level

1. Identifying Policy Actors

2. Tax Strategies and activities promoted and organised by them

3. Relationship with other policy actors.

4. Perception of the person or his group influence

5. The effect of changes in economic or political conditions

C. Specialised questions

List of Interviews¹⁰⁰⁰

Businessmen

- **Carlos Slim**, President Grupo Carso, richest businessman in Latin America, London, October 14th, 1998.
- **Antonio Gutiérrez Prieto**, London, August 22nd, 1999.
- **Lucio Gutiérrez Cortina**, President BDI-Binswager, Mexico, August 23rd, 1999.
- **Bernando Gutierrez Cortina**, Sales Marketing Jugos del Valle, London, August 23rd, 1999.
- **Patricio Slim**, Director General for Massive Markets TELMEX, Mexico, October 19th, 2000.
- **Manuel Díaz**, President ICI Group Mexico, London, February 11th, 1997.
- **Andrés Penate**, Regional advisor for BP Amoco, London, January 22nd, 2000.
- **Jorge Rivera Lozano**, Mexican Textile Exporter, London, July 22nd, 1999.
- **Arturo Astaburuaga**, Europe's Representative of Moctezuma Beer, March 27th, 1999.
- **Jose Luis Jauregui**, Representative Corona Beer in the UK, London, February 16th, 1998.
- **Carlos Ponce**, Banamex UK, London, April 24th, 1999.

Representatives of Business Organisations

- **Eduardo Bours**, President Mexican Business Co-ordinating Council (CCE), London, October 13th and 14th, 1998.
- **Jorge Marín Santillán**, Chairman of the Board, CONCAMIN, October 14th, 1998.
- **Raúl Picard del Prado**, President CANACINTRA, Mexico, September 26th, 2000.
- **Pedro Baca Elguero**, Vice-president CANACINTRA, Aguascalientes, March 12th, 2000.

¹⁰⁰⁰ The interviews list shows the position held at the moment of the interview.

- **Rúben González**, Secretary of the Fiscal Reform Committee, CONCAMIN, Mexico, September 19th and 22nd, 1999.
- **Eduardo García**, Director General, CANACO, September 23rd, 1999.
- **Marcos Sánchez**, Legal Director CANACO, September 22nd, 1999.
- **Sara Cortés**, Head of the Media Department, CANACO, Mexico, September 22nd, 1999.
- **Rafael Escudero**, President of the Small Businessmen Association in Mexico City, May 12th, 2000.
- **Rubén González**, Technical Secretary of the Fiscal Commission, CONCAMIN, Mexico, September 21st, 1999.
- **Carlos Gutiérrez Ruíz**, Former President CANACINTRA, October 25th, 2000.
- **Carlos Abascal**, President COPARMEX, México, September 26th, 1998.

Tax Authorities

- **José A. Gurría**, Secretary of Finance (Zedillo's term), September 23rd, 1999.
- **Guillermo Ortiz**, Secretary of Finance (Zedillo's term), Governor of the Central Bank, Spain, March 15th, 1997.
- **Pedro Aspe**, Secretary of Finance (Salinas' term), September 20th, 1999.
- **Jesús Silva Herzog**, Secretary of Finance (De la Madrid's term), June 12th, 2000.
- **David Ibarra**, Secretary of Finance (López Portillo's term), September 25th, 1999.
- **Martin Werner**, Under-Secretary of Finance, June 25th, 1997 and May 15th, 1998.
- **Tómas Ruíz**, Under-Secretary of Revenue, Mexico, March 25th, 1999.
- **Francisco Gil Díaz**, Under-Secretary of Revenue, Mexico, September 21st, 1999.
- **Alma Rosa Moreno**, President of the System of Tax Administration, September 25th, 1999.

- **Enrique Hernández**, Deputy Fiscal Attorney, Mexico, October 24th, 2000.
- **Javier Treviño**, Oficial Mayor (General Administrator), September 23rd, 1999.
- **Carlos Tello**, Under- Secretary of Finance (Echeverría's term), Mexico, February 29th, 2000.
- **Carlos Mendoza**, General Director of Public Credit, March 16th, 1997.
- **Rigoberto Ariel Yepes**, General Director of Tariffs for Public Services, September 24th, 1999.
- **Juan Amievas**, Head of International Affairs, Secretariat of Finance, Mexico, October 12th, 1997.
- **David Topete**, Director for Europe and foreign investment. January 8th 1998.
- **Diego Yribarren**, advisor to the Under-Secretary of Income, January 11th, 1998 and September 24th, 1999.
- **Javier Sánchez**, former economic advisor to the Under-Secretary of Income, London, June 12th, 1998.
- **Gonzalo Canseco**, Deputy Director Press Office at the Treasury, March 18th, 1999.
- **Lilia Charvel**, special advisor to the Director of STA, London, September 22nd, 1999.

Public Officials

- **Miguel de la Madrid Hurtado**, November 3rd, 2000
- **Luis Echeverría A.**, Former Mexican President, October 12th, 2000.
- **Adrian Lajous**, Former Director of Pemex, March 3, 1999.
- **Juán Ramón de la Fuente**, Health Secretary, London, March 25th, 1997.
- **Herminio Blanco**, Secretary of Trade and Commerce, London, February 11th, 1997.
- **Miguel Limón**, Secretary of Education, October 31st, 1996.
- **Angel Aceves Saucedo**, President CONDUSEF, London October 14th, 1999.

- **Francisco Suárez Dávila**, Chairman of the Treasury Committee at the Chamber of Deputies, London, May 23rd, 1997.
- **Rafael Estrada**, National Deputy Attorney, London, November 12th, 1996.
- **Emilio Rabasa Gamboa**, Coordinator for the Dialogue and Negotiations in Chiapas, London, January 24th, 2000.
- **Carlos Hurtado**, Chief Advisor to the President on Economic Affairs, Mexico, September 19th, 1999, and March 27th, 2000.
- **Carlos Almada**, former speaker of President Zedillo, April 22nd, 2000.
- **Jaime Zabudowsky**, Ambassador to the European Union, August 27th, 1999.
- **Eduardo Pérez Mota**, Secretary of Economic Affairs, Mexican Mission in the European Union, London, February 28th, 2000.
- **Mario Palma**, Under-Secretary of Social Development, Mexico, May 26th, 2000.
- **Javier Moctezuma**, Under-Secretary of Labour, Mexico, September 25th, 1999.
- **Carlos Bazdreh**, Director of Conacyt, Mexico, May 31st, 2000.
- **Federico Rublí**, Director of External Relations, Banco de México, June 4th, 1999.
- **Luis Felipe Vilches**, Director of Foreign Investment, Bancomext, November 11th, 1999.
- **José Ramón López Portillo**, former Under-Secretary of Planning, London, February 17th, 1998.
- **Carlos Casillas**, Private Secretary to President López Portillo, May 7th, 2000.
- **Ernesto Gil**, Private Secretary to President Echeverría, Manila July 24th, 2000.
- **Arturo Núñez**, former coordinator of the PRI at the Chamber of Deputies, June 6th, 2000.
- **Jorge Nuño**, Private Assistant to President Echeverría, November 12th, 2000.

Governors and Local Authorities

- **Vicente Fox**, Governor of the State of Guanajuato, London, June 5th, 1997.
- **Otto Granados**, Governor of the State of Aguascalientes, March 3rd, 1997.
- **Felipe González**, Governor of the State of Aguascalientes, September 19th, 1999 and March 29th, 2000.
- **Ricardo Monreal**, Governor of the State of Zacatecas, London, February 4th, 2000.
- **Cuauhtémoc Cárdenas**, Head of Mexico's City Government, March 25th, 1999.
- **Rodolfo Landeros**, former Governor of the State of Aguascalientes, Secretary of Press Office (López Portillo's term), Mexico, May 8th and June 11th, 2000.
- **Antonio Sampayo**, Former Matamoros Major, March 9th, 1999.
- **Guillermo Huizar Carranza**, Secretary of Planning and Finance in the State of Zacatecas, London, February 4th 2000.
- **Alfredo Reyes**, Mayor of Aguascalientes and President of the Association of Municipal Governments, November 11th, 1997.

Members of Congress

Senators

- **María de los Angeles Moreno**, Leader of the Senate, Mexico, June 7th, 2000.
- **José Luis Medina Guiar**, President of the Finance Committee and President of the National League of Economists, Manila, July 28th, 2000.
- **Oscar López Velarde**, President of the Housing and Urban Development Committee and President Fundación Colosio A.C., March 20th, 2000.
- **Esteban Moctezuma**, former Chair for Fiscal Federalism, May 4th, 2000.
- **Eloy Cantú**, President of the International Relations Committee European and Asian, one of the leaders of the Galileo Group, January 6th, 2000.

- **Fernando Solana**, Former Minsiter of Foreign Affairs (Salinas' term), February 16th, 1997.
- **Luis H. Alvarez**, London, May 7th, 1998.
- **Jesús Orozco**, President of the Transport Committee, Bangkok, July 18th, 2000.
- **José de Jesús Padilla**, July 26th, 2000.
- **Enrique Franco**, September 23rd, 1999.

Deputies

- **Porfirio Muñoz Ledo**, leader of the PRD's branch, February 19th, 1999 and September 19th, 1997.
- **Carlos Medina Plasencia**, leader of the PAN's branch, September 19th, 1997.
- **Oscar González**, leader of the PRI's dissent group "Reflexión," September 19th, 1999.
- **Fernando Gómez**, member of the Budget Committee, September 27th, 1999.
- **Jesús Rodríguez**, former President of the Committee of Budgeting, October 27th, 2000.
- **Agusto Gómez**, advisor to the Secretary of Finance, and former Secretary of Land Tenure, Mexico, March 20th, 1999.
- **Jesús Olvera**, member of the Public Finance Committee, May 23rd, 2000.
- **Abraham González**, May 24th, 2000.
- **Alfredo Phipps Olmedo**, President of the Foreign Affairs Committee, June 14th, 2000.
- **Carlos Jiménez**, leader government workers (FETSE), Manila, July 28th, 2000.

Party Leaders

- **Amalia García**, President of the PRD, London, February 27th, 2000.
- **Luis Felipe Bravo Mena**, President of the PAN, London, February 28th, 2000.
- **Dulce María Sauri**, President of the PRI, London, February 28th, 2000.

- **Santiago Oñate**, former President of the PRI, Chief of Staff to President Salinas, March 8th, 2000.
- **Felipe Calderón**, former President of the PAN, Aguascalientes, June 11th, 1997.

Leaders of Corporate Sectors

National Federation of Peasants

- **Sen. Beatriz Paredes**, former leader, London, September 25th, 1999.
- **Sen. Heladio Ramírez**, current leader, London, September 25th, 1999.
- **Héctor Hugo Olivares**, Mexico, January 13th, 1998.

Mexican Workers Confederation

- **Jorge Rodríguez**, former senator and union leader, July 23rd, 1998 and June 4th, 1999.
- **Alfredo González**, former deputy, union leader, February 28th and September 29th, 1999.
- **Jorge Craviotto**, National Leader of the Professionist association, June 6th, 2000.
- **Jorge Díaz de León**, President of the Associations of Engineers, June 12, 2000.
- **Aleandro Rendón Rivera**, Director of the Civil Engineers College, June 17th, 2000.
- **Romero Apis**, Leader of the National Lawyers Federation, June 23rd, 2000.

Intellectuals and Academics

- **José Saramago**, 1998 Nobel Prize Winner for Literature, London, July 7th, 1999.
- **Carlos Fuentes**, Mexico's living most renowned writer, London, July 7th, 1999.
- **Juan Molinar Horcasitas**, El Colegio de México, London, November 20th, 1997.
- **Enrique Florescano**, London, April 21st, 1997.
- **Arnoldo Córdova**, UNAM, London, December 4th, 1997.
- **Rolando Cordera**, UNAM, Director of TV Nexos, March 10th, 1998.

- **Anthony Giddens**, Director London School of Economics, January 4th, 1999 and September 21st, 2000.
- **Arnold Howitt**, Director A. Alfred Taubman Center for State and Local Government, John F. Kennedy School of Government, Harvard University, September 13th, 1999.
- **John Womack**, Professor of History, Harvard University, September 15th, 1999.
- **Dani Rodrik**, Rafiq Hariri Professor of International Political Economy, March 17th, 1997.
- **Carlos Elizondo**, Mexico, March 24th, 1999 and London, February 20th, 2000.
- **Jorge Castañeda**, Madrid, March 11th, 1998.
- **Miguel González Avelar**, Mexican Historian, México, June 17th, 2000.
- **Carlos Monsiváis**, writer, November 19th, 1997.
- **Alonso Lujambio**, Electoral Council, IFE, London, November 17th, 1997.
- **Sergio García**, México, June 17th, 2000.

International Organisations

- **Enrique Iglesias**, President of the Inter-American Development Bank, Barcelona, March 16th, 1997.
- **Guillermo Perry**, Chief Economist for Latin America and the Caribbean Region, The World Bank, March 16th, 1997.
- **Jean Bonvin**, President OECD Development Centre, Barcelona, March 16th, 1997.
- **Jean Moorhouse**, Director for Latin America, Bank of England, July 8th, 1998 and February 24th, 2000.
- **Nigel Jump**, Chief Economist for the Americas, Barclays Bank, February 22nd, 1999.
- **Anthony Westnedge**, President Canning House, former Johny Walker employer, October 13th, 1998.

Journalists

- **Joaquín López Dóriga**, El Heraldo, London, October 14th, 1999.

- **Jaime Contreras**, Excelsior, London, October 13th, 1999.
- **Jaime Arizmendi**, El Sol de México, London, October 13th, 1999.
- **Vijey, Vetseran**, Chief Editorialist for The Economist, July 14th, 1998.

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