Economic Analysis

The fiscal challenges facing the new administration

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The next government will be faced with major challenges on the fiscal front. First it has to be said that the fact that the future prime minister and his chosen finance minister made it clear in their first messages that they are going to propose fiscal years resulting in primary fiscal surpluses. This will mean that debt as a percentage of Gross Domestic Product (GDP) continues to decline, which in turn will lead to improved financing terms for government, businesses and households.

But achieving this fiscal discipline will be no easy matter bearing in mind that Mexico is a country with very low tax revenues: tax revenues account for just 17% of GDP, the lowest percentage of all OECD countries. And it compares badly not just with advanced OECD countries, but also with countries with similar levels of income such as Brazil, Chile, Colombia and Peru to name a few examples, all of which have higher levels of tax revenue than Mexico. Not only are tax revenues low, but room for manoeuvre in increasing spending is limited. The inescapable components of spending such as debt servicing, pensions and central government contributions to the federal states absorb 60% of non-oil revenues. And these components will continue to grow, in particular pensions, which will increase from 3.5% of GDP to 4.5% in the next five years.

The new administration will take the reins in this context of low tax collection and limited room for manoeuvre with an ambitious spending programme. According to our estimates, the cost of granting doubles the pension currently given to adults, including those who already receive pensions from the IMSS and the ISSSTE (private and public sector health and social services institutions, respectively), as mentioned by Andrés Manuel López Obrador in his speech on the day of the election, would be equal to 0.6% of GDP, compared with the 0.2% now distributed. Whereas granting scholarships to youngsters who neither study nor work (a programme that seems to me very apposite) would amount to 0.9% of GDP.

The next administration's economic team maintains that by achieving efficiencies in spending they will be able to finance these programmes without having to increase indebtedness. They propose consolidating federal government purchases, substantially reducing spending on advertising and consolidating the excessive number of social programmes currently in existence, all of which are excellent ideas that will not only reduce costs but also help combat corruption. They also assert that by reducing corruption they will obtain additional resources equivalent to 2% of GDP. While I do not question the existence of the problem of corruption in Mexico, it seems to me that no-one knows exactly what it costs. So it seems premature to suppose that it will be possible to finance the new social programmes with the strategies referred to. That said, two points mentioned by the AMLO economic team seem positive: i) that they will implement new spending programmes only to the extent permitted by the requirement to maintain a primary fiscal surplus, and ii) that no tax increases can be considered until significant efficiencies have first been achieved in spending.

In view of the difficulties in implementing ambitious social programmes with the fiscal restrictions referred to, I believe there are measures that should be adopted to increase tax collection without increasing tax rates. Among them I would suggest: i) increasing the effective rate of corporate tax paid by companies. Although the statutory rate in Mexico is 30%, there are studies concluding that the effective rate is around 11%. ii) amending the formula for central government contributions to federal states such that entities are incentivised to collect more taxes; in Mexico hardly any tax is collected in respect of property tax, which could be a substantial source of income; and iii) eliminating the regressive VAT exemption for food and medicine.

The new government will face the substantial challenge of maintaining fiscal discipline without increasing taxes and implementing desirable but expensive social programmes. It will not be easy.

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