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The Fiscal Reform Required for Mexico in 2025

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ABSTRACT

The aim of this article is to analyse and explain why tax collection in Mexico is so low, as well as to propose some solutions to this serious problem. The work is framed under the deductive method, hermeneutic paradigm and a quantitative approach. Mexico is a country with a brutal income inequality, where the country's tax burden in 2021 is only 14.7% of GDP (without social security contributions) when the average for Latin American countries is 17.9% and the average for Organisation for Economic Cooperation and Development (OECD) countries is 24.6% of GDP, a very significant difference of ten percentage points. In view of this, tax reform is essential, which in the first stage should seek to equalise with Latin American nations and in the second to come as close as possible to the OECD countries. JEL: H2: Taxation, subsidies and revenues; H3: Fiscal policies.

INTRODUCTION

"Increased taxation is the price of growth" James Tobin.

In Mexico there is tremendous income inequality, between 2016 and 2017, according to the Instituto Belisario Domínguez (2019) the 1% of the population that enjoys the highest income appropriated one-third of the national wealth and even worse, the 10% of the population with the lowest income in the nation gets only 1.6% of the gross domestic product (GDP).

The purpose of this article is to analyze why the country's tax collection is so low, which leads us to propose a fiscal reform, thinking ahead to the commitments that the country's public finances entail. Items such as defined benefit pensions and retirements (in transition) of the Mexican Social Security Institute (IMSS) and the Institute of Security and Social Services for State Workers (ISSSTE) will put pressure on public finances in future years (it is estimated that after 2036 they could lead to a financial crisis in the country) or support programs for seniors over 65 years of age or scholarships for students at the national level.

The issue of the unpostponable fiscal or tax reform is so important that the welfare of future generations and the social stability of the country, framed within the political and economic aspects, will depend on the achievements of this complex task (Moreno *et al*, 2019).

The article is structured in three main sections. The first section deals with the theoretical and conceptual elements of tax policy in Mexico, which will serve to support the conceptual framework. The second section presents some figures on the main contributions at the national level. The third point analyzes the possible tax reform alternatives that can be presented to improve Mexican public finances.

LITERATURA REVIEW

At the beginning of the 1970s, Retchkiman warned of the serious backwardness of the Mexican tax system, stating: "The Mexican Revolution was indebted to the country by not carrying out the profound tax reform that was and is indispensable for the nation" (1974, p. 85). Half a century after the Mexican economist's words, his words still reflect the most acute problem facing the Mexican state: the implementation of a tax reform that would channel the economic, social and human growth and development demanded by the nation's inhabitants.

Tax law is understood as the study of the set of legal norms that regulate the determination and collection of contributions that members of society are obliged to pay (Sol, 2012). Linking law and economics, Fábregas notes: "The concept of fiscal activity considered as a modality of economic activity corresponds to political economy; the concept of the activity of the State in relation to its Treasury belongs to administrative law" (2005, p. 183).

Adam Smith does not define tax, but he does mention the characteristics of tax, contributing mainly with his four maxims or canons related to taxation (Ajogwu, 2022), being the following (Smith, 1985): 1) The citizens of any State must contribute to the support of the Government, in proportion to the income or assets at their disposal; 2) The tax that each individual is obliged to pay must be certain and determined and not arbitrary; 3) Every tax must be exacted at the time and in the manner that is most convenient to the taxpayer; and 4) Taxation must take as little as possible from individuals.

Modern taxation principles are derived from A. Smith's theory (Retchkiman, 1977), and these principles are also observed in section IV of Article 31 of the Constitution, which establishes that all Mexicans have the obligation to contribute to public expenditures where they reside, in a proportional and equitable manner as provided for by law. Contributions are known as tributes or tax revenues, here the three terms will be used interchangeably. Article 2 of the Federal Fiscal Code classifies contributions into:

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taxes, social security contributions, duties (called fees in Spain and other countries) and special contributions for improvements.

MATERIAL AND METHODS

This work was structured on the basis of the deductive method, which was used based on abstractions and universal propositions, seeking to reach the conclusions listed below. A hermeneutic paradigm was followed, based on previous studies and analyses, following a qualitative approach, based on the understanding and observation of the tax policies implemented in our country. In such a way that the framed conclusions are contemplated from an economic viewpoint, interrelated with the social and political effects that the application of a tax reform could have.

This article will not make use of advanced statistics or tools such as econometrics; it will only present descriptive information on the main taxes that impact national public finances, which will serve to reinforce the objective of the paper.

RESULTS AND DISCUSSION

Theoretical and Conceptual Elements of Tax Policy in Mexico

The Mexican oil boom at the end of the 1980s caused the tax system to be neglected, since the basis of public revenues was forged in oil export activities (Moreno *et al*, 2019), and the fiscal modifications of the neoliberal current revolved around focusing public revenues on indirect taxes, specifically the Value Added Tax (VAT), in order to try to balance public finances (Ruiz, 2019).

From 1980 onwards, VAT was introduced in the country, constantly exposing the fact that the Merchant Income Tax, prior to VAT, taxed the population in the form of a 'cascade', i.e. at each phase or stage of production or commercialisation, this consumption tax was paid, causing double or multiple charges on the same base.

VAT has three rates of application for taxes in Mexico: 16%, 0% and exempt. The 0% rate is one of the components of the so-called fiscal expenditure that is most detrimental to public finances, since large VAT refunds come from sectors or activities that are taxed at the zero rate. Hence, it is advisable to abolish the zero rate and leave products with VAT-exempt products, if we want to favour the lower-income strata of the population.

The tax bias based on oil activities prevailed for three decades in the nation, the tax system was characterised by low fiscal pressure, placing Mexico as the nation with the lowest tax revenues in the Organisation for Economic Cooperation and Development (OECD) and Latin America, derived from a tax system with large exemptions and benefits for sectoral interests, as well as inefficient tax collection (López & Vence, 2021). The main problems that substantially undermine tax revenues are tax evasion and avoidance, collection inefficiency, special regimes and those considered as tax expenditures (Moreno *et al*, 2019).

Two of the main evils that reduce tax revenues are tax evasion and avoidance, the former considered as a transgression of the law that involves committing a crime and the latter when loopholes or obscure paragraphs within laws or regulations are exploited. The decision to evade tax can be explained by three motivations: 1) If the taxpayer considers that he/she cannot be punished by the authorities; 2) Depending on the applicable sanction as a penalty; and 3) Depending on the level of risk aversion presented by individuals; while tax avoidance can occur to the extent that the company is at a disadvantage compared to its sectoral peers and increases when the organisation does not have codes of ethics and conduct (Del Río & Rosales, 2018).

According to a study on tax evasion, Fuentes *et al* (2013; cited by Carmona *et al*, 2019), tax evasion on the three main taxes: Impuesto Sobre la Renta (ISR) -Income Tax-, Value Added Tax (VAT), Impuesto Especial sobre Producción y Servicios (IEPS) -Special Tax on Production and Services-, represented 4.4% of GDP in 2004 (37.8% of the total of these taxes) and in 2012 it reached 3.1% (26% of these taxes). Aníbal Gutiérrez (Instituto Belisario Domínguez, 2019) indicates that tax evasion causes the public treasury to miss out on one billion pesos annually (4% of GDP).

Hereafter we will refer to Mexican pesos, which are measured in the metric system and one billion pesos is equal to twelve zeros to the left of the decimal point.

For Carmona *et al* (2019) tax evasion in the country can be explained by two causes: 1) The taxpayer register of the Sistema de Administración Tributaria (SAT) -Tax Administration System- does not have 900 thousand employed persons registered; and 2) Of the taxpayers who are active in the register, a significant part of them do not pay the corresponding taxes.

In the act of tax avoidance, large companies or high-income individuals in the country have accountants and lawyers' firms that help them to 'legally' avoid income tax. What is even worse, many individuals and especially companies collect VAT and if they are in the informal sector or fall into acts of tax evasion, they keep the resources collected from end consumers. In this case, they commit a double offence: charging VAT to final consumers and not handing it over to the public treasury.

The informal economy is another of the country's major tax problems, as it not only affects public revenue, but also harms those who work in the informal economy, as they do not have access to medical services, social security and legal security. In the case that interests us in this study, informality is a phenomenon that limits the number of taxpayers and, consequently, tax collection. Informal employment is characterised by low stability or duration, low wages and lack of social security benefits (Calva, 2019).

Based on information from the Instituto Nacional de Estadística, Geografía e Informática (INEGI) -National Institute of Statistics, Geography and Informatics- (2022), in the National Survey of Occupation and Employment, New Edition of the fourth quarter of 2021, they show that the economically active population (EAP) of the country is 58.8 million people, reaching 56.6 million people (96.3% of the EAP), of which 25 million people are employed in the formal economy (44.2%) and 31.6 million people are informal (55.8%).

By 2020, INEGI (2021) reports that 22% of GDP was produced by the informal economy (55.8% of total national employment); while the formal economy generates the remaining 78% of GDP, so it can be inferred that a formal job is 4.5 times more productive in terms of GDP than an informal job. Taking into account that in 2021, 3.55% of GDP corresponds to income tax for salaried workers, it can be inferred that if all informal jobs paid income tax under current conditions, they would only generate 0.8% of GDP in 2021, with the aforementioned proportion.

Of the most acute and persistent problems in the country, corruption is undoubtedly one of the main evils, rooted since the viceroyalty, which over time has grown and reached multiple spheres and areas of public activities, highlighting in public works since the middle of the last century and especially since the late eighties, leading many productive activities not to comply with their tax obligations to pay taxes (Ruiz, 2019). This lacerating evil that does so much harm to the country is embedded in many sectors of economic and political activities that do not only concern the fiscal aspect, so its solution or reduction would involve analysing many other variables that are beyond the tax sphere.

Fiscal expenditure is also known as fiscal cost or tax expenditure. It is considered as a range of legal instruments that significantly reduce the tax burden, to the benefit of some sectors or economic agents, taking forms such as reduced rates, deductions, exemptions, temporary exemptions, exclusions, accelerated depreciation, tax credits, deferrals and special tax zones (López & Vence, 2021; Comisión Económica para América Latina y el Caribe, 2022). Undoubtedly, the tax policies implemented in previous years (fiscal consolidation, tax credits and special regimes), became a constraint to achieve more public resources (Ruiz, 2019).

Fiscal spending in Mexico meant 2.9% of GDP in 2018 and 2019, while it represented 2.8% of GDP in 2020, according to the OECD (2022), highlighting these specific items:

VAT with 1.4% of GDP (zero rate with 1.2% and exemption with 0.2%).

Income tax for corporations with 0.5% of GDP (deductions 0.1% and others with 0.4%).

Personal income tax with 1% of GDP (deductions 0.1%, exemptions 0.7% and others 0.1%).

It can be seen that the highest tax expenditure corresponds to the zero VAT rate with 1.2% of GDP. In this sense, C. Tello and A. Gutiérrez (Instituto Belisario Domínguez, 2019) state that in terms of tax expenditures, it is necessary to eliminate all special treatments, except VAT on food and medicines, since taxing these goods would make the basic food basket more expensive and thousands of Mexicans would fall below the poverty line; providing the data that the Secretaría de Hacienda y Crédito Público (SHCP) -Ministry of Finance and Public Credit- in its estimate of tax expenditure, makes it comparable to 98% of the total VAT collected in the country or 54% of what is collected by income tax or 250% of the IEPS.

In an empirical study by Banda & Tovar (2018) to determine whether the tax structure is related to the economic growth observed in Mexico from 2005 to 2016, they conclude that the income tax has negative impacts on the level of GDP per capita and on productivity, while the VAT has positive impacts.

F According to Llamas *et al* (2020), the tax reforms applied in the present century in Mexico have brought the following results: a) The tax system is slightly progressive, in terms of taxes and transfers; b) Income tax has high rates of progressivity; c) Indirect taxes are regressive; d) The exemption and zero rate plans reduce the tax base; in addition, they mention that the burden of income tax falls on the last three income deciles, while the rest of the wage earners receive employment subsidies (equivalent to not contributing).

Quantitative Information on Contributions in Mexico

Table 1 presents information on total federal revenues collected from 2018 to 2021 (last four years). It shows the division between the central sector and the sector formerly known as the parastatal sector, which includes directly controlled entities and productive enterprises: the Instituto Mexicano del Seguro Social (IMSS) -Mexican Social Security Institute-, the Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (ISSSTE) -Institute of Security and Social Services for State Workers-, Petróleos Mexicanos (PEMEX) and the Comisión Federal de Electricidad (CFE).

Table 1: Revenues of the Federal Government of Mexico 2018-2021. Thousand million pesos

	Collected 2018		**Collected 2019**		**%GDP**	**Collected 2020**		**%GDP**	**Collected 2021**		**%GDP**
Total	5,115.1	100.0	5,385.0	100.0	22.2	5,340.0	100.0	23.1	5,960.9	100.0	23.9
Central Sector	3,871.6	75.7	4,006.1	74.4	16.5	4,088.5	76.6	17.7	4,317.0	72.4	17.3
Taxable+ Non Tax.	3,329.9	65.1	3,574.2	66.4	14.7	3,890.2	72.9	16.8	3,952.2	66.3	15.8
Taxes	3,062.3	59.9	3,202.6	59.5	13.2	3,338.9	62.5	14.5	3,566.7	59.8	14.3

Income Taxes (ISR)	1,664.2	32.5	1,686.6	31.3	7.0	1,760.5	33.0	7.6	1,895.5	31.8	7.6
VAT	922.2	18.0	933.3	17.3	3.8	987.5	18.5	4.3	1,123.7	18.9	4.5
IEPS	347.4	6.8	460.5	8.6	1.9	460.7	8.6	2.0	399.2	6.7	1.6
Imports	65.5	1.3	64.7	1.2	0.3	57.9	1.1	0.3	75.5	1.3	0.3
Other	62.9	1.2	57.4	1.1	0.2	72.3	1.4	0.3	72.9	1.2	0.3
Non-Taxes	267.5	5.2	371.5	6.9	1.5	551.3	10.3	2.4	385.5	6.5	1.5
Duties	64.3	1.3	83.0	1.5	0.3	72.6	1.4	0.3	90.8	1.5	0.4
Profits/ Proceeds.	203.2	4.0	288.5	5.4	1.2	478.8	9.0	2.1	294.6	4.9	1.2
Oil Renevue	541.7	10.6	431.9	8.0	1.8	198.3	3.7	0.9	364.8	6.1	1.5
Enties & Enterprises	**1,243.5**	**24.3**	**1,378.9**	**25.6**	**5.7**	**1,251.5**	**23.4**	**5.4**	**1,644.0**	**27.6**	**6.6**

Source: Own elaboration (2022). Note: with information from the Ministry of Finance and Public Credit (SHCP): Public Accounts 2021 and 2019. Volume I General Results: Budgetary Revenues.

The tax or fiscal pressure consists of expressing as a percentage the ratio between the collection of contributions (tax revenues) and the Gross Domestic Product (GDP), being the indicator commonly used worldwide to compare the tax situation of a country or region (Carmona *et al*, 2019). Another similar term that is sometimes used synonymously is tax effort, which is derived from tax burden and relates this to GDP per capita.

Between 2018 and 2021, taxes account on average for 60.4% of total federal revenues, corresponding to 14% of national GDP. Duties (fees) account for 1.4% of total public revenues in the same period and 0.34% of GDP. If we add taxes and duties together, they would represent 14.34% of GDP from 2018 to 2021.

On some occasions, information is presented on tax revenues, excluding social security contributions, as this is considered to be a specific issue for pensions and retirement. In order to appreciate the magnitude of the social security contributions paid by formally employed workers, in the Public Account for 2021: Volume VII (Secretaría de Hacienda y Crédito Püblico, 2022), in the Consolidated Social Security Direct Budgetary Control Entities: Double Account, shows that the IMSS collected 391,733 million pesos in social security contributions in 2021, while the ISSSTE obtained 77,210 million pesos, making a total of 468,943 million pesos, which represents 7.9% of total revenues and 1.9% of GDP. This means that tax contributions or revenues as a whole (including social security contributions) accounted for 16.5% of Mexican GDP in 2021.

The OECD (2021) presents international information for 2020 on the tax burden, I take the data in two modalities: including social security contributions and without them (in brackets): Denmark 47.5% (47.4%); France 45.4% (30.6%); Italy 42.9% (29.4%); Germany 28.3% (30.6%); Italy 42.9% (29.4%); Germany 28.3% (29.4%); Germany 28.3% (23.1%); Spain 36.6% (22.9%); Canada 34.4% (29.5%); Great Britain 32.8% (25.9%); Brazil 31.6% (23.4%); Argentina 29.4% (23.8%); USA 25.5% (19.2%); Bolivia 22.4% (15.7%); Ecuador 19.1% (13.6%); Colombia 18.7% (16.8%); and Mexico 17.9% (15.4%). The OECD has 33.5% (24.6%) on average for its members, while Latin America and the Caribbean have 21.9% (17.9%) on average.

In the analysis that includes social security contributions, Mexico is 15.6 percentage points below the average of OECD nations (33.5% vs. 17.9%), while it is 4 points below Latin American countries (21.9% vs. 17.9%). Excluding social security contributions, Mexico is 9.2 percentage points below the average collection rate of OECD countries (24.6% vs. 15.4%), while it is 2.5 percentage points below the average of Latin American and Caribbean countries (17.9% vs. 15.4%).

Jaime Ros (2015; cited by Casar, 2020) states that Mexico in 2012 had a tax burden of 12% of GDP (including local contributions), which would be similar to that prevailing in nations such as the United States, France, Great Britain and Sweden a century ago, when the social state did not prevail, but only served as a guarantor of order and protector of the right to property; developed countries that reached Mexico's current per capita income before the middle of the last century and when they collected 25% of GDP through taxes.

Leaving aside the abysmal aspect that is presented with OECD countries in terms of taxation collected by our nation, when compared to Brazil and Argentina (23.4% and 23.8% respectively), Mexico is far below those Latin American nations, being below Colombia in that aspect as well.

To emphasise the major problem in Mexico with regard to the low uptake of social security income, the average OECD country collects 8.9% of GDP, while Mexicans only contribute 2.5% of GDP in 2020. These are abysmal figures, which is why pension and retirement expenses (especially defined benefit pensions) are destroying national public finances, a problem that will be accentuated notably between 2035 and 2040. In this respect, see the work of Villalobos L. (2022a; 2022b) on the impact of pensions and retirements on public finances.

Before addressing what would be the strategy or the basic steps that the national fiscal or tax reform should follow, let us analyse the impact and who actually pays the contributions in Mexico. The Tax Administration System (SAT, 2022) in its Tax and Management Report for the fourth quarter of 2021, stresses that there are 60.35 million active taxpayers in the country, of which 47.03 million are individuals who receive wages and salaries (78% of the total); 10.96 million individuals with business or professional activity (18% of the total); 2.28 million legal entities (4% of the total); and 11,831 large taxpayers (0.02% of the total).

In the aforementioned report, the SAT (2022) notes that the slightly less than 12,000 large taxpayers will contribute 50% of total tax revenues in 2021 (3.56 trillion pesos), suggesting that legal entities contribute 23%, individuals with business and professional activity 2% of revenues, and employees 25% of total taxes.

The more than 47 million salaried employees who are taken into account by the SAT as active taxpayers with tax obligations seems to me to be a very high figure, taking into account that the INEGI states that there are 25 million Mexicans working in the country's formal economy in 2021, which added to the just under 7 million pensioners and retirees in the country calculated by Villalobos L. (2022a; 2022b) at the federal, state and municipal levels, would bring us to a total of 32 million Mexicans who would be considered active taxpayers. Thus, 15 million more salaried taxpayers reported by the SAT for 2021 would be missing.

We will now analyse the most important taxes in Mexico, namely income tax (ISR), VAT and IEPS. For this purpose, Table 2 was prepared, which presents in detail the main branches that make up the most important taxes in our country.

In the last four years (2018 to 2021), income tax as a whole accounted for 32.2% of total federal revenues and 7.4% of GDP. Table 2 shows that in the last three years (2019 to 2021), 47.4% of income tax was collected via corporate entities, representing 3.5% of GDP in the three-year period. Thus, it can be stated that the ISR collected through corporate profits accounted for 28.6% of total national taxes and 15.2% of total national public revenue.

Table 2: Main Taxes in Mexico 2019-2021. Thousand million pesos

	2019		2020		2021	
Income Taxes (ISR)	**1,687.83**	**100.0%**	**1,762.91**	**100.0%**	**1,895.70**	**100.0%**
Legal Entities	803.64	47.6%	832.12	47.2%	898.77	47.4%
Individuals	45.76	2.7%	43.31	2.5%	50.05	2.6%
Witholding taxing on forein resident	54.69	3.2%	58.20	3.3%	58.31	3.1%
Witholdings on salaries	783.74	46.4%	829.29	47.0%	888.57	46.9%
ISR By Sector of Activity	**1,687.83**	**100.0%**	**1,762.91**	**100.0%**	**1,895.70**	**100.0%**
Manufacturing industries	295.87	17.5%	292.59	16.6%	342.23	18.1%
Financial services and insurance	197.72	11.7%	221.30	12.6%	185.37	9.8%
Business suport & waste managem.	175.59	10.4%	181.11	10.3%	145.34	7.7%
Professional and technical services	138.25	8.2%	132.83	7.5%	135.40	7.1%
Government & international agencies	122.40	7.3%	141.82	8.0%	153.69	8.1%
Wholesale trade	113.43	6.7%	119.28	6.8%	151.40	8.0%
Other activities	644.57	38.2%	673.99	38.2%	782.27	41.3%
VAT By Sector of Activity	**933.33**	**100.0%**	**987.52**	**100.0%**	**1,123.69**	**100.0%**
Manufacturing industries	-267.11	-28.6%	-205.67	-20.8%	-266.62	-23.7%
Financial services and insurance	104.11	11.2%	112.02	11.3%	115.49	10.3%
Bussiness suport & waste managem.	136.43	14.6%	105.34	10.7%	87.00	7.7%
Other	280.33	30.0%	381.23	38.6%	420.02	37.4%
Auxiliary: customs, waste managem.	679.56	72.8%	594.61	60.2%	767.80	68.3%
IEPS	**481.92**	**100.0%**	**460.67**	**100.0%**	**399.15**	**100.0%**
Gasoline and diésel	297.48	61.7%	299.60	65.0%	222.89	55.8%
Aloholic beverages, beer and tobacco	99.85	20.7%	96.16	20.9%	103.05	25.8%
Caloric food and beverages	64.34	13.4%	50.17	10.9%	45.67	11.4%
Other	20.26	4.2%	14.74	3.2%	27.54	6.9%

Source: Own elaboration (2022). Note: with information from the Ministry of Finance and Public Credit (SHCP): Reports on the Economic Situation, Public Finances and Public Debt: Fourth Quarter 2019, 2020 and 2021. Collection Indicators.

The income tax rate in Mexico for legal persons is 30% of profits; however, Fausto Hernández (Instituto Belisario Domínguez, 2019) infers that in Mexico an effective income tax rate of less than 10% is paid, noting that the average income tax rate for legal persons in the OECD corresponds to 22.8% as an average of its members during 2018.

Individuals as a whole, both salaried and entrepreneurial, contribute 49.4% of income tax and 3.6% of GDP from 2019 to 2021. Separating the activities of individuals, wage earners account for 46.8% of income tax and 3.46% of GDP, while individuals with business activity contribute 2.6% of income tax and 0.19% of GDP from 2019 to 2021. Similarly, it can be affirmed that the country's wage earners contribute 28.3% of the nation's public taxes and 15% of total public revenue at the national level in the last three years.

Legal entities and wage earners have almost equal shares in the contribution of income tax in Mexico over the last three years. It is not apparent from the information in Table 2, but the Tax Administration System states that of the 1.89 trillion pesos obtained from income tax in 2021, 55% corresponds to withholdings made by legal entities to their employees, stating "In other words, for every peso that legal entities pay in ISR, their employees pay 1.34 pesos" (Sistema de Adminitración Tributaria, 2022).

As for who pays most of the ISR of salaried employees, F. Hernández (Instituto Belisario Domínguez, 2019) points out that in Mexico, the income taxes of salaried employees is paid by the state points out that in Mexico the income tax of wage earners is paid by people in the VI to X income deciles and with the application of the wage credit the contribution falls in greater proportion on income deciles VIII to X, noting that in this last decile is the 1% of the population with the highest income in Mexico, pointing out that they have instruments and teams of tax experts (lawyers and accountants) specialised in finding ways to avoid taxes, so it can be affirmed that the ISR of salaried workers is paid by captive taxpayers in our country, who have no way of deducting taxes.

In another view, the Ministry of Finance and Public Credit (2020; cited by López & Vence, 2021) shows that the 10th decile allocates only 19.7% of its total income to pay ISR, which in comparative terms is an extremely low tax burden for those who receive the highest income from salaries in Mexico.

By 2020 in the country, people in decile VI earned on average 13,369 pesos per month (INEGI, 2021b), according to data from the Mexican Social Security Institute (Tableau Public, 2022), by December 2020 there were 5. 38 million affiliates earning more than 13,213 pesos per month, with 3.39 million workers earning more than 21,141 pesos per month (decile VIII), so that this group of Mexicans generated the highest ISR tax revenue. Not having the full picture, because there is no open information on public workers.

It should be remembered that the majority of salaried workers in Mexico earn at most two minimum wages, with three out of four IMSS affiliates (Tableau Public, 2022) earning less than 3.5 minimum monthly wages in 2021, recognising this majority as a segment that does not have the taxpaying and economic capacity to pay ISR.

According to J. Casar (2020), personal income tax in Mexico amounts to around 3.5% of GDP in 2017 (the same as that calculated for 2021), while the average OECD country collects 8.2% of GDP and the United States collects 10.4%, a difference of almost 5 percentage points compared to the average OECD country. 4%, a difference of almost 5 points compared to the OECD and 7 points compared to the United States in terms of GDP, explained by three reasons: a) The marginal tax rates are relatively low; b) The existence of various exemptions and, to a lesser extent, deductions, limit the collection of ISR; and c) Non-compliance associated with evasion and informality, which reduces the tax base.

As for the economic sectors by activity that leave the most ISR to the public coffers in Mexico, manufacturing industry covers 17.4% on average from 2019 to 2021; financial and insurance services 11.3%; while business support and disposables management 9.4%; government and international organisations 7.8%; professional and technical services 7.6%; and wholesale trade 7.2%.

The SAT (2022) reports that gross VAT collection amounted to 1.8 trillion pesos, but there are refunds of 647 billion pesos (representing 36% of the total amount), i.e., more than a third of what should be collected was returned as refunds, of which 384 billion pesos corresponded to manufacturing industry (54%); wholesale trade accounted for 75 billion pesos (12%). Between these two sectors, 66% of VAT refunds are concentrated.

Table 2 shows that VAT refunds from manufacturing industries corresponded in net terms to 24.4% of the net VAT collected from 2019 to 2021, the financial services and insurance, as well as business support and waste sectors are the highest paid sectors (11% of VAT paid). It is also noted that customs contribute the majority of VAT in Mexico from 2019 to 2021, 67.1% of this tax. Although the SAT (2022) notes that refunds and offsets for foreign trade operations are not presented in the public information, so the net effect of what they deliver to the treasury is not apparent.

In terms of IEPS, for petrol and diesel consumption, the SAT collected 61% of the total IEPS from 2019 to 2021, representing 7.7% of tax revenues, 4.7% of total federal revenues and 1.11% of GDP in that three-year period. In second place is the tax on alcoholic beverages, beer and tobacco; in third place is the tax on caloric beverages and food.

Tax Reform in Mexico

Retchkiman K. (1974) understands the term tax reform as that which affects a country's tax structure in a profound and comprehensive manner, giving as an example the case of Italy in the 1970s, where a reform was carried out that brought about profound changes in 70% of tax collection. In essence, a tax reform implies changing the tax structure, seeking to modify the different taxes in order to obtain more revenue or to make the distribution of national income fairer.

According to the prominent Mexican author (Retchkiman, 1974), in order to achieve tax reform, the following elements must be observed: a) Before carrying out the reform, profound changes must be made in administrative matters; b) A tax reform cannot be improvised and a projection of all the related problems is required; c) The purposes or goals must be clear and perfectly limited; d) The tax reform must be broad and progressive; e) The context of the tax policy is determined by the economic, political and social circumstances that are present in the nation.

In September 1960, the notable English economist Nicholas Kaldor (2011) pointed out that in Mexico the implementation of a tax reform is urgently needed for the following fundamental reasons:

- Revenues originating from taxes are insufficient for the needs of economic growth and development that the country requires, capturing only 9% of the Gross National Product (GNP) via taxes (federal, state and municipal), when in nations such as Ceylon and India they captured 20% and 10% respectively, even though those nations had per capita incomes equivalent to half and a quarter of Mexico in those years.
- The economic inequality of the social classes has been increasing, together with the regressive nature of the tax system, threatening to collapse the social and, above all, the political edifice, thus endangering social peace and the constitutional regime.

It would seem that Kaldor's analysis is still valid sixty years later, as Ramírez C. (2020) similarly expresses himself on the English economist's accurate diagnosis. A decade later, Retchkiman (1974) notes that Mexico should collect taxes equivalent to 20% of the Gross National Product, which would represent more than double the amount collected in those years, basing his proposals on the concepts and ideas of Richard Musgrave.

In this sense, also J. L. Calva (2019) expressed that in 1961 a proposal by Mexican economists projected that national contributions (including social security contributions) would increase from 10.3% of GDP in 1960 to 17.1% of GDP in 1970; while Kaldor's 1960 estimate projected to reach 24.3% of GDP.

Increasing corporate income tax in Mexico could cause chambers and business representatives to argue that it could provoke capital outflows or curb the inflow of foreign capital, as N. Kaldor (2011) foresaw sixty years ago, when he foresaw such protests from the business sector.

The Comisión Económica para América Latina y el Caribe (CEPAL) -Economic Commission for Latin America and the Caribbean- (2022) points out that in the region there is a very low tax burden, biased towards regressive taxes on consumption of goods and services, and that there is room to improve tax revenue collection, advising the following measures: 1) Actions to limit tax evasion; 2) Review tax expenditures; 3) Adapt tax frameworks to good practices in international and digital taxation; 4) In the medium term, promote tax agreements to strengthen income tax and property tax, trying to make the tax system more progressive.

Del Río & Rosales (2018) propose some alternatives to strengthen national public revenues: 1) Reduce tax evasion and avoidance; 2) Seek greater equity and efficiency of direct and indirect taxes; 3) Increase productivity and efficiency of tax expenditures; 4) Make capital-based and wealth and property taxes more progressive; 5) Evaluate alternatives to social security contributions; 6) Evaluate the application of green taxes; 7) Evaluate the strengthening of sub-national treasuries.

According to the OECD (2022) the measures that have been implemented in López Obrador's six-year term to improve tax collection are:

- Elimination of universal compensation in 2019: previously, different tax balances could be compensated automatically, causing the daily use of 'buying' invoices. This measure achieved an increase of 0.5% of GDP.
- Strengthening of criminal sanctions for tax fraud: considering the issuing and preparation of false invoices as a crime on a par with organised crime. A transaction can be reclassified as non-existent when it has no commercial purpose.
- Implementation of a plan to prevent Base Erosion and Profit Shifting (BEPS) or aggressive tax planning strategies, which could increase by 0.4% of GDP by 2024.
- Taxation of digital services by 2020: regulating VAT and introducing withholding tax for these activities.
- Progressive elimination of tax deductions in the STPS on fuel.

For ECLAC (Comisión Económica Para América Latina y el Caribe, 2022) Mexico managed to accurately locate significant progress in estimating tax expenditure in 2021, finding that exemptions for individuals accounted for 237,216 million pesos in 2021 (0.94% of GDP). But where López Obrador's government has failed to intervene to improve tax collection, according to the OECD (2022), is in the following areas:

- Increasing the ISR-wage tax progressively, as well as gradually reducing tax deductions (medical expenses, interest on mortgage loans, education expenses).
- Establish an independent, non-partisan and autonomous Fiscal Council, in accordance with the principles defined by the OECD itself.

In addition, the OECD (2022) recommends Mexico to: 1) Reduce VAT tax expenditures, especially on some goods with a zero rate; 2) Reduce informality, considering that there are 21 million self-employed and 2 million small and medium-sized enterprises.

The Instituto Belisario Domínguez (2019) puts forward the proposals of several institutions and authors of recognised prestige in tax matters, related to increasing tax collection, while improving tax efficiency for Mexico in 2018, which would be:

- The Instituto Mexicano de Ejecutivos de Finanzas (IMEF)- Mexican Institute of Finance Executivesproposes reducing the income tax rate for companies; full deductibility of social welfare benefits from payrolls; abolishing the tax on dividends, generalising the VAT rate; as well as creating a national autonomous tax council.

• The Confederación Patronal de la República Mexicana (COPARMEX)- Employers' Confederation of the Mexican Republic-: similarly calls for a tax council independent and autonomous from the government; an increase in the taxpayer base; simplification of tax schemes; and global tax rates.

• The Consejo Coordinador Empresarial -Business Coordinating Council- advises gradually reducing the corporate income tax rate and establishing regional consumption taxes.

• Carlos Tello- on income tax, he suggests: 1) Broadening the tax base, eliminating incentives, special treatments and subsidies; 2) Progressive income tax rates capped at 47%; 3) Eliminating the schedular nature of income tax, as well as adding up all the income of individuals and companies; 4) Introducing taxes on capital gains, inheritances and bequests, donations, as well as reintroducing the wealth tax on cars; 5) An extraordinary tax on the income of multimillionaires. On VAT: broaden the tax base and establish differentiated rates and evaluate the best way to tax informality.

• Fausto Hernández- 1) Increasing the corporate income tax rate is not advisable, due to international competition; 2) An increase in personal income tax will only work if informality is attacked, otherwise the effect would fall on captive taxpayers; 3) For personal income of more than one million pesos per month, increase personal income tax; 4) The most advisable way to increase public revenue is to increase VAT, as this would attack informality in some way.

• Aníbal Gutiérrez: proposes that VAT collection, instead of representing 4% of GDP, should be at least double; in addition to taxing people in the highest income deciles at higher rates.

• Carlos Hurtado- advises increasing the VAT rate, as it is low in relation to other countries, and also notes that income tax should not be increased for corporations, so as not to reduce the country's international competitiveness.

Carmona *et al* (2019) mention that Mexico requires tax strategies to increase public resources, including the following: 1) Entering into a fiscal pact between authorities and taxpayers, to incentivise voluntary compliance; 2) Restructuring indirect taxes, seeking to achieve greater horizontal and vertical equity, in order to promote social justice; and 3) Raising the productivity of the SAT, to reduce tax evasion gaps.

J. Casar (2020) proposes to carry out an in-depth Mexican tax reform, which seeks to increase by 5 percentage points of GDP in a conservative manner, for which it is necessary to energetically combat tax evasion and remedy the informal economy. The main measures to achieve this are: 1) It is necessary to increase the maximum marginal rate of income tax for salaried workers; 2) Progressively increase income tax, especially in the highest wage brackets; 3) Specify a basic food basket, especially for the first deciles of income, maintaining the zero rate and taxing the rest of the food at a rate of 16%.

CONCLUSION

The issue of the fiscal reform that cannot be postponed is so important that the economic well-being of future generations and the social stability of the country will depend on the success of this complex task. In the first stage of the next tax reform, Mexico would be expected to reach the average of Latin American countries and, in the second stage, to be as close as possible to the average tax burden of OECD countries. Other measures than should be followed for the next tax reform include the following:

In the area of corporate income tax, the amount collected should undoubtedly be increased, but the current rate of 30% should not be changed, as a matter of international competition, but deductions, which are so widely used by tax experts to reduce profits, should be lowered. This would be achieved by applying a percentage of ISR to the income obtained, thus avoiding the abuse of tax deductions. In income tax for salaried workers, we would seek to make taxes more progressive for deciles VIII to X, paying special attention to the latter, not contemplating so much tax expenditure that current legal norms allow (interest on mortgage loans, medical expenses, and school fees). Progressive rates should also be set for those earning more than one million pesos annually. It is considered appropriate to apply progressive ISR rates to income that does not come from salaries (dividends, capital gains or shares). It is essential to put an end to the zero VAT rate, as it lends itself to companies seeking to inflate their purchases in order to claim refunds. A precise study would have to be carried out to see which foods are consumed by the first four income deciles, in order to apply the corresponding exemption, so as not to harm Mexico's poorest population. Undoubtedly, the increase in tax revenue has to come from VAT, which could be used to tax informality to a certain extent. There should be a Fiscal Council that functions independently and autonomously from the federal executive branch, operating according to the standards suggested by the OECD. It is proposed to end tax expenditures corresponding to special benefits for certain sectors or activities, temporary exemptions, exemptions, reduced rates, excess deductions, accelerated depreciation, and special tax zones. Informal activities generate fiscal distortions, which often exceed the actions of the country's tax authorities. In terms of income tax on salaried workers, and given the estimated productivity of the informal sector, a maximum improvement of 0.8% of GDP would be expected with their incorporation into the taxpayer registers, if the productivity of the informal sector were to maintain its current trend. In accordance with the limits of the article, in the future, it is expected to contemplate each of the tax figures in greater detail, which is why this specification remains as a challenge for future work.

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