Case Study (Full Report)

Transparency of Tax Expenditure Reporting in Mexico

Liliana Alvarado, May 2014

Introduction

Currently, there is no single, universally accepted definition of a tax expenditure. The terms tax benefit, tax incentive, tax concession, fiscal stimulus, and tax break are more commonly used. Although each government defines the technical term tax expenditure according to the particularities of its tax scheme, it is possible to identify some common characteristics. In general, tax expenditures are preferential treatments granted to individuals and businesses in order to reach specific aims, such as promoting investment, generating employment, improving income distribution, and boosting the competitiveness and productivity of certain sectors of the economy. But what are the implications of making use of tax expenditures? For governments, tax expenditures represent a revenue loss. For taxpayers, they signify a reduction, exemption, or deferral of tax payments. Tax expenditures often take the form of differentiated rates, exemptions, subsidies, tax deductions and credits, among others.

Although the main advances in terms of public finance transparency and accountability have been in direct spending programs, there is a growing recognition of the importance of increasing the scrutiny of tax expenditures as well. In Mexico, tax expenditures amounted to 5.15 percent of gross domestic product (GDP) in 2011, while tax revenue represented 10 percent of GDP. Such a significant amount of resources shows why budget transparency cannot be limited to direct spending programs, as tax expenditures form a considerable part of public spending. Because of this, the management of tax expenditures should be more transparent in order to shed more light on how they work, who authorizes them, who benefits from them, how they are estimated, and what benefits they generate. This information is essential to fostering more informed government decision making. Also, transparency and accountability stimulate citizen interest in public affairs and boost monitoring by nongovernmental organizations and other stakeholders, which in turn can lead to improved public policy performance.

This paper is divided into six sections that aim to examine the state of tax expenditures in Mexico in order to identify areas of opportunity to improve their transparency and effectiveness. For this purpose, the paper incorporates points of view from different actors involved in the subject matter. Perhaps the lessons learned from Mexico will serve as a reference for other countries.

Tax Expenditures and Budget Transparency

The Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF) are the two main international organizations that have pushed the issue of budget transparency. They have established guidelines on the subject to help lead governments toward better management of their public resources. In Mexico, budget transparency has evolved in recent years according to such standards. Some initiatives have emerged from the government itself, and other changes have been generated by pressure from external agents. For example, the Federal Law of Transparency and Access to Public Government Information (FLTAGPI), passed in 2002, requires federal agencies to respond to information requests from citizens. In order to guarantee the rights of individuals' access to public information, the FLTAGPI also created the Federal Institute for Access to Information and Data Protection (FIAIDP), which intervenes in cases where federal agents refuse to share information.

In addition, in 2010 the Ministry of Finance and Public Credit (MFPC) published a Citizens Budget for the first time, with the objective of explaining in a clear and simple manner the development of the budget. According to the Mexican civil society organization FUNDAR Analysis and Research Center, this is of utmost importance since it allows citizens to "have information in order to participate in discussions regarding what is done with public resources."[1] In addition, FUNDAR notes that "another great achievement [of the] federal government is the publication of the Budgetary Transparency Portal that allows the publication of information on income and expenditures that was not published before". Likewise, the Mexican Institute for Competitiveness (MIC), argues that, although "the Federal government has significantly increased the presence and activity of institutional counterweights that permanently monitor the obligations of budgetary transparency, such as the Ministry of Public Administration (MPA), the internal bodies of the finance office, and the Superior Auditing Office of the Federation (SAOF), transparency has focused on accounting and not economics". In other words, "in their current state, the processes of transparency are centered on the legality of the use of resources, not on their impact".

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Besides these important steps toward transparency taken by the government, civil society has also actively monitored the proper use of public resources. Some initiatives have resulted in greater transparency and better public policies. For example, since 1999 FUNDAR has been devoted to the study of the federal budget and has become known for its findings on the misuse of public resources in the areas of maternal mortality and HIV/AIDS, among others. Although greater advances in budget transparency may still occur, progress has clearly taken place in recent years.

[1] Translations by *Fundación Ethos* (http://www.english.ethos.org.mx) unless otherwise specified.

However, few individuals and organizations relate the subject of budget transparency with tax expenditures. Perhaps this is because traditionally budget transparency has been associated with direct spending programs. The budget transparency guidelines of the OECD and the IMF put forward some elementary features of the optimum management of tax expenditures. On the one hand, the OECD emphasizes that the tax expenditure budget should:

- describe the estimated cost of revenue loss, at least for the most important tax expenditures;
- display general information for each tax expenditure; and
- classify existing tax expenditures by area or function.[2]

On the other hand, the IMF (2007) asserts that:

- budgetary documents should include an explanation of the nature and importance of tax expenditures;
- the information contained in the annual budget should cover all tax activities (including tax expenditures), because only then is it possible to review all of the resources that are allocated to certain governmental policies or objectives;
- information on the current and future magnitude of tax expenditures and their impact must be revealed, including the future impact of new tax expenditures; and
- the main tax expenditures should be reported as part of the budget documentation, indicating their purpose, duration, and anticipated beneficiaries, and the government should ideally compare the purposes and results of tax expenditures in order to be able to evaluate them.[3]

Although these guidelines set the standard on the basic elements a tax expenditure budget should contain, they are not sufficiently detailed and do not fully reflect the best international practices. For this reason, international organizations should incorporate more specific and updated guidelines, including:

- an indication of the reliability of the revenue loss estimates;
- distributional impact of major tax expenditures;
- information on newly created, recently modified, or eliminated tax expenditures; and
- data used to estimate the corresponding revenue losses.

In the case of Mexico, the government has commonly utilized tax expenditures as a tool to pursue a wide range of goals, including economic and social purposes. Since 2002 the MFPC prepares and presents a Tax Expenditure Budget (TEB).[4] Despite the valuable effort of the Mexican government to

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[2] *OECD Best Practices for Budget Transparency*, 2002, available at http://www.oecd.org/governance/budgeting/Best%20Practices%20Budget%20Transparency%20-%20complete%20with%20cover%20page.pdf

[3] *Manual on Fiscal Transaprency*, 2007, available at http://www.imf.org/external/np/pp/2007/eng/051507m.pdf

[4] According to Article 27 of the Federal Revenue Law, the TEB is presented every year. In practice, the TEB is an informative document that is uploaded to the *Secretaría de Hacienda y Crédito Público* (SHCP) web page and presented to different committees in the legislative branch.

offer greater transparency through this tool, there remain several areas for improvement that will be discussed in more detail below. In addition, beyond the information published by the government in TEB, we find few studies by other actors — such as international organizations, civil society organizations, and think tanks — on transparency of tax expenditures. Even the mass media's monitoring of TEB has not been consistent.

In general, it is important to define good practices more clearly in terms of tax expenditure transparency, as best practices have been defined for direct spending programs. This is even more pressing for Mexico, since the advances in the transparency of tax expenditures have been limited and largely driven by the government. Defining appropriate international standards will facilitate the analysis by nongovernmental organizations, and as a result, encourage transparency.

Regulatory and Institutional Framework of Tax Expenditures in Mexico

The regulatory framework that defines the actors involved in tax expenditure management and the preparation of TEB in Mexico, as well as their duties, is formed by:

- Political Constitution of the United Mexican States (PCUM);
- Organic Law of the Federal Public Administration (OLFPA);
- Federal Tax Code (FTC);
- Federal Revenue Law (FRL);
- Federal Oversight and Accountability Law (FOAL);
- Federal Budget and Fiscal Responsibility Law (FBFRL); and
- Different existing tax laws.

The Mexican Constitution is the legal instrument that establishes general guidelines as well as the actors involved and their responsibilities in Mexican revenue and expenditure policy. Although tax expenditures are not mentioned explicitly, the Mexican Constitution defines a structure of actors and institutions that frame public finance management. In this respect, the most important actors in the authorization process of tax expenditures are the President and the legislature. However, the ministries can also participate in the authorization process as consulting bodies. Article 31 of the OLFPA establishes that the MFPC is authorized to "determine the criteria and overall total amount of tax incentives, listening in that respect to the agencies responsible for the corresponding sectors, and administer its application in cases where it competes to another Ministry".[5] Even more, OLFPA specifically emphasizes that the Ministry of the Economy, the Ministry of Tourism, the Ministry of the Environment and Natural Resources, and the Ministry of Agriculture, Livestock, Rural Development, Fisheries, and Food are to collaborate with the MFPC in establishing tax incentives necessary to promote their own sectors, as to monitor the implementation, and to evaluate the results of the authorized tax expenditures.

[5] OLFPA, 2012, p. 15.

As for the authorization process, Article 25 of FRL indicates that tax incentives and administrative facilities will be awarded based upon the following criteria: economic efficiency, nondiscrimination, limited temporality, and progressiveness. Moreover, it mentions that "in order to award tax incentives, it should be taken into account whether the sought objectives could be reached in a better way with a direct spending program".[6]

In addition, under Article 27 of FRL, current tax expenditures should be reported annually in TEB and published on the MFPC website. TEB must also be delivered to the Finance and Public Credit Committee, the Budget and Public Account Committee, and the Center of Public Finance Studies in the Chamber of Deputies, as well as to the Finance and Public Credit Committee in the Senate. Although FRL does not explicitly obligate MFPC to deliver TEB to the Special Committee for the Analysis of the Tax Expenditure Budget in the Chamber of Deputies, the 2012 TEB indicates that this document is handed over to this committee. In respect to TEB content, Article 27 of FRL notes that it is to include:

- the estimated amount of resources the Ministry of Finance will forgo for the period;
- the methodology used to determine the estimates;
- the legal basis that supports the inclusion of each item;
- the specific aided sectors or activities for each item, where appropriate; and
- the social and economic benefits associated with each tax expenditure.

The application of tax expenditures is predominantly a responsibility of the Tax Administration System (TAS). FRL indicates that this institution can define the general rules to ensure the appropriate implementation of these incentives. At the close of the fiscal year, SAOF has the constitutional power to analyze the public account. According to FOAL, "the audit of the Public Account includes a review of revenues, expenses, including subsidies, transfers and donations, funds, tax expenditures, and the public debt."[7]

Since TEB does not require authorization and the executive branch holds the power to grant tax incentives, it became essential for the legislature to establish an actor responsible for analyzing and tracking this public policy. In 2009, the Institutional Revolutionary Party (IRP), the main opposition power in the country at the time, noted that in terms of public finances, the government of the National Action Party (NAP) had accelerated the growth of expenditures and advanced little in terms of tax collection. In addition, it emphasized the importance of a tax reform that had previously been delayed. In this sense, the IRP proposed the creation of the Special Committee for the Analysis of the Tax Expenditure Budget, as one of its paths to tax reform.[8] The creation of a committee in charge of the analysis of TEB appeared to be the most viable option to dispel the existing opacity surrounding the management of these incentives. In the lower chamber, the agreement that established the Special Committee for the Analysis of the Tax Expenditure Budget revealed that its objective is "to review the

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[6] FRL, 2011, p. 36.

[7] FOAL, 2010, p. 1.

[8] For more information, see http://www.slideshare.net/jangulog/presupuesto-de-gastos-fiscales. It is important to note that the Special Committee for the Analysis of the Tax Expenditure Budget has no mandate at a subnational level.

structure and composition of the tax expenditure budget in order to identify and correct the fiscal structure to increase tax resources in an equitable and proportional manner."[9]

In 2009, during the establishment of the committee, IRP Congressman Sebastián Lerdo de Tejada noted that the committee would help "identify which tax expenditures are justifiable and which ones not, where are the areas of opportunity to improve tax collection, equity, and tax neutrality, and also expose the gray areas or spaces that could encourage tax evasion or elusion."[10] In short, the Special Committee for the Analysis of the Tax Expenditure Budget was intended to play an essential role in monitoring tax expenditures.

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Since its creation, the committee has developed activities to help it achieve its objective. In addition to developing work plans and holding meetings with other committees, it has also held hearings with MFPC officials. However, its impact appears to be limited. In fact, this legislative body has introduced only one bill that has yet to be approved.[11] This bill, which was introduced by Sebastián Lerdo de Tejada in February 2010, proposes to amend some articles of FBFRL and FRL itself in order to:

- link TEB to the annual approval of the federal budget;
- establish the regulatory framework to evaluate the results of each component of TEB, in particular its social and economic impact;
- start such evaluations to ensure that the analysis of the rest of the tax issues include these considerations and are introduced in the final tax reform; and
- initiate the linkage between the analysis, discussion, and the approval of the 2011 economic package.[12]

Despite the importance of the initiative for tax expenditure transparency and accountability and the creation of elements that promote the effectiveness of these initiatives, the bill has yet to be approved by the Chamber of Deputies.

In summary, according to the legal framework governing the management of tax expenditures in Mexico, the president, the congress, and the Ministry of Finance and Public Credit (*Secretaria de Hacienda y Crédito Público*, SCHP) can intervene directly in the authorization process, while other

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[9] See http://gaceta.diputados.gob.mx/Black/Gaceta/Anteriores/61/2009/oct/20091006-II/Propo-2.html

[10] See http://www.diputadospri.org.mx/res-01/oldsite/prensa.php?accion=texto&noticia=281

[11] For greater detail the activities of the Special Committee for the Analysis of the Tax Expenditure Budget during 2009-2010 and its 2010-2012 work program, see http://gaceta.diputados.gob.mx/Black/Gaceta/Anteriores/61/2010/sep/20100909/Programa-2.html

[12] For more information on the articles that are expected to be reformed and their content, see http://www.slideshare.net/jangulog/presupuesto-de-gastos-fiscales

ministries can act as consulting bodies. In addition, MFPC is the institution responsible for the development of TEB, TAS is responsible for its implementation, and, once the tax year ends, SAOF supervises its proper implementation through the analysis of the public account. Finally, the creation of the Special Committee for the Analysis of the Tax Expenditure Budget represented a good exercise in transparency and accountability, because it served as a counterweight to the executive power. Nevertheless, its scope has been limited. The efforts of committee members appear to have been insufficient since they have not translated into concrete policy changes.

The Tax Expenditure Budget

TEB is an informative document that has been prepared by MFPC since 2002 with the purpose of informing congress, civil society, and other stakeholders of the evolution of this tool.[13] The 2012 TEB shows, among other things, the revenue loss resulting from the application of each of the 100 existing tax expenditures, which is calculated using the lost revenue method. Although MFPC has stopped presenting total figures for the revenue loss associated with tax expenditures since the 2010 TEB, Fundación Ethos' estimates for 2012 imply a loss of $769,448 million pesos, which is equivalent to 5 percent of the GDP, 2.6 percent of public spending, or 35.9 percent of non-oil tax revenues.[14] Regarding the estimates of revenue loss, it is important to note that, contrary to what happens in other countries, the reliability of these estimates is not high in Mexico. Moreover, the 2012 TEB includes tax expenditures for the value-added tax (VAT), the Corporate Income Tax (CIT), the Personal Income Tax (PIT), the Single Rate Business Tax (SRBT), and excise taxes.

In addition to the revenue loss (in million pesos and as a percentage of GDP) for the budgeted year and the following year, the 2012 TEB presents the legal basis for each tax expenditure. Furthermore, they are classified by type of treatment, tax, and taxpayer. Nevertheless, although the functional classification allows for a complete analysis of total spending (direct expenditures plus tax expenditures), tax expenditures are still not classified under this category in Mexico. It is important to mention that for some tax expenditures, the economic sector affected is indicated. Although the 2012 TEB contains relevant information for some kinds of analysis, it does not define sunset dates (including tax expenditures, such as the SRBT, whose expiration dates are known), the objectives of each tax expenditure, or the number of real beneficiaries.

Since tax expenditures are such a complicated subject, each year's TEB should present the information in a manner that is easy to understand. The 2012 TEB includes some features that make its analysis difficult. For example, it does not incorporate tables that summarize important information, such as 1) what tax expenditure entails the highest revenue loss: 2) what tax expenditures were recently added, modified, or eliminated: and 3) what sectors receive the most benefits. It also does not enumerate all of the expenditures in order to make them easier to identify, as some are included in tables while others are described in the text.

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[13] TEB is not approved by the legislative branch because each tax expenditure has been previously approved, either by a Presidential Decree or by modifications in the tax laws.

[14] The information on total revenue loss, in million pesos and as a percentage of the GDP, was obtained using the sum of the estimated revenue loss for each tax expenditure, according to the 2012 TEB. In accordance with the 2012 PEF, the estimated total net expenditure is $3.7 billion pesos. The 2012 LIF estimates that the non-oil revenue for the same year will be $2,137,779.9 million pesos.

Finally, an analysis of TEB from 2002 to 2012 illustrates that certain changes over the years have affected the level of transparency. The major advances and setbacks are summarized in Table 1.

Table 1 Evolution of Transparency on TEB from 2002 to 2012

Advances

- Included an additional estimate for the year after TEB is presented.
- Added some sections that explain the legal basis and function of TEB, as well as the definition, coverage, and methods of measurement of tax expenditures.
- Incorporated the legal framework, a brief description of each tax expenditure, and the sources of information used for the estimates.
- Classified the tax expenditures of the personal income tax in the following way: 1) social security expenditures, 2) social assistance expenditures, 3) expenditures related to savings, and 4) expenditures related to education.
- Added information that shows the distribution of certain tax expenditures by economic sector as well as the households that benefit most from the zero percent tax rate of VAT on food and medicine and from the negative Special Tax on Production and Services (STPS) from the subsidy for gasoline and diesel.

Setbacks

- The reasons that justified the change in the method used to calculate the revenue loss reflected in the 2009 TEB are insufficient. Among other things, the major changes in terms of revenue loss were not necessarily due to those tax expenditures pointed out by the MFPC (those that were adjusted for tax evasion). In practice, the methodological change was reflected in a significant decrease in total revenue loss. Currently, such a change makes the comparison of figures over time difficult.
- Although the generation of an aggregate figure can be an imprecise estimation of the total revenue loss given that the estimate does not consider the changes in taxpayer behavior, its publication represents a good exercise in transparency and accountability, showing at least the magnitude of these incentives. Consequently, the elimination of the summary table that contained the total amount of revenue loss is a setback. Currently, not all of the corresponding figures needed to calculate this revenue loss are presented in the tables throughout TEB; rather, some are inserted within the text (e.g.., employment subsidy), which makes identifying revenue loss difficult. To calculate the total amount, one must add the tax expenditures one by one.
- From the 2010 TEB, no information is presented on the negative STPS subsidy for gasoline and diesel fuel, including the breakdown by type of fuel or sector (trucking, agriculture, and other consumers).

In conclusion, TEB presents many opportunities to provide much high-quality information. The points raised in this section are an important exercise in transparency and allow stakeholders to make a deeper analysis of the tool, and therefore, to propose alternative policies that lead to a better use of public resources.

Transparency in the Management of Tax Expenditures

Tax expenditures are framed in different management stages. Looking at them in depth involves the identification of decision makers and stakeholders, as well as the roles they play. The following four subsections describe the different stages of management of tax expenditures in Mexico in theory and in practice.

The authorization process

A rigorous and transparent authorization process is necessary to guarantee the proper use of public resources. Not only does such a process promote the allocation of these incentives to strategic sectors and avoid duplicating direct spending programs but it also makes rent seeking and corruption difficult. At the international level, it is possible to identify a series of best practices for authorizing tax expenditures.

First, the literature shows the importance of defining a responsible body for the estimation of tax expenditures. Generally this function resides with the Ministry of Finance or the tax administration, given that they have the necessary knowledge and information for this purpose.[15] In Mexico, the MFPC estimates the revenue loss derived from the application of tax expenditures. According to Article 24 of the Tax Administration Service Law, TAS provides the necessary data to carry out these estimations, since they are derived from taxpayer returns.

Second, the actors involved in authorizing tax expenditures and their respective functions must be defined.[16] The definition of rights and obligations makes the approval process more transparent and allows individuals to be held accountable in the event of noncompliance. In Mexico the power to approve or modify tax expenditures lies with the President and Congress, but the federal ministries do have the right to express their opinion on tax expenditures that are necessary to boost a sector. Nevertheless, their participation is limited.

Most tax expenditures are automatically applied by taxpayers through their tax returns; however, for the few that are not, the requirements and process necessary to access them are more detailed. For example, Chapter VI of the Income Tax Law (ITL) states that for the approval of the tax incentive for domestic film production, there will be an "Inter-institutional Committee that will include a representative of the National Council for Culture and the Arts, one from the Mexican Film Institute, and one from the *Secretaría de Hacienda y Crédito Público* (SHCP) who will chair the Committee and have a quality vote."[17] In addition, once the grant has been awarded in full, this committee should make public the projects that benefited and the amount of tax incentives for each one of them.

Third, clear guidelines must be developed that specify under what circumstances it is appropriate to grant preferential tax treatments. This is crucial because it prevents the approval of tax expenditures that contribute only marginally to the government´s proposed objectives. As mentioned above, Mexico

[15] Luiz Villela, Andrea Lemgruber, and Michael Jorratt, "*Tax expenditures budgets: concepts and challenges for implementation*," available at http://www.iadb.org/en/publications/publication-detail,7101.html?dctype=All&id=68490%20&dclanguage=en

[16] OECD, "Transparency and tax incentives in Zambia," February 2012, unpublished document.

[17] ITL, 2012, p. 240.

Article 25 of FRL establishes that tax incentives and administrative facilities should be granted based on the criteria of economic efficiency, nondiscrimination, limited temporality, and progressiveness. However, no evidence exists the incentives meet the criteria. It is important to mention that there are detailed guidelines for accessing certain tax expenditures. For example, according to the Income Tax Law, the Inter-institutional Committee in charge of the authorization of incentives for domestic film production has the power to issue general rules for allocating these incentives across different soliciting projects.[18]

Fourth, in order to comply with Article 31 of the OLFPA, coordination mechanisms must be designed for joint decision making on the approval of tax expenditures. That is, the authorization process for tax expenditures should consider not only the opinion of the Ministry of Finance, but also the experience of other ministries involved in the matter because they know in detail the benefits that certain groups or economic sectors already receive through direct spending programs.[19] In Mexico, the way in which other ministries formally collaborate and communicate with the MFPC regarding the approval of new tax expenditures or amendments to existing ones is not clear.

Fifth, beneficiaries' obligations should be defined in some cases. For example, the OECD has recommended that Zambia request periodic reports from the beneficiaries of tax expenditures as much as possible.[20] In Mexico, general obligations for a few tax expenditures are established, while the corresponding tax laws explain them in greater detail. For example, Article 27 of points out that nonprofit organizations authorized to issue tax deductible receipts are obligated to present an annual report. Likewise, article 101 of the Income Tax Law states that corporate entities or trusteeships authorized to receive tax-deductible donations will present an annual report that contains the obtained profit and granted donations.

> *"Clear guidelines must be developed that specify under what circumstances it is appropriate to grant preferential tax treatments."*

Sixth, the information on the type of sectors and activities that benefit from tax expenditures should be made easily accessible to the public. The economic sectors and activities that benefit from a few tax expenditures are spelled out in TEB. For the incentive given to domestic film production, Article 226 of the Income Tax Law states that the Inter-institutional Committee should publish information on the projects that benefited and the amount of support each one receives. In this regard, in February 2012, the MFPC published in the *Official Journal of the Federation* (OJF) the features of the 22 projects that benefited from the stimulus during the 2011 fiscal year.[21] Article 27 of FRL also states that TEB should

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[18] For more information on these general rules, see http://www.sat.gob.mx/sitio_internet/informacion_fiscal/legislacion/52_17924.html

[19] Michael Jorratt, "*Análisis del gasto tributario y propuestas de incentivos fiscales a la inversión y al empleo en Ecuador*," available at http://www.flacsoandes.org/dspace/handle/10469/3870

[20] OECD, "Transparency and tax incentives in Zambia," February 2012, unpublished document.

[21] To know in greater detail the benefitted projects and the amount granted, see ftp://ftp2.sat.gob.mx/asistencia_ftp/publicaciones/legislacion12/acdopteatral_28022012.doc

include the social and economic benefits associated with each tax expenditure. Nevertheless, in practice, TEB disregards the last point and presents neither an analysis nor a description of the social or economic benefits associated with the tax expenditures. This means it is not known whether tax expenditures are accomplishing the objectives for which they were initially created.

Finally, some countries request specific requirements in order to make the approval of tax expenditures less flexible. In the United States and Australia, there exists a requirement to submit a document that expresses the changes that would be generated by altering the tax laws.[22] Moreover, Article 25 of the Income Tax Law requires it to be proven that a tax expenditure is the best option to achieve a particular objective; otherwise, other options should be considered, such as a direct spending program. Currently, there is no evidence that indicates that the government carries out an evaluation prior to the authorization of tax expenditures that would allow them to make the required comparisons.

In conclusion, the cases where the laws require more details with regard to authorization of tax expenditures are exceptions. It is not known for certain whether the MFPC complies with the requirements of Article 25 of FRL on approving tax expenditures based on criteria of economic efficiency, nondiscrimination, limited temporality, and progressiveness. Furthermore, no public information is disclosed on the existence of an assessment prior to the authorization of tax expenditures that would allow them to compare what alternative policies could be more effective in achieving a particular goal. In addition, since TEB does not include the social and economic benefits associated with each of the tax expenditures, the MFPC fails to comply with the provisions in Article 27 of FRL. In general, the authorization of tax expenditures in Mexico presents many areas of opportunity for improvement in terms of processes, the definition of stakeholders, as well as their rights and obligations.

The inclusion of TEB in the budget cycle

Given that tax expenditures can be a substitute for or complement to direct spending programs, it is desirable that they are monitored with the same control mechanisms as the latter. In this respect, some international organizations such as the Inter-American Development Bank (IADB) and the IMF, suggest:

- integrating tax expenditure estimates with the rest of the budget documentation sent to congress (tax expenditure budgets can be presented as an appendix to the federal budget);
- presenting both budgets in the same period; and
- based on their joint analysis, defining the total expenditure limit.

In Mexico, TEB and the federal budget are presented on different dates. In accordance with FRL, the MFPC hands over the Tax Expenditure Budget to the Chamber of Deputies and Senate no later than 30 June.[23] The economic package, which includes the federal budget and FRL, is handed over to congress for its analysis, discussion, and approval in the month of September. In theory, only TEB is presented at an earlier date in order to give legislators time to analyze it in detail before the federal budget is

[22] OCDE, "Tax Expenditures and Tax Incentives: Best Practice," draft, October 2011.

[23] It´s noteworthy that according to Article 74 of the PCUM, in an election year, the deadline for the presentation of the economic package is 15 December.

submitted. Although both documents are presented separately in accordance with Article 40 of the FBFRL, FRL should include ''an explanation on the tax expenditures for the budgeted year."[24] (). However, this could be interpreted in different ways. In practice, FRL initiative contains only a brief summary of tax expenditures, where it basically stipulates why TEB does not include total quantities by tax or all differential treatments of the tax system. It also briefly mentions which preferential treatments stand out for their estimated amount of revenue loss. As a result, legislators do not have complete information on income and spending policy, which in turn affects their analysis and decision making on public finances. The joint analysis of both types of expenditures could promote the definition of budgetary ceilings and floors, but also the proper prioritization and allocation of resources. However, in Mexico, the presentation of TEB and the federal budget at different periods of time makes this task difficult.

In summary, the inclusion of TEB in the budgetary cycle by law would increase the attention and scrutiny tax expenditures receive, allowing for greater room to improve efficiency, for defining expenditure ceilings, and for advancing transparency and accountability. In addition, in the 2012 TEB, the MFPC recognizes that certain tax expenditures are more like direct expenditures and can be submitted under the same controls that govern the federal budget. This represents a significant advance on the subject.

Evaluation

Tax-policy expert Leonard Bernard held that "Periodically evaluating the size and effectiveness of tax expenditures is a necessary (although not sufficient) requirement for good government."[25] The OECD also argues that when a tax expenditure is implemented, it is a good practice to monitor its effects and use the information obtained to perform a systemic assessment to improve its efficiency. A complete analysis of tax expenditures would include assessments of effectiveness, efficiency, distributive impact, and the generated administrative and compliance costs by the tool.

Even so, tax expenditures are rarely evaluated after their approval, since they remain in the law indefinitely once they are approved. In this context, Burton and Stewart (2011) consider that it would be useful to establish sunset dates to facilitate the periodic review of tax expenditures by the legislative power.[26] In Mexico, the main obstacle to the evaluation of tax expenditures is that their corresponding objectives are not made public (assuming that there were objectives set out in the approval process). How can an evaluation be conducted when the desired goals are unknown?

Nevertheless, since 2000, the MFPC has published a series of studies that aim at evaluating the redistributive impact of fiscal policy. One of these, "Distribution of Tax Payment and Reception of Public Spending by deciles of Households and Individuals: Results for the Year 2010," presents an analysis of the STPS and the estimated distribution of the tax burden from the Value Added Tax

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[24] FBFRL, 2012, p. 26.

[25] Michael Thörne, "*18 Billion at One Blow Evaluating Germany´s Twenty Biggest Tax Expenditures*," FIFO Institute for Public Economics, University of Cologne, Working Paper No. 12-4, November 2012, p. 6.

[26] Mark Burton, and Miranda Stewart,"*Promoting budget transparency through tax expenditure management: a report on country experience for civil society advocates*," Melbourne Law School, University of Melbourne, 2011.

(VAT).[27] One of the main conclusions derived from the analysis is that "the impact of VAT with respect to income shows a downward trend as income increases, meaning that as income becomes higher, households of these deciles spend a smaller proportion of their income to cover the tax". Based on this analysis, TEB includes some charts on the redistributive impact of the zero tax rate of VAT on food and medicine. However, this evaluation responds to neither the establishment of expiration clauses nor a regular evaluation process for the great majority of tax expenditures.

Despite this valuable exercise by the MFPC, it is necessary at a minimum to analyze periodically those tax expenditures that represent the highest revenue loss and include such results in each year's TEB. This would help legislators and the general public understand the impact of the tax expenditures, which ones are worth incurring such revenue loss, as well as which ones could be replaced by more efficient direct spending instruments. This is not possible without previously defining each tax expenditure's aim.

"The OECD maintains that congress should appoint a national auditing body or an equivalent organization with the responsibility of submitting a report on the financial integrity of public accounts, including tax expenditures."

Auditing

Performing audits on tax expenditures promotes transparency and accountability. They can verify if tax expenditures were authorized by the law, if the preparation of TEB is adequate, and whether there were any irregularities in implementation, among other things. In this respect, Jorratt notes that the tax administration has the responsibility to "verify that taxpayers make use of tax expenditures as the law establishes, preventing the exploitation of evasion opportunities that are normally produced when exceptions are established in the legislation."[28] For this purpose, "they should make use of the standard oversight tools, such as crossing mass information and selective audits". The OECD maintains that congress should appoint a national auditing body or an equivalent organization with the responsibility of submitting a report on the financial integrity of public accounts, including tax expenditures. In addition, the OECD affirms that administrative procedures should be developed to facilitate supervision and minimize discretion.
According to the PCUM, the federal executive branch sends the Public Account to the Chamber of Deputies in April of the year after the federal budget is put into practice, so that it can be revised by the SAOF. The objective of this action is to ensure that the collection and administration of federal revenues and expenditures are carried out in terms of applicable legal and administrative regulations. Once the Public Account is analyzed, the report with the recommendations is published the February after it is delivered. In addition, the SAOF can conduct special audits in areas considered relevant.

In 2009, the SAOF carried out a special audit with the objective of "overseeing the management of SCHP to verify that the revenue loss and monetary quantification were approved, implemented,

[27] MFPC, "*Distribución del pago de impuestos y recepción del gasto público por deciles de hogares y personas. Resultados para el año 2010*," 2010.

[28] Jorratt, p. 41.

monitored, and evaluated in accordance with the regulation."[29] For this, the SAOF revised "the calculations, methodology, and estimates for the integration of the 2009 TEB, as well as the testing of international best practices with the procedure used by the MFPC to determine revenue disclaimers and its total". The main conclusion from this analysis was that the MFPC "complied with the applicable regulatory requirements for the development and integration of the Tax Expenditure Budget for the 2009 fiscal year, except for not considering historical estimation references and the approach used to define the taxes and the identification of the revenue loss in the Tax Expenditure Budget in line with international best practices."[30]

In addition to the special audit conducted on each year's TEB, SAOF analyzed information regarding tax expenditures in the 2010 Public Account and noted the following:

- Tax expenditures generated a tax revenue loss of $582,745.1 million pesos, equivalent to 44.3 percent of tax revenues and 4.5 percent of GDP.
- One of the public finance section´s conclusions highlights the importance of the assessment of tax expenditures in noting that "to determine the cost-benefit of keeping or modifying its composition and characteristics, SAOF considers it advisable that the MFPC presents a systematic evaluation of the effectiveness and efficiency of tax expenditures, in order to stimulate the economy, boost employment, and redistribute income."[31]
- To ensure the solvency and sustainability of public finances, it is necessary to rationalize tax expenditures, among other things.
- SAOF suggests assessing the relevance of requiring FRLMFPC to present a cost-benefit projection of tax expenditures in FRL before their approval. Furthermore, the MFPC would then be made to integrate an evaluation of the obtained results in the Public Account.
- Finally, SAOF considers that "MFPC should present an assessment of the economic and social impact of the different items that constitute [tax expenditures], in order to have an analysis that supports decisions for their continuation or improvement; to ensure the annual submission of this evaluation, FRL or LFRH must establish it as an obligation[32]

Moreover, the SAOF document titled "Analysis of the 2012 Financial Management Progress Report" contains a section on tax expenditures that shows the magnitude of revenue loss and the composition of tax expenditures. Due to the importance of tax expenditures in terms of revenue loss, SAOF recommends that "the Chamber of Deputies requires the MFPC to conduct evaluations that reveal the economic and social impact of the main components of TEB, in order to estimate the benefits of economic activity, employment, and income of economic agents and taxpayers who take advantage of them, as well as the collateral effects on consumption, savings, and investment."[33] In practice, the

[29] SAOF. (2010). *Informe del Resultado de la Fiscalización Superior de la Cuenta Pública 2010*. Available at http://www.asf.gob.mx/Trans/Informes/IR2010i/Indice/Ejecutivo.htm

[30] Ibid., p. 16.

[31] Ibid., p. 39.

[32] Ibid., p. 84.

[33] Ibid., p. 82.

document has received only minimal attention from both the media and relevant actors.

Tax Expenditures and Subnational Governments

In some countries, TEBs include the estimated revenue loss derived from the application of certain existing tax expenditures at the subnational level. In others, state governments elaborate their own TEBs. In Mexico, states have demonstrated less progress in the subject since they have not implemented any of these actions. Thus transparency with regard to the management of tax expenditures is even weaker at the state level of government.

For state governments, the development of their own TEB would promote the identification and quantification of tax incentives that are awarded to different sectors or activities. In turn, this would allow for an evaluation that shows which of the tax incentives are effective. The existence of ineffective tax expenditures at the subnational level in Mexico is unacceptable, given the situation of the country's public finances, which today is marked by:

- elevated levels of public debt,
- high dependence on federal transfers,
- low tax revenue, and
- growing pressure on public finance planning as a result of the various economic and social needs of the population.

Thus it is necessary to improve the management of tax expenditures at the level of local public finances. In addition, the creation of this document represents a good exercise of transparency and accountability, which are necessary given the high level of opacity in budgetary issues in most Mexican states.

For that matter, it is important to first identify what incentives state governments have in order to develop their own TEBs. In this respect, it was determined that the legal framework related to states' public finances does not indicate the executive's or any other authority´s obligation to develop a state-level TEB. Without a legal requirement, any development of a state-level TEB will have to arise mostly from political will or by a future legally binding federal law.

The States' Transparency and Tax Information Availability Index (STTIAI), developed by the consultancy Aregional, and the State Budget Information Index, produced by the Mexican think tank MIC, are the main points of reference for subnational governments on the topic. [34] Based on these two indices, states have recently presented important advances in budget transparency. In some cases, high-level public servants have approached both organizations in search of guidance on how to improve their performance and so their position in the ranking. Nevertheless, the opacity with respect to managing tax expenditures has not been well studied.

[34] See http://www.colima-estado.gob.mx/transparencia/archivos/Metod_ITDIF_2012.pdf; and http://imco.org.mx/images/pdf/IIPE2012_PPT.pdf

According to the STTIAI, in 2012 the most transparent states were Jalisco, Nayarit, the State of Mexico, and Baja California Sur.[35] Under MIC's Index, Colima, Puebla, Campeche, and Jalisco were the judged best in 2012.[36] Considering the results of both indexes, Jalisco applies the best practices in terms of budget transparency because it provides detailed information on public debt, investment, purchases, operating costs, and performance assessments, among other things. Despite this, a review of the available information on this state government's website showed that information on tax expenditures is almost nonexistent.

Finally, one way to encourage states to present their own TEBs would be to include such indicators within these indexes. More awareness on the relevance and usefulness of this topic, as well as pressure from NGOs, the media, and even the federal government, could also help accomplish such a goal.

Next Steps in Transparency and Accountability?

In recent years, the use of tax expenditures in various countries across the globe has increased. However, the progress made in terms of transparency has not kept the same pace. Tax expenditures, like direct spending, represent a tool by which the government can attempt to achieve social and economic objectives. In this respect, such expenditures should be subjected to greater scrutiny, which would lead to a more efficient use of the tool as well as better accountability. This study on transparency of reporting on tax expenditures in Mexico identified areas of opportunity, which are explained in detail below.

Currently, detailed guidelines on budget transparency exist; however, in terms of tax expenditures, both the IMF and the OECD only point out the basic elements that a tax expenditure budget should contain. First, defining more elaborate international standards on tax expenditure management could increase the quality and quantity of information that countries present in their budgets and so have a positive impact on transparency. Government management would thus be directed towards an international benchmark and probably make the budgets more homogeneous. For this reason, it is hoped that international agencies will soon incorporate more specific and updated guidelines on the subject.

Second, although certain laws shed some light on the actors involved in the management of tax expenditures and their duties, there remain broad areas of opacity that favor discretion and breach some legal codes. On one hand, institutional channels are not well established to ensure the participation of other ministries in the authorization of tax expenditures. On the other hand, it is not known for certain if MFPC complies with Article 25 of FRL on approving tax expenditures based on the criteria of economic efficiency, nondiscrimination, limited temporality, and progressiveness. It is also unknown whether MFPC adheres to Article 25 of FRL on conducting an assessment prior to the authorization of tax expenditures that would allow comparing what alternative policies might be more effective in achieving a particular objective. Moreover, MFPC fails to comply with what is established in Article 27 of FRL, since TEB does not take account of the social and economic benefits associated with each of the tax expenditures. In addition, although the creation of the Special Committee for the

[35] See http://www.eluniversal.com.mx/notas/850465.html

[36] To see the complete results of the State Budget Information Index, see http://imco.org.mx/es/temas/gobiernos_finanzas_publicas/resultados_del_indice_estatal_de_transparencia_presupuestal_2011

Analysis of the Tax Expenditure Budget represented a good exercise in terms of transparency and accountability, as it is a counterweight to executive power, its scope has been limited due to its lack of technical support. As a result, efforts to improve the committee's overall impact have not been effective.

Third, legislators should evaluate spending and income policy simultaneously. The fact that the economic package and TEB are presented on different dates (and FRL provides minimal data on tax expenditures) affects the analysis of and decision making on public finances. The inclusion of TEB in the budget cycle would increase the attention and scrutiny tax expenditures receive, and, as a result, more opportunity to improve their efficiency and transparency would be created.

Fourth, the main obstacle to the assessment of tax expenditures is the lack of information about the objective of each expenditure. Although some tax expenditures have been studied, such as the zero VAT rate on food and medicine and the STPS on gasoline and diesel, neither the establishment of sunset clauses nor the regular evaluation process has been very successful; instead a greater impact has been seen in response to MFPC or petitions from legislators. These evaluations can also be improved by including other variables that allow for a complete measurement of their effectiveness. Alas, there are no assessments for the great majority of tax expenditures.

Fifth, the audit of the 2010 Public Account developed some recommendations in line with international best practices for the management of tax expenditures. For example, it advised the assessment of incentives to determine their effectiveness and efficiency, the presentation of a cost-benefit analysis from its application within the economic package, and the integration of an evaluation on the obtained results into the Public Account. Despite the fact that compliance with SAOF observations is not mandatory, there are certain mechanisms that ensure their implementation by public servants, such as follow-up audits.

Sixth, TEB presents useful information on the magnitude of tax expenditures and some other characteristics of their management. However, an analysis of TEBs from 2002 to the present shows that MFPC has carried out changes that have hindered the level of understanding on the subject among decision makers, civil servants, and the general public. Also, some of the best international transparency practices still have not been incorporated into this document, among them the functional classification of tax expenditures, the publication of estimates' reliability, and the incorporation of tables that summarize the most important information in a clear manner.

Seventh, although having TEB published on the MFPC´s website constituted an important advance in its accessibility, citizens' understanding of the matter is limited. The information in TEB should be as clear as possible in order to be accessible to the entire public, since tax expenditures are a complex subject. In this respect, the development of a Citizens Budget for tax expenditures would allow for greater understanding of the subject at the level of individual citizens.

Eighth, the existence of FIAIDP, as well as state institutes and commissions that offer access to public information, allows for a more active role by the citizenry in the assessment of tax expenditures. Nevertheless, no significant results have been obtained, despite the fact that there has been a more active use of this tool to find information on tax expenditures at the federal level. Since tax expenditures are closely linked to taxpayers' tax returns, there may be obstacles to access to information.

Finally, due to limited knowledge on tax expenditures within subnational governments, the development of their own TEBs by local governments would represent an important advance in transparency. One way to encourage such action is to develop budget transparency indexes, such as those produced by MIC and Aregional, that include specific requirements on tax expenditures.

In summary, the outstanding issues with regard to the transparency of tax expenditures in Mexico are:

- defining the objective that each tax expenditure aims to accomplish;
- improving the quality and quantity of information contained in TEB, such as classifying tax expenditures by function, determining the level of reliability of the estimates, and including the social and economic benefits that derive from tax expenditure implementation;
- Defining comprehensive international guidelines on the subject;
- Integrating both budgets;
- Increasing understanding of tax expenditures by citizens, through the development of a citizens tax expenditure budget;
- clarifying institutional channels so that the actors involved in the management of tax expenditures properly exercise their duties;
- assessing all the tax expenditures periodically, or at least assessing those that generate the greatest revenue loss, through the establishment of an expiration clause;
- enforcing compliance with Articles 25 and 27 of FRL;
- strengthening the efforts of the Special Committee for the Analysis of the Tax Expenditure Budget;
- strengthening of FIAIDP and the promotion of a more active use of this body to analyze public finance policies; and
- including specific requirements on tax expenditures in the indexes on budget transparency developed for subnational governments.