9 A close relationship with the economic elite: the historical roots of the poor Mexican tax state

Mónica Unda-Gutiérrez

Introduction

The Mexican state is a poor state. It currently collects tax revenue equivalent to 13.1% of GDP. This amount is too low to address the socioeconomic problems that afflict Mexican society, such as the lack of growth and the number of people living in poverty – 43.9% of the population in 2020 (Consejo Nacional de Evaluación de la Política de Desarrollo Social [CONEVAL], 2021). This amount is also meager compared to what other countries with similar income levels collect – in 2019, Brazil, Argentina, and South Africa collected 33.1%, 28.7%, and 26.2% of their GDPs respectively (OECDStat, 2021). Even Latin American countries with lower income levels collect more taxes – in 2019, Ecuador, El Salvador, and Honduras collected between 20% and 22% of their GDPs. This is not a new anomaly; it has always been one of the most significant challenges for the country's development in the last century.

This chapter shows how regressive tax institutions with low extractive capacities were established during the post-revolution reconstruction of the Mexican state (1910–1920) and argues that this was a direct result of the influence that the economic elite exerted in the tax policy-making process through its instrumental power. According to Hacker and Pierson (2002), the elite possesses two kinds of power: structural power and instrumental power. Structural strength is derived from the crucial role that companies play in generating wealth and employment, i.e., in the consequences of the investment decisions. On the other hand, instrumental power involves taking deliberate actions to influence public policy. Here, we offer evidence from historical archives that reveal the influence of representatives of the economic elite in tax decision-making processes between 1925 and 1964. These decisions ended up cementing a tax system with low tax collection levels and a lack of progressiveness, which was justified by a faction of the Ministry of Finance and Public Credit (SHCP) as a means to encourage private investment and thus support the process of import substitution industrialization (ISI).

Moreover, this chapter proposes that the creation of a poor tax state has helped strengthen the structural power of the elite, which became more apparent as of the 1980s. The fiscal poverty of the Mexican state puts it at a

DOI: 10.4324/9781003336686-11

disadvantage in relation to the elite by incrementing the economy's dependence on private investment to generate growth and employment. As discussed later, during the ISI period, the Mexican state was characterized by its direct and active participation in the productive process through the state-owned enterprise sector (SOE sector) and its stewardship of the economy – which to a certain extent helped conceal the fiscal anomaly of low tax collection. However, the financial situation of state-owned enterprises, among other factors, aggravated the crisis of the early 1980s that gave rise to neoliberal stabilization and structural adjustment policies. These have also strengthened the position of the economic elite concerning the state.

To better contextualize the questions related to the building of tax systems, it is useful to situate this chapter in a broader theoretical and historical framework. First, the proposal to link state building with the establishment of tax systems is not new. For many (Levi, 1988; Bräutigam et al., 2008; Schumpeter, 1954; Tilly, 1975), the creation of the state's extractive capacity is an essential component of the state. As Burke puts it, "the revenue of the state is the state" (Levi, 1988). Second, to understand the process by which the extractive capacity of the state is created, it is essential to analyze the relationship between the state and the economic elite, since this capacity should be conceptualized as a relational—rather than absolute—phenomenon (Centeno, 1997). In other words, the ability to collect taxes is based on a two-part relationship: it is linked, on the one hand, to the society's willingness to accept this extraction, and, on the other hand, to the state's ability to convince and coerce taxpayers to do so (Levi, 1988). However, in countries as unequal as Mexico, the relational dimension of the state that affects tax collection levels is mainly determined by the relationship between the state and the economic elite that controls most of the taxable resources.

Findings in historical archives (especially the internal documents of the SHCP) allow me to analyze the formation of tax institutions between 1925 and 1964 and to reconstruct the decision-making processes of the most important tax policy measures of that period, as well as the actors—representatives of the state as much as the economic elite—that influenced these processes. By *financial elite*, we mean a small group of people who have power and influence over the decision-making processes in economic policy – those who own assets in the economic sectors that control most of the economic resources. In this period, the economic elite in Mexico consisted of individuals and families that controlled the "economic groups". These groups were industrial and mercantile corporations and financial institutions linked through shared ownership and joint boards (Alba, 2005, p. 157; Hamilton, 1982, p. 33). The leading organizations that represented the economic elite in the period under analysis are the Confederation of National Chambers of Commerce (CONCANACO) and the Confederation of Industrial Chambers (CONCAMIN), which were created in 1917 at the initiative of Alberto J. Pano, Secretary of Industry and Commerce, with the goal of facilitating communication and cooperation between the state and the private sector (Collado, 1996, p. 121), and the

Confederation Patronal de Mexico (COPARMEX), founded in 1929 at the initiative of businessmen in Monterrey.

The analysis of the evidence shows that, on the one hand, there was *tension* between the state bureaucrats that sought to establish a modern tax system – more revenue-raising and more progressive – and those who thought that the priority should be to incentivize the accumulation of capital through an enormously diminished tax burden, in order to boost industrialization. On the other hand, the archival evidence shows that gradually – and especially towards the end of the 1940s – the relationship between the SHCP and the elite became closer. The representatives of the economic elite were invited to sit in on the tax commissions where proposals were discussed in the 1950s and 1960s, where they used their instrumental power to influence the outcome of the reforms. The result of the tightening of the relationship between the state and the elite came at the price of the construction of a regressive tax state with very low collection levels.

The work of historians and political scientists on the post-revolutionary period in Mexico supports the analysis and argument proposed here. According to Hamilton (1982), Knight (1985; 2001) and Reynolds (1972), the decades following the war between the revolutionary factions accounted for the tension between two types of alliance that were latent in shaping the country's development: the "progressive" alliance and the "conservative" alliance, which was also called the "alliance for profits".[1] The former involved coalitions between public officials, governors, and bureaucrats, and the working class and peasantry; the latter was an alliance in which officials of the state apparatus were linked to the economic elite or ruling class. While the progressive alliance prioritized distributive demands, the conservative alliance prioritized political stability and capital accumulation for the sake of economic growth through industrialization.

The reconfiguration of alliances between the state and the elite after the revolutionary struggle was not a linear process, nor did it always converge in the same direction (progressive alliance or conservative alliance). Not only was the Mexican state far from being a monolith, but the Porfirian landed oligarchy (pre-revolutionary economic elite) had been weakened and reconfigured (Knight, 1991). In this sense, the tax policy measures discussed in Section II account for this process of reconfiguration and the tension between the different factions that made up the state, as well as the gradual realignment and strengthening of the elite.[2]

This is why the initial tax policy measures show signs of decision-making that sought "distribution by peaceful means" (Pani, 1926) through the creation of income tax in 1925 or the creation of several other direct taxes that sought greater extraction and progressiveness (the corporate excess profits tax, the tax on credit institutions, or the tax on windfall profits). However, by the end of the 1940s, the approach was different, and the result was failed progressive reforms – such as those of 1951 and 1953, and those of 1961 and 1964 – in which one finds conflicts within the SHCP and ever-growing instrumental power of the organizations that represented the interests of the economic elite. In the end, this resulted in a structurally weakened state.

Alternative hypotheses on low tax collection levels

Before analyzing the process by which the most important tax policies were made between 1925 and 1964, we will discuss some of the hypotheses that are suggested in the literature.[3] The most frequently proposed hypothesis to explain Mexico's low tax collection levels is the presence of alternative resources, in particular, oil revenue (Elizondo, 1999; Martínez-Vázquez, 2001; Álvarez Estrada, 2007). The logic is as follows: if the government can finance itself through sources that will entail a lower political cost than raising taxes it will avoid increasing tax collection.

However, the availability of alternative revenue sources does not fully explain the problem. Tax collection in Mexico was already notoriously low long before the oil boom of the late 1970s. According to Haber et al. (2003), as of 1921, oil production in Mexico began to decline rapidly, and by 1930 had fallen to 20% of 1921's production levels. The production levels of 1921 were not reached again until 1974, and Mexico never recaptured the share of world production that it held at the end of the 1910s (25% of the market). Table 9.1 shows that, by 1935, Mexico was already collecting much less in terms of per capita tax revenue than most of the economies of comparable countries in Latin America.

Likewise, Table 9.2 indicates that, at least since 1950, Mexico's total tax collection as a percentage of GDP was much lower than that of Argentina, Brazil,

Table 9.1 Tax revenue per capita in 1935 (US$).

Argentina	12.93	United States	28.47
Venezuela	13.71	Great Britain	74.21
Uruguay	10.20	France	52.49
Chile	9.02	Germany	35.03
Costa Rica	7.06	Sweden	28.37
Brazil	5.44	Canada	27.66
Mexico	3.34	Norway	27.23
Peru	3.14	Spain	20.81
Colombia	2.59	South Africa	18.91

Source: Studenski, 1939, p. 37.

Table 9.2 Tax revenue (as % of GDP).

	Argentina	*Brazil*	*Chile*	*Colombia*	*Mexico*	*Peru*
1950	17.0	16.0	16.7	12.0	7.5	14.0
1960	14.2	20.1	16.5	10.4	7.1	14.9
1970	15.0	27.0	21.8	13.4	7.9	18.9

Source: Fitzgerald, 1978, p. 131.

Chile, Colombia, and Peru. Since then, and until now, Mexico's tax burden has always lagged far behind that of comparable countries.

My argument is that alternative sources of financing, such as oil revenue, do not explain the root of the problem of low tax collection. Instead, they have *aggravated* it during periods of oil revenue bonanza, as has happened intermittently since the late 1970s. In the last four decades, the periods with the highest oil revenue for the federal government have been 1982–1985, 1995–1997, and 2004–2014, with average levels of 5.7%, 4.2%, and 5.3% of GDP respectively. In turn, Figure 9.1 illustrates that since the late 1980s, oil and tax revenue have modulated each other to supply the federal government with revenue that amounts to 13% to 15% of GDP. It is also clear that tax revenue has increased since 2014 as oil production has declined.

A second alternative source of financing for the Mexican state could have been revenue from the SOE sector. However, according to the most historical consolidated data that is available, SOE sector revenue can hardly be considered a source of state revenue (see Table 9.3). On the contrary, state-owned enterprises, and especially Petróleos Mexicanos (PEMEX), added considerable external debt to public finances from the 1970s, contributing to the so-called "unbalanced growth" that exacerbated the severity of the debt crisis that erupted in 1982.[4] As a result of this crisis, the ISI model was abandoned, and neoliberal structural adjustment policies were introduced in Mexico and in Latin America, which gave rise to the SOE sector that brought extraordinary revenue to the public treasury during the eighties and early nineties. But it also led to a slimming down of the state and a reduced capacity to direct and regulate the economy.

Table 9.3 State-owned enterprise sector (millions of Mexican pesos).

	Revenues	*Expenses*	*Deficit or surplus*	*Deficit or surplus (as % of total federal government revenue)*
1965	28,502	27,304	1,198	1.86
1966	33,364	33,558	−194	−0.29
1967	38,942	38,599	343	0.43
1968	42,384	42,298	86	0.10
1969	48,648	48,185	463	0.47
1970	56,972	56,582	390	0.36
1971	65,675	65,545	130	0.11
1972	71,821	71,538	283	0.19
1973	1,02,734	1,01,792	942	0.46
1974	1,40,489	1,40,688	−199	−0.07
1975	2,00,566	2,00,234	332	0.08
1976	2,41,637	2,45,065	−3,428	−0.65
1977	3,74,458	3,75,461	−1,003	−0.14
1978	4,96,317	4,95,363	954	0.10
1979	6,22,557	5,19,364	1,03,193	7.98

Source: Prepared by the author based on INEGI, 2015.

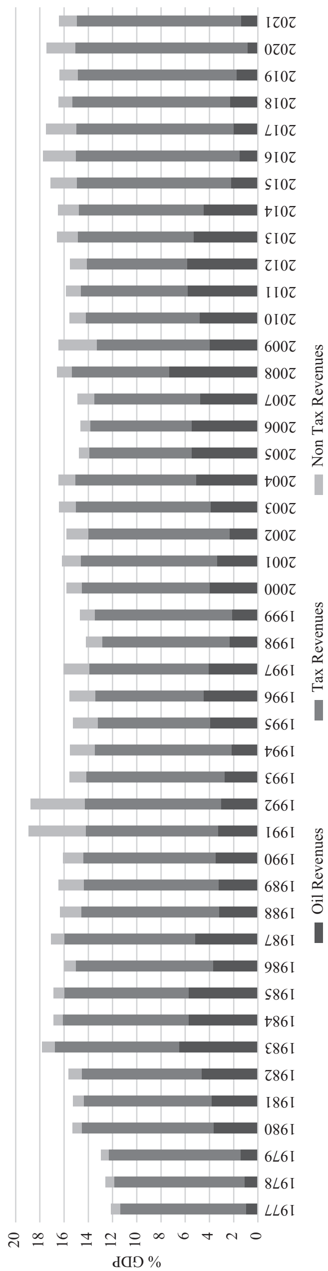

Figure 9.1 Total federal government budget revenue (% GDP). (Source: Based on www.banxico.org.mx/SieInternet/.)

Although aside from the oil revenue shown in Figure 9.1, state-owned enterprises have not been a source of income for the federal government, yet they played a vital role in the economic and social development of the country during a good part of the twentieth century. According to Aspe Armella (1993), the first state-owned enterprises that were founded between 1920 and 1970 were created to support the reconstruction of the country and create the necessary infrastructure to stimulate private investment and manage natural resources. The following ones sought to promote the ISI model through investment in transportation and communications, the creation of development banks, and social security institutions. Many of these enterprises provided inputs to the productive sector at below market prices and subsidized the consumption of basic goods by the masses. In 1970, there were 272 state-owned enterprises, but by 1982 these grew to 1,555, spurred by the oil bonanza, foreign credit, and an unprecedented state economic planning strategy (Aspe Armella, 1993, pp. 178–181). Rather than explaining low tax collection, this enormous Mexican public sector allows us to reconcile the image of a large state that intervened in the economy during the ISI period with the tax poverty of the Mexican state.

The relationship between the state and the elite in the tax sphere

This section is divided into three parts, corresponding to time periods defined by tax policy measures taken between 1925 and 1964. The detailed analysis of each of these periods seeks to support the argument that the tax system that was consolidated in the 1960s was the direct result of the instrumental power that the elites had over the tax policy decision-making process. From a broader perspective, it reflects the forging of a relationship between the state and the economic elite that over time became closer, and that primarily sought to promote ISI by favoring capital accumulation with a low tax burden.

Tax measures between 1925 and 1952: between progressiveness and industrialization

The Mexican federal tax system of the nineteenth century was almost entirely composed of indirect taxes, despite several attempts to introduce direct contributions and to establish *cadastres* (Serrano, 2006; Sánchez, 2006). Direct taxes never contributed to more than 5.5% of total tax revenue during that century (Servín, 1939, p. 8). Such a regressive tax burden was not consistent with the demands for social justice that emanated from the Revolution, nor with the transformation that was taking place in the tax systems of more advanced countries at the beginning of the twentieth century.

Thus, in 1924, President Álvaro Obregón made use of his extraordinary powers to decree the "tax on wages, salaries and profits", which the following year became the "income tax" (*impuesto sobre la renta* – ISR). The adoption of income tax marked a turning point in the country's fiscal history. It introduced a tax that, for the first time, promised to extract resources from a social base that until then had enjoyed fiscal privileges. From a historical perspective, it was an apparent change to the status quo that had reigned in terms of taxation. It was evidently facilitated by the context of crisis and reconstruction that weakened the Porfirian elite (Knight, 2001). Unda Gutiérrez (2017) argues that the creation of income tax was due, in part, to the skills that the President and the Secretary of the Treasury, Alberto Pani, used in overcoming the opposition of taxpayers and reaching an agreement (especially with CONCAMIN) to establish the tax. After all, CONCAMIN and CONCANACO were founded by Pani in 1917.

In addition to the creation of income tax, some adjustments were made to the tax system between 1925 and 1952. In 1941, three new short-lived direct taxes were created, and reforms were made to income tax. Commercial income tax was introduced in 1947, which was one of the main measures taken as part of the fiscal centralization strategy pursued by the federal government of the 1920s (Aboites Aguilar, 2003, pp. 190–213). The tax changes that took place during this period initially reflected redistributive impulses, with the creation of emphatically progressive taxes (a corporate excess profits tax, a tax on credit institutions, a tax on windfall profits, and other taxes) and with changes to income tax which encouraged the greater collection of capital income. However, at the same time, the Manufacturing Industry Laws were introduced in 1941 and the Law for the Promotion of Manufacturing Industries was introduced in 1946. These measures reveal the importance that the industrial sector was acquiring in the fiscal field – the manufacturing industry laws are an example of tax exemption measures granted to the manufacturing industry to promote its growth.

The corporate excess profits tax was established in 1939 and was in effect for two years. It was a general tax on companies that was meant to complement income tax (Servín, 1942, p. 12). It was paid by companies that surpassed certain income levels, was levied on profits exceeding 15% of the company's net equity, and had progressive rates. According to the Records of the Debates of the Chamber of Deputies (*Diario de Debates de la Cámara de Diputados* – DDD), the tax was discussed with representatives of the banking, industrial, mining, and commercial sectors (DDD, 1939). In the discussion, the Secretary of Finance, Eduardo Suarez, alleged that some mining companies, for instance, invested 1.5 million pesos and therefore obtained a surplus of 8 million pesos in one year. In the debates, there was some concern on the part of the federal government to limit excess profits due to the impact this could have on the functioning of the markets. The revenue from this tax represented about 25% of income tax revenue in 1940 and 1941.

A tax on credit institutions was also created in 1939 to tax the additional profits generated by exchange rate fluctuations and that benefited the export sector. According to Servín (1942, p. 17), this made sense because the financial sector had a light tax burden. This tax was only active for one year. Both the corporate excess profits tax and the tax on credit institutions were introduced during the six-year term of Lázaro Cárdenas. However, they only lasted two years and one year respectively.

The income tax law was amended in 1941. The two main objectives of this reform were to improve the regulatory framework of the tax and to raise more revenue. According to a report by the head of the income tax department, Luis Pardo, the tax had accumulated several decrees, amendments, and jurisprudential decisions that made it very complex and confusing (Pardo, 1929). The problem with this "legal jungle", as Pardo called it, was that it made it possible to have different interpretations of the law, which opened the door to disputes between taxpayers and the tax authorities and created possibilities for loopholes. For this reason, the law of 1941 sought to make the tax more coherent and added technical aspects that would clarify the law. To raise more revenue, the income tax reform included an increase in the rates of the five schedules under which the tax was organized.[5] From 1941 to 1943, income tax increased its collection from 0.6% to 1.7% of GDP, mostly coming from increases in the schedules that generated capital income, not labor. This collection pattern continued until the income tax reform of 1953 (Unda Gutiérrez, 2010, pp. 188–190).

The Manufacturing Industry Law was also introduced along with the income tax reform. It sought to support certain manufacturing industries for five years through exemptions for (i) taxes on the importation of machinery, equipment, and raw materials; (ii) export taxes; (iii) stamp duty; and (iv) federal tax. In 1946, through the Law for the Promotion of Manufacturing Industries, this law was expanded to include strategically relevant industries (Cárdenas, 1994, p. 110). However, industrial policy scholars were skeptical or pessimistic about the effectiveness of the pro-industry fiscal measures of that period (Mosk, 1954; Urquidi, 1956; Martínez, 1967) because they were neither selective or temporary nor subject to performance.

According to Servín (1948), the tax exemptions that were granted were not necessary given the already favorable conditions offered by captive domestic demand and international demand. The exemptions granted by these laws represented 12% of total revenue. The SHCP was clear about the ineffectiveness of these incentives, hence the comment of the Secretary of Finance, Ramón Beteta, who in 1949 stated that "it has been found desirable to maintain them due to the psychological effect they produce as a demonstration of the state's support for the birth and progress of national industry" (Beteta, 1951, p. 58).

In 1948, a tax on windfall profits was introduced, which complemented the income tax rates to which companies were subject. In the beginning, this tax collected around 12% of income tax, but after the tax reform of 1953, its collection was drastically reduced. President Miguel Alemán (1946–1952) argued that the tax was introduced to collect more, avoid fiscal deficits, and discourage the use of windfall profits for consumption or capital flight. According to Ramón Beteta, windfall profits resulted from the conditions arising from

World War II and from the economic development programs implemented by the government (DDD, 1948).

This period is seen as a transitional one in which, because of the reconfiguration of the economic elite and progressive fiscal flashes from the SHCP, tax measures still pursued revenue-raising and distributive objectives, but at the end of the period also sought to promote industrialization.

The income tax reforms of 1953 and 1955: the beginning of a close relationship with the economic elite

The empirical evidence on which this section and the following one are based gives us a privileged view of the discussions that took place behind each of these reforms. To the best of this author's knowledge, the 1953 reform was the first time that business organizations were invited to participate in the discussion of tax proposals. Moreover, this analysis gives an account of the incipient and close relationship between business organizations and the SHCP. Due to the nature of the reforms that ended up passing in 1953 and 1955, tax collection remained sluggish, and the pattern of income tax extraction was reversed: income tax began to collect more from income derived from labor than from capital.

In early 1953, the Tax Law Review Commission was established to analyze the legal tax framework and propose necessary changes. The commission was made up of SHCP officials, but included a representative of CONCANACO, and a representative of CONCAMIN was included at its request. The commission worked for several months and suggested two main changes: a new income tax law that would make the tax more organized, and a complementary schedule that would force the consolidation of income, thereby making the income tax more progressive.

Despite all this, the proposal to add a complementary schedule was withdrawn from the bill presented to Congress in December 1953. President Ruíz Cortines (1952–1958) justified the annulment of the complementary schedule on the grounds that for "reasons of public interest, the proposal was withdrawn", that "according to the opinion of some interest groups, a global personal income tax could impede the normalization of the trend of private investment" and that "the executive in return trusts that the private sector will respond by accelerating its efforts to fulfil its role in the economy" (DDD, 1953). It was said that the complementary schedule would remain dormant and would be implemented in a subsequent reform. Confidential studies by the SHCP calculated that having a complementary schedule as of 1956 could increase revenue by 3.2% of GDP, stating that "the new tax would affect the high-income population that currently does not pay taxes according to its economic capacity" (Urrutia, 1954).

The 1953 reform was complemented in 1955. However, before the Executive presented the bill to Congress, CONCAMIN asked the Secretary of Finance to share its draft (Secretaría de Hacienda, 1955). The final version of the reform proposal omitted the complementary schedule again and included income tax measures that were favorable to capital income. The Executive clarified that "the reform did not seek to increase tax revenue but to support small and medium enterprises", and that "the changes implemented sought the reinvestment of profits" (DDD, 1955). This second round of reforms merely reinforced the trajectory that had already been implemented with the 1953 reform and strengthened the relationship with private sector interests. Following the changes to the income tax in 1953, the collection of tax revenue from labor increased faster than that of tax revenue derived from capital (Unda Gutiérrez, 2010, pp. 167–178).

The studies of the Directorate of Financial Studies (*Dirección de Estudios Hacendarios*) disagreed with the decisions taken in 1953 and 1955. They warned of a fiscal imbalance caused by increases in three areas: public investment, current expenditures, and transfers to the SOE sector (Urrutia, 1958). They also warned that the deficit risked becoming more considerable in the future due to the transfers made to the CFE, PEMEX, and Ferronales.[6] Consequently, they proposed two primary measures: increasing tax collection through profound tax reform and tightening the control and coordination of the SOE sector. They suggested reintroducing the global personal income tax, taxing profits from bonuses, and reinstating the tax on excess profits that had been minimized in 1953. Their assessment is supported by the analysis of Cárdenas (1994, p. 35), who considers that from the Great Depression until the end of the 1950s, Mexican public finances were sound: the central bank played a limited role in the inflationary process, and balanced budgets were the norm.

Another confidential report elaborated in 1960 contains data that helps detect and assess the scale of the Mexican public sector's sources of income and the relevance of each one of them to public investment financing (Secretaría de Hacienda y Crédito Público – Banxico, 1961, p. 12). Table 9.4 indicates that, in 1940, 90% of public investment was financed with revenue from taxes and from state-owned enterprises.[7] However, by 1960, domestic and foreign credit financed 31.9% of investment, tax revenue continued to finance the same proportion, and the SOE sector contributed relatively less. Public investment as a percentage of GDP in 1940, 1950, and 1960 was 4.2%, 6.7%, and 5% respectively. In the same years, private investment was equivalent to 4.4%,

Table 9.4 Breakdown of public investment financing.

	Tax revenue	*SOE revenue*	*Domestic credit*	*External credit*	*Total public investment*
1940	37.7	52.2	10.1	0	100
1945	40.4	36.6	18.5	4.5	100
1950	49.0	30.6	4.9	15.5	100
1955	42.8	28.2	17.8	11.2	100
1960	36.1	32.0	10.2	21.7	100

Source: Secretaría de Hacienda y Crédito Público-Banxico, 1961, Box 46.

6.7%, and 10% of GDP (Instituto Nacional de Estadística y Geografía [INEGI], 2015). From this data, one can infer that the resources required to meet the need for increased public investment did not arise from higher tax collection, as had been advised in the multiple reports cited here, but with access to new credits, especially from the 1950s onwards.

In short, within the SHCP, a coalition of officials exerted pressure to make fiscal changes that would make the tax system more revenue-raising and progressive. However, their most essential proposals were not fully introduced in the reforms of 1953 and 1955. Evidence from the archives suggests that the instrumental power of the representatives of business interests influenced the decisions of the Secretary of the Treasury, which were justified to increase the rate of private investment in favor of the industrialization of the country.

The great missed opportunity of 1961 and the consolidation of a close relationship with the economic elite

As suggested by Aboites Aguilar and Unda Gutiérrez (2011), the 1961 reform provided the clearest opportunity in the twentieth century profoundly to change the tax system. The archival evidence reveals the *tension* that existed between two factions within the SHCP – one that fought to change the roots of the tax system's non-revenue-raising and regressive nature and another that did not see the tax system as a means to distribute and instead conceived of it as an instrument to promote capital accumulation and industrialization. Likewise, the internal discussions before the reforms of 1961 and 1964 clearly show the instrumental power that organizations representing the economic elite held in both processes.

In 1960, Nicholas Kaldor was invited to evaluate and propose changes to the Mexican tax system. In his report, he described the tax system as inefficient, because it could not prevent evasion nor was it able to tax capital gains,[8] and unfair because it privileged capital over labor through countless deductions, exemptions, omissions, and preferential treatments unparalleled in similar countries. Among the reforms he suggested were: (i) eliminating the anonymity of movable assets;[9] (ii) creating a personal and corporate income tax; (iii) making income tax progressive by taxing the dividend incomes that incentivized investments, since in practice they were almost completely free of tax burden due to discretionary exemptions; (iv) eliminating the fiscal incentives favoring industrialization due to their lack of effectiveness; (iv) creating a wealth tax that would consolidate all the assets of the individual; (v) improving the tax on inheritances and bequests; and (vi) creating a personal tax on spending. According to Kaldor's calculations, if the changes concerning income tax were to be implemented, revenue could increase by 12 percentage points of the GDP.

In response to Kaldor's report, the Secretary of Finance, Antonio Ortiz Mena, formed a tax commission to draft the bill that would be presented at the end of 1961. The group was made up of officials from the SHCP, Banco de México, and Víctor L. Urquidi, who served as advisors to the Secretary. The debates in the commission, as well as the opinions of several of those involved, show that there was serious friction in the commission between two groups, namely the lawyers and the economists (Turrent Díaz, 2004, p. 192).

Essentially, the economists supported Kaldor's proposals and the position taken by the reports that the Directorate of Financial Studies prepared for the reforms of the 1950s. Despite the arguments put forward by the economists, the Secretary of Finance favored the position taken by the lawyers, who advocated for moderate reform (Urquidi, 1987, p. 923; Izquierdo, 1995, p. 74).[10] He also proposed eliminating the schedular system in the second round of reforms. Indeed, in 1964, the schedular system was eliminated, and the income tax was structured into personal and corporate income tax.

From then on, regardless of the economic activity, companies had to declare and consolidate all types of income. But, at the same time, they were also given generous exemptions and preferential treatments that allowed them to reduce their tax payments (Solís, 1988, pp. 43–44).[11] As for personal income tax, even though Article 79 of the law established the consolidation of individual income, the SHCP decided to annul it. To do so, they used the ruse of introducing the transitory Article 38 into the income law, which stipulated that consolidating was not obligatory. According to Izquierdo (1995, p. 76), the transitory article was drafted by representatives of the private sector. To my knowledge, this was the first of many times to come where business interfered in this way (by drafting a law) in tax policy matters.

In Izquierdo's words:

> the meetings between Ortiz Mena and the presidents of CONCAMIN, CONCANACO, COPARMEX and the Bankers Association, were characterized by an understanding attitude on the part of the SHCP, which greatly took into account the different views on the 1964 tax project.
> (1995, p. 77)

Accordingly, Ortiz Mena justified the measures by saying that "establishing higher taxes on capital income would have undermined the development of the country's financial system" (Ortiz Mena, 1998, p. 162). The results of the 1964 reform clearly demonstrate the influence exercised by the representatives of the private sector (instrumental power) and that the reasoning of the SHCP aligned with the interests of the economic elite.

The consequences of the failed reforms of the 1950s and 1960s

The immediate consequence of the failed attempts of 1961 and 1964 was the change in the composition of income tax. The income tax's disproportionate revenue collection from salaries and professional services compared to tax revenue derived from the capital was intensified (Izquierdo, 1995, pp. 66–67). As Table 9.5 shows, between 1955 and 1966, tax revenue extracted from labor as a proportion of GDP between 1955 and 1966 grew threefold.

Table 9.5 ISR (income tax) composition.

	Collection of personal income tax on labor revenue		*Collection of personal income tax on capital revenue*	
	% of total ISR collection	*% of GDP*	*% of total ISR collection*	*% of GDP*
1955	16.9	0.4	18.4	0.5
1956	17.0	0.5	16.8	0.4
1957	19.0	0.5	17.3	0.4
1958	21.9	0.5	16.6	0.4
1959	22.4	0.5	14.8	0.4
1960	23.3	0.6	16.2	0.4
1961	23.9	0.7	16.2	0.4
1962	29.0	0.8	16.1	0.5
1963	30.5	1.0	12.5	0.4
1964	29.4	1.1	12.3	0.4
1965	30.7	1.2	8.2	0.3
1966	32.8	1.2	5.7	0.2

Source: Equihua, 1968, p. 196.

The income tax's extraction pattern diminished its distributive capacity. By the end of the 1960s, fiscal policy as a whole did not help to reduce income concentration (Urquidi, 1987). These outcomes go hand in hand with the stance that governed Ortiz Mena's decisions, who considered that the primary objectives of the tax system were to stimulate investment and savings, and not to redistribute income (Ortiz Mena, 1998, pp. 162–163).

Another consequence of the type of tax institutions built, especially in the 1950s and 1960s, was the beginning of the imbalance in public accounts that would end in the debt crisis of the 1980s (Aboites Aguilar and Unda Gutiérrez, 2011). The Treasury Secretaries in office had been warned about this countless times. In Urquidi's words:

> the relative insufficiency of tax revenue has made external borrowing necessary beyond what is strictly indispensable and has led the government and the rest of the public sector to use domestic credit from banks to such a considerable extent that, if not corrected, it could constitute an obstacle to monetary policy and to the adequate channeling of credit to the private sector in the future.
>
> (Urquidi, 1964)

It is worth remembering the role of the SOE sector (section I), which, together with tax poverty, contributed to the imbalance of public accounts and the crisis of the 1980s.

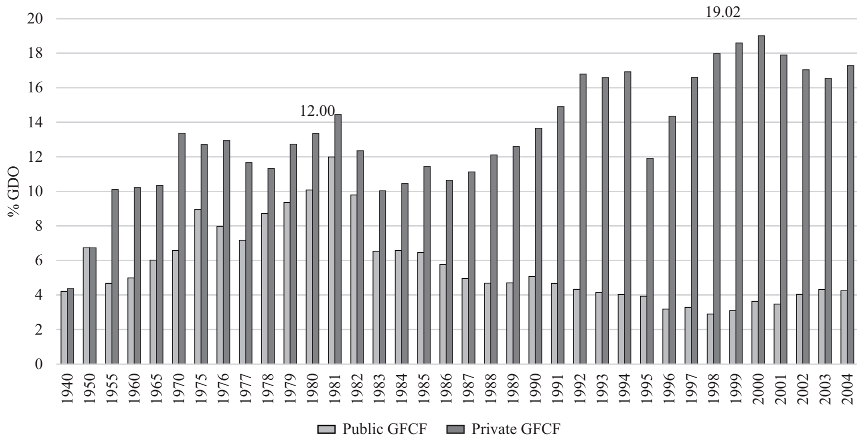

Figure 9.2 Public and private gross fixed capital accumulation (% of GDP). (Source: Based on INEGI, Historical Statistics of Mexico, 2015.)

Another consequence of having cemented a poor tax state has been the strengthening of the structural power of the elite.[12] The fiscal poverty of the Mexican state puts it at a disadvantage in relation to the elite because it increases the economy's dependence on private investment to generate growth and employment. Figure 9.2 shows how, until the early 1950s, the contribution to total investment was equally divided between the public and private sectors. Subsequently, although public investment increased, by the end of the 1970s, 43% of investment was public, and 57% was private. But since the debt crisis, government investment has decreased, and, by 2004, 80% of investment came from the private sector. The point here is not to establish that there is an ideal composition of investment in an economy. It is simply to emphasize that, if much of the structural power of the economic elite lies in the consequences of their investment, the elite now have greater structural power than in the past when several influential officials in the executive branch were pushing for a more progressive tax system.

Since control of or access to economic resources facilitates the autonomy of the government – as it strengthens its capacity to carry out a political agenda that goes beyond the particular interests of individual social groups (Gold et al., 1975) – a poor tax state that collected 7.9% of its GDP in 1970 or 13.1% today lacks the economic resources to be autonomous with respect to the elite, as it depends on the elite's capacity to invest and create jobs.

Final comments

This paper has described the processes of building tax institutions in Mexico from 1925 to 1964. Initially, the measures that were taken reflected redistributive impulses and the aspiration to build a modern tax system (progressive and revenue-raising). An example of this was the introduction of income tax, the corporate excess profits tax, credit institutions, and the tax on windfall profits. The introduction of these taxes coincided with a weakened economic elite in the process of reconfiguration after the shock of the revolution. The structural and instrumental power of the elite, relative to decades after and before the revolt, was debilitated.

However, the evidence gathered here shows that towards the end of the 1940s, the instrumental power of the elite increased and went hand in hand with the formation of a closer relationship between the SHCP and the elite. In the 1950s and 1960s, representatives of the economic elite were invited to sit in on the tax committees where reform proposals were discussed. The discussions that occurred in these committees showed the influence that these groups exercised in the decisions that prevailed. The justification for the reforms implemented was that they would encourage private investment through an extremely diluted tax burden to support industrialization, and the cost was the creation of a regressive tax state that raises very little revenue.

It was also proposed here that one of the many consequences of not having strengthened the tax system, as was advised countless times by some factions of the SHCP, was the strengthening of the structural power of the elite.[13] The latter allows us, albeit partially, to understand why the government of López Obrador (2018–2024) has not reformed the tax system in a structural way. For many, this government was the first in decades that would have been able to break with the close and friendly relationship that has prevailed between the representatives of the state and the economic elite.

Notes

1 The terms "progressive alliance" and "conservative alliance" are used by Hamilton (1982). Reynolds (1972) refers to the conservative alliance as the "alliance for profits". Knight (2001) used other terms to describe the kind of alliance that the Mexican State may have established, but their meaning is essentially the same.

2 In this regard, this chapter differs from Ondetti's (2017) explanation, which argues that Mexico's low tax revenue is caused by "the resistance of an exceptionally mobilized economic elite", which in turn is due to "an anti-state ideology born out of conflicts with the state, especially in the 1930s". The focus here is on the relational process between the state and the representatives of the elites, who forge an alliance that leads to a poor state.

3 For a detailed account of the various hypotheses proposed to explain the low tax collection of the Mexican state, see Ondetti, 2017, pp. 52–56.

4 The literature recognizes two stages during the period of import substitution industrialization: stabilizing development (1950–1970) and unbalanced development (1970–1982). The first stage combined high growth rates (6%) and price stability (3% per year) (Lustig, 1992, pp. 220–221). In contrast, the second stage continued to have relatively high growth rates but began to suffer periods of macroeconomic instability with episodes of devaluation, inflation, and high external indebtedness.

5 In 1925, the ISR schedules were as follows: I. Commerce. II. Industry. III. Agriculture. IV. Placement of money, securities, and credits. V. Contributions obtained from subsoil

exploitations VI. Salaries derived from work. VII. Liberal professions. In 1931, the tax codes were reorganized and the first three were consolidated into one.

6 CFE: Comisión Federal de Electricidad (Federal Electricity Commission). PEMEX: Petróleos Mexicanos (Mexican Petroleum). Ferronales: Ferrocarriles Nacionales (National Railroads).

7 According to the previously cited report "Tax Policy Planning 1955–1958", the state-owned enterprises had access to financing as of 1949.

8 Kaldor points out that many capital incomes were not taxed, and if they were, they were not taxed at progressive rates. This was the case of income from government bonds, private company bonds, interest, and yields on financial securities.

9 This was proposed as early as the tax law revision commission of 1953. However, the system did not change to a nominative system until 1985 (Izquierdo, 1995).

10 It is worth noting the power exercised by the Secretary of the Treasury and his officials in the history of Mexico. For many, the Secretary of the Treasury in Mexico has been akin to a vice president.

11 For example, the tax on excess profits was repealed and the carrying forward of losses was introduced, which benefited many companies for decades (Solís, 1988, p. 44).

12 Apart from another failed reform attempt in 1972 that sought to increase the progressiveness of the tax system (Elizondo, 1994), the only structural change was the creation of the value added tax (VAT) in 1981. Since then, there have been no changes that denote structural modifications in the tax system.

13 Evidently, the unbalanced position expressed in Figure 9.2 is not the only reason for the weakness of the government in relation to the elite. Many other variables and economic policy decisions made by different governments have increased the structural and instrumental power of the private sector, especially since the early 1980s. To mention a few: (i) the monopoly power enjoyed by so many companies or economic conglomerates, some of which originated in the privatization process, and/or due to the lack of effectiveness of a weak competition commission; (ii) the closeness and similarity between the profiles of government technocrats and the economic elite, who often share ideologies and coincide in their interests.

References

Aboites Aguilar, L. (2003). *Excepciones y privilegios: Modernización tributaria y centralización política 1922–1972*. Mexico City: El Colegio de México.

Aboites Aguilar, L. and Unda Gutiérrez, M. (Eds.) (2011). *La reforma tributaria de 1961: La gran oportunidad perdida y la derrota de Urquidi. Obras y documentos de Víctor L. Urquidi sobre la cuestión tributaria en México (décadas de 1950 y 1960)*. Mexico City: El Colegio de México.

Alba, C. (2005). Las relaciones entre los empresarios y el Estado. In I. Bizberg et al. (Eds.), *Una Historia Contemporánea de México: Actores* (pp. 157–196). Mexico City: Colegio de México.

Álvarez Estrada, D. (2007). México: La tributación directa, cálculo de evasión en el impuesto a la renta y desafíos. In J.P. Jiménez et al. (Eds.), *Evasión y equidad en América Latina* (pp. 287–323). Santiago: Economic Commission for Latin America and the Caribbean.

Anguiano Equihua, R. (1968). *Las finanzas del sector público en México*. Mexico City: UNAM.

Aspe Armella, P. (1993). *Economic Transformation the Mexican Way*. Cambridge, MA: MIT Press.

Bräutigam, D. et al. (Eds.) (2008). *Taxation and State-building in Developing Countries: Capacity and Consent*. Cambridge: Cambridge University Press.

Cárdenas, E. (1994). *La hacienda pública y la política económica 1929–1958*. Mexico City: El Colegio de México and Fondo de Cultura Económica.

Centeno, M.A. (1997). Blood and debt: War and taxation in nineteenth-century Latin America. *American Journal of Sociology*, *102*(6), 1565–1605. https://doi.org/10.1086/231127

Collado, M.C. (1996). *Empresarios y políticos, entre la restauración y la revolución 1920–1924*. Mexico City: National Institute of Historical Studies of the Mexican Revolution (Instituto Nacional de Estudios Históricos de la Revolución Mexicana).

Consejo Nacional de Evaluación de la Política de Desarrollo Social (2021). *Multidimensional Measurement of Poverty in Mexico: An Economic Wellbeing and Social Rights Approach*. Mexico City: CONEVAL.

Diario de Debates de la Cámara de Diputados (DDD) (December 21, 1939). Legislatura XXXVII - Año III - Período Ordinario - Fecha 19391221 - Número de diario: 28. *Camara De Diputados: LXV Legislatura*. http://cronica.diputados.gob.mx/DDebates/37/3er/Ord/19391221.html

Diario de Debates de la Cámara de Diputados (DDD) (December 22, 1948). Legislatura XL - Año III - Período Ordinario - Fecha 19481222 - Número de Diario: 37. Camara De Diputados: LXV Legislatura. http://cronica.diputados.gob.mx/DDebates/40/3er/Ord/19481222.html

Diario de Debates de la Cámara de Diputados (DDD) (December 26, 1953). Legislatura XLII - Año II - Período Ordinario - FECHA 19531226 - Número de Diario: 37. *Camara De Diputados: LXV Legislatura*. http://cronica.diputados.gob.mx/DDebates/42/2do/Ord/19531226.html

Diario de Debates de la Cámara de Diputados (DDD) (December 28, 1955). Legislatura XLIII – Año i - Período Ordinario - Fecha 19551228 - Número de diario: 43. *Camara De Diputados: LXV Legislatura*. http://cronica.diputados.gob.mx/DDebates/43/1er/Ord/19551228.html

Elizondo, C. (1994). In search of revenue: Tax reform in Mexico under the administrations of Echeverría and Salinas. *Journal of Latin American Studies*, *26*(1), 159–190 and 272. https://doi.org/10.1017/S0022216X00018885

Elizondo, C. (1999). El reto interno: Balance fiscal en un contexto democrático. *Gaceta de Economía*, *5*(9), 209–225.

Fitzgerald, E. (1978). The fiscal crisis of the Latin American state. In J.F.J. Toye (Ed.), *Taxation and Economic Development* (pp. 126–160). London and Totowa: Frank Cass and Company Limited.

Gold, D.A. et al. (1975). Recent developments in Marxist theory of the capitalist state. *Monthly Review*, *27*(5), 29–51. https://doi.org/10.14452/MR-027-05-1975-09_3

Haber, S. et al. (2003). When the law does not matter: The rise and decline of the Mexican oil industry. *The Journal of Economic History*, *63*(1), 1–32.

Hacker, J. and Pierson, P. (2002). Business power and social policy: Employers and the formation of the American welfare state. *Politics and Society*, *30*(2), 277–325. https://doi.org/10.1177/0032329202030002004

Hamilton, N. (1982). *The Limits of State Autonomy: Post-revolutionary México*. Princeton: Princeton University Press.

Instituto Nacional de Estadística y Geografía (2015). *Estadísticas Históricas de México 2014*. Aguascalientes City: INEGI.

Izquierdo, R. (1995). *Política hacendaria del desarrollo estabilizador, 1958–1970*. Mexico City: El Colegio de México and Fondo de Cultura Económica.

Knight, A. (1985). The Mexican revolution: Bourgeois? nationalist? or just a "great rebellion"? *Bulletin of Latin American Studies*, *4*(2), 1–37. https://doi.org/10.2307/3338313

Knight, A. (1991). Land and society in revolutionary Mexico: The destruction of the Great Haciendas. *Mexican Studies/Estudios Mexicanos*, 7(1), 73–104. https://doi.org/10.2307/1052028

Knight, A. (2001). The modern Mexican State: Theory and practice. In M.A. Centeno and Fernando Lopez-Alves (Eds.), *The Other Mirror Grand Theory through the Lens of Latin America* (pp. 177–218). Princeton: Princeton University Press.

Levi, M. (1988). *Of Revenue and Rule*. Berkeley, Los Angeles and London: University of California Press.

Lustig, N. (1992). Equity and growth in Mexico. In S. Teitel (Ed.), *Towards a New Development Strategy for Latin America: Pathways from Hirschman's Thought* (pp. 219–258). Washington, DC: Inter-American Development Bank.

Martínez de Navarrete, I. (1967). *Los incentivos fiscales y el desarrollo económico en México*. Mexico City: Universidad Nacional Autónoma de México.

Martinez-Vasquez, J. (2001). *Mexico: An Evaluation of the Main Features of the Tax System*. Working Paper 01-12. Atlanta: Georgia State University.

Mosk, S.A. (1954). *Industrial Revolution in México*. Berkeley and Los Angeles: University of California Press.

Ondetti, G. (2017). El poder de las preferencias. Las élites económicas y tributación baja en México. *Revista mexicana de ciencias políticas y sociales*, *62*(231), 47–76. https://doi.org/10.1016/S0185-1918(17)30038-7

Organisation of Economic Cooperation and Development (OECD) (2021). *Global Revenue Statistics Database*. https://stats.oecd.org/Index.aspx?DataSetCode=RS_GBL

Ortiz Mena, A. (1998). *El desarrollo estabilizador: Reflexiones sobre una época*. Mexico City: El Colegio de México and Fondo de Cultura Económica.

Pani, J.A. (1926). *La política hacendaria de la revolución*. Mexico City: Cultura.

Pardo, L.G. (1929). *[Income Tax Report to the Secretary of the Treasury]. Central Archive of the Treasury and Public Credit (Fondo Archivo Central de Hacienda y Crédito Público) / Secretary's Private Secretary Section (Sección Secretaría Particular del Secretario) / Alberto J. Pani (Box 3/ Folder: 101-033-20)*. Mexico City: Archivo General de la Nación.

Reynolds, C. (1972). *La economía mexicana en el siglo XX*. Mexico City: Fondo de Cultura Económica.

Sánchez, E. (2006). La fiscalidad directa en el México decimonónico: El caso de la contribución rústica 1835–1846. In L. Jáuregui (Ed.), *De riqueza e inequidad, el problema de las contribuciones directas en América Latina, siglo XIX* (pp. 225–250). Mexico City: Instituto Mora.

Schumpeter, J.A. (1954). The Crisis of the Tax State. *International Economic Papers*, *6*, 5–38.

Secretaría de Hacienda (1955). *[Telegram sent by CONCAMIN]. Central Archive of the Treasury and Public Credit (Fondo Archivo Central de Hacienda y Crédito Público) / Secretary's Private Secretary Section (Sección Secretaría Particular del Secretario) / Antonio Carrillo Flores (Box 81, Folder 101-300-10)*. Mexico City: Archivo General de la Nación.

Secretaría de Hacienda y Crédito Público-Banxico (1961). *El crecimiento de la economía mexicana 1940–1960. Incorporated Archives (Archivos Incorporados) / Víctor L. Urquidi (Caja 46)*. Mexico City: Historical Archive of the Colegio de México.

Serrano, J.A. (2006). Contribuciones directas y reformas fiscales en las regiones de México, 1820-1836. In L. Jáuregui (Ed.), *De riqueza e inequidad, el problema de las contribuciones directas en América Latina, siglo XIX* (pp. 183–224). Mexico City: Instituto Mora.

Servín, A. (1939). Antecedentes históricos de nuestra política tributaria. *Revista de hacienda*, *3*(14), 7–25.

Servín, A. (1942). *Evolución técnica del sistema impositivo federal*. Mexico City: Fondo de Cultura Económica.

Servín, A. (1948). Las industrias nuevas y necesarias y la indulgencia fiscal. *RFF*, *3*(14).

Silva Herzog, J. (1975). La economía política en México 1810–1974. *Cuadernos Americanos*, *1975*.

Solís, L. (1988). *Intento de la reforma económica de México*. Mexico City: El Colegio Nacional.

Studenski, P. (1939). Los sistemas fiscales modernos, sus características y tendencias de desarrollo. *Revista de Hacienda*, *6*, 37–46.

Tilly, C. (1975). Reflections on the history of European state-making. In C. Tilly (Ed.), *The Formation of National States in Western Europe* (pp. 3–83). Princeton: Princeton University Press.

Turrent Díaz, E. (2004). Política tributaria: El arte de lo posible (interview with Antonio Ortiz Mena). *Análisis Económico*, *19*(40), 185–196.

Unda Gutiérrez, M. (2010). *The Building of a Poor Tax State: The Political Economy of Income Tax in Mexico, 1925–1964* [Doctoral tesis]. SOAS, University of London.

Unda Gutiérrez, M. (2017). A tale of two taxes: The diverging fates of the federal property and income tax decrees in post-revolutionary Mexico. *Investigaciones de Historia Económica-Economic History Research*, *13*(2), 107–116. https://doi.org/10.1016/j.ihe.2016.02.002

Urrutia, R. (1954). *Planeación de una política impositiva 1955–1958. Central Archive of the Treasury and Public Credit (Fondo Archivo Central de Hacienda y Crédito Público) / Secretary's Private Secretary Section (Sección Secretaría Particular del Secretario) / Antonio Carrillo Flores (Box 85, Folder 101-300-10)*. Mexico City: Archivo General de la Nación.

Urrutia, R. (1958). *La situación de la hacienda pública y sugestiones de política fiscal y financiera. Central Archive of the Treasury and Public Credit (Fondo Archivo Central de Hacienda y Crédito Público) / Secretary's Private Secretary Section (Sección Secretaría Particular del Secretario) / Antonio Carrillo Flores (Box 85, Folder 101-300-10)*. Mexico City: Archivo General de la Nación.

Urquidi, V.L. (1956). El Impuesto sobre la renta en el desarrollo económico de México. *El trimestre económico*, *23*(4), 424–437.

Urquidi, V.L. (1964). *La evolución de la economía mexicana 1950–1963 y algunas proyecciones para 1970 y 1975. Incorporated Archives (Archivos Incorporados) / Víctor L. Urquidi (Box 63)*. Mexico City: Historical Archive of the Colegio de México.

Urquidi, V.L. (1987). Nicholas Kaldor (1908–1986). *Trimestre Económico*, *54*(4), issue 216, 919–925.