ICR Review
Operations Evaluation Department

Report Number : ICRR11659

1. Project Data:		Date Posted :	12/01/2003	
PROJ ID:	P074750		Appraisal	Actual
Project Name :	Mx Tax Reform Adjustment Loan	Project Costs (US$M)	303.04	303.04
Country:	Mexico	Loan/Credit (US$M)	303.04	303.04
Sector(s):	Board: EP - Central government administration (85%), General industry and trade sector (6%), General education sector (3%), General finance sector (3%), Health (3%)	Cofinancing (US$M)		
L/C Number:	L7126			
		Board Approval (FY)		02
Partners involved :		Closing Date	06/30/2003	06/30/2003

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2. Project Objectives and Components

a. Objectives

The objectives of the Tax Reform Adjustment Loan (TRAL) were:
(i) to contribute to higher sustainable growth of the private sector by reducing tax distortions and eliminating tax exemptions and special tax regimes;
(ii) to reduce the debt burden;
(iii) to expand social sector services and infrastructure investment; and
(iv) to contribute to GOM's program of reform of the State by reducing corruption, simplifying tax policy, and improving tax discipline and transparency .
Some of these objectives were expected to be achieved only in the medium -term.

b. Components

There were three actions for which the Government was responsible as justification for the loan :
(i) maintenance of a macro-economic framework satisfactory to the Bank;
(ii) adoption on December 31, 2001, of a Budget law for 2002 providing for: (i) a fiscal deficit not to exceed 0.65 percent of GDP; and (ii) an increase in expenditure for education, health, social safety nets, and economic infrastructure of at least 0.8 percent of GDP; and
(iii) adoption on December 31, 2001 of a revised income tax law (see Section 4 below), expected to contribute to the achievement of the objectives stated above .

On the basis of the 2002 Budget Law and the revised income tax law, it was expected that income tax revenue would increase by 0.9 percent of GDP in 2002.

c. Comments on Project Cost, Financing and Dates

The loan was approved on the basis of the adoption by Congress of the Budget Law for 2002 and of the revised income tax law. It was disbursed as a single tranche in December 2002.

3. Achievement of Relevant Objectives:

Based on simulations prepared during appraisal estimating the marginal effective tax rates under the previous and the new tax regime, the revised tax changes had an impact in 2002 in terms of reducing tax distortions. The other objectives are not evaluable at this time .

4. Significant Outcomes/Impacts:

The new income tax law, approved by Congress on December 31, 2001, comprised the following:
1) In the area of corporate income tax :
- broadening the tax base in the agriculture and road transport sectors;
- simplifying the inflation adjustment regime;
- unifying the corporate and maximum personal tax rates at 35 %, and reducing the latter gradually to 32 % by 2005;

- limiting the corporate deductions for payment of fringe benefits to non -union workers; and
- phasing out the reduced tax rate for the publishing industry, bringing it to the standard rate by 2006.

2) In the area of personal income tax:
- aggregating all taxable income whatever the sources and taxing it at a single rate;
- simplifying the rate structure (number of brackets reduced to 5 by 2005);
- reducing GOM subsidy for workers in the formal sector and providing incentives for firms to continue paying it; and
- simplifying the tax regime for individuals who carry out business activities .

5. Significant Shortcomings (including non-compliance with safeguard policies):

The Government did not achieve the two targets set in its 2002 Budget: (i) the fiscal deficit was 1.2 percent of GDP against a target of 0.65 percent; and (ii) the increase in expenditure for the social sectors and infrastructure was limited to 0.18 percent of GDP against a target of 0.8 percent.

Furthermore, the increase in income tax revenue as a result of the revised income tax regime was limited to 0.12 percent of GDP against an estimate of 0.9 percent.

6. Ratings:	ICR	OED Review	Reason for Disagreement /Comments
Outcome:	Satisfactory	Moderately Satisfactory	The fiscal targets were not met. (See Section 5 above).
Institutional Dev .:	Substantial	Modest	Given the size of the Mexican economy and of its budget, the tax measures adopted by Congress are fairly small, compared with the remaining tax reform agenda.
Sustainability :	Likely	Likely	
Bank Performance :	Satisfactory	Satisfactory	
Borrower Perf .:	Satisfactory	Satisfactory	
Quality of ICR :		Satisfactory	

NOTE: ICR rating values flagged with ' * ' don't comply with OP/BP 13.55, but are listed for completeness.

7. Lessons of Broad Applicability:

Tax reform measures deserve to be supported by the Bank only if they are part of an agreed comprehensive fiscal reform program.

In case of support of tax measures based on conditions met prior to Board approval, the design of the loan should include an agreed mechanism to monitor progress throughout the whole fiscal reform process .

8. Assessment Recommended? ● Yes ○ No

Why? As part of a cluster covering the different loans in support of the entire reform program .

9. Comments on Quality of ICR:

The ICR is of good quality. Annex 3 is useful in providing the analytical background needed to assess outcome . It would have been useful to be part of the PR .