

# Free essay on tax reform in mexico

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For the purpose of our discussion I have chosen an article which was published in one of the recent editions of the Economist magazine. In the article author describes the initiative of Mexican government to apply changes to the taxation system by introducing tax reform. Major changes in income tax and VAT regulations majorly will affect country's middle class, which will have to change its buying habits if the reform is introduced. According to the author, tax reform may have serious impact on both consumers and corporate sector. Companies will be prohibited from using tax consolidation – a technique which allows corporations to offset profits in one business with losses from another. In addition, some costs, such as employee benefits, will not be considered as an expense anymore, therefore, the taxation base for the companies will increase slightly. Regular consumers will also be taxed on a different basis – government plans to increase income tax and extend the range of goods where value added tax (VAT) is applied. Given the above, it is not surprisingly that Mexican citizens along with representatives of the private sector oppose the tax reform. Although increase in taxes is associated with decrease in real earnings, the new tax code seem to have certain benefits for the society overall. Firstly, the new regulations will make the taxation system more redistributive. Secondly, increased tax payments will result in direct benefits to the Mexican citizens in terms of new more valuable pension system and limited unemployment insurance. Author states, however, that it is still uncertain whether these benefits will actually come to life, and until then everyone in the country seems to be worse off.

In our analysis of the given issue, we will address the effect of taxation on

consumer spending and its interpretation according to the principles of economics.

The article cites that regular consumers will get affected from 2 types of taxes: an income tax, which is taken away from an individual's salary, and the Value Added Tax, which is paid by the end-consumer after the purchase of the product. We will discuss the impact of both of these taxes separately. The increase in income tax, providing that the income of an individual is constant, will decrease the actual amount of money received by an employee. This suggests, that customer's budget line will shift down, as now he has less funds available. The shift in the budget line means that a customer could now buy less goods than before the tax was imposed. Since individual's purchasing ability decreases, the overall demand for particular goods shall also decrease. Consequently, decrease in real income will shift the demand curve to the left (from  $D_2$  to  $D_1$ ). This will result in the decrease of the equilibrium market price for a particular good, as well as decrease in an equilibrium quantity. Decrease in real income will result in new equilibrium point, which will be on the intersection of  $S$  and  $D_1$ , as shown on the graph below:

The increase in Value added tax will have a slightly different affect. This tax will effect both producers and consumers. The increase in value added tax will result in the increase of cost of goods purchased by a producer, which suggests that the supply curve will shift to the left. Thus, the end consumer will experience the increase in price, which will lead to the decrease in demand. This means that market will reach new equilibrium price, which will be higher than before the tax, and new equilibrium quantity, which will be

lower than before the tax was imposed. The graph below depicts this scenario:

If we combine the analysis of effects of increase in both VAT and income tax, we may see that in both cases there will be a decline in traded quantities.

However, increase in income tax will result in decrease in equilibrium prices, while increase in VAT will actually increase the price. Overall, the economy will be worse off, as the amount of output will decrease significantly.

However, we need to emphasize that increase in these taxes are supposed to result in improvement of social benefits for the population, namely, increase in pension payments and unemployment insurance. Thus, the decline in trade may be offset by the increase in social protection of citizens if funds collected from taxes reach its destination.

## **References**

“ It’s a dog’s life. Fiscal Reform in Mexico.” The Economist. Digital Edition, 4 sep. 2013. Retrieved at <http://www.economist.com/news/americas/21586337-tax-plan-dictated-politics-its-dogs-life>