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# Mexico: Report on the Observance of Standards and Codes—Fiscal Transparency Module

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MEXICO

# Report on the Observance of Standards and Codes (ROSC)
# Fiscal Transparency Module

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August 23, 2002


## Executive Summary

This report assesses the fiscal transparency practices in Mexico in light of the *Code of Good Practices on Fiscal Transparency* on the basis of the authorities' response to a questionnaire, supported by relevant documentation and supplemented by meetings with government representatives.

In recent years, Mexico has made considerable progress in improving transparency in public finances. Major initiatives include reform of the budget process; preparation of an integrated financial management information system; phase-in of a system of human resource management; overhaul of public procurement; streamlining of government regulations; strengthening of internal control and external audit; introduction of prudential criteria for state development banks; and reduction of discretionality in intergovernmental relations.

Overall, government agencies make available to the public an unprecedented volume of information on fiscal developments, including through electronic means. Nevertheless, the authorities acknowledge the need for further action to improve the presentation of information and to make it more useful to interested users, including the Congress.

Fund staff has identified several priority areas where further action would help meet the requirements of the *Code*. Specific recommendations include the following steps: redefinition of the institutional coverage, encompassing the general government while reassigning commercial public enterprises to the rest of the public sector; incorporation of timely information on subnational governments in the fiscal accounts; presentation of the budget in the context of a rolling medium-term framework, clearly specifying fiscal objectives and underlying methodology; publication of estimates of the cost of quasi-fiscal operations, contingent liabilities, and tax expenditures; full implementation of the integrated financial management information system; simplification of tax laws and regulations; introduction of performance audits; and publication of findings and recommendations of external audits, while monitoring their implementation.

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## ACRONYMS AND ABBREVIATIONS

| | |
|---|---|
| ADEFAS | Debts from previous fiscal years (Adeudos de ejercicios fiscales anteriores) |
| BANCOMEXT | National Foreign Trade Bank (Banco Nacional de Comercio Exterior, S.N.C.) |
| BANEJERCITO | National Army, Air Force and Navy Bank (Banco Nacional del Ejército, Fuerza Aérea y Armada, S.N.C.) |
| BANOBRAS | National Public Works and Services Bank (Banco Nacional de Obras y Servicios Públicos, S.N.C.) |
| BANRURAL | National Farm Credit Bank (Banco Nacional de Crédito Rural, S.N.C.) |
| CAPUFE | Federal Toll Roads and Bridges and Related Services (Caminos y Puentes Federales de Ingresos y Servicios Conexos) |
| CFE | Federal Electricity Comisión (Comisión Federal de Electricidad) |
| CNBV | National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores) |
| COFEMER | Federal Regulatory Reform Commission (Comisión Federal de Mejora Regulatoria) |
| CONCAMIN | Confederation of Industry Chambers of the United States of Mexico (Confederación de Cámaras Industriales de los Estados Unidos de México) |
| COPARMEX | Confederation of Entrepreneurs of the Mexican Republic (Confederación Patronal de la República Mexicana) |
| COMPRANET | Electronic System of Public Procurement (Sistema Electrónico de Contrataciones Gubernamentales) |
| FARAC | Trust Fund for Rehabilitation of Concessioned Toll Roads (Fideicomiso de Apoyo al Rescate de Autopistas Concesionadas) |
| FIDEC | Business Development Fund (Fondo para el Desarrollo Comercial) |
| FINA | National Sugar Financing Corporation (Financiera Nacional Azucarera, S.N.C.) |
| FIRA | Farm-Related Trust Funds (Fideicomisos Instituidos con Relación a la Agricultura) |
| FOVI | Housing Operations and Bank Financing Fund (Fondo de Operación y Financiamiento Bancario a la Vivienda) |
| GDP | Gross domestic product |
| IMF | International Monetary Fund |
| IMSS | Mexican Social Security Institute (Instituto Mexicano del Seguro Social) |
| INEGI | National Institute of Statistics, Geography and Computerized Information (Instituto Nacional de Estadística, Geografía e Informática) |
| IPAB | Bank Savings Protection Institute (Instituto de Protección del Ahorro Bancario) |
| ISSSTE | Government Workers Security and Social Services Institute (Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado) |

| | |
|---|---|
| LFC | Central Light and Power (Luz y Fuerza del Centro) |
| LIF | Federal Revenues Law (Ley de Ingresos de la Federación) |
| NAFIN | National Finance Corporation (Nacional Financiera, S.N.C.) |
| OECD | Organization for Economic Cooperation and Development |
| PEF | Federal Expenditure Budget (Presupuesto de Egresos de la Federación) |
| PEMEX | Mexican Petroleum Company (Petróleos Mexicanos) |
| PIDIREGAS | Projects with Deferred Impact in the Recording of Expenditures (Proyectos de Impacto Diferido en el Registro del Gasto) |
| PRONAFIDE | National Development Finance Program (Programa Nacional de Financiamiento del Desarrollo) |
| RFSP | Public Sector Borrowing Requirement (Requerimientos Financieros del Sector Público) |
| SAT | Tax Administration Service (Servicio de Administración Tributaria) |
| SDDS | Special Data Dissemination Standards |
| SECODAM | Administrative Control and Development Ministry (Secretaría de la Contraloría y Desarrollo Administrativo) |
| SHCP | Ministry of Finance and Public Credit (Secretaría de Hacienda y Crédito Público) |
| SIAFF | Integrated Federal Financial Management System (Sistema Integrado de Administración Financiera Federal) |
| SIARH | Integrated Human Resources Management System (Sistema Integrado de Administración de Recursos Humanos) |
| VAT | Value-added tax |

## I. INTRODUCTION

1. This report[1] assesses fiscal transparency practices in Mexico against the requirements of the International Monetary Fund's *Code of Good Practices on Fiscal Transparency.*[2] The assessment consists of two parts. The first part is a description of actual practices in Mexico, prepared by the Fund staff on the basis of discussions with the authorities, official responses to the fiscal transparency questionnaire, and other available information. The second contains a Fund staff commentary on fiscal transparency in Mexico.

## II. DESCRIPTION OF PRACTICES

### A. Clarity of Roles and Responsibilities

#### Scope of Government

2. **The structure and functions of government are clearly defined in the Constitution and in legislation,[3] but the distinction for fiscal purposes between the government sector and the rest of the public sector is not entirely consistent with international standards.** Mexico is a federal republic consisting of the federal government, the federal district, and 31 federative entities (i.e., states) that establish the legal basis for statutes issued by the 2,377 municipalities. Supreme power within the federation lies with the legislative, executive and judicial branches.[4] The federal executive branch is headed by the President of the Republic, and consists of the central administration and the parastatal administration. In turn, the central administration is comprised of 18 state secretariats (i.e., ministries, including deconcentrated bodies), the administrative departments, and the judicial council. The parastatal administration consists of decentralized agencies, enterprises in which the government has a majority interest, including nonfinancial public enterprises and financial public institutions and trusts, and entities or funds engaged primarily in commercial activities (Figure 1). The formulation and implementation of public policy is essentially the responsibility of the federal government, the state governments, and to a lesser extent the municipalities. Nevertheless, the inclusion in the Federal Expenditure Budget (PEF)

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[1] Prepared by a team from the Fiscal Affairs Department, headed by G. Kopits, and including A. Bauer, J.P. Córdoba and J. Viñuela, during a visit to Mexico City on January 16 to 29, 2002. The team met with officials of the SHCP, SECODAM, Federal Audit Office, COFEMER, Budget Committee of the Chamber of Deputies, Center for Fiscal Studies, the Bank of Mexico, INEGI, PEMEX, CFE, BANOBRAS, NAFIN, IMSS and ISSSTE, and representatives of the private sector (CONCAMIN and COPARMEX). The staff team also met with the secretaries of finance of the state of Mexico and of the state of Morelos.

[2] For purposes of this report, the adjective "fiscal" embraces the government finances in their entirety.

[3] Constitution of the United Mexican States (January 31, 1917, as amended on September 13, 1999), the Organic Law on the Federal Public Administration (1976, as amended March 13, 2002) and the Federal Law on Parastatal Entities (1986, as amended January 4, 2001) and the regulations thereto.

[4] A similar division of powers exists within each state.

(encompassing the "budgetary public sector") of the budgets for some major public ("directly controlled") enterprises, prevents a clear distinction between the noncommercial activities of the federal government and the strictly commercial activities of the rest of the public sector.[5] Moreover, the fact that the definitions of the government sector used for budgetary and statistical purposes are not consistent with international criteria makes it difficult to compare Mexico's government finances with those of other countries.[6]

*3.* **Law defines the division of fiscal responsibilities among the levels of government.** The Constitution contains a list of areas where regulation falls exclusively to the National Congress, and another list over which the states have no jurisdiction.[7] It also defines clearly the powers and responsibilities of the municipalities with respect to taxation and expenditure.[8] A residual clause explicitly assigns to the states those functions not reserved by the Constitution to the federal government or the municipalities.[9] In this distribution of powers there is no mention of where responsibility lies for executing the functions that are regulated by Congress. In practice, this legislative gap with respect to public spending has not generated any jurisdictional disputes, and has been filled by negotiated agreements. With respect to revenues, the Constitution reserves for the federal government the sole authority to tax international trade, to use and exploit natural resources, and to impose special taxes on certain goods and services.[10] Nevertheless, by virtue of the Fiscal Coordination Law,[11]

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[5] Due to the importance of certain enterprises such as Petróleos Mexicanos (PEMEX) in government revenues and for purposes of budgetary control, the authorities have opted to include certain parastatal entities in the budget, taking advantage of a faculty recognized in the Federal Law of Budget, Accounting and Public Expenditure (1976).

[6] While the authorities submit the information for the Government Finance Statistics (GFS), it is subject to considerable lags and data on subnational government finances are not readily available in Mexico.

[7] Articles 73 and 117-121 of the Constitution.

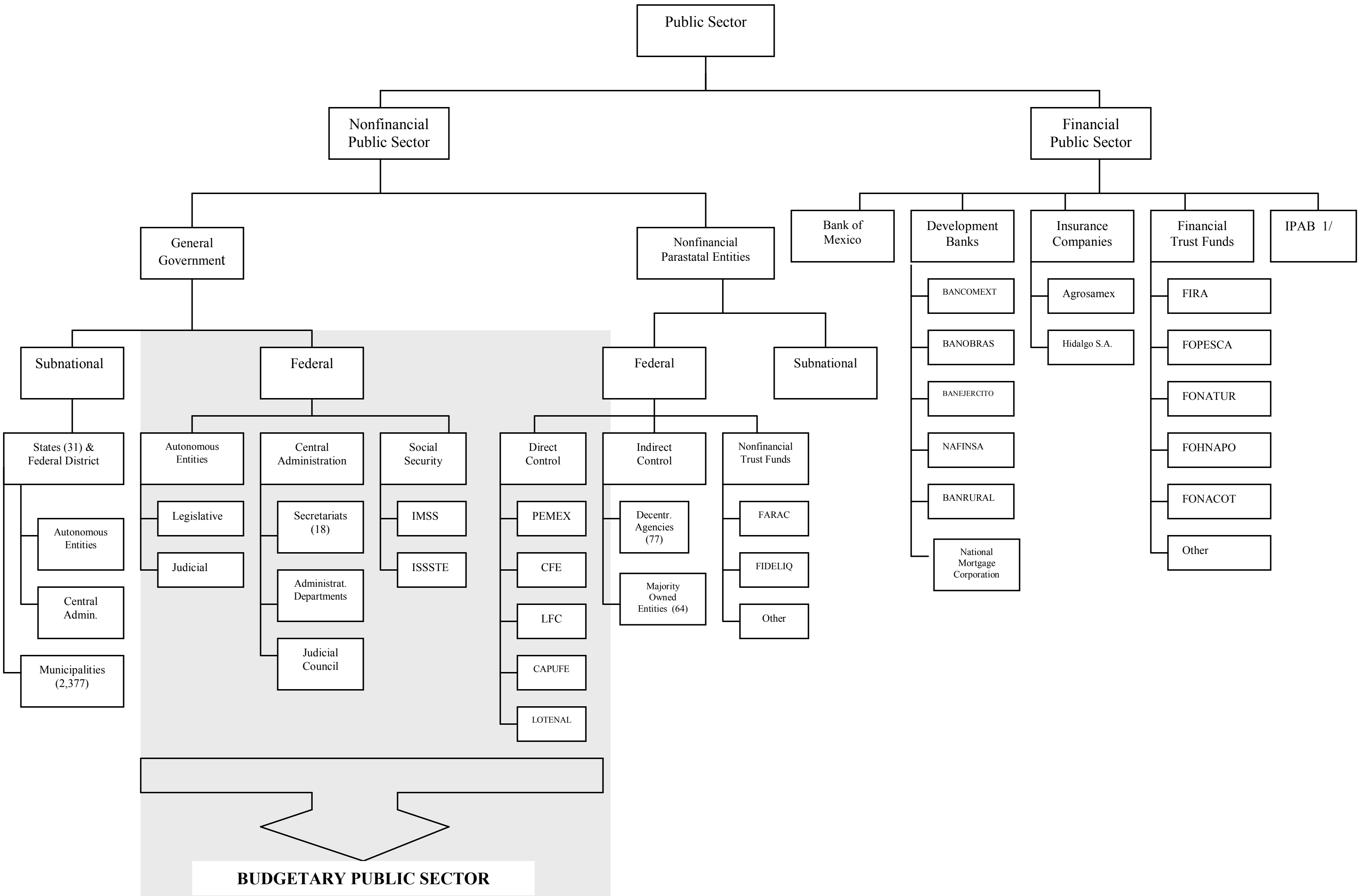
[8] Article 115 allows the municipalities to tax real property and to charge for the public services they provide, in accordance with rules issued by the states. Among their responsibilities are the provisions of public lighting; garbage collection, transfer, treatment, and final disposal; central and retail markets; cemeteries; urban planning; streets, parks, playgrounds, and equipment; public safety, police services, and transit.

[9] Article 124 of the Constitution.

[10] Articles 73 reserves for the federal government the right to levy charges on electricity, tobacco production and consumption, gasoline and other petroleum derivatives, alcohol, beer, and forestry exploitation.

[11] The Fiscal Coordination Law (1979, as amended in December 31, 2000) establishes that the federal government must transfer funds to the states through the General-Revenue Sharing Fund, comprising 20 percent of shareable federal revenues, i.e. revenues from taxes and royalties on petroleum and mining operations (excluding additional and extraordinary royalties on petroleum exploitation): 45.17 percent of shared revenues are distributed among the states in proportion to their population, 45.17 percent in proportion to their share in the collection of federal taxes earmarked for the states (circulation permits and taxes on new vehicles and special taxes on the production and consumption of alcoholic beverages and tobacco), and 9.66 percent in inverse proportion to the amounts established under the previous two calculations.

Figure 1. Structure of the Public Sector




1/ IPAB is an autonomous deposit insurance agency. It is also responsible for the administration of bank restructuring and debtor-support programs on behalf of the Federal Government.

the states have transferred their taxing powers to the federal government in return for a share of federal revenues.[12]

4. **The federal government has no direct control over the states' finances.** However, the Constitution[13] prohibits the states and municipalities, including their decentralized agencies and public enterprises, from borrowing abroad. They may borrow domestically up to the ceilings set by their respective legislatures for productive public investment. Some states (for example, Tlaxcala) prohibit any type of borrowing.

5. **Transparent and nondiscretionary criteria determine the distribution of federal funds to the states through revenue-sharing arrangements and transfers.**[14] A formula automatically establishes state shares in federal revenues. The states, in turn, are required to transfer a proportion of the funds they receive from the federal government to their municipalities. Nevertheless, only some states have clear and properly publicized formulas for distributing revenue-sharing receipts among their municipalities.[15] Generally speaking, the federal government does not have adequate information to verify the use of revenue-sharing funds or to validate the amounts to be transferred to the municipalities. In addition, there are federal contributions specifically earmarked for seven budgetary funds (basic education, health services, social infrastructure, social assistance, municipal strengthening, technical education, and public safety). To access funds for basic education and health services, the states sign contracts with the federal government that define clearly the expenditure responsibilities of each level of government.[16] The remaining revenues are allocated in accordance with the operating rules of each of the funds.

6. **The distribution of budget responsibilities between the executive and legislative branches is generally well established, but there is scope for further clarification.** The budget is approved in two successive stages. First, Congress approves the Federal Revenue Law (LIF) and thereafter the Chamber of Deputies approves the PEF legislative decree. Although responsibilities for preparing and approving the budget are clearly defined, some

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[12] The states' own tax revenues represent approximately 9 percent of their total revenues. Apart from taxes earmarked for the states (see preceding footnote), the principal source of states' own revenues is the payroll tax, but this tax is optional and not all states impose it. The Federal Revenue Law for fiscal year 2002 gave the states the power to impose limited taxes on individual incomes and on the sale of goods and services (Transitional Article 7, sections IX and X). Transfers from the PEF to subnational governments in 2002 amounted to about 7 percent of GDP.

[13] Article 117.

[14] States and municipalities receive two types of transfers from the federal government: the revenue-sharing transfer (*participaciones*), over which subnational governments have spending discretion, and the contributions (*aportaciones*), which are earmarked transfers for social services and infrastructure.

[15] At least 20 percent of revenues received from the General Revenue-Sharing Fund must be transferred.

[16] However, there is no education agreement with the Federal District.

ambiguities remain with respect to the legislature's powers to amend the draft PEF submitted by the executive.[17] On the other hand, the fact that the PEF is approved by legislative decree, and not by law, creates doubt as to the extent of the President's constitutional veto powers.[18] In addition, the time limit for legislative debate and approval (from November 15 to December 15) appears inadequate for a proper and complete review of government plans and programs. The short time available for approving the budget, and the fact that the Constitution says nothing about the status of fiscal policy in cases where the PEF or the LIF are not approved within the established time limit, generate great uncertainty about whether the government could be paralyzed if no agreement is reached with the legislature. This situation has never arisen, but could if political power in the Chamber of Deputies were severely fragmented.[19]

7. **The budget and off-budget activities of the federal government are subject to centralized and clearly regulated coordination and management mechanisms.** The Ministry of Finance and Public Credit (SHCP) coordinates formulation of the current and capital budgets and exerts control over the execution of all fiscal activities. The Federal Law on Budget, Accounting and Public Expenditure and its rules of application give the ministry broad powers to issue standards and set overall ceilings on expenditure (which entities of the centralized public administration and the parastatal public administration must respect in formulating their budget proposals), to approve guidelines and mandatory timetables limiting payments during budget execution, and to authorize amendments to the budget within the limits established by law. Approval by the Chamber of Deputies is limited to the PEF, which covers the budgets of the constitutionally autonomous entities, those of dependencies of the centralized public administration, and those of the entities under direct budgetary control, as well as transfers to the remaining entities of the parastatal public administration or entities under indirect budgetary control. Draft budgets for entities under indirect budgetary control are approved by their coordinating ministries and the SHCP. The Chamber of Deputies receives a forecast of cash flows from each of those bodies, for information purposes only.

[17] The Constitution (Article 74) provides only that the legislature must examine, debate, and approve the budget; it makes no explicit mention of the power to amend the budget. This power is established in Article 22 of the Law on Budget, Accounting and Federal Public Expenditure (1979, as amended on December 21,1995) and allows the legislature to reduce the budget, amend its composition, and even increase the budgetary ceiling, provided it approves the funds to finance the additional expenditure. However, it is not clear whether those funds refer to additional tax revenue or other sources of financing.

[18] Since only the Chamber of Deputies approves the budget (as opposed to both chambers), the budget is issued as a legislative decree and not as a law. The presidential veto power established in the Constitution refers to laws (approved by both chambers) and thus may or may not cover the budget decree. This legal vacuum has not been put to the test as no president has yet vetoed the budget decree.

[19] Currently, Congress is considering several proposed constitutional reforms to correct this problem. The most recent draft was submitted by the government in April 2001. That draft also proposes amendments to other aspects of the budgetary process with a view to enhancing transparency, clarifying the distribution of powers between the two branches of the state and introducing fiscal responsibility principles. Congress has not yet considered this draft.

8. **The Bank of Mexico has full autonomy in the conduct of monetary policy.** The relations between the bank and the government are clearly defined by law.[20] The bank provides cash management services to the federal government (for which it charges a commission), manages the government's treasury account (and remunerates its cash holdings at market rates), acts as fiscal agent for the management of the public debt, and also serves as financial adviser to the government. In special circumstances, the bank may extend credit to the federal government up to the equivalent of 1.5 percent of expenditures authorized in the PEF, for a maximum term of three months.[21] The bank also administers the three public trust funds to which it has made loans in the past.[22] The financing terms on those loans affect the bank's statements of earnings, but such information is not clearly identified in those statements.[23] The federal government discloses general information about financial transactions involving those trust funds, but it does not publish their financial statements.

9. **The Constitution reserves certain strategic areas exclusively to the public sector.** These are the post, telegraph and radiotelegraph, petroleum and other hydrocarbons, basic petrochemicals, radioactive minerals and nuclear power generation, and electricity. It also allows the federal government to participate, on its own account or together with the social and private sectors, in priority areas of development: railways and satellite communications. During the last two decades, the government has privatized or liquidated a number of public enterprises, reducing their number from more than 1,100 in 1982 to slightly over 200 today. The federal government may take an equity interest in private firms, either directly or through the development banking system. As of end-2001, public sector minority participation in private corporations was small and there are plans to sell such participation in the future.

10. **The relationship between the federal government and public nonfinancial enterprises is clearly regulated and the enterprises must report their activities and their earnings statements to the SHCP.** Some of these public nonfinancial enterprises engage in significant quasi-fiscal activities. For example the Federal Energy Commission (CFE) and

[20] Bank of Mexico Law (1993, as amended on January 19, 1999).

[21] These special circumstances are covered in the Bank of Mexico Law (Article 12) and refer to situations where the government's cash account is insufficient to service the external debt. In these cases, the Bank of Mexico will meet the federal government's obligations and issue securities in its name to recover the amounts advanced.

[22] These are the Housing Operations and Bank Financing Fund (FOVI), the Special Farm Finance Fund (FIRA) and the Business Development Fund (FIDEC), which is now being dissolved. In addition, FOVI is being transformed into the National Mortgage Corporation (a development bank) that will consequently be subject to regulation by the National Banking and Securities Commission (CNBV), which will improve the disclosure of information on its operations.

[23] The Bank of Mexico Law requires the bank to maintain to maturity the conditions on trust loans outstanding at the time the law was approved. It also authorizes the bank to renew them for a maximum term of 20 years from that date.

Central Light and Power (LFC) subsidize electricity for residential and farm consumption on behalf of the federal government. In the Explanatory Statement to the PEF, these firms provide an estimate for the value of the subsidies by type of user (estimated at 0.7 percent of GDP for 2002). The CFE and the LFC, however, receive no transfers from the federal government, and the PEF does not explicitly record gross flows between the government and the public enterprises on this score.[24] To keep the public better informed, household electricity consumption bills began to identify the amount of the subsidy in 2001. There are also implicit subsidies for water consumption, but no information is published on their amount or their distribution by type of user.[25]

11. **The development banks, which represent about 30 percent of the total portfolio of the banking system, conduct certain quasi-fiscal operations.**[26] These operations help explain the development banks' persistent losses, and also the recurrent need in the past for the federal government to capitalize them. Quasi-fiscal operations consist primarily in the provision of services on behalf of the federal government, such as foreign trade promotion and technical assistance for small- and medium-scale enterprises, and in some cases the granting of loans at below-market interest rates. The financial statements of the development banks are published after auditing by the National Banking and Securities Commission (CNBV), but without identifying noncommercial activities on behalf of the government, nor do the banks receive transfers from the PEF at a level that would fully compensate them for such activities. Government programs for bank debt restructuring and portfolio purchases, administered by the Bank Savings Protection Institute (IPAB), are well documented in its reports and financial statements. The IPAB receives budgetary transfers sufficient to cover the entire cost of the debtor programs and a portion of the savings programs, but costs not explicitly covered by the federal government[27] must be absorbed in its own financial statements. There are also six financial trust funds that administer public resources, provide

[24] The government has however established a compensation mechanism whereby the enterprises must pay a fixed fee to the federal government for the use of its assets. The value of subsidies granted is deducted from this transfer: if the difference is negative, the enterprise absorbs the subsidy, and if it is positive it is capitalized.

[25] Water supply falls to the municipalities, which are responsible for billing at rates approved by the local legislature. However, very little revenue is collected for this service. The federal government's involvement is primarily limited to infrastructure.

[26] The development banks are the National Public Works and Services Bank (BANOBRAS); National Foreign Trade Bank (BANCOMEXT); National Army, Air Force and Navy Bank (BANEJERCITO); National Farm Credit Bank (BANRURAL), with 12 subsidiaries; National Finance Corporation (NAFIN); National Sugar Financing Corporation (FINA), now being dissolved; and the National Mortgage Corporation, created in 2001.

[27] The estimated capital deficit of the IPAB in September 2001 stood at 11 percent of GDP. A third of these obligations carry the explicit guarantee of the federal government and the remainder are guaranteed by the Congress, under the Bank Savings Protection Act (Article 45): "If the Institute should be unable to meet its obligations, the national Congress will issue the measures it deems appropriate to pay the guaranteed obligations and the financing referred to in the following article. This guarantee must be shown, in accordance with the applicable legislation, in the loan documents or other instruments substantiating those obligations."

financial services, give guarantees, and make loans; very little information is disclosed on these trust funds, and no financial statements are published for them.[28]

12. **Transparency in the regulation of the private sector has been greatly enhanced.** Rules and procedures have become more streamlined, and procedures for reviewing existing regulations and approving new ones have been made public. In particular, the following improvements are now in place: a requirement to call for prior comments, rules for conducting public consultations, regulatory impact estimates, a start at coordination with subnational levels of government, and the creation of specific institutions for coordinating regulatory reform.[29] Although these improvements are only partially reflected in social, environmental, and tax regulations, in the latter two areas procedures have been eliminated and simplified.[30] On the other hand, the consultation process is still a concession and not a right with respect to regulated entities. Mexico is far advanced in facilitating public access through the Internet to existing regulations and to new proposals.

**Legal framework for fiscal management**

13. **The legal and administrative framework for fiscal management is comprehensive and public.**[31] The Law on Budget, Accounting and Federal Public Expenditure, its Regulations and the Manual of Budgetary Rules, which are available to the public, contain detailed rules on the processes of formulating, executing, and monitoring the PEF. The budgetary system reflected in these rules is highly centralized in the SHCP, which maintains strict control over the entire process for reasons of budgetary discipline. However, progress in setting objectives and evaluating the entities covered by the budget has not been accompanied by increased management autonomy. In addition, an excess of authorizations

[28] The estimate of public sector borrowing requirement (RFSP for its Spanish acronym) includes the increase in net assets of the development banks and the public financial trust funds. Nevertheless, no information is published on the nature of the programs of these entities, their noncommercial components nor their relationships with the government. Inclusion of the net assets of the development banks and the public financial trust funds has been viewed as a preventive measure, given the problem in separating the commercial and noncommercial activities of those institutions. Apart from the public financial trust funds there are more than 2000 unstructured trusts with their own capital, about whose operations no information or financial statement is published.

[29] Essentially, the Economic Deregulation Unit of the Ministry of Economy and the Federal Regulatory Improvement Commission (COFEMER).

[30] The Federal Tribunal of Fiscal and Administrative Justice is responsible for resolving disputes, including those relating to environmental and taxation issues, between individuals and the public administration.

[31] The legal framework for fiscal management includes the Constitution, Fiscal Code of the Federation (1981, as amended on December 31, 2001), the Fiscal Coordination Law, the Law on Budget, Accounting and Federal Public Expenditure and its regulations, the General Public Debt Law (1976), the Federal Treasury Service Law (1985, as amended on May 29, 1998), the Federal Parastatal Entities Law (1986, as amended on January 4, 2001), the Planning Law (1983) and the LIF and the PEF Decree approved for the year, and the Manual of Budgetary Rules for the Federal Public Administration (available at www.shcp.sse.gob.mx).

and supervision makes the process still too complicated. Despite recent efforts to devolve to individual entities the responsibility for disaggregating and amending their budgets, the SHCP maintains the power to review those amendments.[32]

14. **Federal, state, and municipal taxes are based on explicit legislation though some uncertainties remain.** The Fiscal Code of the Federation regulates overall aspects of federal taxation. The specific provisions of each tax are approved through individual laws, although in some cases taxes have been approved and rules issued through the LIF.[33] This practice can create instability in the tax regime, since the LIF applies only for one fiscal year. Moreover, legal experts disagree on whether federal taxes could be collected at all if the LIF were not approved in time for the new fiscal year.[34] This legal vacuum would be removed by the budget-related constitutional amendments now under consideration in Congress.

15. **Tax legislation is public and information readily accessible, but some tax laws are complicated by the many exemptions and special treatments.** Federal and state tax legislation is public. The Tax Administration Service (SAT) publishes the texts of federal tax laws on the Internet, together with regulations, administrative provisions, and explanatory material.[35] Administrative provisions of a general nature applicable to federal taxes and duties are issued each year through a miscellaneous fiscal resolution in the *Official Gazette*. Certain internal provisions of the SAT, however, are not publicly available, such as responses to individual consultations that constitute jurisprudence. The simplicity of the laws governing the income tax and VAT suffers from the existence of too many exemptions and sectoral preferences—provided in addition to other fiscal benefits (see also paragraph 22). Moreover, on some occasions the legal drafting by Congress and regulatory drafting by the tax administration lack sufficient clarity.

16. **Taxpayers' rights and the system of tax dispute settlement are clearly defined by law.** The Fiscal Code of the Federation establishes taxpayers' rights and obligations and the system of penalties. Decisions of the tax administration may be appealed via two routes: (1) an appeal for revocation to the administrative authority that issued the resolution (this recourse is optional), or (2) an appeal for nullity before the Federal Tribunal of Fiscal and Administrative Justice. Decisions of the Federal Tribunal of Fiscal and Administrative Justice may be appealed by the taxpayer by bringing a claim for *amparo* (constitutional

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[32] Article 11 of the PEF for 2002.

[33] The LIF for fiscal year 2002 established a sales tax on luxury goods (Transitional Article 8) and provided authorization for the states to establish taxes on income and goods and services (Transitional Article 7, Sections IX and X).

[34] No precedent exists on this matter so far, as the LIF has always been approved in time, as mentioned in paragraph 6.

[35] The LIF for 2002 (Article 28) obliges the SHCP and the SAT to post this information on their web pages within 24 hours after approval.

protection), and by the administrative authority through an appeal for review, which will be decided by the Circuit Collegiate Court. The duration of these procedures varies depending on the route of appeal that is chosen. If all instances of appeal are used, an appeals procedure may last up to 8 months.[36]

17. **Principles of ethical conduct for public officials are stipulated by law and in specific codes, and enforcement is improving.** The Constitution (Articles 108-114) and the Federal Law on the Administrative Responsibilities of Public Servants (2001) establish administrative responsibilities and ethical standards for public officials. These standards require that public officials exercise their duties with impartiality, efficiency, and full respect for the law. The Administrative Control and Development Ministry (SECODAM) is the agency in charge of enforcing adherence to these standards. In addition, some agencies, including the SAT and the Federal Audit Office (Auditoría Superior de la Federación), have specific ethical codes and compliance is improving.[37]

## B. Public Availability of Information

### Commitments with respect to the publication of information

18. **Mexico regularly publishes a considerable volume of fiscal information.** The government must provide Congress with monthly and quarterly reports on the economic situation and the performance of government finances and debt (see paragraph 38). These reports are normally made available to the public on the same day over the SHCP's Internet page.[38] In addition, each quarter the SHCP publishes the *Timely Public Finance and Debt Statistics (Estadísticas Oportunas de Finanzas Públicas y Deuda Pública)*, containing monthly and quarterly information on financial requirements, revenues, expenditures, flows of funds, and debt of the budgetary public sector.

19. **The calendar for publication of fiscal information is consistent with the Special Data Dissemination Standards (SDDS).**[39] Although in practice a great deal of fiscal information is made public, the legal obligation to publish such information is still limited (essentially to the LIF, PEF, and the Public Account). If approved, the draft federal law on

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[36] During 2001, taxpayers filed more than 100,000 appeals for revocation and 30,000 appeals for nullity.

[37] For example, during 2001 some 1,400 SAT officials were dismissed for improper conduct. SECODAM reported that during 2001 a total of 9,601 public servants were found administratively responsible for improper conduct, with sanctions ranging from simple warnings to dismissal from public service.

[38] See http://www.shcp.gob.mx/ieo/index.html. In addition, the SHCP issues a press release summarizing the major aspects of the quarterly report, on the day it is submitted to Congress.

[39] See http://www.shcp.gob.mx/info/html/mex34.html in Spanish or http://www.shcp.gob.mx/english/ieo/index.html in English.

transparency and access to information presently under legislative consideration could result in significant progress in this regard.[40]

**Full information on fiscal activity**

20. **There is information on most federal government activities.** The PEF contains the budgets of the constitutionally autonomous entities, the central administration, the social security institutions, and the decentralized agencies under direct budgetary control.[41] For the parastatal entities under indirect budgetary control, some of which engage in noncommercial activities, the PEF includes only transfers from the federal government and, for information purposes, their projected cash flows. Neither the PEF nor the periodic fiscal reports provide any information on the financial statements of the more than 2,000 public trust funds, which are relatively less important.[42] The quarterly reports provide operating balances of the Trust Fund for Rehabilitation of Concessioned Toll Roads (FARAC), which is empowered to issue debt, and on the outstanding debt of the financial trust funds.

21. **The budget document includes only limited information on past fiscal performance, and no budgetary forecasts for future years.** The explanatory statement to the PEF contains only estimates on budgetary performance for the current year. The executive branch does not provide original or revised budgetary estimates for previous years, making it difficult to compare recent budgetary performance against the proposed budget.[43] There is no description or explanation of changes from one year to the next in the classification or presentation of budgetary items; the only multiyear forecasts in the budget refer to investment projects.[44]

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[40] That draft law requires federal government entities to disclose information on their functions: the objectives declared in their operating programs; personnel, compensation, and services offered; and procedures, requirements, and formats for access to them. It also requires the SHCP to publish fiscal information that is already public de facto, and to disclose the results of audit reports prepared by the SECODAM and the Federal Audit Office.

[41] The so-called PIDIREGAS projects are included pursuant to the specific accounting rule explained in paragraph 23. The PIDIREGAS are capital investment projects that are being undertaken by the private sector on behalf of the public sector. Under the most common scheme, the private sector provides initial financing for the investment project during the construction period.

[42] The trust funds refer to fiduciary accounts established with public funds, generally with development banks having specific mandates (e.g., promotion of loans to sugar mills, guaranteeing loans for public sector pension system participants, etc.).

[43] The Law on Budget, Accounting and Federal Public Expenditure requires presentation in the PEF of information on the preliminary outturn of the previous fiscal year and an estimate for the current fiscal year (Article 19-IV).

[44] However, the SHCP web page publishes the current budget classifier and its predecessor.

22. **There is no systematic and publicly available registry of the federal government's contingent liabilities or of the quasi-fiscal activities of nonfinancial and financial parastatal entities.** The PEF provides little information on quasi-fiscal activities and contingent liabilities. While the budget documentation provides some information on subsidies in the electricity sector, no attempt is made to quantify quasi-fiscal activities by the development banks and other parastatal entities (see paragraph 9). Nor does the PEF provide any analysis or integrated statistics on the federal government's contingent liabilities, for example, the labor liabilities accruing in the pension and health insurance systems of the federal government and the parastatal entities.[45] Such information is important in securing a complete picture of the federal government's fiscal exposure. The LIF for fiscal year 2002 (Article 31) for the first time required the SHCP to prepare and report on tax expenditures.[46]

23. **The federal government publishes information on all components of its outstanding liabilities, but the fragmentary manner of presentation makes analysis difficult.** None of the public reports contains the composition of public indebtedness in a consolidated form. Nevertheless, information on indebtedness of the budgetary public sector is provided, and separately, on the principal components of the public debt that are excluded from that definition.[47] The published information on the indebtedness of the budgetary public sector provides an adequate level of detail and meets the guidelines of the SDDS. Information is offered on the composition of debt by term, type of creditor, and instrument, for both the external debt and the domestic debt. The quarterly reports also provide information on new debt issues during the year, and a forecast of maturities for the coming two years.[48] They also include information on the value of the federal government's financial assets and on the debt that it has guaranteed. A balance is provided for the financial obligations excluded from the definition of the budgetary public sector (such as those for

[45] The PEF must also provide a summary of contingent liabilities of the states.

[46] The law requires this report to include federal revenues foregone through exemptions and special treatment in federal taxation. The SHCP is to define, together with the respective committees of the Chamber of Deputies, the contents and definitions of that report, as well as its delivery date, by February 15, 2002.

[47] See the quarterly *Reports on the Economic Situation, Public Finance, and Public Debt (Informes sobre la Situación Económica, las Finanzas Públicas y la Deuda Pública)* and *Timely Statistics (Estadísticas Oportunas)*. These reports include the public debt of the budgetary public sector and the external debt of the development banks. However, they exclude liabilities of the IPAB, financial obligations flowing from PIDIREGAS projects, and other liabilities of public trusts and the development banks. These liabilities are summarized in the statistics for Historic Balances of Public Sector Financing Requirements, but no information is provided on their composition.

[48] In addition, the SHCP web site publishes the composition of foreign debt by currency and forecasts of foreign debt service for the coming four years.

PIDIREGAS projects[49] and the trust funds), but with no breakdown by term or type of instrument.

24. **Limited fiscal information is available on the subnational levels of government.** The states and municipalities publish their revenue and expenditure budgets and their public accounts in the official state *Gazettes*. This information is available only with a significant time lag, however, and there is no standardized presentation. The SHCP does not publish aggregate information on revenues, expenditures, and fiscal balances of the subnational and national governments on a consolidated basis. Published information is limited to timely record on the stock of state and municipal liabilities.[50] The National Institute of Statistics, Geography and Computerized Information (INEGI) compiles and publishes information on the activity of subnational levels for purposes of preparing the national accounts, but only with a delay of more than one year.[51] However, broadly speaking, a number of states have made progress toward greater transparency, as illustrated by the states of Mexico and Morelos (Boxes 1 and 2).

## C. Open Budget Preparation, Execution and Reporting

### Budget documentation

25. **The budget document provides information on sectoral priorities, but not on the medium-term objectives and sustainability of fiscal policy.** Legally, the sectoral objectives in the PEF must match the medium-term strategy defined for the public sector in the national development plan. In November of each year, the authorities prepare for Congress a document entitled General Criteria of Economic Policy, which accompanies the LIF proposal and the draft PEF, and which quantifies the objectives of fiscal policy in terms of revenues, expenditures, deficit, and debt for the coming fiscal year. The General Criteria for the year 2002 set forth the qualitative goal of achieving budgetary balance over the medium term.[52] The explanatory statement to the draft PEF subsequently includes annual fiscal targets. The National Development Finance Program (PRONAFIDE) summarizes the targets

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[49] Specific accounting rules for PIDIREGAS projects are established in the General Public Debt Law. Article 18 of that law provides that "for purposes of this Law, only financing amounts payable during the current fiscal year and the following fiscal year are to be considered as direct liabilities, and the remaining financing will be considered as a contingent liability." By law, therefore, information on the public debt includes only a portion of the total recognized obligations, which is not in line with international practice.

[50] This record is found on the SHCP web page (http://www.shcp.gob.mx).

[51] The internal regulations of the recently created Unit for Financial Coordination with the States give it the duty of fostering programs for fiscal transparency in the states and municipalities, and creating the National System of Fiscal Information. This system should serve to strengthen and standardize the state financial systems as far as possible.

[52] It is not stated whether this commitment refers to the balance for the budgetary public sector or the RFSP.

## Box 1. State of Mexico

The state of Mexico is the most populous in the country, with 13.1 million inhabitants in 124 municipalities; it is the second largest (after the Federal District) in terms of real GDP.

The Financial Code of the state of Mexico and its municipalities provides the legal framework for state-wide and municipal fiscal management. The law establishes the state and municipal taxes and duties; sets standards for formulation and execution of the budget, government accounting, and accountability to the public; governs fiscal coordination between the state and its municipalities; regulates the public debt; and determines the duties and powers of the fiscal authorities.

Every year, the state congress approves the changes to the Financial Code, the Revenue Law, and the State Budget. The budget covers the legislative, judiciary, and executive branches, plus auxiliary entities (decentralized agencies and enterprises with state participation) and autonomous agencies (administrative tribunal, state university, human rights commission, and electoral bodies) under state jurisdiction. The executive branch is required to submit a draft expenditure budget to the state congress, through the Secretariat of Finance and Planning, no later than December 5 of each year. The congress has broad powers to make amendments to the draft budget, subject to executive veto, which can only be overturned with a two-thirds majority of the congress. There are no clear regulations in the event that the approval process is not completed before the start of the new fiscal year.

Any modification to the approved budget that involves transfers of resources between chapters and items and between public departments and entities requires authorization from the Secretariat of Finance and Planning. No appropriations may be transferred from investment expenditure to current expenditure and the modifications may not increase the approved budget balance.

There are three entities that exercise control over the state budget. The Secretariat of Finance and Planning oversees the implementation of the budget programs by the state entities and administrative units. The Secretariat of Control exercises administrative control over the use of fiscal resources and proper discharge of duties by civil servants. Finally, the Audit Office (Contaduría General de la Glosa) performs external audits at the state and municipal levels. This office reviews the public accounts that the government must send to the state congress by March 15 of every year. It also establishes standards, procedures, accounting and auditing methods and systems, and verifies their proper application.

The fiscal relations of the state with its municipalities are governed by the fiscal coordination system contained in the Financial Code. This system regulates the distribution of federal and state funds to the municipalities. Each year the state congress approves a municipal revenue law, which establishes the generic sources of municipal revenue. The expenditure budget of each municipality is approved by its respective town council. The municipalities may borrow and guarantee obligations with prior authorization of the state congress if payment due dates extend beyond the end of the municipal fiscal year, after duly posting the record in the public debt register of the Secretariat of Finance and Planning.

The state publishes a wide range of information on state government finances. The Revenue Law and the State Budget are published (albeit without detailed annexes) in the *Official Gazette* and on the government's webpage (www.edomex.gob.mx). The government has a legal obligation to report to the state congress on budget execution on a monthly and quarterly basis. These reports are published in the *Gazette of the Congress*. In addition, the webpage features periodic summary reports on the state government finances, as well as information on procurement of goods and services, execution of the public investment program, and the integrated government performance evaluation system of the state (SIED).

## Box 2. State of Morelos

The state of Morelos has a population of 1.5 million in 33 municipalities. Its per capita GDP is 80 percent of the national average.

The legal framework for fiscal management is well developed in the Constitution of the state, the Budget, Accounting, and Public Expenditure Law, the Fiscal Coordination Law, and the Public Debt Law.

The annual state budget is contained in the Revenue Law and the Budget Expenditure Decree, and covers the legislative, judiciary, and executive branches, as well as all parastatal institutions. Legally, the draft budget must include a statement of purpose, a description of the main programs and subprograms, the financing schedule for the public debt, and the current organizational structure and functions of the government. The executive branch must submit it to the state congress, through the Finance Secretariat, no later than November 15 of the preceding year. There are no restrictions on the changes that the congress may make to the draft budget, nor are there any indications of what steps are to be taken if the budget is not approved before the start of the fiscal year.

In the course of the year, the state governor may change the composition of the budget only under very limited circumstances or for public security reasons, and must inform the congress of the use of such authority. The congress must authorize budget increases. However, any savings generated may be allocated by the executive to priority programs, debt repayment, or social assistance.

The Finance Secretariat has broad authority to monitor, evaluate, and control budget outlays. The State Controller's Office conducts internal audits and coordinates with SECODAM the verification of expenditure financed with resources transferred by the federal government. External audits are performed by the legislature through the Office of Financial Audit of Congress (Contaduría Mayor de Hacienda del Congreso), responsible for reviewing the public accounts submitted quarterly (30 days after the end of the quarter), by the executive, legislature, and judiciary branches. Comments by this office on the public accounts are submitted to the state congress for approval.

Fiscal relations between the state and its municipalities are regulated in the Fiscal Coordination Law, which establishes transparent and nondiscretionary rules for the distribution of transfers to the municipalities. The Budget, Accounting, and Public Expenditure Law establishes processes parallel to those of the state government, for programming, approval, execution, and review of municipal budgets. The state congress annually approves each municipal revenue law, while the expenditure budget of each municipality is approved by its respective town councils, within the revenue level approved by the state congress. If borrowing is required to cover budget expenditure, the draft budget must identify the sources of financing, which should be incorporated in the Government Financial Program (covering the state and the municipalities) to be approved by the congress. The State Finance Secretariat is required to maintain public debt records of all government institutions.

Since 2001, the Finance Secretariat has been publishing quarterly the monthly calendar of transfers to each municipality. This facilitates financial management at the local level, and provides information to the public on the resources received by the city council. Once approved, both the budget and the public accounts are published in the *Official Gazettee*. Information on budget execution has been recently made available to the general public on the state webpage (www.morelos.gob.mx).

The state has restructured all its liabilities through two bond issues, which will require the dissemination of additional fiscal data. In this regard, the state received a Ba2 credit rating from Moody's.

for the budget and stock of debt of the federal nonfinancial public sector for the six-year legislative term, but those objectives remain fixed throughout the period and are not revised to reflect actual financial performance. Furthermore, no medium- or long-term projections for the public pension system are publicly available.

26. **Each year automatic mechanisms are established for adjusting expenditure when actual revenue differs from the budgetary forecast, but no permanent fiscal rules have been adopted**—apart from the prohibition on external borrowing and limits on domestic borrowing by states, as mentioned. The PEF regulates the use of revenue surpluses over LIF estimates (increased expenditure or debt reduction) and determines what adjustments may be made in expenditures to maintain the programmed budgetary deficit when, on the other hand, actual revenue falls below the programmed level.

27. **The annual budget is prepared within a comprehensive and coherent macroeconomic framework, but it is not integrated into a medium-term expenditure framework.** The macroeconomic framework for the budget is published in the General Criteria for Economic Policy, but the information is limited to aggregates, without specifying in any detail the assumptions and procedures used in preparing the macroeconomic forecasts. Nor is there any explanation of the methods used for forecasting revenues and expenditures. As mentioned, the only multiyear disaggregated information included in the budget documentation refers to capital projects.[53]

28. **The budget document does not differentiate sufficiently between existing policies and new policies, nor does it provide an analysis of fiscal risks.** Changes in tax policy are summarized partly in the regulatory laws for the various taxes and partly in the LIF. Similarly, the program analyses in the PEF do not explain new policies and their estimated fiscal effects[54] clearly and systematically. There is no analysis of the sensitivity of fiscal aggregates to changes in economic parameters and other uncertainties (such as pending lawsuits and their estimated value) nor, as noted earlier, on the principal contingent liabilities such as labor benefits.

**Budget presentation**

29. **Budget and off-budget data are presented on a gross basis and classified by institution, function, program, and economic category.** The institutional classification divides expenditure into budgetary branches, which include autonomous branches (Legislature, Judiciary, Federal Elections Institute and National Human Rights Commission),

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[53] The PEF for 2002 (volumes 4 and 6).

[54] The PEF for 2002 provides that draft laws or decrees must include also an assessment of the impact on public expenditure to be taken into account if they become law. Congressional committees will also have to include an assessment of that impact in their reports.

administrative branches (Office of the President and 18 secretariats), general branches[55] and entities under direct budgetary control. For each institution, expenditure is classified by program, specifying the function and subfunction for each program, and within each program expenditure is classified by institutional activity, responsible unit, project, and economic category. The functional and economic classification systems used are compatible with existing international classifications, but no attempt is made to present the data consistently with international practice.

30. **The budget document provides basic budget information that is comprehensive, but not very clear.** The PEF consists of six volumes of useful information for the analysis of public expenditure.[56] Nevertheless, the excessively complex budget coding[57] and organizational format make the information difficult to understand. In order to understand the budget and to verify its accuracy, the user must have clearly presented as well as complete information.

31. **The budget document presents a statement of objectives for the principal budget programs.** For each institution, the PEF describes the objectives of each program and the practices for each institutional activity, as well as defining program elements (number and formula of the indicator, universe of coverage, and objective). Yet the authorities recognize that, despite significant progress, the definitions of these elements still suffer from severe limitations in terms of evaluating performance, and they are now under revision.

32. **The officially recorded budget balance is a poor indicator of the general government fiscal balance.** On one hand, the budget documentation[58] contains no information on subnational finances. On the other hand, the budget balance shown in the PEF is not consistent with recommended international practice, because of its institutional coverage. It does not coincide with the central government budget balance, because it includes decentralized agencies engaged in commercial activities, and it excludes others with

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[55] The functions of these other branches include contributions to social security; wage and economic provisions; public debt; contributions to basic, normal, technical, and adult education systems; contributions to state and municipal entities; equity interests in state and municipal entities; debts from previous fiscal years (ADEFAS); expenditure on financial rationalization operations and programs; and expenditure on programs of support for savers and bank debtors.

[56] The first volume contains the explanatory statement. The second offers, for each institution included in the autonomous, administrative and general branches, information on the programming strategy, an economic and financial programming summary, economic budget, and administrative summary of subsidies and transfers to deconcentrated agencies and parastatal enterprises. The third volume breaks down the budget by program and by expenditure object. The fourth volume presents the budgets for the agencies and enterprises under direct budgetary control, from seven perspectives. The fifth volume contains cash flows for entities under indirect budgetary control. The sixth volume presents investment plans, with a projection of financial needs to the year 2007.

[57] The budget code in the PEF for 2002 consists of 15 components and 38 digits.

[58] As noted earlier, this consists of the General Criteria for Economic Policy, the LIF and the PEF.

noncommercial activities. Nor does it coincide with the balance for the nonfinancial public sector, because it does not include all majority-owned nonfinancial enterprises. Finally, the recording of certain transactions (PIDIREGAS projects, interest, etc.) deviates from generally accepted accounting standards. This has led the authorities to establish as a new indicator the public sector borrowing requirement (RFSP),[59] which, while suffering from the aggregation limitations noted above, provides a more reliable picture of the overall fiscal balance.

**Budget execution procedures**

33. **The accounting system used by the autonomous entities and the decentralized public administration does not provide reliable and timely information on accrued expenditures and accounts payable.** Currently, Mexico uses a modified cash-based accounting system.[60] That system is not able to provide timely and reliable information on the different stages of the expenditure process. Although required by law, commitments are not recorded and accrued obligations are recorded at the same time as the payment orders. Furthermore, the treasury does not make all third-party payments directly, but transfers a portion of the funds to executing units, thereby converting them into independent treasuries. Finally, the current accounting system has four subsystems (outflows, inflows, cash, and public credit). Each subsystem operates independently, using semi-automated processes, making it difficult to integrate information and to consolidate and reconcile the data. An integrated system for federal financial management (SIAFF) has been designed and is now being applied: this will provide support for the timely recording of all stages of the expenditure process and will produce fiscal data in real time. Following an experimental introduction in two ministries during 2002, the system is expected to enter into general use in January 2003.

34. **Internal control systems function reasonably well; they are being redesigned to make them more effective and reduce excessive bureaucracy.** Internal control functions are divided by law between the SHCP and the Ministry of Administrative Control and Development (SECODAM). The SHCP exerts its control function by approving mandatory execution calendars for the expenditure budget and by making payments to the budgetary entities. It also approves or authorizes budgetary adjustments and prepares regular reports on budgetary execution on the basis of information that the budgetary entities are required to report within predetermined time limits. SECODAM is responsible for administrative and accounting control and internal auditing, functions that it performs directly through 216 internal control units located in entities of the federal public administration, both centralized

[59] Included, for the first time, in the General Criteria for Economic Policy for 2002.

[60] By February 28 of each year budgetary entities are legally bound to submit to the SHCP , a statement of all recognized obligations pending payment. The account is kept open until March 31 for making payments against recognized obligations from the preceding year, provided they meet certain requirements in Article 45 of the Regulations to the Law on Budget, Accounting and Federal Public Expenditure.

and parastatal.[61] As part of the reform process now underway, SECODAM has assigned top priority to reinforcing its control and management evaluation systems, over which it has exclusive responsibility. On budgetary matters, it focuses on controlling public procurement and contracting, performing financial and compliance audits and contracting for external audits of all parastatal entities. Currently, the audit results are not published. Although mechanisms exist for following up its recommendations, there are no provisions for dealing with audited units that fail to comply with those recommendations.

35. **Civil service regulation is not uniform.** Although recent years have seen considerable progress in rationalizing public servants' pay and making the system more transparent, there is still room for improvement. Public employment is mainly regulated by the Federal Law on Government Workers (1963, as amended on January 23, 1998), on the basis of the Constitution (Article 123, section B), and complementarily by the Federal Labor Code. Except for certain careers subject to specific regulations, all public employees are legally classified according to whether they occupy staff positions or managerial positions.[62] These two types of positions are subject to different recruitment, promotion, and layoff procedures. Generally, job vacancies receive little publicity, and the selection process involves a great deal of discretion, especially for middle-level and senior management positions.[63] The fairness and transparency of the remuneration system have improved substantially with the publication of the Salary Description and Evaluation System in the *Services Manual*, which has laid the foundation for introducing a merit- and responsibility-based pay system, and has reduced pay discrepancies among similar jobs in different entities. The PEF decree includes the pay schedule for public officials. Less progress has been made in implementing the system for evaluating performance and the related system of incentives.

36. **Regulations governing procurement are clear and complete; bidding and contracting systems are transparent.** Regulations governing public purchases[64] call for

[61] The internal control organs are administratively integrated into the entities in which they are located; employees are paid by the entities where they are located, although they are organizationally and functionally under the SECODAM. SECODAM regulates, programs, coordinates and supervises their activities and appoints management level officials: the controller and the heads of the control and evaluation, audit, and complaints units.

[62] Managerial positions are defined in the Federal Law on Government Employees (Article 5).

[63] Responsibility for human resource management is assigned to the SHCP and the SECODAM, depending on whether the proposed measures have a budgetary impact. In recent years, the signing of performance appraisal agreements with the dependencies seems to have relaxed the strict internal controls over expansion of the payroll, changes in status for employees, and amendments to compensation. This has occurred thanks to a program called "computerized human resources management information system" (SIARH), which has streamlined the required authorizations in the personnel field.

[64] The Law on Procurement, Leasing and Services in the Public Sector (January 9, 2000) and Regulations thereunder (August 20, 2001); and Law on Public Works and Related Services (January 4, 2000) and Regulations thereunder (August 20, 2001).

three systems of procurement, depending on the size of the contract or on special circumstances: public bidding, which is the general procedure; two special procedures, involving awards on the basis of three proposals; and direct purchase. The regulations apply to all entities of the federal public administration, except for the legislative and judicial branches, constitutionally autonomous bodies, and transactions between federal and state dependencies and entities. Calls for tender, bidding documents, and awards are made public under all systems. Supervisory and standard-setting responsibilities in this area lie with SECODAM, which has developed an Electronic Public Procurement System (COMPRANET) for publishing all phases, procedures, and forms related to the procurement process.

37. **The federal tax administration reports regularly on its activities but does not have statutory protection against political interference and dismissals.** The SHCP sends quarterly, published reports to the Chamber of Deputies with details on tax collection, revenues resulting from tax audits (and expenditures made in this area), proceeds of fines and legal enforcement, the taxpayers' roll, and other matters.[65] There is no professional career stream for public servants in the federal tax administration. Senior managers of the SAT are appointed by the president, and confirmed by the Senate.

**Obligation to provide fiscal information**

38. **The executive branch has a legal obligation to submit regular reports to Congress on budget execution.** The PEF law (Articles 73.1 and 74) requires the SHCP to submit a quarterly report to Congress on the economic situation, government finances, and public debt, within 35 calendar days after the end of each quarter, and it sets out the required contents. As noted earlier, the published reports provide detailed information on revenue and expenditure budget execution. The reports provide comparisons, in the first case, with planned revenue schedules and, in the second case, with the results from the same quarter of the previous year, and with initial and amended budgets. They also provide information on the evolution and situation of the internal and external public debt, and on physical execution of the capital budget. The SHCP must also provide monthly information to Congress on revenue collection and on the federal government debt, no later than 35 days after the end of each month.

39. **Audited public accounts are submitted to Congress during the following fiscal year.** The executive branch is required to submit the *Public Account* to Congress before June 5 of the following year, and the Federal Audit Office must complete the *Report on the Review and Audit of the Federal Government's Public Account* before March 31 of the year following the fiscal year to which the accounts refer. This report contains detailed execution information on the revenue and expenditure budgets, and an explicit comparison of results against the initial and amended figures; an explanation of results from the major expenditure policies; the consolidated financial statements for the various branches included in the PEF;

[65] See Article 30 of the Federal Revenue Law for details on the information that must be submitted to Congress.

and information on the debt of the budgetary public sector. As of 2001 there is an obligation to provide a midyear status report on the Public Accounts, pursuant to Articles 8, 9, 10 and 11 of the Federal Audit Law (2000). This report is submitted to Congress in August.

40. **Information on the results of budgetary programs must be provided to Congress.** The PEF law (Article 63) requires dependencies and entities, through their sectoral coordinator, to submit a quarterly report to Congress on their compliance with goals and objectives, based on specific indicators, within 15 working days after the end of each quarter.

## D. Assurances of Integrity

### Data quality standards

41. **Budgetary data provide a reasonably reliable indication of actual results.**[66] Supplementary appropriations during the year are held to prudent levels, with most deviations occurring in entities under direct control. Budget execution is also substantially in line with approved budgetary figures.

42. **Public accounts summarize the main accounting principles for preparing the financial statements.** However, the actual accounting principles and manuals for the central public administration and for the parastatal entities are not publicly available.

43. **Data from the public accounts can be reconciled with budgetary and monetary data.** Nevertheless, limitations to the accounting system and the lack of sufficient background information make such reconciliations difficult to perform routinely or in any detail during the year.

### Independent scrutiny

44. **The recently created Federal Audit Office (Auditoría Superior de la Federación) has the autonomy and resources to exert external supervision over the federal executive branch.**[67] The Audit Office reports to the Chamber of Deputies, but has full technical and managerial autonomy and broad powers to conduct subsequent financial and performance audits over all federal branches, the federal public entities, the states, municipalities, and

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[66] Nevertheless, it must be noted that institutional coverage of the PEF is limited (see paragraph 2).

[67] The Federal Audit Office was created at the end of 2000 by the Federal Audit Law, replacing the Senior Comptroller of Finance. Matters that were in process within the Comptroller's Office at the time the new law came into effect continue to be handled by the Federal Auditor under the terms of the Organic Law of the Superior Financial Accounting Office. However, given its recent creation, it is still too early to assess the effectiveness of the Federal Audit Office.

individuals.[68] It audits the public accounts of the executive branch and reports its findings to the Chamber of Deputies by March 31 of the subsequent year.[69] It also publishes these audit reports, but only after submitting them to the Chamber of Deputies. The Federal Audit Office has the authority to require public servants to compensate for any damages to the treasury that it discovers. However, there is no formal mechanism for follow-up to the other recommendations that may be contained in the audit reports.

45. **The production and dissemination of financial statistics on the federal government is the responsibility of the SHCP.** The INEGI, the body that manages the national system of public statistics, does not verify the federal government's financial statistics. However, the INEGI uses that information to prepare the national accounts.[70] The national accounts include information on economic activity of subnational levels of government, in addition to the federal government.[71]

## III. Staff Commentary

46. Until the 1994-95 crisis, Mexico's government finances were characterized by a high degree of discretionality and complexity, with little transparency. Against this background, **extraordinary progress has been made in recent years towards a system that is open overall and follows (in a number of areas) good international practices.** In fact, in some aspects Mexico compares favorably with other OECD countries. Yet there is still a certain lack of relevant, timely, and readily understandable information available to the public or even to the government. Currently, there is an impressive volume of information; in fact, the sheer volume is enough to confuse users.[72] Generally speaking, the presentation of fiscal information needs to be clearer, more relevant, and more timely to respond to the needs of different users –especially for Congress, which has relatively little time to debate and approve the budget.

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[68] The Federal Audit Law establishes the principle of coordination between the Federal Audit Office and the state legislatures and the Legislative Assembly of the Federal District, which has been confirmed in the signing of coordination agreements (to date there are 13 such agreements). Coordination is necessary, since there is duplication of supervisory powers with the state auditors.

[69] The first audit report on the public accounts by the Federal Audit Office (for the year 2001) will be issued no later than March 31, 2003.

[70] The INEGI is a deconcentrated body of the SHCP and therefore does not have technical autonomy. Nevertheless, the current government has made it a strategic goal of its administration to give autonomy to the INEGI.

[71] Methodological information on compiling the national accounts for general government is available at the INEGI website (www.inegi.gob.mx).

[72] For example, the budgetary information as currently presented offers neither the benefit of a database that expert users can process nor the simplicity that would meet the needs of users seeking more aggregated information.

47. In order to enhance the quality of public management and to signal stability to financial markets, **the authorities have repeatedly committed themselves to the goals of fiscal transparency and responsibility.**[73] This commitment has been demonstrated through a series of major initiatives now underway, including the reform of the budget process, with the introduction of a new programming structure, a performance assessment system, an integrated federal financial management information system (SIAFF), and an integrated system of human resource management (SIAHR). In addition, there is now timely dissemination of a growing volume of information on government finances; there has been an overhaul of the government procurement system; there is greater transparency in regulation of the private sector;[74] transparency and deregulation programs have been launched in the public sector; the external control system has been strengthened by creating the Federal Audit Office; there are limits on the creation of trust funds involving public monies; prudential rules for the management of the development banks have been reinforced; and there is less discretionality in the distribution of transfers to the states (Box 3).

48. **The International Monetary Fund agrees with the priority assigned to implementation of these initiatives and suggests that they be supplemented with several additional steps**, consistent with the transparency goals declared by the authorities, and with sound international practices (especially those followed by the majority of OECD countries). These steps include the redefinition of institutional coverage, improvements in documentation, clarification of public accounting practices, strengthening of tax transparency, and introduction of performance audits. In view of the technical capacity and resources in Mexico's public administration, practically all the recommendations could be implemented within a short time. In some of these areas, though initiatives should be launched immediately, completion requires a longer time horizon, namely: full extension of government coverage to state and local governments; estimation of the cost of quasi-fiscal operations and of fiscal risks; major tax simplification; and full development of a system of performance audits. Elaboration of the recommended steps follows.

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[73] The National Development Plan for 2001-06 contains an explicit statement of the objectives of transparency and responsibility: "Discretionary decisions must be reduced to a minimum and must respect and be governed by clear public standards, so as to avoid opportunities for corruption and to allow the citizens to appreciate the honesty and honorability of public servants, as well as to detect any discrepancies in the conduct of public duties." The Decision of February 28, 2001, establishes the Provisions for Productivity, Economy, Transparency and Budgetary Deregulation in the Federal Public Administration.

[74] The Regulatory Reform Program for 2001-06 and the National Program to Combat Corruption and Foster Transparency and Administrative Development for 2001-06 (promulgated on April 12, 2001) establish guidelines for the Federal Regulatory Reform Commission and SECODAM, respectively, in the context of the National Development Plan for 2001-06.

**Box 3. Recent Progress Towards Fiscal Transparency**

- Reform of the budget system

New expenditure programming classifier.
Design and introduction of management indicators.
Development of an integrated federal financial management system (SIAFF)
Development of tax expenditure budget.

- Timely disclosure of fiscal information

Publication of monthly and quarterly fiscal reports.
Publication of public sector financial requirements and historic balances, to correct the limited coverage of indicators for the budgetary public sector.

- Administrative reform

Introduction of a human resources management system.
Transparency in public sector management and deregulation.
Improvements to regulation of the private sector.

- Strengthening control systems

Creation of the Federal Audit Office.
Reform of the public procurement system and introduction of COMPRANET.

- Public financial entities

Strengthening prudential criteria in the management of the development banks.
Limiting the creation of trust funds that involve public money.

- Subnational levels of government

Less discretionality in the distribution of transfers to subnational levels of government.
Better information on government finances encouraged.

**Coverage of government and the rest of the public sector**

49. **Redefinition of the coverage of government and of the rest of the public sector, consistent with sound international practice.** This will require essentially (1) reassigning all parastatal entities engaged primarily in commercial activities (PEMEX, CFE etc.) from the government to the rest of the public sector;[75] (2) incorporating in the government sector all the parastatal entities engaged in noncommercial activities, plus possibly estimates of the cost of quasi-fiscal operations of parastatal entities engaged in commercial activities; and (3) consolidating the states and municipalities, together with the central government, under the general government. This new structure of the public sector would clarify the role and influence of the government in the economy, while enabling the government to exercise ownership and financial control over parastatal entities engaged in commercial activities.

50. **Preparation of fiscal information in general, and particularly of budget execution reports, in accordance with the recommended institutional coverage.** Recommendations (1) and (2) in the preceding paragraph would provide more reliable information on government activities, and would be useful for forecasting and calculating the fiscal stance of the central government. Meanwhile, the activities of commercial parastatal entities would be accounted for under the rest of the public sector.[76] Consolidation of the accounts of these entities with those of the government would permit measurement of the public sector borrowing requirement—comparable to the coverage in other countries—and assessment of public debt sustainability.[77] According to recommendation (3), as information on the fiscal position of subnational levels of government becomes available, consolidated accounts could be prepared for the general government and the entire nonfinancial public sector.[78] Overall, the standard presentation of public sector statistics in this manner would facilitate setting fiscal policy goals and monitoring their implementation, both conducive to a more informed debate on the budget.

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[75] Of course, all parastatal entities devoted to public functions (for example, IMSS) would still be included in government. At the same time, for the sake of simplicity, thought could be given to merging deconcentrated entities and some of the noncommercial decentralized entities within the accounts of their respective ministries.

[76] On this point, the PEF should also include financial statements for the parastatal entities under indirect budgetary control and for the unstructured trusts that engage in noncommercial activities.

[77] This broad coverage of public debt approximates that of the cumulative historical balances of public sector borrowing requirement shown in the *Timely Public Finance Statistics*. Nevertheless, only the central government's debt is shown in comparison with other OECD countries, in the *Reports on the Economic Situation, Public Finances and Public Debt*.

[78] The authorities could stress the programs now underway to standardize the accounting practices of the states with those of the federal government, and to strengthen their budget execution information and monitoring systems.

**Budget documentation**

51. **Inclusion of a quantitative statement of medium-term objectives, priorities and sustainability of fiscal policy in the budget documentation, indicating the extent to which the annual budget is consistent with those objectives and priorities.** The annual budget should be presented in the context of a medium-term macroeconomic and fiscal framework. This rolling multiyear framework, covering a period of three to five years, would be annually updated to show actual performance and the future outlook, including an analysis of medium-term sustainability, possibly for the entire public sector, at a sufficient level of disaggregation.[79] At least, the PEF should contain initial estimates and outturns of the main fiscal aggregates for the two previous years as well as forecasts for the two following years.[80]

52. **Publication of information on the medium-term macroeconomic and fiscal framework stating clearly the methodology, parameters, and supporting macroeconomic assumptions.** The recommended macrofiscal framework and clear definitions of the accounting basis and institutional coverage are essential to the application of fiscal rules.[81] This permits construction of medium term expenditure scenarios that would contain, initially at least, estimates of future expenditures under existing policies—including current expenditures generated by planned investments.

53. **Publication of a summary volume in the budget document explaining the macroeconomic underpinnings of the budget, the objectives of fiscal policy, and the main budgetary measures.** In addition, this PEF volume should include summary tables of revenues and expenditures, compared with those of previous years, classified by functional, institutional, economic, and programmatic category, highlighting new expenditure and tax measures along with an estimate of each measure's budgetary impact. This would facilitate the explanation of the discrepancies between budgetary forecasts and results (especially if there are legislative measures that become effective in the course of the year) and an overall assessment of the reliability of the initial budget as a guide to the final outcome.

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[79] As a minimum, the PEF documentation should include original and revised estimates for the main budgetary aggregates for the two preceding years, as well as forecasts for the most important budgetary aggregates for the coming two years.

[80] In cases where the framework extends beyond the six-year term of government, it would be based on trend projections, i.e., without new policy measures. This would make it possible to set ex ante fiscal goals in quantitative terms, and to show the profile and nature of the government's planned adjustments. In addition, it would provide the basis for ex post evaluation of fiscal performance.

[81] The constitutional reform (Article 126) proposed in April 2001 contains rules relating to the fiscal balance and public indebtedness that, without the necessary institutional infrastructure in place, could lend themselves to creative accounting and noncompliance.

54. **Publication of information on quasi-fiscal activities.** Publication of this information in the PEF presupposes the systematic identification and quantification of the quasi-fiscal activities of the rest of the public sector, and (insofar as possible) the estimation of their cost, that is, their impact on the budget balance.[82] This information should, in the first instance, be reported as an annex to the accounting statements of the entities that undertake them.

55. **Provision of additional information on contingent liabilities[83] and estimates of fiscal risks.** Statistics on government guarantees (i.e., without certainty that they will in fact be invoked), including on conditioned PIDIREGAS investment projects, should be presented in terms of accumulated stock and of projected future impact on the budget balance. For purposes of capturing fiscal risk, it is advisable to prepare medium- and long-term fiscal projections (revised annually), including on the financial balance of the social security system. This system encompasses defined-benefit pensions, health-care benefits and other labor liabilities (IMSS, FOVISSTE, ISSSTE, state pension systems, pension funds of PEMEX, CFE and other parastatals) and the transition cost of reforming the IMSS, plus the guaranteed minimum pension, since all of these constitute future obligations for the general government.[84] In addition, analyses of the sensitivity of budget aggregates to changes in the economic environment are recommended.

**Public sector accounts**

56. **Dissemination of accounting standards and practices.** The PEF and the Public Account documents should include the accounting principles and practices used in preparing information on government finances. In particular, the accounting manuals used by the various entities should be made public.

57. **Implementation of SIAFF for preparing timely information on the different stages of the expenditure process, and thereby estimating the floating debt.** This would allow routine reconciliation of the budget balance against the financial accounts, as well as the calculation of the budget balance on an accrual basis.

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[82] While it is relatively easy to estimate the cost of some governmental operations of the parastatal entities (for example, the financial cost of banking rationalization assumed by IPAB), it is rather more difficult to measure the subsidy element that may be contained in ostensibly commercial operations (for example, the granting of loans by the development banks). In some cases, such operations may include cross-subsidies that have no impact on the public deficit.

[83] It is important to distinguish between guarantees that give rise to a definite government obligation, in effect representing real liabilities even if they are not recognized as such, and those that may but will not necessarily result in a government obligation and are thus considered contingent liabilities.

[84] These medium- and long-term projections should be disclosed with information on the methodology and the demographic and macroeconomic assumptions supporting them. Present value calculations should also indicate the discount rate used.

58. **Adoption of international accounting standards for all public sector transactions.** In particular, it will be necessary to correct the recording of PIDIREGAS projects, consistent with these standards, and thus eliminate distortions in fiscal statistics, including in the measurement of the public debt.

**Tax transparency**

59. **Strengthening the transparency of the tax system.** Despite the efforts that the authorities have been making, there is still considerable room for simplifying the tax system and making it more transparent. Above all, this calls for greater clarity in the drafting of legislation and regulations. The legal mandate to estimate the cost of tax preferences for the year 2002 should be institutionalized and extended to the preparation of an annual tax expenditure budget—using the functional classification expenditures—for presentation as an annex to the PEF. Such a document would be especially useful in Mexico, where the tax system is subject to annual debate and ratification in Congress. The SAT should also disclose the answers and advance rulings in response to queries by individual taxpayers.

**Audit and control**

60. **Preparation and publication of performance audits.** Besides the compliance and financial audits conducted by SECODAM and the Federal Audit Office, there should be a major emphasis on conducting performance audits. For this purpose, it is necessary to begin the development a full-fledged performance auditing system in line with the development of performance-oriented budgeting. This would require additional efforts to define program targets, design and monitor reliable performance indicators, and strengthen and equip the units responsible for conducting them. In addition, it is essential that the conclusions and recommendations in the audit reports (except as they relate to confidential issues, for example, public security and national defense) be widely available to the public, and that compliance with their recommendations be effectively monitored and disclosed.