SECRETARÍA DE HACIENDA Y CRÉDITO PÚBLICO

SHCP

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PRESS RELEASE

Mexico City, December 25, 2006.

APPROVAL OF THE ECONOMIC PROGRAM FOR 2007

- **ON DECEMBER 22, 2006, CONGRESS APROVED THE FEDERATION'S REVENUES LAW FOR 2007 AND ON DECEMBER 23, 2006, THE FEDERATION'S EXPENDITURES DECREE FOR 2007 WAS APPROVED BY THE CHAMBER OF DEPUTIES.**
- **BOTH ORDINANCES WERE APPROVED BY CONSENSUS OF ALL POLITICAL PARTIES, A SIGN OF THE AGREEMENT ON ESTABLISHING MORE STABLE SOURCES OF INCOME THAT ALLOW A SUSTAINABLE INCREASE IN SOCIAL SPENDING AND IN INFRASTRUCTURE.**
- **TOTAL PUBLIC SECTOR REVENUES APPROVED IN THE REVENUES LAW FOR 2007 ARE 10.7 PERCENT HIGHER IN REAL TERMS THAN THOSE APPROVED FOR 2006 AND INCLUDE REVENUES THAT ARE Ps. 26.4 BILLION HIGHER THAN THOSE IN THE EXECUTIVE'S PROPOSAL. THIS INCREASE RESULTS MAINLY DUE TO THE REVISION OF OIL REVENUES, NON-OIL TAX REVENUES AND NON-RECURENT REVENUES.**
- **THE MAIN APPROVED FISCAL MODIFICATIONS FOR 2007 ARE THE FOLLOWING: I) IN INCOME TAX, THE LIMIT OF THE CAR PURCHASE DEDUCTION IS REDUCED FROM 300 TO 175 THOUSAND PESOS, THE AMOUNT TO BE DEDUCTED IN RESTAURANT CONSUMPTION IS REDUCED FROM 25% TO 12.5% AND THE TAX RATE APPLIED TO PRIMARY SECTOR TAXPAYERS IS INCREASED FROM 16% TO 19%; II) IN TERMS OF THE ASSET TAX (IMPAC), THE DEDUCTION OF DEBT IS ELIMINATED AND THE TAX RATE IS REDUCED FROM 1.8% TO 1.25%; III) THE EXCISE TAX ON SOFT DRINKS IS ABROGATED AND THE RATE OF EXCISE TAXES ON TOBACCO PRODUCTS, CIGARETTES AND CIGARS IS INCREASED FROM 110% TO 140%.**
- **TOTAL PUBLIC SPENDING IN THE EXPENDITURES DECREE FOR 2007 IS Ps. 217.8 BILLION HIGHER (10.7% IN REAL TERMS) TO THAT AUTHORIZED BY CONGRESS FOR THE PREVIOUS YEAR. HIGHLIGHTS ARE THE INCREASE OF 14.1% IN PROGRAMABLE EXPENDITURES, 5.4% IN RESOURCES FOR STATES AND MUNICIPALITIES AND, WITHIN THIS, THE INCREASE OF 7.7% IN SHARED REVENUES.**
- **RESOURCES DISTRIBUTED TO THE STATES AND MUNICIPALITIES WERE INCREASED IN Ps. 11.4 BILLION WITH RESPECT TO THOSE ALLOCATED IN THE EXECUTIVE'S PROPOSAL. THEREFORE, FEDERALIZED EXPENDITURES WILL BE HIGHER THAN THOSE APPROVED FOR 2006 BY Ps. 35.5 BILLION.**
- **A CHANGE IN THE FISCAL COORDINATION LAW WAS APPROVED IN ORDER TO TRANSFORM THE PAFEF INTO A CONTRIBUTIONS FUND (FAFEF) THAT WILL BE EQUAL TO 1.4% OF THE FEDERAL REVENUE THAT IS PARTICIPATED TO THE STATES. THIS BRINGS CERTAINTY TO THE FEDERAL ENTITIES ABOUT THE AMOUNT OF THESE RESOURCES. IN ADITION, MUNICIPALITIES AND THE FEDERAL STATES ARE ALLOWED TO SECURITIZE THE RESOURCES THEY**

RECEIVE FROM THE "CONTRIBUTIONS FOR THE SOCIAL INFRAESTRUCTURE FUND" (FAIS) AND THE FAFEF, UP TO 25% OF TOTAL RESOURCES IN BOTH FUNDS.

- **CONGRESS IMPLEMENTED REDUCTIONS OF Ps. 56.8 BILLION FROM THE BUDGET PROJECT SENT BY THE EXECUTIVE. THIS INVOLVED THE FOLLOWING REDUCTIONS: Ps. 35.2 BILLION TO THE GENERAL BRANCHES (AND WITHIN THIS THE REDUCTION OF Ps. 20 BILLION IN THE DEPOSITS TO THE OIL REVENUE STABILIZATION FUND), Ps. 10.1 TO ADMINISTRATIVE BRANCHES, Ps. 6 BILLION TO AUTONOMOUS BRANCHES AND Ps. 5.4 BILLION TO PUBLIC ENTITIES.**
- **THE INCREASED RESOURCES IN THE APPROVED REVENUES LAW AND THE BUDGET CUTS APPLIED TO THE EXECUTIVE'S PROPORSAL, ALLOW FOR EXPENDITURE INCREASES AND REALLOCATIONS OF Ps. 82.9 BILLION. FROM THESE INCREASES, THE FOLLOWING STAND OUT: Ps. 15.5 BILLION TO THE AGRICULTURAL SECTOR, Ps.15 BILLION FOR PRIMARY, SECONDARY AND UPPER EDUCATION, Ps. 12 BILLION FOR HIGHWAY INFRASTRUCTURE, Ps. 5 BILLION TO THE NATIONAL WATER COMMISSION AND Ps. 3 BILLION TO HOSPITALS.**
- **THE APPROVED ECONOMIC PACKAGE IS IN LINE WITH THE PRINCIPLES OF FISCAL RESPONSIBILITY THAT ARE EMBEDDED IN THE FEDERAL BUDGET AND FISCAL RESPONSIBILITY LAW.**

Economic Outlook for 2007

The economic program approved for 2007 considers, as does the Executive's proposal, that GDP will grow at 3.6 percent in real annual terms and inflation of 3.0 percent. Considering the change in the trend of oil prices observed in recent weeks, Congress modified the Mexican crude oil mix reference price from 42.5 to 42.8 dollars per barrel, and it increased the platforms of oil production and exports by 20 thousand barrels per day with respect to the Executive's proposal.

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Economic Outlook, 2006-2007 e/	2006	2007
Gross Domestic Product		
Real growth (%)	4.7	3.6
Nominal (billion pesos)	9,144.0	9,807.7
GDP Deflactor (average growth, %)	4.3	3.5
Inflation		
Dec./dec. (%)	3.9	3.0
Nominal exchange rate */		
Average (pesos per US dollar)	10.9	11.2
Interest rate (28-day Cetes)		
Nominal, average (%)	7.2	6.8
Real, average (%)	3.4	3.9
Current account		
Million dollars	-2,504.0	-19,926.3
% of GDP	-0.3	-2.3
Fiscal balance		
Traditional Balance (% of GDP)	0.3	0.0
PSBR (% of GDP)	0.8	1.6
Other variables:		
US GDP		
Real growth (%)	3.3	2.5
US Industrial production		
Real growth (%)	4.3	3.0
US Inflation		
Dec./dec. (%)	3.4	2.3
Crude Oil (Mexican mix)		
Average price (USD per barrell)	53.2	42.8
Average export platfor (mbd)	1,810	1,648
External Interest Rates		
LIBOR (average, %)	5.2	5.1
Federal Funds Rate (average, %)	5.0	5.0

e/ Estimate.

*/ Since there is a free-floating exchange rate regime, this does not constitute an exchange rate forecast. However, there reference levels were used to estimate some budgetary items.

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The Federation's Revenues Law for 2007

For the 2007 fiscal year, Congress approved total public sector revenues of Ps. 2 trillion 260.4 billion. This amount is Ps. 26.4 billion higher than that proposed by the Executive and 10.7% higher than the one approved for 2006.

Within the increase of revenues with respect the Executive's Initiative, it is worth distinguishing between the changes that Congress made to the tax measures proposed by the Executive, which led to lower revenues than those proposed by Ps. 6.9 billion, and the revisions to several revenue sources that led to an increase in estimated revenues of Ps. 32.9 billion.

Adjustments to the Federation's Revenues Law 2007 (Millions of pesos)	
I. Law Initiative	**2,234,374.7**
II. Approved modifications (1-2)	**26,037.8**
1. Revisions leading to higher revenues	32,901.6
Higher tax revenues	14,087.0
Income tax	3,910.3
VAT	11,837.0
Rest	-1,660.3
Higher oil revenues	7,830.2
Higher non-tax revenues	8,984.4
Higher deferred payments	2,000.0
2. Modifications to the Executive's tax initiatives	6,863.9
Income tax	489.6
Asset tax	1,131.8
Tobacco excise tax	1,269.5
Soft drinks excise tax	3,973.0
III. Approved law (I+II)	**2,260,412.5**

Several changes to the Executive's Initiative led to the reduction in the estimation of revenues by Ps. 6.9 billion:

- The Senate abrogated the excise tax (IEPS) applied to soft drinks. The original proposal, approved by the Chamber of Deputies, was the elimination of exemptions applied to those soft drinks that contain cane sugar as sweetener, a tax rate reduction from 20 to 5 percent to the sale and importation of those products and the incorporation of carbonated drinks into that tax.

- The applicable tax to firms that undertake exclusively primary sector activities was set at 19% instead of the 22% proposed by the Executive. Also, the exemption of 40 times the minimum wage in income tax on individuals who undertake exclusively primary activities was maintained, instead of the reduction of the exemption to 20 times the minimum wage in the Executive's proposal.

- The maximum deduction on car purchases was increased from 150 thousand pesos in the Executive's proposal to 175 thousand pesos in the approved Law.

- The Asset tax (IMPAC) was strengthened by eliminating the deductibility of debt within its base, and reducing its rate from 1.5% in the Executive's proposal to 1.25%.

- A social security fee of approximately Ps. 3 per cigarette package was substituted by a gradual increase of the excise tax rate applied to tobacco products, cigarettes and cigars. The applicable tax rate will be 140% in 2007, 150% in 2008 and 160% in 2009.

It is worth noting that even after these modifications, the fiscal measures approved by Congress for 2007 increase the tax base and improved the tax revenues with respect to what was observed in 2006.

The revisions to budgetary revenues with respect to the Executive's proposal by Ps. 32.9 billion more than compensated the afore mentioned reductions. These revisions are:

- Expected tax revenues increased by Ps. 14.9 billion, specially that from the Income and Asset taxes (Ps. 3.9 billion) and VAT (Ps. 11.8 billion), as additional available data allows for a better estimate of higher tax revenues in 2006, which are the basis of the 2007 projections, in addition to a higher anticipated effort to increase the efficiency of tax collection.

- The forecast of non-tax revenues was increased by Ps. 8.9 billion by considering the minimum guaranteed return payment of PEMEX, higher income on products and non-recurrent revenues derived from asset sales and privatizations.

- Total public sector oil revenues were also increased by Ps. 7.8 billion by considering an average oil price for the Mexican mix of 42.8 dpb and a higher production platform in 20 thousand barrels per day.

- Deferred payments (ADEFAS) for 2008 were increased by Ps. 2 billion. This still implies that the proportion of deferred payments to total income estimated in the Revenues Law will continue with the decreasing trend observed in past years.

Other fiscal measures approved by Congress in 2007 contributed to fiscal simplification, promote voluntary tax payment and the normalization of the fiscal situation of tax payers. The most important are described in what follows:

1. *Fiscal simplification measures:*

- The minimum level of income for which individuals are required to present an annual income tax return is increased from Ps. 300 to 400 thousand, including wages and interest. The modification will start applying with the statement for the fiscal year of 2006 that is presented in 2007.

- The fiscal stimulus to those tax payers that make contributions to investment projects in the national movie industry was better designed. For the application of the stimulus an Inter-institution Committee was created. In addition, these stimuli are applied to those taxpayers who make contributions in 2006 as well. Likewise, the fiscal stimulus to research and technological development was increased by Ps. 500 million.

2. *Measures for strengthening Tax Management capabilities.*

- The possibility of deducting from the income tax base those fiscal losses of societies when stocks are sales is no longer allowed, unless the sale is a consequence of inheritance, donations, corporate restructuring or divisions.
- The Income tax establishes that any revision of documents that establish the origin of fiscal losses will only have effects for the determination of the result of the fiscal year that is under revision.
- Income tax payments for foreign residents are made easier. The trustee will retain the tax for the income that foreign residents obtain through trust funds constituted according to the Mexican laws; asset depositories will make the retention in the case of trust funds that issue stocks and bonds.
- Fiscal stimuli and subsidies to beneficiaries that have the obligation of being subscribed in the Federal Registry of Taxpayers (RFC), or that have reached an agreement to cover past fiscal debts, will be granted to those beneficiaries who are punctual taxpayers.
- The fiscal authority is authorized to correct, only once, any legal vices that could affect the legal validity of a fiscal procedure.
- The requisites of tax consultations are established so any response is mandatory for the authority, as well as the assumptions under which the authority would not be constrained by the response. It is also established that the responses will not me mandatory for individuals and that these can refute the final resolutions in which the authority applies the criteria contained in the responses.

3. *Measures for facilitating voluntary tax compliance.*

- A fiscal stimulus is provided to those taxpayers that are obliged, or who choose, to report their financial statements. If, during 2007, the taxpayer complies in time and form with the provisional income tax returns and all payments are made according to the law, it will have the right to a stimulus equivalent to 0.5% of the result of the exercise or of its taxable return in 2007. The stimulus is reduced in half if the difference between the amounts paid in these returns and the one the taxpayers should have made is not larger than 5% of the result of the exercise of its taxable return in 2007.
- The tax authority is allowed to totally or partially condone, under certain circumstances, the fiscal credits for federal contributions and compensatory quotas, updatings and accessories of both, as well as the fines for non-compliance of obligations different from making

payments. Once the condoning is complete, starting in 2008, the tax authority will provide the credit bureaus with the information of taxpayers with pending and un-guaranteed fiscal liabilities.

- Fiscal credit cancellation in cases of practical impossibility of collecting or the presence of high costs of collection.
- The penalty for omissions in the payment of retained or collected contributions is reduced: 55 to 75% of the omitted payments, instead of the 75 to 100% range.

The measures approved by Congress should lead to higher voluntary payments and the regularization of the fiscal situation of taxpayers; in addition, they will reduce the cost of complying with fiscal requirements contributing in that way to the development of the productive activities of taxpayers.

Additionally, for the fiscal year of 2007, several fiscal stimuli will be continued, especially for those taxpayers in the primary sector and in ground and sea transport. Within other stimuli, there is the credit against the income and VAT taxes of IEPS payments on diesel and of payments for the use of federal highways.

A contribution to the New Cars Tax Compensation Fund is guaranteed to compensate the Federal Entities for the lower collection of this tax due to the exemptions in this contribution. In addition, and only once, a complementary amount will be provided to the corresponding amount for 2006.

The Federation's Expenditures Budget for 2007

The Federation's Expenditure Budget approved by Congress for the 2007 fiscal year amounts to Ps. 2 trillion 260 billion, an amount Ps. 26.4 billion higher than the Executive's proposal and 10.7% higher in real terms than that approved for 2006. The resources destined to the Federal States will be Ps. 11.8 billion higher with respect to the Executive's Project and Ps. 35.5 billion with respect to the program approved in 2006. There stand out a 14.1% increase in real terms of programmable expenditure, a 5.4% increase in federalized spending and of 7.7% in shared revenues.

The Chamber of Deputies made spending increases and reallocations by Ps.82.8 billion as a result of higher revenues of Ps. 26.4 billion and of reductions in expenditures in some spending branches with respect to the Executive's budget of Ps. 56.8 billion.

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Approved Reductions and Expansions for 2007 (Millon pesos)			
	Reductions	Expansions	Net Change
Total	***56,823.3***	***82,861.1***	***26,037.8***
1. Autonomous Branches	***6000.0***	***0.0***	***-6000.0***
Legislative	898.7	0.0	-898.7
Judicial	4191.4	0.0	-4191.4
Federal Electoral Institute	720.2	0.0	-720.2
Human Rights Commission	189.7	0.0	-189.7
2. Administrative Branches	***10123.7***	***61591.9***	***51468.2***
Presidency	0.0	0.0	0.0
Interior	83.3	0.0	-83.3
Foreign Affairs	63.6	0.0	-63.6
Finance and Public Credit	401.5	4581.6	4180.1
Defense	100.0	0.0	-100.0
Agriculture	152.2	10673.4	10521.2
Transport and Communications	395.5	12000.0	11604.5
Economy	83.5	1467.6	1384.1
Public Education	3650.0	13207.3	9557.3
Health	1876.7	3000.0	1123.3
Navy	150.0	0.0	-150.0
Labor	50.0	0.0	-50.0
Agrarian Reform	7.5	745.0	737.5
Environment	130.8	6775.0	6644.2
General Attorney	0.0	0.0	0.0
Energy	0.0	67.0	67.0
Social Development	1467.6	8750.0	7282.4
Tourism	0.0	75.0	75.0
Public Functions	0.0	0.0	0.0
Agrarian Courts	0.0	200.0	200.0
Fiscal and Administrative Federal Court.	0.0	50.0	50.0
Public Safety	1500.0	0.0	-1500.0
Judicial Council	11.5	0.0	-11.5
CONACYT	0.0	0.0	0.0
3. General Branches	***35225.6***	***21269.2***	***-13956.4***
Contributions to Social Security	0.0	0.0	0.0
Wage and Salaries	26581.7	9228.8	-17352.9
Adult Education	643.9	4167.7	3523.8
Federal Contributions to Status and Municipalities	0.0	3021.3	3021.3
Public Debt	4000.0	0.0	-4000.0
Shared Revenue to States and Municipalities	0.0	4851.4	4851.4

ADEFAS	4000.0	0.0	-4000.0
Debt and Savers Supporting Programs	0.0	0.0	0.0
4. Public Entities Under Direct Budgetary Control	***5474.0***	***0.0***	***-5474.0***
ISSSTE	0.0	0.0	0.0
IMSS	0.0	0.0	0.0
CFE	1750.0	0.0	-1750.0
LFC	200.0	0.0	-200.0
PEMEX	3524.0	0.0	-3524.0

Within the expenditure reductions, a reduction of Ps. 26.6 billion in economic and wage provisions stands out, which includes the change approved by the Senate which reallocates Ps. 20 billion that were anticipated to be deposited in the Oil Revenues Stabilization Fund. Other adjustments include a reduction by Ps. 6 billion in the resources destined to autonomous branches, Ps. 5.5 billion in the resources allocated to the Public Entities under Direct Budgetary Control, Ps. 4 billion due to lower financial costs and Ps. 4 billion due to lower deferred payments (ADEFAS).

Within the increases and reassignments of expenditures by Ps. 82.9 billion, the following stand out: Ps. 15.5 billion destined to programs in the Agricultural sector and Ps.15 billion to primary, secondary and upper education. In terms of infrastructure, an increase of Ps. 12 billion is allocated to highway infrastructure, Ps. 5 billion to the National Water Commission and Ps. 3 billion to hospitals.

The net adjustments in expenditure approved by Congress (gross increases minus reductions), imply that the administrative branches that were more highly favored are the following: Transport and Communications with Ps. 11.6 billion, Agriculture with Ps. 10.5 billion, Public Education with Ps. 9.6 billion, Social Development with Ps. 7.3 billion and Environment and Natural Resources with Ps. 6.6 billion.

Federalized Resources

The federal resources destined to the Federal Entities approved for 2007, composed by contributions and shared revenues, are Ps. 696.5 billion, which is an increase of 5.4% in real terms with respect to the amount approved in 2006. Within, there is an increase of 7.7% real terms of shared revenues. It is worth noting that an approved modification to the Fiscal Coordination Law transforms the PAFEF into a Fund of Contributions that will be equal to 1.4% of the Federal Shared Revenue Collection. This provides certainty to the Federal Entities about resource availability. In addition, this reform will allow municipalities and Federal Entities to securitize part of the Fund of Contributions for Social Infrastructure (FAIS) and the new Fund of Contributions for the Strengthening of Federal Entities (FAFEF). To guarantee fiscal prudence, this financing mechanism can only be operated up to the 25% of the resources that Federal Entities and municipalities would be receiving through the FAIS and the FAFEF.

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Federalized Expenditure, 2006-2007 (Millions of pesos of 2007)				
	Approved 2006	Approved 2007	Change	
			Absolute	%
Total	**660,993.8**	**696,501.8**	**35,508.0**	**5.4**
Shared Revenue	301,100.0	324,281.1	23,181.1	7.7
Contributions (33 and 25 Bran.)	359,893.8	372,220.7	12,326.9	3.4
FAEB	218,172.9	229,078.4	10,905.5	5.0
FASSA	40,344.8	41,572.9	1,228.1	3.0
FAIS	29,482.0	31,887.6	2,405.6	8.2
FORTAMUN	30,216.7	32,682.2	2,465.5	8.2
FAM	9,599.3	10,382.6	783.3	8.2
FAETA	3,615.6	3,760.0	144.4	4.0
FASP	5,175.0	5,000.0	-175.0	-3.4
FAFEF	23,287.5	17,857.0	-5,430.5	-23.3

Adjustments mechanisms in case revenues are different from the expected value

In relation to the adjustment mechanisms when revenues are different from those anticipated in the Revenues Law (LIF), in 2007 excess revenues will be allocated according to what is established in the Federal Budget and Fiscal Responsibility Law, the Federal Duties Law, and the LIF according to the following:

- Excess revenues that have a specific destination specified by fiscal laws will be allocated to increases in the budgets of the entities that generate them.
- The entities' own excess revenues will be allocated to their budgets.
- The rest of excess revenue will be used, in the first place, to cover higher spending due to natural disasters (when the Natural Disaster Fund is insufficient), higher non-programmable expenditures and higher spending on fuel for energy generation. The remaining resources will be allocating according to the following rule: 40% to the Oil Revenue Stabilization Fund, 25% to the Federal States Revenues Stabilization Fund, 25% to the Fund for Stabilizing Infrastructure Investment spending in PEMEX and 10% to Federal States investment spending.
- The Federal Budget and Fiscal Responsibility Law states that excess revenue will be allocated to the stabilization Funds until they reach the optimal reserve. Then, additional excess revenues will be allocated according to the following: 25% to investment programs and projects of the Federation, 25% to investment programs and projects of the Federal States, 25% to investment projects in PEMEX and 25% to the Pension Restructuring Support Fund.

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- During the 2007 fiscal year, the collection of the Duty on Hydrocarbons for the Oil Revenue Stabilization Fund can also be used in case of a sudden fall in the price of oil or in the oil production platform.
- The Extraordinary Duty on Crude Oil Exports will be destined to the Federal States for investment programs when the price of oil is observed in the range given by reference price and 50 USD per barrel. When the observed oil price is higher than 50 USD, the additional resources will be allocated to the Federal States Revenues Stabilization Fund (FEIEF).

Conclusions

The economic package approved for 2007 by all the parliamentary fractions stands out by the approval of tax policies that are oriented to increase the availability and sustainability of the fiscal revenues, which in turn will allow for a higher allocation of resources to social spending and infrastructure investment.

The agreement in objectives and the observed consensus constitutes a favorable starting point for a future fiscal reform that contributes to consolidating a competitive economy, more active poverty reduction and a growing dynamism in job creation. All this while respecting the budgetary responsibility criteria that will allow Mexico to attain a higher level of development in a sustainable way.