

# Repercussions of the Informal Economy in the Collection of Taxes in Mexico

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## ABSTRACT

*The purpose of this paper is to identify the main repercussions that the informal economy generates in the collection of taxes and that directly influences the financing to face the public expenditure, and thus to provide all the public services that the society demands and that must to offer the Mexican government every year.*

**Keywords:** formal and informal economy, taxes, social spending, gross domestic product.

## 1. INTRODUCTION

Nowadays, informal employment is expanding to very alarming levels, which is defined as production units or services that do not have their own identity or legal status and, besides not being an unprotected employment, there is no causal and automatic relationship between unemployment and the growth of the informal economy. The open unemployment rate is a symptom, but not the cause of the deficit of opportunities for the population to obtain employment, so the difference in the statement that it is the cause of new informal employment, for this reason, by not paying taxes, public services or rents, the informal economy is the cause of the low tax collection for the government that has a direct impact on the financing to meet its main obligations such as providing basic services, health, education, security and infrastructure, etc.

## 2. DATA ANALYSIS

According to the International Labor Organization [1], informal economy is all economic operations carried out by workers and economic units that are not totally or partially regulated by formal agreements.

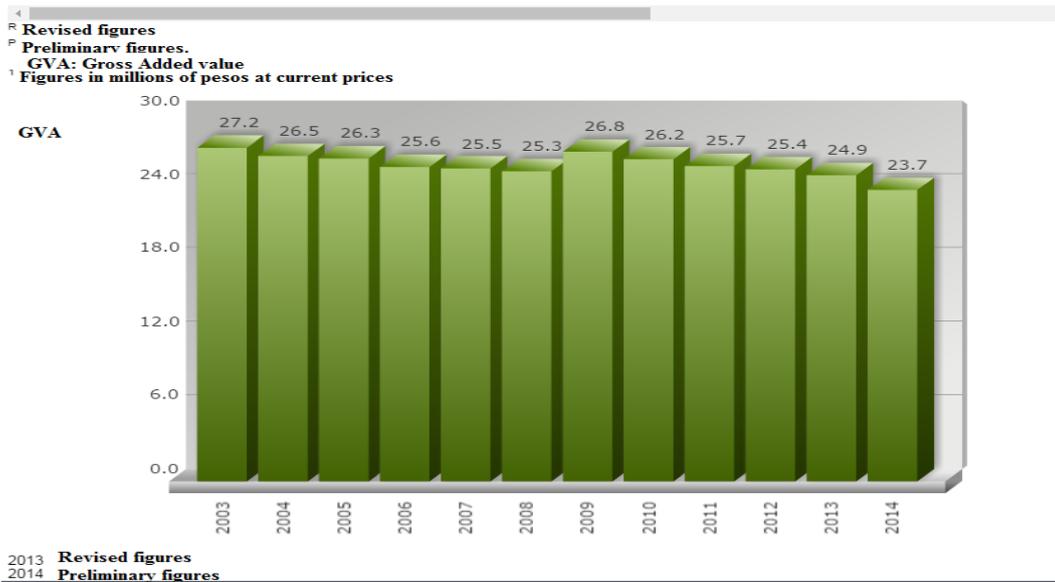
Informality limits economic growth which makes it impossible to have a more egalitarian society; Gross Domestic Product (GDP is the monetary value of final goods and services produced by an economy in a given period) is affected by informal employment every year between 3 and 4 points, which affects one of the lowest levels of tax collection (taxes are the contributions established by law that must be paid by natural persons and morals that are in the legal situation or in fact foreseen by the same and which are other than those indicated in fractions II, III and IV of the Federation Fiscal Code for Mexico according to the Organization for Economic Cooperation and Development [2], only 30% of what could be collected is collected. Informality makes projects of modernization non-viable and competitiveness on a global scale of the country.

Measurement of the informal economy (2014 preliminary, basic year 2008)

- The objective of these results is the measurement of Gross Value Added of Informal Economy to know both its behavior and its contribution to the country's GDP, according to the System of National Accounts of Mexico 2008 (SCNM 2008).

- For the year 2014 the informal economy measurement indicated that 23.7% of GDP is produced in informal economic units and is generated by 57.8% of the employed population that works in informal conditions, while 76.3% of GDP is produced in the formal sector with 42.2% of the formal employed population, in other words, for every 5 American dollars generated in the country's GDP, 3.8 American dollars generate 42% of formal employees, while 1.2 American dollars generate 57.8% in conditions of informality. Of this 23.7% of the total informal economy in 2014, 11.0% is for informal sector, i.e. unregistered businesses of households engaged in the production of goods or services, and 12.7% is for other modalities of Informality, which refer to all work that even while working for economic units other than those of unregistered micro businesses that do not have the protection of the legal and institutional framework as: do not have social security, social benefits and do not pay taxes [3], [7], [8], [9].

Participation of the informal economy in GDP							
Series: 2003-2014							
YEAR	2003	2004	2005	2006	2007	2008	2009
GVA Total economy <sup>1</sup>	7,302,821	8,299,895	9,028,899	10,120,003	10,962,144	11,941,199	11,568,456
GVA Informal economy <sup>2</sup>	1,984,233	2,199,161	2,373,403	2,590,500	2,793,589	3,017,060	3,105,229
contribution (%)	27.2	26.5	26.3	25.6	25.5	25.3	26.8



**Fig.1** Participation of the informal economy in GDP

- The results shown in figure.1 that over the period 2003-2014, informal economy contributes an average of 25.8% per year to the country's GDP, from 2010 to 2014 its contribution tends to decrease, to 23.7% in 2014.
- The average annualized GDP growth rate at 2008 prices for the 2003-2014 serie was 2.6%, while informal economy for the same period showed an average growth of 1.7%, a lower evolution than evinced the total of the economy [3].

**Participation of the informal economy by component in GDP Series 2003-2014**

Año	Informal Economy	Informal Sector	Other Forms of Informality
2003	27.2	11.8	15.4
2004	26.5	11.3	15.2
2005	26.3	11.3	15.0
2006	25.6	10.7	14.9
2007	25.5	10.4	15.1

2008	25.3	9.5	15.8
2009	26.8	12.3	14.5
2010	26.2	11.7	14.6
2011	25.7	11.7	14.0
2012	25.4	11.2	14.2
2013 <sup>R</sup>	24.9	11.3	13.6
2014 <sup>P</sup>	23.7	11.0	12.7

<sup>R</sup> Revised figures

<sup>P</sup> Preliminary figures

**Fig.2** Participation of the informal economy

Figure.2 shows the behavior of the participation of the informal economy in GDP from 2003 to 2014 (preliminary data), averaging a share of 23.65% in GDP, which could be said that almost a quarter part of the total is generated by the informal economy.

According to the TAS [4] (Tax Administration System: it is a decentralized agency of the Secretariat of Finance and Public Credit Organ, which is responsible for applying the tax and customs legislation, in order that individuals and corporations contribute proportionately and equitably public spending), in March 2014 there were 41.1 million individuals registered as active taxpayers, the rest being composed of legal entities. If we take into account that the OEP (**Occupational Economic Population**: refers to all persons of working age, or occupation during the reference period or did not have one, but were looking for employment with specific actions) occupied until March of the same year, was 49.3 million people, this shows that the percentage of that population that is not registered in the TAS is of 57.8%, that correspond to 28.5 million people employed in informal employment [5].

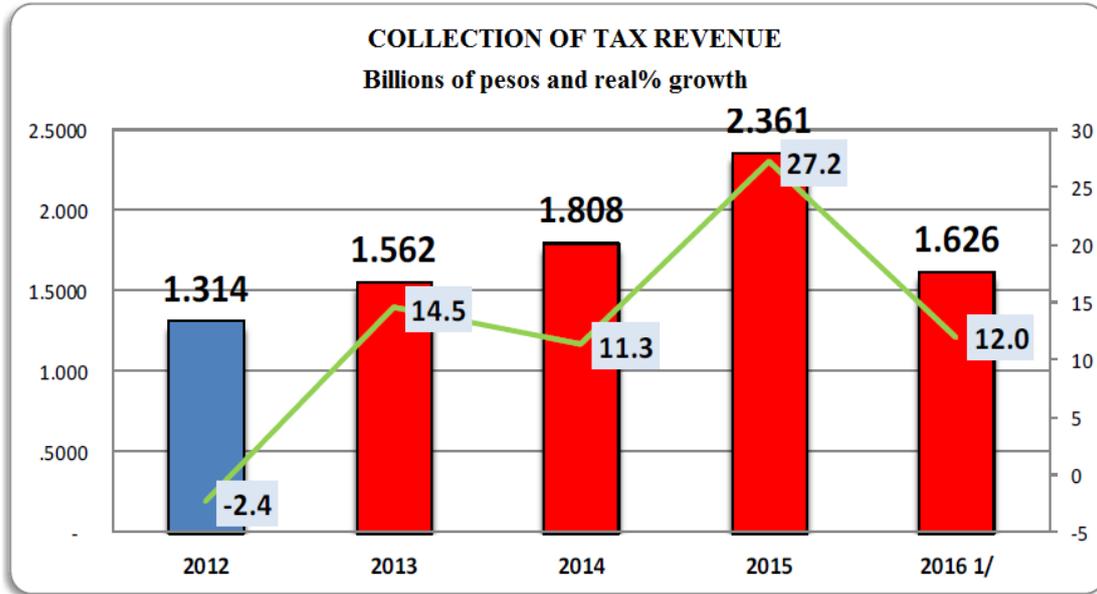
Figure.3 shows figures from Latin American economies [6], where Mexico is in the last places in tax collection, with respect to GDP. As will be seen later, the issue is not that few taxes are paid: many taxpayers register a high tax burden and similar to that of other countries. The problem here is that a proportion of the population does not pay taxes, or pay symbolic amounts.

**Revenue Statistics - Latin American Countries : Comparative tables**

Government		Total													
Tax		Total tax revenue													
Variable		Tax revenue as percentage of GDP													
Year	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Country	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼	▲ ▼
Chile	18.8	19.0	19.0	18.7	19.1	20.7	22.0	22.8	21.4	17.2	19.5	21.2	21.5	20.0	19.8
Mexico	16.5	16.8	16.2	17.1	16.8	17.7	17.9	17.6	20.7	17.2	18.5	19.5	19.5	19.7	19.5
Argentina	18.0	17.5	16.7	19.6	22.0	22.1	22.2	23.0	24.7	25.6	26.7	27.6	29.2	30.6	32.2
Bahamas	15.2	14.9	12.8	13.5	13.5	13.8	15.6	16.3	17.2	16.5	16.1	18.9	18.0	17.1	17.5
Barbados	30.2	31.2	29.6	31.2	31.2	29.5	30.5	30.2	31.1	30.5	30.6	32.4	33.1	29.5	30.4
Bolivia	16.4	15.3	15.6	14.9	16.1	21.6	24.0	24.4	25.3	25.9	23.3	26.2	27.6	28.9	28.7
Brazil	29.5	30.6	31.4	30.9	31.8	32.7	32.5	33.1	33.8	32.4	33.3	33.3	33.3	33.6	33.4
Colombia	14.6	16.3	16.2	16.7	17.5	18.1	19.1	19.1	18.8	18.6	18.0	18.9	19.7	20.0	20.3
Costa Rica	18.2	19.3	19.8	19.8	19.6	20.1	20.6	22.0	22.7	21.2	20.8	21.3	21.3	22.6	22.5
Dominican Republic	11.7	12.9	13.0	11.3	11.9	13.8	14.0	15.0	14.3	12.7	12.3	12.3	13.1	13.9	14.1
Ecuador	10.1	11.5	12.3	11.4	11.4	11.7	12.4	12.8	14.0	14.9	16.3	17.3	19.3	19.2	19.0
El Salvador	12.1	12.1	12.9	13.1	13.0	13.9	15.1	15.2	15.1	14.4	15.1	15.4	16.1	17.0	16.5
Guatemala	12.4	12.7	13.7	13.5	13.4	13.1	13.8	13.9	12.9	12.2	12.4	12.7	12.8	13.0	12.6
Honduras	15.3	15.4	15.6	16.2	17.0	16.9	17.6	19.0	18.9	17.1	17.3	16.9	17.8	18.3	19.8
Jamaica	22.8	21.6	22.1	25.0	24.7	23.3	24.1	24.9	25.0	24.8	25.0	24.5	24.6	25.0	24.2
Nicaragua	13.0	12.6	13.3	14.7	15.3	16.1	17.1	17.3	16.8	16.9	18.0	18.8	19.5	19.9	20.3
Panama	17.4	16.3	15.8	15.7	15.4	15.2	16.8	17.4	17.4	18.0	18.9	18.6	19.4	19.4	18.1
Paraguay	14.5	14.2	13.4	11.6	13.1	13.8	14.2	13.9	14.6	16.1	16.5	16.8	17.7	16.4	17.1
Peru	14.6	15.2	14.7	15.5	15.7	16.5	17.9	18.5	19.0	16.9	17.8	18.5	18.8	18.4	18.8
Trinidad and Tobago	21.4	23.5	21.9	22.2	22.9	26.7	30.4	26.4	29.5	28.4	27.5	26.7	27.4	27.4	28.3

**Fig. 3** Total tax revenue as a percentage of GDP

Figure.4 shows how the tax collection has behaved, showing an average growth of 2012 to 2015 of 1.5%, this without taking into account the percentage of the informal economy that does not enter the government coffers and which are necessary for the financing of public services that society demands.



Source: own elaboration with information of the Secretary of Finance and Public Credit.

1 / The collection corresponds to the first half of 2016 and the growth rate is compared with the same half of 2015

Fig. 4 collection of tax revenue

Note: one billion mexican pesos = \$ 49,141, 836, 397 u.s. dollars (exchange rate february 2017).

Figure.5 presents the percentage of informal workers of the non-agricultural employed population in 2014, the value of India corresponds to 2012. As can be seen the country is at an intermediate level in terms of the occupation of informal workers, being above the main economies of Latin America, as Brazil is, which shows that measures have to be taken so that the government attract that population and is fully recognized by Mexican law.

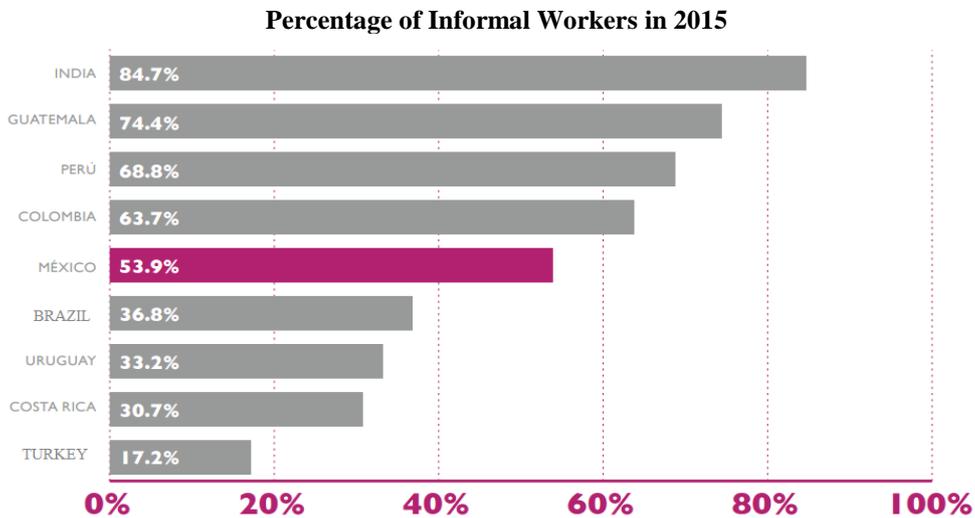


Fig. 5 Percentage of informal workers

Source: International Labor Organization

### 3. RESULTS

Gross Domestic Product (GDP) at market prices was placed in 17,810.957 million pesos current in the fourth quarter of 2014, an increase of 6.2% in relation to the same period of 2013, while for the fourth quarter of the year 2015 presented an increase of 2.55% per year, was placed in 22,299,318 million pesos current according to seasonally adjusted figures.

For the third quarter of 2016 preliminary figures show that the EAP is 54,226,803, the employed population is 52,043,100 people, the unemployed population is 2,183,703 people and the non-economically active population is 35,859,606 (available 5,520,173 and unavailable 30,339,433).

A study by Bank of México [10] that models informality under the characteristics of the "parasite vision" found that if legal entities could impose full compliance with taxes and regulations, labor productivity and production would be 19% larger, allowing informal firms to have access to microfinance so that when they have grown up enough to become formal [12].

The excess of taxes makes it expensive to comply, according to the TAS, "the individual taxpayer in Mexico spends an average of 12,626 pesos pay in order to comply with their tax obligations, while a company costs 55,455 pesos to carry out its task as a taxpayer."

In Mexico, the informal economy produces about 3.559 billion pesos per year, representing 24.8% of GDP [8].

### 4. CONCLUSIONS

According to the analysis of this information, it can be said that one of the main factors that propitiate the informal economy are: the excess of regulations and the high fiscal charges in the country, taxes that are more weight than others, which conditions the degree of fiscal evasion and, therefore, informality.

Where micro, small and medium enterprises want to have profits and survive in the market, opting to evade taxes falling into illegality and informality, where the activities to be developed offer only what is necessary to survive, where the payment of taxes is impossible, being that legality and formality are a privilege, because their limited income leaves them no other option than tax evasion and informality.

The inappropriate policy of tax collection, excessive regulations and procedures have made the informal economy is an alternative of subsistence.

Mexico should improve the effectiveness of tax administration and generate incentives to reduce the informal economy coupled with the inability of legal bodies to enforce legal obligations (taxes and regulations) and the cost of being formal (evading legal obligations allows them to increase their profits)

The inefficiency of informal enterprises do not produce enough to be able to pay taxes and regulations, occupy few productive workers and receive low wages, therefore, will not become formal, as they offer products at prices and quality that do not would allow them to compete with the formal ones because they occupy workers with higher productivity and offer higher wages. As a result, the most unproductive companies choose informality and remain small to not be detected [11], [12].

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While tax burdens in Mexico are similar to those prevailing in the international economy, tax evasion and tax avoidance as well as multiple tax exemptions drastically reduce the amount of taxation as a percentage of GDP: "If you add up what is evaded by (Value Added Tax) and by ISR (Income Tax), an amount equivalent to 23.7% of GDP is added. This significant amount would imply that all social spending (is understood as the delivery destined to the set of policies and public programs oriented mainly to people with lower income, regions with less resources and unprotected social segments.

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