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The recently strong oil market has been one of the overriding factors during congressional deliberations on the 2005 budget. The Chamber of Deputies and the Senate have both presented budget plans that incorporate an increase in Mexico's projected oil-export price in 2005, but the two chambers disagreed on the price that should be used to project government revenues. The revenues portion of the budget (Ley de Ingresos) must be completed before Congress can determine expenditures (Ley de Egresos).

By law, both the revenues and expenditures portions must be approved by Nov. 15. Congress approved constitutional changes to move up the deadline by a full month this year as part of an effort to ensure that the budget-approval process does not extend until the end of December, as was the case in most recent years (see SourceMex, 2004-04-28).

In late October, the Chamber of Deputies approved next year's revenues at 1.824 trillion pesos (US $159.8 billion), based on an average oil-export price of US$27 per barrel. The lower house then sent the measure to the Senate for review. The proposal first moved to the Senate finance committee (Comision de Hacienda), which took a more conservative approach than the lower house. In a vote in early November, the committee set the oil price at US$23 per barrel, reducing the revenues estimate by about 80 billion pesos (US$7 billion). The committee's proposal, which has gained support in the full Senate, is in line with the budget President Vicente Fox sent to Congress in early September, which puts revenues at 1.713 trillion pesos (US$150 billion), based on a projected oil-export price of US$23 per barrel.

The Senate proposal differs slightly from the one presented by the administration because it recommends strict controls on how the government can spend windfall oil-export revenues. These include a requirement that a portion of the extra revenue be spent on health and education and on a special funding program for state and municipal governments.

The versions of the budget in the Chamber of Deputies and the Senate also differed on the amount of debt that the government would be allowed to incur during the year. A wider deficit allows the government greater latitude in spending decisions. The lower house set a fiscal deficit target of 0.3% of GDP, while the Senate opted to reduce the target to 0.2% of GDP. The budget presented by the administration set the fiscal deficit at 0.1%.

Legislators want accountability for windfall earnings

Deputies from the opposition Partido Revolucionario Institucional (PRI), the Partido de la Revolucion Democratica (PRD), and three smaller parties said they were pushing for the higher oil price to force the Fox administration to become more transparent in the manner in which it spends

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windfall oil-export revenues, as was the case this year. Furthermore, said the opposition legislators, the larger budget that would result from an estimated price of US$27 per barrel would guarantee larger allocations for agriculture, education, and social programs.

The PRI, PRD, and their allies from the Partido del Trabajo (PT), Partido Convergencia por la Democracia (PCD), and the Partido Verde Ecologista Mexicano (PVEM) in the lower house have pledged to restore the US$27 price once the Senate sends back its budget version, which will be used in drafting the expenditures portion of the budget. The Ley de Egresos, however, must still be ratified by the Senate, which could presumably bring oil-price levels back to US$23 per barrel. "If this happens, we may find it necessary to call a special budget session after Dec. 15," said PRD Deputy Alfonso Ramirez Cuellar, who oversees economic issues for his party in the lower house. The debate over oil-price levels has created some division among PRI legislators, with many senators backing the lower oil-price level. Party leaders are confident, however, that the PRI will find common ground on the issue.

One compromise proposal would have the PRI support a price of US$25 per barrel, said PRI Deputy Francisco Suarez Davila, who is secretary of the budget committee in the lower house (Comision de Presupuesto). Legislators from the governing Partido Accion Nacional (PAN) in both houses of Congress cited concerns about the volatility of the oil market as a reason for opposing the projection of US$27 per barrel. PAN Sen. Fauzi Hamdan, who chairs the budget committee in the upper house, said such a price could create "unrealistic expectations" about the level of the federal government's finances. "If we are not careful to set the oil-export price at a reasonable level, we run the risk of having to increase debt or cut expenditures to comply with our budget obligations," said Finance Secretary Francisco Gil Diaz.

Still, the 2005 revenue projections by both houses of Congress and the Fox administration all represent a significant increase from the revenues of 1.653 trillion pesos (US$144.8 billion) that Congress approved in the 2004 budget. That estimate, however, was based on a projected average oil price of US$20 (see SourceMex, 2004-01-07). The estimate for oil-export prices has climbed steadily in recent years. Congress approved revenues based on an average oil price of US$15.50 per barrel in 2002 and US$18.35 in 2003 (see SourceMex, 2002-01-09 and 2002-12-18).

Debate driven by strong global oil market

The Congress and the administration say their decision to use a higher projection for oil-export prices in 2005 is justified by forecasts that the global oil market will remain strong next year. Global and Mexican oil prices have been increasing steadily since the middle of 2002 but have been especially strong in 2004. In September of this year, the average price of Mexican crude oil surged to US$40.63 per barrel, in line with prices above US$50 on the global oil market. This year's oil-export prices have been the highest since 1990. In contrast, the average price of Mexican crude oil was just US$25.48 per barrel at the beginning of the year.

The high oil prices have provided a nice windfall for the state-run oil company PEMEX, which earned US$15.2 billion from crude-oil exports in January-September. If global oil prices remain as high as they have been in August and September, some analysts project PEMEX oil-export revenues for the entire year could be as much as US$7 billion above those attained in 2003. Still,

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private economists sounded a warning about the Mexican government's continued reliance on oil-export revenues to fund the treasury, which has prevented legislators from enacting meaningful tax reforms.

Sensing strong opposition from Congress for serious reform, Fox included only minor tax reforms in the plan he sent to the Chamber of Deputies. One of these reforms, which came from the national tax convention (Convencion Nacional Hacendaria, CNH) earlier this year, would have reduced the general value-added tax (impuesto al valor agregado, IVA) to 12% but also would subject previously exempt food and medicines to this tax. The CNH, however, produced no major proposals to boost tax revenues (see SourceMex, 2004-08-25).

The Fox-CNH plan was troublesome for some legislators because the reduction of four percentage points in the IVA would lower tax revenues by about 50 billion pesos (US$4.38 billion). Tax revenues would not increase significantly even if the politically unpopular measure to impose an IVA on food and medicines were approved.

The Fox budget plan also proposed an increase in the special tax (impuesto especial sobre produccion y servicios, IEPS) on gasoline and alcoholic beverages, but the lower house also turned this down. The budget plan approved by the lower house had very little in the way of tax reform. The only provision approved was a measure that empowered states to impose special taxes on honorariums and special events. The failure of the administration and Congress to advance meaningful tax reforms drew criticisms from private economists. "The absence of tax reform in the Ley de Ingresos implies that public finances will continue to depend heavily on oil-export earnings," analysts from Scotiabank Inverlat said in a report published in early November.

Similar statements came from the Centro de Estudios Economicos del Sector Privado (CEESP), which noted that Mexico's public finances and current account have benefited from an increase in the export price of oil. Cuauhtemoc Gonzalez, CEESP's director of economic research said the lack of tax revenues has prevented the government from devoting sufficient resources to the kinds of projects and programs that would help improve the standard of living for Mexicans.

"We are not doing enough to increase income," said Gonzalez. "There has been no significant tax reform." Rodrigo Rato, director of the International Monetary Fund (IMF), said a change in the country's tax structure would not only increase government revenues but also provide growth opportunities. "In comparison with other countries, Mexico has an extraordinarily small tax base," Rato said during a visit to Mexico City in early November.

Other analysts said the high price of oil could prove a double-edged sword for Mexico because of its negative impact on the US economy, which is the most important destination for Mexico's exports of manufactured goods. "The high price of oil could influence consumption patterns in the US, which would have a negative impact on Mexican exports," said Manuel Sanchez, director of economic studies at BBVA Bancomer. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Nov. 10, reported at 11.41 pesos per US$1.00] (Sources: Reuters, 09/30/04; Dow Jones newswires, 10/15/04; Agencia de noticias Proceso, 09/07/04, 10/19/04, 11/08/04; Associated Press, 10/15/04, 10/29/04, 11/08/04; La Cronica de Hoy, 07/29/04, 08/23/04, 09/08/04, 09/09/04, 10/04/04,

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