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Prospect of Weak Global Oil Prices to Shape Discussions on 2016 Budget

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Prospect of Weak Global Oil Prices to Shape Discussions on 2016 Budget

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Even with a recovery in global oil prices, an uncertain and volatile market could have an impact on the 2016 budget proposal that President Enrique Peña Nieto's administration will send to Congress in the next few weeks. Analysts say the recent increases in global oil prices are partly the result of projections that US production has peaked and worldwide demand has increased. The rise in US output was one of the reasons prices declined at the end of last year and into this year. The other reason was the decision by Saudi Arabia and other members of the Organization of Petroleum Exporting Countries (OPEC) to boost production, and it appears that those countries intend to maintain production at the recent high levels.

Officials at the Secretaría de Hacienda y Crédito Público (SHCP), which will prepare the revenues and expenditures budgets that the administration will send to Congress, are taking into account the volatile oil market. They worry that further adjustments might be necessary to the preliminary projection that the SHCP has developed. "We would need another small adjustment, as the market is weaker than we anticipated," deputy finance secretary Luis Madrazo said in an interview with Reuters.

Economists and market analysts say the 2016 expenditures budget could be the most difficult to put together because of market conditions. "The decline in the international price of oil will continue in 2016 because of the expected participation of Iran in the market," said the daily business newspaper El Financiero. Other factors that will have a deep impact on the budget are the increase in interest rates in the US, the depreciation of the Mexican peso versus the US dollar—which implies increased costs for debt payment—and the decision of the Peña Nieto administration to apply the zero-base concept to the budget, which requires that all expenses be justified for each new period that is covered.

To complicate matters, the budget decisions will be in the hands of a Chamber of Deputies that will begin the first of its three years in office, which means that many of the members are not experienced with the budget process.

The weak oil market was already a major concern when Congress considered the 2015 budget (SourceMex, Nov. 19, 2014), and reduced oil-export revenues forced the administration to implement some budget cuts at the beginning of the year (SourceMex, Feb. 4, 2015).

The weak oil prices are reflected in the bottom line for the state-run oil company PEMEX, which reported net losses of almost 101 billion pesos (US$6.2 billion) in the first quarter of the year, about 180% higher than the losses reported in January-March 2014. PEMEX said the negative numbers were the direct result of a nearly 52% decline in the average price of its crude export basket, which went from US$$92.41 per barrel in the first quarter of 2014 to US$44.84 per barrel in January-March of this year.

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The weakness of the global oil market was reflected in the recent poor economic performance of some of the states in Mexico that rely heavily on the energy sector, including Campeche, Tabasco, Veracruz, Tamaulipas, and Chiapas, according to a report released recently by Grupo Financiero Banamex (GFB). The GDP in those states has fallen below the median national growth rate. In some instances, states like Campeche are projected to record a negative GDP this year.

The strong performance of other states like Aguascalientes, Querétaro, Jalisco, the Federal District, and México helped Mexico's GDP end 2014 on the plus side. "Our country is a mosaic of different activities and productive areas," said Guillermina Gutiérrez, director of economic research at GFB. "We cannot speak of a single country but of the sum of divergent levels of growth across the length and width of our land."

Economic growth to remain anemic

Mexico's overall economy grew by 2.1% in 2014, and the projections are for GDP growth to remain relatively low this year. The most recent forecast of the central bank (Banco de México, Banxico) is for Mexico's GDP to grow between 1.7% and 2.5% in 2015. However, this is lower than earlier projections that put growth as high as 4.2%.

The projection for July is for a GDP growth of less than 1%, buoyed by a 2% increase in the automotive sector, which counterbalanced declines in the oil and mining sectors and a weak domestic retail market, said the GFB report.

The SHCP believes that Mexico has made significant progress in reducing reliance on oil to boost government revenues, which could bode well for the budget process in future years. Finance Secretary Luis Videgaray said that oil-related revenues accounted for just 16% of the total federal budget revenues in the first quarter of the year, compared with 30% in January-March 2014.

"The combination of a tax reform that significantly increased non-petroleum revenues and the reduction in oil revenues mean that in a short period of time we have an effective 'depetrolization' of [Mexico's] public finances," Videgaray said in an interview on Radio Fórmula.

Still, many analysts believe the fundamental weakness in the oil market is here to stay at least for the next few years, and oil prices will continue to have a deep impact on Mexico. The prospect of oversupply remains a driving force. In addition to the steady OPEC production, recent political developments involving Iran and Libya could see those countries return as suppliers of crude oil. "US production could also be on the rise again," said a recent analysis from the financial services company Morgan Stanley, which said a recovery in the global oil market is less certain than previously thought. "The slump could last for three years or more."

Despite the weak performance of PEMEX, the government's revenues increased by more than 9% in January-March, in part because of the concession of a new television network (SourceMex, April 15, 2015).

Administration proposes zero-base budget

In the face of the budget uncertainties, the federal government is trying a new approach in developing its proposals for the spending and revenues plans for 2015—the zero-base budget. Zero base requires that all expenses be justified and that every function within an organization be

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analyzed for its needs and costs. Budgets are then built around what is needed for the upcoming period, regardless of whether the budget is higher or lower than the previous one.

Videgaray said the concept is targeted primarily at government entities and is not meant to have a direct impact on citizens and on businesses.

Jorge Suárez-Vélez, a columnist for the daily newspaper El Financiero, says the logic of a zero-base budget is the requirement that every entity that wants to spend money justify that expenditure. There is also the requirement that each expenditure be prioritized according to need. "One can say that spending is like a fingernail, which requires constant clipping," said Suárez-Vélez. "This is most evident in public expenditures, where the incentive to spend is infinite and the benefits of savings are not an immediate priority."

"The size of our government is excessive and its cost grotesque, especially when we have such high poverty. The existing structures are seeking to make themselves indispensable," added Suárez-Vélez. "A zero-base budget is a useful to tool that would allow us to question every expenditure, the need for every office, every employee, every program, and every ministry."

Suárez-Vélez wondered, however, if the Peña Nieto government is serious about the plan or is just giving the concept lip service, particularly given its track record of promoting big projects like the Mexico City-Querétaro high-speed rail, a large aqueduct in Monterrey, and the expansion of the Mexico City airport (SourceMex, Nov. 12, 2014, and Aug. 12, 2015). "One would get the impression that this administration is seeking the highly visible projects rather than more strategic investments," said the El Financiero columnist.

Other analysts believe the budget should promote true fiscal reform rather than place the emphasis on restricting expenditures. Even the recent tax reforms that Congress approved in 2013 are seen as insufficient to provide the government with the revenues it needs to invest in the economy.

"The truth is that the majority of Mexicans do not pay taxes because many work in the informal economy, and this means that, unlike most of the world, we have never financed government spending with taxes," columnist Luis Enrique Mercado wrote in the daily newspaper Excélsior. "There have been times when we have financed our government with debt, and then with oil revenues. Now that we are not producing enough oil, we are reverting to the debt option."

Mercado recommended several actions to boost government finances, including implementing politically unpopular measures like a value-added tax (impuesto al valor agregado, IVA) on all consumer goods, an increase in the IVA to 20%, and the elimination of exemptions and loopholes in the income tax (Impuesto sobre la Renta, ISR).

Other observers see the zero-base budget as dangerous for programs that help the poorest people in Mexico. In its effort to eliminate duplication, the government could eliminate benefits for people who need them the most. Under the SHCP plan, 261 programs would be merged, which would reduce the number of programs to 99. The scheme would change oversight responsibility for another seven programs and actually create four new programs.

"The biggest impact could be on social programs," Jesusa Cervantes wrote in agencia de noticias Proceso (apro). She noted, for example, that a preliminary SHCP zero-base budget proposes to merge the Programa de Apoyo Alimentario, which provides food to poor families, with Prospera, which offers direct supports to vulnerable communities to improve nutrition, health, and education.

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This move toward efficiency could have the impact of reducing benefits for those who need them most.

Congress has mixed reactions to zero-base budget plan

Reactions are mixed among legislators of the largest opposition parties, the center-left Partido de la Revolución Democrática (PRD) and the conservative Partido Acción Nacional (PAN).

The PRD expressed support for the proposal to eliminate excessive bureaucracy. "It is not a bad thing to hold debate on this issue," said PRD Deputy Fernando Belaunzarán, a member of the anti-corruption and transparency committee (Comisión de Transparencia y Anticorrupción) in the lower house. "Our current oil revenues provide enough coverage for this year, but we might face an emergency situation in 2016."

Other PRD legislators demanded that any zero-base budget contain sufficient safeguards to protect priority programs like food assistance, health, and agriculture supports. "If we begin at zero, and we prioritize our needs, then we could find areas where resources are wasted," said PRD Deputy Socorro Ceseñas Chapa, who chairs the agrarian reform committee (Comisión de Reforma Agraria) in the lower house. "We could devote those resources to urgent areas like health, housing, and infrastructure, but only if they guarantee a large collective benefit.

The PAN delegation in the lower house disagreed with the administration’s proposal to implement a zero-base budget for 2016 because it could deprive the economy of the stimulus to provide much-needed jobs. "It is worrisome that our stagnated economy does not respond to the demands of the growing number of youth who are entering the work force," said Deputy Marcelo Torres Cofiño, floor leader of the PAN delegation in the lower house, who said spending on public works is one of the mechanisms to help boost economic productivity.

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