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Finance Secretariat's Budget Proposal for 2016 Takes into Account Energy Reforms, Weak Global Oil Market

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President Enrique Peña Nieto's administration has submitted a budget proposal for 2016 that takes into account the energy reforms approved by Congress in 2013 and 2014 (SourceMex, Dec. 18, 2013, and Aug. 6, 2014) and ongoing weakness in the global oil market, which forced a reduction in expenditures in the 2015 budget early this year (SourceMex, Feb. 4, 2015).

The budget that Finance Secretary Luis Videgaray presented to Congress reduces government allocations for the state-run oil company PEMEX by about 20%, leaving private companies or conglomerates to assume a portion of the expenditures for exploration and development of oil fields. The administration has already been reducing outlays to PEMEX because of a decline in oil-export revenues, which have historically accounted for about one-third of overall government revenues.

The reliance on oil revenues has changed in recent months because of changes enacted by the administration. For the January-June semester, oil-export revenues accounted for only 18.6% of GDP, compared with 39% of GDP as recently as 2011, according to a study from El Centro de Estudios de las Finanzas Públicas (CEFP), which is affiliated with the Mexican Congress.

Budget cuts PEMEX allocations by 20%

Analysts said the 20% reduction in allocations for PEMEX adds greater urgency to the administration's plan to seek joint ventures with private companies and conglomerates in the exploration of and development of wells.

"[The reduction] forces PEMEX to accelerate the process of forming partnerships," analyst Alejandra León of the Mexico City office of IHS Energy, said in an interview with Bloomberg news service. "Pemex's new framework forces it to consummate its independence and to generate its own resources. This changes its investment strategy."

The administration is optimistic that private companies will become major participants in the Mexican oil sector even though phase 1 under Ronda Uno of the privatization scheme was somewhat disappointing (SourceMex, July 22, 2015). Phase 2 of Ronda Uno is scheduled for Sept. 30, and Phase 3 is set for Dec. 15. The final two phases of Ronda Uno still have no established timetable.

PEMEX is targeting 10 joint ventures with private companies, which would help production recover from the lowest levels recorded since at least 1990. Production of crude-oil reached 2.43 million barrels a day in 2014, compared with about 2.67 million bpd in 1993 (SourceMex, Jan. 19, 1994) and 2.85 million bpd in 1996 (SourceMex, May 15, 1996), and 3.34 million bpd in 2002 (SourceMex, Sept. 11, 2002)

The Peña Nieto government's budget projects oil production at an average 2.25 million barrels a day in 2016 and a price of US$50 per barrel for Mexican crude-oil exports. The projected price for 2016 represents a huge drop from the initial estimates of US$82 per barrel for 2015 and US$94 per barrel for 2014 (SourceMex, Nov. 19, 2014).

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"The main challenge for economic growth is the fall in the oil price and oil production," Videgaray told reporters after presenting the administration's 2016 budget proposal to lawmakers in early September.

Videgaray also offered assurances that Mexico does not plan to cut production to help boost global oil prices. The finance secretary's comments followed a statement by Iran's Oil Minister Bijan Namdar Zanganeh that Mexico is willing to work with the Organization of Petroleum Exporting Countries (OPEC) if the group tries to stabilize crude markets amid a global supply glut and slide in prices. The Iranian official said his comment was based on a conversation with Mexican Labor Secretary Alfonso Navarrete Prida.

"One of the fundamental purposes of [the energy] reforms was precisely for Mexico to produce more oil, to take better advantage of its natural wealth that's the property of the nation and all Mexicans," Videgaray told reporters. "That's the objective of oil policy. It's not foreseen that Mexico would participate in any mechanism to reduce production."

Overall budget reduced by 221 billion pesos

The budget presented by the Secretaría de Hacienda y Crédito Público (SHCP) also projects a reduction in economic growth in 2016, with the GDP expected to increase by only 2.6% to 3.6%. This represents a decline from the range of 3.3% to 4.3% that the administration had forecast for 2016 in a report released in March.

The SHCP budget blueprint reduces overall expenditures by 221 billion pesos (US$13.35 billion) in 2016, which the administration says is an effort to maintain economic stability amid a challenging global situation. The finance secretary said revenues obtained from taxes have increased in the past year because of the fiscal reforms approved by Congress in 2013 (SourceMex, Oct. 23, 2013). "Thanks to the reforms, we reached a historic high in earnings from tax collections, which has allowed us to reduce dependence on oil revenues," said Videgaray.

Some analysts praised the budget blueprint presented by the administration. "[This proposal] is a good compromise between doing enough fiscal consolidation en route to fiscal sustainability and trying to soften the blow to the economy," said Carlos Capistran, chief Mexico economist for Bank of America Corp.

"This is the most austere budget that this administration has presented since it took office," columnist Carlos Elizondo Mayer-Serra noted in the daily newspaper Excélsior. "The excess expenditures contained in the previous three budgets did not help the economy grow. Not only was the money taken off the hands of the consumer through higher taxes but also the revenues were not spent well. That is the reason why the public deficit grew from 2.6% of GDP in 2012 to 3.54% in 2014."

"What is certain is that the reduction of 221 billion pesos is a very significant number," columnist Leonardo Kourchenko wrote in the daily business newspaper El Financiero. "The government will now have to tighten its belt, even though it has pledged to keep the basic allocations for basic programs and essential social expenditures."

In addition to the cuts in PEMEX, the administration proposed making significant reductions in overall operational costs and in personnel. Expenditures for some departments are also on the

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chopping block, including some operations for the Secretaría de Gobernación (SEGOB). Allocations for the Centro de Investigación y Seguridad Nacional (CISEN) will be reduced by 50%.

Sen. Ernesto Cordero, a former finance secretary and member of the conservative opposition Partido Acción Nacional (PAN), said he was encouraged by the overall budget, which requires that all expenditures be justified. However, he said he was concerned about how the administration would determine where to make cuts.

Congressional leaders for the center-left Partido de la Revolución Democrática (PRD) said members of their respective delegations in the Chamber of Deputies and Senate will not accept a budget that makes any reductions in social programs, particularly health, education, agriculture, and social development. "We will not accept any proposals to eliminate or reduce important programs," said PRD Deputy Jesús Zambrano Grijalva, who serves as president of the Chamber of Deputies.

The Chamber of Deputies, which must approve the revenues budget (Presupuesto de Ingresos) by Oct. 20, is unlikely to make many changes to the blueprint, since the governing Partido Revolucionario Institucional (PRI) holds a plurality in the lower house. The Senate has a deadline of Oct. 31 to approve the revenues budget once the measure is passed in the Chamber of Deputies.

The lower house has a deadline of Nov. 15 to approve the expenditures budget (Presupuesto de Egresos). The Senate is not required to approve the expenditures plan.

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