Low Oil Prices Force Government to Consider Budget Reductions, Especially for State-Run Oil Company

Carlos Navarro

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The continuing slump in oil prices and the weakening global economy has forced Mexico to begin planning budget reductions for 2017, although some cost adjustments are possible in 2016. In announcing the possibility in early February, Finance Secretary Luis Videgaray hinted that the state-run oil company PEMEX would take the brunt of the reductions in expenditures.

The slump in oil prices forced Mexico to reduce the budget in early 2015 (SourceMex, Feb. 4, 2015)—eliminating planned expenditures in energy and transportation—including the budgets for PEMEX and the federal electrical utility (Comisión Federal de Electricidad, CFE). The continuing weak prices during 2015 had a major impact on the 2016 budget blueprint that President Enrique Peña Nieto sent to Congress at the end of the year, which included a 20% reduction in funding for PEMEX (SourceMex, Aug. 19, 2015, and Sept. 16, 2015).

This month, Videgaray announced that further reductions would be coming in expenditures to PEMEX in 2017. Non-PEMEX expenditures will not be affected significantly by the slump in oil prices because the government acquired hedging contracts that guarantee oil prices at an average of US$49 per barrel during 2016. The government acquired similar financial instruments during 2015 (SourceMex, Feb. 4, 2015) and during a prior global oil slump in 2008 (SourceMex, Nov. 19, 2008).

New PEMEX director in charge of determining cuts
José Antonio González Anaya, who recently replaced Emilio Lozoya as head of PEMEX, will be charged with making the decisions on how to reduce expenditures for the company. Some observers said it was no coincidence that González Anaya had been appointed to the post, given his reputation as a budget-cutting expert at the finance ministry, the Secretaría de Hacienda y Crédito Público (SHCP).

“José Antonio González Anaya arrives at the helm of PEMEX as a specialist in ‘cleaning’ and making revisions to the finances of public entities,” columnist Carlos Fernández-Vega wrote in the daily newspaper La Jornada. “He has accomplished this task on many occasions, and now he has three years to reach the difficult goal [in PEMEX], provided he is allowed to work without interference from the SHCP.”

González Anaya wasted no time in outlining his plans. “The main priority is to determine exactly how to implement these cost cuts, which are necessary given the circumstances,” he said in an interview on Radio Fórmula, adding that the reductions would not necessarily come from eliminating jobs.

A reduction in government disbursements to PEMEX was part of the energy reforms that Congress approved in 2013 and 2014 (SourceMex, Dec. 18, 2013, and Aug. 6, 2014). The reforms were intended to bring an infusion of private capital into the state-run oil company, particularly in the areas of exploration and production. The slump in the global oil market, however, has kept private
participation in PEMEX at a much lower level than the Peña Nieto government had anticipated (SourceMex, July 22, 2015, and Oct. 14, 2015).

PEMEX reported a net loss of nearly US$20.75 billion in the first nine months of 2015, up 138.4% from the same period in the previous year

**Reductions in 2017 to target PEMEX, government jobs**

While González Anaya is expected to make the bulk of budget adjustments via a reduction in administrative costs, the weak global market looms over the Mexican economy, and hedge contracts are not viable for 2017.

At his press conference earlier this month, Videgaray alluded to the real possibility of new reductions in the general budget and in PEMEX in 2017. The finance secretary did not provide specific figures. “A very important aspect of this adjustment will have to come in the expenditures of Petróleos Mexicanos, which is experiencing directly the consequences of the drop in oil prices,” Videgaray told reporters.

Any reductions in other government expenditures would come by trimming the public payroll, the finance secretary said in a subsequent radio interview. Again, Videgaray did not offer specific figures, but pointed out that any government employee who loses his or her job would receive the required severance pay.

The SHCP usually submits the budget blueprint for the ensuing year to Congress in September, but cost estimates are likely to come earlier because of the global oil slump. "It is more efficient to adjust spending early in the year, before the ministries begin contracting, so we are thinking about doing something in the next few days or weeks," Videgaray said. "We will announce the specific amount shortly."

Deputy finance secretary Fernando Aportela Rodríguez provided more specific estimates for job reductions next year, suggesting that 15,000 public servants could lose their positions in 2017.

Analysts and economists, responding to a survey conducted by the daily newspaper El Universal estimated budget reductions for next year would range from 90 billion pesos (US$4.7 billion) to 130 billion pesos (US$6.8 billion). Expenses for 2016 were cut by about 97 billion pesos (US$5.1 billion), which followed cuts of 124 billion pesos (US$6.5 billion) in 2015.

Some analysts pointed out that other costs savings in 2016 and 2017 will come from a reduction in current expenditures and the cancellation of planned projects, which will have more of a detrimental impact on the Mexican economy than the 2015 cuts.

“We are going to notice a bigger difference this year than last year,” analyst Delia Paredes of Grupo Banorte said at a business forum in Mexico City in mid-January. “Last year, the government spent more at the federal and state level because it was an election year.”

Cuts made last year were to projects that had not yet been launched, including the high-speed train between Mexico City and Querétaro, and the rail line in the Yucatán Peninsula (SourceMex, Nov. 12, 2014), which reduced the impact on the 2015 budget, Paredes said.