

## THE LACK OF TRANSPARENCY AND ACCOUNTABILITY MECHANISMS FOR MEXICO'S OIL INCOME

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In 2005, oil income represented almost 40 percent of Mexican public sector revenue, a proportion that has grown during the last three years due to high oil prices. Given the substantial resources that come into the country via oil sales, it is necessary to have transparency and accountability mechanisms that can track how they are used and distributed, especially the surplus income [over annual budget projections], which has been particularly high in recent years. Moreover, since this income is generated from a non-renewable resource, it is important to be able to know that it is being used in long-term policies and in high-priority areas that benefit the general population.

### Have the Advances in Transparency Measures been Enough?

During the last five years, greater political pluralism and division of powers within the government in Mexico have resulted in new mechanisms of transparency and accountability, which are important for the democratic consolidation process. Two important changes were the passage of the Federal Law for Transparency and Access to Information (LFTAIPG in Spanish), and the creation of the National Superior Auditor's Office (ASF in Spanish). Both helped increase budget oversight and allowed access to the information needed to enrich public debate. However, these important achievements have not been enough to be able to exercise precise control over the use of surplus income generated from the operation, processing and sale of petroleum. There are two specific problems:

- a. Discretionary use of surplus income on the part of the Treasury Ministry (SHCP in Spanish); and
- b. The lack of transparency and accountability mechanisms that would make it possible to monitor the use of surplus income transferred to the states.

## Executive Free Rein in the Use of Surplus Oil Income

At the time that the LFTAIPG was approved in Mexico, the legal framework that was used to develop the federal budget was the Budget Law (Ley de Presupuesto, Contabilidad y Gasto Público, or LPCGP in Spanish), which included guidelines for how surplus oil income was supposed to be used. This law was created in 1976, and although it had undergone several reforms, it still had a number of gaps in it. Lawmakers tried to patch them with the Decree on the National Spending Budget, but it was not enough, especially because both documents lacked the transparency and accountability measures necessary to be able to oversee surplus oil income.

The LPCGP established that after subtracting any increase in non-projected expenses—that is, all expenses that occur throughout the year that are not part of the fixed budget—the Executive could assign additional resources to programs it considered worthwhile and, when the time came to process the transfer of funds, could authorize it directly.

The law thus endorsed the discretionary use and distribution of surplus income by the Executive Branch; in practice, this meant it was spent without any kind of control mechanism. The Congress could not act to check the Executive, nor monitor how the money was being used, since information about it was not provided in a timely way: Members of Congress did not have any way of knowing that there had been surplus income [beyond annual projections]. Much less did they know how it had been distributed, until months later when the resources had already been spent. Furthermore, the free rein exercised by the executive branch resulted in budgetary decisions in which the presidential administration's priorities did not match those of the nation. Several times, for instance, surplus resources were used to pay current budget expenses, as in the case of a teachers' wage increase or the payment of the deferred-cost infrastructure projects (Proyectos de Infraestructura Diferidos en el Registro del Gasto, known as *Pidiregas* in Spanish).<sup>1</sup>

In other cases, the SHCP has refused to turn over information to the National Superior Auditor's Office to justify its use of surplus income. When questioned about its use of that income to cover what it listed simply as "other needs", the SHCP defended its refusal to produce documentation by claiming, "to have discretionary powers to apply surplus income."<sup>2</sup> During 2003, the Auditor's Office reviewed and monitored the Public Revenue and Budget accounts for that year, and thus tracked the amount of money coming in by way of surplus resources. In that year, the SHCP stated that it had used more than

<sup>1</sup> SHCP, "Cuenta de la Hacienda Pública Federal 2004, Resultados Generales, Política de Gasto," p. 68, available at: [www.shcp.gob.mx](http://www.shcp.gob.mx).

<sup>2</sup> ASF, "Informe del Resultado de la Revisión y Fiscalización Superior de la Cuenta Pública 2003," p. 455, available at: [www.asf.gob.mx](http://www.asf.gob.mx).

29 million pesos to cover the line item it called “other needs”, in order to maintain the income/expenditure relationship it had established at the beginning of the year. According to the auditors’ report, this concept was not something the Decree provided for; however, the SHCP stated that it had to cover the deficit that Congress had approved and that, furthermore, the Decree granted it the power to interpret the Budget. Between the LPCGP and the Decree, then, the SHCP has had the legal right to make arbitrary and discretionary decisions about the use of surplus funds.

Today there is a new Federal Law on Budgets and Fiscal Responsibility, which replaces the old LPCGP. The new law was approved in March, 2006, and incorporates some transparency and accountability mechanisms, including category labels designating how surplus funds are to be spent when these are used to cover non-projected expenses. This means that people will know how surplus oil income is supposed to be spent ahead of time, at least partially eliminating the previous free rein in spending. The control is only partial, however, since there is no way of knowing the proportion of resources that will be assigned to these categories to cover non-projected costs.

Thanks to the reformed budget law, opacity in surplus spending has been reduced. However, executive latitude should have been curtailed even more in that reform, ensuring more control and monitoring of surplus income.

The approval of the LFTAIPG was necessary, but not enough: the information available was not timely; the powers of Congress were limited; and there was no space to discuss how extra resources should be used. For the transparency law to be truly effective, all the other laws that act against it—that create opacity around the use of oil money—would have to be reformed as well.

### **What is Missing?**

Despite this great movement forward, there is still opacity in the use of surplus income that is not used to pay non-projected costs. Specifically, there are still no mechanisms to control the use of extra resources distributed to the states through the State Trust Fund for Infrastructure (Fideicomiso para la Infraestructura en los Estados, or FIES in Spanish), which is a fund set up to promote infrastructural development at the state level.

The new budgetary law specifies that 25 percent of the surplus income, once non-projected costs are subtracted, should be directed to the states by way of the FIES. However, it does not give any indications about developing accountability measures for how that

money is spent. There are rules built into the trust fund that stipulate that in order for the states to be able to receive that money, they must present the SHCP with a proposal—a description of the programs or projects they will fund. Yet there is no clear reporting mechanism through which the states would have to show how they actually spent the money. This means that there is no guarantee that resources are being directed at top priority programs and infrastructure projects.

Cases have been discovered in which surplus income from the production and sale of oil—a non-renewable resource—is being used effectively for infrastructure, but is not generating any impact in terms of economic development. For example, in the state of Chihuahua, 124 million pesos were budgeted to build a baseball stadium, and, in the Yucatan 6 million pesos were used to remodel churches. It is justified, then, to say that there has only been a “partial” reduction in discretionary spending.

Currently, thanks to the LFTAIPG, people can get copies of the applications states submit annually to the SHCP for FIES funds. In this aspect, at least, the opacity that surrounded the process is diminishing. However, there is still a need for better accountability to ensure that the funds are being used on long-term policies, on projects that will have a social and economic impact in the population. The use of these funds should be regulated, and there should be a regulatory agency set up to do so.

## **Recommendations and Conclusions**

Despite the significant advances in transparency and accountability during recent years, there are still problems when it comes to knowing how surplus oil income is used. The reality is that none of the existing laws or regulations defines transparency and accountability mechanisms that could ensure an efficient and non-discretionary distribution of these funds. Without such guidelines, there is no guarantee that the government will not spend these non-renewable resources on projects which, under other circumstances, would not be viable, and which turn out to be low priority—that is, if the goal is really to address the country’s most pressing needs.

With Mexico’s substantial oil income, it is important and necessary to develop transparency and accountability mechanisms to oversee the spending and distribution of the surplus—including the resources that are transferred to the states. Given that the resources come from a non-renewable resource, it is also important to build in guarantees that they will be used strategically, on high-priority projects that will benefit the society through long-term policies.