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Q and A: How Should Mexico's State-Run Pemex Be Reformed?

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In an interview with Fortune, the CEO of Mexico's Pemex, Juan José Suárez Coppel, described the state oil company's problems as having "too many cooks in the kitchen," adding that efficiency gets lost. Coppel suggested that sweeping changes would have advantages and though they are unlikely to occur this year, could happen in the future. Will energy policy and changes to Pemex play a significant role in the next election? If so, which proposals are likely to be debated? What steps should Pemex take to increase efficiency within its current limitations? How should the company be reformed in the medium to long-run?

A: José Alberro, director of the Berkeley Research Group and former CEO of Pemex Gas and Basic Petrochemicals:

"Pemex is in the news and the headlines are: proven reserves replacement rate will reach 100 percent in 2011; a small field containing light crude discovered in the Gulf of Mexico; and incentive-based contracts awarded to two private firms allowing them to exploit abandoned and stripper wells at a compensation rate of $5 per barrel. Pemex started investing massively in its transformation after the PAN kicked the PRI out of office. Investment in 2011 is four times what it was a decade ago and the effects are starting to show. However, Pemex's incentive structure rewards obedience, not improvements, thereby stifling innovation. Pemex needs sweeping changes if it is to join the rank of well managed national oil companies (NOCs), but those changes are unlikely to occur this year, given that 2012 is an election year. The controversial 2008 energy overhaul put the issue front and center, leading to barricades in Congress to prevent the passage of reforms that were advocated by sympathizers of the losing candidate in the 2006 presidential election. Mr. López Obrador is running again and there is little doubt that the energy policy in general and changes to Pemex's operation will be a significant issue during the campaign. The debate will be phrased as it has been for two decades: the populists will stir up weary nationalistic reflexes to denounce the voracious appetite of foreigners and call for re-nationalization of activities related to oil; they will find in poverty an excuse for maintaining billions in gasoline subsidies and accrue to the rich and middle class. On the other hand, there will be those who insist that a deal in which Pemex pays $5 and sells for $100 is pretty good and that the sovereign interest rather lies in how to utilize the $20 billion generated in this manner, not in continuing with a system that led to pilfering and a major drag on productive efficiency. Oil and Pemex are an integral part of any conversation about Mexico's future. That discussion has become increasingly coherent. It will soon be vociferous. Let's hope that after the noise settles down, Pemex is allowed to continue its opening up and its efficiency programs."

A: David Shields, independent energy consultant based in Mexico City:

"Indeed, there are too many cooks in the kitchen at Pemex, but the Calderón administration has wasted every opportunity to do something about it. The 2008 Pemex reform calls on the company's board to approve a restructuring plan based on efficiency and rationalization of costs and staffing, but that was quickly shelved. Downsizing staff at Pemex would have a political cost and would be opposed vociferously by the union and the PRI opposition. This administration has no stomach for that at a time when it is losing the war against drug cartels. The 2008 reform has been implemented very slowly, without conviction. Priorities such as performance-based drilling contracts and refinery building are moving ahead, but also far too slowly. Mexico would benefit from well thought-out changes that would allow for deregulation and competition in all segments of the oil industry. A new Brazilian-style legal framework would be a good option, but it seems it won't happen. There is no will anywhere in the political system nor any catalyst for oil industry reform in Mexico at this time, nor will there be as long as oil prices remain high and the confidence of Mexicans in Pemex as a real force for a better future remains low. Oil reform remains a sensitive, ideologically charged issue, so politicians of all stripes will want to keep it out of the presidential election campaign. Once a new president is in office in 2013, he will decide what to propose for Pemex, if anything."

A: Ricardo Falcón, associate II for Latin America energy at IHS CERA:

"As the 2012 election approaches, Mexico's energy debate will likely get put back on the front burner. Political candidates are expected to center their proposals on the issues that were not fully addressed (or solved) by the 2008 energy reform package. Some of them are the continued decline in hydrocarbons reserves, its negative impact on oil output and the government's heavy dependence on oil revenues. The question, however, is not whether these topics will be discussed, but rather how the next administration will prioritize them against other urgent issues in the policy agenda. No matter who wins the election, the new president of Mexico will have to reach workable agreements with the different parties in Congress to push legislation forward. Otherwise, Pemex's capacity to deliver on its business plan will continue to be limited by the Treasury's implicit controls, by the annual federal budgeting process and so forth. The state-run company has certainly moved a step forward with the recent award of its first incentive-based service contracts for three mature oil fields in the southern state of Tabasco. Yet this effort is modest before the huge challenge that Mexico will face in the near future. Service contracts are best suited for the development of discovered resources that entail manageable downside risks; still they prove unattractive for the high-risk, capital-intensive exploration projects that will be needed to reach a production target of 3.3 million barrels per day by 2024. Pemex will thus have to increasingly concentrate available investment resources on more challenging ventures if it is to surpass, or at least maintain, current oil production levels for the next decade. Its ability to lure more private capital and diversify risk will depend on how effectively the next administration prompts greater policy change, and constitutional amendments should not be discarded."

A: Nicolás Mariscal, chairman of Grupo Marhnos in Mexico City:

"Oil has traditionally generated a significant proportion (above 40 percent) of public revenue in Mexico. Fiscal pressures will intensify in the upcoming decades unless fundamental changes are made in the structure of taxes and public spending at the same time as energy policy. So far, the Mexican economy remains highly dependent on oil in a situation where production and reserves are declining, gas imports are increasing and spending is rising. Energy proposals will play a significant role in the next elections. The debate that has been building is between the left, which is against any involvement of private capital in the oil sector, as required by the current constitution, and the right, which promotes the entry of the private sector, especially looking to explore the deep waters. According to reports from the energy ministry, Mexico will face major problems of deficits in oil production by 2021. Because of the amount of time that this type of project requires, it is urgent to being exploration in the deep waters and, at the same time, make financial, operational, and technological changes. Improving energy productivity and raising reserves requires awareness on the part of senators and representatives to pass the necessary reforms. At the same time, it is a great challenge for Pemex officials to operate steadfastly and legally in favor of efficiency."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at kuleta@thedialogue.org with comments.*