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11-10-2010

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Recommended Citation

Agren, David. "PEMEX Cries Poverty, Analysts Beg to Differ." (2010). https://digitalrepository.unm.edu/la_energy_notien/156

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PEMEX Cries Poverty, Analysts Beg to Differ

By David Agren

When Finance Secretary Ernesto Cordero delivered his 2011 budget to Congress in early September, complaints surfaced almost immediately in the state oil company PEMEX about the size of next year's proposed US$20.4 billion allocation--some 30% less than requested.

The concerns once again highlighted perpetual challenges in PEMEX's finances as the federal government relies on oil revenue to fund roughly one-third of its budget, which insiders say puts the company at risk of losing money and going into debt and not carrying out new projects to stem a decline in its petroleum reserves. The concerns also highlighted the challenges PEMEX faces as lawmakers perpetually treat the company as a cash cow for funding politically popular projects and an easy source of revenue that allows them to avoid having to implement unpopular tax increases.

The current fiscal regime and the perceived lack of government investment prompted company president Juan José Suárez Coppel to warn lawmakers during an appearance before the Senate energy committee that PEMEX risked losing money in the upcoming year.

"In the case of PEMEX, today, with the tax treatment it has, it's not profitable," Suárez Coppel said to lawmakers, who, barely two years earlier, crafted a comprehensive energy-reform package. "All this leads to a bleeding of PEMEX that cannot be sustained. Therefore, we have to go back into debt to guarantee things."

Suárez was hardly the first PEMEX director to plead poverty before Congress or decry the state of the company, which is beset with difficulties such the rampant theft of refined petroleum products, service-station franchisees notorious for shortchanging customers, and a powerful union that holds five of the 11 seats on the PEMEX board and reportedly dictates hiring and firing in many places.

Past pleas have found some favor among lawmakers in Congress, says George Baker, publisher of Mexico Energy Intelligence, an industry newsletter, as lawmakers fail to fully understand the dynamics of PEMEX and fear harming a company that represents sovereignty as much as petroleum and development to many Mexicans.

"PEMEX is sort of like the US Army," Baker says. "The US Army is always going to tell Congress, 'If you want us to be ready for some emergency, then we're going to need more money.' It goes with having a state monopoly....They don't have to worry about competition, all they have to do is lobby the Congress to get more money. It's the endemic difficulty for the Mexican government because they don't really know if it's true or not."

Baker and other observers confess not knowing if Suárez Coppel's pleas are entirely true or false. But they question the company's recent track record of declining production that has come despite a steady increase of investment funds during much of the past decade.

"We're getting ever less benefit for the investment," says David Shields, an observer of the Mexican energy industry and a columnist with the Grupo Reforma newspapers. "I don't know what they're doing with the money. This year I have not seen one major project in historical terms to be tendered."

PEMEX is projected to receive 263.4 billion pesos (US$21.2 million) in 2010--the seventh-consecutive year it receives an investment increase. The company received just 113.7 billion pesos (US$9.2 million) in 2003, according to figures provided by Suárez during a September presentation at the Club Industriales in Mexico City.

Calls for increased investment in PEMEX are nothing new and have been considered important since the company's reserves have been in decline and its best asset, the massive Cantarell field in the Gulf of Mexico, has gone from producing more than 2 million barrels of oil per day to far less than 1 million bpd.

PEMEX currently produces roughly 2.6 million bpd. Shields finds that number curiously low since a former PEMEX president said in the last decade that the company would produce 6 million bpd if it had an investment of US$20 billion--about what is called for by the federal government's proposed budget.

"We're still going down, although we're certainly not going down as fast as we were," Shields says. "We may be stabilizing (in the) short term."

The steady budgetary increases raise questions for Shields about what PEMEX does with the additional funds. He confesses not knowing what exactly happens with the additional funds, but he does admit being perplexed by PEMEX's lack of ambitious projects for 2011--especially considering the company's calls for more money.

"PEMEX is not tendering new projects," Shields says. "They can talk about all the money they want to talk about, but where is it being invested?"

PEMEX has outlined plans to invest heavily this coming year in stemming output declines in Cantarell, working Ku-Maloob-Zaap, the country's most productive oil field, and exploiting Chicontepec, a basin northeast of Mexico City that has been technically difficult to exploit.

Shields questions where ambitious projects were.

"With smaller budgets, they did much bigger projects 10 years ago or 20 years ago," Shields says. "The classic example is the Cantarell project."

Both Baker and Shields say part of PEMEX's problem comes from legal uncertainties remaining from the 2008 energy-reform package, which set out to give the company more managerial autonomy, improved oversight, tax incentives to make it worth exploiting mature fields, increased money through issuing "citizen bonds," and more flexibility to partner with foreign firms to exploit petroleum reserves.

The Mexican Constitution forbids foreigners and private firms from holding petroleum reserves--something left untouched by the 2008 reforms. Oil companies often claim a portion of the reserves in the projects they exploit through partnerships, but lawmakers created a system through which PEMEX could instead pay performance bonuses. The constitutionality of these bonuses is being challenged and, according to analysts, is preventing PEMEX from issuing major tendering contracts.

"They're suffering from the problem that there's a constitutional challenge to the performance contracts," Shields says. "And that is one of the reasons they cannot invest in major drilling contracts that imply performance benefits."

PEMEX's inability to increase production despite continually receiving increased funding during much of the past decade strikes at another core issue: the lack of viable projects.

Baker says it remains unknown how much potential PEMEX has to exploit potentially vast reserves in both shallow and deep waters.

Shields is more pessimistic. He points out in his Sept. 14 Grupo Reforma column that "PEMEX suffers the problem--and it recognizes it--that three of every four of its oil fields are in the mature phase and easy and cheap oil is ending....Therefore, PEMEX requests an improved fiscal treatment each year to compensate for the low profitability of its new projects."

"It's not very believable that projects like Chicontepec or deep waters are highly profitable. To the contrary, it can be shown that they have not been until now," he adds.