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Q and A: Will Peña Nieto Be Able to Win Support for Energy Reform?

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Mexican President-elect Enrique Peña Nieto has said that reforming the state-run energy sector will be his "signature issue" and that he aims to refashion Pemex in the image of Brazil's Petrobras, Bloomberg News reported. However, the Institutional Revolutionary Party fell short of an outright majority in the country's Congress and energy reform has proven to be elusive in the past. Will Peña Nieto be successful in his bid to reform Pemex? What changes will he try to implement and what challenges is he likely to face in getting them passed?

A: Ricardo Falcón, senior research analyst for Latin America energy at IHS CERA:

"Mexico's postelection chapter has not concluded yet. The Federal Electoral Court has until Sept. 6 to officially declare the validity of the election after evaluating the opposition's challenges against the virtual winner, Enrique Peña Nieto. Although the court seems unlikely to overturn the results, this process signals the numerous obstacles that the Institutional Revolutionary Party (PRI) will face to set its policy agenda. When it takes office on Dec. 1, the new administration will need to intensely negotiate with the opposition if it is to push for deeper changes in the politically sensitive hydrocarbons sector. The PRI and its natural ally, the Green Ecologist Party of Mexico (PVEM), may reach a voting strength of 48 percent in both houses of Congress. But this coalition would still require the support of the National Action Party (PAN) or the Democratic Revolution Party (PRD) to pass any constitutional amendment—which requires a two-thirds vote in Congress plus the majority of the state legislatures. A window of opportunity could open as all parties appear to agree on the need to improve Pemex's overall performance. The PRI could pursue a further review of the state-run company's fiscal regime or even discuss the chances for more commercially attractive hydrocarbons exploration and production contracts, as Peña Nieto proposed during the campaign. Nevertheless, the PRI is unlikely to promote any change that may significantly reduce the government's control of oil tax revenues— which currently account for almost one-third of its fiscal income—or damage its long, close relationship with the national oil union. Importantly, in 2008 the PRI played a key role in the approval of a diluted energy reform package that ruled out further private participation in the oil and gas sector. The overall trends thus suggest that Mexico's oil policy change, if any, will continue to be incremental."

A: Shannon K. O'Neil, Douglas Dillon Fellow for Latin America Studies at the Council on Foreign Relations:

"In the days since the election, Peña Nieto and his team have reaffirmed their commitment to reform Mexico's energy sector. Though still an uphill battle to cobble together the necessary two-thirds constitutional reform coalition, a few factors increase the chances of reform in comparison to the past. The first is that the PRI (and others) recognize the need. Since 2004, output has been on the decline (it just stabilized in 2010), and falling revenues are worrisome not just for the broader economy but for the government itself, as oil revenues account for roughly a third of its budget. Even if production stabilizes, Mexico will likely become a net oil importer during Peña Nieto's tenure. For a party that aspires to remain in power, unleashing additional revenues is vital. Second, the PRI has the advantage of counting on the Pemex union as an ally, not an opponent. Its leader, Carlos Romero Deschamps, was just elected to the Senate on the PRI's proportional representation list, as was the union's treasurer, Ricardo Aldana. Their presence, rather than stymieing negotiations, may help smooth the process, enabling a Nixon-in-China moment for Mexico. And finally, Mexico's 2008 experience with (more limited) energy reform should help pave the way for a more comprehensive initiative, having lowered the once seemingly insurmountable hurdle of even talking about opening up Mexico's energy sector."

A: John D. Padilla, managing director at IPD Latin America:

"Even before the July 1 elections, it was increasingly evident that if the PRI won (in coalition with the PVEM), it would not secure the congressional super-majorities needed to have a chance at constitutional reform. Although the coalition secured slightly less congressional seats than anticipated (roughly 48 percent in both chambers), the overall dynamic has not changed. That implies that, like the past two PAN administrations, it will require opposition support. The good news for the PRI is that the PAN is unlikely to oppose major reforms, at least initially. Such a stance would have negative consequences for the PAN. It would dissatisfy party constituents, who tend to broadly support increased private participation, and make them look self-contradictory (they criticized the PRI for opposing important reforms during the past PAN administrations). The party also has no near-term prospects of regaining substantial political power. As such, waiting until it can secure the credit for passage of reforms will not factor in the way it did with the PRI. Hence, the PRI has good chances of pushing a reform agenda forward right out of the blocks to take advantage of its honeymoon period and build momentum, just as President Calderón successfully did (albeit via ultimately 'lighter' reforms). Its bigger challenge will be its ability to keep PRI factions together. The party will be confronted with difficult decisions that affect important factions of its power base. And unlike the commanding heights it controlled during most of its 71-year rule, this time around will be different. That means less money and influence to keep powerful interests mollified. The new administration knows it needs to strike some quick 'wins' in order to build momentum and demonstrate its ability to be an effective governing party in a time of need. It wants to meaningfully demonstrate a changed image, as it believes that is its ticket to retaining power now that it is back in office. Despite the views of skeptics, the PRI has a lot to lose should it prove incapable of meaningfully changing the economic, social and security status of the country."

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

"Much is being said about turning Pemex into a 'company,' rather than a government office that provides fiscal revenues. But there is not a consensus on what the 'company' would look like. Pemex is already a company in many ways, producing fuels, exporting oil and buying and selling gasoline, but its fiscal role is overwhelming. All kinds of vested interests, including the oil workers union which weighs heavily in the PRI, work against major reform at Pemex. Thus, a push for change will require a lot of political capital. Also, the temptation remains to maintain the status quo, as long as oil prices remain high and Pemex keeps bringing in the money. There are, after all, other immediate reform priorities to be dealt with: political, fiscal, security, labor and education. Energy reform should go hand-in-hand with fiscal reform to reduce Mexico's dependence on oil revenues. If Petrobras is to be the 'company' model, that should mean constitutional change, selective openings to direct private investment, competition in all oil market segments, concessions and joint ventures in oil production and raising equity in Pemex through the stock exchange. It sounds nice, but Pemex will not be not ready to raise equity unless it can turn a profit, which means the government must partially release it from its fiscal stranglehold. And it is not at all clear that Mexican public and political opinion is ready for such ideas as direct investment in the oil industry, concessions, competition in the fuels market or selling shares in Pemex."

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