Congress Votes to Let PEMEX Keep Larger Share of Revenues

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In late June, the Chamber of Deputies approved an initiative allowing state-run oil company PEMEX to keep a larger share of its revenues rather than turning them over to the Mexican Treasury. The measure, approved during a special session of Congress, is considered only a small step in the effort to give PEMEX greater financial independence.

The bill in the lower house, which mirrors a similar initiative approved in the Senate earlier this year, would allow PEMEX to retain the equivalent of 25 billion pesos (US$2.3 billion) next year, with amounts possibly increasing in subsequent years, depending on government finances.

The new tax structure becomes effective on Jan. 1, 2006. Reforms elicit mixed reactions The initiative received mixed reactions, with some analysts praising the Congress for finally enacting some reforms to the PEMEX tax structure and others criticizing legislators for not going far enough. "This is an indispensable step," said Ernesto Marcos, a former PEMEX chief financial officer who currently heads Mexico City consulting firm Marcos y Asociados. "It's not enough, but it's a step in the right direction."

The financial rating company Standard & Poor's called the reform encouraging but also urged the Mexican Congress and the federal government to draft a plan during the next several years that allows PEMEX to invest the additional funds in the most efficient manner. "[T]he long-term financial solutions for PEMEX and the federal government must include radical reforms in the way the corporation is managed which is extraordinarily wasteful compared to other major international oil corporations and in the restructuring of the tax system to not only increase revenues but also to improve the quality of public spending," wrote analyst Manuel Suarez-Mier in Bank of America's The Situation Room.

Among other things, PEMEX is in dire need of upgrading its infrastructure. The company has blamed a lack of funds for failure to upgrade its pipelines and other facilities in the oil-producing states of Tabasco, Veracruz, Campeche, and Tamaulipas. Faulty equipment has resulted in incidents such as a massive spill in Veracruz state in December 2004 (see SourceMex, 2005-01-05) and more recently a major explosion in Tabasco state.

Marcos Mares, a commentator for Mexico City-based Radio Formula, criticized the Congress for failing to look at the big picture when voting on this measure. "[This reform] represents a single breath of air for PEMEX, which is facing a difficult and dangerous financial situation," said Mares. He said the measure also puts the federal government in a precarious position because Congress did not approve a mechanism to compensate for the revenues lost to the Mexican Treasury.
High oil prices helped decision

Some observers said Congress had little difficulty approving the limited fiscal reform for PEMEX because of the recent surge in global oil prices, which has given the government more revenues than originally anticipated (see SourceMex, 2002-01-09, 2002-12-18, 2004-01-07, and 2004-11-10). PEMEX is now the third-largest supplier of crude oil to the US market, trailing only Saudi Arabia and Canada. "But [this trend has] translated into windfall gains for the federal government, not for PEMEX," said The Dallas Morning News, which noted that the oil company has resorted to issuing bonds on the global debt markets to finance major projects. PEMEX's debt stood at US$46 billion as of the end of 2004, double the levels prevalent at the end of 2000.

Some administration sources agree with analysts that the tax reforms are far short of what PEMEX needs to cover its capital-investment needs. "[PEMEX] requires about US$15 billion annually to become a self-sustaining oil company and to maintain its current export levels," Energy Secretary Fernando Elizondo recently told reporters.

Sen. Manuel Bartlett Diaz, who has long advocated for full Mexican control of its oil resources, took issue with Elizondo's comments, saying President Vicente Fox's administration is intent on privatizing Mexico's oil sector. "This is more than just a breath of air," said Bartlett, a member of the former governing Partido Revolucionario Institucional (PRI). "We have given PEMEX more than enough money to cover its needs." Analysts say tax reforms needed to offset lost revenues Many analysts said the failure of Congress to approve tax reforms could put the Fox government and successive administrations in a bind.

Tax collections currently account for only about 12% of GDP, while federal expenditures are close to 20% of GDP. "The fact that Congress has now approved PEMEX pocketing a larger share of its revenues without designating additional sources of income for the government poses a financial dilemma for the Fox administration," said Suarez-Mier.

Some governors have raised the concern that the reduction in revenues from PEMEX will force the government to cut allocations to state governments, which have increased in the last couple of years because of the higher oil-export revenues. "[This proposal] would have negative repercussions on public finances," said Veracruz Gov. Fidel Herrera, who has asked the Confederacion Nacional de Goberadores (CONAGO) to find ways to boost revenues in case federal allocations to states are cut back.

The Congress, however, has pledged that future budgets sent to the president will not reduce the amount of money allocated to the states. "We have a scenario where the average export prices for crude oil will reach US$27 per barrel next year," said a report produced by the energy committee (Comision de Energia) in the Chamber of Deputies. "In this case, the funds allocated to states and municipalities would actually increase to 82 billion pesos (US$7.7 billion).

Reform does not help petrochemical, refining sectors

Still, there is some concern that the reduction of funds from PEMEX will force the federal government to cut back on some expenditures. Ironically, one of the sectors that could be affected is
the petrochemical industry. Some observers suggested that the government's decision to reconsider the petrochemical project El Fenix might have something to do with a projected decline in revenues next year. El Fenix, which proposes to increase production of ethylene and other petroleum derivatives, would reduce Mexican imports of these products by 30% (see SourceMex, 2004-10-27).

Within a period of less than a week, administration sources issued conflicting statements on whether the controversial project would go forward. The project was initially declared dead by Rafael Beverido, director of the PEMEX subsidiary Pemex-Petroquimica. Presidential adviser Eduardo Sojo later denied that the administration had cancelled the project, only to be contradicted by Energy Secretary Elizondo, who said El Fenix was in the process of being "redefined."

President Fox finally reassured reporters that the administration had not abandoned plans to construct the plant but had decided to reevaluate the project to ensure that it would be sufficiently profitable. "The decision to reevaluate El Fenix was obvious because the amount of funds obtained from PEMEX would be reduced by about US$2.2 billion," said Eduardo Andrade, president of the Asociacion Mexicana de Energia Electrica (AMEE). The project has been marred by controversy since it was announced in October 2004, with Veracruz and Tamaulipas states fighting over where the plant would be constructed.

Whether El Fenix is cancelled or simply downsized, analysts see a troubling neglect of the energy-processing sectors. "The changes in strategy regarding El Fenix send a negative signal to international markets," said Pedro Fernandez, president of la Asociacion Nacional de la Industria Quimica (ANIQ).

Economist Olivia Sarahi Angeles, who specializes in fiscal matters related to the Mexican oil industry, said the structure of the tax reforms approved by Congress does not allow PEMEX to invest the additional resources in key areas such as petrochemicals and refining. Instead, those resources must be spent on production and exploration. "This is a problem because the high cost of petroleum is forcing us to import refined products, whether oil or gas, at increasingly high prices," said Angeles. "Ironically, our gasoline prices are extremely high even though we are a petroleum-rich nation," she added.

Nationally syndicated columnist Sergio Sarmiento said the El Fenix case is a clear example of the constraints that politicians have placed on industrial projects in Mexico. "Mexico will continue to lose its competitive position in many industrial sectors," said Sarmiento. "This is not because we lack expertise, but because our political system continues to place unnecessary roadblocks." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on July 20, reported at 10.63 pesos per US$1.00] (Sources: The Dallas Morning News, 06/29/05; Agence France-Presse, The Situation Room-Bank of America, 06/30/05; Radio Formula, 07/01/05; Reuters, 07/11/05; Agencia de noticias Proceso, El Siglo de Durango, El Sol de Puebla, 07/12/05; Notimex, 06/20/05, 07/01/05, 07/14/05, 07/15/05; La Jornada, 06/30/05, 07/02/05, 07/03/05, 07/16/05, 07/17/05; El Financiero, 06/21/05, 07/11/05, 07/18/05; La Cronica de Hoy, 06/30/05, 07/12/05, 07/14/05, 07/18/05)