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President-elect Felipe Calderon has pledged to continue plans by his three predecessors to bring private investment into Mexico's energy sector, but any significant changes are going to be difficult. The new president will, like his predecessors, be hampered by the Mexican Constitution. And any efforts to change the Constitution will put the new administration at odds with a center-left coalition in Congress, the Frente Amplio Progresista (FAP), which has vowed to block all efforts to turn over the energy sector to private parties, most of whom are likely to be foreign companies.

This means that Calderon will have to rely heavily on the other major opposition party, the Partido Revolucionario Institucional (PRI), to approve any new initiatives to bring private capital to the oil, electric, petrochemical, and natural gas sectors.

Calderon's three predecessors, Carlos Salinas de Gortari, Ernesto Zedillo, and Vicente Fox, promoted policies that brought private investors into activities that were at one time exclusively reserved for the government. Salinas initiated the process through a policy that allowed private companies to produce a small amount of electricity for their own use (see SourceMex, 1993-06-16). This concept was expanded during the Zedillo and Fox years (see SourceMex, 2000-05-17). However, a proposal to change the Constitution to allow private participation in the electrical sector was shot down in 2002 (see SourceMex, 2002-06-05).

Under Salinas and Zedillo, the state-run oil company PEMEX entered into agreements with foreign partners to assist with such tasks as oil exploration, refining, and extraction, but the company remained in control of all projects. Zedillo also succeeded in opening such functions as distribution of natural gas to private entities (see SourceMex, 1996-04-24), but a plan to privatize petrochemical plants failed because of strong opposition in the Congress (see SourceMex, 1996-10-23).

Fox pushed through a plan to allow private entities into exploration and extraction of natural gas in the Burgos basin in northeastern Mexico through multiple-services contracts (contratos de servicios multiples, CSMs). This plan met considerable opposition, but Fox had enough support from his pro-business Partido Accion Nacional (PAN) and from the PRI to implement the program (see SourceMex, 2003-07-23 and 2004-04-24).

Calderon urged to restructure PEMEX's tax situation

The partial privatization of some PEMEX functions during the Salinas, Zedillo, and Fox administrations was an effort to address PEMEX's extreme cash-flow problems. The oil company has been used for decades to finance the Mexican Treasury, surrendering a large share of its earnings through "taxes." Revenues from crude-oil exports are used to finance about one-third of the federal budget, which is limited by an extremely inadequate tax-collection system.

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The World Bank estimates Mexico's tax collection in recent years has been 12% to 15% of GDP, one of the lowest in Latin America, which has led the government to rely on PEMEX to finance its operations (see SourceMex, 1999-11-03, 2001-04-04 and 2004-08-25). Under the current system, PEMEX pays the "taxes" to the government and then receives a budget that is many times smaller than the amount of money transferred to the federal treasury.

"This situation has to be reviewed very carefully," said Gilberto Ortiz, who chairs the energy committee at the Camara Nacional de la Industria de Transformacion (CANACINTRA). "They have to stop bleeding PEMEX and ensure that the company has the resources required [to operate properly]."

Other advocates of structural reforms to PEMEX say that that any comprehensive changes have to include measures to reduce or eliminate corruption and waste. "There has to be a strict audit of PEMEX activities, because we know that this has been a very corrupt company," said Miguel Gaytan Molina, an analyst with the consulting company Bursametrica. Even with record-high oil-export prices the last several years, PEMEX has been left with little money to invest in upgrading infrastructure and in exploration and development of deep-water wells (see SourceMex, 2005-07-20).

Leticia Armenta, director of the Centro de Analisis Economico at the Tecnologico de Monterrey, said PEMEX would be a very profitable company under normal circumstances, considering that extraction and production costs are only about US$10 per barrel while selling prices are about US$60 per barrel.

The company's profitability is also limited by its lack of infrastructure, especially refineries. This has forced PEMEX to pay high prices for gasoline imported from US refineries (see SourceMex, 2005-10-26). "The refining network is not sufficient to produce the amount and quality of gasoline that our country requires," said Gaytan.

The Calderon administration is going to have to push for structural reforms that address both the energy sector and the tax system. If the government begins to reduce reliance on oil-export revenues, the tax base is going to have to be increased to keep the government solvent. Analysts say Calderon has made it clear that private investment is the best strategy for PEMEX to remain a viable entity. "The state-run oil company cannot use its earnings for its operations because they are needed by the federal government and the states," said Gaytan. "Therefore, private investment is needed to support efforts to modernize its infrastructure."

Center-left coalition to oppose privatization

Any options to bring in private participation to help finance the oil company's operations are limited by the Mexican Constitution. And if Calderon moves to modify the Constitution to allow more direct investment by private entities in PEMEX or the state-run electrical utilities, the center-left Partido de la Revolucion Democratica (PRD) and two other parties that comprise the FAP are more than ready to block those efforts in Congress.

The FAP is supported by 320 labor and civic organizations, including the independent Sindicato Mexicano de Electricistas (SME), which have formed a coalition, the Frente Nacional en Defensa de

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la Soberania Energetica, whose principal mission is to prevent any efforts by Calderon to open the energy sector further to private investments. The FAP said one of its goals is to push the government to create a "social rate" that will make electrical power affordable for everyone in Mexico.

Among those involved in the new coalition is former presidential candidate Andres Manuel Lopez Obrador, who lost the 2006 election to Calderon by a very narrow margin (see SourceMex, 2006-07-12 and 2006-09-06). "We are not going to allow the privatization of the electricity or oil industry in any form," Lopez Obrador said in a radio interview.

David Shields, a private energy consultant, said a wide variety of other interests in Mexico oppose major changes to the structure of PEMEX. "If [Calderon] wants to give PEMEX autonomy and allow PEMEX to reinvest more of its profits, he's going to find opposition from the petroleum-workers union, businesses, public officials, and governors who are interested in maintaining the status quo and do not see the state-run oil company as a private entity," said Shields, who writes a column for the Mexico City daily newspaper Reforma.

Therefore, the new president is not expected to push hard for any major reforms at the start of his administration, especially given the extremely narrow margin of victory in the presidential election. "If Calderon attempts to push such reforms at the start of his administration...he runs the risk of suffering major defeats that could damage his ability to govern during the rest of his term in office," said Shields.

Conversely, Calderon is facing pressure from the business sector to make the changes necessary to PEMEX to ensure that it becomes a viable company. "This is an important first battle," analyst Benito Nacif of the Centro de Investigacion y Docencia Economica (CIDE) told the Christian Science Monitor. "In the industry sector, there is a consensus that this reform is necessary, that you have to open it up [to the private sector]. The question is: 'Will [Calderon] be able to build sufficient [political] consensus?'"

New president expected to work closely with Congress

Calderon has been cautious regarding how far he would take the opening of the energy sector, even though he knows he can count on the full support of the PAN, which won a plurality in both houses of Congress in the July 2 election (see SourceMex, 2006-07-12). "The PAN delegation in Congress has the same priority as the president-elect," said PAN Sen. Juan Bueno Torio. "We want to strengthen PEMEX with private investment in the areas that need it the most."

This means that any initiatives on energy reforms will depend heavily on Calderon's ability to negotiate with the PRI and its coalition partner the Partido Verde Ecologista Mexicano (PVEM). The two opposition parties could opt to align with either the PAN or the FAP. As recently as 2005, the PRI approved a resolution expressing its willingness to consider some opening in the energy sector (see SourceMex, 2005-03-16).

Calderon is expected to eventually offer a package to Congress that maintains strict government control of PEMEX and the state-run electric companies but also offers opportunities for participation

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beyond the flat-fee CSMs enacted by Fox. Unlike Fox, who often found himself in battles with Congress, Calderon is expected to have a better relationship with legislators. This is partly because he has served in both the legislative and executive branches, first as floor leader for the PAN in the lower house and later as energy secretary under Fox. "He has qualities that could prove to be a key to success," said Shields. "He has legislative experience and a willingness to work closely with legislators to build consensus."

The president-elect has already promised to ensure that Congress has a significant role in the final decision on opening the energy sector. "I will respect any decision reached by Congress on this issue," Calderon said during a meeting in Ottawa with Canadian Prime Minister Stephen Harper in late October. One option that has been proposed is to list PEMEX on the Mexican stock exchange (Bolsa Mexicana de Valores, BMV).

This proposal has drawn the interest of some Mexican entrepreneurs, including Roberto Gonzalez Barrera, chairman of the board of the food company Grupo Industrial Maseca (GRUMA). "Even though we are a [food company], we would certainly be interested in acquiring shares in PEMEX if this option becomes available to the public," said Gonzalez Barrera, who also serves as chairman of the board of Grupo Banorte, one of Mexico's largest banking institutions.

The limits to private investment in PEMEX and its inability to keep its earnings have left the company no alternative but to resort to global money markets to issue bonds. As of September of this year, the company had a debt of 594.6 billion pesos (US$54.8 billion). This is an increase of about 57 million pesos (US$5.2 million) from a year ago. And PEMEX officials have already said they plan to issue as much as US$2 billion in global bonds and other debt instruments to finance projects during 2007.

Cuauhtemoc Cardenas endorses some private investment

During October, two respected personalities offered surprising positions regarding bringing private capital into the energy sector. PRD founder Cuauhtemoc Cardenas, whose father, ex-President Lazaro Cardenas del Rio (1934-1940), nationalized the oil industry in the 1930s, issued a position paper calling for more private investment in PEMEX secondary activities. Conversely, billionaire Carlos Slim Helu made comments to reporters that private investment was not needed in the expensive process of exploring and extracting deep-oil reserves in the Gulf of Mexico. Cardenas released his position paper in late October in which he acknowledged that PEMEX is in dire need of financial resources to expand secondary activities like refining and production of petrochemicals.

To accomplish this, said Cardenas, the company "should explore new forms of association" with Mexican and foreign partners. The position paper, which was released on the 36th anniversary of the expropriation of the oil industry, recommended that petrochemicals and refining become the departure points for a new industrial policy in Mexico.

The PRD founder also presented positions that coincided with proposals offered by PAN and PRI members in Congress, including making major changes to the PEMEX tax structure and giving legislators a greater say in oil extraction. The document found support within the PRD. Party secretary Guadalupe Acosta Naranjo said the plan is acceptable to the party because it maintains

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regulatory control of PEMEX in the hands of the state and allows the participation of the private sector only in secondary activities.

Slim Helu, one of Mexico's top business leaders, offered his unexpected comments during a tour of deep-sea oil-drilling platforms. Slim said he saw no need for private entities to participate in exploration and extraction of Mexico's deep-sea oil reserves. "Yes, PEMEX can conduct this activity on its own," said Slim.

Slim acknowledged, however, that PEMEX would not have the resources for exploration and extraction without major reforms to its financial structure. He recommended that the company be given budgetary independence rather than having to rely on allocations from the federal government. In June, PEMEX announced the discovery of a major reserve in the deep waters of the Gulf of Mexico (see SourceMex, 2006-06-21).

In recent statements, Calderon said the oil company cannot conduct expensive activities like exploration and extraction in the deep waters of the Gulf of Mexico without external technological and financial assistance. He said he would like to work with companies like Brazil's Petrobras, which has experience in deep-sea drilling. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Nov. 8, reported at 10.84 pesos per US$1.00] (Sources: The Herald-Mexico City, 09/28/06; The Houston Chronicle, 10/01/06; Reuters, 10/03/06; The Christian Science Monitor, 10/27/06; Milenio Diario, 10/04/06, 10/05/06, 10/10/06, 10/13/06, 10/20/06, 10/23/06, 10/31/06, 11/01/06; El Economista, 10/04/06, 10/18/06, 10/23/06, 10/26/06, 11/01/06; Notimex, 11/02/06; Excelsior, 07/07/06, 10/04/06, 10/10/06, 10/31/06, 11/02/06, 11/07/06; La Jornada, 09/28/06, 10/04/06, 10/10/06, 10/16/06, 10/23/06, 11/01/06, 11/07/06; Reforma, 09/28/06, 10/04/06, 10/10/06, 11/06/06, 11/07/06; El Universal, 09/28/06, 10/24/06, 10/27/06, 11/01/06, 11/06/06, 11/07/06; El Financiero, 10/10/06, 10/11/06, 10/31/06, 11/01/06, 11/06/06, 11/07/06; La Cronica de Hoy, 10/20/06, 10/27/06, 11/01/06, 11/07/06)

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