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President Felipe Calderon Offers Plan To Reform Pemex; Center-left Coalition Forces Extended Debate

by LADB Staff
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The proposal to reform the state-run oil company PEMEX finally got back on track after the major parties in Congress agreed to schedule a special session in May-July to hold a 70-day debate. The Frente Amplio Progresista (FAP), a coalition of center-left legislators, was the main catalyst behind the special session. FAP legislators took over the podium in both houses of Congress to protest President Felipe Calderon’s proposed reforms for PEMEX and the president’s suggested timetable for Congress to approve relevant legislation by the end of its session on April 30.

The FAP coordinated its strategy with former presidential candidate Andres Manuel Lopez Obrador, who has denounced Calderon’s plan as an effort to sell Mexico’s oil sector to private interests. The Calderon plan would bring the private sector into certain PEMEX operations, but it also contains many safeguards to ensure that the oil company remains in the hands of Mexicans.

Congress welcomes president’s decision to present plan

The Congress was pleased that Calderon had finally put forth a proposal to reform PEMEX, but the short window suggested by the president did not sit well with many legislators from the FAP and from the opposition Partido Revolucionario Institucional (PRI). In presenting his proposal, the president said reforms had been put off for many years and it was urgent to begin to address a looming crisis for PEMEX. The company not only faces a major decline in crude-oil reserves in the next several years (SourceMex, March 07, 2007) but also a lack of capital to conduct deepwater drilling and exploration, construct new refineries, and replace aging and increasingly dangerous infrastructure (SourceMex, August 10, 2005, October 18, 2006, October 31, 2007, January 30, 2008).

All the political parties in Congress agree that PEMEX could become more financially viable if it is allowed to keep more of its revenues to devote to its operations. In recent years, Congress took small steps toward this goal by enacting changes in the tax structure for PEMEX, allowing it to keep an increased percentage of its revenues (SourceMex, July 20, 2005 and September 19, 2007). The major disagreement is whether a change in PEMEX’s financial structure will provide sufficient capital for the company to conduct exploration and extraction activities for new reserves and also handle all the needed construction projects. PEMEX officials say the company does not have the money or the expertise to begin gaining access to recently discovered reserves in the deep waters of the Gulf of Mexico (SourceMex, March 22, 2006).

PEMEX director Jesus Reyes Heroles said Mexico must obtain about 500,000 barrels per day (bpd) from deep waters by 2021 to keep production at around 3.1 million bpd. The drop in reserves translates to a drop in output. In a report in late April, PEMEX reported that production declined by 7.8% in the first quarter of 2008. "We have to act now, before it’s too late," Calderon said when he presented his PEMEX-reform proposal in early April.
The administration officials argue that an influx of capital into PEMEX would help make the company more viable, which would benefit the Mexican economy in the long run. "Strengthening the oil industry would generate benefits for the country...and increase the rate of growth of our GDP, which could increase by close to 1%," Energy Secretary Georgina Kessel told participants at a business conference in mid-April. The FAP which includes the Partido de la Revolucion Democratica (PRD), Partido del Trabajo (PT), and Partido Convergencia por la Democracia (PCD) agrees on the need to strengthen PEMEX financially but says this can be accomplished without the participation of private entities.

The coalition contends that the company can become financially self-sufficient if reforms are comprehensive enough, especially with oil prices expected to remain near record-high levels for the foreseeable future. The average price for Mexican crude oil was hovering near US$100 per barrel in mid-April, twice the prevailing price of about US$49.28 in early 2006 (SourceMex, March 22, 2006). The 2008 budget approved by Congress was based on a price of about US$49 (SourceMex, November 14, 2007). Proposal careful about not violating Mexican Constitution Calderon had wanted to propose much more comprehensive changes to PEMEX, including greater private participation. But he decided to send Congress a diluted proposal to give the legislation the best chance of passage, particularly if he is able to sell the plan to the PRI. In his plan, Calderon was very careful to leave out any proposal for PEMEX to form joint ventures with foreign companies, which would be construed as a violation of the Mexican Constitution.

The proposal also bars private entities from investing directly in exploration and production. What the plan offers private parties is the opportunity to build and operate refineries, pipelines, and storage facilities through "incentive contracts," whereby companies would be paid for a job well done. Reyes Heroles told reporters that these contracts would be more interesting to up-and-coming oil companies rather than international giants like Royal Dutch Shell PLC or ExxonMobil Corporation. "Maybe not ExxonMobil, but other companies," Reyes Heroles said when asked what kind of companies would be attracted by these contracts. The president's plan also proposed that PEMEX be given greater flexibility to work with foreign companies with expertise in deep-water drilling like Brazil's Petroleo Brasileiro, S.A. (Petrobras) in developing oil fields in the Gulf of Mexico.

Additionally, the legislation proposes to free the company from bureaucracy and micromanagement by Congress and the Secretaria de Hacienda y Credito Publico (SHCP). "It is a positive move for PEMEX to make adjustments to its budget and use as much as 10% of its profit without any intervention from the SHCP," said nationally syndicated columnist Sergio Sarmiento. And, in an effort to make the company's operations more transparent and to stem corruption, the plan would add four outside experts to PEMEX's board.

One controversial provision of the plan would allow the government to sell special PEMEX bonds available only to Mexican citizens. Officials see this not only as a small source of revenue but also as another step to improve corporate governance because the bondholders would have an interest in ensuring that the company operates responsibly, said Finance Secretary Agustin Carstens. Oil-industry analysts labeled the plan a good start but said it falls short of making the sweeping changes necessary to set Mexico's ailing state oil company back on track. "[The Calderon government] is
perhaps taking 50 tiny steps in the right direction," said David Shields, a Mexico-City based analyst who has written extensively about the Mexican oil industry. "That's better than nothing, but it's not much better than nothing."

Conversely, the proposal to involve the private sector in any way in PEMEX has provided a rallying point for Lopez Obrador and the FAP. The former presidential candidate organized two huge rallies at Mexico City's Zocalo square in April to protest Calderon's plan to "sell out" the patrimony of Mexicans. The leftist leader, who has called any private investment in PEMEX a threat to national security, said he has signed up 28,000 volunteers who are ready to carry out blockades of oil fields if Congress approves a law that transfers any part of the operation to private hands. "We cannot accept or allow

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