

The Mexican energy sector under the Vicente Fox administration

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Energy reform is perhaps the third most important issue for the Fox administration after cultural and indigenous rights law and the new fiscal policy proposals. Throughout his presidential campaign, Fox referred to the energy sector in terms of openness and privatization, particularly before the American public. However, before the Mexican public, his statements acquired a different tune and content. He compromised on earlier statements not to privatize either PEMEX or the Federal Commission of Electricity (CFE). Where does energy reform stand after six months under the Fox administration?

ENERGY POLICY: A WORK IN PROGRESS

The energy policy under the Fox administration is still a work in progress. Most importantly, Mexico is participating in a process led by the United States—the institutionalization of a North American energy market—but there are many issues that are not resolved.

In the oil sector, *Petróleos Mexicanos* (PEMEX)—one of the leaders of national development—will continue to operate as a state firm. The macroeconomic importance of oil income for Mexico is well known. For the year 2000, hydrocarbons represented 3 percent of GDP. In budget terms, this represents a contribution of 36 percent. The strategy for the future of PEMEX is to modernize in order to be competitive with international oil industry levels of performance. This is one of the explanations for the integration of an eight-member advisory council, who will support PEMEX board of directors' decisions, having a voice although no vote at meetings. A second step toward modernization proposed by Fox is integral fiscal reform—designed not only to fulfill the economic program but also to aid the industry's drive to modernize by retain-

ing part of its income for reinvestment in PEMEX-defined priorities.

In spite of significant levels of oil production—three million barrels a day—PEMEX has difficulty supplying the refining and natural gas industry. This difficulty will have to be overcome by increasing imports of both fuels. The petrochemical industry has also faced obstacles in the privatization process. In the rest of the industry, private investors are expected to be introduced under the modality of “creative investment schemes.” To this point, private capital has been working with PEMEX through so-called service contracts, in several areas of the industry. Upstream activities, such as exploration and development, are not open to private investors. (See the table on the facing page.)

In the electricity industry, the main problem is financing. Official documents estimate that \$5,000 million annually is required to meet supply and demand; this is between 6 to 7 percent of the annual rate. During President Zedillo's administration, an electricity reform was proposed. The intent was to increase and encourage the private participation already existing in this sector (self-generation, co-generation, and

small production of power), as well as for other activities such as distribution, commercialization, and generation. Nevertheless, the Mexican Congress did not approve the proposal. It is not clear if the new administration will adopt the same electricity reform proposal or introduce changes. Meanwhile, the sector is being prepared to implement market mechanisms, such as the creation of a wholesale market to attract risk capital to the industry.

THE CONSTITUTIONAL QUESTION

The energy sector faces a different kind of dilemma. The reforms already implemented such as the partial electricity sector openness (1992) and the natural gas reform (1995), have fulfilled their goals and met their targets. Government argues that its revenue base is reaching its limits. Even in terms of raising monetary resources, these are better oriented to social and educational programs. In the case of natural gas, the level of investment required to increase the non-associated natural gas supply is tied to the annual approval of the Treasury Ministry and the House of Representatives and not enough money has been set aside for new developments. It is therefore obvious that major changes are necessary to attract risk capital. However, a paradox arises due to the new political spectrum in Mexican society. One of the results of increased democracy is that the pluralism practised by the divided Mexican Congress has refused to give Fox *carte blanche* to privatize the publicly controlled energy sector.

In order to implement the necessary changes to open up the sector to private investors, President Fox must convince the opposition to modify secondary rules (PEMEX procedural rules) as well as to amend important constitutional articles 27 and 28.

Article 27 states that

[t]he domain of all natural resources belongs to the Nation ... fuels, minerals, oil and all hydrocarbons ..., no concessions are allowed in the case of oil, solid, liquid and gas hydrocarbons ..., the Nation is in charge of exploitation of all these products ...

Article 28 states that

[i]t does not constitute a monopoly the exclusiveness of State functions in strategical areas; ... oil and the rest of hydrocarbons; basic petrochemicals, electricity, nuclear energy etc. ...

These constitutional reforms would require a qualified majority in Congress (two-thirds of balloting) and a simple majority of 51 percent in the 32 local congresses. While the National Action Party (PAN) will support the presidential proposal, Fox needs support from the Revolutionary Institutional Party (PRI). It is not clear how the PRI will vote. The Democratic Revolutionary Party (PRD) opposes radical changes to the constitution but favours the introduction of different possibilities or financial schemes to encourage private investors. Therefore, the opening of the sector is likely to continue in a slow and gradual way. At the moment, the most realistic approach to achieve openness is the secondary rules for private investors.

A NORTH AMERICAN ENERGY MARKET

As for the big picture, the Fox energy project seeks to “make real” the old U.S. proposal to create an integrated energy market between the three NAFTA partners. The energy integration discussion is not new, but in the Mexican case it has been accelerated by NAFTA and today is part of a bilateral agenda with the United States. This change may be the result of the hardening of the U.S. foreign policy toward Mexico and the disposition of the Mexican administration to give in to the U.S. demands to avoid pressure. It also certainly has to do with changes in Mexican foreign policy.

Oil Products Foreign Trade 2000 (Thousand of barrels a day)

	Oil	GLP	Gasoline	Fuel oil	Diesel	Natural gas (MMcfd)	Petrochemicals (Tt)
Exports	1,652	5.5	69.7	0.1	4.4	23.6	1,116.2
Imports		122.5	90.6	116.5	27.7	231.4	317.3

Source: PEMEX, Indicadores Petroleros, México, Petróleos Mexicanos, www.pemex.com/eimporpetro.html.

GLP=LP Gas MMcfd=Millions of cubic feet daily Tt=Thousand of tons

Mexico negotiated for an immigration agreement and for the possibility of exclusion from the annual certification process on drug-dealing activities. This is an annual U.S. congressional procedure for approval of cooperation strategies. Fox indicated approval for Bush’s demands to consolidate the North American energy market, although it is not clear what was really negotiated. The details are few and there is no clear framework. There is interest in Mexico to develop the non-associated natural gas resources found in the northeast of Mexico in the Burgos and Sabinas Basin and also in the gulf of Baja California. There are two types of gas reserves: associated reserves and non-associated reserves. Associated reserves are found with petroleum and most of these are located in the Campeche Gulf where oil production is very important. Non-associated reserves or dry gas can be found with or without oil. A long-term goal is to make Mexico a net natural gas exporter. At present natural gas exportations are virtually insignificant—0.53 percent in 1999 and .035 percent in 2000. According to estimates, Mexico will be a net importer for the next 10 years and later, depending on non-associated gas production, could become a significant exporter.

In the electricity sector, it is expected that 1,600 MW of power capacity will be built on the northern Mexico border to help solve California’s energy crisis and generate hundreds of millions in new energy revenues. Since January 2001, Mexico has been exporting electricity to California at US\$195 per megawatt hour. From January 16 to February 28, the value of these electricity exports was

US\$3,278. The main source of power is fuel oil, 45 percent in 2000, with hydro resources contributing only 17.3 percent. Natural gas is expected to play a major role in the future.

All evidence indicates that Mexico will continue to play the role of crude oil supplier to the continental market, with 80 percent of its exports going to the United States. In the natural gas sector, border infrastructure is being improved to enhance trade with the U.S. southern market, and there is one proposal to leave the private sector in charge of LPG imports. Under Bush’s proposal, Mexico’s collaboration is helping to solve California’s electric sector problems. With the possibility of blackouts in Arizona and perhaps even in New York, there is talk of building generation facilities in Mexico to export to the United States as a sort of electricity *maquiladora* industry.

As we can see, integration has mainly occurred with the United States and in some ways the United States defines the modality, depth, and rhythm of the Mexican energy sector. Mexico’s relationship with Canada is limited to technology imports, although there are Canadian investors in the oil industry as well as in the electricity industry.

The U.S. interest has always been to guarantee open access to Mexico’s oil supply, as with Canada’s oil resources, and to let foreign investors participate in hydrocarbon upstream activities. But again, this requires a constitutional change that must be approved by a Mexican Congress, and Fox will have to persuade the Congress about the “goodness” of such concessions. 