Felipe Calderón's Proposed Energy Reform

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The Senate debate on the reform.

Introduction

Mexico is debating the energy reform bill President Felipe Calderón sent to the Senate. It is fundamentally a reform of the state-owned oil giant, Petróleos Mexicanos (Pemex), and the oil industry. Its aim is to open up investments to the private sector in all activities, specifically to broaden out exploration and drilling in already localized basins and on the new frontiers, above all in the deep waters of the Gulf of Mexico, where the government proposes to multiply exploration, drilling, etc. ten-fold.[1] To this end, the government proposes Pemex's administrative and business reorganization to strengthen its corporate governance in the manner of multinational corporations.

This article's aim is to present an overview of the Energy Reform Bill, its main proposals and the most important reactions to it, and to propose some alternatives for energy policy.

Calderón's Energy Reform

Several months before presenting the bill, the Calderón administration, in the style of his predecessor, Vicente Fox,

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> Every one of Calderón's affirmations was refuted by specialists, academics, opposition political leaders and most importantly by retired Pemex experts, who used official figures from Pemex itself and the Ministries of Energy and Finance to demonstrate that the country did have large oil reserves that would last 30 years.

launched a media campaign to present a series of arguments to convince the public of the need for private investment and strategic alliances with multinational corporations in the oil sector. The administration argued:

1. Mexico's oil reserves will only last nine years;
2. Pemex does not have the money to do the exploration necessary to find the deposits that would compensate for the drop in reserves and of crude pumped;
3. Pemex does not have the technology to explore and drill in the deep waters of the Gulf of Mexico, and therefore it needs to partner up with international companies that have that technology; and
4. The government is not going to privatize Pemex.

Soon, every one of these affirmations was refuted by specialists, academics, opposition political leaders and mainly by retired Pemex experts, former executives, who used official figures from Pemex itself and the Ministries of Energy and Finance (SHCP) to demonstrate that the country did have bigger oil reserves that would last 30 years. In addition to the government-recognized proven reserves (11.0476 billion barrels), there are 11.0339 billion barrels in probable reserves and another 9.8253 billion in possible reserves. All tolled, Mexico has certified 33.093 billion barrels of 3P reserves.[2]

Later, the government itself reported that in addition, the country has prospective Gulf of Mexico deep-water resources calculated at around 29.5 billion barrels, and. the bill introduced April 8 to amend the regulatory legislation for Article 27 of the Constitution states that the country has 100 billion barrels.[3]

In addition, Pemex generates sufficient earnings to invest in the industry's activities that are currently in the red. It is the company that generates the most income from sales in the country. For example, in 2007, it earned US$104.5 billion.[4] For Pemex to invest in repairing the deterioration caused by the different administrations over the last 25 years, it would be enough for the government, through the Finance Ministry, to reduce its taxes and fees.

Technology can be purchased or rented. This is something that the world's main multinational oil corporations do. Therefore it is unnecessary for Pemex to form partnerships with foreign companies.

It is also false that it is urgent —or even a good idea— for Mexico to search for oil in deep waters, which is very costly and uncertain. While drilling a well on land and in shallow waters (less than 500 meters deep) costs US$25 million, in deep waters, the price rises to US$150 million and the government is projecting the drilling of 2,000 wells.[5] The cost of this experiment will be US$300 billion.

What is advisable is to invest in developing the probable and possible reserves and increasing exploration of shallow waters, and at the same time, for Pemex to advance in deep water exploration and drilling just as it has been doing. To date, one well, the Lakach-1, has been drilled, a 988-meter deep shaft that turned out to hold non-associated gas.[6]

Regarding the government's statement that it will not privatize Pemex, the theory about privatization should be kept in mind. The 1993 book *Accounting, Valuation and Privatization*, published by the UNCTAD as a guide for nations, defines privatization as going beyond the transference of public property to the private sector: it includes the more general concept of introducing or strengthening already existing market forces. Worldwide, privatization has been carried out in three main ways:

1. State-owned companies contracting out activities to private companies;
2. Deregulating monopolies or quasi-monopolies; and
3. Selling public goods or assets.[7]

Clearly, the Calderón administration is promoting the privatization of Pemex in the first way, that is, by its state-owned companies contracting out activities to private companies.

DIAGNOSIS OF THE SITUATION OF PEMEX

A few days after introducing its reform bill, on March 30, the administration, through Energy Minister Georgina Kessel and

Pemex Director Federico Reyes Heroles, presented a document called "Diagnóstico: situación de Pemex" (Diagnosis of the Situation of Pemex). This analysis focuses on detecting Pemex's activities' deficiencies in order to open Pemex up to private investment for business purposes, or increase an already existing participation. This would be legalized through the legislation presented in the reform bill.

The Reform Bills and Proposals

The energy reform consists of five bills:

1. A bill outlining a new charter for Petróleos Mexicanos;
2. The Reform Bill to Change the Federal Administration;
3. A bill to reform the Law on the Energy Regulatory Commission;
4. A bill to reform the Regulatory Law for Article 27 of the Constitution;
5. A bill to create the Oil Commission.

Pemex's new charter would establish as the company's objective a substantial increase in its production of oil and derived and refined gas, as well as its participation in exploring for new reserves. To do this, it proposes:

- A change in management by strengthening corporate governance, in the style of multinational corporations, with a board of directors and auditing and remunerations commissions. On its web page, Pemex states that this change will allow it to make timely decisions based on entrepreneurial criteria.
- To give the Board of Directors full authority to reorganize and restructure the company, management, etc., whereby it will transform Mexico's oil industry. In addition, four professional members, appointed by Mexico's president, would join the board, with access to all the information they need about Pemex to be able to carry out their duties. What is even more important is that any decision made by the board would require the vote of at least two of these professional members.
- To reiterate that Pemex needs to increase its operating capacity, free up productive capacity, modernize, etc. To do this, it needs greater flexibility in order to explore new production frontiers. That is, to move into deep water.
- To give Petróleos Mexicanos greater management autonomy for managing its budget and acquire debt.
- To authorize the Board of Directors to issue citizens bonds. These securities would not offer either property or corporate rights over Petróleos Mexicanos, nor would they affect the domain or exploration of oil. They will be linked to Pemex's performance and the payment of its debt. Although the proposal states that these bonds can only be purchased by Mexicans, it also stipulates that the pension-management funds (Afores) will also be able to purchase them, which will benefit foreign banks that own the Afores.[8]

The government proposal makes Pemex responsible for the debt that the federal government should shoulder since it is a state-owned company.

Some important aspects of the Reform Bill to Change the Federal Administration are that private individuals will be encouraged to participate in the sector's activities and energy-related concessions, permits and authorizations will be revoked.

The Decree Reforming the Law on The Energy Regulatory Commission

This decree changes paragraphs of articles in the law to regulate the activities being privatized:

- First-hand sales of products derived from refining, gas and basic petrochemicals.
- Transportation and distribution of gas and the products obtained from refining oil and basic petrochemicals, through pipelines, as well as the storage of these products (Article 2, paragraph VI).

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- The transportation and distribution of bio-fuels, through pipelines, as well as their storage (Article 2, paragraph VII).
- The Energy Regulatory Commission is ordered to regulate the participation of the social and private sector in the transportation, storage and distribution of oil products and basic petrochemicals, as well as to continue presenting proposals for legislation. It should be assumed that this regulation will harmonize with the regulations the United States establishes through the Federal Energy Regulatory Commission (FERC), and that these regulations will be shared by the member countries of the Security and Prosperity Partnership of North America (SPP), signed by former President Fox in March 2005 and taken on board by Calderón.[9]

Among the changes proposed to the Regulatory Law for Article 27 of the Constitution in the Oil Sector are those in the bill's Article 6: "Petróleos Mexicanos and its subsidiaries will have the power to sign contracts with individuals or legal entities for works and services." The bill's Article 4 stipulates that the social and private sectors, will be allowed, after obtaining permission, to carry out activities of transportation, storage and distribution of gas, the products derived from oil refining and from basic petrochemicals.

Article 1 of the bill on the Oil Commission creates that body as a decentralized entity of the Ministry of Energy for operations involving exploration and exploitation of hydrocarbons in their different spheres.

The Most Important Positions

Ever since the forum about the first point of debate on the agenda, the constitutional analysis of the bills,[10] two positions clearly emerged: that of experts who supported the government proposal, and those who critiqued it. The administration and its allies argued:

- That the energy reform is not unconstitutional and if a few points were inconsistent, they should be perfected.
- The energy reform does not privatize the industry, although it supports private investment in all activities according to the government's proposal itself.
- It will substantially increase Pemex's production levels of oil, gas and derivatives, and allow it to participate in exploring for new reserves. To this end, the reform proposes to make Pemex's management more autonomous, to increase its operational capacity through broadening out the participation of the private sector in all oil industry activities and by reorganizing Pemex along business lines, giving the Board of Directors the authority to create or liquidate subsidiary companies.
- That exploiting oil consists only of exploration, drilling and pumping.

Critical experts argue that Calderón's energy reform proposal is unconstitutional. Outstanding constitutionalists participating in the debate, among them former Supreme Court Judge Juventino Castro y Castro, stated that Calderón's energy reform is unconstitutional because it proposes that Pemex and its subsidiaries give contracts to the private sector, something expressly prohibited in the Constitution.

Article 27, Paragraph 6 of the Constitution stipulates, "In the case of oil and solid, liquid or gas hydrocarbons or radioactive minerals, no concessions or contracts will be given, nor will those which already exist be honored, and the nation will carry out all exploitation of these products in the terms stipulated in the respective regulatory legislation."[11]

Constitutionalist attorneys like Raúl Carrancá y Rivas argued that the Constitution's ban is unambiguous, leaving no room to legislators for interpretation, contrary to the government position defended by its allied jurists who, basing themselves on the theory of interpretation, say the proposal is not unconstitutional. Several of the reform bills are unconstitutional because they establish the possibility of signing contracts, or even direct assignation or contracts with incentives.[12] Multinational corporations like Shell have expressed interest in obtaining one of these to explore deep waters.

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The formulation of several of the bills is also unconstitutional, according to Jaime Cárdenas, for example, in the attributions they confer on the Board of Directors, such as those involving the budget and contracting of debt, which Article 74 of the Constitution establishes as the sole prerogative of the Chamber of Deputies.

The Government Proposal vs. The Real Situation of Oil

Calderón's proposal for reforming Pemex and the oil industry would privatize it and favor multinational corporations. In addition, it is counter to the constitutional principle giving the state exclusive rights to exploit oil.

Article 4 of Calderón's proposal to reform Article 27 of the Constitution states that the social and private sectors will be able to get permission to carry out transportation, storage and distribution activities of gas, the products derived from oil refining and of basic petrochemicals.[13]

The five bills propose the participation of the private sector in oil industry activities. With this, the administration is proposing the privatization of transportation, storage and distribution not only of gas but also of gasoline, diesel fuel, turbo fuel, fuel oil, as well as other products derived from oil refining and petrochemical production.

Calderón's proposal will privatize aspects of refining because his bill to reform the Regulatory Law for Article 27 of the Constitution stipulates that Petróleos Mexicanos and its subsidiaries will be authorized to contract out oil refining activities. The persons who carry out these activities or services will be allowed to build, operate and own pipelines, installations and equipment.

As has already been explained, deepwater exploration is neither urgent nor appropriate for Mexico given the high costs of exploring and drilling. While technology does exist for exploring and drilling, there is no technology available in the world for pumping oil from 3,000 meters below the seabed. In addition, Mexico has 29.5 billion barrels of certified reserves on land and in shallow water (under 500 meters), where the cost of exploring and drilling is lower. Pemex can also pump that oil without the need to resort to alliances or partnerships with multinational corporations, which operate according to the criteria of the greatest profit and would take an important part of oil earnings with the contracts they would sign with Pemex, something that would increase even more if they were contracts with incentives.

Oil exploitation involves all oil industry activities: exploration, drilling, extraction or production, refining, petrochemical production, transportation, distribution and commercialization.

The governors from oil states have been very vocal in their support for Calderón's energy reform, but they ask to be allowed to participate in the exploration and exploitation of mature deposits that were abandoned by Pemex when it found richer, less costly fields.

Public Consultation

During the debate organized by the Senate, the head of Mexico City's government, Marcelo Ebrard, proposed consulting the public about the energy reform, particularly the reform of Pemex, "which [the public] has a right to under the Constitution." This proposal was accepted by some state governments headed by members of the Party of the Democratic Revolution (PRD), but rejected by the federal government and its allies.[14]

Conclusions: Possible Alternative Energy Policies

I think the following proposals should be taken into account as measures that can lead to a new energy policy for Mexico:

1. Comply with the Constitution, which stipulates that the nation shall control oil and all hydrocarbons, a responsibility that is inalienable and over which there is no statute of limitations.

2. The elimination of the confiscatory tax and payment regime.
3. A reform of Pemex to eliminate corruption in the upper echelons of the union and company officials and support for political campaigns, as well as to correct productive deficiencies.
4. An oil policy aimed at the country's economic development, including the redistribution of oil revenues, using what is needed to foster energy use based on alternative renewable energy sources.
5. A policy to integrate Pemex, the oil industry productive chain and the energy sector as a whole.
6. The elimination of international reference prices for domestic operations. The oil that Pemex Exploración y Producción (exploration and production) sells to the other three state-owned companies (Pemex Refinación, Pemex Gas y Petroquímica Básica and Pemex Petroquímica) should be sold at the value of the cost of production (US$4 to US$6.50 per barrel), not at international prices that range from US$80 to over US$100. VM

NOTES

[1] Minister of Energy Georgina Kessel announced this in a television news interview with Carlos Loret de Mola, anchorman of Televisa's *Primero Noticias* early-morning news program, on February 14, 2008.

[2] Pemex, *Anuario Estadístico 2006* (Mexico City: Pemex, 2006), on line at http://www.pemex.com/files/content/AnuarioEst_06_Portada.pdf. [Editor's Note.]

[3] See http://sil.gobernacion.gob.mx/Archivos/Documentos/2008/04/asun_ 2423743_20080425_1209149652.pdf. [Editor's Note.]

[4] Pemex, *Anuario Estadístico 2007* (Mexico City: 2007), available at http://www.pemex.com/files/content/Anuario20071.pdf. [Editor's Note.]

[5] Energy Minister Georgina Kessel in her February 14, 2008 television interview.

[6] According to Pemex, this field is producing from deposits located at depths starting at the sea floor, between 3,000 and 3,200 meters down, with production tests of 25,000,000 and 30,000,000 cubic feet a day in a vertical well. *Diagnóstico: situación de Pemex*, pp. 66-67, on line at http://www.pemex.com/files/content/situacionpemex.pdf.

[7] United Nations Conference on Trade and Development, *Accounting, Valuation and Privatization* (New York: UNCTAD, 1993), on line at http://unctc.unctad.org/aspx/allDocsYear.aspx. [Editor's Note.]

[8] The proposed new charter is available on line at http://www.sociedadenmovimiento.org.mx/debatepemex/docs/Iniciativa_de_la_Nueva_Ley_Organica_de_PEMEX.pdf. [Editor's Note.]

[9] See http://209.85.215.104/search?q=cache:IhFAXx8Gu34J:grupo reforma.reforma.com/infograficas/nacional/LCRE.pdf+Decreto+por+el+que+se+reforman+diversos+art%C3%ADculos+de+la+ley+de+la+Comisi%C3%B3n+Reguladora+de+Energ%C3%ADa&hl=es&ct=clnk&cd=15&gl=mx. [Editor's Note.]

[10] Other points are how Mexican oil income should be spent; exploration, exploitation and restitution of the oil reserve; transborder deposits; self-sufficiency in oil refining; and policies for strengthening the petrochemical industry. Other issues are relations with foreign companies and the jurisdiction of international courts; Pemex's tax regime; and its organization and management.

[11] See the current *Constitución política de los Estados Unidos Mexicanos*, on line at http://www.diputados.gob.mx/LeyesBiblio/pdf/1.pdf. [Editor's Note.]

[12] Article 5 of the proposed new charter of Pemex states that "Petróleos Mexicanos and its subsidiaries, in accordance with their respective objectives, will be authorized to sign all manner of acts, agreements and contracts as well as to contract debt with private individuals or institutions, maintaining exclusive control of the Mexican State over hydrocarbons, subject to the applicable legal stipulations." Articles 44, 45 and 46 of this bill allow for awarding contracts without bidding, by direct assignation, in the cases of spills and other risks; Article 46 even proposes contracts with incentives: "Pemex will have the authority to agree on incentives that would tend to maximize effectiveness or the success of a work or service, which will be paid solely in cash." See http://www. sociedadenmovimiento.org.mx/debatepemex/docs/Iniciativa_de_la_Nueva_Ley_ Organica_de_PEMEX.pdf.

[13] Felipe Calderón Hinojosa, *Iniciativa de reforma energética* (Mexico City: 2008), available on line at http://www.pan.org.mx/?P=reforma_ energetica. [Editor's Note.]

[14] It was proposed by the Broad Progressive Front, made up of three parties of the moderate left (the PRD itself, the Labor Party [PT] and Convergence) as well as private citizens from a broad spectrum of society. The results of this consultation, held July 27, 2008, can be found at http://www.consultaenergetica.df.gob.mx/. [Editor's Note.]