Business Standard

Mexico's reforms: Implications for India's energy security (Comment: Special to IANS)

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On Dec 1, 2012, when he became President of Mexico, Enrique Peña Nieto had his mind made up. He realized that the pulsating Mexican economy - whose GDP growth slumped to 1.3 percent in 2013 - needed some structural reform to take the next leap forward.

Mexico is a member of the OECD, the G20 and the North American Free Trade Area (NAFTA). Organically linked to the US, facing an onslaught from cheap Chinese imports, and resistance to fuller integration with its patrimonial Latin American cousins, Mexico is unique.

Mexico's Carlos Slim is probably the richest man in the world. President Peña Nieto is attempting to whittle down his telecom monopoly. He is also working on taxation reform. For all this and more, he has reached out to the right-wing National Action Party (PAN), which ruled Mexico for the previous 12 years. He needs still

more support.

Realizing this, he proposed a Pact for Mexico soon after taking charge. This involves the PAN as well as the left-wing Democratic Revolution Party (PRD), whose presidential candidate Andres Manuel Lopez Obrador, stung by his second defeat in the last presidential election, is in no mood for compromise. Nor, for that matter, is the PRD, which Lopez Obrador has since dissociated himself from.

In power from 1929-2000, Peña Nieto's own Institutional Revolutionary Party (PRI) began to splinter in the late 1980s with the departure of Cuauhtemoc Cardenas, who formed the PRD. He is the son of president Lazaro Cardenas, who nationalized the oil industry in 1938. The reverberations of that momentous decision continue to affect the Mexican economy.

The cornerstone of President Peña Nieto's reform is the further opening of Mexico's rich oil and gas sector to private and foreign investment. Shortly before midnight Dec 11, the Congress passed, by a two-thirds majority, the principles of energy reform, following the Senate's approval earlier in the day. This momentous vote raised uproar among the Left, which had been out in the streets protesting against the move to privatize the Mexican people's patrimony.

The constitutional reforms still need to be approved by 17 of Mexico's 32 state Congresses, but with 25 PRI or PAN governors this does not appear difficult. Thereafter the implementation will be through secondary legislation, which will determine the oil and gas blocs to be offered, and the terms for private sector and foreign participation.

Mexico's hydrocarbon resources are estimated at 115 billion barrels of oil equivalent (BOE). Three-fourths of these are identified as unconventional (shale oil, shale gas and deep waters), which cannot be exploited by the private sector under the existing legal framework. Earlier reforms had already opened up midstream and downstream activities to the private sector (refining, transportation, storage and distribution).

In 2008, Mexico passed a law that opened a very small proportion of mature fields to private investment. The "Pemex Law" (named after

the national oil company Petroleos Mexicanos - PEMEX) allows for contracts that would provide remuneration, based on a proportional scale, to contractors whose efforts incorporate the latest technology.

Despite a dramatic increase in the government's oil spending to $20 billion a year from $4 billion just a decade ago, output has declined from 3.4 million barrels a day to about 2.5 million. Proven reserves are down 41 percent since 2001, the Mexican Institute on Competitiveness says. The US contracted 70 companies to drill 137 deep-water wells in its offshore areas in 2012. Mexico, using only Pemex, drilled six, according to Mexico's government. While in the US controlled areas of the Gulf of Mexico, oil companies extract 300,000 barrels per day from deep water wells, in the Mexican area of the same Gulf, the output is zero. Pemex estimates potential reserves of 50 billion BOE in its deep water area. According to Pemex's CEO, Emilio Lozoya, it should be spending around $60 billion per year in E&P. Current spending is $25billion per year.

According to the US Energy Information Administration, Mexico ranks very high in terms of technically recoverable shale oil and shale gas. It estimates reserves of 150-460 billion cubic feet. The International Energy Agency estimates gas potential of 680 billion cubic feet. Mexico's Ministry of Energy estimates $20 billion of investment is needed annually for the next 10 years to develop its shale gas resources.

Pemex processed an average of 438,000 barrels of gasoline a day at its six refineries during the year's first 10 months. It still had to import an additional 344,000 barrels per day to cover domestic demand. According to Lozoya, the company needs $40 billion to add more refining capacity. With Pemex limited in funding and technology, the government wants to open this sector to private companies.

The reform law establishes different types of possible contracts: service contracts, profit sharing, production sharing, and licensing (where a firm would pay taxes and royalties in exchange for exploration and drilling rights). It allows companies to post reserves, though they must specify that the oil and gas belongs to Mexico. It

creates a sovereign Mexican Petroleum Fund to manage the country's oil revenues. The law calls for increased transparency and mechanisms to reduce corruption. It also removes Pemex union members from the state-owned company's board, reducing their role (and power).

India imported almost $2 billion worth of crude oil from Mexico in 2012-13. Its public and private sector companies are already invested in Latin America and poised to acquire more concessions in oil producing countries around the world. Pemex has established collaboration agreements with Shell, BP, Petrobras, Intec, Heerema, Pegasus, among others. Indian companies should pay closer attention and look at the possibility of investing in the hydrocarbons sector of one of the stablest countries in the Latin American region.

(15-12-2013-Deepak Bhojwani has served as ambassador in Latin America. The views expressed are personal. He can be contacted at bhojwani@latindiaconsult.com)