



Candarella Pemex Platform, Gulf of Mexico. Photo: Lynsey Addario/Corbis

# Mexico fails to stop oil decline

*The administration of President Felipe Calderon introduced cautious reforms in the oil industry, but they will not be enough to halt the accelerating decline of Mexican oil production. Experts are sombre about the prospects for Mexico if the political situation does not change.*

| by Rudolf ten Hoedt

Mexican oil production has declined dramatically for four years running. Not because of a shortage of oil, but as a result of the inadequate performance of state oil company Pemex, a corrupt and inefficient Moloch.

Pemex was once the fifth or sixth largest oil company in the world but has fallen to 11th place. It is the most indebted oil company in the world. Despite record high oil prices, Pemex posted a loss of \$1 billion in the first six months of 2008, due to expensive gasoline imports, subsidised fuel prices and corruption. Pemex replaces only 20% of its production with new reserves; 83% of the oil fields are in decline. If this continues, Mexico – still the third largest oil supplier for the US – will cease being an oil exporting country within five to 10 years.

The most obvious solution for Pemex would be to partner with major oil companies to develop new offshore fields. However,

a 70-year old article in the Constitution forbids the involvement of private companies and foreign countries in the oil industry. During the past few months, Mexican President Felipe Calderon has tried to introduce reforms but has met with great resistance. According to David Shields, a renowned Mexican energy expert who publishes the prestigious *Energia en Debate* magazine, the reforms are too meagre to attract foreign investments.

**In a couple of weeks Mexican lawmakers are expected to pass oil reforms. Will they have any results?**

The reforms do not allow any direct foreign investment in the industry. Foreign involvement will be limited to contracts. But there may be some improvement in the contracts that Pemex is able to close. The idea is to make existing contracts usually based on a fixed payment more attractive and to get oil

## A small opening?

George Baker, an oil analyst at the Houston-based consultancy Energia.com, seems slightly more optimistic about the prospects of Mexican oil production than his colleague David Shields. 'The reform package in itself does not bring us to home base, but it opens the door to another phase. They are going to change the legal structure that governs Pemex. In the past, the board of directors only had a ceremonial function. The new board will have real power to make market-oriented rules and develop new contractual models. What we do not know is whether they will make the right rules. If the government allows Pemex to grant exemptions from standard procurement rules, then that could be the beginning of a whole new era of contractual models that may make sense to the international oil companies.' According to Baker, the Mexican government 'is in relative ignorance as to what the real issues in the oil industry are. All professional people work for Pemex, or for the Schlumbergers and Haliburtons that work for Pemex, too. There is no intellectual capital inside the government to protest anything that is going on.'

service companies more involved. It is not clear whether these new performance contracts will be attractive enough to get international oil companies involved.

**Other analysts think Pemex will be allowed more corporate autonomy and the freedom to grant exemptions from the government's procurement rules, enabling it to get international oil companies more involved.**

Calderon has proposed the possibility of granting exemptions from the government's procurement rules. I think this will go ahead. Pemex would have its own procurement system, and the performance contracts would fall within this context. But I am not sure whether this will be interesting enough for the IOCs to get involved. Furthermore, these performance contracts will have a high political profile, which is another reason not to get involved. Everyone will scrutinise them. They will be in the news, and many companies do not appreciate having their names in the papers. But they may be attractive to some companies, especially when they apply to deep water projects.

**If it is not good enough for international oil, is it good enough for Mexico?**

In my opinion, it is not good enough for Mexico. In the short to medium term, oil output will continue to fall. There is no prospect of Mexican oil production or export increasing. Mexico needs much more radical reforms and requires a constitutional change that would allow private investments.

**So energy reform is dead until a new president is elected in 2012?**

The political consensus is that oil reform is dead. But if the overall energy situation deteriorates, it may be necessary for Congress to reconsider.

**What impact will this modest oil reform have on the exploration and development of Mexico's deep water potential?**

The contracts for most of the Mexican Gulf will be slightly more attractive. Perhaps some IOCs will get involved. Then there is the interesting issue of the cross-border fields. If you extract oil on one side of the maritime border, you can affect pressure on the other side. Mexico will have to enter into some sort of treaty with the US. And a treaty will release these fields from Mexican

law. It will involve some kind of joint exploitation, or Mexico may be granted some kind of remuneration for oil extracted on the American side. Perhaps under this law, Pemex could enter into some kind of joint venture with IOCs at locations along the maritime border.

**Is this a sad message for Mexico?**

I would rather see the IOCs come in to achieve a more open and competitive oil industry. But that will not happen because Mexicans have historical prejudices against international capital and IOCs in particular. Ordinary Mexicans feel that foreigners have always come to take away their riches.

**And vested interests are using these prejudices for their own interests?**

Absolutely. Some groups are already contractors for Pemex, and they want to keep their business and not open it up to other people. Then there are the unions, which have a lot of clout within the political system. Nobody wants any problems with the unions.

**So what will the future hold?**

The Mexican oil industry is in decline, and not only because of falling production. It's declining environmentally, geologically and politically. Mexico is finding it very hard to change course. ■

### Relentless decline

Mexican oil production reached a peak of 3.4 million barrels a day in 2004. During the first eight months of 2008, production amounted to 2.83 million barrels, a 9.2% drop compared with the preceding year. Export fell by 19% to 1.43 million barrels. The main reason for the decline is the dramatic drop in extraction in the Cantarell deep-sea oil field, where production in the first eight months of 2008 dropped by 29.2% to 1.11 million barrels per day. In January 2008, Mexico's reserves covered only 9.2 years of oil production and 8.2 years of gas production.