International Outlook

Patronage and Intrigue are Keeping Pemex and Mexico Behind

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March promises to be an exciting month in the Mexican Congress and Pemex. Mr. Fox will essentially be testing the country's appetite and capacity for change when he asks Congress to approve new contracts to allow foreign companies the right to run operations in Mexico's largest natural gas fields. While the proposed service contracts are constitutional, Mr. Fox has very strong opposition from the paradoxically named Institutional Revolutionary Party (PRI), the old governing party which ruled for seven decades, and from the PRI supported labor unions.

Despite some positive changes taking place with Mexican President Fox's government, Petroleos Mexicanos (Pemex) remains a pillar of the PRI. Mr. Fox promised to make Pemex a "successful, competitive, honest and transparent" company. Investors interested in the Mexican oil sector have to be aware that Pemex remains mired in patronage and intrigue, much as it was when it was created in 1938. What happens to Pemex is important because the company's development seriously influences the evolution of Mexican politics and the economy. Additionally, Pemex's improvement or decline has significant consequences for the United States, which buys 1/6 of its imported oil from its southern neighbor.

Yet, Pemex is still considered 'patrimonio nacional,' an expression really meaning a significant symbol of nationalistic pride. While President Fox would like to allow foreigners to invest in Mexico, he faces very powerful labor unions and PRI opposition, which accuse him of 'selling out to foreigners.'

Even the current administration would be very concerned about completely relinquishing Pemex. Taxes and duties on Pemex finance more than one-third of the federal budget. Since Pemex's creation, the government has taken almost every peso Pemex earned. Sometimes, the government has forced Pemex to borrow to pay its tax bill. In the first nine months of 2001, for example, Pemex made almost $21 billion, and the government took $22.1 billion away.

Unsurprisingly, this kind of practice leaves Pemex with little funding, if any, to explore new fields or to repair old plants and equipment. Consequently, fatal accidents occur and a serious pollution problem becomes increasingly worse. Undeniably, Pemex is in dire need of billions of dollars for exploration and refining. Particularly in an environment of lower oil prices, sources within Pemex say that about $30 billion over the next five years must come from foreign investment.

What's Next?

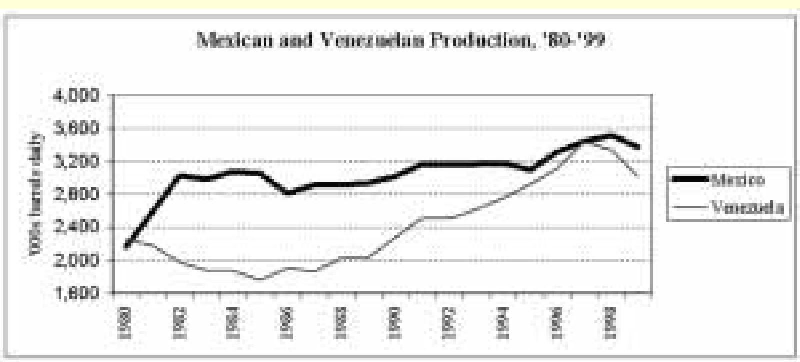
Mr. Fox has to confront not just the PRI or labor unions, he has to confront an entire mentality of his compatriots brought up thinking that the creation of Pemex, after the oil expropriation, was the culmination of Mexico's independence. There still remains deep-seated fear that foreign investment, particularly from the U.S., means a take-over of Mexico.

One of Mr. Fox's most serious challenges is to contend with the oil workers union of about 130,000 members, which for years oiled the PRI political machine. Given that the oil union workers and Pemex underpinned PRI, Mr. Fox would like to decrease their power (not only to allow foreign investment in the country but to cement the power of his party, National Action Party or PAN).

See U.S Crude Oil Imports Graphic on Page 13

The Mexican Congress has stymied any effort by Mr. Fox to decrease Pemex's power. For example, last year Congress dissolved an independent board that Mr. Fox had appointed to oversee Pemex. Early this year, Mr. Fox's government charged that PRI had illegally taken $120 million from Pemex to use against him during the 2000 elections; PRI denied the accusations, and Congress has not done much to follow up on the allegations.

As part of his struggle against Pemex and PRI, Mr. Fox has also ordered an audit of the company's books. Moreover, he has ordered an audit of Tabasco's Governor, Madrazo, a staunch Fox opponent and hopeful presidential candidate. Already, Mexico's Comptroller-General, Mr. Francisco Barrio Terrazas, has frozen the bank accounts of nine current and former Pemex executives, as well as accounts controlled by oil workers' unions. Undoubtedly, company officials and Congress will be fighting against the whole auditing process. Corruption charges brought by Mr. Fox's comptroller-general in the alleged campaign finance scheme have some senior congressional politicians openly saying that they will not pass Fox's initiatives to open Pemex.



Source: U.S. Department of Energy.
Note: Data are published with a significant lag.

What PRI and Pemex refuse to admit is that unless Pemex is opened up and foreign investment is allowed, the company's inefficiencies will become starker. After Venezuela, Mexico has the second largest reserves in the Western Hemisphere, and Pemex produces about 3.5 million barrels daily. Yet, despite these great assets, Mexico has to import more than a quarter of the gasoline that the country needs, because refineries are overburdened. Moreover, worker inefficiency is significant. In comparison to Venezuela, Pemex employs twice the number of workers for the same level of oil production. Additionally, as Mexico's demand for electricity increases, the pressure on oil production becomes even more intense.

PRI's focus on regaining political power and Pemex's inefficiencies are costing the whole country significant financial loss. Equally gruesome if not worse, Pemex's old equipment is damaging Mexico's environment and even causing death, as has happened several times when people have died from exposure to excessive fumes.

Without investment into infrastructure, Pemex will not improve its safety record, which has very negative implications for the lives of Mexican people and will stymie the development of the Mexican economy. Moreover, in the current environment, where there is renewed interest in reducing dependency on OPEC, Pemex and PRI are missing a very good opportunity to become more significant players in international oil markets, particularly by supplying more oil to its conveniently close northern neighbor, one of the largest consumers of oil in the world.