World Economic Situation and Prospects

Weekly Highlight

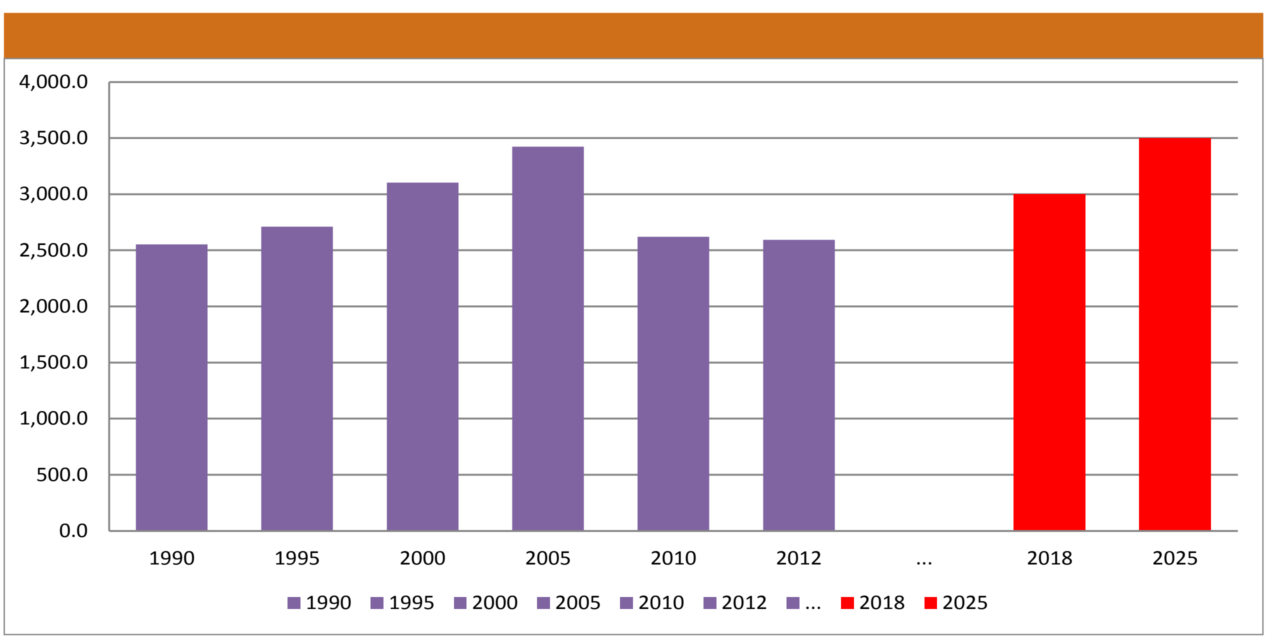
Prepared by Sergio Vieira **09 October 2013**

A bold oil sector reform in Mexico

The oil sector in Mexico has been the source of intense debate and speculation in the past months, after President Peña Nieto announced possible reforms to allow foreign private investments in the national company PEMEX. The oil sector in Mexico has been suffering from under-investment and consequently has been facing a steady decline in oil output, falling from almost 3.5 million barrels per day in 2005 to 2.6 million barrels per day in 2012 (see figure). This trend, due in part to current limitations in national conventional oil production, could be reversed, however, if the vast Mexican shale deposits and deep water drilling were explored. The Government estimates that investments of 7 billion to 10 billion dollars a year for the next eight years would be necessary to explore its own non-conventional reserves. If the necessary capital and expertise were provided, the national oil output could reach 3 million barrels per day in 2018, increasing GDP growth by one additional percentage point and creating 500,000 additional jobs, according to official estimations. The major challenge, however, is the fact that PEMEX does not have the necessary capital, and that private investment is restricted in the oil industry, which was nationalized in 1938. In order to increase private participation, the Constitution, or at least some of the secondary laws, would need to be amended.

Despite potential macroeconomic benefits, the suggested constitutional reforms from President Peña Nieto, permitting private investments in the energy sector, are facing strong resistance from several political sectors. First, there are concerns about the country's sovereignty over the energy sector. Second, the economic estimations advanced by the Government are considered excessively optimistic and may not benefit the average Mexican as much as expected. Third, production costs are extremely high in Mexico, which means the investments may not be profitable, in particular if oil and gas can be imported cheaply from the United States. Finally, the environmental costs associated with the exploration of shale deposits are not yet fully understood, but there are concerns about water depletion and contamination, for instance. So far, the political opposition has rejected the President's proposal and calls for a referendum on energy reform, asserting that all Mexicans should be involved in this decision.

Figure: Oil production in Mexcio. Number of barrels per day (in thousands)



Source: Oxford Economics for years 1990-2012; official government estimations for 2018 and 2025.