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With two cabinet ministers by his side, President Enrique Peña Nieto announces his much-anticipated energy reform package in August.

RAISING LÁZARO

In a year that brought an eruption of ambitious reform measures, the biggest of them all is the proposed overhaul of Mexico's iconic national oil company.

BY **DUNCAN WOOD**

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SEVENTY-FIVE YEARS AGO, ECSTATIC Mexicans thronged the Zócalo, their capital city's immense central square, to celebrate President Lázaro Cárdenas's decision to nationalize the assets of the foreign companies that controlled Mexico's oil. By the tens of thousands they donated jewelry, cash, and even chickens to help provide the compensation Cárdenas had promised the companies. The day the decision was announced, March 18, became a national holiday marking what many Mexicans still consider a signature moment in their country's struggle for dignity and freedom from American imperialism. Oil was the *tesoro nacional* (national treasure), and Petróleos Mexicanos (Pemex), the national oil company Cárdenas created, became a monument to Mexican pride.

Today, however, Mexico's streets ring with speeches and chants by demonstrators opposing an array of ambitious reforms proposed by President Enrique Peña Nieto during his first months in office, none more significant than his call in August to shake up Pemex and reopen the country's economy to foreign oil companies and private domestic firms.

The government's proposal came hard on the heels of several other sweeping pieces of legislation. A labor law reform, passed with Peña Nieto's support just before he took office, promises to bring Mexican labor markets some much-needed flexibility. A controversial school reform bill would subject teachers to formal evaluations and generally make them more accountable. In telecommunications, the government challenged virtual monopolies in the telephone and television markets with new antitrust measures, and a financial reform will encourage banks to increase lending to consumers and businesses. In September, Peña Nieto capped a busy year by introducing a package of revenue-raising tax reforms, including the promise of an old-age insurance program. But because of its great potential to generate jobs and economic growth, the energy package is seen as the "mother of all reforms."

Since Peña Nieto took office last December, under the banner of the Institutional Revolutionary Party (PRI), he has achieved more than his two National Action Party (PAN) predecessors, Vicente Fox and Felipe Calderón, were able to pull off in 12 years. Each of Peña

Nieto's reforms has required taking on powerful vested interests—the labor unions, teachers, telecommunications billionaire Carlos Slim, and the banks, respectively—and coordinating closely with the main opposition parties, the conservative PAN and the leftist Party of the Democratic Revolution (PRD). Both opposition parties have been weakened by internal divisions, and the dominant faction in each believes that working with the government may persuade frustrated voters that it can get things done. The result has been a period of extraordinary cooperation. It is not for nothing that the international press is calling this "Mexico's Moment."

ONE OF THE GREAT IRONIES OF THE current situation is that Peña Nieto's PRI is the same party that ruled without interruption for 71 years until 2000, creating and defending many of the institutions he now seeks to overhaul. It was the PRI, emerging from the Mexican Revolution of 1910–20, that created Pemex and shaped modern Mexico, controlling the national political scene by co-opting the opposition and fixing elections. But by the turn of the century Mexicans had had enough of a system once described as "a perfect dictatorship" by Peruvian novelist and political leader Mario Vargas Llosa, who said it exceeded even Soviet communism in its malign subtlety. They had tired of its recurring financial crises (known as the *sexenio* crises because they often coincided with the end of a president's six-year term) caused by financial mismanagement, corruption, and surges of pre-election spending. By choosing the PAN's Fox as their president in 2000, the voters opted for a fundamental shift toward a more democratic system and the promise of faster economic growth and greater accountability from government.

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Then came a dozen years of frustration. That is not to say that nothing changed. The country's political system evolved, and Mexico consolidated its democratic institutions, establishing competitive elections as the norm. Although the process of building a democratic culture is far from complete, the shift to free and fair elections is particularly impressive given the country's recent history.

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Petroleum and patriotism have long proved a heady mix in Mexican politics. "Serving the nation," says this 1956 Pemex sign.

Thanks in part to the North American Free Trade Agreement, Mexico has become one of the world's leading exporters, shipping more manufactured goods abroad every year than the rest of Latin America combined. Increasingly those goods go not just to the United States, but to many other customers around the world—everything from textiles to high-value-added goods such as automobiles, aircraft parts, and metalworking machines. Mexico's middle class has grown, too, and the rate of homeownership is on the rise. Gross domestic product per capita rose from about $5,600 in 2000 to some $9,700 in 2012.

Despite the growth of the economy and the consolidation of democracy, however, nearly half the population remained in poverty. Fox and Calderón were widely criticized for failing to create a more equitable society. Along with this harsh assessment came accusations of corruption and general ineffectiveness. In the six years before Peña Nieto took office, for example, Calderón saw his reform proposals rejected at every turn by an opposition PRI party that was simply unwilling to negotiate. All of these failures were magnified by the upsurge of drug-related violence and insecurity that began after 2006 with

the Calderón administration's war against major drug traffickers.

PEMEX WAS ANOTHER ROCK FOX AND Calderón failed to move. The national oil company remained an almost sacred symbol of Mexican sovereignty and national pride. Yet the company's performance left much to be desired. Mexicans have long celebrated the nationalization of 1938, yet it marked the beginning of a long period of virtually stagnant output. By the 1960s, Mexico had been reduced to importing foreign oil.

Pemex was another rock Fox and Calderón failed to move.

Only the chance discovery of a huge oil field in the Gulf of Mexico reversed the decline. The find came after a fisherman named Rudesindo Cantarell repeatedly accused Pemex of oil spills, complaining for several years that oil floating on the surface of the ocean had been ruining his nets. When Pemex geologists finally went

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Once a bountiful source of oil, the Cantarell field in the Gulf of Mexico has suffered rapidly declining output since 2006.

to investigate in 1976, they stumbled upon the field. Estimated to be the third-largest oil deposit in the world at the time, the Cantarell field catapulted Mexico into the big leagues of the global oil industry. By 2004 the country was producing more than 3.4 million barrels per day (bpd) and was exporting more than half of it, primarily to the United States.

Pemex was not just pumping oil; it was also pumping money into the government's coffers. Dependence on tax revenues from Pemex, which provide about a third of its income, contributed for many years to the government's reluctance to free up the company financially or operationally. And the abundance of the Cantarell field made it easy not to think much about the future. While better-governed national oil companies such as Ecopetrol in Columbia and Petrobras in Brazil have advanced, Pemex has skimped on investments in technology and operations. This has left it unable to keep producing at the high levels seen a decade ago. Inadequate spending on exploration and production—a serious problem since the mid-1980s—has hurt Pemex's ability to tap new resources. As a result, oil production has declined dramatically over the past nine years.

Mexico's national oil production currently stands at 2.55 million bpd, down slightly from 2.6 million in 2010. While, thanks to high oil prices, production has been sufficient to maintain a steady flow of money to Pemex and the government, the decline has caused consternation in policy ranks. The reduction of output by more than 800,000 bpd since 2004 translates into a loss of some $80 million each day in revenue (assuming a price of $100 per barrel). Given the fact that national hydrocarbon consumption is rising, Mexico will have to boost both its reserves and its production significantly in coming years if it is not again to become a net importer of oil.

Beyond the overwhelming focus on oil, a second vitally important energy issue has gone largely unnoticed: Mexico's failure to develop its natural gas resources, including massive shale gas reserves that rank as the world's sixth largest, according to the U.S. Energy Information Agency.

Gas-rich Mexico is struggling desperately to increase gas imports from the United States.

Because of its preoccupation with efforts to stem the rapid decline of oil production in the Gulf of Mexico, Pemex has made only minimal investment in shale gas. That has led to the unhappy spectacle of gas-rich Mexico struggling desperately to increase gas imports from the United States.

The shale gas revolution to the north has created thousands of new jobs in the United States and greatly enhanced its global competitiveness. But a perverse effect has occurred in Mexico. The surge of cheap gas coming onto the market drove prices down, increasing demand. Because its conventionally sourced gas costs more to produce, however, Pemex cut gas production. On a number of occasions during the past two years, gas shortages have forced companies in Mexico to shut down manufacturing processes. Pemex has increased natural gas imports from the United States, but the cross-border natural gas pipeline network is already operating at full capacity, and it will take several years before it can be expanded. Mexicans must now watch in dismay as their energy-rich country loses out to the United States in the competition for new industry. General Electric, for example, recently shifted some of its refrigerator production from China and Mexico to Kentucky in part to take advantage of low fuel costs.

PEÑA NIETO'S PEMEX PROPOSALS WILL not provide a quick fix for the natural gas imbroglio, but they nevertheless promise profound changes in Mexico's energy sector. The president laid out five main areas of reform, including a corporate reorganization and a reduction of the government's take of Pemex's revenues. By far the most important change involves an amendment to the constitution. Invoking the spirit of Lázaro Cárdenas, Peña Nieto tiptoed through a political minefield by proposing to restore a clause that was written into the Constitution in 1940 but later removed. It prohibited land concessions to foreign oil companies but did give the government much greater flexibility in determining how to exploit Mexico's oil and gas reserves. Specifically, it allows both production- and profit-sharing contracts with foreign firms and private Mexican companies. But, in deference to the delicacy of the subject, Peña Nieto cautiously specified that he would only seek legislative approval for profit-sharing deals. That means that foreign firms will not physically possess any of the precious *tesoro nacional*. But it also means that companies will have significantly less incentive to invest in the Mexican energy sector. (A profit-sharing scheme makes it much more difficult for companies

to book any gain in their own oil reserves, and thus harder for them to raise capital for ventures in Mexico.)

There are various ways to navigate these and other challenges. Although the government has speculated that the reforms will bring much-needed private capital, it is unlikely that we will see a flood of major investments in the short term. The finer details of the legislation and contracts still need to be defined, and many companies will want to wait and see how the first few contracts work out before diving into the deep waters of the Gulf of Mexico. However, in the long run this promises to be a transformational shift in the Mexican oil and gas sector.

The PRD, led by its éminence grise on energy issues, Cuauhtémoc Cárdenas, the son of Lázaro, immediately denounced what he saw as the hijacking of his father's name and called on opponents to protest against the "privatization" of Pemex. They have been joined by followers of Andrés Manuel López Obrador, a firebrand leftist and two-time PRD presidential candidate. But in Mexico City, where antigovernment protesters regularly take to the streets, their protests have been overshadowed by those of the national teachers' union, which is opposing the government's education reform. However, Peña Nieto's constitutional proposal on energy also has the support of the PAN, so there is little doubt that it will pass.

Although the Pemex reform is far from being the "whole enchilada" sought by many on the right in Mexico and by the global oil and gas industry, it will move Mexico another step forward in the consolidation of the liberal economic development path that began with the debt crisis of the 1980s and the North American Free Trade Agreement in 1992. Mexico still faces large problems. Poverty and inequality are rife, violent crime is pervasive, and the rule of law remains a distant goal. Democratic progress has brought elections that are largely free and fair, but individual rights and those of minorities are far from secure. And Pemex itself must still deal with many challenges, including crushing debt and a tenacious labor union. Yet this is a great moment. Change in Mexico can be glacial, but Peña Nieto has managed to set in motion reforms that could markedly improve the lives of all Mexicans. We can hope that Mexico today is enjoying more than a moment of change. ■

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