

Energy reform: will Mexico's newest revolution boost renewables – or just fossil fuels?

As Mexico breaks up its energy monopolies and auctions off oil exploration areas, emerging players promise cleaner energy including natural gas and solar power

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For the first time since 1938, the world's largest oil companies are preparing to invest in Mexico. The last time they were there, things ended badly: President Lázaro Cárdenas seized their assets, created state-owned oil monopoly Petróleos Mexicanos - or Pemex - and sent foreign competitors packing.

Now, 77 years later, Mexico is inviting them back. As part of its far-reaching hydrocarbon and electricity reforms, the country is reopening its largely untapped oil and natural gas reserves to foreign investors and competitors. The process will begin in earnest in mid-July with an initial auction of 14 oil exploration areas in the Gulf of Mexico.

More than two dozen companies, including global energy giants ExxonMobil, Chevron and Total, as well as Pemex, are lined up to bid next month after Mexico's oil regulator prequalified them last week.

But as the country moves forward, questions remain. Will the breakup of Mexico's decades-old monopolies and the arrival of new oil, gas and power players lead to renewed growth and investment across the economy? And will they cause a new host of problems, including increased environmental damage?

'Building a better country'

Mexico's momentous policy shift was enabled by several controversial new laws and constitutional amendments that were approved over the last year. "Reforms are the foundation for building a better country," said Mexican President Enrique Peña Nieto, speaking last month at the World Energy Forum on Latin America, held in Quintana Roo. "They are a platform for beginning a new stage of development."

Not everyone is excited about the new development, however. Environmental groups including Greenpeace have expressed concern over increasing oil and gas exploitation in Mexico. In March, Greenpeace blasted the UK government over a \$1bn investment involving Pemex and other fossil fuel companies.

But the energy business can have a positive impact, says Eduardo Reyes Bravo, a Mexico-based director of infrastructure and energy strategy with PricewaterhouseCoopers. "One of the key elements of the reform is to enable competition in the market," he said. "Competition should

bring better prices to industry, which, in turn, can be more competitive, increasing exports, generating new employment and reducing prices in the local market.

The reform measures aim to boost competition, and the government and energy companies claim they can improve Mexicans' economic opportunities, environmental protections, health and trust in their institutions.

“If we really want to achieve change in these [corrupt] practices, then this has to be a structural change throughout society,” Peña Nieto said. “We have to be the government that knocks down the walls that are in the way of our achieving a more equitable and just society.”

‘Change does not happen overnight’

Joseph Stiglitz, a Nobel laureate and professor at Columbia University who co-chaired the World Economic Forum on Latin America, called Mexico's reforms - which also encompass education, telecommunications and finance - “very impressive”. He said: “I’m very optimistic that these really will spur economic growth.”

Stiglitz also said he was pleased that energy reform included a development trust, funded with petroleum income. Banco de México, the country's central bank, will manage the fund, which will support pensions, science and technology, infrastructure investments, and scholarships. It could become a substantial development asset if managed properly, Stiglitz said. Mexico expects \$62.5bn of new foreign investment into its energy sector in the next three years.

Direct action by energy companies that result from the reforms will also have an enormous impact on Mexico's development in the years to come. In a report released this year, investment research firm Sustainalytics predicts Pemex will improve its subpar track record on health, safety and corruption, as it transitions from a government agency into a company competing with global corporations that have higher standards on such issues.

“As Pemex looks to stay relevant and participate with Western integrated oil majors in joint ventures, we expect a rapid ‘catch-up’ process will be required in terms of both technological modernization and [environmental, social and governance] management,” the authors wrote.

“Change does not happened overnight, but we are off to a good start,” Pemex boss Emilio Lozoya said at the World Economic Forum. Lozoya did not directly address allegations of corruption at Pemex, or the company's recent fatal explosions at offshore rigs in the Gulf of Mexico.

In response to concerns over growing greenhouse gas emissions if Mexico produces more oil and gas, the Pemex chief executive said the country could boost its fossil fuel consumption without increasing emissions by continuing its “tremendous transition” from oil to natural gas in power generation, saying gas is “at least half less polluting”. (In actuality, lifecycle carbon emissions from natural gas come to about 28% less than those from oil, according to the UK Forestry Commission's Biomass Energy Centre.)

Pemex is involved in a joint venture with US-based investment management company BlackRock and private equity firm First Reserve to build a pipeline to bring Texas-produced natural gas to Mexico.

A renewable future?

Mexico's reforms will also create new competition for electricity monopoly Comisión Federal de Electricidad, or CFE. The new market rules - still in draft form - are intended to open up power generation to all participants and guarantee nondiscriminatory access to the electric grid. They also aim to promote energy efficiency and renewable energy through new market incentives, auctions and a clearly defined annual roadmap to reach 35% clean energy by 2024.

Big questions still surround the role of renewables. On one hand, high-efficiency natural gas units that generate both heat and power - so-called cogeneration plants - qualify as clean energy under the reform. But when it comes to renewable energy's potential to contribute to Mexico's development, Lozoya sounded a pessimistic note. "Everybody wants more renewable energy, but the technology and price are still not aligned," he said.

Not surprisingly, solar energy entrepreneurs in Mexico disagreed, saying the reforms would help their industry make a difference. Javier Romero, a board member of Mexico's national solar association, says solar companies can take advantage of the reform's new clean energy certificates to help fund projects and new wholesale electricity market rules. These allow "qualified users" such as commercial and industrial businesses to buy power directly from solar power plants or other independent generators, instead of only from CFE.

"The photovoltaic sector will benefit the population generating clean energy with zero emissions, with more jobs within the industry's production chain and finally with cheaper energy to the final consumer," Romero said.

Outside investors agree that energy reform offers potential for renewables. "Mexico's energy reform is a real revolution," Ignacio Sánchez Galán, chief executive of Spanish energy group Iberdrola, said at the forum. One of the few foreign energy companies already operating in the country, Iberdrola has committed to investing about \$5bn in wind farms and combined-cycle natural gas plants in Mexico by 2018.

Hector Olea, whose company Gauss Energía developed Mexico's largest solar power plant in La Paz, Baja California Sur, says the reform will help position Mexico "to be the next boom in solar", fueled by prices on par with wind and even some conventional generation sources.

Olea says the reform's new rules will help solar play a much larger role in Mexico's development. "There are so many different benefits for Mexico. We are very optimistic, but we have to wait until the final rules are settled."

As Mexico's competitive energy markets take shape and foreign oil companies re-enter the country for the first time in almost eight decades, it remains to be seen whether the emerging business community can really bring Mexicans the cleaner energy, greater economic opportunity, improved health and safety, and more transparent transactions promised in this reform.

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