Mexico's Energy Reform

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Dr. Lourdes Melgar outlined the progress to date on Mexico's comprehensive energy reform in a talk in the Energy Policy Seminar on Monday, November 21. Melgar, the former Deputy Secretary of Energy for Hydrocarbons, who played a leading role in shepherding the reform effort, detailed the ambitious scope of the effort and the progress to date.

The current reform effort, which began in 2012, aimed at first primarily at addressing declining oil and gas production, by encouraging additional investment and participation by companies with expertise in unconventional oil and gas extraction technologies. Initial plans, Melgar said, were targeted just at the oil and gas sector, but policymakers decided that effective reform would need to also include the electricity sector. Accordingly, in December 2013, a comprehensive reform plan was enacted, that covered oil and gas and electricity sectors and which included provisions related to clean energy.

The reforms, which required Constitutional amendments, aimed to modify the existing system of national monopolies in hydrocarbons and in electricity to allow for market competition while maintaining Mexican national ownership interests in key assets, such as hydrocarbons in the subsoil, and creating a new, independent, and transparent fund to oversee and invest oil revenues.

Key elements of the change, Melgar explained, have involved restructuring the former monopoly government entities Pemex and the Federal Electricity Commission (CFE), breaking out independent system operators to manage competition in the oil and gas and electricity sectors, and breaking up other parts of the monopolies in order to facilitate development of markets. As these former government monopolies have been restructured, the government has had to manage a comprehensive change in the relationship between the industry and consumers. The old system, in which the government monopolies took responsibility for security of supply, for complying with price caps, and for providing additional social services, no longer applies. The market system replacing the old structure, then, is under pressure from the beginning to function well enough to ensure secure supply, and the government, in its turn, has had to find new ways to subsidize energy for low income customers and to ensure that communities hosting large infrastructure projects, such as gas pipelines or wind farms, see benefits from these projects.

Thus, since 2012, the Mexican government has been managing a massive, simultaneous process of change throughout the energy sector. Auctions have been conducted to open up oil and gas resources to new development and the electricity sector to new sources of generation. Concerted efforts have been made to provide infrastructure support in the form of expanded natural gas pipelines and electricity transmission. Unexpected developments have included the collapse of oil and gas prices since the reform was initiated (connected to the new supply brought online by hydraulic fracturing in the United States) and an auction for renewable electricity production that resulted in some of the lowest prices available in the whole world.

Looking ahead, Melgar noted certain ongoing challenges and uncertainties. Declining oil and gas production rates, the initial impetus for reform, are still declining. Observers are hoping for robust participation in an upcoming December 2016 auction for development of deepwater oil and gas resources. A policy ensuring security of supply for refined products has yet to be worked out. And it is not yet clear how or whether the restructured Pemex and the newly competitive electricity companies will be able to flourish under the new system. Whether public patience will sustain the reforms until positive results can be shown may be the key question for the future prospects of the reformed system, Melgar noted.

Melgar spoke as part of the Kennedy School's Energy Policy Seminar Series, which is sponsored by the Consortium for Energy Policy Research of the Mossavar-Rahmani Center on Business and Government.