

Mexico's energy reform can benefit from Latin America's petroleum sector development

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The decision makers behind Mexico's budding energy reform can learn from the history of the development of the petroleum sector in Latin America, according to a new paper by an expert in the Mexico Center and the Center for Energy Studies at Rice University's Baker Institute

for Public Policy.

"The development of the petroleum sector has been characterized by a succession of cycles of investment and expropriation – for example, forced renegotiation of contracts, nationalization, changes in fiscal rules, etc.," said Francisco Monaldi, a fellow in Latin American energy policy. "These cycles have been particularly pronounced in Latin America, although other regions and even developed countries have also experienced this phenomenon."

Monaldi's paper, "The Rule of Law and Foreign Investment in Oil: Petroleum Nationalism in Latin America and Its Implications for Mexico," intends to provide elements for understanding why these cycles occur in light of the regional experience and to derive lessons to be considered during the implementation of the petroleum reform in Mexico.

The paper was written for a Mexico Center [research project](#) examining the rule of law in Mexico and the challenges it poses to implementing the country's [energy reform](#). The project's findings are compiled in a Spanish-language [book](#) and are being posted on the Baker Institute's website in English.

Mexico's [energy sector](#) had been under strict governmental management since 1938. This changed in 2013 and 2014 when Mexico amended its constitution and passed enabling legislation overhauling its energy sector to allow private and foreign investment.

"The fiscal and contractual framework for the exploitation of petroleum resources in Latin America has undergone important changes over the course of the past decades," Monaldi wrote. "During the 1990s, the hydrocarbons sector of the region was opened up to private investment, and the fiscal and contractual frameworks were made more flexible to

attract [foreign investment](#); during the first decade of the 21st century, the significant increase in the price of oil generated great political and social pressures to increase the government take and exercise more state control.

"This trend materialized strongly in countries such as Argentina, Bolivia, Ecuador, Venezuela and, more recently and with less intensity, Brazil, although in one way or another, it had an impact in all productive countries. Expropriation, forced renegotiation of contracts and other regulatory changes that negatively affected foreign investors had significant effects in terms of reputation, which contributed to the fact that the region did not take advantage of high oil prices in order to increase investment and production, with the significant exceptions of Brazil and Colombia.

"Considered as a whole, Latin America produced slightly less in 2013 than when the price boom started in 2003. Latin America lost 1 percentage point of the worldwide market share and now has the lowest rate of extraction among regions in the world."

Monaldi said the Mexican petroleum reform has the advantage of being able to apply lessons learned from the experience accumulated over the past two decades in the region.

He said several lessons are noteworthy: "There are significant risks of reversing reforms; the failure of reforms to attract investment and increase production can be a reason for their reversal, but significant success in terms of reserves and production can also exert pressure to renege on contracts; significant changes in the international price of oil can generate incentives for renegotiation as long as contracts do not properly cover such contingencies, and sometimes even when they do; and the credibility of the regulatory framework is an essential condition for maximizing the benefits of the petroleum sector, since regulatory

insecurity leads to either less investment or a smaller share of profits for the state."

More information: The Rule of Law and Foreign Investment in Oil: Petroleum Nationalism in Latin America and Its Implications for Mexico: [www.bakerinstitute.org/media/f ... w_Monaldi-012417.pdf](http://www.bakerinstitute.org/media/f...w_Monaldi-012417.pdf)

Provided by Rice University

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