Mexican constitution, it has exclusive authority for all exploration and production of petroleum products.

Recent buoyancy in oil prices and a need to generate foreign currency have emboldened the expansion plans of Mexico's energy sector. PEMEX has announced aggressive investment and modernization plans in an effort to expand oil and gas production, increase operating efficiencies and promote the use of cleaner natural gas.

Mexico's energy sector suffered several politically inspired setbacks with the planned privatization of PEMEX's secondary refinery assets. Mexico's constitution protects the state ownership of the country's energy fields. The interpretation of how such sovereignty legislation affects downstream refining assets was tested in Mexico's Congress in 1996. Political posturing forced the government to repackage the sell-off and limit foreign ownership of PEMEX's existing secondary petrochemical assets.

While secondary petrochemical assets became a political football for battling congressional parties and factions, the privatization of the natural gas transportation and distribution system has proceeded with few problems since enabling legislation was enacted in 1995. Both domestic and foreign investment is encouraged in these activities, as well as in storage, which is becoming a priority for PEMEX.

Opportunities

Reform in the gas sector was needed to meet expanding demand. Gas consumption in Mexico will rise to 4.2 billion cubic feet per day by the year 2005. Demand growth is led by efforts to convert oil-burning power plants to gas, by the promotion of gas as the new industrial energy source of choice, and by extending access to natural gas to all regions of the country, especially the energy-hungry industrial northern border area.

Planned distribution and transportation projects are expected to attract close to US$10 billion in private sector investment over the next five years, concentrated in pipeline technology, construction and engineering services. Ten permits for the transportation of natural gas have either been awarded recently or are due to be awarded in the short term. The privatization of four local gas distribution systems — in Monterrey, Mexico City (two) and Toluca — will go to bid shortly. These projects are expected to generate investment of US$1.3 billion. A further four distribution regions, worth US$294 million will come up for tender in the next year and others are under discussion. Additionally, concessions will be granted to build and operate six regional gas ducts, connecting production to consumption areas. These include Rosarito, San Agustín, Valdivia to Samalayuca; Hermosillo to Guaymas; Monterrey to Alemán City; and Palmillas to Toluca. Also, two cross-border pipeline installation projects are being studied — San Diego to Rosarito and San Luis to Río Colorado. Transportation permits can also be granted upon application by an interested company, provided that a strong business case is presented. Permits are non-exclusive, are granted for an initial 30-year period and entail mandatory third-party access.

The expansion and modernization of PEMEX over the next three years will focus on three areas — exploration and production, maintenance and safety, and modernization and expansion of refining capacity.

At present, PEMEX's total energy production reaches 8 quadrillion Btu (British thermal units) per year and is projected to reach 10 quadrillion Btu by the year 2010. To achieve that growth, in 1997 PEMEX will invest almost US$6 billion in exploration, production and upgrading projects, a 75 percent increase over the 1996 budget. It expects to spend an equivalent amount in each of the next three years. More than half the budget will be dedicated to two enormous projects — Cantarell in Campeche Sound and Burgos Basin in the north. Mexican construction companies are expected to lead international consortia of financial and technical partners to capture the public tenders issued over the next few years. In turn, these consortia will seek niche suppliers of, for example, drilling equipment and services (50 percent of Mexico's wells are drilled by foreign suppliers), engineering services and extraction equipment to meet PEMEX's ambitious public tender deadlines.

In 1996, PEMEX suffered a series of high-profile industrial accidents, causing both human and facility losses. Under political and public pressure, PEMEX revised its budget planning and made maintenance and safety a top priority. In 1996, the total maintenance budget reached US$1.5 billion, a 73 percent increase over 1995. The PEMEX Gas budget for industrial safety programs rose from US$6.4 million to US$21.9 million in the same period. These newly raised levels should be maintained over the next few years.

Now that PEMEX has decided to maintain a controlling interest in its secondary petrochemical assets, it must invest heavily in modernizing these facilities. The investment focus over the next few years in these plants and other processing assets will be on improving production efficiency by reducing waste and automating operating systems.

Constraints

The public tendering process in PEMEX continues to be highly centralized. PEMEX began quietly announcing plans to decentralize its operations and purchasing structure in 1995. However, little official movement has begun. To effectively decentralize PEMEX, the organization's subsidiaries must become independent profit centres. Also, a decentralized PEMEX will force decision-making power to move closer to production facilities, a change that many high-ranking officials resist. In spite of the challenges of such change, decentralization is needed to improve operational efficiency. For suppliers, it will mean fewer market-entry barriers but a more complex and expensive environment in which to market products and services.

PEMEX remains a complex and cumbersome organization. Potential suppliers must be registered in advance, and understanding the unique business practices followed by PEMEX typically requires personal connections. Most Canadian firms will need a Mexican agent or partner with extensive PEMEX contacts to penetrate this market.

Strategy for Market Access

PEMEX's public tendering has become more transparent over the last few years. Greater corporate scrutiny at the purchasing level has honed PEMEX's buying habits, and the state monopoly can afford to be more demanding in its quality standards. Foreign suppliers are encouraged to seek out a Mexican partner or agent prior to entering a bidding process. Finding a Mexican partner with the right technical and sales skills remains the most difficult challenge to market entry for foreign suppliers.

Action Plan

Market Intelligence and Information

- Establish a flash fax service to provide information on specific opportunities to industry associations and interested Canadian companies.
- Attend American Chamber of Commerce energy conferences/seminars.
- Publish a quarterly Canada-Mexico energy newsletter including upcoming tenders, Canadian success stories, regional industrial profiles, privatization progress, etc.