# The Resource Governance Index

## 2019 Interim Evaluation Report for Mexico (Oil and Gas)

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### Key messages

- The Mexican oil and gas sector has achieved marginal improvements in governance, scoring a "satisfactory" overall performance in this interim evaluation, which uses the Resource Governance Index methodology. Its score of 70 out of 100 points represents a two-point increase compared with its 2017 score.

- Mexico generally earned good or satisfactory scores in the assessment of its realization of value from the oil and gas sector. However, it scored in the "weak" band for governance of local impacts. The strongest area in the assessment's value realization component was taxation.

- Mexico showed significant improvement in revenue management.

- The coexisting contracting models in Mexico (Pemex direct assignations and privately held contracts) should be fully and equally transparent. Pemex must also improve transparency around its spending.

- Mexico's lowest scores are in policy areas related to the local impacts of oil and gas related activities. The Agency for Security, Energy and Environment must better enforce the Law of Ecological Equilibrium and Environmental Protection.

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## SUMMARY

This report presents the Natural Resource Governance Institute's (NRGI) evaluation of Mexico's oil and gas governance in the 2017-2018 period according to the methodology set forth in the Resource Governance Index (RGI). It also includes recommendations for improving the sector's governance.[1]

This is a country-specific interim assessment that NRGI designed to provide in-depth analysis of the evolution of Mexico's resource governance performance since the previous RGI (2017).[2]

Mexico's oil and gas sector scores 70 out of 100 points in this 2019 interim assessment. This is a "satisfactory" score, according to the RGI performance band classification, just five points short of a "good" classification. Mexico has earned a two-point increase from its 2017 assessment and has showed improvement in its implementation of rules.

NRGI constructed the RGI using three overarching component topic areas, each representing an aspect of resource governance commonly found in resource-producing countries. The first two subcomponents, "value realization" and "revenue management," are based on the chain of decisions governments and societies must make to benefit from natural resources. The third component assesses a country's "enabling environment" for good governance in the extractive sector.

In the value realization component, Mexico's oil and gas sector achieves a satisfactory score of 74 points. It earned a good score for its revenue management with 76 points. In the enabling environment component, Mexico maintained a satisfactory score of 62 points.

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1   The RGI methodology is available on the RGI website at www.resourcegovernanceindex.org/about/methodology. A dataset for this interim evaluation, which includes every question and its justification, is available on the same site.
2   This report does not provide a comparative analysis with other countries or rank Mexico among a group of resource-rich countries. The Natural Resource Governance Institute (NRGI) will update these scores and provide a comparative analysis in the next full edition of the RGI, which it will release in 2021.

A more detailed look at the subcomponents within the three main categories shows that local impact is Mexico's weakest subcomponent of the extractive sector-specific topic areas, scoring only 53 points. The next lowest-scored subcomponents are in the satisfactory performance band: the state-owned enterprise sector scored 71 points and subnational resource revenue sharing scored 73 points. All other subcomponents in the extractive sector-specific topic areas are in the good performance band, with taxation having scored highest at 92 points.

The sector also had a relatively narrow implementation gap with its scores for law an average of nine points higher than those for practice.

Figure 1. Resource Governance Index subcomponent scores, Mexico interim evaluation (oil and gas)

**COMPOSITE**
**70** /100

VALUE REALIZATION    **74**/100

REVENUE MANAGEMENT    **76**/100

ENABLING ENVIRONMENT    **62**/100

| PERFORMANCE BANDS | |
|---|---|
| Good | Scores over 75 |
| Satisfactory | Scores 60-74 |
| Weak | Scores 45-59 |
| Poor | Scores 30-44 |
| Failing | Scores under 30 |

## INTRODUCTION

This report covers a transitional period in the Mexican hydrocarbon sector. The 2017 edition of the RGI covered the period from 2015 to 2016 and evaluated the Mexican government's first steps toward implementing a new set of regulations that opened the oil and gas sector to private investment. The 2019 assessment covers a period (2017 to 2018) in which both the new set of rules and the implementation of the reforms were fully in motion. In 2019, however, the new government administration introduced a set of guidelines for the hydrocarbon sector that radically departed from the regulatory framework of the previous government's energy reforms. This means that the focus of the hydrocarbon sector is now squarely on Pemex, the national oil company.

The RGI does not assess the ideological backbone of a set of regulations that any given government administration develops and implements. The RGI methodology consists of a questionnaire that evaluates the existence of regulations and the implementation of law and public policy related to accountability and transparency of the extractive sector. This interim report will assess all regulations set by the current and last administration up until 2019. However, the full implications of the current administration's reforms will likely only be truly clear in the 2021 RGI assessment, which is currently underway.

Although the current administration is ideologically different from the previous one, what remains the same is the importance of the hydrocarbon sector to the Mexican national agenda. This is mainly due to Pemex's historical role as the flagship nationally owned oil company. However, today the sector represents less than 2 percent of Mexico's national gross domestic product (GDP).[3] Oil revenues have been steadily falling since the last peak in 2011, when they accounted for 5.6 percent of GDP.

3    *Oil income (% of GDP) – Mexico* (World Bank, 2017), datos.bancomundial.org/indicador/NY.GDP.PETR.RT.ZS?end=2017&locations=MX&name_ desc=false&start=1970&view=chart

Falling oil prices and meager production figures have negatively impacted the sector. Pemex's inability to generate a profit due to its high levels of debt have further diminished the sector.[4] However, since 2010, Mexico has also reduced its dependence on the commodities sector by growing industry and commerce.

The 2014 energy reform introduced a set of regulatory changes at the constitutional level that aimed to open the oil sector to foreign companies. These reforms created a legacy of regulatory bodies and processes to manage the burgeoning investment in the sector. So far, the government has signed 111 contracts with private companies to explore and produce hydrocarbons in Mexico. [5,6]

Unfortunately, the Partido Revolucionario Institucional (PRI) administration's failures in addressing corruption, ensuring political stability, and reducing violence compromised the political legacy of the energy reform. Pervasive failures in governance have caused the Mexican population to distrust institutions throughout the government, and in the oil sector in particular.[7] Polls show however that the change in government has been followed by increased trust in government—though the perception of corruption within the government remains high.[8]

It is in this context that the RGI can serve to neutrally assess the advances and failures in governing Mexico's oil sector. The RGI is a tool that public officials, civil society actors and journalists can use to ascertain how the country's resource governance rules and practices compare to international standards.

## 2019 RGI INTERIM EVALUATION RESULTS

As discussed in the introduction, three components make up the index composite score. Two—value realization and revenue management—measure key characteristics of the extractives sector and a third captures the broader context of governance—enabling environment. These three overarching dimensions of governance consist of 14 subcomponents, which are comprised of 51 indicators, which we calculate by aggregating the answers to 133 questions.

Independent researchers, overseen by NRGI, complete a questionnaire to gather primary data on value realization and revenue management. For the third component (enabling environment), the RGI draws on secondary data from a number of external sources.

In this analysis, we focus on the two sector-specific components: value realization and revenue management. For each component we will use elements from the enabling environment component as context to complement the analysis.

### Value realization

The value realization component covers the allocation of extraction rights, exploration, production, environmental protection, revenue collection and state-owned enterprises. Mexico increased by three points on the value realization component since the 2017 RGI to 74 out of 100 points. This component therefore remains in the satisfactory performance category.

Mexico earned good or satisfactory scores in almost every subcomponent of the value realization component. However, it scored in the weak band for local impact. Mexico's strongest area in the value realization component was taxation. This subcomponent improved by 11 points since the previous assessment. The weakest policy area in the taxation subcomponent is related to the disclosures of company payments. Even though the law requires the government to disclose data on payments from extractive companies (for which it scored 100 points), the actual disclosures score is 67 (which is still considered a "satisfactory" mark).[9] The inconsistency relates to the two different contracting models that co-exist in Mexico: the Pemex direct assignations (known in Spanish as "asignaciones"), and exploration and development contracts signed with private companies. Pemex disaggregates its assignations data by geographical region but not on a company-by-company or project-by-project basis. However, it signs contracts on a project-by-project basis and so reports its disclosures that way.

4   Miguel Gutierrez and Daina Beth Solomon, "Mexico gives struggling Pemex $5 bln to pay debt, refinancing planned," *Reuters,* 11 September 2019, www.reuters.com/article/us-mexico-pemex/mexico-gives-struggling-pemex-5-bln-to-pay-debt-refinancing-planned-idUSKCN1VW1WG

5   Mexico hydrocarbon contracts are available at www.resourcecontracts.org.

6   The reforms have been praised because of their focus in creating checks and balances for the sector and enriching the quality of disclosures. Nick Snow, "Mexico reforms may help raise energy transparency bar, speakers say," *Oil and Gas Journa*l, 25 January 2017, www.ogj.com/general-interest/article/17288614/mexico-reforms-may-help-raise-energy-transparency-bar-speakers-say.

7   "México detiene caída en el Índice de Percepción de la Corrupción: Transparencia Mexicana", 22 January 2020,  www.tm.org.mx/ipc2019

8   "Confianza en el gobierno federal pasó de 25.5% a 51.2% en dos años, según encuesta del Inegi," *Infobae,* 21 May 2020, www.infobae.com/america/mexico/2020/05/22/confianza-en-el-gobierno-federal-paso-de-255-a-512-en-dos-anos-segun-encuesta-del-inegi

9   Article 58 from the Law of Hydrocarbon Revenues (LISH) requires that the Mexican Oil Fund for Stabilization and Development (FMPED) publishes in the aggregate as well as disaggregated each type of payment companies make to the state.

## Table 1. Mexico's RGI score trends between the 2017 edition and the 2019 interim evaluation (oil and gas)

| | OIL AND GAS | | |
| --- | --- | --- | --- |
| | 2017 score (revised) | 2019 score | Trend |
| **RGI COMPOSITE SCORE** | 68 | 70 | +2 |
| VALUE REALIZATION | 71 | 74 | +3 |
| Licensing | 78 | 79 | +1 |
| Taxation | 81 | 92 | +11 |
| Local impact | 46 | 53 | +7 |
| State-owned enterprises | 78 | 71 | -7 |
| REVENUE MANAGEMENT | 68 | 76 | +8 |
| National budgeting | 75 | 89 | +14 |
| Subnational resource revenue sharing | 57 | 73 | +16 |
| Sovereign wealth funds | 72 | 82 | +10 |
| ENABLING ENVIRONMENT | 65 | 62 | -3 |
| Voice and accountability | 70 | 72 | +2 |
| Government efficiency | 82 | 66 | -16 |
| Regulatory quality | 82 | 80 | -2 |
| Rule of law | 60 | 48 | -12 |
| Control of corruption | 43 | 35 | -8 |
| Political stability, absence of violence | 30 | 45 | +15 |
| Open data | 90 | 85 | -5 |
| | | | |
| AVERAGE SCORE FOR LAWS | 79 | 85 | +6 |
| AVERAGE SCORE FOR PRACTICES | 74 | 76 | +2 |
| GAP (PRACTICES LESS LAWS) | -5 | -9 | -4 |

### PERFORMANCE BANDS

| | |
| --- | --- |
| Good | Scores over 75 |
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The differences between the two types of contracting systems are apparent in the licensing subcomponent as well. Mexico's oil and gas sector achieves a satisfactory score in this subcomponent with 74 points. In the cadaster policy area, we see an improvement of 1 point compared to the 2017 RGI score as a result of better reporting of the areas covered by Pemex assignations. The National Hydrocarbon Commission's (CNH) implementation of the information portal "Tablero de Asignaciones" was the main adaptation to disclose the assignation contracts.

The state-owned enterprise subcomponent assesses policy areas relevant for Pemex. In this interim assessment, Mexico dropped seven points to 71, declining from good to satisfactory. Weak performance in three policy areas explain this setback: non-commercial spending disclosures, commodity sales disclosures, and joint ventures and subsidiaries disclosures.

In contrast to the 2017 RGI, in the period covered by this interim assessment Pemex failed to disclose payments related to its non-commercial commitments such as social services and public infrastructure. Ideally, a company should refrain from engaging in these types of activities or publicly disclose the amount spent there as non-commercial commitments. The RGI research shows that between the 2017 RGI and the 2019 interim assessment, Pemex supported social services, engaging in community development projects in areas influenced by the oil industry.[10] However, its available disclosures show only the amount of money spent as donations to communities.[11] Pemex does not provide information about its spending on non-commercial social services.

The commodity sale disclosures indicator score of 38 remains unchanged since the 2017 RGI and reflects that Pemex discloses only aggregated information related to its production volumes, sold values and the dates on which it sold resources. There is no legal mandate or practice that prompts the disclosure of its buyers. (Commodity sales governance practices are still a relatively new frontier in the hydrocarbon sector. In the 2017 RGI, only 11 countries scored good or satisfactory in the indicator "commodity sale rules". )

Finally, the joint ventures and subsidiaries disclosure score of 40 points reflects weaknesses in the way Pemex shares information about its participation in joint ventures, the levels of ownership and the costs and revenues deriving from such associations. This is particularly concerning, as it is important that all joint ventures (and not just the ones allocated through a specific contract model) disclose Pemex's participatory interest. Because of the national oil company's financial struggles, it is important that the public and experts can remain vigilant about the gains and losses resulting from a joint venture.

At a score of 53 points, local impact is the weakest subcomponent in this 2019 edition of the RGI. This score represents an improvement of seven points from the 2017 RGI, but remains weak. This subcomponent's weaknesses are concentrated in four policy areas: environmental and social impact assessment (EIA/SIA) disclosures, environmental mitigation plan disclosures, environmental compliance practice and compensation to land users and owners.

The EIA/SIA disclosure issues stem from problems with the implementation of the Law of Ecological Equilibrium and Environmental Protection (LEGEEPA). In the case of the hydrocarbon sector, the Agency of Security, Energy and Environment (ASEA) enforces this law. So far, ASEA has published some EIAs that correspond to the contracts signed in the last few years on CNH's website, but they are not complete. ASEA has also failed to fully disclose the environmental mitigation management plans, resettlement and compensation action plans.

### Revenue management

The revenue management component covers the key aspects of governments' management of income from oil and gas in Mexico: national budgeting, subnational resource revenue sharing and sovereign wealth funds.

With improvements across the board, revenue management was the best performing component in the interim assessment with 76 points. This represents an eight point improvement from the 2017 RGI score. The subnational resource revenue sharing subcomponent earned a 16 point improvement since the 2017 RGI, followed by the national budgeting subcomponent, which scored 14 points higher than in the last assessment. The sovereign wealth fund subcomponent also improved by 10 points.

The national budgeting subcomponent remained the strongest in the interim assessment due to the strength of the sector's open data portals. Since the 2017 index, CNH successfully implemented information portals both for the contracts allocated during the bidding rounds and Pemex's direct assignations. Another policy area relevant for this subcomponent is adherence to a fiscal rule, something in which Mexico succeeds. However, the Fiscal and Budgetary Responsibility Federal Law, which establishes the fiscal rule in Mexico, does not mention any type of external audit for the fiscal rule.

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10   *Annual Report* (Pemex, 2018), www.pemex.com/acerca/informes_publicaciones/Documents/Informe-Anual/Informe_Anual_2017.pdf
11   Pemex: Resources granted for social investment (2013 – 2020) www.pemex.com/etica_y_transparencia/transparencia/social/inversion_social/Paginas/recursos-otorgados.aspx

The Mexican oil and gas sector nearly received a perfect score for its subnational resource revenue sharing subcomponent, save for two particularly relevant aspects. First, the disclosure of subnational transfers could improve if the government disclosed the separate revenue streams that constitute the transfers from the Stabilization Income Fund of Federative Entities to subnational governments. Second, there were no recorded external audits to subnational transfers within the timeframe of the research, even though the Constitution and the Public Accounts Oversight Law (Ley de Fiscalización de la Cuenta Pública) establishes that the Superior Audit Office must perform a public audit of all transfers (including those coming from the different stabilization funds).

## RECOMMENDATIONS

### Value realization

The coexisting contracting models in Mexico (Pemex direct assignations and privately held contracts) should be fully and equally transparent. This is especially relevant to the licensing phase, in which authorities such as the Ministry of Energy and the Ministry of Finance fail to report Pemex payments on a project-by-project basis despite doing so for contracts awarded through the bidding rounds.

Transparency in spending is another area for improvement, particularly for Pemex. The national oil company should improve its level of reporting on social spending in communities, as donations and social programs are non-commercial activities on which Pemex does not currently report.

The sector-specific environmental authority (ASEA) must properly enforce the Law of Ecological Equilibrium and Environmental Protection to address weaknesses associated with local impact management.

### Revenue management

The National Hydrocarbon Commission should keep updating and improving its data portals, specifically "Rondas Mexico" and "Tablero de Asignaciones." Rondas Mexico was designed to interoperate with sources of information from other regulators and authorities such as ASEA and the Ministry of Energy.

The government should disclose the separate revenue streams that constitute the transfers from the Stabilization Income Fund of Federative Entities to subnational governments.

## ABOUT THE RESOURCE GOVERNANCE INDEX

The RGI is a freely available, public data product that provides a global benchmark, country and sector diagnostic tool and a roadmap for policy reforms at the global, regional and country levels. The RGI evaluates how resource rich countries govern their oil, gas and mining sectors, in particular from the perspective of transparency and accountability.

The 2017 RGI results showed that the effective governance of oil, gas and mining sectors is not an insurmountable challenge but that many countries still struggle to adequately govern their natural resource wealth. The 2017 RGI assessed how 81 resource-rich countries govern their oil, gas and mineral wealth. The results from the 2017 RGI are available at www.resourcegovernanceindex.org.

This interim update assesses Mexico's performance during the period from 2017 to 2018 against the same measures included in the 2017 RGI, which assessed the period from 2015 to 2016. This interim update provides NRGI, partners and stakeholders with a unique opportunity to measure Mexico's performance over time, to identify where it has made progress and where it can act on recommendations ahead of the next global RGI, which will be published in 2021.

Given that this is a unique country-specific RGI update, it does not provide a comparative analysis with other countries or rank Mexico among a group of resource rich countries. Comparative analysis will be possible with the 2021 RGI.

### Methodology

The RGI consists of three components: value realization, revenue management and enabling environment, which in turn consist of 14 subcomponents, 51 indicators and 133 questions.

The first component—value realization—covers the allocation of extraction rights, exploration, production, environmental protection, revenue collection and state-owned enterprises. The second component—revenue management—covers national budgeting, subnational resource revenue-sharing and sovereign wealth funds. The third component assesses a country's enabling environment, by drawing on pre-existing research to measure the broader context, such as political stability, control of corruption, rule of law, freedom of expression and other factors.

More information about the methodology, framework and questionnaire used to construct the RGI is available at www.resourcegovernanceindex.org/about/methodology.

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