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Mexican Senate

Topic: The prospective reformation of PEMEX, and its role in the Mexican economy

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I. Committee Background

The Mexican Senate is the upper legislative body of the country, along with the Chamber of Deputies, these individuals are in charge of reforming and restructuring the country. Elected to serve 6 years, hundreds of amendments and resolutions have passed through the hands of Senators, with them having the power to dictate policy for the entire presidential term.

It was in the year of 1823 when the first session of congress was held. This newly formed congress had an upper and lower chamber as a means of managing the tasks of the legislative branch. One, where members were proportional to population, and another one where each entity had the same number of members.

Made up of 128 senators, there are 3 for each of the 32 federal entities, and 32 senators whom are divided among parties in proportion to their share of the vote. The chamber is renewed completely every 6 years, since Mexico does not allow for immediate reelection. The current session is known as the *LXIII Legislatura*, which lasts from 2015 to the presidential elections in 2018, but current senators have been in place since 2012, seeing as their role in the government lasts 6 years. The most important functions of the senate is to reject or ratify international and domestic deals, as well as the heads of bodies in the government.

Delegates in this special committee will need to learn about creating collateral agreements with multiple parties, as well as knowing how to navigate through debates and votes in order to pass something that is beneficial for the greatest amount of Mexicans.

II. Introduction

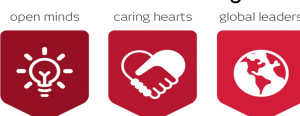
Description and Definition of the Topic

Petróleos Mexicanos (PEMEX) is a Mexican state-owned petroleum company, created in 1938 by the nationalization of all private, foreign, and domestic oil companies at that time (Britannica, 2017). The founder of the aforementioned company was former president Lázaro Cardenas. Today, it is still owned by the Mexican government, with its headquarters located in Mexico City and the current CEO being Jose Antonio Gonzalez Anaya. In 2016, PEMEX generated approximately 2.5 million barrels of oil a day and more than 6 million cubic feet of natural gas. It is one of the largest, most important companies in Mexico, and also the biggest tax contributor (PEMEX.com).

The PEMEX crisis is the result of structural and circumstantial problems like the petroleum price crash. The low price on international markets, hulking debt, and strong competition forced the company to take drastic measures for pumping reduction. It was also

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compelled to cut personnel, suspend projects, and minimize costs. Because of the current crisis it faces, production has dropped from 2.5 million barrels to 1.9 million barrels per day (*TCM, 2016*). If this continues, PEMEX is estimated to be down to a daily production of 1.7 million barrels by 2018. Keeping in mind that PEMEX has no competitors, there is plenty of room for corruption, and as a result, inefficiency.

PEMEX has many faults that have driven it to bankruptcy multiple times, but at the same time, it has been able to survive thanks to the federal government loans, however this leads them to a position where they can not pay their ever increasing debt. Some of the key inefficiencies are: money, lack of support, lack of leadership leading to bad administration and corruption, and the fact that it is a public company.

The corporation has been able to survive for many years with negative numbers since the federal government is able to bail them out, sending it further down a vicious cycle of debt and inefficiency. PEMEX has a incrementally huge long term debt. In 2015 this debt was of 1.301 billion pesos (68.5 million USD). This problem has become increasingly dangerous in the last five years because of the decrease in the world market price of a barrel of oil. Crude oil is PEMEX's primary source of income since it does not have many refineries, which turns the raw resource into gasoline or other usable substances.

For the last thirty years, the federal government has had the opportunity to invest public capital from the Secretaria de Hacienda y Crédito Público (SHCP) and from Banco de Mexico (Banxico), but not until 2015 had this monetary help been significant to the company's financial issues. The lack of funds, lack of federal interest on helping PEMEX, and lack of necessity were some reasons that contributed. Nonetheless, the federal government granted PEMEX 123,500 million of pesos to help pay part of their debt and annual expenses. This monetary help came on three fronts: a direct capital injection of 26,500 million pesos; a public debt bonus of 47,000 million pesos; and a change in the fiscal system where PEMEX's taxes are reduced saving about 50,000 million pesos.

The problem that has always been a key part of PEMEX and has not been fixed is the lack of leadership and the awful administration PEMEX has, which ties with the extensive chain of corruption inside the company. Of all the mentioned public funds the government gave PEMEX in 2015, about 45% were used to pay pensions, and the other 55% were used for paying a debt PEMEX had with its suppliers. Currently, Petroleos Mexicanos has about 150,000 employees, in comparison to 73,500 from Exxon Mobil, or 65,000 from Saudi Arabian Oil Company (estimated to be the most valuable company in the world) There has been a long debate between Mexican businessmen and politicians, whether if PEMEX is better of as a public company or if should be given to the private sector. Being a public company helps not only the country, but also gives the possibility of the federal government funding and helping the business directly. If PEMEX is to become a private company, it could benefit of a better administration with less corruption and more oversight, but the government would have limited ability to help it financially, and the company could go to bankruptcy faster.

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The Problem

The operational proficiency of PEMEX is a vital issue to study in regards to the contribution of energy (oil) resources to economic growth and prosperity in Mexico. Multiple circumstances have led to the current PEMEX crisis. Taking this into account, there exists a direct correlation between the dysfunctionality of the organization and the poor administrations in the company. Over the years, especially this past decade, the company has been constantly declining further into predicament. These same years, former CEOs have proven to be inefficient and incompetent while leading the company. This was witnessed when Emilio Lozoya -who took over for 3 years starting on 2013- accomplished little and reached insignificant advancements during his tenure (Wood, 2016). Not only did Lozoya fail to improve PEMEX, the ex-CEO allegedly received bribes from Odebrecht, further proving the corruption behind PEMEX's leaders (Diaz, 2017).

This an extremely strenuous issue to solve due to its connection to the Mexican government. Operation in strict adherence to Mexico's authoritarian political system instead of a commercial enterprise, and having major investment decisions taken by its government-dominated board, forces PEMEX to make negligent and unproductive judgements. The disadvantages of a state-owned oil monopoly have been exposed, including that the federal government depends on oil revenues to balance its budget; in the process, depriving PEMEX of the money and modern industrial practices it needs to modernize and become efficient. This can be particularly seen by the fact that over the past years, Mexico's government has depended on oil for up to 35% of its revenue (Wood, 2016). With lowering prices and production, a gap is left in the federal budget; which in turn is covered by cutting spending in infrastructure projects and government salaries and services. All in all, it can be seen that there are many different aspects that have led to PEMEX's inefficiency and its degradation.

III. History of the Topic

Chronological History of the Topic

Before the expropriation of oil in 1938, the refining business in Mexico was controlled by the Mexican Eagle Company, a branch of Royal Dutch Shell. While they accounted for 60% of the total oil production, American companies such as Jersey Standard managed another 40%. The Mexican Constitution of 1917 claimed that any natural resources, even those discovered below ground, belonged to the Mexican government (Office of the Historian, 2016). As a result, tensions arose between the United States and Mexico due to the fact that foreign companies were a topic of resentment amongst local people. This was because Americans wanted to claim that oil, but Mexican companies refused to give it to them. By the 1920s, Mexico had become the world's second largest producer of oil, but little profit was gained; most of the oil would be exported due to the small domestic market. The situation worsened in the 1930s due to the Great Depression and a surplus in oil production, causing the government's oil revenue and production to drop (Office of the Historian, 2016). To make matters worse, large companies paid their employees about twice as much as their Mexican workers (Office of the Historian, 2016).

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The aforementioned developments in progress and the intense resentment from the people led to a mayor turmoil.

After several strikes by workers, the Mexican government decided to take action and tried to tackle the issue. President Lázaro Cárdenas implemented the Expropriation Decree in March of 1938. The Expropriation Decree consisted of the Mexican government removing the control and power over oil within the country from foreign-owned companies (Philip, 1982). This measure led to the creation of PEMEX on June 7th of 1938.

International repercussions summed up to an already challenging beginning in the history of the company. Soon, Mexican oil exports had dropped by 50% as countries took their stance against PEMEX and established an embargo on Mexican oil (Office of the Historian, 2016). Mexico's political enemies multiplied as a result of the Expropriation Decree, Great Britain being one of the main global powers against it. The United States reactions to the creation of PEMEX were quite conflicting. The U.S. government was understandably upset as the expropriation cost their companies, companies that paid millions of dollars in taxes. On the other hand, they realized that they had enough political enemies internationally already, and that it was important to have Mexico on their side. Due to high global tension from the second World War, both the Mexican and the American governments agreed and signed the Cooke-Zevada agreement which stated that the Mexican government will pay 29 million USD to a handful of American oil companies, on April 18, 1942. During the 1950s, American oil companies faced several challenges and eventual failures and felt obligated to stop trying to succeed in the Mexican oil market. Alternatively they set up office and thrived in The Middle East and Venezuela (Office of the Historian, 2016).

Between the years 1989 and 1995, PEMEX had cut its staff almost in half, yet there are still about 108,000 people employed. Even then, there was still a lack of efficiency as there were too many workers and not a lot of work that needed to be done. Indeed, even the American oil producer Exxon, which had roughly five times PEMEX's revenues in 1995, recruited fewer workers. Despite these issues, PEMEX soon developed into one of the largest oil companies and accounted for 70% of Mexico's foreign exchange by the early 1990s.

Historical Case Studies

The creation of Petróleos Mexicanos

During the 1920's, Mexico was the second greatest producer of oil worldwide, second only to the United States. However all this oil production was controlled and profited by american companies. This lead to the inevitable creation of Petróleos Mexicanos (PEMEX). PEMEX was initiated by the Mexican Congress in 1938 after President Lázaro Cárdenas del Río nationalized the foreign-owned oil organizations working in Mexico at the time in order to better manage the consolidated industry. In July 1992, the Organic Law of Petróleos Mexicanos and Subsidiary Entities brought about the formation of the accompanying four decentralized Mexican government-owned public elements: PEMEX-Exploration and Production; PEMEX-Refining; PEMEX-Gas and Basic Petrochemicals; and PEMEX-Petrochemicals. Each of

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these subdivision met the qualities of a PEMEX subsidiary, and together they undertook the operations that were previously overseen straightforwardly by PEMEX (Petróleos Mexicanos, 2016).

Inefficient Administration

As previously stated, PEMEX's former CEO's have proven to be inefficient and incompetent while leading the company. This was witnessed when Emilio Lozoya -who took over for 3 years starting on 2013- accomplished little and reached insignificant advancements during his tenure (Wood, 2016). Not only did Lozoya fail to improve PEMEX, the ex-CEO was accused by ex directors of Odebrecht, a brazilian construction company known for bribery and corruption, of allegedly receiving bribes from Odebrecht (Lopez, 2017)(Diaz, 2017). In this bribery scheme, Lozoya seemingly received \$10 million in bribes to obtain public work contracts (Staff, 2017)Over-generous pension promises have also proven to be a key factor in the deterioration of PEMEX over the years. Recently, it was revealed that 14 retired PEMEX officials receive over 2 million pesos annually -greater than a Mexico senator's yearly salary. These retirees also receive over 6,000 pesos a month for expenses and end the year with a 400,000 peso bonus. They garner between 238,000 to 362,000 pesos a month while president Enrique Peña Nieto's monthly salary is about 360,000 pesos (Rivera, 2017). One of the pensioners is Carlos Arnaldo Morales Gil who's pension last year was 3 million pesos. Morales used to be the director of PEMEX Exploration and Production until 2014 and in 2015 he became the CEO of PetroBal, a direct competitor of PEMEX (PEMEX Pensioners, 2017). Unfortunately, Morales is not the only case seen for this problem for which PEMEX is losing money.

The Energetic Reform

Before 2013, Enrique Pena Nieto alongside PEMEX leaders argued that amendments were largely needed to insure the future success of PEMEX. Their arguments were based on the companies inefficiencies and constitutional boundaries that did not allow the international oil giant to compete and keep up with the rest of the world, technologically speaking.

Against all odds and pressure, the federal government presented the Energetic Reform on August 12, 2013. The Reform was amazingly approved by the Federal Senate on December 11 of 2013 and by the Chamber of Deputies a day later. In December 18 of the same year, the Reform was declared constitutional by the Federal Legislative power and was enacted by the Executive power on December 20th to give its formal implementation a day later.

The reforms has ten major objectives and fundamental premises that vows to follow including: maintain the ownerships of the nation's property over natural gases; strengthen PEMEX and CFE (Federal Electricity Commission) while maintaining them as government businesses; bring up a controlled but competitive electric network; encourage more and stringer private capital injection to the electric and oil networks; guarantee international standards in both the electric and oil sectors; combat the corruption in both markets; and, encourage growth with a responsible and eco friendly vision.

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One of the key points about the Energetic Reform is the opening of the National oil reserves to foreign international companies, and the de-monopolisation of the oil market by letting foreign firms produce and sell gasoline and other hydrocarbons. This bold move is set to decrease local gasoline prices because of market competition and more national production. This will also apply a lot of pressure to PEMEX because foreign firms like Shell are more productive and cost efficient. If PEMEX does not change and improve, it might be taken out of business by such international companies.

Past Actions

2008 Oil Reform

In 2008 former president Felipe Calderon's executive government presented a Petroleum Reform to the senate for ratification and approval. The controversial but highly praised reform sought to change five secondary laws, without touching article 27 that ensures Mexican oil is property of the Mexican people only. Some basic upsides to this reform include: a stronger and more transparent corporate government, seeing as PEMEX is a government ran corporation; citizen titles that let any citizen help pay PEMEX's debt while also helping citizens win money; a more lucrative tax scheme for PEMEX, decreasing its expenses; more power given to PEMEX with more freedom to do as they please; the creation of the National Commission for Hydrocarbons; more stable and strong incentives to the production and use of clean energy; and, more power to the Secretary of Energy (SENER). This reform was praised by many politicians as the most important oil reform since the oil expropriation of 1938, because of how it gives more liberty to the company. However, there was a lot of controversy since many viewed it as an undercover privatization of Mexican oil and of PEMEX. The reform, in the eyes of many experts, was not as detailed and concrete in many aspects, which might bring future problems and loopholes in the legal system. It gave PEMEX the possibility to contract private firms to do multiple jobs, something seen poorly in the eyes of citizens. Nevertheless, the reform was passed on October 2008 by the senate and was approved by the Supreme Court of Justice, thus letting the Federal government enact the law.

IV. Key Players and Points of View

Emilio Lozoya Austin

Prior to becoming CEO of PEMEX in 2012, Emilio Lozoya Austin handled the International Affairs Office for Peña Nieto's campaign in the Institutional Revolutionary Party (PRI). He was appointed General Director of PEMEX in December of 2012. During his first two years, Lozoya stated how he envisioned PEMEX could become like the Brazilian company Petrobras. This firm had improved its presence in the market through reforms that allowed it to establish commercial alliances with businesses in the private sector; Lozoya planned on following its example. He also asserted that President Peña Nieto's energetic reform would strengthen PEMEX, just as it had happened in Brazil with Petrobras and in Colombia with Ecopetrol (Riquelme, 2017).

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In July of 2014, the company informed that after a thorough analysis, Odebrecht had been elected as the firm that would guarantee the experience and capacity to develop PEMEX's pipeline project in shape and time. That same year, Lozoya was acknowledged as the "Petroleum Executive of the Year" (Energy Intelligence, 2017). PEMEX's numbers also increased by 13% during Lozoya's term; the company went from operating with a 476,660 mdp budget to 540,580 mdp (Riquelme, 2017).

However, the fall of raw prices forced the company to offer international corporations greater participation in PEMEX's projects (Reforma, 2017). A series of recorded conversations between Lozoya and OHL Mexico directives were leaked where PEMEX's director allegedly induced the company into forming an alliance with a Spanish firm to participate in an unidentified licitation. PEMEX and Emilio Lozoya denied these claims. In 2016, he was removed as director of Petróleos Mexicanos. Finally, it was published in April of 2017 by *Aristegui Noticias*, *Proceso* and Brazilian newspaper *O Globo* that Lozoya had received a total bribe of 10 million dollars, –beginning since 2012 when he was still part of Peña Nieto's campaign–from Odebrecht to promise the procurement of contracts. Once again, Emilio Lozoya denied these claims.

President Enrique Peña Nieto

In the beginning of his presidency, he proposed different solutions for uprising problems within PEMEX. These proposals included: constitutional changes, that would entitle PEMEX with risk and profit-sharing partnerships between them and foreign firms; renovating and getting hold of improved technologies rather than the ones currently used; and becoming more sustainable and socially accountable, through the increment of the company's transparency (McCrummen, 2013).

President Enrique Peña Nieto appointed Emilio Lozoya Austin as the CEO of PEMEX in December of 2012. Prior to this, Emilio Lozoya was a senior official in Enrique Peña Nieto's presidential campaign. Although he was no longer PEMEX's CEO since February 2016 when José Antonio González Anaya took over.

José Antonio González Anaya

As stated before, in February 28, 2016, José Antonio González Anaya became PEMEX's Chief Executive Officer and General Manager. Although he took the job in one of the company's worst situations, (the fall of prices for oil and natural gas) he has been able to make a turning point for PEMEX, "since the company's financial situation has been bolstered, while at the same time its crude oil production has stabilized and eventually began to increase" (Last year marked a milestone in Pemex's history, 2017).

Pedro Joaquin Coldwell

Pedro Joaquin Coldwell has served as the Secretary of Energy since December of 2012, a key roll in the mexican government, and one of Enrique Pena Nieto's most trusted men.

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Coldwell, alongside Peña Nieto, has stated that the goal through several energy reforms is to modernize PEMEX, not to privatize it. When first elected, Pedro Joaquin Coldwell was very clear that one of his main job as Secretary of Energy is to “increase autonomy in the administration of PEMEX”.

José Antonio Meade

José Antonio Meade served as Mexico’s Secretary of Finance and Public Credit, and he is now running for President for the next elections in mid 2018. According to Meade, oil is significantly important to Mexico’s Economy as it is fueling its economic growth. Furthermore, José Antonio has worked together with José Antonio González Anaya, the General Director of PEMEX, multiple times. On September 2016 in London, Meade, accompanied by José Antonio González Anaya, met and discussed with british investors. As part of this meeting, Meade and González presented the main attributes of the Energy Reform and explained how it provides business opportunities in Mexico for British Companies (PEMEX, 2016). Later, on April of 2017, once again alongside José Antonio González Anaya, Meade met with companies and explained that the company's strategy was to increase financial efficiency therefore maintaining an adequate balance and sustainability. Adding on, they also reported on the progress of implementing the 2017-2021 Business Plan of the company, which defines the actions to be performed throughout the business lines Moreover, they explained that the leading axis is profitability, and it is for this purpose that the tools and flexibility of the Energy Reform are being employed (PEMEX 2017)

Ildefonso Guajardo Villarreal

In the third round of negotiations, the United States proposed a plan to regulate energetic enterprises related to PEMEX. Ildefonso Guajardo Villarreal, Mexico’s Secretary of Economy, criticised that all these businesses like Exxon, who bet on the reform and established investments with the petroleum company would not be content (El Economista, 2017). In an interview, Guajardo expressed that one of the problems PEMEX had was that it had no capacity to invest in extracting. “Oil is so profitable that whatever money there is, it is invested in oil.” (Aguilar, 2014)

Cuauhtémoc Cárdenas

The ex-presidential candidate, Cuauhtémoc Cárdenas, asked the federal government for a thorough investigation following the Odebrecht case. He stated that they should sanction whoever had to be sanctioned, proceeding according to the law (Zavala, 2017). Cárdenas also responded to President Peña Nieto in August of 2017 about the *gasolinazo*. Cárdenas outlined six measures for what PEMEX needed in order to reduce prices, improve the company's efficiency and hinder its deterioration. His ideas were to create an international forum of experts to analyze and propose solutions to the problems; retrieve the operation of the refineries to supply 50% of demands; augment PEMEX’s inversions to increase capacity; propel the

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construction of safe ducts that ameliorate the company's efficiency of national transports and put a halt on gas theft; have a zero-base federal budget for the strict economic benefit of the country; and integrate auditable government accounting through digital platforms that operate on the information of public spending and its regional balance (García, 2017).

V. Possible Solutions

Finding viable and realistic solutions for the problem at hand is a great challenge due to the inefficiencies of the business and its immense size. Regulate and improve PEMEX's refining system and platform is key; it has an annual deficit of more than 100 billion pesos. Experts believe that PEMEX and the federal government should sell these refineries and the entire platform to the private sector or find aliancias with the private sector to modernize and inject highly needed capital to improve this business' cash flow. Another major objective that has shown some advancement in the Energetic Reform is the reduction of passive labor payments. Each year PEMEX pays billions of dollars to retired employees, but the federal government was able to reduce the amount, although there is still much to be done. PEMEX's oil production has had a steady decrease of oil exploitation even though it has had a stable increase in the number of employees. The government should look at possible ways to increase PEMEX's production and efficiency, especially because it is one of the oil companies with the biggest number of staff and lowest production of oil. The federal government has power to help PEMEX, specially in its financial and fiscal side. When PEMEX buys international gasoline, at a low price, to sell to the mexican people, they have the ability to earn a lot of money because of big margins, but because PEMEX had to pay a lot of taxes related to selling imported gas, its earnings decreased significantly. On another note, PEMEX is set to have a big change in its distribution system in order to become more competitive and not lose market power to foreign oil companies. Nonetheless, the federal government should be supervising this change to make sure it is for the best of the company as a whole.

VI. Current Status

With oil prices plummeting, a long history of corruption and a somewhat pressing problem with too many staff and debts, PEMEX is in urgent need for reform. All of Mexico's law makers are focusing their efforts in attempt to modernize the Mexican petroleum company. Even though a possible partnership with Exxonmobil is likely to shape their future there is still a long path to efficiency and transparency. The seemingly immortal PEMEX monopoly might be coming to an end. However Mexican leaders have made it very clear that PEMEX is going through a modernization process, which does not mean that it will become a private company.

In 2016, the federal government, in conjunction with PEMEX and other government organizations, raised the cost of fuels nationwide by more than 20%. This increase in the cost of hydrocarbons was an action taken by the president trying to reduce the amount of money that the federal government spends on subsidies that the government had implemented for more than 20 years. These subsidies have kept the price of fuel at a unrealistic price compared to the

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international price. Also, PEMEX was on the verge of financial collapse, so the price increase was a necessary action to save PEMEX from reaching bankruptcy.

The biggest problem with this president's action was the social reaction it brought. The public in general called the action "El Gasolinazo". The social discontent came from the fact that the president promised to lower the prices of gasoline and electricity with the new energetic reform, but this crisis did the opposite effect. Large protests, usually violent, were the result of El Gasolinazo, which caused tremendous damage to private and public property, as well as gas stations, and the theft of millions of gallons of gasoline.

Hate on "El Gasolinazo" has already decreased exponentially, even though the prices of hydrocarbons continue to stay elevated. Even so, the federal government is hoping the entry of new gasoline companies to the Mexican market will reduce the cost of gasoline and other energy products.

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