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ENERGY GUEST BLOG -- JIM SAMUEL

Might Mexico's new approach to oil and gas shake things up in Ohio?

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Here's a question: Will Mexico develop a forward-thinking national energy policy before the United States? A week of positive headlines might turn out to be nothing but ink on paper, but could the Mexican political momentum be the catalyst that outpaces or deflates American energy gains?

This column has flowed with unabashed optimism regarding the Utica shale play and the shale boom nationally. Yet the recent attention-grabbing headlines by Mexican President Enrique Pena Nieto have given me a brief pause to ask these questions to provoke a moment of thought.

Mexico was the first country with significant oil and gas deposits to nationalize the ownership of its hydrocarbons, which it did in 1938. Proceeds from hydrocarbons account for roughly one-third of Mexico's revenue and one-fifth of all its exports. However, while their resources are vast, the state controls all aspects of the development and ownership of the mineral rights. Production has declined in recent years.

Last week, President Nieto said, "This is the first step in creating an energy sector for the 21st century for Mexico." He was referring to a constitutional amendment to essentially end the monopoly in its oil and gas sector by allowing a profit-sharing model with private companies. It's a bold statement, but one that comes from a government that has built an effective, working coalition that, in just a few months, passed constitutional reforms limiting powerful public teacher unions and removing immunity for public officials from criminal prosecution.

Mexico's oil and gas reserves are significant. The U.S. Energy Information Administration lists Mexico as one of the 10 largest oil-producing nations in the world, and it lists the nation fourth in the estimated natural gas reserves from shale.

Will Mexico's constitutional amendment to reform their energy industry pass? Experts say it is highly likely it will be enacted by the end of the year. Are Mexico's reforms everything the energy industry would like to see? No, but they are a major step forward on an issue that is considered to be a third rail of Mexican politics. (Think Medicare or Social Security reforms here in the United States.)

So what does Mexico's advancement have to do with Ohio?

A shift of capital investment to areas of lower cost for production, better return on the product or better market access is always a reality. The technologies and mechanisms used to extract hydrocarbons from shale are costly. Repetition and concentration of drilling activity brings down the cost per well. But at a cost of almost $5 million per well, companies are undoubtedly looking and responding to ways to mitigate the costs tied to all aspects of shale development.

To make the point on the fluidity of the industry, one can look at the drop in the number of Pennsylvania-based Marcellus rigs as rigs increase in the Ohio-based Utica. It isn't the industry bailing on the Marcellus; they are simply reallocating their capital for drilling away from the predominantly dry gas of the Marcellus for the wetter gas of the Utica that fetches a higher commodity price.

My chief concern for the growth of the industry has been and will remain the intrusion of federal regulators, stifling common-sense advancement of technology and industry to capitalize on the nation's abundant resource. The geology is there, pricing and markets will work themselves out over time as demand adjusts, and (bite my tongue) even major tax policy discussions may prove to do far less to dampen the activity of permits and rig counts than has been predicted. But if we enter an increased federal regulatory environment, we could see a real impact on the direction and location of the industry.

The U.S. EPA continues to pursue restrictive oversight of the oil and gas industry expansion and has focused its efforts on areas of regulation where it can pre-empt the state-level jurisdiction over the drilling industry. If this is successful, it threatens to add massive delays to the permitting process and likely snuff out parts of the industry that otherwise would develop and flourish in a harmonious regulatory environment. Certainly, U.S. regulation will not reduce the national or global demand for hydrocarbons; it will simply push the capital needed for production to lower cost markets.

Enter Mexico, a known quantity and region, with a relatively stable government and relatively lax environmental controls, eager to advance its energy policy and enter into a pro-growth era.

Some might say it is highly unlikely that the industry will shift rapidly away from the promising U.S. shale market. But on my desk I keep a copy of an article from May 2005 that states in no uncertain terms, "U.S. oil production began an irreversible decline 30 years ago."

Today, oil production is on a significant growth track, and the United States is the world's largest producer of natural gas all due to shale. But eight years ago, people were ready to write off any growth in the oil industry as the trend was "irreversible," and the future for natural gas was liquefied natural gas imports.

Technologies and trends can change rapidly. International players are positioning themselves to grow their own markets and will eagerly absorb the fallout of any fickle U.S. energy policy signals.

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