CONTINUITY OR RUPTURE? MEXICO’S ENERGY REFORM IN LIGHT OF ELECTORAL EXPECTATIONS

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Mexico’s future hinges on the outcome of the upcoming July 2018 presidential election. With just a few feet remaining from the finish line of the presidential race, the oldest horse, both in terms of age and political track record, is still a few steps ahead of the youngest, which follows in second place. A few days after the first presidential debate, Andrés Manuel López Obrador, the “left-wing” candidate representing the National Regeneration Movement (MORENA, according to its acronym in Spanish), was still in the lead over Ricardo Anaya, the “right-wing,” National Action Party (PAN, according to its acronym in Spanish) candidate. The candidate from the governing Institutional Revolutionary Party (PRI, according to its acronym in Spanish)—José Antonio Meade—plods along at a slow pace, seeming to have not heard the gunshot that started the electoral race.

The suspense building at the ballot boxes is nothing new. In 2006, when Felipe Calderón pulled ahead of López Obrador (also known by his initials “AMLO”) after the two candidates were nearly neck-and-neck in the race, the country underwent a period in which the credibility of Mexico’s democracy suffered a notable decline. Nevertheless, from the start to the end of his term as president, Calderón rode out the trials, strikes, and complaints regarding his victory. His first initiative in office was to push for energy reform in 2008, a move that was considered to be rather extreme and, ironically, was consequently curtailed by the PRI. The reform actually turned out to be insufficient—to the point that the succeeding Enrique Peña-Nieto administration had to propose another initiative that would significantly open the electricity and hydrocarbons industries. The reform, which was led by the PRI and the PAN and was approved in just three weeks’ time, liberalized the entire hydrocarbons value chain, though there were limitations to private participation in the transmission, distribution, and supply phases of the electricity sector due to Mexican consumers’ resistance to the open market.

That was the major difference between the 2006 presidential campaign and the 2012 election. When Calderón ran against AMLO, in terms of energy, private companies did not have as much to lose, given that Mexican energy monopolies still dominated the market. Furthermore, by the time Calderón completed his presidential term, the status quo remained the same. If López Obrador would have defeated Calderón, due to the static nature of the energy model, there wouldn’t have been much to revert in that sector. Before and after Calderón, Petróleos Mexicanos (Pemex) and the Federal Electricity Commission (CFE, according to its acronym in Spanish) were still omnipotent and continued to be until Peña-Nieto’s administration took charge and made intense, incessant invitations to the private sector throughout his presidency. Similarly, whoever beats the PRI in 2018 may bring the reform to an end and disturb the companies who are already involved in the energy sector. Therefore, if the election results in a win for AMLO, who has called himself the greatest opponent to the opening of the energy market, it could have a major impact on said opening, without changing a single letter in any of the laws or the Constitution itself. Is López Obrador the only primary danger to the energy reform? Or could any of the other candidates modify it due to political motives?

The previous paragraph accurately describes the main hypothesis of this paper: the energy reform may become extinct simply by omission, no matter who is in power. As will be
argued in the coming paragraphs, the reform legislation conferred substantial legal powers to the president and his administration, enabling him to single-handedly halt the reform. Thus, the main goal of this paper is to expose the various ways by which the president can legally stop the reform, as he has control of the promotion and development of new energy projects. This is particularly possible in the current environment, given that the reform has serious problems in terms of social legitimacy due to pledges made by the Peña-Nieto government that went unfulfilled for reasons that will be explained further below.

This lack of legitimacy could be used in particular by López Obrador, whose discourse appeals mostly to the Mexican poor. Thus, the reform may be legal but, in López Obrador’s view, it lacks legitimacy, which in itself is hard to define. To establish a clear definition of legitimacy, we have chosen the conceptual framework provided by economist Joseph Stiglitz, who argues that legitimacy can be identified if transparency, competition, and fairness are present. In this paper, we discuss if these elements are present in the reform and, if not, whether their absence could strengthen Lopez Obrador’s opposition to it. In the final section, we analyze the specific weaknesses embedded in the vast powers conveyed exclusively to the president, which could make it possible to paralyze the creation of new energy projects. Lastly, we mention some examples about how this could be achieved.

We’ve mentioned López Obrador in particular, as he is the clearest, most visible opponent to the new energy model. However, PAN candidate Anaya’s position on energy remains unclear, due to his alliance with the Party of the Democratic Revolution (PRD, according to its acronym in Spanish), which previously opposed the reform but has not indicated its current position. If by chance Meade wins with the PRI, the most viable option is to continue with the same model, barring any unforeseeable events such as an outbreak of social unrest. Such a development would require setting price controls for certain energy resources in order to establish order. Alternatively, due to other pressures, Pemex would once again be given a place in a competitive market that it should no longer rightfully hold. It is true that none of the parties or candidates have a monopoly to stop the energy reform, even if doing so were in their best interest. It is important to mention that the party that upheld the status quo with Pemex and the CFE for nearly 80 years is the same party that drove the reform, for both political and pragmatic reasons.

And if López Obrador wins the presidency this time, what will happen? López Obrador wavered on his position for months until just a few weeks before the electoral race, now demonstrating an increasing radicalism against the energy reform. An April 2018 report by The New York Times features the most categorical statements by AMLO advocating for the dismantling of the reform through “revisions” of the current exploration and exploitation contracts, suspensions of crude exports, and construction of refineries using public capital, among other measures, to exclude private capital investment.1

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Such steps may be achieved through legal means. If López Obrador is against private and/or foreign investment in energy, he could suspend it without violating a single acquired right. Hence, according to Constitutional Articles 25, 27, and 28 and their corresponding provisions, it is the nation’s prerogative (represented by the executive branch and the Federal Public Administration) to promote investments that are complementary to the State’s productive companies, although it is no longer an obligation. In other words, the government can, if it chooses to, bid out exploration and production contracts and electrical production projects; provide access to private pipelines from CFE and/or the National Control Center for Natural Gas (CENAGAS, according to its acronym in Spanish); authorize the construction of refineries and gas processing plants; and even privatize facilities that are public property, among other measures, in order to make the reform a reality. But there are no obligations in the Constitution nor in the reform legislation stating that the direction set by the outgoing administration must be followed. The nation reserves the right to open and close the doors to this sector as it sees fit, whether the companies that may be barred from participating like it or not. And if Pemex and CFE continue to dominate the energy sector under the command of a hostile government? Neither AMLO nor anyone else for that matter can legally deprive private companies of their rights if they have complied with the conditions of their contracts, permits, and/or any qualifying documents. The delicate question then becomes who will be in charge of determining whether they are in compliance with their obligations. A hostile government could intimidate such companies with inspections, penalties, permitting delays, and other actions that could exhaust their financial resources. Of course, they could always defend themselves through legal means.

These “exit clauses” in the Constitution and the laws are no accident; rather, they arise from the ambivalence with which all of the political forces in Mexico have perceived a liberalized energy sector. Throughout the design and approval processes, the indecision between “opening” the energy sector and shutting it off from private investment, and between exposing it to and protecting it from market forces, was palpable. Important steps were not taken, such as turning Pemex into a public company listed on the stock exchange, while the reform included contract termination measures, which were atypically aggressive and unilateral, such as administrative rescission. After the constitutional reform, the parties negotiated the insertion of so-called “exit clauses” in case the government decided to retract its decision. The self-destruct button for the energy reform can be found within the reform legislation itself; it is in the president’s hands.

Reverting to an extreme scenario, if the acquired rights of a company in any segment of the value chain were to be violated, whether in hydrocarbons or electricity, it has a limited

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2 CENAGAS is the National Gas Center, which was created in order to acquire and manage the National Gas Pipeline System, formerly owned by Petróleos Mexicanos and now called SISTRANGAS (Integrated Natural Gas System). The transfer of contracts and assets was conducted so that Pemex would not form a barrier to the entry of other users and retailers.

3 Administrative termination, which is included in the provisions of the constitutional reform as well as in the hydrocarbons law, authorizes the National Hydrocarbons Commission to execute the unilateral termination of oil company contracts, due to failure to comply with certain clauses included in the law and further explained in the contracts, plus the payment of damages.
number of options to seek a remedy. For example, if the cost of getting out of a contract is higher than the cost of litigation, it can pursue a resolution through the courts or even alternative dispute resolution mechanisms such as commercial and investment arbitration. However, not all rights are acquired simultaneously, and a project typically requires an endless number of permits, authorizations, licenses, and other qualifying documents that are acquired over time. In such cases, a company could safeguard the rights detailed in its contract, but may also find itself at a standstill in terms of compliance with the regulatory framework throughout the course of the contract’s execution.

The decision about how to proceed will therefore depend on the affected company’s view on the seriousness of the violation and the costs it would incur to defend its rights. If a company only has a document granting its rights but has not put any assets on the ground, it might be best to abandon the project and pack its bags (if it’s a foreign company) or choose another line of business (if it’s a national company).

This perspective changes when a company already has assets in place that it can no longer remove. The energy industry is particularly voracious in catching investors or companies that are overly trusting off-guard. For that very reason, some have opted not to challenge conditions in a country that has suddenly drawn its claws against them. A quintessential case is that of Venezuela, where, despite expropriation actions, companies have opted to continue doing business in the country because it would cost them more to leave. Sunk costs are a very strong anchor, even in ground that has been beaten down by the government.  

Nevertheless, the case of Mexico is very different from that of Venezuela for multiple reasons, besides the fact that the comparison between López Obrador and the late Hugo Chávez and/or current Venezuelan President Nicolás Maduro has no empirical foundation. Furthermore, ironically, even the Chavist legal framework of hydrocarbons extraction is more open than the Mexican framework was prior to the 2013 reform; consequently, Venezuela, both before and after Chávez, already had and continues to have substantial sunk costs in its land. In Mexico, meanwhile, there are fewer projects coming in—progressively yet quickly. In regard to exploration and extraction, except for deepwater projects that only exist on paper, the already considerable number of contracts being granted are for relatively modest projects on a national and global scale, comparatively speaking. Pemex is still currently the sole oil producer in Mexico, although its production is rapidly falling. Consequently, if the energy reform is halted, each company would suffer a blow proportionate to the size of the investment it made—big or small. However, Mexico could lose, or suspend, a great promise of development.


5 According to Pemex’s oil indicators, in January 2017, its production was 2.318 million barrels per day (MBD), which dropped to 2 MBD in December of the same year. See: http://www.pemex.com/ri/Publicaciones/IndicadoresPetroleros/eprohidro.esp.pdf.
Here we have the *quid* of the question. The credibility of the supposed benefits of the energy reform was called into question due to a series of events related to promises that were unviable from the start, and foreseeably impossible to fulfill. In its eagerness to convince Mexicans of the benefits of the reform, the government resorted to a failing pledge: the vow that the prices of the most widely used energy commodities in everyday Mexican life would drop simply by changing the Constitution and the laws. This is especially unlikely in Mexico’s energy industry, which is far behind in its institutional framework and management practices, lacks technological modernization, and is hampered by corruption and a lack of financial transparency. These conditions prevent energy resources from being cheaper, much less by decree and in the blink of an eye. Furthermore, the wave of political scandals surrounding former Pemex general director Emilio Lozoya Austin, which cast a shadow over Peña-Nieto’s 2012 election campaign, were revealed to the public at the same time as the rise in the price of liquefied petroleum gas (LPG) and gasoline. The cause-and-effect relationship between inefficiency, corruption, and price increases is easy to suspect, but very difficult to confirm. However, perception is reality when dealing with injustices.

The PRI wanted to clean up its image. In order to rid the party of the residue of corruption left behind by some of its members, it selected Meade as its presidential candidate, a federal public official with a technical profile who pledged to eradicate “nonpartisanship.” However, with regard to the energy sector, Meade is still known as the secretary of finance responsible for increasing the price of gasoline both during Calderón’s presidency and with the steep *gasolinazo* of 2016-2017. Consequently, there is the perception that Meade has contributed to the abuse of Mexicans, whether under one party or the other.

Considering the current climate, the energy reform may be legal, but it is undergoing a visible crisis of legitimacy. The prices of the energy resources Mexicans most frequently use in their daily lives have increased, the jobs that were promised as a result of the reform have not been created, and crude oil production remains low. Meanwhile, Pemex has not fully transitioned to corporate culture. It is therefore important to note that the reform has not caused the financial, organizational, and technological deterioration of Pemex. On the contrary, in this paper, we maintain that Pemex is on the decline because the reform was not timely enough, nor was it thorough enough to transform the company. Through the constitutional change, Pemex could have become a publicly traded company, nourished with

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private capital and with a more adaptable, less bureaucratic management and structure. With more flexible rules and fewer longstanding beliefs regarding the intrinsic goodness of state ownership, perhaps it would have been possible to transfuse private capital to Pemex long ago. Now it may be too late, due to the scandals surrounding the organization.

In order to understand why the reform seems vulnerable, it is necessary to distinguish between two different dimensions: the political and the technical. In general, the legislative reform technique is appropriate, except for a few regulatory disincentives, which until now had not been obstacles for individuals. The reform has generally been implemented at a steady pace. Both the hydrocarbons and electrical models have made progress at their own respective pace. In regard to hydrocarbons, the National Hydrocarbon Commission (CNH) has had a very positive learning curve compared to other agencies. It has been widely accepted by national and international actors within the industry as being transparent during the bid rounds. While some requests for bids were more successful than others, the CNH has earned a good reputation among its stakeholders. In a short period of time, the regulatory body has positioned itself well among bidders for exploration and production contracts. However, it is doubtful that CNH’s positive image will aid in the social legitimization of the reform in general. Efficiency in awarding the different contracts is very far-removed from the general population’s consciousness. The victories and heartaches associated with tenders do not have a very wide-reaching impact in terms of convincing the public of the adequacy of the energy reform. The extraction of a barrel of oil, its sale, and even its transformation into various products used for daily consumption is very far-removed from the so-called “ordinary citizen.” Whether the tenders are successful or not, it is not likely they will influence Mexicans’ electoral decisions.

However, the prices of gasoline and other energy resources that people need for a shower or a hot meal can sway votes in one direction or another. In contrast to the exploration and extraction of crude oil, changes in the gasoline, LPG, natural gas, and electricity markets is a delicate subject, since their fluctuations have immediate social effects, which at times can be explosive. In such cases, consumer frustration is usually aimed at the most visible people in charge—and more so considering that there are already various stakeholders in the market. Consequently, the public’s target has been the Ministry of Finance. For quite some time, this ministry set the price of fuels and their corresponding taxes. For decades, fuel was also given away to consumers in order to earn votes for the PRI, but this practice later became burdensome when its popularity became unaffordable and the so-called gasolinazos began during Calderón’s six-year term. Ironically, Meade, the PRI’s celebrated pre-candidate for the presidency, has been at the head of the rises in gasoline prices, under both Calderón and Peña. This explains why the PRI misrepresented it, in its eagerness to paint the gasolinazos as “technical” and “apolitical,” by putting a spotlight on who (for good or bad) specifically made the promise that gasoline prices would drop. In order to save

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11 In 2017, the CNH and the Center of Economic Studies and Teaching conducted a study on transparency in Mexico’s hydrocarbons industry, which is yet to be published.
12 Namely, the secretary of energy, the Energy Regulatory Commission, and the Ministry of Finance.
13 See Grunstein, “The Winter of our Discontent.”
14 Ibid.
Meade’s candidacy, could the government subsidize prices once again? Doing so could disrupt at least part of the energy reform.

With regard to the relationship between politics and energy, sometimes a decision that seems undeservedly rough has a technical justification; other times, a policy justified as technical is actually an abuse. In terms of rising gas prices, there are very few residents who would be receptive to the economic rationale behind it. The population has been figuratively whipped with chains by “frauds” and “mega-frauds” at the hands of public officials and, consequently, is suspicious of any measure that will raise the prices of their necessities, no matter how technically appropriate such increases may be.15

Additionally, no matter how technically desirable a “privatizing” model might be, it is unlikely that it would not be questioned by the vast majority of Mexican residents. Before conceiving the energy reform, the administration needed to address criticism of previous privatization initiatives, such as telecommunications and broadcasting reforms, as the lack of competition in these sectors had users trapped in the companies’ webs: there was no alternative service for unhappy customers to use.16 In the beginning of Peña-Nieto’s administration, the “Pact for Mexico”17 involved the implementation of the first structural reforms, which were intended in part to improve the perception of the privatization of telecommunications and broadcasting by weakening the dominant actors in the industry and strengthening regulators.

Was there anything illegal in the first telecommunications reform? Doubtful. Or does it merely have a bad reputation in terms of its legitimacy?18 Most likely. In the case of the energy reform, its legality does not necessarily mean that it will be viewed as legitimate by the public, particularly if it doesn’t offer the benefits pledged. Although easy to say, this last statement is one of the most complex to adhere to. Which benefits should come from the insertion of private capital in the energy sector? Those promised by the government? The unfulfilled promise of low prices for energy resources is the one that most resounds in the Mexican population’s reproaches of the energy reform. And the supposed guarantee of low prices cannot be fulfilled by any market, much less one as volatile as the energy market. A duly open, modern, and competitive industrial model could, however, bring about greater technological development, job creation, introduction of cleaner energy sources, and increased revenue for the state, among other benefits, as long as the conditions of said opening comply with a series of premises.

15 In recent months, the so-called “Estafa Maestra,” or master fraud, has been described as follows: “The master fraud involved delivering 7,670 million pesos in illegal contracts. Eleven federal offices, eight universities, and over 50 public officials participated.” See “La Estafa Maestra: así fue como el gobierno federal desvió millones a través de empresas fantasmas,” Animal Político, September 5, 2017, http://www.animalpolitico.com/2017/09/estafa-maestra-desvio-millones/.
16 José Roldán Xopa offers a good explanation of the transformation of the strategic areas in The Constitution and the Market (Mexico: Porrúa Hermanos, 2004).
This concept also involves major complexities. As a pretext for our analysis, we’ve considered economist Joseph Stiglitz’s reflections on legitimacy and legality, as they allow us to accomplish the objectives of this paper: to show the relationship between legality and legitimacy and how the absence of the latter can considerably weaken the strength of the former. And based on this lack of legitimacy, any presidential candidate can question the reform, no matter how legal it may be. As previously mentioned, Mexico’s energy reform may be suspended according to the political will of the executive branch without contravening a single letter of the Constitution or the reform legislation. After briefly explaining Stiglitz’s general hypothesis, we describe in detail how the very rules of the energy reform infringe on its transformation to an open market—i.e., the market will stay open as long as the president decides it should remain so.

From our perspective, Stiglitz’s analysis of the “rule of law” precisely links the conditions of legality and legitimacy. For a “legalist,” the rule of law would merely be a series of conditions that ensure the rights of the actors involved. However, Stiglitz is not a legalist, and his notion of the rule of law is not limited to the existence of rules; rather, it also includes immersion in an environment of transparency, competition, and fairness in relations among the government, companies, and civil society. Nevertheless, it is easier to determine whether something is legal than whether it is fair. When, or for whom, is a reform “fair”? In the following paragraphs, we will briefly discuss the concepts of transparency and competition in order to conclude whether the presence of these two conditions ensures the existence of fairness. That is, if there is “transparency” and “competition,” then could there—or should there—be fairness?

**The Immaculate Conception: Saint Transparency**

A factor of utmost importance in hydrocarbons extractive activities is the revenue received by the state and how it is used. A value that must be considered in order to make any judgment about transparency in crude oil production is how much the public knows about the origin and eventual use of the profits. Trust can only be built if the owners—in this case, those in charge of hydrocarbons—know that each barrel supports their livelihood. An exemplary, highly referenced case is that of Norway, where it is generally accepted that the money produced from each barrel of crude oil is used to benefit the citizens.

With regard to the rest of the hydrocarbons and electricity value chain, transparency refers to detailing the various market activities, of which the intelligibility of the factors that determine the prices and rates of energy goods and services are noteworthy. Namely, the stakeholders in an energy market—the consumers—have a right to know not just what oil revenues the country receives but also what they are paying for energy services as customers. In mature electricity markets, various factors allow the public to understand the composition of prices. However, since the electricity market in Mexico is still in its initial

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19 Stiglitz, “What is the Role of the State?”
20 Ibid.
stages and the majority of the services are still covered by the state through the CFE, transparency in electricity rates in Mexico pertains more to the state than the market. In reality, the development of the liberalized electricity industry is so limited in Mexico that the reform’s impact on rates even for major consumers is still barely perceptible, while medium-sized consumers have been adversely affected.  

Among the actors in the energy sector, the CNH has been the apostle of transparency and has used it to legitimize the competitive process of awarding contracts, regardless of the commercial results. When only two contracts were awarded to the same consortium of companies in the first tender for 14 exploration and production contracts, the government affirmed that Mexico had won due to the transparency of its bidding process. However, there is still uncertainty about what the government meant when it said the tender has been transparent, in accordance with the strictest international standards. Within today’s political context, the CNH claims to be transparent. Would it still be considered so under the incoming administration? Regardless, few Mexicans will question or even stop to think about transparency in the bidding process. Rather, they might be interested in the origin and eventual use of oil revenues. Once the money is distributed to smaller and less auditable coffers, such as those owned by the states and municipalities, then the oil revenues seem to crawl into an obscure black hole in which corruption scandals are concocted and then reported in the national and international media. Therefore, while a very limited percentage of the population understands transparency in oil tenders, there is much broader public awareness about the black holes in which the oil resources may eventually fall. The candidate that lights the fuse of public outrage over oil revenues that have been diverted from their due course will have a brightly lit path toward victory.

There are, however, hopes of observing things with greater clarity. Mexico is now part of the Extractive Industry Transparency Initiative (EITI), which requires the country to make information related to each step taken in hydrocarbons exploration activities accessible to citizens and compels governments and companies to promote the dissemination of this information.

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24 It is noteworthy that while the regulatory commissions should not experience changes in their staff due to political changes, the heads of the Mexican Oil Fund that manages non-tax oil revenues—such as the secretary of finance and the secretary of energy—will be replaced.


The Impossible Condition? The Coveted Competition Factor

Before the 2013 reform, it was sacrilegious to speak of competition in the energy sector. With the exception of the opening of the natural gas market in 1995, and the privatization of the petrochemical industry since the 1990s, the other facets of the hydrocarbons and electricity value chain intended for public services were categorized as so-called “strategic areas,” as stipulated in Article 28 of the Constitution. This term, more than alluding to the importance of an activity, reserves an activity to exclusive execution of the State. The term “strategic” encompasses activities with different degrees of socioeconomic influence. For example, while prior to the reform, oil and other hydrocarbons were labeled strategic areas, the telegraph still is too, although its technology is obsolete. The point here is that “strategic” is not a category that refers to the importance of an activity, but rather the state’s exclusive control over its execution. After the reform, hydrocarbons “exploration and extraction” was the only strategic area left, but with a particular meaning. The nation can relinquish its exclusivity over these activities if it deems it appropriate, and it has done so, as the growth of competition in these activities illustrates. CNH’s tenders, some of which have been more successful than others, have placed special attention on this issue, and Pemex has gradually absorbed the hard fact that it no longer exists to “come, see, and conquer.”

Furthermore, Pemex has had to become more conscious of networking, and has established associations and alliances with companies such as BHP Billiton, Chevron, Inpex, and Petrofac for different projects, such as joint ventures and joint operation agreements. It has also opted to compete alone, winning various contracts. In the end, although it walks with feet of clay, Pemex continues to produce nearly all of the country’s hydrocarbons; it still refines, processes, and imports a significant amount of oil, and supplies fuel to the majority of gas distributors and gas stations, whether through a supply contract or a franchise. Other factors influence the bottleneck: as it once performed many of the state’s exclusive “strategic areas,” much of the hydrocarbons infrastructure in Mexico is the property of and controlled by Pemex. The exception to this would be the gas pipelines owned by CENAGAS, which acquired Pemex’s pipelines and transportation

28 In 1995, Articles 3 and 4 of the regulatory law in Article 27 of the Constitution regarding the oil industry opened natural gas transportation, storage, and distribution activities and issued the Natural Gas Regulations and the Law of the Regulatory Energy Commission that regulated these activities.
30 This was especially visible in Bid 4 of Round 1 and Bid 4 of Round 2.
31 This is how it won Contract Area 18 in Bid 4 of Round 2. See results of the fourth call for bids of Round 2 at https://rondasmexico.gob.mx/r2-104-bloques/.
contracts after the reform and must manage the capacity of said pipelines in order to prevent Pemex from impeding the activities of users and traders.33

As it were, the majority of the gas that flows through such pipelines belongs to Pemex and, to a lesser degree, to traders who import their own gas.34 This means that, until now, suppliers haven’t had other distribution options than using CENAGAS or CFE pipelines. The market has to grow substantially before independent pipelines can provide service to residential, commercial, or industrial users.

CFE’s story differs from that of Pemex, as it has maintained its own pipelines, and CENAGAS has no authority to perform as administrator of electricity infrastructure. It is important to highlight that the tenders for private pipelines for services to CFE have been dynamic and more numerous35 than the bidding processes for CENAGAS, which has not developed new transportation projects. Furthermore, the division of CFE into various subsidiary companies, a move intended to stimulate competition, enabled the creation of a gas supply company called CFE Energy.36 Is it possible that, between PEMEX and CFE, other companies may not be able to compete and will be crushed by the two giants, especially when they must depend on the state’s pipelines without any other alternatives?

The market behaviors analyzed in this paper do not alter the public’s perceptions, as these activities are far removed from their daily lives. In my view, few are aware of the great importance of oil tenders, and only a limited number of people know that it is important for bidding processes to be competitive in order to ensure the best revenues to the state, as they finance many necessary public services. It is also my belief that the public does not understand how the lack of competition has led to the increase in gas prices. Furthermore, natural gas, in contrast to LPG, has had a relatively low level of

33 Nevertheless, in Mexico the age-old story of David and Goliath repeats itself: the law is intended to intimidate a giant with skilled fighters, armed with just one slingshot. Since it has been in existence, CENAGAS has had to lean on Pemex for pipeline operations for a very simple reason: few entities outside of this now so-called state productive company have operated pipelines on such a large scale. It is odd that Pemex, the alleged adversary of the competition, operates the pipelines that CENAGAS took away from it.

34 In the second capacity auction “The 780 requests of 24 companies represent a transportation capacity requirement of 3.4 million gigajoules, of the 2.7 million gigajoules available, required by Cenagas.” This means that CENAGAS has opened the use of capacity to third parties in order to eradicating Pemex’s dominance. See “Taking advantage of the second round with natural gas,” Reforma, April 7, 2017, http://www.reforma.com/aplicacioneslibre/articulo/default.aspx?id=1086322&mld=flafc38683f294f69877e7b57ae73bd&ta=0dfdbc11765226904c16cb9ad1b2efe&lcmd5=4b135d3b1b64746c8f8b8d2768496987.


36 CFE Energy was an initiative strongly promoted by Enrique Ochoa Reza, former general director of CFE. This is described in the following document: “Intervention of Dr. Enrique Ochoa Reza, general director of the Federal Electricity Commission, in the act of the commencement of construction of the Topolobam-El Encino gas pipeline, in the state of Sinaloa,” http://saladeprensa.cfe.gob.mx/direccion/show/32/.
penetration in Mexican households.\textsuperscript{37} Gasoline and electricity are different, as they are part of Mexicans’ everyday lives.

The case of gasoline is particularly unfortunate in the view of the public. It would appear to the average resident that the introduction of competition caused the increase in prices, although that’s not really the case. It is also important to mention that the government committed a major blunder by creating the expectation that the energy reform, by mere decree, would reduce fuel prices. When the energy reform was approved and first being implemented, the deficiencies in Pemex’s refining system were already very extreme and the company’s low prices were unsustainable. The combination of limited refining capacity, imports purchased with a depreciated currency, the lack of transportation infrastructure, storage issues, labor costs, and the continuously mentioned but intractable fuel thefts make refined fuels expensive in Mexico. If we add the applicable taxes to this list, filling up with fuel at a gas station in Mexico represents not only the purchase of an essential good, but also an act of taxation for the state. Although gas stations in Mexico now bear different company logos and colors, this has not led to a distinguishable difference in consumers’ satisfaction at the gas pump. Whether it’s Oxxo, Shell, BP, Chevron, Repsol, or Pemex itself, gasoline prices keep rising despite the liberalization of the industry\textsuperscript{38} since the beginning of 2018. The government released fuel prices to the invisible hand of the free market, but the only thing this process has achieved is pushing gas prices higher.

Consequently, the increase in gasoline prices has been the apple of discord between the government and society. Even though it is inaccurate to say that the crisis began with Peña-Nieto’s administration, it is not out of the question to say that the lack of understanding of the issue is due to the government.\textsuperscript{39} That is, the government has achieved its goals, but not its promises, when the latter is much more important to the population, which feels that its expectations have been betrayed. There is more competition in the retail sale of gasoline, but the prices are similarly high within each geographic area.\textsuperscript{40} Also, the number of gas stations is low in proportion to the consumer population. There are entire stretches of highways in Mexico where a gas station seems to be an oasis for an automobile with a tank low on reserves.

These reflections all center on one particular message: Although Mexico has indicators of greater competition in various activities within the energy industry, the direct benefits for Mexicans are not perceptible at all. Does that mean that Stiglitz was wrong to say that competition is a trigger for the legitimization of private capital inflow? After 76 years


\textsuperscript{38} In an international comparison, they are not disproportionately high.

\textsuperscript{39} In accordance with the “Agreement that establishes the timeframe for easing the prices of gasoline and diesel contained in Provisional Article Twelve of the Law of Federal Income for the 2017 Tax Year,” published on December 26, 2016.

\textsuperscript{40} This comparison can be observed in GASOAPP, an application by the CRE that can be checked by any user.
without competition in Mexico’s energy industry, the markets are being built little by little, with many moments of trial and error.

This is why Peña-Nieto’s government and those who supported the energy reform should not have used cheap gasoline as a bargaining chip to gain public support. Ironically, López Obrador is not the only presidential candidate that has used the government’s false promises as a silver bullet against the PRI.

Former PAN leader Anaya—currently the head of a political coalition that includes both those who drove the reform as well as those who rejected it—denies that he proclaimed that prices would decrease by the work and grace of increased competition. The political discourse in Mexico can be so incongruent that the day may come when the PRI may turn its back not only on the unfulfilled promises to the public, but on the same reform upon which it had bet its extraordinary immortalization, without ever imagining the impending political cost the party would pay.

**The Immaculate Correction**

What does it mean to do what is fair? In conducting this analysis, we even doubted the appropriate Spanish translation of the word “fairness” used by Stiglitz in his reflections on a well-conducted transfer of public management of government resources to private hands. More than a question of public policy, this refers to a philosophical discussion of justice, which steers away from the objectives of this paper. Nevertheless, we cannot ignore this condition mentioned by Stiglitz, since neither transparency nor competition would make any sense if they didn’t support “fairness.” Unfortunately, the author does not provide a reasonably functional definition that allows us to determine whether it is present in a specific case. Talking about fairness, a noteworthy example is the “Social Impact, Use and Occupied Surface Area of the Land for the Deployment of Energy Infrastructure,” which is a particularly slippery slope for both companies and landowners (including private, ejido, and communal landowners). Governments, whether at the federal, state, or municipal level, could also find themselves in serious trouble if intense, increasing confrontations were to occur among owners, communities, companies, and governments, which could yield a variety of possible outcomes. These are cases in which deciding what is fair can be extremely complicated due to all of the rights and interests at stake.

When talking about occupying land, what is fair? The law establishes certain steps for acting “fairly”: prior, free, and informed consultations; the assessment of social impact; a regulated contract negotiation; contract ratification by a federal judge (to steer clear of future claims); and even a mediation procedure led by the Ministry of Agrarian, Territorial, and Urban Development (SEDATU, according to its acronym in Spanish) if an agreement is

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not reached during the negotiation process.\textsuperscript{42} However, if all of this foresight to reach a peaceful agreement were to fail, the Constitution itself, with the reiteration of the secondary laws, establishes that the energy industry is of “public interest” and will therefore have preferential use of the land over any other party. In sum, if the resistance to cede the use of the land for energy projects persists, the competent authority may impose a “legal easement” or the expropriation of the land that is the subject of discord; therefore, owners could be deprived of their rights according to the rules established by the reform, in the name of progress in the energy industry.

Despite the fact that for some it may be easy to take sides—whether to defend progress or advocate for human rights, particularly in indigenous communities—settling land disputes is a rather difficult dilemma and could be the Achilles heel of the implementation of the energy reform. In a country with such vast breaches, “doing what’s fair” for everyone, under any circumstances (for companies, civil society, governments, and anyone else involved) could be an unattainable dream. Meanwhile, any political group wishing to put out the fires with gasoline could take advantage of these clashes to make martyrs out of those protesting against fuel increases.

Three Ways to Stop the Reform

These last few ideas are expressed under the hypothesis that any party in power could stop the energy reform, not only the so-called left-wing, part of which now has an alliance with the Mexican right-wing. The party that brought Peña-Nieto to power cannot escape the possibility that it may come to “regret” the reform, if moving forward with its implementation involves very high political costs. After all, this was the party that reduced Calderón’s reform, which was much more modest than the 2013 reform, to insignificance over a decade ago. It was also the party of price controls, whose bastion of power was Pemex, until it changed course for reasons that are still not clear. With regard to MORENA, anything that can be said at this point is speculative. Through its rhetoric, the party has resisted the reform; in reality, it has done nothing. Something happened that made its members notoriously scandalous, although passive, during the discussion and approval of the reform, and there were no substantial elements of conviction up until the present, in which extreme measures would need to be taken in order to revert the existing projects, which would imply considerable political, economic, and social risks. The violation of companies’ rights could lead to a very aggressive response from them and their governments of origin; or if anyone had the notion to close gas stations and accuse them of looting the people, it could unleash a wide spectrum of responses, fluctuating between rage and euphoria, that could culminate in ungovernability.

Whether improbable or not, we should discuss the possibility that parties that are supposedly opposed to the reform (MORENA, PRD, and PT) suddenly revive the statist fervor and push to overturn the reform, which would require a two-thirds consensus in

\textsuperscript{42} The processes for the acquisition, temporary use, and occupation of land can be found in the respective chapters of the Hydrocarbons Law and the Electricity Industry Law, which went into effect in August 2014.
Congress and half of the local legislature to reverse the constitutional articles. We do not consider this option feasible due to internal disagreement on energy policy within left-wing parties in Mexico, which, for the time being, have achieved ideologically atypical combinations. The exodus of left-wingers to the right and vice-versa indicates that there are no duels of ideological principals over Mexico’s policies, but rather cockfights. What matters here is betting on the strongest horse, not the most consistent. Furthermore, a constitutional reform would disrupt nine new laws and 12 secondary laws, besides the fact that hundreds of administrative provisions would have to be revised. For any incoming government, this would be rather exhausting, considering that when a new regulation sets out in a different direction, it runs the risk of bouncing back in multiple directions like a billiard ball. If the current legal framework is shaken up, Mexico’s energy industry may enter a tunnel that could become devoid of light indefinitely. Provided that surprises may occur unexpectedly, as political decisions are usually unpredictable, in this paper we maintain that the legal and institutional framework itself has suspension or exit clauses from the liberalization of this sector. In our opinion, the following three options, each a variation of the next, are most worth noting as they can be accomplished single-handedly by the president and his cabinet.

The Executive Branch Gives Orders; The Administration Obeys

The energy sector’s regulatory system revolves around its heads: the secretaries of energy and finance, which are the arms extending from the head of the executive branch. In addition to being the highest decision-makers in regard to hydrocarbons and electricity projects, they also, by law, oversee the boards of directors of both PEMEX and CFE. This puts the secretary of energy—Pedro Joaquín Coldwell—in a very interesting conflict of interest. As the head of the sector, the secretary must promote competition, transparency, and fairness in order to provide incentives for investments by sources other than companies. However, as board president for PEMEX and CFE, he must worry about the companies’ interests, which contradicts his duty to promote competition among third parties. In regard to transparency, it must be exhibited by the ministry as well as the private companies involved in the sector, although it’s obvious that companies might withhold information that could put their interests at risk. For example, Pemex’s tendency to not disclose information for reasons of national security is already a given.\footnote{In a recent case, which is especially noteworthy, Pemex refused to disclose data on fuel theft to the newspaper \textit{Excelsior}. See Nayeli González, “5 years of milking damages are reserved; Pemex claims ‘national security’” \textit{Excelsior}, January 12, 2018, \url{http://www.excelsior.com.mx/nacional/2018/01/12/1213194}.} It is highly contradictory that, as the secretary of energy, Joaquin Coldwell spreads the gospel of transparency while, as the head of Pemex’s governing board, he seemingly condones opacity as a praxis. What position would the heads of the sector and Pemex and CFE maintain with regard to transparency when the next government is in power? If the new administration is against the reform and against state companies competing with private entities, and wanted to shield them from public criticism, it could simply act by fiat and delay implementation of the reform. Doing so would protect Mexican parastatal companies from having to compete in an open market and also provide a buffer against...
public opinion. Though Pemex, for instance, could be subject to scrutiny from the National Institute for Transparency, Access to Information, and Personal Data Protection, that agency’s activities depend on the federal budget, which is under the control of the Ministry of Finance, despite its constitutional autonomy. Consequently, the transparency of the energy sector in Mexico largely depends on the will of the executive branch and its arms. Lack of transparency by Pemex and CFE could affect the competition and smooth functioning of the markets.

In terms of fairness, Stiglitz’s concept is difficult to define, as noted above, and it would be even more difficult to explain when judging the actions of the secretary of energy and/or the secretary of finance. What would be more fair, raising the price of gasoline or maintaining it artificially low? Giving in to consumers’ desire for lower gasoline prices would impact public finances, but the entry of new providers that could not comply with price controls would aggravate the already advanced deterioration of the national refining system. When a system has suffered from so many breakdowns, what is fair? An increase in prices that would be condemned by consumers who don’t have faith in its benefits? In that case, Mexico could try to return to the old system of subsidies to calm people down at least until the new government settles into power. But often, neither seeking political popularity nor providing social support lead to doing what is fair.

**Regulatory Bodies: Coordinated or Controlled?**

In announcing the results of the second long-term electricity auction for CFE, the current chairman of the CRE declared that this regulatory body marches at the pace set by the secretary of energy.44 These words not only reveal the subordination of a technical organization to political powers, they also portend the organization’s risk of being subject to the will of the next head of the sector, whose agenda could be antagonistic to that of the current government. Let’s imagine that instead of Coldwell, who has remained consistently in favor of market logic for the past six years, the next energy secretary is Rocío Nahle, MORENA congresswoman and the energy advisor to López Obrador, who has generally maintained a discourse of opposition to the creation of said market. Would the president of the CRE then say that the agency would no longer follow in the footsteps of the Ministry of Energy and that it would defend the liberalized model at any cost? This would be a heroic act, but it could also be suicidal since the regulatory agencies depend on the budget set by the Ministry of Finance. What’s more, despite the fact that the regulators can, by law, retain the revenue received for issuing qualifying documents such as contracts, permits, and authorizations for activities related to new projects, the promotion of said projects depends on the executive branch. The plans, programs, and strategies issued to support these projects are developed by the Ministry of Energy, with the nonbinding opinion of the regulatory bodies. It is important to remember that the thrust behind private projects is the nation’s legal authority manifested through its governmental organizations, but it is not an obligation. If the new public policy dictates suspending the inclusion of private investment

44 This statement was made during the announcement of the results of the second long-term electricity auction organized by the Energy Control Center on September 22, 2017.
in the energy sector, there is little to nothing the regulatory bodies could do to stop this change, as they merely implement the public policy issued by the executive branch.

**Will PEMEX and CFE Fight Back?**

Pemex and CFE’s economic, financial, and operational systems are effectively black boxes. That is, there are intuitions—even hard data—indicating that something is wrong, but very few know, line by line, the financial realities of these so-called state productive companies. The public may find Pemex’s finances and operations confusing due to the mixed signals from the government. At the beginning of the energy reform, Pemex made a presentation for investors demonstrating why it was a good idea to partner with the company due to its entrepreneurial dynamism. Simultaneously, however, in order to promote the reform, the government argued that Pemex’s situation was financially and operatively unsustainable, requiring the urgent investment of private capital to ease the load. Furthermore, Peña-Nieto appointed Emilio Lozoya Austin, who lacked business experience in the oil industry—or any other industry, for that matter—to serve as Pemex’s general director, adding another element of confusion on the plans to strengthen Pemex. However, that was not the biggest cause for concern. Prior corruption accusations against Lozoya, including allegations that he accepted millions of dollars in bribes during his tenure as the coordinator of international affairs for Peña-Nieto’s campaign, have damaged the perception of both the design and implementation of the energy reform. In reality, however, Pemex is being dragged down by decades of deterioration, though possibly accelerated by Lozoya’s abuses. Nevertheless, it is not true that the liberalization of the market led to refinery break downs, repeated infrastructure disasters, increases in fuel thefts, and Pemex’s decline. Although it may seem otherwise, the reform cannot possibly include a diabolical plan to take down Pemex, to be sold for parts. Pemex’s deterioration has not occurred due to a change in the rules, but rather due to a lack of depth in its organization, leadership, and corporate purpose. Union corporatism, bureaucratic disorder within its operational areas, and the absence of a true corporate culture at Pemex are not conditions created by the reform. However, they are conditions that the reform has not been able to remedy because of Pemex’s *modus operandi*, both during the current administration and way before it came into power.

Pemex reached a critical low point at the same time that the reform began, though it is not possible to claim, with any degree of seriousness, that one is due to the other. Nevertheless, the best card for any presidential candidate who wishes to take up Pemex’s cause is to promise to resurrect it from the ashes. The incoming government could make promises that don’t cost a thing, after all, until the consequences come to light after said pledges are not kept. For example, without violating the Constitution or the energy reform legislation, the incoming government could grant more areas for hydrocarbons exploration and extraction, authorize the construction of refineries and pipelines, and present optimistic projections for all the public revenues and resources that could be turned around in order for Pemex to regain its monopoly status.
The electricity industry is less visible, but no less important. While hydrocarbons are a very versatile utility, electricity is currently a very important factor in competitiveness and development. A country without electricity not only exists in the dark, but rather in obscurity. Vital services such as health care, education, access to information, financial operations, and an endless list of conditions for a good quality of life depend on the flow of electricity. However, the electricity reform has drawn a lot less attention than the hydrocarbons reform. Even while CFE has held long-term electricity auctions and a wholesale electricity market is under development, the repercussions of these developments on rates for residential and agricultural users have been trivial. As before, more than complaints about increases and decreases in the electricity service, what exists among the population of “ordinary people” is a lack of understanding about why they’re paying what they’re paying. There is no competition for residential users that don’t consume directly from the market because CFE is the sole supplier. There’s also no rate transparency since, despite the fact that the CRE published its methodologies for calculating the electricity rates for basic services, the Ministry of Finance established its own rate methodology and still has not kept its promise to break down the costs of services in consumers’ electricity bills. This leaves the issue of fairness in question, as users still don’t know if they’re paying what they should be, no more, no less.

Some industrial and commercial users have generally been confused by the price methodologies published by the CRE, particularly because this regulatory body has determined that there have been some “erratic” cases. It stated that some charges have increased disproportionately and, consequently, the rates would have to be “adjusted” “a little bit” in order to regularize them. This has sparked accusations among industrial and commercial users against the CRE and CFE. While the companies and the regulator have assured the public that there have been no general increases in the electricity rates, the former, in particular CONCANACO, revealed that increases have oscillated between 100% and 400%, particularly for medium voltage users, which are commercial customers.

It is possible that the problem is mainly one of communication. Once again, the government created overly lofty expectations and lacked the foresight that an electricity market presents very significant complexities. If Peña-Nieto’s government promised low rates, it did so in order to earn votes of confidence that are now gone and will never be regained. The point here is the viability of the alternatives. In our opinion, it is not viable to go back to dependency on CFE for every home, plantation, business, and industry. However it may unfold, with the introduction of private investment after 1992, CFE already received a large part of its generation from independent and private producers that had self-supply projects,

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though this didn’t significantly contribute to efficiency in the electricity sector either, since the rates were still high. What followed was an electricity market that still relied on trial and error to achieve competition, transparency, and, finally, fairness.

There is no turning back. The candidate that intends to win the presidency by making CFE a market martyr would be making a huge mistake. In our view, the aspirations behind the reform are on the mark: achieving fairness through competition and transparency. The president-elect who suspends or reverts to the market energy model instead of rethinking its design could be making a mistake with very serious consequences for the country’s development. If the mold adopted by the reform has methodological oversights, emphasis should be placed on correcting them. A nationalist upheaval that would return exclusive operation of the energy sector to CFE could leave Mexico in the shadows with even higher costs than unfulfilled promises.

**Final Reflections**

For decades, Mexico’s energy sector was impenetrable by the global market. Nowadays, investments come from many places that perceive the country as an attractive area of opportunity. Ironically, during the development of the reform that broke down the industry’s walls, the U.S. presidency was won by a candidate whose discourse, in my opinion, is sectarian, ethnocentric, and surprisingly distant from free market principles. What’s more, Donald Trump’s rise to power came at a time when the North American Free Trade Agreement (NAFTA) was due for an update. For example, the agreement’s chapter on energy, with regard to Mexico, could not have been more obsolete, as it was written at a time when many activities were being privatized in the country, except for energy. For that very reason, there is not much clarity in terms of what direction Mexico’s relationship with its neighboring country will take, not only in terms of commercial relations, but also in regard to historical and cultural connections. Despite Trump’s rhetoric toward Mexico, companies from the United States—some of which are very important—have reached Mexico.

Moreover, hydrocarbons producers from the U.S. have a natural market in Mexico due to its proximity, which creates fewer logistical complications. However, whomever takes the baton from this government will have to point the telescope much farther than the northern border, as it has already done. On the one hand, we have the diversification of actors in national territory and on the other, it’s also important to create alternatives to commercial trade. With López Obrador leading the polls, we don’t believe there is danger that Mexico will close the energy industry to the markets for one pragmatic reason: the former so-called “monopolies” do not have the capacity to maintain the energy industry in Mexico. No matter how much resistance there is on the part of Pemex and CFE, they need to lean on others for financial and operative reasons or they will collapse, leading to catastrophic consequences for the country. Far from being the polar opposite of Trump, what’s worrisome about López Obrador is that he shares the U.S. president’s nationalist rigidity. Perhaps MORENA’s platform gives priority to national investment when it’s not prepared to sustain the gigantism of the energy industry. From the perspective of
customers, the danger for Mexico would be a barrier formed between the Mexican business elite and the poor people’s candidate.

No matter who wins, there is a populist tendency in all of the dominant parties in Mexico, which, to date, none have been able to resist. For instance, the PRI was the founder and maximum executor of the price controls. During Vicente Fox’s presidency, the PAN intervened in the natural gas contracts with industrial consumers and, at the time, the price of LPG. And Calderón proclaimed the creation of the “Bicentennial Refinery,” which amounted only to a fence built around a site that was later forgotten. Now, López Obrador is announcing the construction of three refineries.

Lastly, we believe that energy will not be the key factor that sways the majority of the votes. Mexicans have placed a higher priority on other issues, such as corruption, insecurity, and the associated impunity. An explosion of social unrest will occur when these latter factors combine with an unsustainable rise in the prices of energy resources that no Mexican can live without. Perhaps then politicians will realize that an energy industry cannot be built without solid foundations in the rule of law, or within a six-year term. Transparency, competition, and fairness are not built in a day.