

# The Energy Reform A Long-Term Strategy

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Members of the Mexican Electrical Workers Union (SME) march against privatization.

The energy reform, a cardinal element in the Fox project, has been seriously questioned by those

who think that its paralysis is one of the failures of the executive's political-economic project, a reflection of its inability to negotiate and come to consensus with the country's different political forces, but mainly with Congress. Critics argue that not only the

viability of the energy utilities but the economic future of the country itself depend on its being passed. To overcome the impasse, during his third report to the nation, President Fox announced some important changes in his cabinet that indicate his turning away

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from his initial use of head hunters and their entrepreneurial slant in hiring and clearly returning to the old style of recruitment. Once again, politics has become the central axis that will make it possible for the administration's proposal to meet with success.

Among the changes involving the energy sector is the replacement of engineer Ernesto Martens as minister of energy by Felipe Calderón Hinojosa.<sup>1</sup> Officially, the operator of the Fox project is Minister of the Interior Santiago Creel Miranda, charged with

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the task of coming to the necessary agreements to make it a reality. He is supported by Minister of Finance Francisco Gil; the new head of the Ministry of Energy, Felipe Calderón Hinojosa; the director of the state-owned oil giant, Pemex, Raúl Muñoz Leos; the director of the Federal Electricity Commission (CFE), Alfredo Elías Ayub; and the director of the Central Mexico Light and Energy Company (CLYFC), Luis de Pablo.

In Congress, paradoxically, Elba Esther Gordillo, former teachers' union leader and majority leader of the Institutional Revolutionary Party (PRI) caucus, heads up the efforts for the chief executive's energy project. A first response from Congress to the presidential initiative has been the different parties and their caucuses' willingness to start negotiations to come to a definitive resolution of the reforms.

In one sense or another, everyone seems to agree that some solution has to be found. The debate turns on what orientation that solution should have and this touches on a central point about the nature of the state. Thus, while for the executive and the National Action Party (PAN) the state should play a subsidiary role to supplement and complement the market, the PRI in contrast—particularly its more nationalistic factions—defends the state playing a major economic role and leading national economic development based on constitutional mandate (Articles 25,

27 and 28). While in the first case, the exaltation of the role of the market averts any discussion about equality, underlying the second case are the jurisdiction and performance of the state as a tool in the quest for social justice. The latter is usually overlooked or minimized in discussions about the direction the energy sector should take. That is to say, the arguments center on the problems of companies' competitiveness, efficiency and financial solvency, but rarely get to the heart of the matter by also dealing with it as a problem of equality and the distribution of wealth.

The so-called energy reform is supposed to be integral, including both electricity and oil, but legal changes are only immediately viable for the electricity sector. In order to not create false expectations like those that emerged at the beginning of the Fox

administration, the idea now is to effect a gradual reform implemented as the different measures become politically viable. It would begin by creating legal certainty for already existing foreign investment in different forms of electricity generation by independent producers, recognizing them in the Constitution. It should be remembered here that the liberalization of surplus electricity decreed by Vicente Fox in May 2001 was finally overturned by the Supreme Court in April 2002. Shortly after taking office, the current administration proposed the creation of an electricity market initially for large consumers but that could be extended to all clients in the medium term. The first step was the amendment of the Regulatory Law for Public Service of Electrical Energy in May 2001 to liberalize production and sale of surplus supply. Since this amendment was rejected by the Supreme Court in April 2002, the executive sent Congress a bill proposing constitutional and legislative changes to achieve its initial aim. In the long run (10 to 15 years), the strategy would consist of the gradual establishment of a totally deregulated electricity market.

Changes are also brewing in the oil industry since Pemex has continued to open bidding on multiple service contracts<sup>2</sup> offering private capital the opportunity to invest in natural gas exploration and development, although natural gas is not part of the first stage of the Fox strategy. Despite the fact that the legality of multiple service contracts is being questioned and that officials admit that incorporating the private sector into natural gas production is complex, in fact, Pemex is acting with the legal certainty it has by virtue of not being part of the execu-

tive. The company considers that its actions do not come under the same jurisdiction as a strategic public company and that therefore it can continue to hold bidding for multiple service contracts using its own criteria. Its legal strategy, in contrast to the electricity sector, is not to propose changes to legislation, since Pemex considers the changes it is promoting to already be legal. It is betting, rather, on the technical difficulties that the legislature has in going to the Supreme Court, the body which can put a stop to permits in the case of controversies with Congress over the multiple service contracts. Meanwhile, oil and gas companies are already investing in Pemex in the hopes of achieving legal access to exploration and drilling of deposits first of natural gas and, with time, of crude oil.

#### THE TECHNICAL ARGUMENTS

The administration's strategy combines the entry, consolidation and expansion of the private sector and the gradual weakening of the historic electricity operators, the Federal Electricity Commission (CFE) and the Central Mexico Light and Energy Company (CLYFC). This strategy consists of granting the private sector the right to the construction and operation of all new installations planned for public service, thus aiming to de facto privatize electricity generation and then change the Constitution to create guarantees for private investment. In the second place, the strategy has been to consciously contract excessive debt for the CFE through *Pidiregas* (Deferred Impact Projects in Spending), a contingency debt that is not as lethal as direct in-

debtedness, but is manipulated in the media to discredit the public institution's financial solvency and ability to respond to growing demand.<sup>3</sup> In the third place, investment in electricity generation and maintenance has been reduced, causing black-outs, bad service and economic losses, in order to discredit state management of the public utility. In general, the government aim is to create an atmosphere of crisis and uncertainty about electricity investment and supply by manipulating public opinion to minimize the fact that it is de-capitalizing the companies using dif-

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ferent methods: through the enormous taxes that it levies on both the CFE and Pemex and by forcing them to seek financing in the domestic and international markets.<sup>4</sup> Finance Ministry officials have been systematically reducing investment in the generation, maintenance and distribution of electricity.

The government's argument about natural gas emphasizes Pemex's precarious financing for investment. And, even in the era of globalization, in which extreme integration and liberalization are promoted, in Mexico, the weight of gas imports in the oil balance is overestimated, to the degree of sometimes giving it the status of a national security problem.

Along these lines, the following actions have been taken:

- Building and expansion of CFE installations have stagnated. The new

plants in the national electricity system are owned by independent producers, not the CFE or the CLYFC.

- Encouragement of growing indebtedness. Most construction and maintenance work done is paid for through *Pidiregas*, an extremely costly contingency debt.
- Strangling, paralyzing control measures by the Ministry of Public Functions.
- Corporate transformation. Plans to divide the CFE into different companies for generation, transmission and distribution; the creation of a virtual electricity market that functions parallel to the merit order dispatch.
- Limiting activities. Neither the CLYFC nor the CFE are allowed to build electricity plants with their own resources. The CFE is only authorized to work on small projects and was also forced to sell its natural gas distribution network, going against the worldwide trend of integrating electricity, gas, water and other services.
- Application of an excessive fiscal regime on the CFE. It is being charged a nine-percent tax on fixed assets in operation, which is not charged to the independent producers, self-suppliers or co-generators.
- Removal of the CFE's and the CLYFC's best clients. Promoting, facilitating and subsidizing self-consumption by granting permits for self-supply and co-generation to big clients individ-

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ually or in groups of self-consumers has encouraged the development by the private sector of operations of a public utility.

### THE POLITICAL STRATEGY

The main opposition to the Fox energy proposal has come from nationalists in different parties in Congress, but particularly from members of the Institutional Revolutionary Party (PRI). As part of this faction, Senator Manuel Bartlett heads up a sector of the PRI identified with positions opposing the privatization of the sector, backed by the mandate from the last National Assembly of the PRI's Political Council. Their proposal is to strengthen the CFE and Pemex, in the first case by maintaining exclusive state power over electricity so that it continues to be organized as a public service. Their proposal is to reform legislation, but not the Constitution. Along these lines, their position is that state property and strengthening of public institutions cannot be abandoned given that the state must play a fundamental role in certain strategic activities that generate public goods and that have a different dynamic from that of private companies.

The other important actors with similar positions are the electricity workers' and oil workers' unions. Mexican Electrical Workers Union (SME) leader Rosendo Flores has roundly rejected

the privatization of national electricity companies. Government strategy vis-à-vis the oil workers' union has aimed at weakening union clout through Pemexgate and the elimination of congressional immunity for Senator Ricardo Aldana due to his being implicated in the case, at the same time that it attempts to discredit the PRI and strengthen Pemex's general director.<sup>5</sup>

The PAN strategy consists of negotiating with forces and groups inside the PRI who do not agree with Senator Bartlett, in an attempt to "open up spaces" for their party to come on board for the reform. Basically, the PAN is trying to split up the PRI. It falls to Elba Esther Gordillo to facilitate this task. Linked to former president Salinas, Gordillo maintains a well-known close friendship with Fox and his wife; she is a former leader of the teachers' union and a very distinguished member of the PRI; her byword is to divide her party and weaken nationalist positions in the legislature. The job she has been given is to block any possibility of unity among the nationalists and to reduce their number both in the Senate and in the Chamber of Deputies.

Some PRI members clearly oriented toward the market support the structural reforms proposed by the executive. Among them are Enrique Jackson, Genaro Borrego, Alejandro Gutiérrez, Marco Antonio Fernández, Emilio Gamboa, Jorge Chávez Presa, Enrique de

la Madrid, Roberto Madrazo and the group of deputies loyal to former President Salinas.

The Fox strategy also includes flirting with legislators inside the Party of the Democratic Revolution (PRD), some of whom, like Senator Demetrio Sodi de la Tijera, have already said that they favor elevating existing legislation on electricity to the constitutional level. Other members of the PRD think these changes should be postponed for the moment.<sup>6</sup> For all these reasons, we can say that none of the parties has a unified position to stop the energy reform.

One interest group that has done heavy lobbying in Congress is the independent producers. They are fighting for "independent electricity production" to be part of the Constitution; that is, they want to legitimize legislation whose legality is currently under fire. These producers already possess 30 percent of the country's capacity for electricity generation.

### CONCLUSIONS

The technical complexity of the electricity and oil industries makes it difficult for economic and political groups and/or specialists directly involved with the reform to develop alternative visions to the one presented by the government. It is not only the asymmetry in media coverage that favors the Fox project, but the complexity of the sector itself. However, there are those who understand very well that the debate is by no means trivial. What is at stake is the role of the state in the vital energy sector in Mexico. In any case, the discussion centers on the possibility of making mechanisms for private par-

ticipation more flexible with a complementary role to public investment or giving free rein to the incorporation of national and foreign private businessmen into the industry with all the legal guarantees they need for their best performance. Everything seems to indicate that gradual de facto privatization of the sector will continue even without the establishment of legal certainties, and that it will culminate only in the long run. The constitutional changes will accelerate and deepen the transfer of energy industries to the private sector. The appointment of Felipe Calderón Hinojosa as the new minister of energy is a point in favor of the country's businessmen who seek to participate in an attractive company like the CFE with sales of about U.S.\$14 billion a year. The reason behind the quest for reforms, then, is not that the national energy companies are not profitable. Quite to the contrary. It is precisely their economic attractiveness, the large profits they make, that is behind the interest of the international and, today, national, business community. Everything points to the Fox reform consisting precisely of elevating existing legislation to the constitutional level, thus giving legal certainty to producers already operating in the industry.

Nevertheless, the reforms' results are questionable in terms of their effects on the nation's economy, since it depends so greatly on economic relations with other countries, and particularly with the recovery of the U.S. economy. At least in matters of energy, Fox's proposals are not in the national interest, but favor the dictates of the neoliberal model and the demands of domestic and foreign interest groups. **MM**

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#### NOTES

<sup>1</sup> Other important changes were the replacement of Minister of the Environment Víctor Lichtinger by National Action Party activist Alberto Cárdenas, and the appointment of right-wing economist Luis Pazos to head up the National Public Works Bank.

<sup>2</sup> At the end of 2001, Pemex announced its intention of asking oil companies for their help in increasing the production of non-oil-associated natural gas. The first place to be developed would be the Burgos Basin. These companies would participate through multiple service contracts (CSM), which, according to Pemex, did not require legislative changes to be applied. This strategy is justified using four general premises: 1) the urgency of expanding national gas production to deal with rapidly growing demand; 2) Pemex's lack of capital for increasing production given the apparent impossibility of obtaining it in the short and medium terms given public budget limitations; 3) the need for sophisticated technology and oil companies' experience to develop the Burgos Basin; 4) signaling the structural changes in the country. While the legal complications of these *sui generis* contracts are both numerous and complex, one of the most important is linked to the fact that the contractor would have the right to carry out exploration and development (both banned by the Constitution), transportation and storage of natural gas and condensed products in a specific area for a period of 20 years. They could build and operate pipelines and gas processing plants. From the moment that Pemex announced its intention of calling on international oil companies, different sectors of society have objected. They question both the form and the content of the measure, as well as the arguments used to justify it. For them, there are technical, economic, legal, political and strategic reasons why exploration and extraction of gas should not be opened up. They also object to the terms of

the negotiation established in the proposed contract.

<sup>3</sup> One of the pillars of financing the CFE has been *Pidiregas* (Deferred Impact Projects in Spending). Private investment in the financing of infrastructure for generation, transmission and transformation is done through *Pidiregas* in its two forms: through external producers of energy (generation) and through the participation of private entities in financed public works. In the first case, the investment is owned by private entities; in the second case, the infrastructure becomes property of the CFE when the investment contract expires.

<sup>4</sup> In this sense, in recent public statements the programming manager of the Central Mexico Light and Energy Company, Carlos Crowley Pérez, emphasized the need for the company to invest 11 billion pesos in 2004. Otherwise, he said the company would run the risk of having more black-outs because it would not be able to cover the public's demand. *El Heraldo de México*, 11 September 2003, p. 3F.

<sup>5</sup> "Pemexgate" refers to the scandal in which public funds—at least U.S.\$50 million and perhaps up to U.S.\$150 million—were diverted to finance the PRI's 2000 electoral campaign. Several leaders of the oil workers' union intervened in that operation, now fully documented and judged, including Senator Aldana. The scandal led to the Federal Electoral Institute, the body in charge of regulating Mexico's electoral processes, fining the PRI approximately U.S.\$100 million, which will be withheld from the stipend they would normally receive under the law. [Editor's Note.]

<sup>6</sup> This is the position of Senator Jesús Ortega.