

The Energy Reform, Or Pushing the Mexican State Out Of the Energy Sector

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This article deals with a historic event in Mexico: the 2013 energy reform, which will undoubtedly change the country's future and the daily lives of its citizens given the importance of the sector, both in terms of the generation of income and in the supply of energy sources and the economic impact of their operation.

The reform is a watershed since its implementation will dismantle the Cardenist model of managing the sector, based on guaranteeing the nation, through its public, decentralized bodies (Mexican Petroleum [Pemex] and the Federal Elec-

tricity Commission [CFE]), the direct exploitation of these resources, as well as the full, direct revenues accruing from oil rent by the state.

The new management model, which we could call the "indiscriminate, transnational opening model," leaves all the aforementioned principles to the play of the "market," divorced from the historical, legal, and economic bases that are the fundamental pillars of our energy industries. The international management models that its promoters are attempting to emulate (those of the United States, Brazil, and Colombia, among others) correspond to situations quite different from ours. That is why they have little to contribute, and, in some cases, are far from being as successful as publicized

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THE UNITED STATES

Historically, economic and social dependence on hydrocarbons in the United States is very high. This is despite the fact that energy efficiency has managed to drop consumption by 2 MMB/d, in addition to promoting diverse forms of energy that will surely broaden out future supply. For the moment, the United States' supposed energy independence, based on the scope of the energy revolution due to lutite deposits, is a questionable goal since, according to recent Department of Energy estimates, in the best of scenarios, imports will cover a shortage of 32 percent by 2040. This clearly shows that domestic production will not be able to cover the country's monumental 19 MMB/d consumption.

BRAZIL

Brazil's success can be explained by its own level of technological and industrial development, the result of a historic geopolitical, strategic vision. This achievement is far from being based solely on foreign investment in the sector. This has been clear in the different rounds of bidding in which government earnings have been criticized as meager, while those of foreign multinationals have been very high, draining enormous amounts of resources from the country, reflected in the need for Dilma Rousseff's administration to make budget adjustments. On the other hand, increased production has far from met expectations.

COLOMBIA

Another attempt has been to replicate the Colombian case, which involved the indiscriminate opening to foreign investment since that country is hydrocarbon-poor, which is very different from Mexico. In addition, as the director of Ecope-

rol himself has said, after that country's so-called zero round,¹ the state-owned company's development capabilities were very limited because the best fields and reserves had been taken from it.

NORWAY

The Norwegian case is a successful model because of the oil fund it has accumulated; it represents a substantial intergenerational support equivalent to almost three percent of world gross domestic product (GDP).² Nevertheless, this success is based on its total managerial autonomy *vis-à-vis* the government, freeing it from pressure to funnel resources into government running expenses. In the case of Mexico, given the design of the constitutional reform, based on the transitory articles, although it talks about the determination that authorities not re-channel resources, this was not respected when the Mexican Oil Fund was created as a trust in Mexico's Central Bank. It is led by a committee presided over by the minister of finance, which we think will make it the prisoner of temptations and pressures to funnel funds into general running expenses and not into investment.

THE MEANING OF THE CONSTITUTIONAL ENERGY REFORM³

This reform consists of substantial changes to certain articles dubbed *fundamental political decision-making mechanisms* that negatively affect their strengthening or historic evolution.⁴ Several constitutionalists, such as Diego Valadés, Ignacio Burgoa, Mario de la Cueva, Jorge Carpizo, and Jaime Cárdenas, agree that the permanent constituent assembly, like the one that amended the Constitution in 2013, does not have the power to make these kinds of changes. They argue that that power could only emanate from a completely original, full constituent congress, or it should have resorted to a plebiscite, a right established in the Constitution's Article 35. They do say, however, that this is inapplicable due to the lack of regulatory legislation to carry it out. However, as is well known, constitutional rights are applicable in and of themselves and cannot be suspended because there is no regulatory legislation; therefore, there should have been a national consultation before making the changes. Not having carried one out creates a situation of constitutional illegitimacy.

The changes in Articles 25, 27, and 28 constitute a completely new design of Mexico's economic and administrative law, since they redefine strategic areas and those where private investment can be made, and it creates as-yet-undefined legal categories such as those involving the state-owned productive corporations (previously known as decentralized public bodies). This administrative change in the state-owned productive industries is the result of a modification in the state's role,⁵ all without having carried out thorough studies or analyzed its economic and social consequences.

The changes in Article 27 eliminate the ban on contracts for exploration and production introduced into the Constitution with the reform of 1960. Although the restriction for granting concessions from the 1940 reform remains, the transitory articles that establish licenses and permits, above all in downstream industry activities,⁶ in fact constitute concessions.⁷

The reforms proposed by the executive put the nation's patrimony in grave danger. The amendment to Article 27 allows third parties to operate exploration and exploitation activities through shared-profit contracts, shared-production contracts, and licenses, with few explanations about how these contracts will work, leaving everything to the absolute discretion of the executive branch. If these contracts operate like those established for Pemex in the Law on Hydrocarbon Earnings, they will not even fulfill the objective of sharing the risk, as the media have erroneously and insistently reported, since the state will reimburse 100 percent of the operating companies' costs, effectively assuming all the risk.

The only risk these companies will run, then, would be waiting for the state to pay them. Private companies can only have profits, no losses. This is why their profits will directly be to the detriment of the state's oil rent. At current oil prices, this varies between US\$70 billion and US\$80 billion a year, and is the equivalent of Pemex's profit before the taxes that it currently pays into state coffers.

On the other hand, with these changes to Article 27, Pemex and the CFE will stop being the only operators in their respective sectors and become just two of several, thus disarticulating the Cardenist management model. The central part of the latter is granting contracts, since the federal executive, through the Ministry of Energy (Sener) will grant the big contracts in oil and electricity, while Pemex and the CFE will be able to grant contracts or partner up in the assignments that the Sener itself grants, with the pompously dubbed "zero round." Undoubtedly, in this zero round, both Pemex and the CFE will inevitably gradually lose their importance and see

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their resources reduced, as has already started in Pemex's zero round begun March 21, 2014. Suffice it to look at the statements by the Sener's Vice-ministry of Hydrocarbons to the international press offering foreign investors 75 percent of the country's prospective resources.⁸

Despite the rhetoric about maintaining strategic areas under state purview, Article 28 was seriously limited,⁹ since it

1. downgrades the state's stewardship, since today it is exclusively responsible for the ownership and central management and strategy of the oil industry;¹⁰
2. reduces the state's exclusive stewardship of nuclear energy generation, planning for the national electricity system, and the public service of transmission and distribution of electrical energy. These areas are no longer the exclusive domain of state activity in the generation, handling, and commercialization of electricity. Electricity planning will no longer be carried out by the CFE, but directly by the executive branch through the Sener. Also removed from exclusive state stewardship are the generation of electricity other than nuclear, and its sale, including its import and export;
3. cancels the obligation of ensuring that public companies or bodies operate in the oil industry, eliminating Pemex's constitutional status;
4. allows unlimited private investment and organizes the oil and electricity industries as markets open to foreign capital;
5. reclassifies, with the amendment to Article 28, the activities of refining, transport (pipelines), and basic petrochemicals from strategic to priorities; this means that they can be auctioned off to the private sector, making the risk of the loss of national patrimony very great;
6. eliminates the exclusive authority of the nation over oil industry downstream and upstream activities, creating a large bureaucracy in charge of the regulatory process and of setting up a supposed market as the coordinated

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regulatory bodies for energy issues (National Hydrocarbon Commission, Energy Regulatory Commission, and others in charge of managing pipelines, controlling electricity, and industrial security included in the law's transitory articles). The Mexican Oil Fund will be controlled by the Ministry of Finance without the intervention of the legislative branch.

THE 21 TRANSITORY ARTICLES

In an unusual move, an attempt to delineate the regulatory legislation that would make the constitutional changes concrete and operational, 21 transitory articles were also passed. Outstanding among them are Article 2, about labor relations; Articles 4 and 11, about contracts; and several more about administration. The following bodies were also created: the Mexican Fund for Stabilization and Development, the National Center for the Control of Natural Gas, the National Agency for Industrial Security and Protection of the Environment of the Hydrocarbon Sector, and the National Center for Energy Control. This creates a huge bureaucracy without real coordination.

In addition, the legal character and structure of the National Hydrocarbon Commission (CNH) (which includes the National Center for Hydrocarbon Information), the Energy Regulatory Commission (CRE), Pemex, and the CFE have all changed.

Transitory Article 8 includes the idea that, given their strategic character, the exploration for and extraction of oil and other hydrocarbons, as well as the public service of transmitting and distributing electrical energy take precedence over any other kind of work involving the use of the land and the subsoil. This opens up the possibility of expropriating and utilizing private, public, and socially-owned property to the benefit of multinationals, overriding any other right.

CONCLUSIONS

The constitutional changes promoted by the energy reform constitute major surgery. They change ownership rights and push the state out of the energy sector industries. In the best of cases, they turn the state into an administrator and make it responsible for regulating bodies, which in practice will not have much power in the face of multinationals, which in turn will try to move toward a market model, confining the state to the areas that do not generate profits.

With this reform, Mexico is subordinated to the elites from around the world and North America, putting the pool of hydrocarbon reserves at the disposition of oil companies from around the world, as well as international financial capital. This is in tune with the moment of globalization we are going through: capitalism based on accumulation by dispossession, through the convergence of hoarding territories and raw materials in connivance with international speculative capital seeking a grip on fixed assets. ■■■

NOTES

¹ The zero round is a process whereby Pemex presents a proposal to the Ministry of Energy with the information about the areas for oil exploration and fields to be adjudicated according to Transitory Article 6 of the December 30, 2013, reform of the Constitution.

² The fund is commonly referred to as "The Oil Fund" (in Norwegian, *Oljefondet*). As of the June 2011 valuation, it was the largest pension fund in the world, although it is not actually a pension fund as it derives its financial backing from oil profits and not pension contributions. As of December 31, 2013, its total value is NOK5.038 trillion (US\$828.9 billion), holding one percent of global equity markets. With 1.78 percent of all European stocks, it is said to be the largest stock owner in Europe.

³ "Decreto por el que se reforman y adicionan diversas disposiciones de la Constitución Política de los Estados Unidos Mexicanos en materia de energía," *Diario oficial de la federación* (DOF), December 20, 2013.

⁴ The reform amends the Constitution's Article 25, paragraphs 4, 6, and 8; paragraph 6 of Article 27; and paragraphs 4 and 6 of Article 28. It also adds a seventh paragraph to Article 27 and an eighth paragraph to Article 28.

⁵ Article 25 reads in part, "The public sector will have exclusive responsibility for the strategic areas defined in Article 28, paragraph four of the Constitution, with the federal government always maintaining ownership and control over any state productive bodies and companies that may be established. With regard to planning and control of the national electricity system, and the public transmission and distribution of electrical energy, as well as the exploration and extraction of oil and other hydrocarbons, the nation shall carry out these activities in the terms stipulated in paragraphs six and seven of Article 27 of this Constitution. In these activities, the law will establish the relative norms for administration, organization, functioning, contracting procedures, and other legal acts that the state-owned productive companies carry out, as well as the regime under which its personnel shall be remunerated, to guarantee their effectiveness, efficien-

cy, honesty, productivity, transparency, and accountability, based on best practices, and shall determine the other activities that they can carry out. . . .

“Using criteria of social equality, productivity, and sustainability, the companies in the social and private sectors of the economy shall be supported and fostered, being subject to the modalities dictated by the public interest and usage, to the general benefit, of productive resources, protecting their preservation and the environment. . . .

“The law shall encourage and protect economic activity by private citizens and shall provide the conditions for the development of the private sector to contribute to national economic development, promoting competitiveness and implementing a national policy for sustainable industrial development that includes sectoral and regional aspects, in the terms established in this Constitution.” *Constitución política de los Estados Unidos Mexicanos*, amended December 20, 2013.

⁶ Refining, petrochemicals, and the distribution and commercialization of hydrocarbons are considered down-stream activities; up-stream activities are exploration for and production of oil.

⁷ Article 27 states, “In the cases referred to in the two preceding paragraphs, the nation’s control is inalienable and has no statute of limitations, and the exploitation, use, or enjoyment of the resources involved by private citizens or companies established according to Mexican law is not permitted except through concessions granted by the federal executive, in accordance with the rules and conditions stipulated by law, except in the case of radio broadcasting and telecommunications, which will be granted by the Federal Telecommunications Institute. The legal norms regarding works or exploitation of minerals and substances referred to in paragraph four will regulate the execution and proof of those that are effected or must be effected starting from the moment they are in force, regardless of the date the concessions are granted, and if they are not conformed to, the concessions will be canceled. The planning and control of the national electrical system corresponds exclusively to the nation, as do the public service of transmission and distribution of electrical energy; no concessions will be granted for these activities, regardless of the fact that the state can sign contracts with private citizens in the terms established by law, which will determine the way in which private citizens can participate in the other activities of the electricity industry.

“With regard to oil and solid, liquid, or gaseous hydrocarbons in the subsoil, the ownership by the nation is inalienable and has no statute of limitations, and no concessions shall be granted. In order to obtain income for the state to contribute to the nation’s long-term development, it shall carry out exploration and extraction of oil and other hydrocarbons through the assignation to productive state enterprises or through contracts with these or with private entities, in terms stipulated in the regulatory legis-

lation. To fulfill the object of said assignments or contracts, state productive companies will be able to establish contracts with private entities. In any case, hydrocarbons in the subsoil are the property of the nation, and assignments or contracts shall so stipulate.” *Constitución política de los Estados Unidos Mexicanos*, amended December 20, 2013.

⁸ Jude Webber, “Mexico Opens Deepwater Oilfields to Tender,” *Financial Times*, March 26, 2014.

⁹ Article 28 reads in part, “The functions that the state exercises in the following strategic areas will not be monopolies: mail, telegraph services, and radio-telegraphy; radioactive minerals and the generation of nuclear energy; planning and control of the national electrical system as well as public service of transmission and distribution of electrical energy, the exploration and extraction of oil and other hydrocarbons, in the terms stipulated in paragraphs six and seven of Article 27 of this Constitution, respectively, and the activities expressly stipulated in the laws passed by the national Congress. Communication via satellite and railroads are priority areas for national development in the terms laid out in Article 25 of this Constitution; while the state oversees their management, it will protect the nation’s security and sovereignty, and when granting concessions or permits, will maintain or establish its control over the respective means of communication in accordance with the respective legislation. . . .

“The state will have a central bank, autonomous in the exercise of its functions and administration. Its priority objective will be to ensure the stability of the national currency’s purchasing power, thus strengthening the stewardship of national development that is an attribution of the state. No authority will be empowered to order the bank to grant financing. The state will establish a public trust called the Mexican Oil Fund for Stabilization and Development, whose fiduciary institution will be the central bank, and it will have as its object, in the terms stipulated by law, to receive, administer, and distribute the earnings derived from the assignments and contracts referred to in paragraph seven of Article 27 of this Constitution, with the exception of taxes. . . .

“The Executive branch will have coordinated regulatory bodies for matters of energy, called the National Hydrocarbon Commission and the Energy Regulation Commission, in the terms dictated by law.” *Constitución Política de los Estados Unidos Mexicanos*, amended December 20, 2013.

¹⁰ Strategic activities are those carried out directly by the state in accordance with normative planning, which is obligatory for public bodies and organisms. By contrast, priority activities can be carried out by any institution or individual in the framework of an indicative government plan, which would not be binding for operators. See Enrique Peña Nieto, president of Mexico, “Decreto por el que se reforman los artículos 27 y 28 de la Constitución política de los Estados Unidos Mexicanos,” mimeograph (Mexico City: Centro de Reflexión Energética Nacional [Ceren], August 12, 2013).



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