

Energy Reform in Mexico

MEXICO'S OPENING ENERGY MARKETS IN THE
CONTEXT OF MAJOR ECONOMIC REFORMS

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Significance of Mexico's Energy Reform



Represents a Paradigm shift from the model started in 1938



Some have compared this reform to NAFTA in significance



The reform is broad and comprehensive and opens the sector completely to private investment

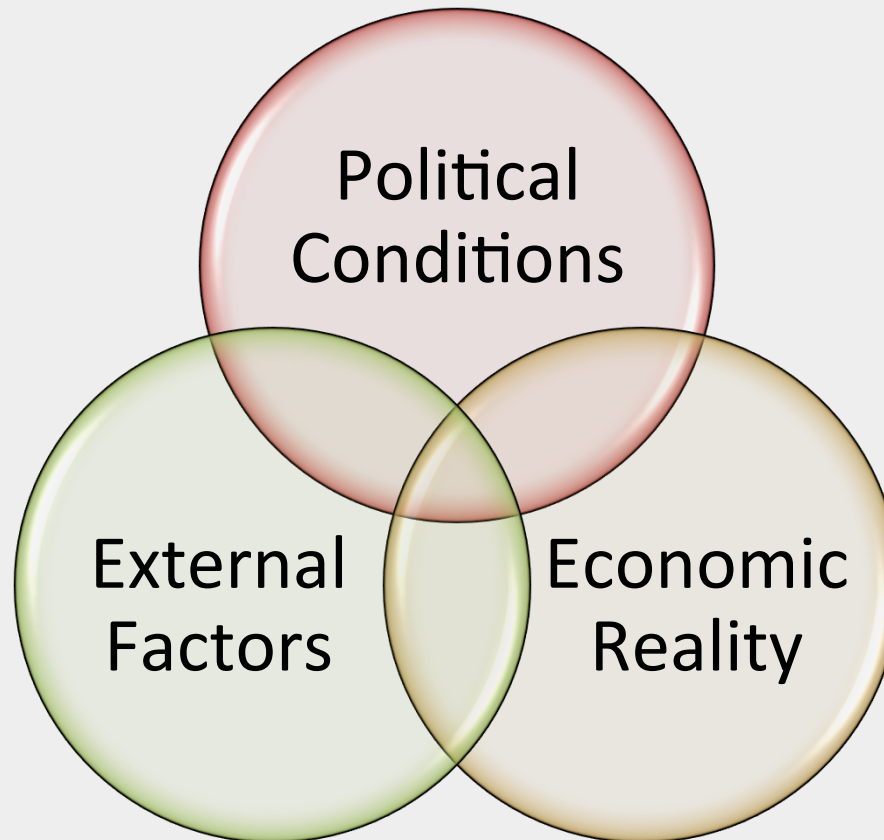


Implied Constitutional reforms and changes to dozens of laws

Energy Reform: Window of opportunity

Opening energy sector to private investment had long been a “third-rail” in Mexican politics. So what changed?

3 main factors:



Energy Reform: Window of Opportunity

Political Conditions

- Policy wise, there was an understanding among policy-makers (from the past 4 administrations) about the need to change
- Some opening attempts tried during the past 15 years – which resulted in some limited opening (electricity as an example)
- PRI's return to power in 2012 an opportunity to consolidate a disciplined voting block
- Done in the context of 10 more reforms with the Pacto for Mexico

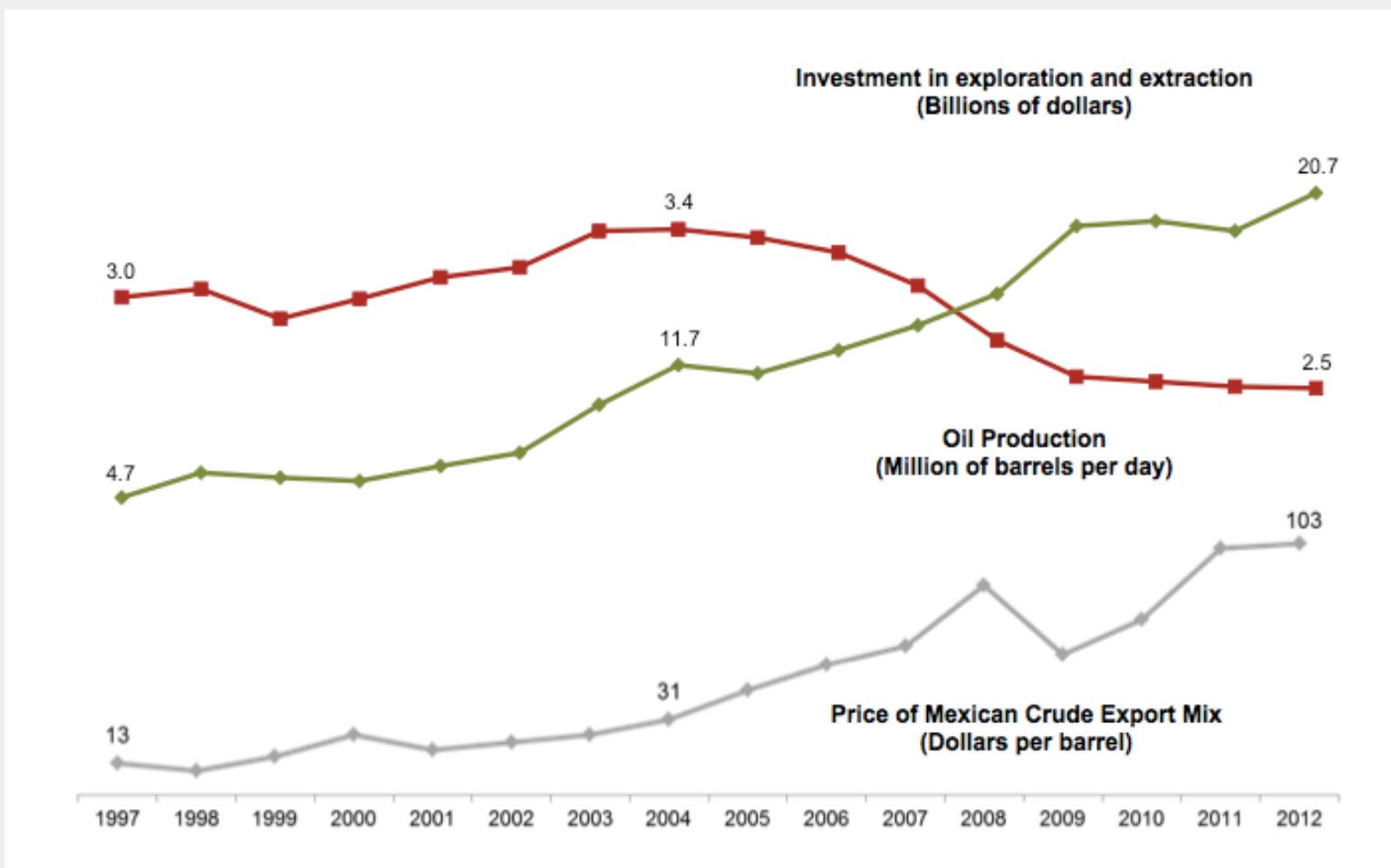
Energy Reform: Window of Opportunity

Economic Reality

- Declining oil production despite higher investment
- Resulting in an increase of imports on refined products and also of crude
- Mexico was going to become a net oil importer
- Government's continuous dependence on revenues from Pemex – the state oil company

Why now?

75 years after Mexico nationalized the oil industry, the time was right for the reform.

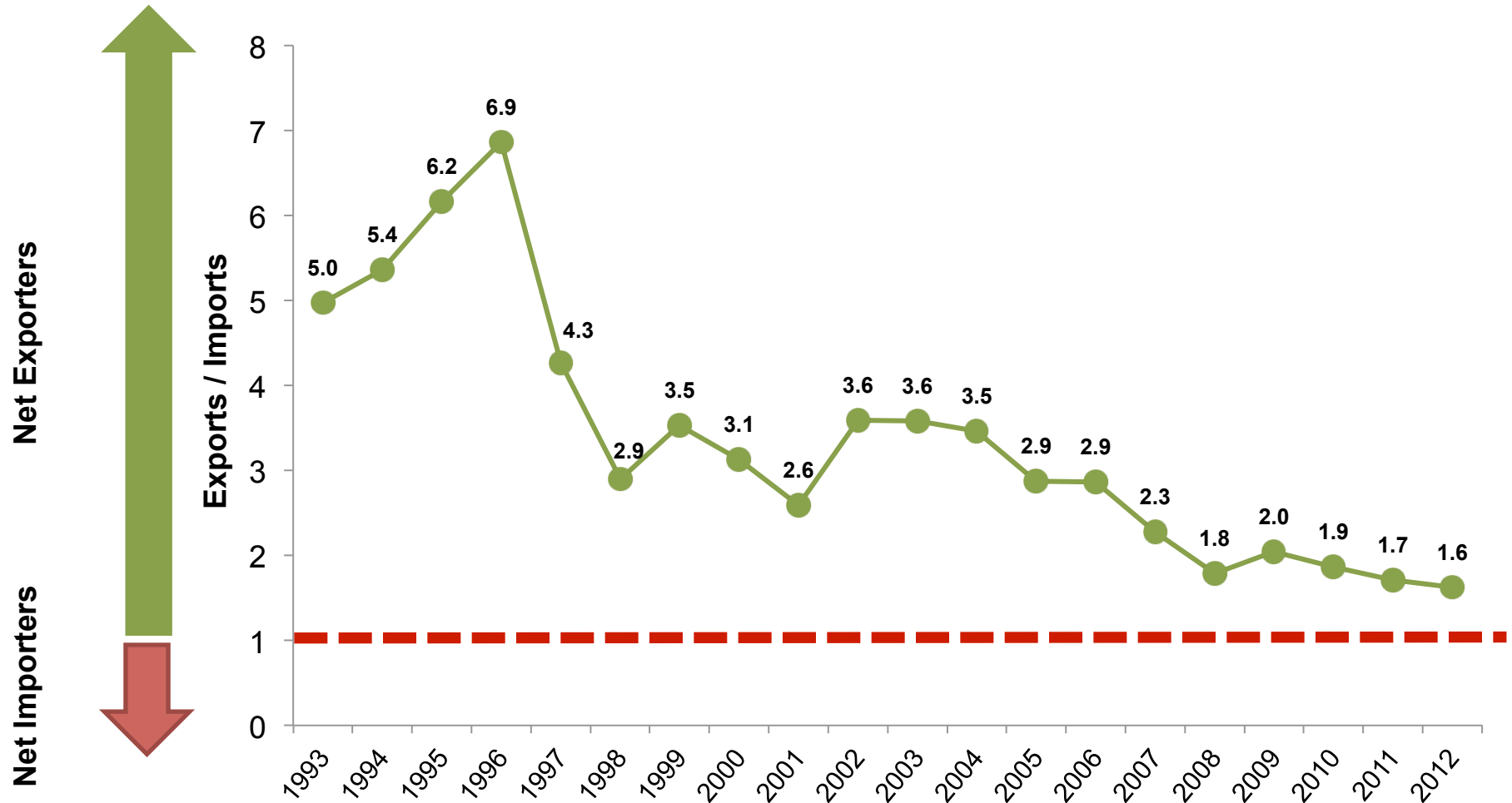


Mexico with high risk of becoming net importer of crude
– already importer of refined products and natural gas

Source: Courtesy Office of Congressman Javier Treviño (PRI – NL)

If the current trend continued, Mexico will become a net importer of oil, natural gas and oil products over the next few years. Production still expected to fall in 2014

Exports and imports value ratio for oil, natural gas and oil products



Source: Courtesy Office Congressman Javier Treviño (PRI-NL) - National Hydrocarbons Commission with information of the Mexican Central Bank.

Energy Reform: Window of Opportunity

External Factors

- The shale revolution in the United States an influence
- Realization that without a change Mexico would:
 - Be overly dependent on foreign oil and gas
 - Not take advantage of its rich hydrocarbons reserves and potential reserves
- Not different than those drivers that led to NAFTA 20 years ago

Mexico: more than just energy reforms

We need to look at the Energy reforms in the context of a broad reform agenda:

- Economic reform agenda had stalled since 1997
- Economic growth had suffered due to the lack of second and third generation of economic reforms
- A framework to build consensus about needed reforms:
Pacto por Mexico
- **11** major reforms passed: Labor, Education, Economic Competition, Telecommunications, Financial, Tax Reform Energy (7 in economic realm); Other: Penal System, Justice System, Electoral, Transparency

Mexico: more than just energy reform

Main objectives of the reforms:

Increase Productivity and Competitiveness

The main rationale was not: how to generate more growth in the energy sector....

But how by modernizing the energy sector, firms and families can get lower energy costs → translating it into higher competitiveness

Political Support

Among Political Parties:

Political support for the reform has been broad among political parties → Constitutional Reforms needed 2/3 majority in Congress

Secondary legislation was approved by the same margin

Among Business Sector:

Support was across the board – with emphasis on developing more domestic content in supply chains

In favor:



Against:



Political Support

Among population at large:

Initially a high level of support:

A poll by Vianovo (Sep 2013) found that **53% of Mexicans approved** of the energy reform (38% opposed) at the time of the submission of the Constitutional reforms*. These results were consistent with other surveys

When mentioned some of the potential benefits of the reform in terms of reduction of energy prices and more jobs, support increased in double digits*

As months passed, popular support for the reform has eroded, mostly due to the sluggish economic growth and the belief that energy prices are actually going to go up. After the process was completed, support averaged 40%

*Source: Vianovo Poll on Mexico Energy Reforms, Sep 20, 2013 <http://vianovo.com/news/vianovo-releases-new-poll-on-mexico-energy-reforms>

New Institutions and players

Energy Reform improves Mexico's institutional and legal framework:

It strengthens institutions like the Hydrocarbons Commission (CNH) and the Energy Regulatory Commission (CRE)

Clarifies the roles of the Energy Department and takes PEMEX and CFE (Electricity Company) out of the Federal Budget

Creates new institutions like the Industrial Safety and Environmental Protection Agency for the Hydrocarbons Sector

New Institutions and Players

It also increases the number of players in the sector:

- New regulatory bodies (with new functions)
- Private Firms and Business Organizations
- Civil Society Organizations (as it has happened in Texas)
- State and Local Governments (new roles for them)

There are challenges due to the lack of expertise and need to develop human capital fast

Main role of state governments

Promoters of economic development and local partnerships

- The regulatory framework is controlled by the Federal Government
- States need to be prepared in order to help provide infrastructure, and human capital
- Several states along the Texas border have been thinking about the different issues, and looking at examples like the Eagle Ford region
- One good example is the [Energy Strategy](#) just released by the state of Tamaulipas



Roles for states

Main Opportunities and Challenges

- **Activity will definitely increase → in the short term more work in developing infrastructure (midstream) will be seen.**
- **There is a need to move fast to maintain momentum → thus government set up an accelerated implementation pace:**
 - Round Zero results announced before deadline
 - Establishment of new agencies pushed forward 2-3 months
- **Development of Human Capital will take time**
- **Numerous areas of joint opportunities between Texas and Mexico – specially regarding construction of pipelines**

Main areas of opportunity

Five main areas of opportunity

Shale oil & gas

Several areas: main one in the border with Texas

Pipelines

Mexico needs the infrastructure

Partnering with Pemex

Joint partnerships after round zero

Electricity

Addition of power generation capacity and grid improvement

Opportunities to go alone, partnership with Pemex, CFE, or other private Mexican firms

Human Capital

Joint Educational Endeavors

Thank You

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