

# Mexico: The PAN's approach to energy reform

Emerging Markets • Economics • Latin America • Mexico

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## The proposal in brief, and the political pre-requisites for approval

- In this note we present the main changes to the constitution that Mexico's opposition Partido Acción Nacional (PAN) is proposing as the main component of its energy reform initiative presented to Congress this week. We also summarize some of the contents of the electoral reform initiative, which the PAN sees as a pre-requisite for the approval of the energy reform.
- We remain optimistic that the PAN and the ruling PRI (along with the PVEM) will have enough votes in the lower house and in the senate to approve a meaningful energy reform in the upcoming weeks. This, in our view, would represent the most significant structural change affecting the Mexican economy in the past twenty years, since the signing of the North American Free Trade Agreement, NAFTA.

Earlier this week Mexico's opposition party PAN (Partido Acción Nacional) presented to congress its long-awaited energy reform initiative. We have gone through it and are favorably surprised about its concise, direct and liberal nature.

In our view, the main constitutional change that the PAN is proposing has to do with the sixth paragraph of Article 27. Specifically, the PAN is proposing to delete the last three sentences from that paragraph which currently "prohibit concessions and contracts" related to oil and hydrocarbons, and that also states that "only the Nation can generate, transform, distribute and supply electricity." The PAN's proposed language for these sentences is that "the State must guarantee the maximum benefit to the Nation from the oil rent through the operators that undertake exploration and production".

The PAN is also proposing changes to Article 28 to make "priority areas" for the country's development of the following: "exploration and production of oil and of other hydrocarbons, as well as the generation, transmission, distribution and commercialization of electricity". According to Article 25 of the constitution, the public sector can participate with the private sector on the "priority areas" for the country's development. For consistency reasons, the PAN's proposal also seeks to eliminate "oil, other hydrocarbons, basic petrochemicals and electricity" from the fourth paragraph of Article 28 that currently makes them the exclusive responsibility of the public sector under federal government ownership.

In other words, the PAN is effectively seeking to end the state's monopoly on oil, hydrocarbons, petrochemicals and electricity, without imposing restrictions on the nationality of potential private sector investors in the future. At the same time, it is proposing the creation of the Mexican Oil Fund, which would be in charge of registering oil and hydrocarbon reserves, and to whom Pemex and other operators would pay for exploration rights.

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In a radio interview, President Enrique Peña Nieto said yesterday that he will likely send his own energy reform initiative next week. In a separate interview, the leader of the PRI bloc in the Senate, Emilio Gamboa, stated that this will likely happen on Wednesday. Meanwhile, PRI senator David Penchyna, who also heads the energy commission in the Senate, welcomed the PAN's energy reform initiative, stating that it has "very valuable elements", a "very integral vision" and that, therefore, it had to be thoroughly analyzed.

The PAN's energy reform initiative, along with several comments made by high profile members of the PRI (starting with President Peña Nieto), suggest that the two largest political parties in Mexico, PRI and PAN, agree on the need to make significant changes to the legal framework governing the energy sector. These parties, along with the PRI's political ally, the PVEM, have enough seats in both houses of congress to approve a constitutional reform. PAN, PRI and PVEM have 71% of the seats in the lower house and 77% in the Senate. Changes to the constitution require the approval of at least two-thirds of the members of each house.

For now, the suspense about a potential approval of a meaningful energy reform seems to be associated with the desire of some PAN senators that an electoral-political reform takes place beforehand. Opinions within the PAN are split, however, as to how deep this reform should be.

On one hand, the president of the PAN, Gustavo Madero, said yesterday that an electoral reform is needed along the lines of the addendum to the Pacto por México signed last May. Among other things, this addendum calls for the full punishment of electoral frauds, the suspension of political activities with social program beneficiaries in the 45 days before the elections, the promotion of citizen participation to monitor spending by state governments around electoral processes, and the creation of "plural commissions" at the state level to ensure equal conditions for political parties ahead of local elections. According to Madero, Congress should tackle in the near-term the electoral reform that addresses all the "errors, imbalances, and unfair and fraudulent practices" that took place in the July 2013 elections.

On the other hand, some high profile members of the PAN, including Javier Lozano and Ernesto Cordero, have stated that a full political-electoral reform should be voted in Congress ahead of the energy reform. Some of the elements of this political-electoral reform that the PRI would most likely reject include: a run-off vote in presidential, gubernatorial and mayoral elections; and, allowing for the immediate re-election of mayors and members of congress (with certain time limits). Other likely controversial initiatives include the elimination of political immunity to all elected officials (including the country's President), the granting of full autonomy to the Attorney General's office and the ratification of cabinet members by congress. PAN president Madero sees these changes as part of a political reform, which does not have to be addressed with the same degree of urgency as those related to the Pacto's addendum. We think that one way or the other the PRI will strike an agreement with the PAN to make progress on pending electoral items from the Pacto, and to leave a potentially more contentious discussion for later.

Long-time observers of political processes know quite well that: (1) Reform stories change frequently, even several times per day, depending on the progress of the negotiations; (2) it is impossible to forecast the exact outcome and/or the timing of congressional votes; and, (3) Mexican legislators can move very quickly to pass a reform, but also very slowly. Despite these features of the Mexican political process, we think that there is finally enough political will within the PRI and the PAN to finally strike a deal on a constitutional reform to re-shape the Mexican energy sector. We think that this will happen early on in the next ordinary congressional session that is set to begin on 1 September. If we are right, this would represent the most significant structural change to the Mexican economy in twenty years, since the signing of the North American Free Trade Agreement, NAFTA.

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