BRIEFINGS DE L'IFRI

Center for Energy & Climate

09 JULY 2021

Mexico's Energy Policies During the Presidency of Andrés Manuel López Obrador
Sovereignty and Security

Isabelle ROUSSEAU

Key Takeaways

- In power for three years, President Lopez Obrador leads a National Revolution. The energy sector sees the strengthening of the State and state-owned companies, the Federal Electricity Company and Petróleos Mexicanos, against the liberalization principles implemented in the Energy Reform (2013-2014).
- The aim is to reach self-sufficiency with oil, coal, and gas, while private investors in renewables no longer have confidence in the economic, political, and regulatory framework. Mexico nevertheless also relies on hydro, geothermal and nuclear power, but the expansion of these capacities is not taking place.
- Legal disputes are increasing with private investors and tensions are developing over the treatment of foreign investments within the framework of regional free trade agreements.
- Climate change is not a priority for the president, who still intends to launch a reforestation plan.

AMLO IS DEPLOYING A NEW ENERGY POLICY PARADIGM

Having received 53% of the vote on July 1, 2018, Andrés Manuel López Obrador (AMLO) has been President of Mexico for three years, with a strong mandate, that is an unprecedented achievement given Mexico's last 30 years of neoliberal government. In parallel with his own election, his party – Morena (Movimiento de Reneración Nacional) – won a majority in both the Chamber of Deputies and the Senate, giving him much capacity for action. AMLO was elected on a program whose letter and spirit differ in every respect from the (neo)liberal paradigm that had been at the heart of Mexico's government policies since 1982. With his inauguration, he proclaimed the country's Fourth Transformation (dubbed the 4T): a national revolution that will not shed blood.[1]

A President with a strong mandate

In the energy sector, this immediately led to the strengthening of the State and its companies (the Federal Electricity Company – CFE – and Petróleos Mexicanos – Pemex) in opposition to the principles of liberalization implemented in the Energy Reforms of 2013-2014, which aimed to strengthen competition in order to create a genuine market. Despite the complex situation that shaped these reforms' delivery (the significant reverse oil shock in 2015-2016, the limited time to flesh out the reforms, and lack of preparation by top staff), the results were nevertheless rather encouraging: between 2015 and 2018, 112 oil exploration and production contracts were signed, earning $45 billion.[2] Moreover, 71 renewable-energy contracts attracted nearly $9 billion in investment. In addition, an institutional arrangement to match this opening-up of the sector was created, with autonomous regulators, and sovereign wealth funds, etc. These transformations went hand in hand with the implementation of an energy transition policy, set out in the Energy Transition Law (*Ley de Transición Energética, 2015*), whose goal was to achieve 35% of electricity production from clean energy sources by 2024.

AMLO's coming to power has put a stop to the privatization of the sector, which is deemed to be contrary to the interests of the nation. For the new government, energy sovereignty and security are the two key principles of its energy policy. They fit in with promoting a protective and proprietary state, an endogenous model of development (the search for self-sufficiency), and the priority given to political criteria at the expense of technical, economic and financial considerations when making decisions. Finally, contrary to the multiple rules established during the Energy Reforms, it is clear that the Presidency of the Republic alone will lead the game: AMLO is taking over the traditional role of the *Tlatoani* ("the king" in Nahuatl).

1. 4T follows three other major transformations by Benito Juárez (1858-1872), Francisco Madero (1911-1913), and by Lázaro Cárdenas (1934-1940).
2. Comisión Nacional de Hidrocarburos.

This nationalist and dirigiste stance has propelled the two state-owned enterprises, Pemex and CFE, to the fore, while private companies will have only a complementary role. The 2018-2024 Nation project is clear in this regard: "to save this sector (…) we must financially strengthen Pemex and CFE, consolidate them at the operational level in order to reduce dependence on the outside and allow energy to become again one of the pillars of development."[3]

In this new context, what are Pemex and CFE's real financial, technical and technological capacities to play the full role that AMLO has reserved for them? At the financial level, the question is very relevant: in 2019, Pemex was the world's most indebted oil company ($106 billion) and its debt rose by a further 13% in 2020. The Fitch agency has lowered Pemex's rating, threatening its borrowing capacity.[4] In response, the government is injecting large amounts of money to save the national company.[5] But CFE, which is less vulnerable financially, must remain cautious; for three years, it too has had a negative balance sheet.

The new policy for hydrocarbons

In 2020, AMLO decided that oil policy should change course and aim at self-sufficiency. Mexico's trade balance in oil products in 2020 was negative, by - $13,9 billion. Exports of crude oil amounted to $17,4 billion, whereas imports of petroleum products were worth $31,4 billion.[6] To reduce imports, crude production will now be destined for refining at the expense of exporting. The construction of a new refinery in Dos Bocas (Tabasco State), and the reconfiguration of another six are part of this goal. Nevertheless, the Dos Bocas project has attracted considerable criticism from experts. The location is inadequate, subject to repeated flooding and being far from centers of electricity consumption. Also, the cost of the project has been rising steadily and is exorbitant, at $8 billion, even though the national company is suffocating financially.

At the same time, the new government is seeking to weaken private companies to give Pemex the leading role in all segments of the oil and gas value chain. Thus, on January 9, 2019, the Ministry of Energy terminated new calls for tender for upstream activities, set out in the Five-Year Plan (SENER, 2017). With respect to midstream activities, the Ministry issued the new Petroleum Resources Law (April 22, 2021) to favor the national company in importation, distribution and the marketing of fuels. For example, the new law creates unacceptable conditions for licensing: candidates must have storage capacity even before they know if they will get a license. Aside the discretionary nature of decisions, the authorities are not required to justify their resolutions. Hardly had it been voted, before law was challenged and then suspended temporally.

3. AMLO's official website, "Proyecto Nacional 2018-2024", November 20, 2017, available at: https://lopezobrador.org.mx.
4. On March 2, 2021, Pemex canceled its contracts with Fitch Ratings (retaining only two agencies: Moody's and Standard and Poor's). A standoff between Pemex and Fitch followed, as the agency decided to continue to assess Pemex as a service to investors.
5. $14 billion in 2020: an increase of 14% over 2019.
6. INEGI, "Exportación e Importación", available at: www.inegi.org.mx.

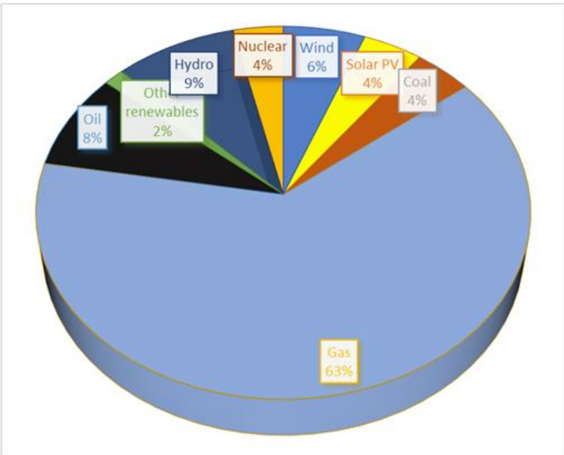
The role of natural gas in Mexico changed in 1997, when the country decided to produce electricity from combined-cycle power plants. However, domestic production has not kept up with the considerable increase in demand (8 billion cubic feet per day).[7] Mexico is doubly vulnerable: It is a net importer (about 5 billion cubic feet per day),[8] from a single market, the United States, and the gas is supplied by pipelines to the northeast of the country (97%), beset by the extreme violence of drug cartels. These could lead to attacks on pipelines that are vital to the country's energy security. Another weak link is the infrastructure for gas storage and distribution. Finally, Pemex uses flaring despite regulatory sanctions, which exacerbates environmental degradations. Aware of this extraordinary dependence, AMLO has announced that Mexico needs to recover 2008 production levels (6,9 billion cubic feet per day) by 2024. But no clear plan has been put forward to achieve this goal.

The energy transition is under threat

The electricity sector is following the same path: CFE's Director General, Lic. Manuel Bartlett, wants to restore the dominance of the state-owned enterprise (CFE) in production. This new nationalization threatens the place of renewable energies which mainly come from projects financed by private companies (in 2020, renewables accounted for 10.1% of electricity produced, with 4.25% being photovoltaic and 5.85% from wind power).

Natural gas largely dominates electricity production: in this, the 4T continues the path outlined by the previous government, which had established contracts on the basis of strong financial and commercial commitments to build the missing gas pipelines and guarantee the arrival of gas from the United States, for 35 years. As a result, CFE has become the main builder of natural gas infrastructure in Mexico.

Electricity production by sources, 2020



Source: IEA Data and Statistics.

7. Y. Ordaz, "En octubre, México alcanzó su segundo mes con las mayores importaciones de gas natural", *Milenio,* January 1st, 2021, available at: www.milenio.com.
8. SENER, "Prontuario Estadístico", December 2020, available at: www.gob.mx.

Surprisingly, coal is back center stage: initially set to close in 2026, the new administration has decided to keep coal-fired power plants (for political-electoral reasons) until the end of their technical lives – despite their environmental impact and high maintenance costs (nearly $390 million per year). Heavy fuel oil has also been brought back into fashion: given the large quantity Pemex produces, the company sells it to CFE rather than selling it on the market at a lower price. This is one of the perverse effects of the restrictions imposed by the reforms of the Marpol Agreement (January 1, 2020).

Among clean energies, the government is promoting hydro-electric power, geothermal energy, and nuclear power. These are established technologies that are primarily being deployed by CFE and have strong symbolic value for the country.

For AMLO, hydro-electric power is undeniably the pillar of renewable energy: net production was 25,305 GWh in 2020,[9] equivalent to 8.76% of the electricity mix. However, power plants pose several problems: they are mostly obsolete and often inefficient, their operating and maintenance costs are very high, and two-thirds have very small installed capacity. Despite this, the head of state has decided to upgrade 60 rundown plants (17% of installed capacity): restoration work will face water issues and social difficulties (protests from surrounding communities), as well as profitability problems (production costs are far higher than for solar and wind power).[10]

Geothermal energy is a technology that does not face problems of an intermittency. And Mexico is a country of volcanoes with enormous potential. It now ranks sixth in the world in installed capacity and has eight power plants. Yet the industry is today on standby, because the government, seeking to favor CFE, no longer grants concessions to private companies. This is paradoxical, as CFE is not investing either, due to a lack of funds.

The government issued a series of measures against renewables

Finally, the Ministry of Energy (Sener) is, in theory, in favor of nuclear power, which contributes 3.64% of electricity generation. In July 2020, it extended CFE's license for 30 years for the Laguna Verde generating station (Veracruz). Yet, despite the promise of a third reactor in the near future, nothing has been done.

The president is not interested in wind and solar projects. His administration announced very quickly the cancellation of the fourth long-term tender for renewable energy, although previous tenders would have provided CFE and other participants with very low-cost electricity. Starting in 2020, under various pretexts, the government issued a series of measures against renewables: their intermittency would affect transmission lines, and the transmission of their electricity flows has been heavily subsidized by CFE (50% of the total transmission and distribution cost). On February 1, 2021, the executive sent out a draft Electricity Industry Law that

9. CFE, *Informe Anual 2020*, April 2021, available at: https://infosen.senado.gob.mx.
10. This would cost $1 billion. Source: *Prodesen 2018-2033*.

changed the order in which different technologies are called to dispatch electricity.[11] The origin of production now takes precedence over the price: the production of CFE power plants is to be dispatched before that of the private companies.

This Law was quickly suspended following legal suits lodged by many private companies. Just before, in October 2019, the Government had wanted to change the conditions for the acquisition of Clean Energy Certificates (CELs): a mechanism had been created at the time of the 2014 reforms to accelerate the implementation of new clean electricity projects and to meet the commitments signed in the Paris Agreement. The CELs were granted only to new, clean electricity projects. The change made in 2019 should allow electricity plants created before 2014 to acquire CELs too: this again favors CFE. As a result, CELs have lost value in the markets and the desired result has been canceled, namely reaching the clean electricity quota by 2024. The private sector actors have mobilized and so the amendment has been provisionally suspended.

Reactions by the private sector

Private energy companies now feel fragile in the face of the new government. On the one hand, they are under intense pressure to show constantly that they are working for the country and that they are not linked to any cases of corruption.[12] Moreover, they are exposed to public authorities that act in a discretionary manner. For example, in April 2021, the CRE (Comisión Reguladora de Energía) canceled 125 licenses for private oil trading companies.[13]

On the other hand, Pemex is benefiting from the indulgence of the National Hydrocarbon Commission (CNH, *Comisión Nacional de Hidrocarburos*). The company has been unable to fulfill its commitments neither in terms of investment nor exploration and drilling: only 18 new wells out of a planned 62 have been drilled, with investments amounting to 17 billion pesos out of a planned 50 billion pesos. Despite this, the CNH has left Pemex with "assignments,"[14] thus offering the company a second chance. In addition, the company's poor results are never publicized: production in 17 out of 20 priority fields is significantly behind schedule, with output at only 92,000 barrels per day (b/d), compared to an expected 222,000 b/d: i.e., production is running at 41% of the expected scenario.[15]

The private companies immediately launched legal procedures against the measures the government adopted on arriving in office, and which challenge retroactively contract

11. While the dispatching entity (Centro Nacional de Control Eléctrico, or CENACE) first received its cheapest electricity from renewables, and then the other sources according to their cost, under the new law, hydro-electric power will be given priority, and followed by other resources used in production by CFE. Finally, electricity from private projects (NG and renewables) will be dispatched.

12. One of the main objectives of AMLO's election campaign was to fight against corruption. And this remains emblematic of his administration, which is targeting the private sector in particular.

13. "CRE cancela 139 permisos a privados por no iniciar operaciones", *Oil & Gas Magazine*, April 29, 2021, available at: www.oilandgasmagazine.com.mx.

14. This is the term given to the (E&P) blocks allocated to Pemex in 2014, during the "Ronda 0" (Call for tender 0).

15. "Informe Trimestrial de Campos Prioritarios", CNH, October 2020 (last document published) available at: www.gob.mx.

terms as well as investments carried out and guaranteed under the rules and institutions established by the Energy Reforms (the laws of August 11, 2014). Until now, the judges defending them have won the legal battles they have fought, because these changes run counter to the fundamental articles of the Constitution and international treaties that Mexico has signed. By ignoring market laws (free competition), these amendments are contrary to the fundamental principles of the United States-Mexico-Canada Agreement (USMCA) on free trade, and by violating the principle of non-retroactivity, they also undermine any legal certainty. Moreover, by curbing access to a healthy environment, they limit human rights and thwart Mexico's commitments on clean energy (the Paris Agreement). Some laws are designed to cancel the autonomy of certain bodies – the Energy Regulatory Commission (ERC) and the Federal Economic Competition Commission (COFECE) – and assign discretionary powers to the authorities, contrary to the transparency mechanisms implemented in 2014.

These legal proceedings began with the Clean Energy Certificates (October 28, 2020). Then, in 2021, two judges and experts in the field of economic competition, broadcasting and telecommunications, appealed and succeeded in temporarily suspending the implementation of the reforms to the Electricity Industry Law (March 21, 2021) and then of the new Hydrocarbons Law (May 17, 2021). So far, it has therefore not been possible to impose new reforms. Yet the climate of uncertainty and confrontation with the private sector is not conducive to investment.

These various attempts, which are very clearly aimed at reversing the Energy Reforms of 2013-2014, if they eventually succeed, will run into the fundamental principles of the new treaty signed between the United States, Mexico and Canada (USMCA), which came into force on July 1, 2020.[16] The new trade agreement has effectively locked in the Mexican energy sector. Although it recognizes nations' rights to reform their constitutions and laws if they do not affect the USMCA, a provision such as the investor-State disputes settlement ("ISDS") mechanism protects US and Canadian private investments in Mexico, while Chapter 14 obliges partners to accord the same treatment to firms in all three countries. Unlike Donald Trump, who turned a blind eye to the various distortions that AMLO had imposed on certain USMCA rules, President Biden will not accept such actions. But for his part, López Obrador will hardly agree to Canadian and/or American companies being considered to be on an equal footing with Pemex and/or CFE.

The confrontation between these partners will sharpen strongly by 2024, if AMLO does not change his position. Several disputes are already on the agenda. From January to May 2021, the US Departments of State, Energy and Commerce blamed the Mexican government for generating uncertainty by changes to energy-sector laws and regulations. Justin Trudeau and Joe Biden have threatened retaliation against Mexico, and there is nothing to stop the companies affected from using USMCA dispute-resolution mechanisms.[17]

16. On July 7, 2020, AMLO made his first overseas trip under the pretext of launching the Treaty in Washington. In fact, he traveled to support Donald Trump's candidacy for the US presidency (while Justin Trudeau carefully refused to join them).
17. This would have a huge cost for Mexico in terms of sanctions.

It is difficult to appreciate the impact in terms of costs these counter-reforms could have on energy investment in Mexico. Beyond the losses caused by the cancellation of upstream tenders and renewable-energy projects, one thing is certain: confidence has gone. Potential investors are turning to other parts of the world. This is the case, for example, of the head of Iberdrola (from Spain) who, in October 2020, indicated that the $5 billion for new projects in Mexico will migrate to other destinations. In upstream activities, oil companies are withdrawing to operate in priority blocks and shedding off ancillary activities; some (like Petronas from Malaysia) are moving their regional headquarters to Brazil, a promising and safe country. The Mexican Wind Energy Association (AMDEE) has reported that the sector has lost 61% of its investments in 2021 ($500 million compared to $1,300 in 2020). Solar energy may suffer a little less, as it is favorable to small local projects (distributed production), and is in harmony with 4T's vision.

Potential investors are turning to other parts of the world

But Mexico's credibility has been affected, and it will be very difficult to turn things round. Investments that have left or are subject to hesitancy are likely to be permanently lost.

Mexico and the COP26

Prior to the arrival of the 4T, Mexico played a dynamic role on the international stage in favor of decarbonization. It was the first developing country to have passed a General Climate Change Law (2012), and in 2015 it submitted a voluntary greenhouse gases (GHG) reduction plan to the UNFCCC, before the summit that led to the Paris Agreement.[18]

Yet with the COP26 now coming up, the situation has changed. Mexico has put forward unambitious targets for its Nationally Determined Contribution (NDC). In addition, Mexico's Climate Change Fund has been abolished and the budget for mitigation and adaptation programs has been strongly reduced.[19] In violation of the progressivity principle set out in 2015, the country is now simply confirming the targets established in 2015: reducing GHG emissions by 22%, and black carbon emissions by 51% in 2030.

At the climate summit in April, 2021, organized in the United States by President Joseph Biden, Mexico's head of state gave a very short speech: a five-minute parenthesis during his usual morning press conference. He did not mention directly Mexico's commitments to reduce emissions, and only touched on the theme of hydroelectric modernization. By contrast, he used the summit to promote his *Sembrando Vida* ("Sowing Life") program, a reforestation program that he wants to extend to Central America. The Mexican press saw the Mexican president's participation as completely out of step, making it clear that climate change is not a top priority.

18. The law had been adopted at the Earth Summit in Rio, in 1992, whose goal was to stabilize greenhouse gas concentrations.
19. These mechanisms were adopted when the Paris agreement was signed, and correspond to each country's efforts to reduce its domestic emissions and adapt to climate change.

The 4T cleverly cultivates a certain ambiguity. According to the Government, the country will respect the commitments made at the signing of the Paris Agreement: 35% of electricity production will come from clean sources in 2024. Without denying the importance of the energy transition, the 4T favors the search for a new balance between primary and secondary energy sources, within a framework of social justice: to provide universal access to quality energies in rural and peri-urban areas. The government has created the Fund for the Promotion of Sustainable Energy (Fondo de Aprovecamiento Sustentable de la Energía, FOTASE*)* and has included it in the Energy Transition Law. Contrary to the market logic that accompanied the mega-projects promoted by the 2013-2014 reform, the new projects favor distributed community-based electricity generation using renewable technologies, in order to ensure the autonomy of marginalized communities. Based on an alliance between the state and the communities, these mini-projects will produce energy using local natural resources, with the aim of fostering energy justice. Nevertheless, these projects can only be complementary to larger projects that will ensure mass production – whether renewable or not – to guarantee Mexico's industrial development (of its iron & steel industry, etc.). Mexico is thus really going into reverse in terms of fighting climate change.[20]

The future of the energy sector after the June 6, 2021 elections

In this uncertain context, the results of the June 6, 2021 elections provide a framework for examining the continuation of the President's six-year term in office, and, in particular, concerning the possibilities that the ruling party will have to change the Constitution and thus the energy sector.[21] At the legislative level, the Morena Party has remained in a strong position: it holds a majority in more than 50% of local congresses, and, although it does not have a qualified majority in the Chamber of Deputies, it can win it through subsequent negotiations with certain parties (the Institutional Revolutionary Party – IRP – and/or the Citizens' Movement).[22] Aware of his strength, AMLO quickly declared that he would put forward constitutional reform to transform the energy sector. If he does not get enough votes in Congress, he could play another card, by trying to co-opt the Supreme Court of Justice in his favor.[23]

20. For its part, Mexico's private sector is faring no better: despite its climate-related criticism of the government, it has not embraced any of the international proposals to achieve "net-zero" emissions by 2050.

21. These elections have been the most important in the country's history, given the number of jobs at stake. They were region-based elections that underscored Morena's enormous increase in its local presence (now providing 11 out of 15 governors), with the exception of the capital, where the opposition Alliance prevailed (made up of: the PRI, the National Action Party (NAP), and the Party of the Democratic Revolution (PDR)).

22. In 2018, Morena did not have a qualified parliamentary majority, but acquired it after negotiations. Constitutional reforms require a qualified majority: 2/3 of votes in both chambers, plus 50% in the 32 local congresses.

23. Morena currently has four out of eleven ministers who favor it. It is possible that the president of the Supreme Court of Justice could align himself to AMLO's advantage, as AMLO has offered to extend his post until 2024. It would then only require the support of one more minister to win.

But nothing is sure at present. Should the ruling party succeed in overturning the Energy Reforms (2013-2014), then many measures will be at odds with USMCA rules. In this case, it may be asked what answers the Mexican government can provide, given it does not want to leave the Treaty.[24] Could AMLO seriously resort to Russian and/or Chinese investments if the Americans show too little understanding? This would be a very risky gamble, given that Mexico is not Venezuela. It is difficult at present to see clearly what may happen. But it is certain that the path chosen by AMLO is strewn with difficulties.

Isabelle Rousseau *is a professor and head of the Energy Program at the Center for International Studies of El Colegio de Mexico***.**

How to quote this publication:

Isabelle Rousseau, "Mexico's Energy Policies During the Presidency of Andrés Manuel López Obrador: Sovereignty and Security", *Briefings de l'Ifri*, Ifri, July 9, 2021.

ISBN: 979-10-373-0392-9

24. Mexico's economy is closely linked to that of its northern neighbor: America's post-Covid economic success will improve things in Mexico too.

french
institute of
international
relations

since
1979

27 rue de la Procession
75740 Paris cedex 15 – France

Ifri.org