

EASTER AND ELECTRICITY IN MEXICO – THE ELECTRIC SECTOR REFORM DEBATE, CONGRESSIONAL VOTE AND WHAT COMES NEXT

INSIGHTS FROM THE INSTITUTE OF THE AMERICAS

INTRODUCTION

After a raucous Easter Sunday session and final vote, Mexico's Congress denied President Andres Manuel Lopez Obrador the 2/3 majority needed to amend the Mexican Constitution and his proposed reform of the electric sector. It was the culmination of a months-long debate begun when the president submitted a proposed bill to Congress last September. The proposed reform sought to reduce private sector participation to the benefit of state power utility CFE, as well as eliminate the nation's energy regulators and subsume the system operator, CENACE, back into CFE.

Almost two months were spent in early 2022 with Congress hosting what was called an open parliament, where a long list of sector participants and the government argued their cases for or against the reform. The longer the discussions extended, the polarization deepened, and the president and his congressional allies called a vote despite clear signs of insufficient support. Postponing the vote to Easter Sunday was seen as a cynical ploy to deter attendance by representatives of Mexico's lower house. The members traditionally have an extended Easter recess and are away from San Lazaro and Mexico City.

For insights and perspectives, we convened our Mexico team to prepare short summaries of where they view the sector after the last several months and as we move forward in the wake of the historic vote in Congress.

LEONARDO BELTRAN, NON-RESIDENT FELLOW



Although President Lopez Obrador back in 2018 received historical popular support to change policy across the board, the mandate in the energy sector was very clear: Mexico wanted to continue the path to a modern, sustainable, and efficient clean power sector. Yet the efforts of the President's energy team have been working against this obligation. Certainly, part of the work of all CEOs is to increase its market share, and push for more favorable conditions. Nevertheless, in any market, the most efficient way to enjoy consumer preference is to improve its suite of products, whether it is augmenting the catalogue, providing better service, lower costs, or new technologies. However, in the case of Mexico's national utility the bet is on a completely market-less logic. On the one hand, the administration is committed to taking the company out of competition and setting a mandate to secure CFE's market share. On the other hand, it is increasing the cost of production by favoring the use of inefficient assets (fuel oil) and granting privileges on tariff subsidies to certain groups for political gain. Fortunately, the opposition in Congress read the strong signals coming from all the different stakeholders and constituencies and did not support the constitutional amendment.

Still, the government, in the second half of the administration, most likely will continue to pursue its plans at the institutional level, with an Energy Regulatory Commission (CRE) and the System Operator (CENACE) already working in tandem with the administration to grant preferential treatment to CFE at the expense of the system, and ultimately in detriment to the consumer who would face higher costs, lower reliability, and a larger environmental footprint.

FRANCISCO XAVIER SALAZAR, NON-RESIDENT FELLOW



Where do we stand after last Sunday? It is worth recounting what has happened in the energy sector since this administration began.

During the final part of his campaign, Andres Manuel Lopez Obrador assured that he would not seek to reverse the energy reform. In fact, at the beginning of his six-year term, he declared that there would be no legal changes, at least in the first half of his term. And indeed, it started like this: his intervention in the sector in the beginning was only through changes in energy policy and regulation (after taking control of the once-independent regulator). But as these changes were contrary to the legal framework when the industry began to challenge them in the courts the judges froze them.

After two years of failed efforts to change the regulations to favor CFE, the president made the decision to break his promise and proceeded to change the Electricity Industry Act. However, most of changes went against the Constitution, which resulted, among other things, in the judges once again granting suspensions, and the opposition in the Senate presenting a “nullity” trial before the Supreme Court of Justice. The president then sought to expedite the constitutional reform initiative in Congress.

Naturally this was difficult to achieve after the results of the 2021 midterm election when he lost the qualified majority in the Chamber of Deputies. However, he wanted to take the risk and tried to break the opposition in various ways. Even if he did not succeed, he knew that the mere discussion of the issue would become a populist political campaign issue where the private sector was presented as a public enemy.

The PRI had requested that the vote on the constitutional amendment not take place until after the next elections. The speculation in this regard is that there was a negotiation in which if they won, some states would grant him the votes that the president required to reform the Constitution. However, when the president felt confident to avoid declaring the electricity law unconstitutional in court, he considered that he no longer needed the reform. It is for this reason that in a matter of weeks the vote in the Chamber of Deputies accelerated.

Indeed, President Lopez Obrador got the four votes he needed in court to avoid a declaration of unconstitutionality. In these circumstances he knows that the litigation will continue and that, in the meantime, he will be able to continue controlling the sector. It is for this reason that although last Sunday's result is excellent news because it has prevented a radical change in the industry, deep down things have not changed much: CRE, CFE and SENER will continue to hinder the development of private investment in the industry.

Clearly, this will deepen the problems of the sector: the lack of energy, insufficient transmission, the delay in the energy transition and, paradoxically, the deterioration of CFE. This implies that the next administration will have to make a radical turn and make up for lost time. Otherwise, the size of the crisis will be unsustainable.

CHRIS SLADEN, NON-RESIDENT FELLOW



In some ways, this was a defeat snatched from the jaws of victory. Just a few days after the President had won a resounding victory in a recall referendum which he had created, the President then lost a key vote for one of his flagship reforms. It is a noteworthy high-profile loss but is unlikely to have any impact on his popularity. The President, showing his mastery of politics, immediately shifted the energy conversation to his plans for lithium. Meanwhile, the President retains full control over the energy sector through his control of the energy regulators, through his ministries, and his direct appointments of the CEOs for both PEMEX and CFE, and many of their subsidiaries. Having so much control, particularly of the regulators, the President can simply use the regulators to block, slow and frustrate private investors in the electricity sector to the favor of CFE. This is a similar situation to that which has developed in the

downstream fuels supply and fuels retailing sectors, with permits for private investors being denied, ignored or processed very slowly. Investors will need enormous patience should they wish to go it alone in the energy sector without either CFE or PEMEX.

CECILIA AGUILLON, DIRECTOR, ENERGY TRANSITION INITIATIVE



The rejection of AMLO's electricity reform by the Mexican Congress on Easter Sunday may not change the current situation of the power market in the country. Large-scale renewable energy development will likely continue to stall as AMLO could discourage market growth using regulatory changes. Thus, new clean energy auctions will most certainly be absent through the rest of the current administration.

The distributed generation (DG) markets will likely continue to grow in the residential and commercial sectors. DG markets have proven to be resilient so far, particularly in the residential and commercial sector. However, uncertainty will continue to slow down renewable projects for heavy industry sectors. Unless the government sends clear signals that large qualified users of energy can count on uninterrupted contracts for clean electricity, industrial companies will have a

hard time meeting their decarbonization goals.

Representatives of the primary and secondary sectors in Mexico made it clear to members of Congress at a forum organized by the Commission of Economy, Commerce, and Competitiveness on March 30 that industrial users require a power market that is clean and competitive. Global industries are committing to decarbonize their supply chains. Sending a signal that the industrial sector can use clean energy to power its factories could attract investments through the nearshoring efforts underway in North America. However, should AMLO persist on undermining clean energy markets through regulations, Mexico will miss the opportunity to further attract high-tech manufacturing. In addition, Mexico's power sector will continue to move backwards as the world accelerates its uptake of low-cost renewable electricity.

JEREMY MARTIN, VICE PRESIDENT, ENERGY & SUSTAINABILITY



Elections matter. In Mexico's June 2021 mid-terms, the ruling Morena party lost its supermajority. Those seats lost by Morena were crucial. Their loss, together with a unified opposition, proved too much for President Andres Manuel Lopez Obrador to overcome to meet the 2/3 threshold required to amend the Mexican Constitution and the country's electric sector. According to several sources, it marks the first time ever that a president's proposal to amend the Constitution was rejected.

By almost every estimation, the rejection was merited; the bill was seen as a major step backwards for the electric sector, the Mexican public and the nation's competitiveness. It brought a halt to the president – and director general of state power firm CFE – most extreme effort to translate their anachronistic and resource nationalist ideology to the Mexican power market.

The bill's defeat brought relief and satisfaction. That enough legislators sought to make informed decisions on the proposed reform in the face of intense jingoistic posturing from the president and his allies in Congress was important. The last week placed in stark relief the desperation of the president and those most fervently pushing for an overreaching and deleterious reform.

After Easter Sunday, there are without question reasons to be reassured about democracy, the rule of law and the role of civil society. But, at the same time, this is not a president that will respect the merits of democracy in action when it counters his objectives and desire. Make no mistake: The president and his energy team will continue to politicize the country's regulators and independent power market system operator, to the detriment of investment. They will almost certainly pursue actions to further intervene in the sector to assert the primacy of the state. Look no farther than "nationalizing" the country's heretofore undeveloped lithium reserves through a new law passed only hours after the electricity reform defeat. Nevertheless, Sunday's vote does ensure that the overall framework for the power sector and its key fundamentals remain unchanged and will allow for a more feasible reboot when that day arrives.

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The Energy & Sustainability program has played a crucial thought-leadership role in shaping policy discourse and informing policymakers and investors on the most important trends in the energy sector. We focus on matters related to energy development, investment, natural resource use, and energy transformation in the Americas.

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