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FEATURED Q&A

Can Mexico's Oil Sector Compete With Brazil's?

Mexico has recently blamed low investor interest in its oil sector on Brazil's ability to attract investment to its oil sector. An offshore oil platform of Brazilian state oil company Petrobras is pictured above. // File Photo: Agência Brasil.

Q **Brazil's Senate on Dec. 12 cleared the extension of a preferential customs regime for the oil industry, which suspends import duties on exploration and production equipment and makes the country's oil sector more attractive to outside investment. The move comes as Mexican state oil company Pemex said the week before that it saw tepid interest in a deepwater oil auction due to higher interest in Brazilian oil investments. How is Brazil faring in the global oil and gas sector? Are prospects in Brazil as attractive to foreign investors as Mexico believes? What can Latin American oil exporters do to boost production amid global prices for hydrocarbons that are far below their peak levels from several years ago?**

A **Cleveland M. Jones, researcher at the National Institute of Oil and Gas and member of the geosciences advisory board at NXT Energy Solutions:** "Decades of outdated legislation and ideologically driven policies stifled business initiatives and made oil and gas investment unattractive in both Brazil and Mexico. Both countries became accustomed to their inefficient national oil companies, which nevertheless survived based on a substantial resource base and high oil prices. In Mexico, changes only came about recently, after President Peña Nieto's election in 2012, when his administration proposed a new oil and gas legal and regulatory framework. Even so, the first bid round to deliver blocks to private firms only came in 2015, after the new lower-for-longer world oil price scenario and declining oil production had already shown that Mexico's outdated rules were untenable.

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TODAY'S NEWS

POLITICAL

ELN Attacks Scuttle Talks With Colombian Gov't

Colombia's National Liberation Army, or ELN, rebel group resumed attacks on Colombia's military and oil infrastructure following the expiration of a cease-fire between the two sides. The attacks led Colombia to pull out of a round of scheduled peace talks.

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BUSINESS

Rio Tinto Drops Bid for Stake in Chile's SQM

The metals and mining corporation said it would pursue other ways to capitalize on electric cars.

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POLITICAL

Mexican Interior Minister Resigns, Eyes Senate Seat

Mexican Interior Minister Miguel Ángel Osorio Chong resigned from his position ahead of his expected run for a seat in the country's Senate. Osorio Chong, who has overseen security in Mexico, has faced a spiraling rate of homicides and other crime.

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Osorio Chong // File Photo: Mexican Government.

POLITICAL NEWS

Mexico's Interior Minister Steps Down, Eyes Senate Seat

Mexican Interior Minister Miguel Ángel Osorio Chong on Wednesday announced his resignation from the post, as had been widely expected, and is expected to seek a Senate seat in elections later this year, Reuters reported. Osorio Chong oversaw security, migration and human rights as interior minister and grappled with spiraling rates of crime and homicides. To replace Osorio Chong, President Enrique Peña Nieto tapped his labor minister, Alfonso Navarrete Prida, the Financial Times reported. Roberto Campa, who had served as undersecretary of human rights, was named the new labor minister. In other cabinet changes, Luis Miranda resigned as social development minister and is expected to run for a seat in the lower house of Mexico's Congress. Miranda appointed his deputy, Eviel Pérez Magaña, to succeed him. Osorio Chong had been seen as a top contender to run for president as the candidate of the ruling Institutional Revolutionary Party, or PRI, but the party is instead backing former Finance Minister José Antonio Meade. Mexico's rising rates of homicides and other crimes is expected to be a key issue during the campaigns. On Wednesday, the U.S. State Department urged U.S. citizens not to travel to five Mexican states—Colima, Guerrero, Michoacán, Sinaloa and Tamaulipas—due to violent crime there.

ELN Attacks Scuttle Talks With Colombian Gov't

Colombia's National Liberation Army, or ELN, resumed attacks on oil infrastructure and Colombia's military on Wednesday follow-

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But after 80 years of strongly nationalistic policies that turned Pemex into an inefficient company, these changes may be too little, too late. In Brazil, major changes had already happened in 1997, resulting in years of successful ANP bidding rounds and gains in credibility and growth of its oil and gas industry. The Lula administration brought the house down in 2007 by suspending bidding rounds, setting the country back many years in oil and gas industry activity. The resumption of bidding rounds, as well as very recent reforms in the legal and regulatory framework, including the Repetro rules, have somewhat restored confidence in Brazil's oil and gas industry. However, very favorable exploration prospects, based on assessments of the yet-to-find oil potential of the pre-salt region and the exceptional productivities commonly achieved there, are Brazil's main advantages. Thus, it is not surprising that Mexico finds itself playing catch-up with Brazil. Despite Mexico's recent start on reforms, Brazil is significantly ahead in the game. Mexico came close to threatening Brazil as an oil and gas investment destination, but now it is clear that the stagnation imposed by the Lula and Dilma administrations was only a temporary setback in its longer history of modernization. The recent bidding rounds in Brazil were successful in attracting billions of dollars in investment, and the upcoming rounds this year and beyond are likely to continue that trend, to the detriment of competing investment destinations, including Mexico."

A **David Shields, independent energy consultant based in Mexico City and editor of Energía a Debate:** "State-owned Pemex is probably wrong in its assessment that global interest in Brazil's recent oil auctions contributed to the failure of its own attempt to find a partner for its Nobilis-Maximino deepwater project. The real problem is that

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NEWS BRIEFS

Retired U.S. Ambassador to Lead Board Examining Health Incidents in Cuba

Peter Bodde, who retired last year after serving as a U.S. ambassador to countries including Libya, Nepal and Malawi, has been named to lead the State Department's Accountability Review Board to examine the mysterious health problems that affected diplomats in Cuba, who reported hearing high-pitched sounds, CNN reported Wednesday. In a hearing Tuesday on Capitol Hill, State Department and federal investigators said they have been unable to determine the cause of the symptoms. Cuba's government has denied carrying out any attacks on diplomats, and U.S. officials have said Cuba is cooperating with the investigation.

Inter-American Court of Human Rights Backs Same-Sex Marriage

The Inter-American Court of Human Rights on Tuesday said all Latin American countries should legalize same-sex marriage, endorsing the push for marriage equality despite disapproval by the Roman Catholic Church, Reuters reported. The decision came in response to a petition submitted to the court two years ago by Costa Rican President Luis Guillermo Solís, who has vowed to increase rights for LGBTQ Costa Ricans.

Rio Tinto Dropping Out of Bidding for Stake in Chile's SQM

Rio Tinto decided to drop out of the bidding for a stake in Santiago-based miner SQM, one of the world's biggest lithium producers, and instead will be pursuing other ways to capitalize on the electric car boom, people familiar with the matter said, Bloomberg News reported Wednesday. Other strategic bidders for Canadian firm Nutrien's 32 percent stake in SQM reportedly remain interested in the stake.

ing the expiration of a cease-fire between the Marxist rebel group and the Colombian government, Reuters reported. Peace talks had been scheduled to resume in Quito on Wednesday, but President Juan Manuel Santos

> **"I deplore the decision by the ELN to reactivate its terrorist attacks."**
> **— Juan Manuel Santos**

ordered his chief negotiator to return to Bogotá following the attacks in order to reassess the future of peace negotiations between the two sides. The rebel group carried out three bombings early Wednesday on the Caño Limón oil pipeline, forcing the suspension of pumping operations, the government said. The group also carried out a grenade attack on a naval base in Arauca province, injuring two soldiers. State oil company Ecopetrol also reported an attack by the ELN on one of its facilities in the rural Casanare province. "I deplore the decision by the ELN to reactivate its terrorist attacks," Santos said Wednesday in a televised address. "The government was always willing to extend the cease-fire. Inexplicably, the ELN refused. Under the circumstances I have ordered the return of our chief negotiator to evaluate the future of talks." In the past, the ELN has said it would not push to extend the cease-fire that began in October, hoping instead to change the terms of the deal.

THE DIALOGUE CONTINUES

Will Kuczynski Be Able to Complete His Term as Peru's President?

Q Several public officials in Peru have resigned in the wake of President Pedro Pablo Kuczynski's near-impeachment and his subsequent pardoning of former President Alberto Fujimori, who was serving a 25-year prison sentence for abuse of power and human rights violations. The pardon led to street protests, leaving Kuczynski's presidency on shaky ground despite surviving the impeachment vote in December. Will Kuczynski be able to complete his five-year term? How can he regain public confidence and political influence? Will Peru's fractured politics throttle back investment and economic growth this year?

A Alexander F. Watson, former U.S. ambassador to Peru, former assistant secretary of state for Western Hemisphere affairs and managing director at Hills & Company, International Consultants: "The most serious damage caused by this series of events is to the public's confidence in Peru's fragile political system. Political leaders again are seen as cynically pursuing their own narrow political interests at the public's expense. President Kuczynski has lost credibility by denying to Congress that he had any relationship with the Odebrecht construction firm, and then by pardoning highly controversial former President Fujimori in what appears to be a favor in return for the abstention by Congressman Kenji Fujimori and others, which torpedoed the impeachment motion. The president is severely wounded politically, as several ministers, legislators and important supporters have abandoned him, leaving him isolated. The legislatively dominant fujimorista Fuerza Popular party is also damaged by its politically driven rush to impeach Kuczynski without careful consideration of the facts and then failing to do so when Kenji defected, as well as by credible accusations that party leader Keiko Fujimori received bribes from Odebrecht. Relations among the three Fujimoris and the future of Fuerza Popular could become a soap opera. Peruvians are understandably disgusted and outraged by these developments, and some are seeking reversal of the pardon. How this will play out politically is far from clear. Investors are accustomed to Peruvian political confusion and will not panic, but if Kuczynski, with whom they are comfortable, should fall from power, they are likely to hold their breath until the dust clears. The impact of all this on the April Summit of the Americas hosted by Peru, which ironically chose 'Democratic Governance against Corruption' as the principal theme, will be interesting. "

EDITOR'S NOTE: The comment above is a continuation of the Q&A published in Tuesday's issue of the Advisor.

ECONOMIC NEWS

Canadian Officials Tamp Down NAFTA Withdrawal Concern

Canadian officials on Wednesday distanced themselves from a report that the country's government is concerned that the United States will soon pull out of the North American Free Trade Agreement, or NAFTA, The Hill reported. A Canadian government official pushed back on a report by Reuters earlier Wednesday, which cited two government sources, that Canadian officials were becoming convinced that U.S. President Donald Trump would withdraw from the agreement, calling the report "inaccurate." "Progress on NAFTA was made during previous rounds and the December intersessional, and we expect more progress to be made in January," the official said. The sixth round of talks in the NAFTA negotiations is set to begin Jan. 23 in Montreal. Trade officials from the United States, Canada and Mexico have imposed a March deadline on completing negotiations. Soon after the Reuters report was published, the Toronto Star reported that while Canada is "actively preparing" for the United States' possible withdrawal, officials are not "convinced" that the United States will do so.

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Pemex most likely sought too high an entry fee for an unattractive prospect. But Mexico has not lost its allure for international oil companies interested in deepwater. The proof is that 29 companies from 16 countries have just registered for Mexico's Round 2.4 auction, which offers many contracts that will be almost certainly be awarded successfully early this year. Pemex needs to get its act together if it wants to find partners to help finance and operate its oilfield projects. It should seek to farm out a large number of shallow-water and onshore fields, rather than go for deepwater. Apparently it intends to do so, but why so slowly? Production and drilling activity in Mexico and the rest of Latin America have been dampened by low oil prices and maturing fields. The region has been notoriously uncompetitive as compared to U.S. fracking. Mexico, above all, should give priority to the fast development of shale oil and gas, if it hopes to regain higher production levels. Northeastern Mexico is believed to be one of the regions with the highest shale potential in the world, as it shares some of the Permian Basin and Eagle Ford geology. However, legal and regulatory certainty will have to be ensured if frackers are to be enticed across the border. The government will likely give priority to this after the upcoming presidential elections."

A **Adriano Pires, director at the Brazilian Centre for Infrastructure (CBIE):** "The key takeaway is that extension of the preferential customs regime for the Brazilian oil and gas industry, Repetro, which the Senate approved last month, is of fundamental importance to maintaining investment attractiveness in the Brazilian oil and gas sector. After being signed into law, the bill will provide greater legal security. The bill has already contributed in 2017 to the attracting of exploration and production investments in oil regulator ANP's bidding rounds. Since late 2016, the Brazilian oil sector has been undergoing a new virtuous cycle of investments, prompted by a set of changes promoted by the new government. The Temer administration has made significant progress on the regulatory agenda, and the amendment of the production-sharing regime to remove the Petrobras obligation to participate as operator in all consortia was one of the most relevant achievements. For five years (between 2008 and 2013), the process of discussing a new regulatory model for the pre-salt left all oil and gas exploration and production rounds in suspension. After this period, the sudden drop in the price of oil and a reduction in Petrobras' investments due to the company's financial crisis significantly affected exploration activity and, consequently, the number of discoveries and drilling wells. Signaling the improvement in the regulatory conditions of the sector, global economic agents have turned their interests back to the country, which enjoys immense pre-salt potential to be explored—estimated in billions of barrels of good-quality oil reserves. Latin American investment opportunities for offshore exploration are currently focused on Brazilian pre-salt, as stated above. In addition, the offshore Equatorial Margin (north of Brazil, The Guianas and Suriname) has shown signs of a new frontier for the sector. Offshore exploration and production technology is continuously advancing and, after oil prices fell, costs have been falling. Local oil companies with connection to good suppliers will have a lower breakeven price and increased profit margin, as long as they place their investments into promising reservoirs and projects. Having partnerships with global oil companies is a good strategy to help deliver the results."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

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