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FEATURED Q&A

Is Peña Nieto's Energy Reform Plan Bold Enough for Investors?

Q Mexican President Enrique Peña Nieto on Aug. 12 presented his highly anticipated plan to overhaul the country's energy sector and break the state's monopoly on oil and gas production and electricity generation. His reforms, though not as extensive as those proposed by the National Action Party, will likely be approved by Congress, analysts say. What are the key elements of Peña Nieto's proposed energy reforms? Will they have the desired effect on Mexico's energy sector and economy overall? How should international companies and investors interpret the proposed reforms?

A Maria Jose Hernandez Medina-Mora, associate at the Eurasia Group's Latin America Practice: "President Enrique Peña Nieto's proposal is a significant step to open up the energy sector in Mexico. While not as liberal as the one presented by the National Action Party (PAN), the two proposals taken together offer a political path for changing the Mexican Constitution in ways that will allow private investment in the sector—a policy revolution unthinkable even a few years ago. Peña Nieto's proposal includes constitutional amendments to articles 27 and 28 of the Constitution. He aims to remove the ban on contracts in the hydrocarbons sector, but still prohibit concessions. Moreover, he seeks to remove electricity and hydrocarbons from the list of strategic sectors, allowing private investment in related activities. Interestingly, markets last week skeptically focused on the fact that uncertainty remains. But while investors should not lose sight that negotiations will prove difficult, the risks are actually less than meet the eye. The government will only be able to secure approval with support from the PAN. And the PAN is unlikely to advance energy reform negotiations unless political reform moves forward. However, Peña Nieto is likely to cede ground on this front—he can't afford to see energy reform to fail. Ultimately, the

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Bachelet Has Big Lead in Chile Presidential Race

Former Chilean President Michelle Bachelet is leading her nearest rival by more than 30 percentage points as she seeks to return to the presidency, according to a poll released Thursday. The election is scheduled for Nov. 17. See story on page 2.

File Photo: Chilean Government.

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NEWS BRIEFS

Protesters Take to Streets of Bogotá in Support of Farmers

Tens of thousands of people headed to the streets of Bogotá Thursday to show their support for a strike by the country's small-scale farmers who are complaining that free-trade agreements are flooding the country with cheap agricultural products as fuel prices raise their production costs, according to BBC News. Teachers, health workers, students and farmers marched to the city's main square to show support.

Mexican Authorities Capture Alleged Sinaloa Cartel Lieutenant

Mexican police on Wednesday captured Mario Núñez, an alleged former lieutenant in the Sinaloa drug cartel who is accused of involvement in the murders of more than 350 people whose bodies were found in mass graves in 2011, the Associated Press reported. Police captured Núñez, also known as "M-10" in the border city of Ciudad Juárez. According to U.S. court documents, Sinaloa's leader, Joaquín Guzmán, hired Núñez to take smuggling corridors from rival cartels, and he is blamed for an increase in violence in the area.

Mexico's IPC Suffers Longest Losing Streak Since 2009

Mexico's IPC stock index declined Thursday for the seventh consecutive day, its longest losing streak since January 2009, Bloomberg News reported. The index of 35 stocks fell 0.2 percent to close at 39,162.49. Among the decliners, **Coca-Cola Femsa** declined 1.3 percent and **Wal-Mart de México** shed 1.8 percent. The streak began after the country's statistics bureau said Aug. 20 that the economy had expanded less than economists had forecast in the second quarter.

Political News

Bachelet Has Big Lead in Chile Presidential Race: Poll

Former Chilean President Michelle Bachelet is leading her rival by more than 30 percentage points ahead of the country's November presidential election, according to a new poll, Reuters reported Thursday. Bachelet, the center-left candidate, has the support of about 44 percent of Chilean voters in her attempt to return to the presidency, according to the poll by CEP. Her opponent, conservative former labor minister Evelyn Matthei, garnered 12 percent support in the poll. A fifth of those who participated in the poll said they did not know who they would support or declined to specify their preference. Four percent of the respondents backed independent economist Franco Parisi and the same percentage backed left-leaning politician Marco Enríquez-Ominami. A candidate would need more than 50 percent of the vote to win a first-round victory on Nov. 17. If no candidate reaches that level, a runoff would be held Dec. 15. Analysts say smaller candidates could splinter votes away from Bachelet and Matthei and push the contest to the second round, Reuters reported. While Bachelet is widely expected to win back the presidency, much attention is focused on whether she will win the necessary majority in Congress in order to push through her legislative agenda. Bachelet, who was in office from 2006 to 2010, has said she wants to work toward free education, boost corporate taxes and reform the country's Constitution. The CEP poll of 1,471 people was conducted between July 13 and Aug. 18 and has a margin of error of plus or minus 3 percent. [Editor's note: Michelle Bachelet is a co-chair of the Inter-American Dialogue, which publishes the *Advisor*.]

A candidate would need more than 50 percent of the vote in the first round to avoid a runoff.

Economic News

Brazil Gradually Recovering From Slowdown: IMF

Brazil's economy, the largest in Latin America, is experiencing a gradual recovery from a slowdown that started in 2011, but the government must continue its efforts to increase productivity, competitiveness and investment, the International Monetary Fund said Wednesday, Reuters reported. In its report, the IMF praised the efforts of President Dilma Rousseff's government, saying measures to ease supply-side constraints would lead to more investment and alleviate bottlenecks in infrastructure. Rousseff's government has implemented tax breaks and other incentives in efforts to increase industrial output, but the economy is in its third year of sluggish growth. "After a protracted period of weakness, investment has begun to recover in recent quarters while business confidence has firmed," the IMF said in the report. However, it added, "In addition to headwinds from external conditions, domestic supply-side constraints and policy uncertainties may be holding back near-term growth." A low level of unemployment and significant increases in real wages have bolstered consumption, and the economy is operating at nearly full potential. However, supply constraints have curbed growth and stoked inflation, the

Rousseff

File Photo: Brazilian Government.

To Our Subscribers

The Latin America Advisor *will not be published Monday, Sept. 2 in observance of the Labor Day holiday in the United States. We will resume publication on Tuesday, Sept. 3.*

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report added. The IMF report, released before Brazil's central bank boosted its benchmark interest rate a half percentage point to 9 percent, also praised the monetary tightening. Wednesday's increase was the central bank's third consecutive rate hike since April when the Selic rate stood at a record-low 7.25 percent. Last week, the central bank began a $60 billion foreign exchange intervention program to support the real, which has lost some 15 percent of its value in the past three months. Brazil also needs to increase domestic savings, improve its indexation for minimum wage and continue pension system reforms, the IMF added. "Other efforts to foster private investment should include streamlining taxation and improving business conditions," it said in the report. Brazil also has a sound banking system that can implement capital requirements that are part of Basel III ahead of schedule. However, the IMF added that the country's levels of household credit and mortgage loans need to be closely monitored.

Company News

América Móvil Prepared to Drop Bid for Royal KPN

Mexico's **América Móvil** said Thursday that it is prepared to scrap its attempt to take over **Royal KPN** after the company's foundation exercised an option to buy shares in order to block América Móvil's bid, Bloomberg News reported. The foundation described the bid by Mexican billionaire Carlos Slim's company as hostile and said it was acquiring preferred shares, giving it nearly 50 percent of the issued and voting stock. América Móvil has offered 2.40 euros per share for majority control. The Mexican company currently owns approximately 30 percent of the Dutch phone company. "It's hard to determine whether this offer is fair," the KPN foundation's chairman, Jacques Schraven, told reporters Thursday in Amsterdam. "We've asked whether this offer can be retracted and negotiations can be reopened. They haven't responded to that up until now. This wasn't an easy decision."

Featured Q&A

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reform's impact will depend on the contract details such as tax regime, booking of reserves and other technical details, which will emerge in secondary legislation once the constitutional changes are approved. But both the government and the PAN realize that an attractive contract scheme is necessary for the reform's success."

Andrés Rozental, member of the *Advisor* board, president of Rozental & Asociados in Mexico City and senior fellow at the Brookings Institution: "President Peña Nieto's proposed energy reform is a big step in the right direction, but unfortunately an incomplete one. There are two key missing elements: 1) excluding a regime of concessions to private sector investors, both Mexican and foreign, who would like to participate in future hydrocarbon exploration and exploitation in deep-water reserves and shale; and 2) not having explicitly allowed private-sector companies to book any reserves they find. Including both of these options would have made the proposal much more acceptable to major new investors. That said, the proposal still marks a sea change from the existing exclusionary regime. There are still many details to be worked out and publicized, many of which will be discussed when Congress takes up the reform package starting next month. Allowing profit sharing and giving the state oil company, Pemex, an early advantage through a 'zero round' should satisfy most, but not all, of the reform's strongest critics from the left. These will oppose any change to the current state of affairs, no matter how minor or major, so the government rightly decided to make this a 'transformational' effort, opening the door to further changes in the future. There are also important changes planned to the way Pemex operates and is managed, which should allow the company to compete on a more even footing with private-sector players, some of whom may choose to associate with the state-owned company rather than strike out on their own. It remains to be seen how many changes the draft legislation undergoes as it wends its way through both houses of Congress. However, it appears likely that a PRI-PAN coalition has the necessary votes to pass the constitutional changes, and that would be a major victory indeed for Peña Nieto and his government."

Jeremy Martin, director of the energy program at the Institute of the Americas: "The Aug. 12 energy reform unveiling by the Peña Nieto administration was quite a moment. Indeed, the majestic Palacio de Bellas Artes in Mexico City might have been a more appropriate site for the performance. The government's roll out was draped in history invoking the hallowed name of President Lázaro Cárdenas, but also starred the economy and a strong pocketbook argument. The administration emphasized the reform's economic importance and its potential to ignite activity, from a 1 percent boost to GDP and creation of half a million jobs to the populist promise of reduced power and natural gas prices during the Peña Nieto sexenio. Beyond economic issues, there are two additional key elements: The constitutional amendments and legislation that will allow for increased private participation in the oil and gas and power sectors. The amendments are critical to developing a new contractual framework for upstream activity, and the possible contract modality has provoked furious debate. Will the proposed profit-sharing contracts be sufficient to lure significant private investment, particularly in the costly and challenging deep-water and shale plays? Assuming the Constitution is amended, the finalization of secondary laws, as well as how Mexico develops and manages private sector bidding, will go a long way to determining companies' interest. But Mexico should garner substantial investment by companies from across the globe, many of who have been toiling on the margins for years in anticipation of a real opportunity to bring to bear their technical and financial capabilities to unleash the

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Featured Q&A

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country's energy potential. But whether those investments will deliver the economic benefits set forth in the reform proposal—before the end of the Peña Nieto term—is not entirely clear."

A George Baker, president of Baker & Associates and publisher of *Mexico Energy Intelligence*: "Both the PRI and the PAN propose measures to allow some degree of market forces in the oil-and-gas and electric sectors. On both, the extent of the commercial privileges remains to be seen. Attention is being given to the oil side, where the government is proposing a form of 'profit-sharing' arrangement. A distinction is made between 'cost oil' and 'profit oil.' The idea is that an international oil company (IOC) is to recover its investment by receiving a share of production (cost oil) and the company is also entitled to a profit in compensation for the risks incurred (profit oil). Peña Nieto hopes to attract oil companies by splitting the profit oil in some negotiated manner, offering the cash equivalent instead of the physical barrels. What's new is that it links payment to market prices; what's 'old' is that the legal framework is to be that which was in place in 1940, when Lázaro Cárdenas was president. On the power side, an unexpected innovation is the proposal to create an Independent System Operator which would bring public oversight and transparency to the rules by which generation from public and private operators is transmitted. This measure should reassure investors of fairness and lower the delivery price of electric power from the present high levels. The list of desired effects is long, so I will mention only those at the top of the upstream. One desired effect is that the 30 billion barrels of oil equivalent in deepwater reservoirs will be put into production by qualified companies under financially and politically affordable terms. Another desired effect is that a government agency other than Pemex take responsibility for administering contracts with IOCs. The PAN urges the Hydrocarbons Commission to take on this role; the PRI is less specific. A third desired effect is that as a side effect of IOC investment in the upstream, Pemex E&P goes international, either as a 100 percent state company, or (preferably) as a new, stock-bearing NOC with a minority of its shares in a major exchange."

A Jonathan C. Hamilton, partner and head of Latin American arbitration at White & Case LLP: "President Peña Nieto will join ministers, ambassadors and a cadre of Mexican and American CEOs for a historic 'Shared Destiny' summit in Mexico City next month, spearheaded by the U.S.-Mexico Foundation, which promotes binational partnerships and philanthropy. It is a time for putting momentous change in the energy sector into historical perspective. Latin America long has been marked by cycles of nationalization and privatization, including the 'Washington Consensus' toward the free market that emerged in the 1990s and the backlash in countries like Venezuela and Bolivia over the past decade or so. For many decades, and throughout two decades of the NAFTA era, the 1938 Mexican nationalization of the oil and gas sector has persisted somewhat like a fly in amber, trapped in time and immutable to change. In this context, the mere opening of the energy sector trumps most any dispute over the details. Domestically, the potential for change emerged from the unique Pacto Por México that has driven reforms throughout the year. Economically, the government predicts a boost in investment of $10 billion a year through 2025 and the creation of up to 2.5 million jobs in the same time period. Politically, the change may bring significant social impact (including potentially on immigration), by creating massive investment flows through the free market, rather than waiting on aid that always seems insufficient. Critically, internationally, the move represents a major opportunity for increased binational collaboration with the United States, from private investment to philanthropy. It is indeed a shared destiny, soon to be even more so."

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