

## Mexico Intelligence Report – 17th July 2015

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## Keep your chin up: an underwhelming auction, with a moderately net positive balance



This week the government launched the first round of bidding for oil blocks, opening the possibility for private investors to enter its energy sector, something that hadn't happened in close to 80 years. The immediate result was underwhelming. Out of 25 prequalified players, only 9 made bids and out of 14 shallow water blocks only 2 were awarded, below the 30-50 per cent hit ratio the government was anticipating. Overall the vast majority of the blocks received no bids at all.

The outcome seems to seal a nefarious week for the country, following the escape of its most notorious drug-lord. Yet in this case the forest should not be mistaken for the trees. True, there is scarce room to spin the numbers of the auction itself. However, if the focus is placed on the process of the auction itself then the net result is marginally positive.

Since the approval of the 2014 Energy Reform, the various governmental bodies in charge of implementing this paradigm shift have carried out their work with a combination of Germanic efficiency and Scandinavian transparency.

All the meetings between firms and the National Commission for Hydrocarbons (the sector's regulator) were videotaped and their minutes published online. The meetings could not take place unless two commissioners were present at any given time.

The auction itself was almost pious in its emphasis of transparency. Not only was the entire process broadcast live (an almost five-hour long marathon), but even the desks on which the envelopes containing the bids were placed were made out of perfectly see-through glass.

The reasons as to why the first auction didn't receive the response the government expected range from too stringent requirements to the quality of the blocks on offer. Neither of these factors should prove to be prohibitive in successive rounds. The government has proven to be flexible and welcoming in listening to suggestions and concerns from the industry and the most coveted blocks (deepwater) are on their way.

If anything, the government's institutional behaviour has sent strong signals that should provide greater certainty to investors, whilst proving that Mexico can play catch-up quite quickly with international trends and standards, although some fine-tuning should follow. A fitting testament to this from the private sector, was that the consortium that won the two blocks was comprised of Mexican, American and British firms.

## Get Shorty





Upon visiting Mexico, Andre Breton, the father of surrealism, is alleged to have said that Mexico was the most surreal country on the planet. His words certainly rung true on Sunday when Joaquín Guzmán Loera, better known as “El Chapo” (Shorty), Mexico’s most notorious and once again most wanted drug lord escaped from a high security prison, for the second time in less than 15 years.

Whereas in his first escape he did so by hiding in a laundry cart; this time he disappeared through a 50cm hole in his cell’s shower down to a ten metre shaft, which led to a 1.5 km tunnel with ventilation and a rail system built by his now almost legendary team of engineers.

Mr. Guzman’s arrest in February of 2014 could not have come at a better time for President Enrique Peña Nieto’s, who was on a roll with the passage of a series of landmark historic reforms and the darling of international press. His capture seemed to lend credence to those that argued that a government that delivered on its promises was enabling Mexico to finally leave behind the less becoming features of its political and governance history.

Yet irony seems to have a sense of symmetry, given that Mr Guzman’s arrest could also not have come at a worse time for the current administration. Since October, President Peña Nieto has faced public fury due to a string of conflict of interest scandals involving his wife and some of this closest collaborators, continued violence due to organized crime, a heated conflict with one of Mexico’s teachers union which threatens to undermine the legacy of the education reform and simmering disquiet due to lacklustre growth in the economy and an unpopular fiscal reform.

During this time, the issue of corruption and weak rule of law -one that is never far from the electorate’s radar- has gained increasing prominence, to the point that it was one of the main drivers in the past mid-term elections and will most likely be so again in the presidential elections of 2018.

In this sense, Mr. Guzmán’s escape only adds fuel to the fire. Although accomplished engineering had an important role in his escape, the fundamental factor behind the event is corruption, given that beyond intimidation or payoffs there is no other plausible explanation for how his engineers could open a gate to his freedom from the comfort of his shower and how he could exploit a “blind spot” in his cell’s CCTV surveillance for enough time to vanish without a trace.

Regardless of the embarrassment it now has to endure, the government will have its work cut out in the flak it is receiving in terms of not having done enough to crack down on corruption.

As of now the government’s response seems to be as shocked as that of Mexican society as a whole, yet less quick to come up with an appropriate response. The public response has been a blend of exasperation and mockery.

It is now a hallmark of President Peña Nieto’s style to resist calls to reshuffle his cabinet in times of crisis, an approach that at the time of writing he has stuck to. The eye of the storm has focused on his Minister for the Interior, Miguel Osorio Chong, who absorbed control over security affairs at the beginning of the administration and was until last Sunday a potential successor to President Peña Nieto.

If more days go by without Guzmán being apprehended –which is perfectly likely since he was a fugitive for 13 years after his first escape- and Mr. Peña Nieto refuses to make any decisive changes, then his credibility could quickly diminish. His party’s recent win in the mid-term elections provides him with a buffer in the form of a legislative majority with which to navigate the second half of the presidency, but that will be far from sufficient to protect whatever succession plans he might have.

Beyond the electoral implications of Mr. Guzmán’s escape, the event certainly signals a long road ahead for Mexico’s security problem, not so much because “El Chapo’s” new-found freedom may increase tensions between rival cartels, but because it evinces that the structural deficiency behind violence in Mexico –weak security and law enforcement institutions- is in need of many years of unrelenting reform.

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