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199 DER A-29**Energy****Mexico's Police Corruption in Guerrero
Raises Questions for Energy Investors**

By Emily Pickrell

How to deal with Mexico's persistent security issues will be a consideration for would-be energy investors—a problem most recently illustrated by the disappearance of 43 students in the southern state of Guerrero two weeks ago and the indications of corrupt police involvement.

Security officials in Guerrero have since said that a combination of narco-traffickers and police were responsible for a Sept. 26 confrontation, where a group of police and armed forces attacked two buses of students, killing six and leading off an additional 43, who are still missing.

Both the mayor of Iguala and the head of the town's municipal security force have been closely linked to organized crime, according to a report issued by Mexico's Center for Investigation and National Security, and leaked by El Universal.

The apparently substantial presence of organized crime in government and the police force—more than 30 police have already been arrested for the Iguala violence—is a problem not exclusive to Guerrero. Northern Mexico's Tamaulipas, where many of the most promising oil and gas reservoirs lie, also has severe security and corruption issues, a risk that energy investment will have to weigh in determining investment interest.

“Guerrero as a state has very similar problems in terms of institutional weakness as Tamaulipas, Michoacan and Veracruz,” said Duncan Wood, the director of the Mexico Institute at the Woodrow Wilson Center. “When you see what was possible in Guerrero and what is currently happening, it is not a stretch to imagine the same thing could happen in Tamaulipas.”

Tamaulipas One of Most Dangerous States

Indeed, Tamaulipas is currently considered one of the most dangerous states in Mexico, with more than 480 kidnappings since President Enrique Pena Nieto took office at the end of 2012. In August 2014, 20 individuals were kidnapped, according to Stop Kidnapping, a Mexico City-based human rights organization.

While the impact that security will have on energy investment has yet to be quantified, the cost of such violence is high for the country as a whole: Its total economic impact is roughly \$300 billion per year, or nearly 30 percent of Mexico's gross domestic product, according to a report by the Institute for Economics and Peace.

Some of this economic impact is the added cost of doing business in places like Tamaulipas, because of the security concerns.

“In Tamaulipas we have a huge problem—it is the kidnapping capital of Mexico, by far,” said Rodrigo Elizarrars, a security analyst with Mexico Evala, a public policy think tank. “They have to solve this to make it attractive for investment, otherwise, all the industries will invest a lot in security for their infrastructure and their CEOs, because security is a huge issue.”

The costs are not expected to deter the big players, such as Shell and ExxonMobil—both of which have expressed vocal interest in Mexico – but could influence the entrance of the smaller companies that specialize

in areas such as unconventional drilling.

"These very large companies already operate in adverse environments, so they can probably operate in environments like Mexico," said Dwight Dyer, a senior security analyst for Mexico City-based Control Risks. "But if you are a small company, operating profitably and looking across the border, you probably see the same conditions at Texas, except that security sucks. Your margins are small enough that crossing the border makes no sense."

Police Force to Address Economic Concerns

The Mexican government has already announced modest plans to beef up security with a portion of its newly formed national gendarmerie, a separate police force of about 5,000, Treasury Secretary Luis Videgaray told the International Monetary Fund in a meeting in Washington during a mid-October visit.

"One of the fundamental objectives in creating the gendarmerie in the federal police was to be able to dispatch them to economic activity zones, including the energy industry, just as they have been dispatched to other industrial sectors," Videgaray said, acknowledging that reports of the kind of violence that took place in Iguala, Guerrero could impact international investment.

Further plans to focus on the security concerns for the energy sector are more likely to be discussed behind closed doors, however, Wood said.

"The government has been very careful, because if they say 'we are developing a special plan for the energy sector, it looks as though they are protecting foreign oil companies as opposed to its own citizens,' Wood said. "You can't do that, so it has to be very carefully messaged."

Mexico's poor record of upholding its laws and prosecuting wrongdoers, meanwhile, undermines many of these efforts, in a country where less than five percent of murders and kidnappings are ever successfully prosecuted. The government has also been slow to implement its promised judicial reforms and the special gendarmerie police force was reduced from a promised 40,000 force to 5,000 because of internal budget disputes.

"Deep, Deep Trouble."

"What we are looking at is the fact that the Pena administration has invested all its time in pushing through congress all the structural reforms, including energy, but has neglected the fact that the administration and justice institutions are worse than ever before and in deep, deep trouble," said Tony Payan, director of the Mexico Center at the Baker Institute at Rice University, predicting that the increased cost of security will raise the return expected on any investment. "That is something that will come back to haunt them."

Several of the major companies that are looking to invest in Mexico have discussed pooling their resources for a common security strategy for onshore operations, one senior official at a major oil company said.

International oil service providers already operating in onshore Mexico—which includes Halliburton and Schlumberger—have implemented a strict daylight work schedule, ensuring that daily operations shut down by 5 p.m., in order to reduce security risks for employees, according to Mexican security specialists operating in Tamaulipas.

"Companies have been making some adjustments to their operations, thinking about how to make them safer," the senior major oil company official said, but noted that the specific discussions on safety between individual companies and Mexican state and local government in Tamaulipas have not yet taken place.

Even so, some in Texas envision that the energy industry could play a constructive role in reducing Mexico's security concerns.

"If any industry is capable of outshining the lure of the narco-economy, it is most certainly the energy industry," said Christi Craddick, a Texas Railroad Commissioner, whose organization oversees Texas onshore oil and gas regulation, wrote in an Oct. 14 editorial in the Houston Chronicle.

Mexican security specialists, however, are more circumspect, pointing to the problems the industry has brought to countries like Nigeria.

"Oil generally does not ameliorate security issues - it tends to worsen them, because there is more money and there are more people to extort and attack," said Miriam Grunstein, an energy lawyer and law professor at the CIDE, a public research university in Mexico City. "For Mexico to become safe, it would have to become very militarized and a very smart security strategy would have to be crafted."

And even with the best plans, observers generally agree that while the laws for the energy overhaul may have been written in less than a year, the institutional and infrastructure changes needed to improve security will take much, much longer.

"What Iguala highlights is that this is a problem that is not going away any time soon," Wood said. "It poses a very big challenge to the legitimacy of public security organizations in this country. Because it happened in Guerrero, it is not so important in terms of the energy outlook, but when you see it happening in Tamaulipas, or Tabasco, or Mexico City, then people will begin to react."

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