The Politics of Mexico's Oil Monopoly

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Pemex, the state owned oil company, is in crisis as a result of the choices made by its manager, the federal government. It is true that Pemex is an indebted oil company because it is heavily taxed. It is also true that Pemex is currently one of the main sources of revenue for the federal government, especially in era of high oil prices. However, the company faces serious problems such as whether it should be privatized or not.

In this paper I will discuss various questions that need to be taken in consideration in any discussion of privatization of Pemex. In the first part of this essay, I provide a brief history of Pemex in order to emphasize the circumstances under which the oil sector in Mexico was nationalized. In the second part, I discuss Mexico-United States relations regarding oil because the United States is currently the major consumer of Mexico's oil. The third section looks at the current problems that Pemex needs to address as soon as possible if it wants to maintain its status as an oil exporter.

A brief history of Pemex

In order to understand the current politics of Mexico's oil sector it is useful to remember under what circumstances Mexico decided to nationalize its oil sector. Some Mexican scholars believe that the history of oil since the beginning of the twentieth century to the present can be broadly divided in three periods (Del Villar 1979; Meyer 1978). The first era ended in 1938 with the nationalization of the oil sector. During this period the oil companies had exclusive rights over the hydrocarbons and the Mexican state was too weak to do anything about it. The second period began in 1938 and ended in 1976; during that era Mexico hardly exported any oil because the new state-owned company focused on supplying the domestic market. The third period began in 1976 when Mexico becomes once again a major oil exporter.

It is useful to remember that since the beginning of the twentieth century until 1938, oil companies operated in Mexico with a lot of autonomy; they were a state within a state (Krauze 444). According to historian Enrique Krauze (1997), the oil companies "had left nothing good in places they exploited: not one school, not a theater, not a hospital. Only wasteland (Krauze 444)." The general attitude of the oil companies was that they were in "conquered territory," and they could get away with a lot because they had "powerful friends (Krauze 444)." The oil wells were so protected that the Mexican Revolution that lasted from 1910 to 1920[1] did not have much impact in oil production. In fact, oil exports increased during the armed conflict (del Villar 119).

Another point that needs to be emphasized is that before 1938 the state was too weak to be able to enforce Article 27 of the Mexican Constitution of 1917 (del Villar 119, Meyer 593). In the 1917 Constitution, Article 27, paragraph four states that "…corresponds to the nation the direct control of all natural resources, including hydrocarbons (Shields 135)." In addition, Article 27, paragraph six states, "the nation will carry out the exploitation of these products (Shields 135)." After 1917 the issue between the oil companies and the state was whether Article 27 was retroactive. In 1921 the Mexican Supreme Court stated that Article 27 was not retroactive, meaning that the oil companies maintained exclusive rights over the hydrocarbons (del Villar 120). Article 27 could not be enforced by the state but it began to pave the way towards the nationalization of oil.

Lázaro Cárdenas, president from 1934-1940, decided once and for all to solve the oil question. It is believed that his past encounter with the oil companies truly influenced his decision to nationalize the oil sector. As he put it: "When we met General Mújica in the oil fields of Cerro Azul and Potrero del Llano, we were detained at the gates of the companies that had closed off the roads and it was only after waiting an hour that their guards arrived to open up the way for us. And this happened to the Military Zone Commander himself! (Krauze 444)." In 1937, a year before the nationalization took place, Lazaro Cárdenas wrote to himself, "The entire oil industry should also come into the hands of the state so that the nation can benefit from the riches of the subsoil that are now shipped away by foreign companies (Krauze 473)." That same year, the Council of Conciliation and Arbitration, a commission of experts, issued a critical report on a labor dispute between the oil companies and their workers. The report stated that the multinationals had manipulated their account books, "hidden profits and inflated expenses (Krauze 473, Falcón-Bautista 19)." In addition, as part of the ruling by the arbitration council, the companies were required to pay 26 million pesos to their workers (Krauze 473).

On the other hand the oil companies were willing to pay 20 million pesos but no more than that. It seems that the oil companies miscalculated the intentions of the

[1] Some historians believe that the Mexican Revolution lasted for 30 years, from 1910 to 1940 (Krauze 1997, 240).

Cárdenas' administration. As put by Standard Oil in November 1937, "We cannot pay and we will not pay (Krauze 473)" or as stated by the company's representative: "They will not dare to expropriate us (Krauze 474)." On December 18th 1937, the Federal Conciliation and Arbitration Council issued their final ruling with two key points: 1) the oil companies had to pay 26.3 million pesos to the workers; 2) and they had to hire eleven hundred new workers (Krauze 473). By 1938 the labor dispute had escalated, and the federal government was directly negotiating with the multinationals. After multiple meetings between the oil companies and President Lázaro Cárdenas, the companies finally agreed to pay 26 million pesos (Krauze 474). However, by this time President Cárdenas was already determined to nationalize the oil companies. On March 18, 1938 Lázaro Cárdenas announced to the nation from the National Palace, "the far-reaching decision of the government of Mexico to recover the oil wealth that foreign enterprises have been exploiting…(Krauze 474)" Subsequently, the National Cooperation Fund was created to help raise funds to pay the expropriated companies their assets. Finally, on June 7 1938 *Petróleos Mexicanos* (Pemex) was created (Falcón-Bautista 15). If we believe Krauze's description of this conflict between the oil companies and the federal government we can safely assume that the Cardenas' administration felt threatened and disrespected by the multinationals which had exclusive territories within Mexico.

The nationalization of the oil companies in 1938 began a new era for the oil sector in Mexico. From 1938 to 1976, the newly created state-owned company focused on providing subsidized oil for the domestic market in order to industrialize the country (Shields 9, del Villar 124, Falcón-Bautista 19). Pemex would provide subsidized oil for the industry, agriculture, commerce, and transport sectors as part of the state led development model (Suárez-Guevara and Palacios-Solano 24). As a result, Pemex's performance as an oil producer was very poor during this period due to high production costs and low revenues (del Villar 133). In fact, from 1971 to 1974 Mexico imported oil to meets its domestic needs (Falcón-Bautista 19). From 1936 to 1967, the belief among Mexico's ruling elite was that Mexico's oil was for Mexico.

The third phase for the history of Mexico's oil begins with the administration of José López Portillo (1976-1982) when Mexico becomes a major exporter of crude oil. "Output rose from 191,000 barrels per day in 1973 to 2,746,000 b/d in 1982 (Philip 39)." The various neoliberal administrations that have ruled Mexico since 1982 have maintained the policy of exporting as much oil as possible. At the same time the federal government has chosen not to contribute enough funds to modernize Pemex. Thus, currently Pemex finds itself in a difficult situation with critical issues to solve.

Mexico and the United States

I believe that it is important to talk about Mexico-United States relations when discussing oil privatization because oil has traditionally played a key role in the relations between these two countries. Among the reasons why Mexico's oil is critical for the United States are the following: 1)Mexico's oil is important for the United States' national security, 2)Mexico and America's share a common border which creates many opportunities for cooperation and conflict.

First, it has been confirmed multiple times that Mexico's oil is critical for America's national security because in critical times when Mexico's oil sector went through rapid changes the United States indirectly intervened. The classic example discussed in the literature is the oil nationalization of 1938. The important point to highlight in this discussion is how the United States responded to the expropriation of American and British oil companies. It is believed that America seriously considered sending the military to Mexico to secure the oil wells (Williams 56, Meyer 583). As Levy and Székely (1987) put it, American and British oil companies pushed unsuccessfully for military intervention in order to "teach rebellious Mexico a lesson (Levy and Székely 229)." Fortunately for Mexico, Roosevelt's Good Neighbor Policy "was intended to keep the nations of the Western Hemisphere together when the outbreak of world conflict was most feared (Levy and Székely 228)."

Second, the basic fact that Mexico and the United States share a common border creates many opportunities for interaction where oil has usually played a key role. The issues of trade and migration are examples of Mexico and the United State's interdependence. On the one hand, Mexico's exports of goods to the United States accounted for 86 percent of its total exports in 2005, and imports of goods from the same country accounted for 53 percent of Mexico's total imports.[2] On the other hand, the United States exports of goods to Mexico accounted for 13.3 percent of total exports in 2005, and imports of good from the same country accounted for 10.2 percent of the United State's total imports.[3] As Levy and Bruhn (2001) put it when discussing trade relations between the two countries, "Mexico has also become more central for the United States. It is the second-largest market for U.S. goods, after Canada. However,

[2] Retrieved June 14, 2007, from: http://www.state.gov/r/pa/ei/bgn/35749.htm.

[3] Retrieved June 14, 2007, from: http://www.census.gov/foreign -trade/statistics/highlights/top/top0612.html.

the size of the U.S. economy limits the effects of this shift. Because the GDP of the United States is more than twenty times that of Mexico, even substantially increased bilateral trade is a drop in a large bucket (Levy and Bruhn 254)." In regards to international migration, the United States has decreased Mexico's unemployment and social problems by unwillingly accepting Mexico's emigrants. Furthermore, the United States geographic location makes it a natural market for Mexico's oil because of low transportation costs relative to the Middle East's oil exporting countries. In addition, the fact that the United States needs oil and Mexico has a surplus of it increases their interdependence (Williams 47). It is true that oil is only one of the many issues in the bilateral agenda, yet for Mexico oil is one of its few bargaining tools.

The relationship between these two countries regarding oil has intensified in recent years since Mexico has increased its oil exports to the United States. In 2003 it exported about 1,500,000 barrels of oil per day (Please see table 3). In 2004, more than 80 percent of Mexico's oil went to the United States, making Mexico the number two exporter of oil to the United States after Canada (Shields 46). Put in a different way Mexico's oil accounted for 16 percent of America's oil imports (Shields 46).

It is clear that Mexico has increased its production of oil in the last ten years by almost one million barrels per day (Please see table 4). It is also obvious that the current rate at which Mexico is extracting oil is not sustainable. Some students of oil politics believe that Mexico might have to import oil in ten years if it does not seriously invest in new exploration projects (Shields 47). If that is the case, why is Mexico choosing to export large amounts of oil? Part of the answer can be found in the low levels of taxation in Mexico and the pressure to provide services to Mexico's population that the federal and state governments face.

The current status of Pemex

The current status of Pemex is important to our discussion of privatization because there are pressing problems that Pemex needs to solve. In any discussion of whether to privatize a state-owned company questions of efficiency, profitability or the overall status of the company are usually considered. In the case of Pemex I belive it is important to ask: 1) How long can oil last in Mexico based on the current oil reserves and oil production? 2) For how long can Pemex function under the current taxation system?

For how long will Mexico's oil last? It has been reported by oil analysts that Pemex will run out of oil in about 11 years (Shields 54). The solution is pretty simple since Pemex needs to either increase its oil reserves or decrease its oil production but it is extremely costly to carry it out. In 2003 Pemex was ranked 8th in the world in terms of oil reserves by having 16,041 **million** barrels. (please see table 1). Compared to the countries with the most oil reserves in the world which are Saudi Arabia and Iran, Mexico has very few oil reserves. For instance, Saudi Arabia has 259, 400 million barrels and Iran has 125,800 million barrels (please see table 1).

Now, if we look at oil production for 2003, Mexico was ranked 3rd in the world when it produced 3, 723 thousand barrels per day, and Saudi Arabia and Iran once again were the top two oil producers (Please see Table 1). It is helpful to put Pemex in comparative perspective in order to clearly see that Pemex is producing oil at a very rapid rate. Put in a different way, Mexico is ranked eighth in the world in terms of oil reserves but it is ranked third in terms of oil production per day. As we can observe, there is a big gap between oil reserves and oil output, thus, Pemex does not have the oil reserves to have the luxury to be one of the three main oil producers in the world.

We would expect to see Pemex trying to improve its total reserves or decrease its production but the reality is very different. Let me first define "total reserves" which are divided into three types: proved, probable and possible. "Proved reserves" have a probability of 90 percent of being exploited. "Probable reserves" have a probability of 50 percent of being exploited. "Possible reserves" have a probability of 10 percent of being exploited (Shields 53). In 2004, "total reserves" attributed to new discoveries were replenished by only 57 percent of its total, or 916.2 million barrels (Shields 55). Even worse, "proved reserves" attributed to new discoveries in 2004 were replenished by only 14.9 percent of its total or 240.8 million barrels (Shields 55). The international norm is that "proved reserves" need to be replaced by 100 percent every year, yet, this is not happening in Mexico. Oil experts believe that Mexico has large amounts of oil deposits in deep waters of the Gulf of Mexico but it is very expensive to extract them and currently Pemex does not have the technology to do it by itself (Shields 52).

To make matters worse Cantarell's output is beginning to decrease. Cantarell is the oilfield with the most reserves in Mexico and the second largest oilfield in the world. In the year 2004 Cantarell produced 2, 079,000 barrels per day which is 61.4 percent of Pemex's total production. (Please see Table 5). It is widely believed that Cantarell was the main reason why Mexico became an oil exporter due to its geographic location near the cost, extraction costs are only about 2.83 dollars per barrel (Shields 106). To put it in perspective, the United States produces twice as much oil as Cantarell, and needs 500,000 wells when Cantarell only has 212 wells (*Mexico and Nafta Report*). Yet most analysts believe that Cantarell has reached its full potential, and now it is in decline. In early August 2006 Pemex announced that Cantarell's output was expected to decrease by 9 percent for that year by producing only 1,860,000 barrels per day (*Mexico and Nafta Report*).

Another problem that eventually Pemex needs to solve is the high levels of taxation under the current system? Pemex's revenues per year are enormous but the state monopoly is heavily indebted because it is heavily taxed by the federal government. On the one hand, for 2003, Pemex ranked 8th in the world when its gross income was $ 55, 926 million (Please see Table 1). On the other hand, it paid $ 59, 543 million to the federal government, which means that it registered a loss of $ 3,617 million (Shields 27). The reason is Federal taxation. Until January 2006 the government's tax on Pemex was 60 percent; at that time it was lowered to 52 percent (*Mexico and Nafta Report*). Currently the federal government collects about a third of its total revenue from taxing Pemex (Shields 37).

Conclusion

In this paper I have tried to provide a general review of the issues that are important in any discussion of oil privatization in Mexico. Eventually the various political actors in Mexico are going to have to reform Pemex if they want the state owned oil monopoly to stay in business. Is Pemex in need of serious reform? Yes, and the Mexican government needs to act quickly before there is no viable solution to the multiple problems that Pemex faces. Should the state monopoly be privatized? Absolutely not. There are many private companies that go bankrupt on a daily basis, thus, privatization does not equate success. What is important is how the oil monopoly is managed, not who owns it. Mexico's federal government needs to realize that Pemex should not be used as one of its main sources of revenue. Oil is a scarce commodity and the countries that have it must use it wisely.

Table 1: The Top 20 oil companies:

	Reserves (a)	Production (b)	Gross Income (c)	Net Income (d)	Employees
1. Saudi Aramco*	259,400	9,045	93,100	n.r.	53,954
2. Exxon Mobil	12,856	2,516	222,654	21,510	88,000
3. NIOC (Iran)*	125,800	3,852	28,400	n.r.	115,000
4. PDV (Venezuela)*	77,800	2,500	45,000	n.r.	35,000
5.BP	10,081	2,121	235,899	10,482	103,700
6. Royal Dutch/Shell	7,257	2,334	205,212	12,496	119,000
7. Chevron Texaco	8,599	1,808	114,666	7,230	61,533
8. Total	7,323	1,661	119,250	8,005	110,783
9. Petróleos Mexicanos*	**16,041**	**3,723**	**55,926**	**-3,617**	**138,215**
10. PetroChina**	10,997	2,120	36,783	8,402	417,229
11. Conoco Phillips	5,171	1,241	91,392	4,735	39,000
12. KPC (Kuwait)*	99,000	2,170	36,000	n.r.	13,000
13. Sonatrach (Argelia)*	10,533	1,729	28,000	n.r.	50,000
14.Adnoc (Abu Dhabi)*	55,210	1,200	25,470	n.r.	85,000
15.Petrobras (Brazil)**	9,722	1,701	36,483	6,559	48,798
16.Pertamina (Indonesia)*	4,722	1,139	22,357	n.r.	27,600
17.ENI (Italia)**	4,138	981	60,556	6,364	72,405
18.Repsol YPF	1,882	594	42,577	2,302	31,121
19.Lukoil (Rusia)**	15,977	1,622	22,299	3,701	41,000

20.NNPC (Nigeria)	21,153	2,166	22,184	n.r.	16,000

Note: These rankings are from the *Petroleum Intelligence Weekly* (12/13/2004), based on the results for the year 2003. Source: Shields (2005), p.24.

(a) Liquid hydrocarbons, **in millions** of barrels.
(b) Liquid hydrocarbons, **in thousands** of barrels per day.
(c) In millions of dollars.
(d) In millions of dollars.
n.r. = Not reported.
*State-owned.
** PetroChina is 90 percent state-owned, Petrobras is 32 percent state-owned, ENI is 30 percent state-owned, and Lukoil 8 percent state-owned.

Table 2: Pemex: Number of workers for 2004 (includes transitory workers)

Corporate (includes medical services)	19,750
Pemex Exploration and Production	50,102
Pemex Refinery	45,820
Pemex Gas and Basic petroquimica	12,086
Pemex petroqumica	14,387
Total	142, 145

Source: Shields (2005), p. 42.

Table 3:Pemex: Exports of crude oil to main buyers (in barrels per day)

Year	United States	%	Spain	%	Japan	%	Others	%	Total
1988	684,900	52	204,700	16	174,400	13	242,700	19	1,306,700
1990	720,600	56	213,100	17	145,700	11	197,600	15	1,277,000
1992	797,200	58	238,700	17	89,700	7	241,500	18	1,367,100

1994	960,800	73	154,400	12	81,200	6	110,000	8	1,307,400
1996	1,209,600	79	95,200	6	86,900	6	143,100	9	1,534,800
1998	1,341,500	77	134,800	8	31,500	2	233,400	13	1,741,200
2000	1,241,600	75	142,800	9	34,600	2	233,100	14	1,652,100
2001	1,285,400	75	144,400	8	16,700	.9	263,800	15	1,710,300
2002	1,339,000	79	141,000	8	10,000	.5	215,000	13	1,705,000
2003	1,437,000	78	143,000	8	11,000	.5	253,000	14	1,844,000
2004	1,482,000	79	149,000	8	0	0	239,000	13	1,870,000

Source: Shields (2005), p. 48.

Note: Exports to the Netherlands Antilles which had the United States as its final destination were included in the "Others" column. The exports were as follows: 67,000 b/d (barrels per day) in 1996; 86, 500 b/d in 1998; 109,700 b/d in 2000; 132,500 in 2001; 92, 000 in 2002; 105,000 in 2003; and 116,000 in 2004.

Table 4: Pemex: production of crude oil.

Year	Barrels per day
1995	2,617,000
1996	2,858,000
1997	3,022,000
1998	3,070,000
1999	2,906,000
2000	3,012,000
2001	3,127,000
2002	3,177,000
2003	3,371,000
2004	3,383,000
2005*	3,371,000

* For first semester.

Source: Shields (2005), p. 59.

Table 5: Oil production in barrels per day

Year	Cantarell	Other oilfields	Total
2002	1,851,000	1,326,000	3,177,000
2003	2,054,000	1,317,000	3,371,000
2004	2,079,000	1,304,000	3,383,000

Source: Shields (2005, p. 75.

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