MEXICO-U.S. OIL RELATIONS

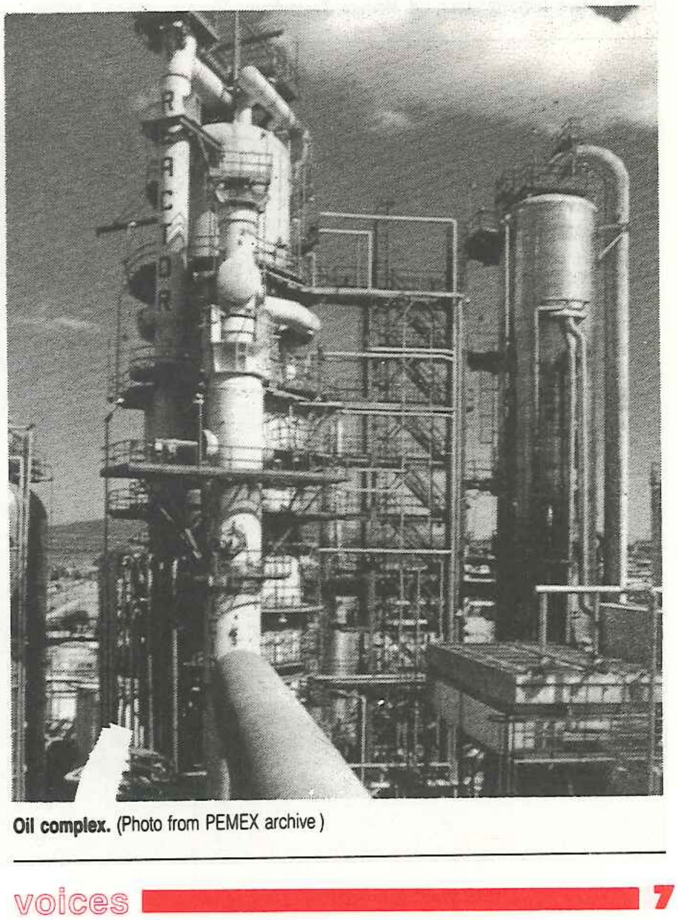
Marcela Serrato

With its effect on the energetics sector, external trade and international finances, the oil slump of 1986 marked the beginning of a new stage in the energetics relations between Mexico and the U.S. In the months immediately following the third oil slump, there were clear differences between them respecting the balance of cost against benefit. From the U.S. point of view, even although the fall in prices would have grave consequences in the oil industry and the economies of the oil producing states, there would definitely be greater benefits for the country and for the community of industrialized countries in general, in terms of accelerated economic growth and the reduction of unemployment levels and inflation.

Setting prices through the simple mechanism of supply and demand means they will be excessively low and even below production costs

For its side, the Mexican government maintained that, as much with oil producing countries as consumers, the new oil crisis would have a predominantly negative outcome, since the lowering of prices of crude oil would affect not only the oil industry itself but also the behavior of the economy, finances and international trade. The majority of oil producing countries and exporters would have to apply drastic economic measures, practically to the point of seeing their margin for internal manouevre used up. The oil importing countries would find themselves forced to reduce their dependence on external oil supplies, and to develop new policies on alternative sources of energy. For the sake of a supposed short term benefit of greater economic growth with lower inflation, obtained through lower oil prices, the stability and rational equilibrium of the world economy would be endangered.

On the other hand, within the framework of the new oil crisis, the U.S. maintained its traditional support for the interaction of supply and demand in international oil price fixing, considering it consistently as "just another raw material". In contrast, Mexico maintained a position favoring intervention in the oil market to regulate supply and price protection with two basic arguments. In the first place, oil is a raw material of strategic importance whose exploration, production, refining and commercialization re-

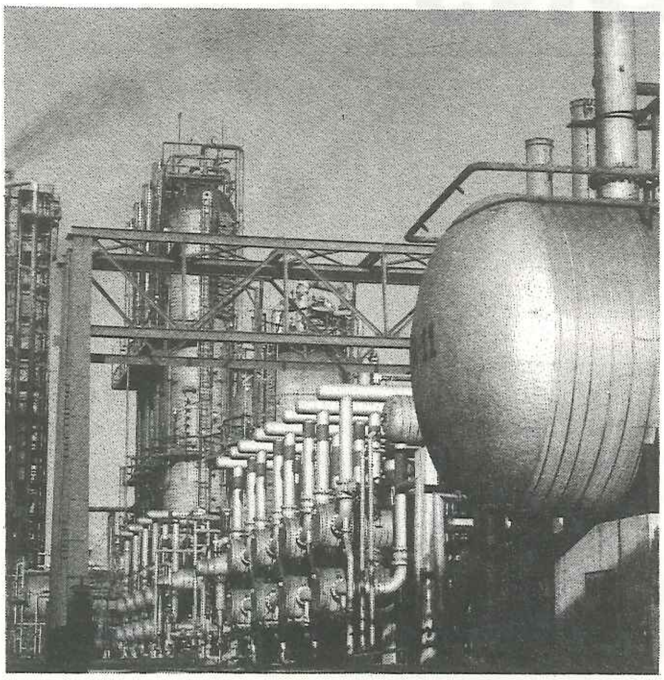


Oil complex. (Photo from PEMEX archive)

Director of the International Market Analysis, Ministry of Energy, Mines and State Industry (SEMIP).

quires long term program design and inversion projects that involve thousands of employees and an investment of thousands of millions of dollars. This cannot be subjected to the arbitration of speculative forces.

In the second place, in a context of an extreme excess in production capacity of between 11 and 12 MBD principally among member countries of the OPEC and representing around 45% of oil traded internationally, price fixing only through the criteria of supply and demand would imply excessively low price levels, in many cases, below cost. Even with the supposition of an increase in demand of 2 percent annually, equivalent to around 900 MBD, it would take 10 years to close the breach between real and potential supply and demand in the oil market.



DEMEX Metal removing unit, Cd. Madera, Tamaulipas. (Photo from PEMEX archive)

Economic Strategy

Consequently, the stablization of prices through automatic mechanisms would imply, on the short term, a long period of erratic movements resulting in high costs as much for exporting as for importing countries, in a global framework of uncertainty and instability. On the long term, it would result in a new oil crisis with abrupt price rises in the next ten years, should an excessive dependence on oil again arise.

Instead of waiting for stability in the world hydrocarbon market, and heeding only the market forces, Mexico applied a double strategy of coordination with other exporting countries with efficient mechanisms to regulate the oil supply and give oil an economic and strategic value, apart from the strictly commercial one.

While incorporating its economic value, the price of oil would take into account the exploration costs, and the development of new oil fields that would guarantee the renewal of the volumes extracted and secure the role played by this energy source in the world energetics balance. The great differences existing between various regions in the world in terms of extraction costs would also be taken into account in this economic valuation. In incorporating its strategic value, oil would be priced at its correct value not only in terms of energetics but also economics and politics, allowing for aspects of independence and vulnerability.

Suddenly, the negative effects of the oil crisis in the American oil industry began to appear, in terms of lowering of production, and increase in demand and imports. The expected stimulus of price-lowering on economic

PEMEX: MARKETS AT HOME AND ABROAD

In 1986, the international oil market lived through one of its most critical stages, when the price of crude oil fell by almost 50% in the first three months of the year.

As a result of this, and other factors, the global income, from external sales of Mexican oil and derivatives decreased considerably.

Mexican oil production is the exclusive responsibility of Mexican Oil (PEMEX), a state monopoly since 1938, when it was expropriated from the American companies who had worked it for years.

Since the Mexican subsoil is rich in hydrocarbons, it soon became the country' s main economic activity and the most important export item surpassing agricultural production and other aspects of the economy.

In this sense, the fall in oil prices in the international market was a real blow for Mexico, at present suffering from one of the worst crises of its history. The details of sales of oil and its derivatives in 1986 are as follows:

In 1986, PEMEX had a positive balance of trade, 5 451.6 million dollars, down by 59.8% on the 1985 figures.

Crude oil constituted 90% of the total value of external sales: oil products 8.7% and petrochemicals 0.5%.

The average daily export of crude oil was 1 289.6 million barrels (MBD), of which 44.4% was Istmus and 55.6% Maya.

Over the year crude oil was exported to 23 countries, of which the five main clients were the U.S., 50.6%; Spain, 15.2%; Japan, 14.1%; France, 6.3% and Israel, 3.0%.

The average export price per barrel was 11.84 dollars, in December reaching 13.67 dollars.

The oil product exports were 115.7 MBD, 14% down on the 1985 figures.

The oil products registered a positive trade balance of 181.3 million dollars, of which the most outstanding were diesel exports, 28.9%; petrol 26.8%; liquid gas, 11.6%; pentane, 11.0% and gas, 9.9%.

The petrochemical exports reached 187.9 million tons, 22.6% down on the 1985 figures.

During 1986 there was a general decrease in the volume of internal sales. Oil products fell by 1%, natural gas by around 19% and the petrochemicals by 1.88%, with respect to the previous year.

In what in oil industry terms is considered to be an unprecedented fall, the liquid gas sales fell by 1.3%, turbane gas and diesel by 4.1% and 6.8% respectively.

In contrast, gas and combustibles increased their sales by 2.7% and 2.2% more than in 1985.

The petrochemicals fell considerably in the sales of acetaldehyde, 24.8%, butadiene, 37.8% and paraxylene, 15.9%.

There were gas price increases to the order of 84.2% for Nova and 71.4% for Extra, although this did not affect sales.

The same occurred with domestic gas, whose price increased over the year by a total of 250%.

As a result of price increases and in spite of the decrease in sales, the institution's income rose by 101% over the previous year, going from 1 570 212.2 million pesos to 3 156 880.7 million pesos.

growth did not happen. At the same time, there were some important shades of changes in the external oil policies, with a clear effect on the course of energetic relations with Mexico.

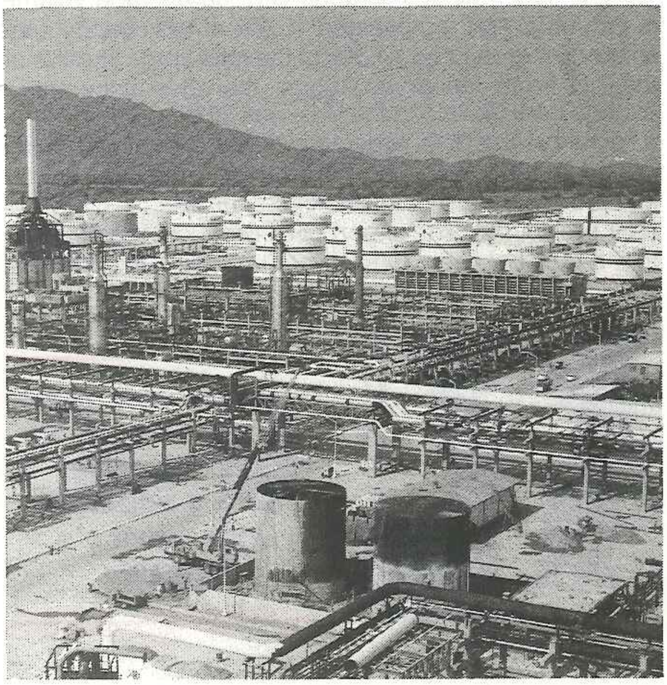
Although the U.S. continued to cling to the principle of the interaction of supply and demand, rejecting proposals such as a tax on crude oil imports or the application of import cuotas, they finally recognised that no one was benefiting from the lowering of prices and even made discreet diplomatic interventions in favor of the stablization of the oil market. In fact, while the Energetics Secretary, Herrington, publicly repeated the U.S. obligations towards the free markets, the Vicepresident, Bush, paid a visit to Saudi Arabia in the summer of 1986 to convey a message contradicting this. Weeks later, OPEC agreed on the re-establishment of production controls to raise prices.

To a great extent, this change in the U.S. position came from an awareness of the effect on national security signified by the price fall of 1986. In a medium term, the persistance of these tendencies pointed clearly to an international setting that would lead to an abrupt rise of prices.

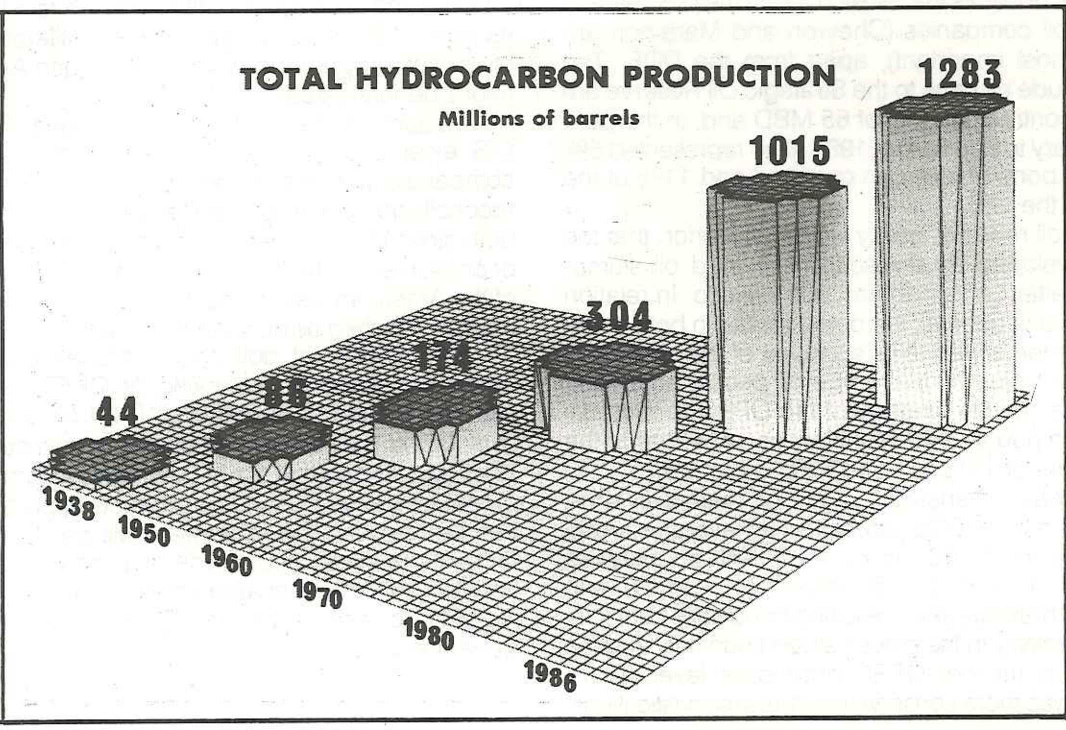
In March 1987, the U.S. Department of Energy (DOE) issued a bulletin on energetics security where, on the basis of the growing external vulnerability provoked by the third oil slump, they urged the Reagan administration to give renewed impetus to the traditional axis of the policies of energetics (energy saving, diversification of resources, sources and increase of strategic inventories) and to establish fiscal and reglamentary measures to promote the development of the oil industry in this country. In particular, the DOE demanded priority for nuclear energy, with the search for formulae to obtain the support of the member countries of the International Energy Agency (AIE) for the future development of this energy source.

In principle, a greater U.S. awareness of the significance of energetics security is advantageous to Mexico because it implies a lowering of their dependence on supplies coming from unstable zones such as the Middle East, and more strategic interest in supply sources, both closer to home and stabler, such as Mexico. Nevertheless, what is imperative in strategic terms might not be so in strictly commercial terms. (And in the last instance, for a country such as the U.S. with a serious external trade deficit, it is probable that the commercial considerations will prevail finally over the strategic).

Recent experience indicates that, in spite of constant reference, on the part of the U.S. authorities, to the problem of vulnerability signified by the growth in crude oil imports, these are maintaining their tendency to in-



Tank area in Salinacruz, Oaxaca. (Photo from PEMEX archive)



crease, and the participation of the Organization member countries stays around 50%, for reasons of a strictly commercial order: a greater competitivity in OPEC crude oil sold at official prices against non-OPEC crude oil (Mexico among others) sold also at prices that are official but tied by formulae for spot prices.

Oil Trade Mexico U.S.

The export of Mexican crude oil to the U.S. has been subject to production capacity, to the availability that is controlled by a self-imposed export platform, and to the criteria of geographic sales diversification. From January to September 1987, Mexico sold the U.S. an average volume of 625 MBD that represented 46.6% of this country's total crude exports and 14.3% of the total crude imports of the U.S. From January to August, the value of the crude exports from Mexico to the U.S. was 2632 million dollars, a figure that was 39% larger than that obtained in the same period in 1986, reflecting the average price recovery to levels of 16.60 d/b in the American market (11.93 d/b a year previously). The export of oil products from Mexico to the U.S. between January and August 1987 reached 80.7 MBD, equivalent to 43% of the total import of products in the U.S.

Francisco Rojas, director of PEMEX.
(Photo from PEMEX archive)

The new turn taken by the U.S. in its foreign oil policy is more compatible with Mexico's position

The folder of clients that Mexico has in the U.S. already includes 18 oil companies (Chevron and Marathon are among the most important), apart from the DOE. The volumes of crude oil sales to the Strategic Oil Reserve are subject to a contractual goal of 65 MBD and, in the period from January to September 1987, they represented 5% of the total exports of Mexican crude oil and 11% of the total sales to the U.S.

The new oil relations policy with the exterior, that the U.S. has developed as a result of the third oil slump, promises a better understanding with Mexico. In relation to the oil market in general, the oil authorities in both countries have demonstrated their approval of the tendential changes of the international crude oil prices, attributing success to the double strategy of the OPEC to reestablish production quotas and official prices, as well as to the support actions of various non-OPEC countries.

The prospective analyses of the oil market at short term, created by the DOE, predicted an average crude oil price of around 17.70 p/b by 1987, with an increase in world consumption of 0.8 percent (400 MBD) with respect to the previous year, resulting principally from lower economic activity in the industrialized countries, and the maintenance of the non-OPEC production level. On its part, Mexico was more conservative in its prognostications,

In a country like the United States, with its serious foreign trade deficit, commercial interests prevail over strategic concerns

with an estimate in the 1987 budget of a yearly average price of 12 d/b. The dynamics of the Mexican crude oil prices and the achievement of the export goals produced an income, through crude oil sales to the exterior during the first nine months, of 6042 million dollars (MMD), which exceeds, by 348 MMD, the calculated for the entire year.

As much from the Mexican as the American point of view, even when the basic aspects of the market (supply and demand) appeared to have reached a certain equilibrium, this should not be seen as a reason for complacency. In fact, in the months of July and August 1987, the prices of crude oil reached their highest level in the year for eminently speculative reasons (the raising of the American flag in Kuwaiti ships, and the deepening of hostilities between Iran and Iraq) without necessarily reflecting the fundamental conditions of supply and demand in the short term. The violation of the OPEC production quotas (estimated in 2.2MMBD during the third quarter of the year), and the consequent excessive supply, practically nullified the effect of the Persian Gulf War of raising prices. By the end of the year, this reduction could determine, in its turn, a lower OPEC production and a price stabilized around 18 d/b.

The only disturbing element in the commercial oil relations of Mexico and the U.S. in recent dates has been the application, for December 1987, of the U.S. crude oil tax on imports for the treatment of toxic waste (the so-called "Superfund"). Together with other crude oil-exporting countries that were affected, Mexico demanded the General Agreement on Trade and Tariffs (GATT) to remove this tax on the grounds of discrimination, and received a positive answer to the petition. In bilateral meetings, Mexico emphasized its preoccupation with the fact that little taxes of the "Superfund" type could proliferate in support of various programs in which the Reagan Administration might be interested.

To sum up, the new turn taken in recent dates by the U.S. external oil policy certainly indicates a position more compatible with that of Mexico. To a great extent, this reconciliation of interests is the result of an awareness on both sides of the adverse effects on everyone, producer or consumer, of the low oil price policy, and, in particular, of the American view of the energetics problems originating from the third oil slump in questions of national security.

For the moment, both countries take the position, common in the oil maket, of backing the OPEP's effort to regulate supply and to re-establish fixed official prices. The evolution of the bilateral oil trade at government and company level shows that the U.S. remains the most solid part of Mexico's crude oil and oil products exporting effort. As can be foreseen, this closeness will persist while the effects of the lowering of crude oil prices persists and will intensify with a greater awareness of their vulnerability with regards to energetics on the part of the American government.□