Mexico's (black) golden egg

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Mexico's oil reserves are being sized up for future development by Mexicans and Americans alike. An FTA which includes oil threatens to siphon the profits from Mexico's most lucrative industry into foreign coffers. Mexico would prefer to keep the profits at home, but can it move ahead without outside investment?

This article has two aims: the first is to explain U.S. interest in Mexican oil, and the second, to discuss the possibility of including oil in the FTA negotiations. It should be remembered that any conclusions would be purely tentative, because if anything has caused confusion and given rise to speculation it is the precise place of hydrocarbons in the FTA.

This is thanks in part to the statements of U.S. officials who seem to imply that the incorporation of oil on the agenda is a practical fact. This, and Mexican refusal to include oil, or to allow foreign capital to own shares in Mexican oil reserves for constitutional reasons, all tend to shroud the subject in a fog of uncertainty.

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U.S. interest in Mexican oil

The most obvious reason for U.S. interest in Mexico's oil reserves is the decline of existing reserves in U.S. territory and the high costs of drilling in older fields. Certain estimates indicate that the future will not be any rosier for U.S. proven reserves (28.2 billion barrels including condensates)[1], and if consumption increases there is a virtual certainty that the U.S. will become increasingly dependent on imported oil, with the consequent implications for national security.

This is no big news for the U.S. oil industry. It was in just this situation that the first oil shock took place. What then has reignited U.S. interest in Mexican oil? First of all, departing from previous American energy strategies, the Bush administration admits that U.S. vulnerability cannot be totally eliminated even with stringent restrictive measures. The new energy strategy doesn't attempt to achieve self-sufficiency in energy products or to bring down oil imports if such a measure would involve a high economic and environmental cost.

In President Bush's energy policy announced in February of 1991, a series of measures were proposed which intend to raise domestic supplies and encourage oil production in other countries. Mexico was envisioned as a high production country, along with Venezuela. That the emphasis was on production capacity and not simply on reserves reflects the U.S. oil industry's interest in co-investments and associations with the producer nations, particularly with Mexico.

Another reason for the reemergence of the oil question is related to the sharp drop in Mexico's oil reserves (from 72,500 MMDB in 1983 to 66,450 MMDB in 1990), and fears over reduction in future supplies to the U.S. market.

According to George Grayson, a Mexican studies expert, if this trend continues Mexico will become a net oil importer by 2004[2]. A recent Pemex report states that even with massive

1 It is estimated that if the present trend continues, reserves will be down to 15.1 billion by 2010. *Annual Outlook for Oil and Gas 1990*, Washington, D.C. May 1990, p. 23.

2 Grayson, G. "Can Mexico Prime the Oil Pump Without Foreign Capital," the *Wall Street Journal*, 19th of October, 1990.

foreign investment Mexico will be a net importer by 1997[3]. Independent organizations such as the Overseas Development Council are even more explicit, pointing out that "...it is the stagnation in Pemex that explains why the subject of hydrocarbons is essential in the FTA discussions[4]."

"The U.S. is beginning to acknowledge that its increasing dependence on foreign oil cannot be eliminated..."

Of course anxiety over increased consumption in producer nations is nothing new, particularly in developing ones, because it obviously means a reduction in the amount of oil for sale to developed consumers. What is new is the conviction that Mexico cannot get itself out of this state of stagnation without millions of foreign dollars.

Another side of America's encouraging stance toward increasing reserves and production in other countries has to do with the environment. In the Bush administration's National Energy Strategy one of the proposed alternatives for raising domestic oil supplies is to exploit areas classified by even the administration as environmentally fragile, such as the Continental Shelf (OCS) and the Artic Wild Life Reserve (ANWR)[5], areas that up to now have been strictly off-limits to the oil companies.

Environmental groups in the United States have so much clout that they alone they may be enough to drive the U.S. oil industry to other countries with weaker or non-existent anti-pollution laws.

The costs of environmental protection would be paid for by the amendment to the Clean Air Act of October 1990. It raises costs of oil and automobile industries and consumers to pay for the higher emissions standards, cleaner air, and reduced acid rain called for in the act. Petrochemical industries are motivated to use Mexico as a production platform for the important California market because stricter anti-pollution laws there compel producers to cushion themselves against exorbitant cost increases[6].

"... and as Mexican reserves fall, U.S. oil companies think they can lend a hand"

Finally, Mexican oil has remained a part of U.S. energy strategy ever since the 70's because of its relative security, though there has been no shortage of observers watching the shrinkage of Mexican reserves. What is clear is that Mexican oil will continúe to act as a secure reserve for U.S. energy products.

Pemex's traditional private trading partners, Chevron, Phillips, ARCO, etc. would also like to buy more Mexican crude oil, and they have made clear their interest in becoming directly involved in Pemex's activities. In other words, they want risk contracts and direct participation rather than merely acting as financial suppliers to the state-owned Pemex[7].

Another group hungrily looking toward Mexico is the suppliers of services and oil technology, some of which have been associated with Pemex for years. It should be pointed out that the rapprochement between Pemex and the oil companies stems in part from the Mexican government's search for joint investments -both with the U.S. and other countries- to offset the decline in productivity and to find the capital needed by Pemex[8].

Alfa, Cydsa, Mitsubishi, Dow Chemical, Shell and Exxon have all been solicited[9] for investments, although the Mexican government has been obliged to limit the conditions under which they might participate so as not to violate the Mexican Constitution.

The petrochemical industry is another powerful group that has begun to air its deeply felt desires. Its negotiating position is built on the assumption that Mexico is the active seeker behind the FTA and wants to speed up negotiations so that free trade may sooner go into

3 Christopher, Whalen, "Depleting Asset. Trouble Ahead for Mexico's Oil Monopoly," *Barron's*, 22nd of October, 1990.

4 *El Economista*, 16th of April, 1990.

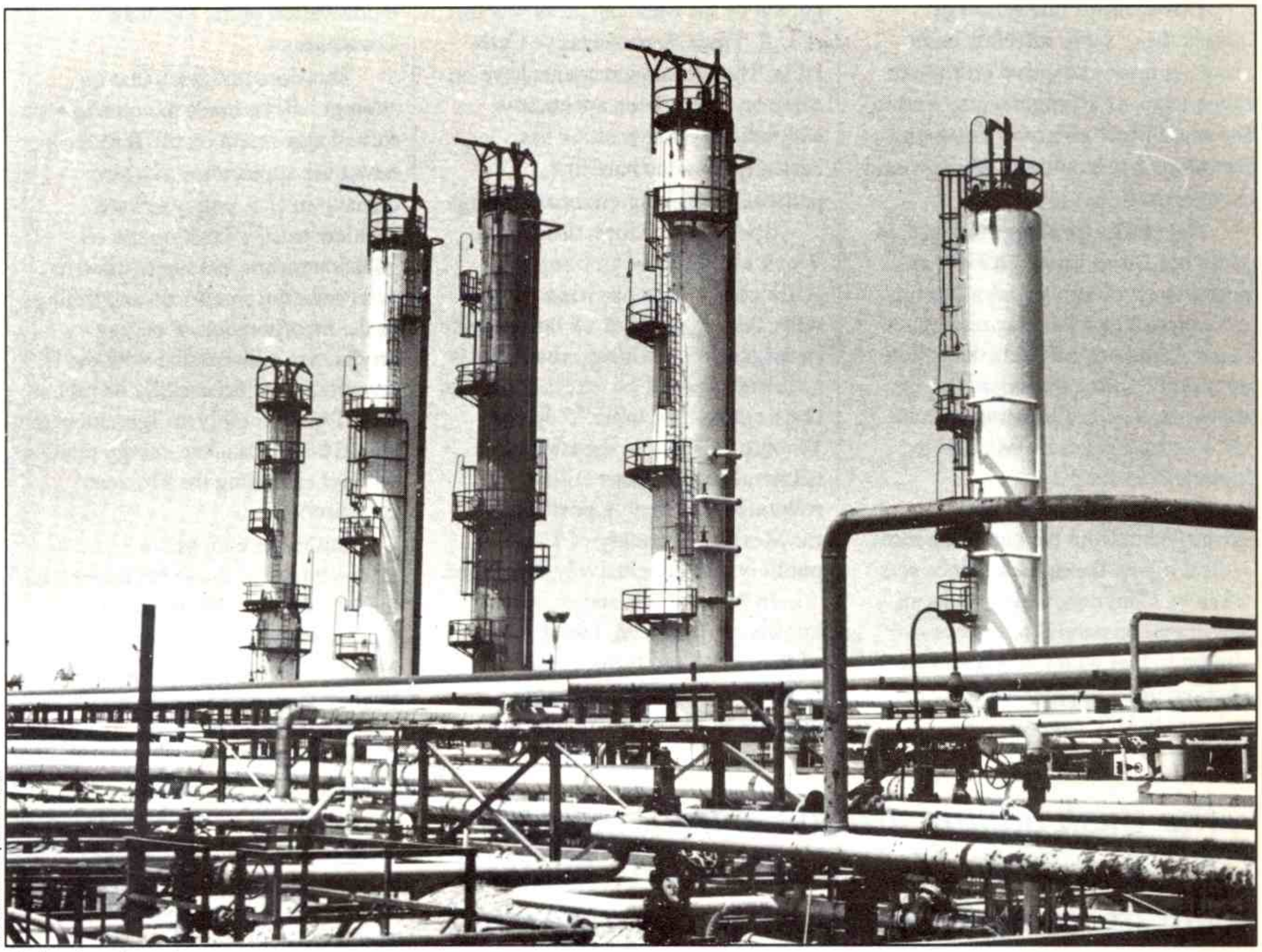
5 Department of Energy, "National Energy Strategy," Washington, D.C., February 1991, p. 14.

6 "Recomienda GAO a Washington pedir autonomía de la industria petroquímica de Pemex en el TLC," El Financiero, 13th of March, 1991.

7 For more about these companies, see David Clark Scott, "Mexico's Oil Giant Pemex May Open to Private Sector," *The Christian Science Monitor*, 18th October 1990 and, *The Oil and Gas Journal*, Tulsa, Oklahoma, 27th of August, 1990.

8 Pemex executives have said they need U.S. $20 billion over the next five years.

9 Salinas, Roberto, "Privatization in Mexico; Good but Not Enough," Backgrounder, Heritage Foundation, November 1990, p. 12.


Julio Candelaria/Cuartoscuro

Under American siege.

effect. Hence Mexico should be making the concessions[10].

The petrochemists want absolute control over both the plants and their operations. They are looking for equal access to energy resources and oil derived inputs, and above all they want guarantees that foreign investment reforms, such as that of May 1989, will not be rescinded at the end of Salinas de Gortari's presidential term.

Although there are other interest groups, such as border entrepreneurs, whose agendas will also be considered at the negotiations, the above are the real heavyweights and their positions typify the industry's wheeling and dealing.

Mexican oil in the FTA negotiations

It is pretty clear that Mexican oil has a role in American energy strategies. However, the debate over oil and the FTA has given undue importance to Mexican oil within the larger field of U.S. energy options. Admittedly, the debate is relevant in Mexico because of the uncertain fate of natural resources if the treaty now under discussion becomes a reality.

It is well known that Mexico can credit itself with more importance than it really has in U.S. thinking, and this is true in the case of oil. The Mexican press has tended to overemphasize both Mexican oil's strategic importance and role in the U.S. market at the same time that it bemoans U.S. greed for Mexican oil resources. This might be due to the lack of accurate official information about what the Mexican government is really negotiating, and the dichotomy between official assurances that oil will not be part of the negotiations and the reality which seems to give those assurances the lie.

Through July Mexican representatives insisted that the Constitution would not be changed in any way, nor would the volume and price of Mexican crude oil be negotiated. Public officials up to the President have promised that the ownership of oil resources is not at all in doubt.

10 Declarations made to the press by Dick Patterson, Head of Govt. Relations, Dow Chemical Co., "Que se incluya la petroquímica básica en el TLC," *El Financiero*, 5th of February, 1991.

However, in international circles these same officials have shown a more receptive attitude to other types of arrangements, and to the search for "creative" financing formulas that would not run aground on constitutional law[11].

Generally speaking, the U.S. is plugging for as broad an FTA as possible -preferably including oil, of course. Yet it has dawned on some American officials that oil is so fraught with symbolism that it would be best not to mention it at all, let alone pressure Mexico to include it in the FTA.

As to the rest of the U.S. government, from the outset the most radical oil-on-the-agenda stance was taken by Congress, which seeks an agreement on natural resources similar to that with Canada and the opening up of the Mexican oil industry to U.S. capital.

Some in Congress intimated that once negotiations were underway pressure should be brought to bear so that energy should not remain outside the agreement[12], and there were even some who wanted to link approval of the fast track to the inclusion of oil in the talks.

The administration itself seems to suffer from differences of opinion. One of the opinions most quoted by the Mexican press was that of U.S. Trade Representative Carla Hills. Though her statements have on some occasions been apparently contradictory, her position has basically been the hard line, particularly in congressional hearings.

Speaking before the House Ways and Means Committee, Hills said, "Our position is that with the exception of large-scale immigration nothing, absolutely nothing, should be excluded from the negotiating table[13]." In the Toronto meeting at the start of trilateral negotiations Hills reiterated just that -a position that the Mexican Secretary of Trade publicly and conclusively dismissed.

In Mexico this stance is best known as American, but an analysis of the twists and turns of the negotiations and the probable changes in the Mexican energy sector suggests that a parallel strategy exists in Mexico.

Bush's policy is tactical, and envisions an agenda devoid of any open pressure to introduce discussion of hydrocarbons, or oil. Bush must be well aware of the political risk that these imply for the Salinas administration, yet at the same time must be convinced that the changes will eventually come about[14]. He also believes that the financial needs of the energy sector and the demand for U.S. capital and technology will impel modification of the Mexican Constitution.

This does not mean that no attempt will be made to come to some formal agreement on oil. It reflects rather the appearance of a new element in U.S. policy toward Mexico: trust[15]. Trust on the oil question means leaving Mexico to determine the conditions and timing of the incorporation of energy products in a discussion with the U.S. that would not necessarily be part of the FTA, preferably an agreement that would institutionalize energy relations without amending the Mexican Constitution.

But in the end, to the astonishment of many Mexicans, on the 9th of July, 1991 the Mexican Secretariat of Trade announced that oil and petrochemicals had filtered into the negotiations under the heading "other sectors of industry." It was insisted that their incorporation would not mean changing the Constitution because the discussion would be limited to the commercial aspect. That is to say, the possibility of doing away with tariffs and non-tariff barriers gradually.

"The Bush administration is treading softly, convinced that Mexico will decide by itself that its financial needs make constitutional change worthwhile"

From speeches to facts

The significant changes in the Mexican energy sector are becoming ever more apparent, suggesting possible privatization of activities formerly tied to the public sector. In the oil industry this trend affects everything from exploration to the distribution of fuel products. These changes have not collided with Constitutional law because they have avoided ownership of services and risk contracts, keeping themselves busy with the purchase of services and technology.

Meanwhile some activities once considered strategic no longer are. In sum, all the conceivable arguments to

11 See David Clark Scott, "Mexico's Trade Chief Sees Role for U.S. Oil Investment," *The Christian Science Monitor*, 18th of October, 1990.

12 "El TLC deberá permitir la participación directa de EU en la exploración y producción petrolera en México," *El Financiero*, 5th of April, 1991.

13 "Privatizar todas las paraestatales excepto Pemex, el objetivo del TLC con México," *El Financiero*, 21st of February, 1991.

14 *Excelsior*, 8th of April, 1991.

15 I would like to thank Adolfo Aguilar Zinser for this suggestion.

de-politicize oil and turn it into a negotiable commodity have been tried.

Another means through which this was tried was external financing through the U.S. and Canadian EXIMBANK. Credit deals and negotiations with U.S. and Canadian companies are yet another link in a process that since 1986 has clearly tended toward the privatization and internationalization of the Mexican oil industry. Credit will obviously speed up this process.

The U.S. press called this loan a watershed in Mexican policy, noting at the same time that it was the biggest financial transaction in the history of Pemex. The loan granted by the United States was requested by the Mexican government in November 1990 at the meeting between Salinas and Bush in Monterrey, Nuevo León[16]. The total package amounts to U.S. $5.6 million over a period of 5 years, of which U.S. $ 1.5 million have already been disbursed.

Under the circumstances, this cannot be considered as just another loan to Pemex. It has meant a virtually open door for U.S. firms offering services and oil technology. So far two contracts have been drawn up, one with Triton of Houston to work in the Bay of Campeche, and the other with Smith International to install new drills (the most modern, known as the "horizontal" method) in the Chicontepec field.

The Triton contract follows the "keys in hand" plan[17], originally intended for the petrochemical industry. It marks the beginning of foreign financing for a Mexican oil industry eager to see foreign corporations participating in complex petrochemical activities.

The Canadian EXIMBANK credit of U.S. $500 million serves Canadian interests by opening up a market for Canadian businesses, particularly those from the oil province of Alberta, which provide technology and services from exploration to refining and marketing. Nevertheless, there are other industries which interest Canadians more[18].

capitalized by acquiring greater access to Pemex, and thereby the possibility of concretizing a relationship which for many years neither Mexico nor the United States had wished to formalize.

American tactics have been to leave it up to the Mexican government to persuade Mexicans that their oil industry cannot get out of the doldrums of recent setbacks -increases in Mexican gasoline imports and the projected increase of petrochemical and natural gas purchases -without a strong dose of financing to improve production and refining capacity.

"The Salinas administration has tried to de-politicize oil, turning it into merely another negotiable commodity"

That external financing is being channelled into one of the sectors that officially will not be part of the FTA, that Triton won a contract just prior to congressional approval of the fast track, and that in June Pemex, following the suggestion of the U.S. petrochemical industry, freed another of its basic petrochemicals (ether methyl terbutyl) for foreign investment by demoting it to a secondary petrochemical product, might make one think that the Mexican government is giving way, not only in response to pressures to include energy products in the negotiations, but possibly as a shrewd attempt to ease the approval of the fast track and thus open the doors to the capital necessary for salvaging the oil industry.

Conclusions

The FTA negotiations have once again brought Mexican crude to American attention. The U.S. has

If Mexico is using its oil potential to attract capital from abroad it should consider carefully its negotiating leverage, and take into account that the United States has other energy options both domestically -large coal fields and significant reserves of natural gas- and in other parts of the world, some of them, Venezuela and Kuwait for example, offering perhaps greater availability.

Furthermore, the international oil market will probably continue to be a buyers market, enabling the United States to put off worrying -up to a certain point. Finally, international competition for capital is another prominent feature of this industry, and countries such as the Union of Sovereign States have shown that they too require a good deal of financing in order to halt the recent slide of their production. This makes them direct competitors for the loans Mexico is drilling for

16 "Salinas under Pressure to defend Possible U.S. Role in Oil Industry," Nations and World, *The Houston Post*, 29th of November, 1990.

17 In this case Triton would provide drilling equipment, services, materials, know-how and logistics.

18 "México no puede ser obligado a incluir el sector energético en la negociación," *El Financiero*, 22nd of May, 1991.