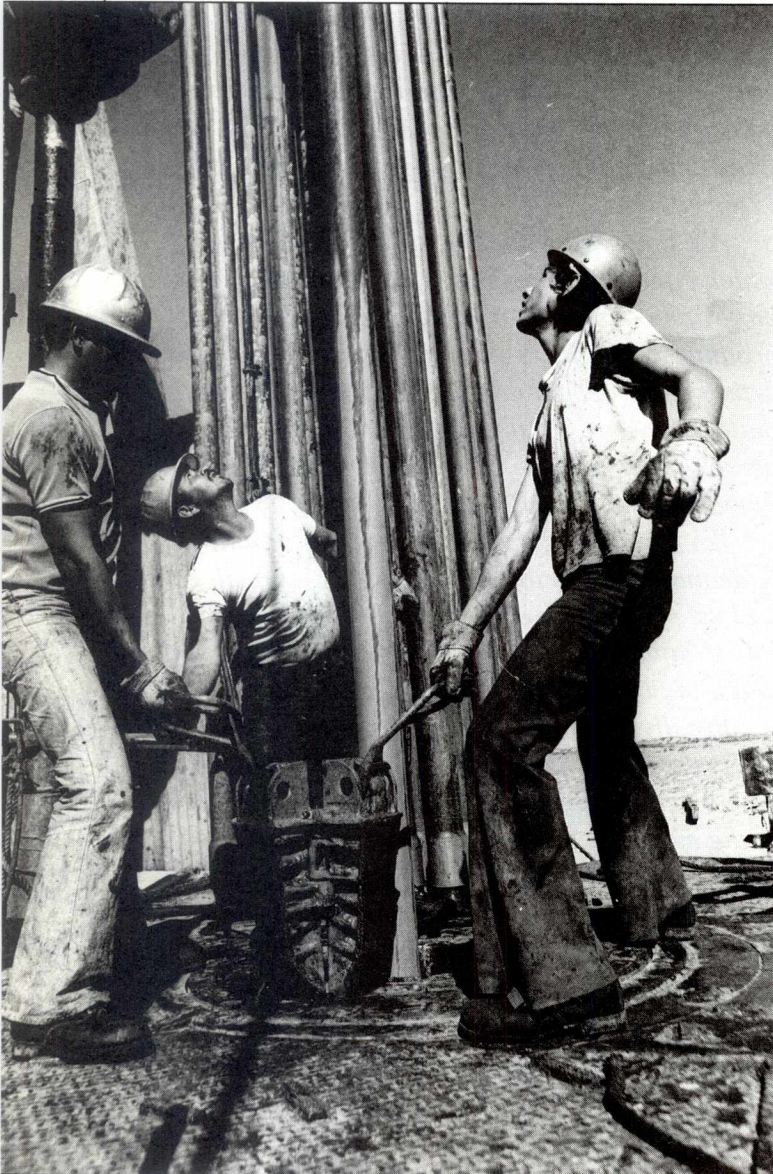


The oil agenda at the end of the 20th century

*Víctor Rodríguez-Padilla**

*Rosío Vargas***

Rogelio Cuellar.



Sovereignty over resources

The exercise of sovereignty, by whatever means it judges suitable to its particular circumstances, is the inalienable right of every government to make decisions within its boundaries. Sovereignty in the field of natural resources means effective control over these resources and their exploitation. In the case of hydrocarbons, the Mexican state has exercised this right constitutionally, by awarding itself exclusive and complete ownership of oil and gas found within the nation's territory, both in the subsoil and at surface level; the exclusive right to carry out all activities related to said products; and decisions relating to the regulation and planning of these activities.

Until the early 1980s, Mexico and many other producer countries tended to equate the principle of sovereignty with that of autarchy, confusing sovereignty with nationalism. At that time the oil industry was the responsibility of the state, which took charge of everything having to do, directly or indirectly, with hydrocarbons.¹ In the '90s this schema has become unsustainable, for a series of reasons:

1. The result of management based on short-term political criteria and objectives has brought decapitalization, inefficiency, low productivity and loss of technical and economic control over the petroleum chain. Serious problems have been caused by not taking into account the fact that oil is an international, high-risk,

¹ Víctor Rodríguez-Padilla, "Sovereignty Over Petroleum Resources: The End of an Era?", *Energy Studies Review*, Vol. 3, No. 2, October 1991.

* Coordinator of the master's program in energy engineering, Faculty of Engineering, UNAM.

** Researcher at the Center for Research on North America (CISAN), UNAM.

capital-intensive industry which matures over the long term.

2. The new two-headed structure of the international oil industry, in which producer countries control production and commercialization while multinationals have majority control over transport, refining and distribution, makes it imperative to consider the interdependence linking the two groups.

3. The global context of a retreat by government in favor of the private sector, bringing with it the disincorporation and privatization of government economic activities.

4. The opening up of trade (joining GATT), the formation of economic blocs (such as that of North America with the signing of NAFTA) and the massive acceptance of foreign capital (Mexico's new investment law is one example) are measures which exercise pressure for freeing up investment and trade in the hydrocarbon sector, as well as for a growing integration of the local and foreign oil industries.

Five key, interrelated points make up the oil agenda for the end of this century: sovereignty over resources, Pemex's link to the state, the relation of Pemex to the private sector, participation in the world market and U.S. energy policy towards Mexico.

The current world-wide tendency is to separate the tasks of regulation on the one hand from property in resources and the exercise of productive activities on the other. The latter are left in the hands of the private sector and the former in those of the state.²

Due to considerations of an economic, financial, commercial, political, ideological and geo-economic nature, Mexico is on the road to a different solution, one better fitted to its present situation and to the specifics of

the Mexican petroleum industry. The principle of this solution is that the best way to exercise sovereignty to the fullest is by conserving:

Exclusive and complete ownership of hydrocarbons in the subsoil. This means excluding risk contracts *stricto sensu* and service contracts with access to production, in which payment for services rendered is made in kind, providing the contractor with property rights over oil and gas *in situ*, directly in the first case and indirectly in the second. Nevertheless, the possibility of making other "arrangements" satisfying the interests of both parties is not excluded.

*A monopoly of essential activities under Pemex's responsibility.*³ This implies, on the one hand, defining which activities are considered to be essential and, on the other, granting the state company broad autonomy for defining and implementing a strategy allowing it to fulfill the tasks assigned to it by the nation, with the means it considers necessary, including associations with the private sector (for more effective, efficient and less costly operation), so long as this does not compromise present and future production.

Regulation of oil-related activities. This is through an ad hoc regulatory commission.

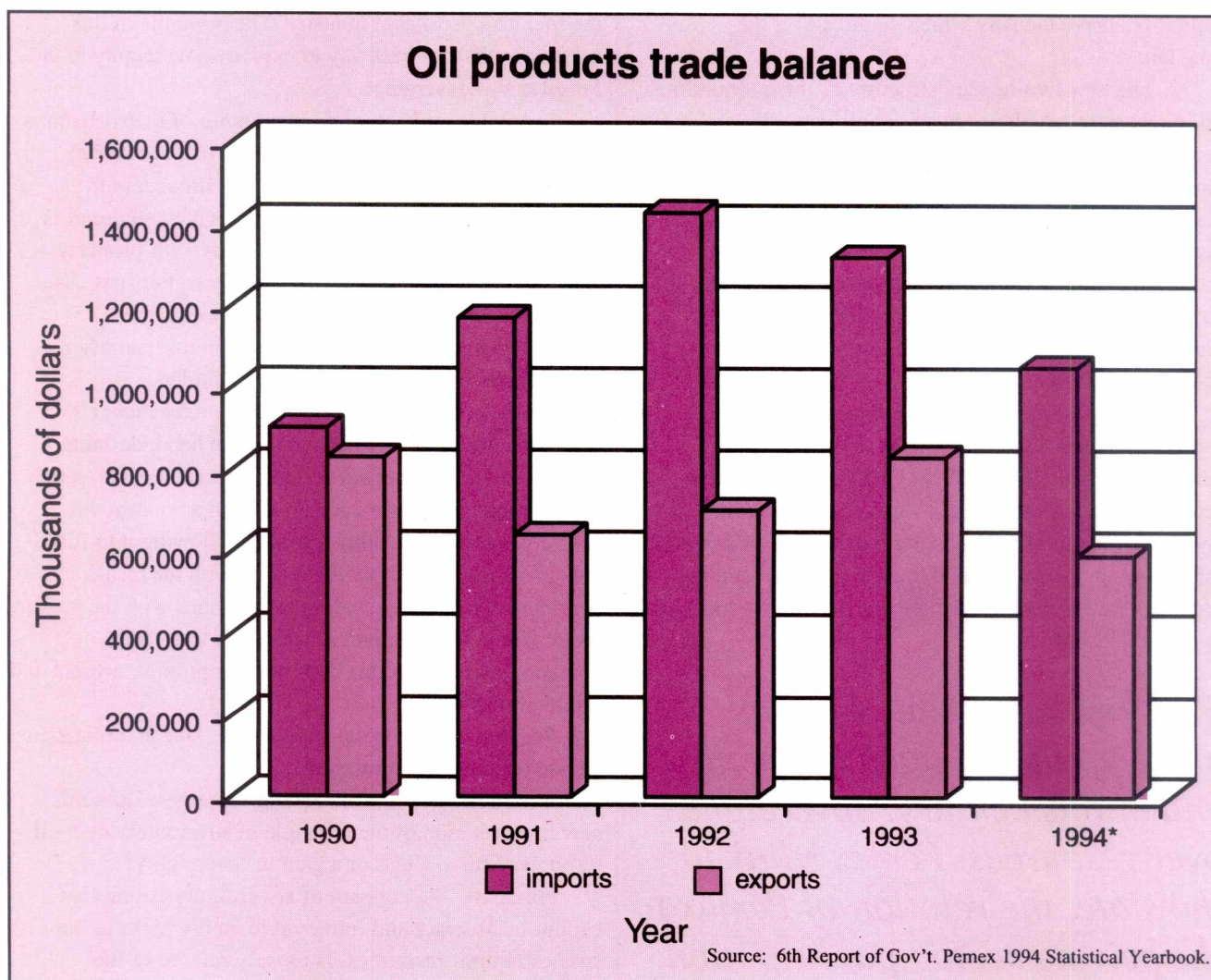
At this point it is worth asking ourselves: Does this new interpretation of the principle of sovereignty over oil resources lead to a loss or a gain in sovereignty?

For some, the concept of sovereignty is one that cannot be abstract and immovable, and which, in the case of natural resources, is closely related to the "national project" to which one aspires. The strategy for advancing towards the fulfillment of that project, realistically and objectively, requires a coherent and consistent interpretation of sovereignty. This would therefore be defined according to context, circumstances, the relation of forces and the dominant ideology.

This pragmatic interpretation is refuted by those who consider that the notion of sovereignty has a precise meaning: being able to make decisions and take action freely and autonomously, without the resulting decisions and acts affecting, sooner or later, the future power to decide and act. Thus, from this perspective, managing the oil industry according to exclusively commercial objectives and criteria is incompatible with sovereignty. For example, granting long-term guaranteed supply contracts, within the framework of a strategic alliance, is an act which limits sovereignty, since such a decision "ties up" that part of production which is committed to such contracts, and the

² Ascher William, "Survey of Issues in Government Policy and Public Management of State Oil and Mining Companies in Developing Countries," *Natural Resources Forum* 18 (1), 1994, pp. 3-11.

³ Pemex is Petróleos Mexicanos, Mexico's state oil company.



government is not free to use that portion at its convenience. This is the case even if such contracts involve a secure buyer and an acceptable economic return on the exported product. The state loses the possibility of selling hydrocarbons to whomever, for economic, political or geostrategic reasons, it chooses to sell to, and the sovereignty which was to be protected is thereby diminished.

The state's relation to Pemex

In the drive to achieve higher levels of productivity and technical, administrative and operational efficiency, Pemex has carried out spectacular changes, making the shift from a "closed" growth model to an "open" one. These changes have included streamlining the company, operating along business lines, modernization of its administration and industrial programs, heightened fuel

quality and the incorporation of environmental protection measures.⁴

Nevertheless, it is still not a modern enterprise with the ability to participate efficiently in an ever more competitive world market, promptly fulfill its responsibilities, face challenges nor take advantage of the opportunities it encounters. The result is a certain degree of vulnerability vis à vis other players on the international oil stage, since up to the present its relation to the government has remained substantially unchanged.

Despite its restructuring, the state company continues to be managed in line with non-business objectives, and continues to serve as the

⁴ See F. Colmenares, *Pemex: crisis y reestructuración*, Mexico City, UNAM, 1991; and H. Leos, *Origen y naturaleza de la modernización de Petróleos Mexicanos*, Mexico City, UNAM, 1993.

indispensable, fundamental instrument for dealing with macroeconomic imbalances. Its financial and administrative autonomy is quite limited, as is the openness of its decision-making; its fiscal burden —albeit improved— is unstable and inefficient from an economic standpoint; and key decisions and personnel appointments are the prerogative of Mexico's president.⁵

The government's objectives with regard to petroleum —objectives to which Pemex is subordinated— are counterposed in a number of ways. Among them are to respect the Constitution, renew reserves and production capacity, face up to increasing technical costs, maintain export-generated profits, satisfy internal demand, provide the national treasury with substantial resources, keep the hydrocarbon sector under control, provide an opening to the private sector, maximize the price of petroleum sold on the world market, preserve the environment, etc. In light of the situation, it is urgent and fundamental to establish priorities.

Today, the most important task is to redefine Pemex's relation to the state, especially in terms of the role each will play in designing and carrying out oil policy and long-range strategic planning.

The central objective of this new relationship must be to allow Pemex to operate as a business with the following characteristics:

- *Autonomy.* With the freedom and ability to make economic, financial, commercial and technological decisions without interventionism and without being conditioned by the government's political commitments and objectives.
- *Modernity.* So it can act efficiently and productively, broaden technical and economic

control over the oil and gas chain, and be highly competitive.

- *A solid presence abroad.* So it will remain part of the world oil industry long after Mexico's reserves have run out, and carry out profitable business for the nation's benefit.

In line with these conceptions, the state must focus exclusively on defining oil policy and seeing that it is followed: regulating the activities of the national company and its partners, supporting Pemex's international strategy, and applying a fiscal regime that strikes a balance between the principles of economic efficiency and political acceptability. This means, in the first place, that the fiscal regime be applicable, equitable and neutral; and secondly, that it reflect the role petroleum policy is projected to play within overall



⁵ V. Rodríguez-Padilla, "Les sociétés nationales et la modernisation du régime fiscal dans les pays exportateurs d'hydrocarbures," *Économies et Sociétés*. Cahiers de l'Ismea, Série l'Économie de l'Énergie (6), September 1994.

economic policy, without the company becoming, in practice, an appendage of the Treasury as it has been until now.

Pemex and the private sector

Foreign companies' resources and experience can be put to work for Pemex's benefit, helping fill its considerable needs on the financial, technological, industrial, administrative and commercial levels.⁶ Contractual and financial modalities exist which can facilitate this cooperation without a loss of ownership over geological assets. This would, however, not be the case with regard to industrial assets, which from now on are to be shared.

Among these modalities are service contracts, which can cover all oil activities, from geological surveys through product distribution; contracts for facilities rental; financial participation in refining abroad; and strategic alliances for joint action throughout the

petroleum chain. The breadth and time-frames for establishing associations are key and should be the object of serious, deep-going study.

Well-designed strategic alliances could allow the national company to ensure commercialization and, above all, to improve its technical and economic grasp of the petroleum chain. These alliances, above and beyond simple risk and service contracts, could —under certain circumstances— be the solution to decapitalization, technological lags and Pemex's technical and administrative inefficiency.⁷

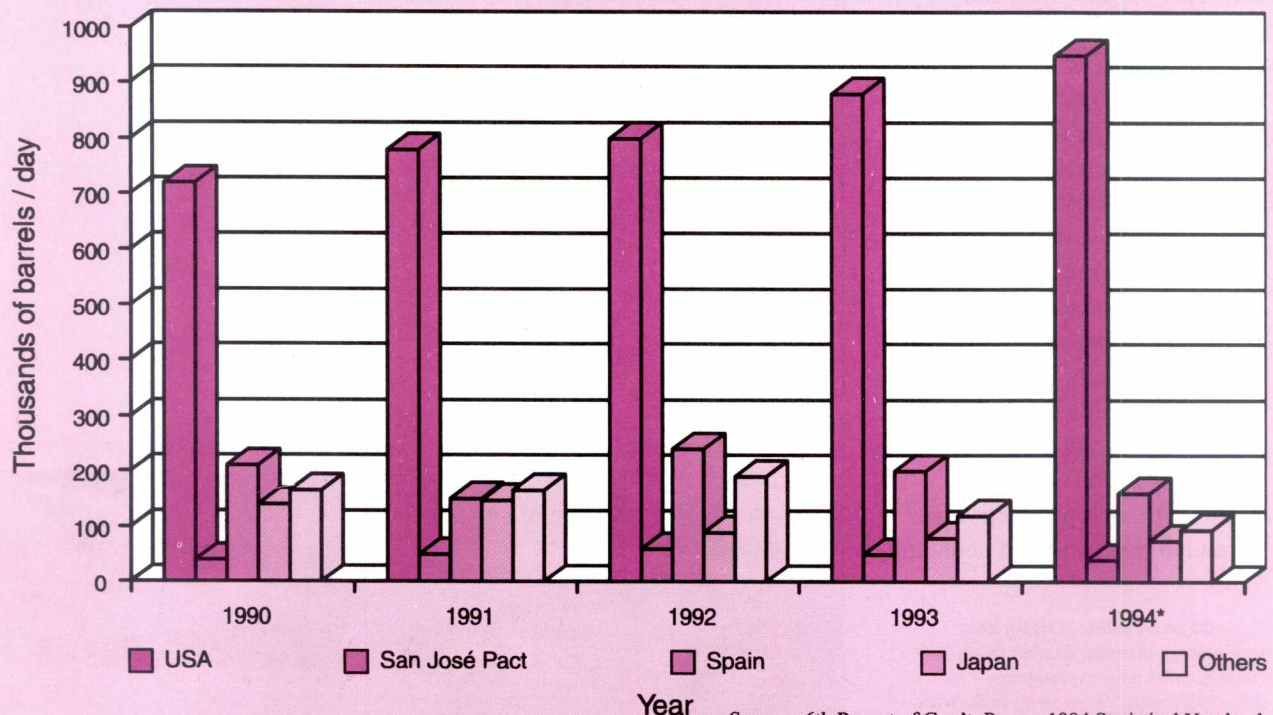
Nevertheless, these accords are subject to negotiations in which each party must look out for its own interests, in addition to having important political repercussions which should be very carefully weighed. We should not let ourselves be swayed either by the siren songs of those who describe the enormous benefits to be had with the entry of foreign companies,⁸ nor by the

⁶ B. Bourgeois, "Les relations entre compagnies pétrolières nationales et internationales: des accords contractuels aux relations de coopération?", international IEPE/CGEP seminar, *L'avenir des sociétés nationales des pays exportateurs d'hydrocarbures*, Paris, May 26-27, 1994.

⁷ V. Rodríguez-Padilla, "Las nuevas formas contractuales en la industria petrolera internacional: contratos de servicio o de riesgo?", *El Financiero*, February 8 and 16, 1994.

⁸ G. Baker, "Tax Consequences of the Unthinkable: U.S. Oil Companies as Pemex, Upstream Partners?", *Mexico Policy News*, No. 9, Fall, 1993.

Oil exports by geographic destination



Source: 6th Report of Gov't. Pemex 1994 Statistical Yearbook.

catastrophic scenarios prophesying massive imports if such entry is not accepted.

Participation in the world market

Oil-exporting countries have very diverse objectives in the economic, ideological, social, political and military fields. If we add to this their different economic, demographic and geological characteristics, we get multiple—and even counterposed—development models and oil pricing strategies. Nevertheless, all these countries share the same need and demand: maintaining world market stability.⁹

⁹ A. Ayoub, "Rente pétrolière et développement économique dans les pays arabes producteurs de pétrole," *La Revue de l'Énergie*, No. 451, 1993.

Since 1982, when the oil market became a "buyers' market," OPEC has been experiencing the uncertainties and instability of an "impossible cartel." Its chronic instability has produced similar effects everywhere, convincing all and sundry of the need to work towards a stable market based on three conditions:

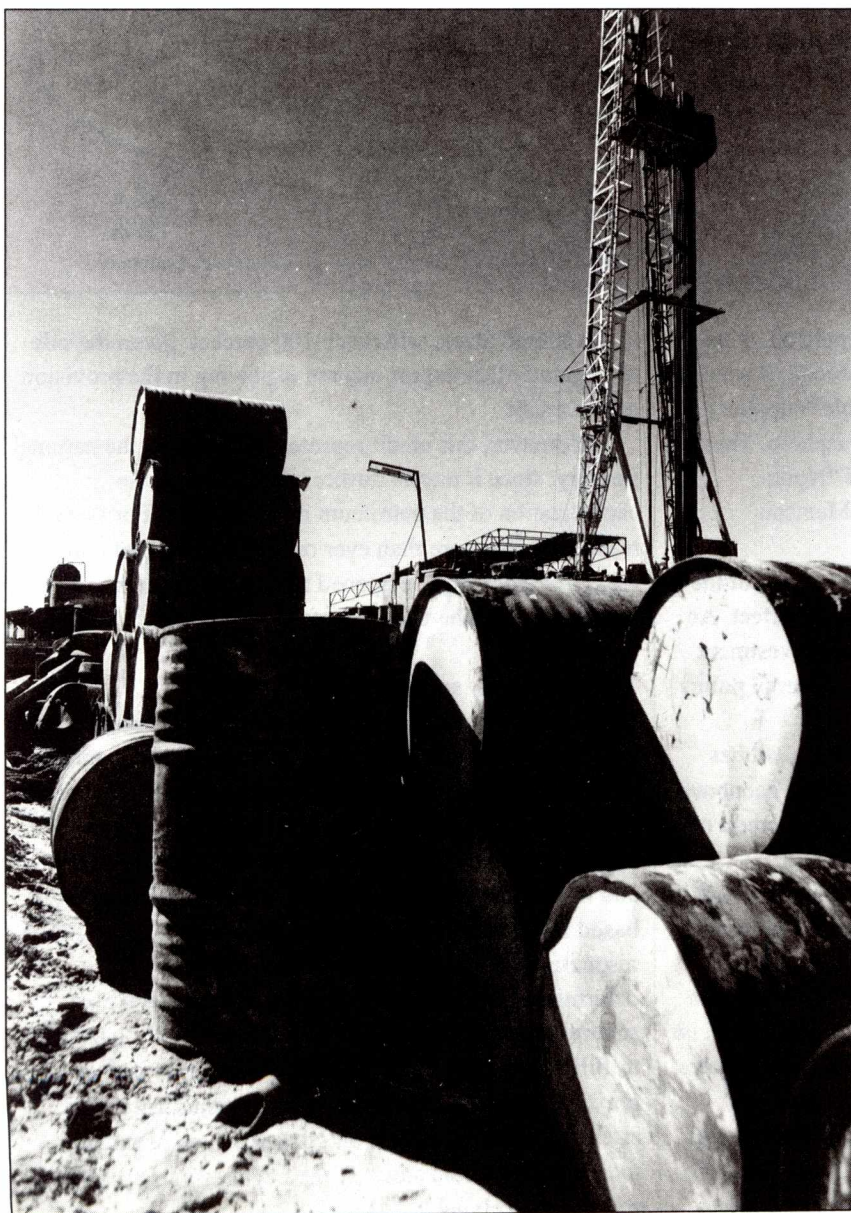
1. Returning to a certain form of vertical integration.
2. Taking into account the structural changes that have occurred since that time, with a recognition of the interdependence among producer countries, companies and consumer countries.
3. Designing and putting into effect new forms of "upstream" and "downstream" cooperation.

Mexico must define the role for which it is most suited and which it can play in the restructuring and integration of the international petroleum industry. Right now, what is required is a reformulation of export policy. To increase sales volume—for conjunctural budgetary reasons—when there is a situation of overproduction in no way contributes to market stability; on the contrary, this accelerates the exploitation of reserves. On the other hand, to sacrifice short-term profits in favor of longer-range benefits is to think of future generations.

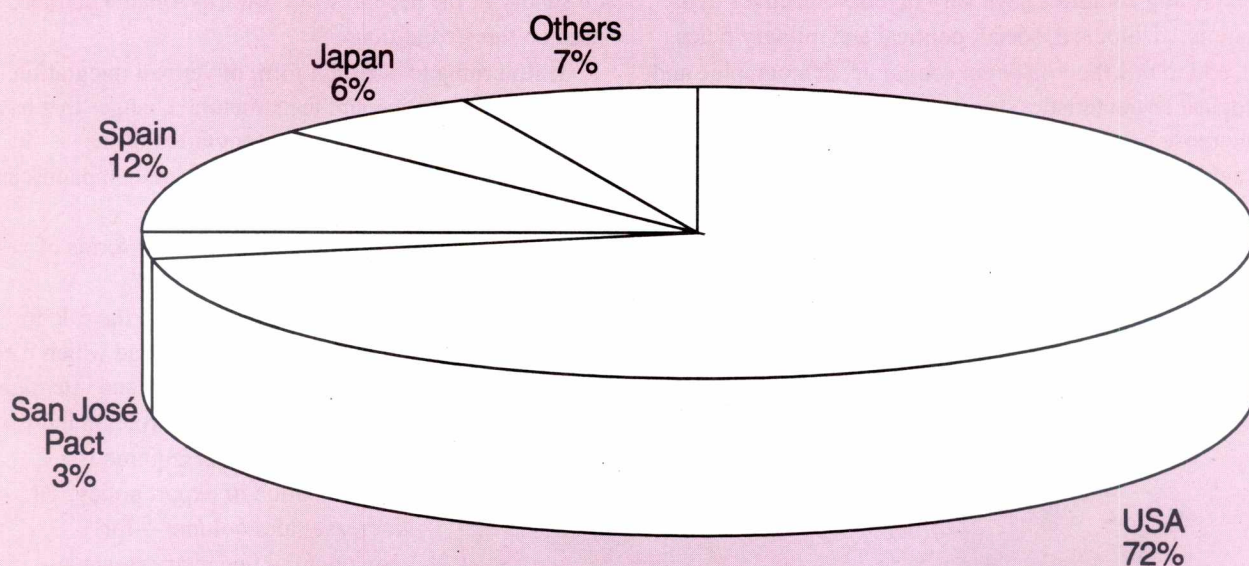
U.S. energy policy towards Mexico

Two key aspects will have to be analyzed over the course of the rest of this decade.¹⁰ In the first place, the pressures on the Clinton administration to take on a more active role in questions related to the environment, security and income distribution. Belief in an unavoidable and growing dependence on the producer countries of the Persian Gulf has led some specialists and officials to pressure the White House to see that the objective of energy security is not left solely to

¹⁰ R. Vargas and V. Rodríguez-Padilla, "El mercado petrolero internacional y la seguridad energética estadounidense," *El Financiero*, June 9 and 20, 1994.



Percentile distribution of exports by geographic destination 1994



Source: 6th Report of Gov't. Pemex 1994 Statistical Yearbook.

market forces. The policy to be followed would be, at the domestic level, greater energy efficiency; abroad, it would involve strengthening production by "reliable" suppliers, above all those located in the Western Hemisphere. Thus it is not surprising that there is already talk of "North American oil reserves," most of which are Mexican reserves.

The other pertinent aspect will be the evolution of the regional energy market since NAFTA went into effect. An important part is played in this regard by both investment trade flows and the reformulation of national energy policy by Mexico, the United States and Canada.

In light of the 1995 Mexican financial crisis, oil has once again taken on a leading role in the national economy. As in the '80s, oil has become the collateral for a credit on the order of 20 billion dollars, granted by the U.S. executive branch, so that Mexico can restructure its short-term debt with this credit's backing. Only this time, the conditions are much harsher and give a glimpse of the terms of the future relationship with the U.S. The 7 billion dollars which Pemex obtains annually from oil sales will be deposited in a Bank of Mexico account at the United States Federal Reserve (the "Fed"), with the evident goal of guaranteeing payment on the credits. If the prior prognosis was that by late 1995, 80 percent of total oil sales would be concentrated in the U.S. market, it now looks like exports

to the United States will reach 100 percent, given the role of guarantor that export income is playing in the provision of this credit.

Moreover, this credit represents a drain on the national treasury, since it means further restrictions on the capitalization of the petroleum industry itself. For these reasons, today more than ever one can expect that many areas of Pemex will be opened to direct foreign investment, especially from the United States.

Towards a new social contract in oil

It is urgently necessary to work out a new social contract with regard to oil, establishing that the income generated by this finite, non-renewable resource should be directed solely towards raising the population's living standards. It is likewise necessary to redefine the goals of oil policy and to design a suitable, effective, open and consensus-based long-term strategy. Suitable, in terms of respecting and strengthening the principle of self-determination, national interests and independence, sovereignty and security; effective, so it will be possible to fulfill the objectives established; open, in order to prevent changing situations from determining its interpretation; and based on consensus, so Mexican society will be conscious of the expectations, challenges and risks involved. ❧