The Oil Dumping Controversy Mexico's Perspective

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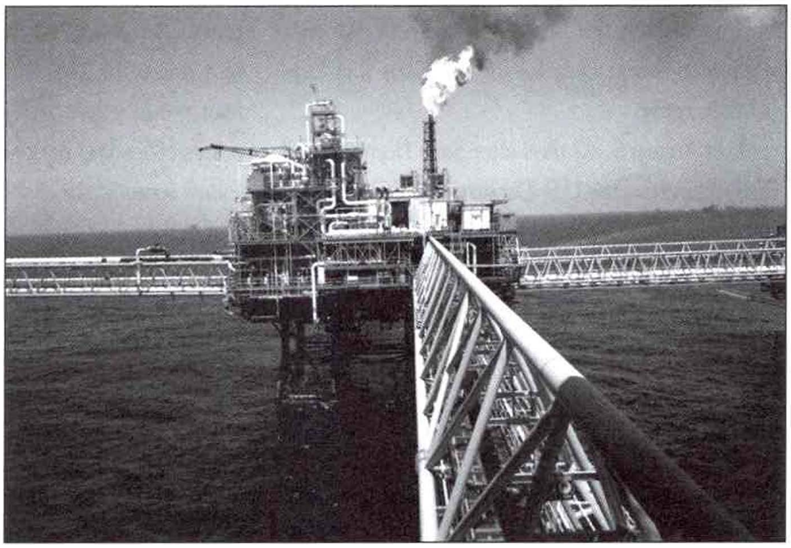

Oil prices are determined by the international market regardless of production costs.

INTRODUCTION

The world's oil industry has recently begun to recover from a period of extremely depressed prices. The unstable world economy of late 1997 and 1998 significantly reduced the growth of global oil demand.

In October 1997 the International Energy Agency (IEA) predicted that world oil demand would reach 75.6 million barrels per day in 1998. By December 1998, after most of the year had gone by, the IEA revised that number down to only 74.3 million barrels a day.

As a result, oil prices reached their lowest levels, in real terms, since the Depression. Oil companies saw their revenues fall substantially, and slashed their capital expenditure budgets. No company or oil producing country escaped.

On June 29, 1999, a group of 12 independent U. . oil producers, primarily from the Midwest, organized under the name " ave Domestic Oil," submitted their Petition for the Imposition of Antidumping and Countervailing Duties to the U. . Department of Commerce and the U S. International Trade Commission.

In the petition, Save Domestic Oil alleged that during 1998 and the first quarter of 1999, Mexico, Saudi Arabia, Venezuela and Iraq regionally saturated the U.S. oil market by dumping or selling crude oil at less than its "normal value." Basically, this means selling crude oil either at less than the fully allocated cost of production, or at less than the prices at which crude oil is sold in the home market or a third market.

In the petition, the independent producers also alleged that their companies could not compete against Mexico, Saudi Arabia, Venezuela and Iraq

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because, they said, these countries subsidize their state oil companies.

The petitioners requested the U.S. government impose antidumping duties on crude oil imports of 33.37 percent for Mexico, 84.37 percent for Saudi Arabia, 102.61 percent for Iraq and 177.52 percent for Venezuela. They also requested an additional countervailing duty of U.S.$6.18 per barrel be imposed on the imports of each of the four nations to compensate for the subsidies they supposedly apply.

Mexican Minister of Energy Luis Téllez.

Last August 9, 42 days after Save Domestic Oil filed its petition, the U.S. Department of Commerce announced that it would not initiate the investigation to impose antidumping and countervailing duties because the petition lacked the required support from or standing in the U.S. oil industry.

The Mexican government firmly rejected the allegations presented against its crude oil exports into this market. This was not a dumping problem.

MEXICO'S POSITION

The depression of world oil markets from late 1997 to early 1999 made for difficult times not only for independent U.S. producers, but for all oil producing countries. The price of Mexican crude, for example, reached lows unheard of since the beginning of the second phase of its oil history in the mid-1970s. As a result the government was forced to revise revenue projections downward and make three major budget cuts totalling U.S.$3 billion during 1998. This implied scaling back or canceling several public projects and imposing austerity measures.

Nevertheless, the drop in Mexican crude prices, as well as the drop in every other crude, was due to world oil supply temporarily exceeding demand. Since the petition was filed before the U.S. authorities, the Mexican government firmly rejected the allegations presented against its crude oil exports into this market. This was not a dumping problem.

Oil is a commodity heavily traded around the world in transparent, well established markets. Every day approximately 75 million barrels of oil are consumed worldwide for innumerable activities. Oil prices are set openly in these markets by the forces of international supply and demand. Pemex, like practically every other oil company in the world, prices its oil in accordance with world markets. Taking into account quality differentials, its pricing mechanism uses widely known formulas that translate the prices of leading benchmark crudes, such as WTS, LLS and Brent, into equivalent prices for Mexican crudes. Therefore, Mexican crude prices move in strict relation to the prices of leading benchmark crudes. They do not follow a predatory or dumping policy.

On the other hand, a country like Mexico, where population growth continues to be significant and the satisfaction of social needs are a tremendous challenge, simply cannot afford to waste resources on subsidies to a company like Pemex.

Due to its low extraction costs, Pemex is profitable and an important source of government revenue, accounting for between 30 and 40 percent of total state income (depending on the year). Since Pemex's taxes and profits underwrite a large portion of Mexico's federal budget, any dollar used to subsidize Pemex is one dollar less for government spending. It would make no economic, social or common sense to do so.

Mexico does not subsidize Pemex and its oil operations in any way. Moreover, any subsidy of Pemex would directly countervene national interests.

POTENTIAL IMPLICATIONS FOR MEXICO

Over the past 20 years, Mexico has been able to diversify its economy. Today, oil exports represent less than 10 percent of total export earnings, versus 78 percent in 1982. Nevertheless, as mentioned above, oil continues to be a significant part of Mexican government revenues.

Either antidumping or countervailing duties on Mexican exports of oil to the U.S. would have made Mexican oil uncompetitive there and would have resulted in its being exported to other important oil consuming countries.

While in the long run this displacement from the U.S. market would have little effect beyond the absorption of increased transport and handling costs (since other major oil markets are farther away), it would have created problems in the short run. Most Mexican oil, like that of other countries, is sold under medium-term contracts and has certain characteristics that make it difficult to easily switch markets at short notice.

This short-term disruption in Mexican oil exports would undoubtedly have temporarily reduced oil revenues and therefore government revenues. Either of these measures would have temporarily affected the economy.

Conclusion

The antidumping and countervailing duty petition presented by Save Domestic Oil has potentially alarming implications and would not have helped anybody, even the petitioners.

No one can argue that the situation of the U.S. oil industry was good. However, neither can it be argued that the petition would have improved it now or in the future. What is clear is that it could have negative consequences for everyone.

These duties would have provided little relief for independent U.S. producers. Once the short term change in trade flows took place, oil prices in the U.S. would have remained largely unchanged, as the duties would have simply reshuffled the destinations of countries' oil exports.

They would have only reduced the imports of oil from these four countries, but as these countries diverted their exports to other important markets in Europe and Asia, other exporters would have shifted their exports toward the U.S. market, quickly filling the gap.

Moreover, the transition would have been very difficult for all oil producers. The rerouting of more than 4 million barrels of oil a day is not an easy task and would have been accompanied by a brief period of uncertainty and volatility in world, and hence U.S., oil prices. The final impact this volatility would have had on prices is anybody's guess, but what is clear is that uncertainty would have hurt all producers.

The petition was against the spirit and essence of free trade and the basic principle that markets work. In recent years, Mexico has sought to establish a strong bilateral relationship with the U.S. The North American Free Trade Agreement, the signing of numerous treaties and accords and cooperation on a wide range of issues all show the strong ties between Mexico and the U. . Both Mexico and the U.S. have benefited significantly from this close relationship, and there is no apparent reason why they should not continue to do so.

The case brought by Save Domestic Oil against Mexico, Saudi Arabia, Venezuela and Iraq was dismissed because opposition to the petition exceeded support for the petition from U.S. producers. Consequently, it lacked adequate domestic industry standing.

Mexico welcomes the decision made by the Department of Commerce. The Save Domestic Oil petition was spurious and false and contained erroneous information that in no way provided evidence that Mexico engaged or engages in unfair trade practices in oil.

The risk of a petition of this nature being submitted is always present in a trade relationship of this importance and magnitude. That is why it is of utmost importance that goodwill prevail and the proper mechanisms be in place for the solution of any trade controversy in strict compliance with the law.

The successful resolution of this process is an excellent example of how future trade disputes should be addressed. VM

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