Oil and Nation Building

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Jared Diamond brilliantly put forward the complex circumstances that explain the supremacy of Europeans in the Americas in his celebrated book *Guns, Germs and Steel*. A publishing success, as reflected in the *New Yorker* review, the book's subtitle, *The Fates of Human Societies*, presages his lesser known work, *Collapse, or How Societies Choose to Fail or Succeed*. However, the cases of historical failures reviewed in this second work lack the spectacular display of grandeur and misery surrounding the conquest of the "New World." This prompts the question of why he did not include the case of Mexico and oil as one of his chapters.

The first of his books might inspire the analysis of the expropriation of oil by the post-revolutionary generation led by the legendary Lázaro Cárdenas and other lesser known figures. The painful twilight of Mexico's oil industry and the ominous doubts about the viability of its "nation building," as put forth since the end of the Revolution, could well have been an object of analysis in the second book mentioned above.

Valley of Mexico civilization dominated the vast territory that is today pompously called the Mexican United States, compared in naïve nineteenth-century thinking to a "horn of

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Mexico's first experience with oil came at a time when there was a new political class, the product of the independence movement and its naive liberal ideology.

plenty," of which all that is left is a yearning for a past that, if not better, was at least more poetic. So, it is surprising the region is so populated despite its adverse climatic conditions. Mexico is situated between parallels 20 and 30, the same location as the great Sahara and Gobi Deserts and the one on the Arabian Peninsula; this makes it a site that seems not very promising for hosting a vast, viable society. However, from the times of the splendor of Teotihuacan and Tenochtitlan, New Spain and contemporary Mexico, its very existence seems to defy logic.

The capital of New Spain occupied a vacuum left by the Aztec empire's lake capital and became the jewel in the monarchy's crown on the head of Spain's overseas empire. Soon, the dreams of the mythical cities of Cíbola and Quivira, with their endless lodes of gold, began to fade. In their place, silver deposits would ascend to legendary dimensions and make it possible to finance not only New Spain's viceroyalty, but the military adventures and exploration of the Austrian and Bourbon dynasties. The unending stream of vessels loaded with the gleaming metal would finance everything from the Caribbean navy to the plateresque and baroque architecture of the Iberian Peninsula.

The War of Independence and the chaos that followed the end of Spanish domination did not favor the expansion of silver production and export. The celebrated silver coins bearing the seal of Mexico's mint would continue to circulate throughout the world, but the colonial period boom would not last very long. During the decades of anarchy, the new nation's credit would suffer such blows that it would lead to military threats and interventions by the European powers. The flow of silver along what was called "the Silver Road" winding through the mining towns of Taxco, San Luis Potosí, Pachuca and others, was no longer sufficient to finance the ambitious national project.

The introduction of the railroad in the nineteenth century made it possible to overcome regional isolation and to create a national market, something the Balkanized geography had impeded. Together with steam ships, this made it possible to export agricultural products with commercial value on the international market. However, this was not enough to finance the launch of a traditional, unproductive society, fraught with inequality and the extreme poverty and ignorance of the mass of peons bound in servitude, with an agricultural sector incapable of supporting a massive population, until the post-Revolutionary governments introduced irrigation well into the twentieth century.

In the midst of all these extraordinary events emerges the key factor to modern Mexico: "black gold." The new nation's first contact with oil took place in the framework of a centuries-old mining tradition, but with, on the one hand, a new native political class, the product of the independence movement and of its naively liberal ideology, and on the other hand, a new generation of adventurers and explorers who, instead of brandishing sword and musket, now held pick, shovel and theodolite for surveying. The nineteenth-century liberals abandoned the theory of state ownership of the sub-soil and adopted the U.S. vision of complete ownership by the owner of the surface area. They even awarded excessively generous concessions, to the point of giving foreign investors tax-exempt status. They thus recreated the story of native indigenous exchanging gold for glass beads from the Europeans, believing them to be benevolent, protective demigods who had come to graciously redeem them in their ignorance and primitivism free of charge.

The first incursion of foreign entrepreneurs was in refining oil and gas, which were still being imported, at Walter Pierce's processing plant in the port of Tampico in 1887. Exploitation of the sub-soil would have to wait until the discovery of the large oil deposits in northern Veracruz and eastern San Luis Potosí. Edward Doheny and his partners set up a small oil company in 1901 called Ébano. Finally, they founded the Huasteca Petroleum Company in 1907 with US$15 million in seed capital. It became one of the most successful oil companies, whose most famous well produced 33,000 barrels a day in 1915. The other large oil company was the English-Dutch-owned El Águila, founded in 1908, whose shareholder equity rose to US$50 million by 1915. After 1910, the year the Mexican Revolution broke out, more companies were founded. By 1920, when the bloodiest part of the armed struggle had come to an end, there were around 200 nationally- and foreign-owned oil companies in Mexico.

During the civil war period of the Revolution, the main companies, owned by foreign investors, paid their own permanent army under the command of a supposedly revolutionary general named Peláez, who provided them with faithful, effective protection. U.S. Ambassador Henry Lane Wilson considered himself the protector of U.S. investors' interests, particularly those of the oil companies. The influence of the oil interests was noticeable and on-going: some authors think that one contributing factor in the fall of naïve President Francisco I. Madero was a Mex$0.20 tax he levied on each ton of oil. Years after leaving his post, the former ambassador confessed to a reporter that he had expressed his acquiescence to deposing the unfortunate martyr, alleging that he never knew that the rebels commanded by Madero's own Ministry of War and the Navy intended to assassinate him.

The need to protect oil interests led the U.S. government to extremes that provoked the enmity of the revolutionary leaders. President Woodrow Wilson was in favor of the Revolution, but not of the state's declaration of eminent domain over the sub-soil and oil deposits. That may be why he supported the financial viability of the revolutionary fraction contrary to the so-called "constitutionalists," who were responsible for the 1917 Constitution and its Article 27. U.S. diplomacy successfully neutralized the government plan of applying Article 27 to the letter.

The regimen of concessions via contracts replaced the regime of full ownership, but quite a few oil companies were able to survive under the 1917 Constitution. During the first years it was in force, there was a climate of low-level confrontation between the companies and the administrations of Carranza, Obregón, Calles and those under the latter's tutelage. The *modus vivendi* that had been reached only changed with the 1929 financial crisis and the discovery of new oil deposits in other developing countries (Venezuela and the Middle East) that had comparative advantages *vis-à-vis* property ownership which were friendlier than Mexico's.

In Mexico and other Latin American countries, the domestic tensions produced by the global economic slowdown favored the development of different kinds of populism, of a more or less authoritarian nature, that put a priority on state intervention in the economy. In Argentina, General Juan Domingo Perón, and in Brazil, Getulio Vargas inaugurated right-wing populist governments, while in Mexico, General Lázaro Cárdenas launched a left-wing version, with massive land redistribution that eliminated huge and medium-sized pieces of rural private property in favor of collective farms and small private holdings, and the expropriation of oil.

It cannot be argued that the expropriation took the oil companies by surprise. Some had even already begun to transfer their operations to Venezuela. According to Lázaro Cárdenas's advisor, Jesús Silva Herzog, the private companies' oil tankers had already been moored in safety on the other side of the northern border. The installations and infrastructure had not been kept up, and years of scant investment left them ramshackled and obsolescent.

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The reaction of the most important companies should have been to strengthen their negotiating position to avoid the retroactive application of the law and the Constitution, as well as to optimize conditions for compensation, because the expropriation enjoyed almost general acceptance. It was so popular that large public collections were taken up to pay the compensation, including donations of personal possessions in the midst of a wave of patriotic fervor and nationalism.[1]

The response of those affected was formidable. Not only did they block the sale of oil on the international market, but they even tried to boycott the sale of silver, Mexico's other export, for which it enjoyed one of the first places in the world. Despite the fact that President Cárdenas was always conciliatory, two factors led to the failure of negotiations: first, the companies' vengeful attitude, and secondly, the outbreak of World War II, which tempered the position of the U.S. government and its allies, who finally put an end to the boycott and renewed its purchases from Pemex.

The first civilian president after the Revolution, Miguel Alemán, called "the gentleman president," was Catholic, conservative and rather unenergetic. He was responsible for the turn toward economic modernity and the acceleration of capitalist development. During his administration, exploration and pumping concessions were once again awarded to foreign companies; these concessions could almost be called excessive because of the favorable conditions they gave contractors.

The Adolfo López Mateos administration also stands out in matters referring to oil because of the reform to constitutional Article 27, adding a sixth paragraph that seemed to restrict private participation even more. This paragraph seems to ban the awarding of concessions and contracts for the exploitation of hydrocarbons. However, it also delegates establishing the limits of this exclusion to the regulatory legislation.

The Regulatory Law and practice itself tempered the constitutional ban. The law expressly allowed for the possibility of signing contracts for services with private parties as long as they were not those considered risky or for participation in production itself. In practice, not only did contracts for the exploitation of hydrocarbons continue to be signed with private parties, but they even increased, as can be seen in the criticisms the famous former director of Pemex, Antonio J. Bermúdez, made at the time. The most conclusive result of the constitutional reform was the cancellation of the service contracts signed under the Miguel Alemán administration. We can safely say that one of the possible motives for this reform was putting an end to these contracts.

It is not clear why risk contracts were banned in 1960, taking into account that the risks are on the part of the contractor and not the state-owned company. What is more, in Brazil's specialized literature, analysts consider that the introduction of risk contracts, together with the adoption of the structure of a private company for the public oil company Petrobras, were in large part responsible for the modernization and boom of the most successful state-owned oil company in Latin America and the developing world in general.

The last Mexican constitutional reform was in 1987 under President Miguel de la Madrid. It reinforced the ban on private participation in all branches of the industry, except in so-called secondary petrochemical sector. It did not, however, establish a precise scientific distinction between basic and secondary petrochemicals.

During the term of Carlos Salinas de Gortari, Pemex's internal structure was changed, decentralizing it into three subsidiaries. However, its fundamental problem continues to be its being a para-state entity, since its organization is neither that of an efficient company nor that of a government ministry. It is a kind of hybrid. The control it is subjected to by centralized federal bodies is not only excessive and paralyzing, but even inefficient. Innumerable bureaucrats in the monitoring sections of the Ministries of the Public Function, Finance and Public Credit, Energy and even of the Economy and National Defense and the Navy have a say in the decision-making bodies of this publicly-owned company. Or at least, they dream of having that say, even if only as a status symbol, because in reality, they simple do not have enough trained personnel to do it, in contrast to Pemex's qualified staff.

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In addition to the excessive number of checks, two other fundamental problems plague Pemex operations: 1) the state's practically confiscatory taxes, which exceed 60 percent of its earnings and prevent it from having sufficient funds for investing in exploration or expansion; and 2) the regimen of contracting suppliers' services, which is cumbersome and obsolete. Federal legislation about public works is inexplicably primitive, on the one hand, and excessive, on the other. Federal public investment in oil is about 47 percent of programmed investment in infrastructure. However, the law only allows for two types of contracts: those denominated in unit prices and those that allow for unit-price increases under certain macro-economic conditions over time, with the idea that, as a general rule, these contracts are signed once a year.

For decades, contracts for public works signed in the most developed countries of Latin America have included more functional contracts for energy-sector infrastructure, for example, using contracts for costs or incentives. But, until today, the federal government has not promoted a fundamental reform of regulations in this area. In addition, in the field of exploration for and exploitation of oil and gas, the most common kinds of contracts in Latin America are shared risk contracts, or shared production contracts, which are not allowed in Mexico.

The long-term future of the oil industry seems to lie in deep-water drilling, since the crude oil deposits on land or in shallow water do not seem very abundant. However, when people propose the need to partner up with other state-owned oil companies like Petrobras or Norway's Statoil, the response is to minimize the technical problem and say that Mexico can solve it on its own, like it did after the expropriation of the oil companies. This ignores the fact that private enterprise continued to participate extensively and intensively under the Lázaro Cárdenas administration and even continued to do so, to a lesser extent, after the statist reforms of López Mateos and Miguel de la Madrid. In addition, they were not starting from scratch: after the expro-

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priation, all the facilities of almost 200 companies and their pipelines continued to exist, as did hundreds of Mexican employees who had been trained to operate them.

In several spheres, including that of energy, the nationalist discourse that served to legitimize the last century's inefficient statism continues to be accepted as true, without questioning its content and value for the needs of a globalized Mexico in the twenty-first century. Unfortunately, the Biblical metaphor of Sarah turning into a pillar of salt as punishment for looking back seems to apply to the fake or real blindness of the prophets of out-of-this-world traditionalism. Maintaining the appearances of realities that are now out of date —or never even were a reality at all outside the demagogic rhetoric of a self-satisfied, vacuous political discourse that can only be continued by cynical, ingenuous or ignorant manipulators who want to delay the reforms and reformulations that were urgent yesterday and today, if not undertaken, threaten to mortgage the immediate future and that of generations to come— will have no other result than to give us another thing to recriminate ourselves for in the future. In addition, we could be giving Jared Diamond the another topic for his book *Collapse, or How Societies Choose to Fail or Succeed*. VM

Notes

[1] They intended to take preventive action to discourage other attempts to affect their interests in other countries that were considering following Mexico's example, such as the case of Iran under the Mosadeg government.