After Macondo Considerations for Mexico

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The goal of this essay is to underline the importance of analyzing the problems stemming from the Gulf of Mexico oil spill: its impact on Mexican oil policy, as well as some of the considerations Mexican policy design should include about the geopolitical context and the geological situation of its oil fields.

The Macondo oil rig spill is important for Mexico because it affects U.S. energy security. For this reason, the decisions made now to guarantee that security will depend on the level and rhythm of our neighbor's oil production and will affect other producers, members and non-members of the Organization of Oil Producing Countries (OPEC) alike. Since Mexico is one of the main suppliers to that market, U.S. policies and norms have an impact on the state-owned oil company Pemex and its production strategies. In general, our neighbor's actions will determine global supply, and that is leading many of the industry's important actors to propose effective solutions.

The context of the oil spill in which these actors design their proposals could be called a scenario plagued with regulatory and technical deficiencies, violations of federal security operating regulations, and the lack of appropriate focuses for managing the risks inherent to the oil industry's deepwater drilling.[1] The picture drawn by the numerous investigations into the spill's causes and the resulting penalizations has recently been completed by the December 15, 2010 Justice Department resolution against British Petroleum (BP) and eight other companies involved in operating the Macondo well. The fundamental argument is that BP and a group of contractors violated operational security regulations. The forceful, blunt verdict is that decisions were made to save time and money when better alternatives could have been chosen. According to the Oil Pollution and Clean Water Acts, BP's fine promises to be large.[2]

For its part, the Obama administration and the U.S. Congress have planned legislative measures and regulatory safeguards, as well as performance safeguards to be complemented by institutional changes like the replacement of the Mineral Management Service, the body in charge of granting permits for oil drilling, by the Bureau of Ocean Energy Management Regulation and Enforcement.

The U.S. oil industry, another important actor, is also implementing its own actions to ensure that oil production does not come to a halt. Among the mechanisms it is using is to exert pressure to raise the moratorium the Democratic administration has imposed. On a company level, they are discussing technological improvements to be used at the first sign of possible oil spills, reviewing their "best practices," guidelines, and protocols, as well as running simulations —up to and including "worst scenario" simulations— to come up with a gamut of alternatives that will make better response capability possible.

The industry is convinced there is no alternative to moving into deep waters, and therefore the only thing left to them is to reduce the risks. In the face of this, governments are readying themselves to back up oil exploration and drilling management in extreme environments, including dangerous operating conditions with important environmental and human risks.

Actually, their priorities are a reflection of international geopolitics, characterized by structural changes on the international oil scene that are unfavorable for the industrialized nations and private oil corporations. In this context, the latter have made clear their need to generate alternatives to counter

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their disadvantages by speeding up their drilling and pumping to avoid a dip in profits where they still have resources.

To avoid another Macondo, governments and the international oil industry are analyzing how to regulate offshore production based on the Norwegian regulatory experience. Of particular interest is its advantage in the comparison of the U.S. Mineral Management Service to its counterpart, the Research Council of Norway.

However, this comparison must take into account the fact that the improvements the Norwegians have carried out have not been limited to regulatory requirements, but also include voluntary (risk-based) measures adopted by most of the companies in its oil industry.[3] This means that regulation is not necessary when the political will to make improvements is a conviction that leads to effective action.

Another of the international experiences of note is Brazil's. While the international oil industry's tendency is to move into deep waters, the experience of countries like Brazil will have to be interpreted correctly. Its development does not depend on the tutelage of the transnational actors, and therefore, is independent, with the certainty that going into deep waters does not pose a risk *per se*, given the fact that its technological capacity allows it to guarantee success in its projects. Applying international experiences in their contexts and according to their particularities in order to not extrapolate

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situations alien to a national policy design is a conceptual priority and a necessary exercise in epistemological objectivity.

The sinking of the Deepwater Horizon platform and its fallout have made it clear that Mexico lacks the appropriate regulations to be able to deal with contingencies like oil spills; this is important given that the Mexican government intends to move into deepwater drilling. While the proposal actually responds to the interests of multinational corporations, undoubtedly Macondo will be the driving force behind the design of new regulations for upstream and offshore activities.

The spill has also been the opportunity to brush the cobwebs off issues debated at the time of the 2008 Energy Reform, such as the urgency of moving into deep water, looking at transborder issues in order to come to an agreement to share borders and develop resources (reserves), as well as a sup-

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posed U.S. commitment to increase Mexican oil production.[4] The neoliberal project now has a new opportunity given the need for greater regulation of the oil industry. Clearly, regulation is the operational part needed to constitute a market, and therefore, to privatize substantial activities.

The regulatory changes required to avoid environmental catastrophes of the magnitude of the BP spill will demand answers. For that reason, it will be necessary to connect oil production estimates to economic costs and the changes being made in the regulatory process in the Gulf of Mexico. Undoubtedly, this will involve higher costs.

According to some estimates, the costs of upstream activities (indices) will grow in the short run, given that deepwater production trends point to more offshore services, and exploration and development of new territories create the need for new infrastructure and an additional tension in supply chains.[5] Indexed to year 2000 prices, the cost of US$1 billion in capital in that year would come to US$207 billion; and the operating costs for an oil deposit in that same year would rise from US$100 billion to US$173 billion in 2010.

Another impact to take into consideration in these estimates is the restrictions to offshore production both in the United States and in Mexico. In the case of the former, it would result from maintaining the ban on oil exploration and exploitation in the Gulf of Mexico and the Arctic, in addition to developing stricter regulations in these same areas.[6] In the case of Mexico, it would be due to Pemex's change in its deepwater production program. Due to the lack of a regulatory framework for deepwater and ultra-deepwater drilling, Mexico's state oil company postponed drilling in the Perdido area, near the U.S. border. Later, the National Hydrocarbons Commission (NHC) issued directives stating that Pemex should not drill in ultra-deep waters (with a sea bed deeper than 1 500 meters from the water's surface) as long as the NHC guidelines sent to the Federal Commission for Improved Regulations (Cofemer) were not fulfilled. These guidelines consist of industrial security technical procedures and requirements that must be observed when carrying out deepwater activities.[7]

Except for this, the Macondo spill has not changed the strategy Pemex is implementing in any major way. However, the energy policy decisions to be made should consider Mexico's role in our neighbor to the north's oil policy. Taking this into consideration implies designing a national policy using the room for action left to Mexico in light of the asymmetry in power *vis-à-vis* the United States. This asymmetry is evidenced in Mexico's subordinate integration with regard to energy, given that it is increasingly clear that it is following the U.S. energy priorities to design its own oil strategy.

Issues like guaranteeing Mexico's future oil security must be taken into account in light of the official aim of maximizing today's oil production levels by developing all the existing productive options. It should be pointed out that the aim of maximization does not necessarily correspond to domestic market requirements, since around 50 percent of national production is currently exported to the United States. Therefore, maximization is part of the neoliberal (non-proprietorial) model that aims to extract the maximum economic value from developing resources,[8] since in that model, resources have no value when they are in the ground, but only when they have been extracted, that is, if they are developed. The matter becomes controversial in a context of declining resources that would seem to demand moderating oil production rates to conserve them for future generations.

With regard to this, it would be important to establish development priorities so they can be implemented in a production cost curve that jibes with the range of productive alter-

natives corresponding to the national geological and technological situation. Clearly, productive decisions reflect not only a certain way of managing projects, but are also the result of the influence of interest groups covered by official policy to favor national and foreign private interests.

Undoubtedly the central question to consider is oil rent.[9] The fact that it accrues to the government may be a necessary condition —though it is not sufficient— to ensure that those revenues benefit society. But this runs into difficulties if the aim is maintaining the welfare state and sharing oil revenues with the private sector, particularly foreign interests. Although oil rent is distributed in the private sector all along the chain of production, it is hoarded by private investors, and this explains their deliberate low profile and/or virtual absence in today's debates and Supreme Court decisions when it hears constitutional cases on these issues. Today, the oil rent is hidden, disguised in the form of risk and efficiency premiums to investors, and is transferred to private hands through new kinds of contracts (the "contracts with incentives").

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Under neoliberalism, the rent is disguised by the legal paraphernalia, economic theory, and corporate law that deny its importance; you also have to deal with the appropriation of oil reserves in a context of supposed sovereign management given the pretension that today these reserves constitute a "patrimony of humankind."

Clearly, the new forms of appropriating producing countries' oil income do not even require foreign occupation by developed countries' armed forces, such as in the case of Iraq. Today, it is more effective to gain "access" to upstream sectors in oil producing countries through concessions, joint production agreements, or, as in Mexico's case, based on a regime of contracts through which oil rent is appropriated by covering up the *de facto* loss of a country's oil reserves to the benefit of multinational companies, exploration and drilling service providers, and other participants from the national private sector.

The dispute over oil rent continues to be the most important political issue related to oil. All these aspects must be incorporated into the design of the most appropriate national options together with any industrial security measure. The objective of regulating the market is to establish a legal regimen to ensure investments in the oil industry. The regulations that will come out of Macondo could lead us down a camouflaged road toward that same objective. So, what kind of regulations are we talking about? VM

Notes

[1] The National Academies, "Interim Report on Causes of the Deepwater Horizon Oil Rig Blowout and Ways to Prevent Such Events" (Washington, D. C.: National Academy of Engineering and National Research Council of the National Academies, November 16, 2010), p. 5.

[2] Thomas Hart, "Justice Department Files Oil Spill Lawsuit against BP and Others," http://personalmoneystore.com/moneyblog/2010/12/15/oil-spill-lawsuit/, accessed December 17, 2010. The amount that has been mentioned is US$40 billion. The company did not use the best drilling technology nor the surveillance assets required to protect workers. Due to the prohibitions in the Clean Water Act, BP has tried to get the fine reduced by questioning government estimates of the spill's volume.

[3] Jan Erik Vinnem, "Evaluation of Offshore Emergency Preparedness in View of Rare Accidents," *Safety Science* no. 2, vol. 49 (2001-2002), pp. 178-191.

[4] See Lourdes Melgar, "Impact of the Deep Horizon Oil Spill on Mexico's E&P," Gulf Oil Spill Impacts Series (Washington, D.C.: The Center for Strategic and International Studies, National Security Program, and the Institute of the Americas, August 5, 2010).

[5] Cambridge Energy Research Associates (CERA), "Cost Building and Operating Upstream Oil and Gas Facilities Begin Measured Rise" (Cambridge, Massachusetts: CERA), http://press.ihs.com/article_display.cfm?article_id=4335, accessed December 17, 2010.

[6] This is what Secretary Ken Salazar stated December 3, 2010.

[7] Alma Hernández, "Ponen reglas para aguas profundas," *Reforma* (Mexico City), December 9, 2010, http://www.cicm.org.mx/noticias.php?id_noticia=4857, accessed January 14, 2011.

[8] The concept of the non-proprietorial model is based on Bernard Mommer's work *Global Oil and the Nation State* (2002), where he alludes to the two existing forms of property in the oil industry today: 1) proprietorial, in which the state maintains ownership of mineral resources (oil), issuing permits in exchange for royalties. This model is based on international land rent, on a state responsible for the intermediation of distributing that rent, the existence of which is the result of the state ownership of the territory; and 2) the other, non-proprietorial form that emerged in the 1980s, based on the notion that mineral resources are a "free gift of nature," spurs the industrialized countries through their companies to seek "access" to producing countries' oil resources through a change in the legal regimen to gradually decrease the state's store of oil rent to turn it into profits that end up in the pockets of investors, above all foreign investors and large transnational corporations.

[9] This is the international price of crude multiplied by the total volume of production, less production costs. Its amount could be considered the equivalent of available income, although there can be certain variations in its quantification due to the concept of rent on which the estimation is based.