

CALDERON'S INITIATIVE TO PRIVATIZE THE OIL INDUSTRY

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Several weeks ago, the federal administration began a broad campaign in the electronic media, stating the need to affect changes in the country's oil industry. As part of this campaign, the Secretary of Energy (SENER, its initials in Spanish), and Petróleos Mexicanos (PEMEX, its initials in Spanish), presented the document "PEMEX's situation" at the end of March. Much like commercials aired on television and radio and in speeches delivered by various functionaries of the federal administration, including President Felipe Calderón, this document is noteworthy in its propaganda regarding the vast reserves of hydrocarbons in the Gulf of Mexico. Such sources repeatedly state that these reserves are to be found in deep waters, and that their exploitation would require large-scale investment and technology that PEMEX does not possess. As such, they warn that it is of utmost importance for PEMEX to reward contracts to private sector oil companies in order to widen services. They insist upon the supposition that investments to explore and to begin to extract crude in these zones should be made as soon as possible, given that hydrocarbon reserves are diminishing considerably and that income from oil sales constitute a significant part of public finances. The publicity campaign continues to the date and represents the principal source of justification for the reform proposals. Authorities proceed as if legal changes have already been approved and as if it were possible for the government to undertake any and all actions it desires.

On Tuesday, April 8, the federal administration presented to the Senate of the Republic an initiative denominated the Energy Reform, which is comprised of five proposals to either modify or establish a number of laws relating to the country's oil industry. In addition, the administration announced that in the near future other proposals to modify laws relating to the petroleum industry, principally dealing with the industry's fiscal aspects, would be presented to the Chamber of Deputies. The first of the two initiatives was sent to the Chamber of Deputies on May 14th, and includes modifications to PEMEX's fiscal regimen as related to financial resources obtained from the extraction and commercialization of crude oil and natural gas in the Paleocanal de Chicontepec field and in the deep waters of the Gulf of Mexico. The five documents presented to the Senate include the following proposals: a) the reform of the Organic Law of public administration, with the objective of giving new functions to the Secretary of Energy as a result of changes to the Reglementary law of the 27th Article of the Constitution and to the new Organic Law of PEMEX, amongst

other changes; b) the reform of the Law of the Energy Regulatory Commission, with the objective of granting new powers for the regulation of transport, storage and distribution of oil-based products and basic petrochemicals produced by the private sector; c) a new Organic Law for Petr6leos Mexicanos; d) the legal initiative to create the Petroleum Commission as a decentralized organ entrusted with the tasks of planning, supervision and regulation of the oil industry's exploration and production, and; e) the initiative to modify and add articles to the Reglementary Law of the 27th Article of the Constitution that modify the conditions of organization, management and investment in the petroleum industry. In synthesis, no changes are proposed to any article of the Political Constitution of the United States of Mexico and only one document contains the objective of modifying a reglementary law of an article to the Constitution.

Officials maintain that such modifications respect both the letter and the spirit of the Constitution's text and that changes in several aspects of the secondary law clarify and recognize the authority of the 27th Article of the Constitution. According to the federal administration, the group of reforms must be approved as a whole in order to protect and develop the oil-based wealth of the nation, and by extension, the nation itself. The changes proposed in relation to the attributes of the Secretary of Energy are not possible without the approval of the modifications to the Reglementary law of the 27th Article of the Constitution. The new functions of the Energy Regulatory Commission and the creation of the Petroleum Regulatory Commission cannot be considered until alterations are made to the Reglementary law of the 27th Article of the Constitution, such as presented in the federal administration's initiative. Moreover, the substantive part of the modifications contemplated in the proposal of the new Organic Law of Petr6leos Mexicanos, particularly those relating to administrative autonomy, the management of finances and the unrestricted contracting of external debt, are only possible if the reform initiative is approved and if several elements are added to sections of the Reglementary Law of the 27th Article of the Constitution dealing with oil. The same is the case with the reform initiative and the addition of various elements to the Law of Rights, which seek to establish a specific fiscal regimen for the hydrocarbons that are obtained from the zones of Chicontepec and the deep waters of the Gulf of Mexico. As such, a substantive area of debate arises regarding the content and character of this initiative.

The initiative to reform and add to the Reglementary Law of the 27th Article of the Constitution and the subsequent group of reforms are objectionable from an economic point of view, particularly in terms of the requirements and technical and technological capacities that PEMEX and the country's oil industry possess and should possess. But it is also unacceptable due to the fact that it contradicts what is established in the 27th Article of the Constitution. It is a form of privatizing the oil industry, violating elements of the text, and therefore is unconstitutional.

The initiative contemplates changes to allow for the participation of private capital in the activities of exploration and extraction of petroleum, particularly in deep water reserves, but also in the industrial processing of crude oil and in the activities of transport, storage and distribution of hydrocarbons. In other words, it implies that private companies can exploit petroleum.

Official documents state that the exploration, drilling and exploitation of possible reserves in deep water should proceed as soon as possible, as if this zone of the Gulf of Mexico were subjected to an intense extraction of crude by the United States and Cuba, the other two countries that have rights to the region, or due to the fact a large part of worldwide oil production comes from deep water reserves. The very same reform initiative envisions that production in the fields under the jurisdiction of the United States will only begin between 2010 and 2014. In addition, the use of technology to drill for and extract crude from this type of reserves is a recent phenomenon, and in large part is still in development. In 1996, one percent of worldwide petroleum production came from deep waters, growing to 7.6 percent in 2006. The technology that is used in these fields is created on site and a part can be acquired and submitted to processes of innovation. What is not explained in the various initiatives presented to the Senate is the abandonment of research in this area, particularly in the case of the Mexican Institute of Petroleum. For years, federal governments have decided to systematically reduce the resources destined to the financing of technological research, impeding PEMEX from using small amounts of earnings for such purposes.

Officials also point to shortcomings in terms of the transport, storage and distribution of oil-based products and basic petrochemicals. For example, the network of oil ducts has not been expanded and the ground transport of gasoline creates waste. In the initiative to modify and enlarge the tasks entrusted to the Energy Regulatory Commission, officials suggest that resources should not be diverted away from PEMEX's more essential and profitable activities such as exploration and extraction of petroleum and natural gas. Therefore, the initiative considers that the Reglementary Law of the 27th Article of the Constitution should be modified to allow for the participation of private capital in the areas of transport, storage and distribution of oil-based products and basic petrochemicals. Officials do not explain the origin of such shortcomings, although as in other areas of the country's petroleum industry, the existence of unfulfilled needs guarantees that investments can be recovered and that they can foment other economic activities. PEMEX's income and even the expansion of its productive capacities forms the basis for the profits of private sector capital that participate in these activities.

The area of gasoline is noteworthy for the growth of imports. In the initiative to modify the Reglementary Law of the 27th Article of the Constitution, officials affirm that the commercial deficit in petrochemicals has been higher than the rest of the national commercial balance's deficit for more than two years. Increases in the consumption of gasoline will add new supply needs on top of the current deficit, furthering the need for large scale increases in gasoline producing capacity. Several of the presented initiatives claim that in order to produce the total amount of gasoline needed, it will be necessary to reconfigure three refineries and build five or six more in the next two decades. Accepting this point without conceding the amount of refineries and the time frames for their development as established in the proposal, there are no technical reasons to suggest that the refineries cannot be built by PEMEX. In the past they have been built with the company's own resources. The time frame presented in the documents sent to the Senate exceeds a decade, and as stated in the initiative for a new Organic law for PEMEX, the institution is projected to register surpluses for a large part of this period. Due to the noticeable scarcity of gasoline in the country, refineries are investments whose returns are guaranteed. In addition, the supply of oil is assured by PEMEX, which will likewise buy

gasoline for its commercialization in the country. By allowing private investment in refining, profits are guaranteed for private capital, which could result very lucrative given the wide discretion that contracts may entail if the proposed reforms are passed.

In the expansion of gasoline producing capacity, as with other aspects of the petroleum industry, the problem has been that regardless of the extraordinary earnings achieved through the foreign sales of petroleum, refining capacity has not been expanded. Rather, the nation's oil-based wealth has been squandered, and the solution offered to the problem is to once again allow private capital to take over complete areas of petroleum exploitation, guaranteeing private profits.

The objective of the reform is to lay the groundwork for the widespread participation of private capital in all sectors of the economy that are overseen by the Secretary of Energy (SENER). As such, the reform of the Organic Law of Federal Public Administration widens the functions of the SENER. Of particular note is the modification of the fraction V of the 33rd article, whose new wording states: "promoting the participation of the private parties in the activities of the sector, under legal rules and terms". The sector overseen by the SENER includes exploration, exploitation and transformation of hydrocarbons and the generation of electric and nuclear energy. The law's current wording, which officials are seeking to change, establishes that the SENER shall promote the participation of private parties, under legal rules and terms, in the generation and utilization of energy. There is no mention at all relating to promoting the participation of private parties in the exploration, exploitation and transformation of hydrocarbons.

The promotion of private party participation in the generation of electric energy has permitted the existence of 21 independent producers of electric energy that belong to a small group of transnationals, despite the fact that the letter of the 27th Article of the Constitution states that: The generation, channeling, transformation, distribution, and supply of electric energy **corresponds exclusively to the Nation**, as their objective is the provision of a public service. **In these areas no concessions will be granted to private parties** and the Nation will utilize natural resources as required. Today, the three largest multinational corporations that generate electricity in the country are: Iberdrola, Repsol through its subsidiary Gas Natural and Unión Fenosa, all based out of Spain. In their respective internet pages, these corporations highlight the importance of their investments in Mexico, stating that they are fully guaranteed, given that all energy generated for periods of over fifteen years is and will be bought by the state-owned company entrusted with the distribution and commercialization of electricity, CFE. All of the independent energy producers have invested in combined cycle plants. However, their supply of natural gas is guaranteed, and changes in its price cannot affect their earnings.

The content of the new Organic Law of PEMEX points towards a similar direction. For example, a special exceptional regimen is established to negotiate no-bid contracts with private companies. In terms of the development of technological innovations, as well as in financial services and the evaluation of risk and risk coverage, contracts can be issued as direct awards and limited competition contracts. A substantial number of PEMEX's activities are subject to this exception. The conversion of PEMEX into a large firm that administers contracts with companies that benefit from the use of the nation's oil-based

wealth implies that in a second stage, restrictions will be eliminated for the direct contracting of external debt. As stated in the new Organic Law, PEMEX will be able to negotiate, without requiring the Secretary of Finance and Public Credit's authorization, access to external capital and money markets. PEMEX would also be able to contract any required external financing and debt obligations.

Currently valid rules regarding the contracting of external debt by the Federal Executive branch would no longer be applicable to PEMEX. In any company, the debt which is contracted grants lenders a part of the firm's earnings. The guarantee of debt payment is the firm's assets. In PEMEX's case, the debt grants the right to a part of the organism's income and the guarantee is assets that include reserves of hydrocarbons. The decision to contract debt is therefore a decision of whether or not to appropriate a part of the nation's oil wealth.

Included in the time frames for PEMEX's reorganization is the issue of the management of its resources and in particular those relating to its own surpluses, which are currently passed directly on to the Secretary of Finances and Public Credit. The initiative establishes several stages for their release, starting with 25 percent, then 40 percent, later 60 percent and finally 100 percent. A limit of 15 billion pesos is also established while the liberation of surpluses for PEMEX's use proceeds. Among the conditions to free up surpluses, an issuance of citizen bonds has been proposed, in quantities initially equivalent to 3 percent of PEMEX's total short and long term debt, incrementing to 5 percent. As shown, the initiative entails a broad and different scheme of financial management, which includes maintaining the notable contribution of PEMEX to public coffers for a considerable period of time. This is a particularly evident aspect of the privatization proposal.

The objective of maintaining PEMEX's contribution to public finances, in order to finance a large part of the federal public sector's current expenses and various other expenditures regarding state and municipal executives, while at the same time earmarking areas of the oil industry for the benefit of transnational corporations, can be better understood upon considering the changes to the Federal Law of Rights. The fiscal regimen for hydrocarbon exploitation in the deep waters of the Gulf of Mexico and in the Paleocanal de Chicontepec imply a lesser contribution to public finances. But in addition, other deductions are established, such as 100 percent of investments for exploration once production begins. There is also a favorable deduction regimen for investments made in the areas of extraction, transportation and storage of hydrocarbons, all of which are conceived so that private companies will be able to benefit from their contracts with PEMEX. The deductions incorporated into this fiscal regimen are a form of sharing oil-based wealth and financing the investments of private parties.

It is possible that exceptional conditions will also be established for the accelerated amortizing of investments in the areas of refinery, oil duct operation and hydrocarbon storage, constituting a method of transferring wealth from PEMEX to transnational companies. In addition, a large part of extracted crude would be immediately sold to foreign markets. As a group, these conditions do not permit hydrocarbons to be used for the development of the country.

In recent years, the resources produced by the sale of hydrocarbons to foreign actors have been used to finance diverse areas of federal and state government's current expenses. This does not allow for the development of the petroleum industry, nor does it foment economic growth. The privatization initiative will not modify this situation. To the contrary, it maintains it, and in many senses uses it to argue that shortfalls of resources make the participation of private capital necessary.

Areas of business interests, which were the object of the 1938 expropriation, would be reestablished for a small group of capitalists with wide discretionary power over their spending, while the role of PEMEX as the principle contributor to the government's current expenses would continue. Such is the possible privatization. There would be new areas of business for a select few without changing the basic policy of indiscriminately extracting petroleum, which is principally sent to other countries where it can be transformed into a large number of products, therefore generating added value and creating positive impacts in terms of employment, spending and investment outside of Mexico.

In Mexico, the transformation of crude into gasoline will also be a private endeavor, as will be the widening of the transport and storage networks, despite the fact that the 27th Article of the Constitution maintains that: **As related to petroleum and to solid, liquid and gaseous hydrogen carbides and radioactive minerals, no concessions or contracts shall be awarded, nor will existing contracts be honored and the Nation shall carry out the exploitation of these product.** Such clear and direct language does not allow for interpretation and does not permit possible exceptions. The text is also consistent with the 28th Article of the Constitution, which determines the areas that are not considered monopolistic, such as petroleum, other hydrocarbons and basic petrochemicals, as such sectors are considered of a distinct nature and form part of the strategic areas exclusively reserved for the state. The 25th Article of the Constitution establishes that the public sector will exclusively control the strategic areas that are defined in the 28th Article of the Constitution.

In 1938, when President Lázaro Cárdenas expropriated the oil industry, he declared: "for the cause of the public utility in favor of the Nation, the following is declared expropriated: the machinery, installations, buildings, oil ducts, refineries, storage tanks, communication lines, tankers, distribution centers, cargo ships and all other goods that are property of the company..." and proceeded to list off the company names.

One of the substantive results of the Mexican Revolution that is embedded in the Constitution of 1917 is the recuperation of solid combustible minerals, oil and all hydrogen carbides, liquid or gaseous, for the direct dominion of the Nation. However, the recuperation was only made effective with the expropriation of 1938. The dominion over petroleum is impossible to exercise unless the Nation also owns the means that make exploitation possible.

The initiative of the federal administration once again wants the machinery, installations, buildings, oil ducts, refineries, storage tanks, communication lines, tankers, distribution centers, cargo ships and all other goods that pertain to the exploitation of petroleum to belong to private parties. Through these means large companies would have access to the

nation's oil wealth and would obtain profits through its exploitation. It is a project tailored to the interest of a few transnationals and the maintenance of a public sector that finances a considerable part of its current expenses with the oil sector's resources. It is a proposal to privatize the petroleum industry that does not strengthen PEMEX.