Mexico's oil industry and the privatization initiative of Felipe Calderón.

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In recent weeks, the price of oil has continuously increased in international markets. Estimates by investment banks such as Merrill Lynch, Morgan Stanley and Goldman Sachs indicate that the immediate future will not bring a significant reduction. Executives of other companies, such as Alexy Millar, general director of the state-owned Russian firm Gazprom, voice similar opinions. Not even functionaries of international financial organisms offer dissenting viewpoints.

The behavior of prices in futures markets can be explained in part by the displacement of financial capital employed by investment banks, hedge funds, and other financial agents in the face of the lack of profitability in derivative instruments. As such, it is entirely possible that prices will not necessarily be maintained for more than a year. However, there are also other factors, such as the maintenance of consumption in the United States under conditions of declining oil reserves and the sustained growth of China and other Asian economies that demand a growing quantity of hydrocarbons. The sum of these factors suggest that the era of inexpensive oil has now been over for some time.

Under these conditions, the Mexican federal administration presented towards the end of April a group of proposals to modify the conditions of operation of the country's oil industry. Both in the initiatives of Felipe Calderón, and in the media campaign, the lack of resources for the modernization of this industry is emphasized.

In a previous document that diagnoses the problems facing the country's industry and Petróleos Mexicanos (PEMEX), the same point of view is expressed. Other causes are added, such as technological shortcomings, but the lack of financial means is once again insisted upon. However, the behavior of oil prices in past years and the increase in the earnings of PEMEX disqualify this conclusion. Nor can these findings be sustained when taking in to consideration the earnings to be made in the immediate future, if only from the extraction and exportation of crude oil.

In Mexico, the state institution entrusted with the task of organizing and developing the oil industry is PEMEX. No other institution or private company is permitted to engage in this activity. For an idea of what PEMEX represents, in 2007 its earnings equaled 11.65 of the gross domestic product (PIB). No other economic entity has a similar weight in the country. Notably, its earnings as a proportion of GDP have been growing in recent years. In 2002 they equaled 7.68 percent of GDP and in 2005 11.09 percent. From 2004 to the present date, the earnings from PEMEX as a proportion of GDP are the same or greater than all tax revenue collected by the public sector during the same period.

Regardless of the noticeable increase in its earnings, PEMEX has not realized significant investments, such as the construction of a new refinery. Yet today officials insist that it is of utmost importance to build three refineries in the span of ten years and it is therefore necessary to incorporate private capital. Similar arguments are made in relation to other activities that conform the oil industry. If the federal administration's initiative is approved, it will be possible for private companies to invest in and manage oil ducts and storage facilities. The administration affirms that serious shortcomings exist in the transportation, storage and distribution of hydrocarbons, petroleum products and petrochemicals and new oil ducts and storage facilities must be developed as soon as possible. PEMEX cannot act in these areas as to not distract it from its more substantive activities. However, in any case PEMEX will assuredly provide the hydrocarbons and will also buy the petroleum-based products that result from refining processes in their entirety. The companies that invest in these activities will have full supply guarantees for the duration of their contracts, as well as for the purchase of their products.

To the date, six initiatives have been presented to modify various laws or to give new powers to state organisms such as the Energy Regulatory Commission or to create new government institutions. Five legislative initiatives have been presented to the Senate of the Republic and one to the Federal Chamber of Deputies. The latter is a clear example of the content and characteristics of the privatization that the federal administration of Felipe Calderón seeks to establish.

Upon approving these initiatives it will be possible for PEMEX to award so called extended service contracts to private companies. Those which sign contracts for the exploration and extraction of hydrocarbons in the zone denominated as Paleocanal de Chicontepec – located in the coastal plain of the Gulf of Mexico, in the north of the state of Veracruz and the northeast of the state of Puebla, which covers an area of approximately 3,300 km2 – and in the deep waters of the Gulf of Mexico, will have a specific fiscal regimen that will determine the contributions that PEMEX will make to the federal government. The initiative establishes a special regimen for royalties that is lower than the current one for all other hydrocarbon extraction. Realized spending will also be considered as deductible up to levels higher than those applicable for the rest of extractive activities. Costs associated with transport and storage are also included as deductible. Contracts will take results into consideration in order to establish the reimbursement that PEMEX will make to private companies. Taken together, these measures offer clear benefits to private sector companies that undertake such investments. In effect, a part of the nation's oil wealth will be shared with them, while at the same time mechanisms are being established to allow private enterprise to at least partially finance their investments.

However, the initiatives also maintain the conditions under which PEMEX can continue to be the number one contributor to the country's public finances. Between 2004 and 2007, the public sector revenue generated by the oil industry was between 36 y 38 of total revenue. In other words, forty cents of every peso colleted by the state comes from the oil industry. Calderón's reforms will not modify this situation. As such, they will not strengthen PEMEX. To the contrary, its role as an organism that administers contracts with private companies and transfers earnings to the Secretary of Finance and Public Credit to be spent as current expenses by the public sector will only be accentuated. The extraordinary earnings of past years have not been used for investment.

Another objective of Calderón's reforms is to maintain and, if possible, to increase PEMEX's crude oil exportation. For years PEMEX has exported more than 50 percent of the petroleum that it extracts. The highest level of exportation was in 2005, at 1.82 million barrels per day. The exportations are highly concentrated. Until 1988 only 52.4 percent of crude exports were sent to the United States. In the following years until 1993 there was a slight increase. However, from 1993 onward, once the federal administration headed by Salinas de Gortari accepted the North America Free Trade Agreement (NAFTA), the composition of crude oil exports was radically modified in terms of their destination. In 1993, 73 percent of crude exports was sent north of the Rio Bravo. During the following years this number increased to 80 percent.

In recent weeks, the Secretary of Finance and Public Credit and other offices of the federal administration have insisted upon the delicate situation that relates to the reduction of crude exports. The content of the initiatives, the management of the financial resources resulting from the increase in the prices of hydrocarbons and the declarations of various functionaries indicate that maintaining sales to the United States and even increasing them is a commitment to that country's government. However, maintaining its condition as an exporter of crude oil is not in Mexico's best interest. Between January and May the extraction of crude oil diminished. As such, the exportations for the first five months of the year were on average 1.462 million, 252,800 fewer barrels than in the same period of 2007. Regardless, the entry of foreign currency from crude oil exports was far greater than that of the same period during the previous year. The adjusted price of the Mexican mix of crude was 89.4 dollars per barrel, 76 percent greater than that obtained in the same period of the previous year.

The budget for public sector expenditures in 2008 incorporates a price for the sale of the Mexican mix of crude at 49 dollars a barrel. Programmed spending is based on this number. The existence of a large financial surpluses can be used for the development of PEMEX, to initiate diverse investments in exploration, refinery construction, maintenance and development of the network of oil ducts and other tasks that would allow for the industrialization of the petroleum industry in the country. It is absolutely necessary to change the country's status as an exporter of crude oil and importer of petroleum products. In recent years the importation of gasoline has increased, to the point that currently 41 percent of national gasoline consumption in imported.

Allowing permit private companies to construct and own refineries in order to sell gasoline to PEMEX as international prices dictate is not a solution, even less so if the cost structures of these companies include long term contracts that guarantee the supply of oil and fix prices in highly unstable markets. This would mean creating business opportunities for a few transnational companies without strengthening PEMEX.

The maintenance of a platform for the extraction of crude to guarantee a million and a half barrels a day or more for the United States and the channeling of the resources from these sales to the current expense account of the public sector and to the payment of the various contracts established with private companies likewise does not strengthen PEMEX, nor does it link the use of the country's oil-based wealth to the development of the country.

If Calderon's initiatives are approved, or others that establish greater spaces for private investment in the country's oil industry, the same economic conditions that provided the basis for the expropriation of the oil industry in 1938 would once again be created. The proposed changes imply that, with ample discretionary elements at their disposal, profitable conditions are created for a small group of transnational corporations and their national associates. At the same time PEMEX's role as the primary contributor to the public sector's current expenses is maintained. This is the possible privatization in the context of the current situation of public finances.

In the text of 27th Article of the Constitution, it is established 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.