

# Hydrocarbon Policies in Mexico: The Difficulties of Changing and Modernizing the Oil and Gas Sector in the Framework of the Democratic Transition (2000- 2005)

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# Introduction

- New trends in the international oil sector have had important repercussions on international oil companies in oil producing countries.
- The Mexican oil national company –Petróleos Mexicanos (PEMEX)- has to successfully confront this new panorama and create a new corporative organization that can offer more efficient administration and quality products.
- However PEMEX confronts a very serious dilemma:
  - On one hand: cultural, historical, political, economic and social context influences discussions and decisions regarding energy –especially the oil sector- (oil nationalization in 1938 is seen as a national sovereignty issue and Article 27 of the Mexican Constitution limits the intervention of the Private Sector).

- On the other hand: it's necessary to modernize PEMEX. Business logic has come to the forefront like never before.

### **The problem:**

**The much needed transformations in the Mexican oil industry require a series of Constitutional changes.**

- However, it is difficult to do so when political transition is characterized by a “divided government” -a scenario where none of the 3 main parties dominate and can impose its views at any level: Executive, Legislative or Judicial. And any changes in the Constitution requires the approval of the two-third part of the votes in the Federal Congress AND the majority of the votes in local congresses.
- This situation of inertia and/or blockade is relatively new (1997). Executive Power lost the central role it got before and Congress is becoming the main actor in the decision-making process.

## In this framework:

*1. How is it possible to implement changes when a large part of the political class opposed to them?*

*2. What kind of strategies succeeded and what kind failed?*

*3. How –and how far- have the strategies of government actors interested in promoting a “business” logic succeeded in bringing important modifications in the oil sector?*

- We'll focus on three examples to analyze the strategies employed in each case during the current administration.
- It's important to notice that we do not pretend here to evaluate the relevance of the different projects. We are just interested in actor's strategies.

## A. The Multiple Service Contracts in Mexico: An Experience of Association Between Public and Private Investments

- Since the mid-90's, Natural Gas (NG) is gradually replacing fuel in the production of electricity. NG demand has been increasing in a very important way and in a very short time. Mexico has to import 30% of its NG consumption.
- In order to relieve public finances, to preserve the macroeconomic stability, and reduce the gap between NG demand and supply within constitutional restrictions, Vicente Fox administration created a special figure - **Multiple Service Contracts (MSC's)**- to facilitate the investments, gathering different services in ONE contract.
  - Government was expecting 6,000 millions dollars from private companies to complete PEMEX investments in upstream for Non Associated NG in Burgos Basin.

➤ *MSC's cover exploration, production, transport development and infrastructure construction for NG in a single contract, which is valid for twenty years and the private companies costs will be refunded depending on the gas price.*

- **The legal aspect** of MSC's has been the core question:
  1. *Promoters (Government) said that they were not **risq share contracts** (which are forbidden in Mexico).*
  2. *Opponents called into questions their constitutional character.*
- Since the beginning, the MSC's promoted split opinions and extremely passionate and ideological debates among the promoters and the opposition. For this reason, the bids took place in a judicial and political controversial environment.
- For this reason, the government didn't get the expected results from the private sector:
  1. *The bids for the two biggest and most important blocks were declared void.*
  2. *The other five blocks were taken by a group of oil companies, that didn't include none of the "majors" companies.*
- In June 2004, a group of PRI congressmen put a Constitutional Controversy against PEMEX and Energy authorities. The Judicial Power's verdict has been negative for PEMEX: the definition of MSC's is confused so the company is not allowed to promote new bids.

## *The different actors' strategies and incentives*

- The government, frightened by the public opinion reaction to the participation of private companies, tried to act outside of the political scene, and refused to engage public opinion in debate. This attitude increased all kind of doubts and suspicions.
- The opposition focused on the legal and technical issues of the contracts, and made excellent use of the nationalist element which still has a great impact in the public opinion.
  - *Besides, many claimed that the MSC's were unnecessary: Previously, PEMEX had been successful in the exploration and production of NG (Burgos Basin).*
- The International Oil Companies:
  - *On one hand, they were interested in coming back to Mexico. It could have been a first step.*
  - *But the restrictions MSC's implied –they won't book reserves and they wouldn't share profits for the risks and results- were not a good incentive. It's the reason why the majors didn't want to participate.*

## B. Natural Gas Underground Storage and Liquefied Natural Gas (LNG) Projects in Mexico

- These two NG storage programs represented another innovative plans to implement changes in order to improve the situation of NG in Mexico, giving flexibility to the supplies and more stability to the prices.
- We'll analyze the following two cases. Each one failed but the reasons are different.
  - *The first case is associated with the development of underground storage project (Tuzandéptl Project).*
  - *The second one is the failure of the “regasificación storage project” (Marathon Oil Company Project).*



## 1. Tuzandéptl Project

- The objective of this project was the use of the Tuzandéptl caverns –gem salt caverns- for fuel storage.
- But, two laws blocked the project:
  - *The Mining Law that considers that these are gem salt caverns. The law gives priority to the mineral extraction activity over any other. To use the caverns, the mineral has to be extracted until its depletion.*
  - *The Constitution in its 27th article, stipulates that gem salt is State property.*

In this context, to use the caverns it is necessary to modify both laws. It is very unlikely in the actual Congress.

- So, in 1999, PEMEX announced that the project had been cancelled.

## 2. Marathon Oil Company Project

- The project objective was the construction of NG “regasificación plants” in Baja California (close to Tijuana). Marathon Oil Company won the bid.
- For Federal Authorities (CRE and SEMARNAT), the project fulfilled the legal, technical and safety conditions stipulated in the present legal framework. Ministry of Environment authorized the project.
- But the neighboring communities, the environmental groups and Local Authorities opposed to this project.
  - *On February 28th 2004, local authorities don't want to authorize the using of the land that was designated for the plants; after that, they took ownership of the lands.*
  - *In March 2004, the Marathon Oil Company informed that the project was being cancelled.*

## *The actors' strategies*

- The opposition of a local government against the federal power shows that local actors, as well as political and environmental groups, have gained greater autonomy and increased their political capacity (because of the pluralist political system and the decentralization process in Mexico).
- The Federal System (CRE, and Federal Government) was completely astonished. They didn't anticipate oppositional activities and didn't know how to react. However this incident will serve as a precedent for future planning (ChevronTexxaco in Coronado Islands).

## c. PEMEX Fiscal Reform

- The principal energy actors (political parties, PEMEX, SENERr (Ministry of Energy ), etc.) have recognized for a long time the need to change PEMEX fiscal regime.
  - *This regime is very counterproductive and prevents the company from making the necessary investments for its expansion and modernization.*
  - *PEMEX has been acting as the governments financial tool by paying a very high tax (60.8%).*
- On September 8th 2004, the Executive presented a decree initiative for the fiscal reform of PEMEX.

- *This initiative was sent first to the House of Representatives. At the end of October, it was unanimously approved and sent to the Senate to be endorsed.*
- *However, in the Senate, the major political parties split. Opposition parties decided to get together and present an alternative plan.*
- *This new proposal returned to the House of representatives and finally got passed on June 28th 2005.*
- *President Fox didn't accept the new reform and made some observations so the new reform has not been passed.*

# ➤ Which factors and actors' strategies played an important role ?

## 1. The importance of the leaders

partially explains the differences between House of Representatives and Senate positions.

. In the House of Representatives, the Energy Committee congressmen (Dip. Francisco Javier Salazar) had a very proactive role in promoting a common point of view among the congressmen.

. In the Senate, the PRI's power had prevailed over the PAN administration in the Energy committee (Senator Bartlett's group), using nationalist element as the major argument.

. The role of the leaders is important in a country like Mexico where the actors' personality is particularly significant in politics.

## *2. The political timing*

**As we approach the end of the six year administration , the need to show a positive balance is increasing, even though the results aren't what was expected.**

***- The opposition took advantage of these needs by stopping the President's plan and making a new proposal.***

***- This rush explains the PAN's attitude (the presidential party). In the end, their approval to the reform was more a real agreement along the lines of the new reform.***

### 3. The political need of all actors in Congress to “take out a reform”

- The Congress has a very negative image. The fiscal reform was a good opportunity to change public opinion.
- The differences between the three main Mexican political parties regarding PEMEX’ role have played a fundamental part in getting the reform.

**This situation underlines once more the extreme politization of the hydrocarbon industry in Mexico.**



# Making a Balance

Besides the “divided government”, other parameters have played a significant role in the adoption of strategies.

## A. The Constitution and the nationalism

The Constitution marks clear limits to the private sector and the nationalization of oil in 1938 turned it into a strongly loaded mythical element connected with ideas like “sovereignty” and “national dignity”. Both elements play a very important role in the acceptance of the programs and determines the available strategies.

- . It involves a confusion between “Nation’s ownership” and “Monopoly of State”.

- . For instance, Vicente Fox administration began opening first the upstream in the gas sector (MSC’s). It could have been a two-step process. (after that, oil upstream)

- . Gradual opening have been chosen over a radical one.

## B. New Actors: The ability displayed by new actors in the Mexican Political Transition:

1. The importance of **Congressmen**. The problem is that they cannot be “reelected” as members of House of Representatives immediately after the end of their period. So that they cannot acquire a real competence and specialization in some issues, and they stay mainly influenced by the position of their political party.
2. The **Judicial Power** increased its visibility. It became THE area where political actors settled their differences. Judges and lawyers have acquired a more important role in a “cognoscitive” and normative way. They have to create jurisprudence and establish criteria on what can or cannot be accepted.
3. **Local Authorities**: A new Pluralist system where local authorities do not belong always to the same party than the President gives them more autonomy and new faculties.
4. **Civil Society**: more active.

## C. The coexistence of two opposing logics in the same industry poses a problem.

How is it possible to reconcile the **monopoly** in oil industry upstream with the **free market** in the downstream?

It seems that **State monopoly prevails** in every case.

## D. Governance problem:

1. Vis à vis PEMEX, Regulatory Committee (CRE) and Ministry of Energy (SENER) are institutions whose decision capacity is quite marginal.

## 2. The lack of clear divisions of tasks in the Mexican Energy sector:

- The Ministry of Energy (SENER) has very limited margins of maneuverability; PEMEX controls planning and strategic administration.
- Meanwhile, the Ministry of Treasury has a very strong control over PEMEX. It authorizes the company projects.
- There is great bureaucratic control from the Ministry in charge of public service. This underlines that PEMEX works like a federal dependency and not like an oil Company.

### E. Discussions and decisions about changes in oil and gas sectors are split into two opposite positions: “Opening to Private Sector” or “State Monopoly”.

There is a need for a global and more equilibrated debate about the new organizational structures that could bring a higher productivity. Coexistence between public ownership and private management criteria could be possible.

And the debate is also necessary to create a social consensus in Mexico about the definition of a new oil and gas policy. Because it's quite sure that “divided government” –that is to say “political pluralism” will continue being the new political rule.