

Mexico's New Petrochemicals Strategy¹

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Soon after the federal government announced its new strategy for the petrochemical industry on October 23, Congress approved by 277 votes (almost a two-thirds majority) the bill that President Ernesto Zedillo submitted to change the Petrochemical Law. Only the first step in the new strategy, this new legislation is of utmost importance and was passed only 10 days after being announced. We are convinced that the Senate will soon approve the bill, turning it into law.

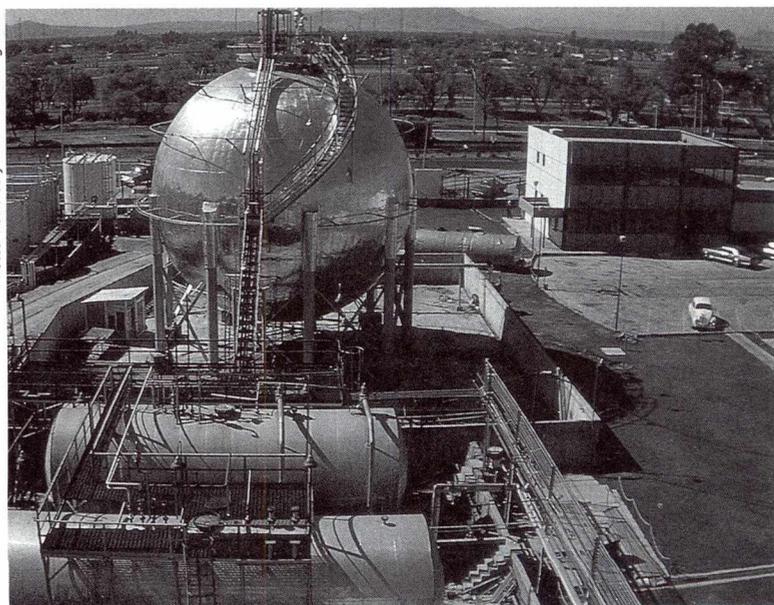
From then on, the Mexican petrochemical industry will have a fair, clear legal framework, which will not only spur the growth of the 49 percent share of the publically owned petrochemical plants now for sale, but, more importantly, will aid in the development of new projects.

Business in every sector, large and small, especially those linked to petrochemicals, business organizations, particularly the National Association of the Chemical Industry (ANIQ), and potential investors have been encouraging. The support for this strategy in general, and in particular for the modifications of the Petrochemical Law, is very stimulating for us.

Allow me to situate the important step taken October 23 in the perspective of the federal government's general strategy for the petrochemical industry. To do so, it

will be useful to review the main aspects and orientations of that strategy:

1. The first step is to acknowledge the great potential of Mexican petrochemicals due to the relatively high level of liquid gas linked to Mexican oil and its high ethane levels.
2. Consequently, the cornerstone of the strategy is the following premise: increased investment, mainly from the pri-



Photos: *Petróleo y Electricidad* magazine

Government's goal in petrochemicals is to increase total investment for the fastest possible growth.

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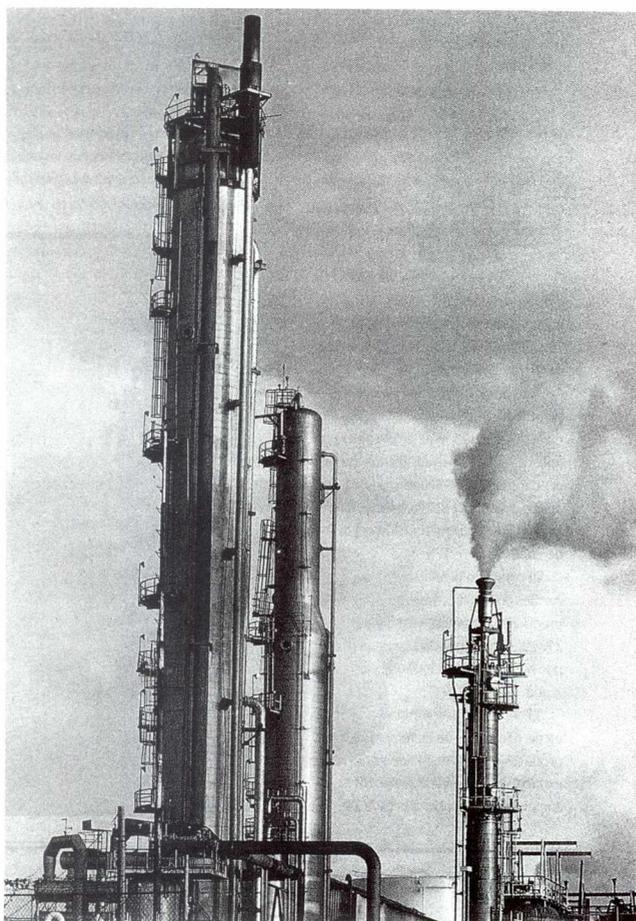
Photos for this article are courtesy of *Petróleo y Electricidad* magazine.

¹ Remarks during the Inauguration Session of the XXVIII National Chemical Industry Forum, in Mexico City, October 24, 1996.

vate sector, is required to develop petrochemicals and therefore, all measures should be directed toward that objective. The goal is to increase total investment, both public and private, foreign and domestic, to expand the sector as rapidly as possible. It must be remembered that since the 1992 announcement of the privatization of PEMEX-Petrochemicals' assets, unfortunately there has been hardly any investment in key petrochemical activities. The public sector has not made any because it has been promoting divestiture. The private sector has not invested either, because it has been waiting for this process to take place, to first participate in the divestiture, and then develop additional projects.

3. The new strategy recognizes that to attract new private investment, it is necessary to have:

- Legal certainty, clearly defining those activities restricted to the public sector and those open to the private sector.



For petrochemicals to grow, there must be equitable conditions for competition between the private and public sectors.

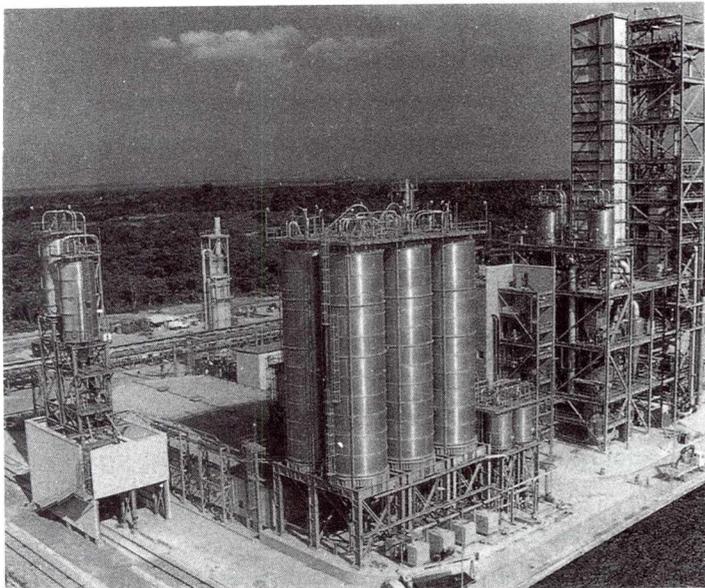
- A clear and stable regulatory framework.
- Equal conditions for competition between private and public companies. As I will later explain, this requires transparency in commercial and financial relations between public and private concerns. To achieve this, PEMEX-Petrochemicals must be divided into different concerns.
- Guaranteed input supply. This implies: a) guarantees of sufficient and prompt delivery; and b) competitive prices.
- Possibilities for productive linkages (coordination) among companies in integrated chains.

4. To maximize investment in petrochemicals, the new strategy opens two doors for private investment:

- 100 percent private investment in “new” petrochemical plants, with absolute legal certainty and appropriate conditions for competition. Current legislation puts no limits on foreign participation in this kind of investment.
- Up to 49 percent private investment in companies with a majority of public capital. Currently, ways to apply NAFTA are being analyzed (NAFTA limits the initial sale of a 49 percent interest in companies which produce 13 specific products to companies with a majority of Mexican capital).

5. In this framework, the following basic actions of the strategy can be implemented:

- *Modification of the Petrochemical Law.* The first step was taken October 23. It is clear that PEMEX is not being privatized, that it is not opening the possibility for “risk-contracts” and that Articles 27 and 28 of the Constitution continue in effect.
- *Modification of administrative regulations, like:* a) rescind the Petrochemical Regulation to eliminate all permit requirements regarding basic petrochemicals; and b) change the Oil Regulation to adapt the supervisory mechanisms for basic petrochemicals. These actions are obviously presidential prerogatives, once the Petrochemical Law is enacted by Congress.
- *Creation of new majority state-owned petrochemical corporations with PEMEX-Petrochemicals' assets, with two main objectives:* a) to create conditions for fair competition between public and private enterprises, as referred to in the third item of the new strategy; and b) use the resources



Privatization will permit a 100% investment of foreign capital in new plants and 49% in petrochemical companies now owned by the State.

obtained from the privatization of 49 percent of currently state-owned petrochemical affiliates for urgent investments to eliminate bottlenecks and keep the plants technologically up-to-date.

Setting up these affiliates as private companies will have other positive effects:

- They will have more autonomous managerial capacity than PEMEX-Petrochemicals.
- They will be subject to the same tax laws as competing private enterprises.
- They will pay normal property taxes.
- With total respect for workers rights, the collective bargaining agreements of each affiliate, negotiated by the Oil Workers Union (STPRM), will ensure excellent labor relations. Simultaneously, the legal procedures for "employer-substitution" will apply. These actions concern mainly the Ministry of Energy, with the support of PEMEX, STPRM, business organizations and interested investors, among others.
- The initiation of operations of the new public sector

petrochemical companies by early 1997. This implies the separation of PEMEX-Petrochemicals' present activities, not the placement of 49 percent of the shares. Two factors will make this possible so quickly: the appraisals are ready, as a result of the previous divestiture process (the book value of PEMEX-Petrochemicals' net assets was 18.029 billion pesos by July 31, 1996 [approximately 2.24 billion dollars]); additionally, organizational and legal documentation had already been prepared to support the previous process.

- The first placements of 49 percent of the shares of the new public petrochemical companies will be made in the second quarter of 1997 with the goal of concluding the first operation by mid-1997. The resources obtained will be used to finance urgent investments to eliminate bottlenecks.
- The last measures that should be mentioned are those aimed at immediately promoting private investment in new non-basic petrochemical plants.

6. Having enumerated the main actions, it is worthwhile to review the reasons for changing the Petrochemical Law:

- To specify exclusive state activities in the oil industry, especially in basic petrochemicals.
- To grant total legal certainty to the social and private sectors that will participate in non-basic petrochemicals.
- To stress the principles of the Nation's property rights and direct domain, as well as the state's exclusive right to exploit these resources according to Article 27 of the Constitution; and to conciliate these principles with the protection of private economic activity under the principle of state rectorship established in Article 25 of the Constitution and the definition of

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strategic areas mentioned in Article 28 of the Constitution.

- To establish a legal and regulatory framework that will facilitate reaching the basic objective of fostering the Mexican petrochemical industry and increasing private investment.

7. Mexico is the only country in the world that requires separate classifications for basic and non-basic petrochemicals. This is a result not necessarily of technical criteria but of the institutional framework established in our Constitution that reserves certain activities to the state. Therefore, the corresponding classification combines economic policy, industrial strategy and technical criteria. The activities in basic petrochemicals exclusively reserved for the state are those which produce hydrocarbons and fulfill the following criteria:

- They are the result of a first industrial transformation process;
- They are the starting point of other petrochemical chains;
- They are produced in important volumes by PEMEX and its subsidiaries, as an inherent part of their oil-related activities;
- Therefore, they are strategic raw materials for the development of the petrochemical industry as a whole;
- The basic petrochemicals proposed are hydrocarbons, but to serve as raw materials for petrochemical chains, according to the law, they must first be subject to industrial transformation.

The proposed classification, approved by Congress October 23, has other essential implications:

- It grants specific and precise content to the constitutional principle of state rectorship regarding petro-

chemicals, mentioned in Article 25 and 28 of the Constitution.

- It allows for development planning as well as the achievement of the state's commitment to foster and legally protect private investment in a more active participation in the development of the non-basic petrochemical industry.

- Basic petrochemicals are specified by law, according to Article 28 of the Constitution. Previously they had been established only by administrative resolution.

I would like to close by saying:

- The federal government has launched a new strategy for the development of the petrochemical sector.
- In this new strategy, divestiture is only one element.
- Many questions remain pending; we will have to analyze and solve them together. Perhaps the most important part of the new strategy is precisely that: it is susceptible to change.
- The federal government reviewed its objectives and continues to emphasize the main one: fostering the Mexican petrochemical sector.
- The federal government has complied with the president's basic directive and will continue to do so: to act with transparency and in absolute accordance with the law.
- Society and government debated the subject for months in one of the most open and democratic processes that we can remember.
- The legislative branch claimed its prerogative of legally defining basic petrochemicals.

Now we all have to work together rapidly to do what had been postponed and to unlock the great potential of the Mexican petrochemical sector. This is the goal that President Ernesto Zedillo set.

There are steps and stages that must be accomplished. We cannot and will not skip them. We will advance in an orderly fashion, according to the law and with total transparency. ❧