# Mexico's International Oil Diplomacy

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The recent plunge in oil prices is due to structural and momentary factors of both supply and demand. The structural factors involve the inability of the Organization of Oil Exporting Countries (OPEC) to regulate supply rationally; the momentary factors involve the economic crisis that forced the Asian economies to stop production, thus lowering their energy consumption; the mild winter in Europe and the United States; and, finally, the relaxing of U.N. sanctions against Iraq, which has been permitted to sell almost 2 million barrels a day (bd) on the international market.[1]

The producers' strategy is a watershed in the history of the international oil market given that it is the first attempt by OPEC members and non-members to work together to reduce crude production and stop the fall in prices. In cooperation with that effort, the Mexican government has taken initiatives and decided to join with the rest of the world's producers in setting production quotas for crude and aid in softening the differences between Saudi Arabia and Venezuela to cushion the current crisis. Until now three important meetings have been held with this aim. At the first, held in Ryad, Saudi Arabia, March 22, 1998, Mexico, Venezuela and the Saudis committed to withdrawing 100,000 bd, 200,000 bd and 300,000 bd, respectively, from the market.

That was the first time that Mexico supported a real initiative to reduce production and agreed with the two most difficult OPEC member nations on a significant measure to control oil supply.[2] Mexico is also playing a key role in reducing tensions between Venezuela and Saudi Arabia, who have accused each other of exceeding OPEC production quotas.

The next meeting took place June 4 in Amsterdam, and resulted in the OPEC deciding to lower supply by 1.3 million bd, a measure seconded by non-OPEC members, bringing the world total to 3.75 million bd. While the effect on prices was immediate, it was ephemeral given that the cuts were limited and compliance with commitments incomplete.[3] Since the agreement did have a certain positive impact on the price, however, OPEC was able to call for another informal gathering on November 25, 1998. At that meeting producers decided to extend the time limit for the production cuts from June 1999 until December 1999, with a production quota of 3.1 million bd. Despite the efforts of Saudi Arabia and Mexico to extend the time limit even further, the Persian Gulf economies refused saying that neither Venezuela nor Iran were complying with the quota.[4]

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After the last meeting, despite its conciliatory position, Mexico announced that if OPEC does not comply with the agreed-upon cuts, it will change strategy and could increase its export platform again. Given this, the questions are: What obstacles could be put in the way of a production increase or decrease both domestically and internationally? Can Mexico do it, and to what degree is it a good idea to break with the strategies agreed upon with the other producers?

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## NATIONAL OIL POLICY

The design of Mexico's oil policy is conditioned both by domestic and international factors. The Mexican government acts within the confines which allow it to comply with the role oil has in the national economy, obviously attending to the needs of the oil industry itself. The government has attempted to alleviate the impact of the drop in prices, proposing, among others, the following measures: a) an increase in tax revenues together with a fiscal reform that includes both tax hikes and price adjustments for the public sector; b) cuts in public spending proportionate to the drop in oil income. As a result, the 1998 budget suffered three cuts, initially estimated at 5 billion dollars; c) reduction of the impact on government revenues through assuming the costs of an increase in the fiscal deficit,[5] and d) an overall fiscal reform to increase federal revenues, ensuring a 20 percent increase in tax earnings vis-à-vis GDP, thus diminishing the economic importance of oil income.

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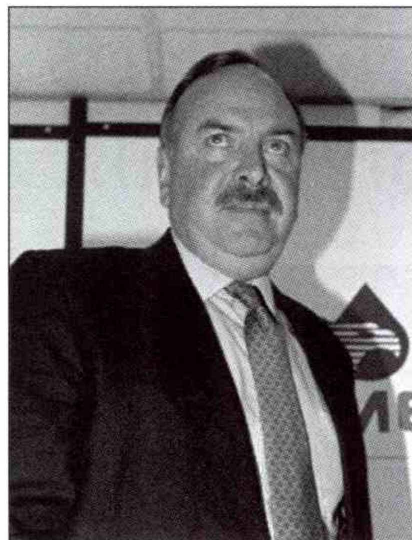
## THE U.S. MARKET

The proximity and dynamism of the U.S. market constitutes another of the fundamental aspects that mold Mexico's oil production and marketing policy decisions.

One of the basic changes today in trade policy vis-à-vis the 1980s is the elimination of the criterion that Mexican crude



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Pemex CEO Adrián Lajous.

exports to a single country should not exceed 50 percent of all exports. Shipments to the United States have increased noticeably, particularly since the signing of NAFTA; from the end of 1995, sales to the United States represent 80 percent of total exports. Between 1994 and mid-1998, oil trade with the U.S. market has increased 46.8 percent. Today, sales to the U.S. oil industry average 1.36 billion barrels of crude and, in April 1998, they represented 87 percent of all sales abroad.

The situation in the U.S. oil market is relevant because it is the cornerstone for Mexican oil export decisions. The United States is not only the greatest oil-consuming economy in the world; it is also of note that it depends enormously on foreign oil supplies (52 percent) and it will soon stop being one of the world's major oil producers because of the depletion of its own reserves. Despite the international oil market bonanza and U.S. recourse to Caspian Sea producers, the United States is concerned about its own future energy sources since, even though it has abundant sources of supply throughout the world, energy security considerations take into account that Mexico, due to its geographical proximity, guarantees rapid supply at a lower transportation cost. The United States has in its neighbor to the south a convenient, trustworthy and cheap supplier to satisfy its domestic needs. This relationship is also fundamental to Mexico in terms of its economy's dependence on petrodollars, which makes oil an element of economic security.

It is not strange, then, that Mexico occupies an important place in the U.S. oil market. In 1997, it was the second largest supplier (with 16.7 percent) to U.S. refineries, coming after Venezuela (with 16.9 percent) and before Saudi Arabia (16.3 percent) and Canada (with 15 percent).

In the opposite direction, the import of petroleum products from the United States into Mexico have increased considerably, particularly gasoline, of which one of five barrels consumed in Mexico come from abroad. This is a clear reflection of the renunciation of the energy self-sufficiency policies that prevailed until 1988.

In reality, this structural link, as well as the fact that one of the main beneficiaries of the current oil crisis is the U.S. economy as a whole, force Mexico to take into account three fronts when determining its export platform: a) the international oil

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market, Mexico's participation in it and its wish to cooperate to increase prices; b) its links to the U.S. market, where it competes for space with producers of the stature of Saudi Arabia, Venezuela and Canada; and, c) the fact that it has not wanted to separate itself too much from other exporters with whom it has common interests, like price stability and the preservation of room in the market to guarantee a certain level of tax revenues. Proof of this is Mexico's incorporation into the Organization for Economic Cooperation and Development (OECD) although it is not a member of the International Energy Agency (IEA), the body created by the industrialized nations to serve as a counterweight to the OPEC.

One of the Mexican authorities' arguments —which has even been suggested by the specialized international press— is that Mexico neither benefits from nor contributes much to the international oil market because of its limited participation. However, under current conditions of supply, 3.15 million bd in 1998 (4.13 percent) are not to be underestimated in relation to the world total of 76.198 million bd.

Mexico's international activism since the beginning of 1998 can be explained by its fiscal situation, with its activities aiming at a concerted reduction of supply and cushioning the drop in oil prices. The United States does not seem to look askance at Mexico's activism, however, since a slight increase in prices would suit its interests by reviving its battered local oil industry and that of its Middle East allies, who have also lost influence in the region due to plummeting prices, thus affecting delicate regional balances.

Specialists say that the relevant issue in analyzing Mexico's situation is that most oil revenues depend less and less on the international price of oil and more on the differential between production costs and the final market price, which can even be deducted from future earnings and still obtain significant oil income. Mexico argues that it has a lot of room for manoeuver given that its production costs are low (between U.S.$2 and U.S.$4 per barrel), creating an important differential despite the drop in the international reference price of crude. The important thing here is the cost reduction due to technological factors which, together with other structural changes in the oil industry, will play a fundamental role in establishing the scenario for oil in the future.

Javier García/Imagenlatina

Mexico's Minister of Energy Luis Téllez.

Mexican oil policy decisions are based on the idea that the international oil industry will go through 10 to 15 years of low prices, and therefore preparations are being made to increase competitiveness.

## CONCLUSION

The international oil industry, the press and different bodies suggest that Mexico, as well as other producers, open its industry more to foreign investment given the pressures of its own economic and investment requirements. They argue that Mexico should open up more areas to privatization, particularly in up-stream activities of exploration and extraction, in order to garner more earnings that would allow it to deal with the current price crisis and at the same time improve the company's efficiency. What they do not say is that the large corporations are in reality not only not divesting themselves of their assets, but are actually merging and integrating with each other vertically and horizontally with an eye to reducing production costs, improving technology and increasing oil reserves.

Examples of this, to name only the most important, are the three mergers of large oil companies: EXXON-Mobil; Shell, that merged with Amoco; and France's Total, that joined forces with Belgium's Petrofina. In addition, while it is the case that projections about future oil prices are the basis for the decisions to merge, privatize and broaden or reduce the oil production platform, these projections are somewhat uncertain. Some international specialists affirm that prices will rapidly recover once world oil production reaches its peak, which may happen in the first years of the next century.[6] In this scenario, government companies which have liquidated their fixed assets will not be able to

benefit from recovering prices. Government statements indicate that Mexican oil policy decisions are based on the idea that the international oil industry will go through 10 to 15 years of low prices, and therefore preparations are being made to increase competitiveness.[7] IEA predictions that world demand will drop from 2.9 percent of the growth of world consumption in 1997 to 1.6 percent are cited to support this scenario.[8] Once again, future scenarios are uncertain. The only thing that can be said today is that the recover of prices will depend on increased demand and producers' fulfilling the commitments they have agreed upon.[9] Today's market scenarios which serve as points of reference for policy decision making are important for the future not only of Pemex, but of the country as a whole. VM

## NOTES

[1] Banco Nacional de Comercio Exterior, "Lecciones de la crisis petrolera para América Latina," *Comercio Exterior* (September 1998), pp. 739-748.

[2] Antonio Rojas Nieto, "Notas para analizar la caída de los precios del petróleo," in *Economía Informa* 267 (Mexico City: Facultad de Economía-UNAM, May 1998), p. 20.

[3] Banco Nacional de Comercio Exterior, op. cit., p. 741.

[4] At that time, Venezuela's quota was 500,000 bd and Iran's, 300,000 bd. Another meeting is planned for March 1999 in which it is hoped that commitments can be clarified. [This meeting was held in Vienna in March 23; there OPEC members and non-members agreed to reduce crude production once again. Since then prices have gone up. Editor's Note.] An additional factor that has had an influence may be Saudi Arabia's attempt to maintain its position in the U.S. market, and its preference for lowering prices rather than lose it. The Arabs' main concern in this market is Venezuela, whose large investments with foreign companies may guarantee it a market in the United States.

[5] Banco Nacional de Comercio Exterior, op. cit., p. 744.

[6] Projections about future supply in the international oil market vary greatly. However, *The Coming Oil Crisis*, a book by industry specialist Colin J. Campbell, seems to be exercising important influence in the conformation of a vision of the future. Campbell sustains that prices will rise when global production reaches its zenith, which will happen in the first few years of the twenty-first century. See Mary H. Cooper, "Oil Production in the 21st Century," *Congressional Quarterly* 8, no. 29 (August 7, 1998), pp. 673-696.

[7] One analysis states that the probability that crude oil prices remain low for a prolonged period will diminish when demand peaks, given the loss of production capacity this will cause. See Bob William's analysis in "Oil Producers Face Key Question: How Long Will Prices Stay Low?" *Oil and Gas Journal* (December 28, 1998), p. 23.

[8] The questionability of figures even from prestigious bodies like the International Energy Agency has been shown in recent discrepancies with information put out by the same organization about oil supply and demand and inventory levels, called "missing barrels." This has sparked an investigation in the U.S. Congress itself through its General Accounting Office, which questions IEA data and its effects on prices.

[9] Antonio Rojas Nieto, "Impuestos y renta petrolera: reflexiones preliminares sobre la coyuntura actual," *El Cotidiano* 91 (September-October 1998), p. 7.

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