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An Oil Collapse Foretold

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The Official Argument

For Fox administration officials, Mexico's oil problem does not center on the country's lack or abundance of black gold, but the state-owned oil company Pemex's inevitably sinking into bankruptcy if it continues to reject private investment. President Fox, Minister of Finance Francisco Gil Díaz, Minister of Energy Fernando Elizondo and the new director of Pemex, Luis Ramírez Corzo, all regularly threaten there will be national chaos if private, multinational capital continues to be barred from fully incorporating into the oil industry with all legal guarantees, even though for a long time now it has been well known that it is already investing.

If we go along with the government's logic, there is reason for concern: oil reserves that had been estimated at 25 billion barrels were down to 14 billion barrels in 2001. If this trend con-

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tinues and we want to avoid Mexico becoming a net importer of crude in the next 10 or 15 years, about U.S.$20 billion in investments are needed annually. Since that amount cannot be rounded up either with more debt or from the national budget, the solution for averting the paralysis of the industry would be the energy reform to allow the inflow of private capital.

Opposition groups like the National Union of Oil Industry Salaried Workers (UNTCIP) maintain that in the four years of the National Action Party (PAN) administration, energy policy and official discourse have both been based on figures manipulated to show that the only solution to funding requirements is private foreign investment.

What is Pemex's real situation? Where is it going?

THE REALITY

The scare-tactic tone is nothing new. It was inherited from Pemex's former director, Raúl Muñoz Leos (2000-2004), who told Congress that the company's situation was acute and that its liabilities were already unmanageable, and announced its imminent collapse.

The federal government, for its part, boasts that Pemex is one of the world's leading oil companies: it is the third largest producer of crude; the sixth in assets; the seventh in crude oil reserves; the tenth in production of natural gas; the 13th in refining capability; and the fifteenth in gas reserves. In effect, these are comparative advantages, but unfortunately not the most significant ones.

The fact is that Pemex is far from being at the top of the list in terms of availability of capital, particularly risk capital; the creation of cutting-edge technology; experience in a broad gamut of operational areas; administration of projects, vertical integration abroad; horizontal integration in different energy industries; and strategic alliances throughout the sector's productive chains. Let us just say that in what really matters, that is, the technical-economic control of oil and gas and energy in general, Pemex is far from being like the merged, restructured "majors," and its deficit is not measurable in years, but in decades.

We could say that given restrictive economic policies and the marked ideological bias with which the country's most important company has been managed, Pemex is now incapable of satisfying the demand for oil, natural gas and petrochemicals without resorting to massive imports. It does not refine or sell either gasoline or diesel fuel in the United States, Europe or Japan.

Pemex is known only in Mexico. It does not explore for or produce oil and natural gas in the Middle East, Africa or South America. It is not capable of exploring or producing in deep water, much less in super- or hyper-deep waters. The company declares itself incapable of efficiently managing 1,000 upstream contracts, so it outsources to private companies through multiple services contracts to manage and direct the projects, which, paradoxically, are the smaller and less important ones. Also, Pemex is not part of the liquid natural gas chain. It does not create technology. It is not a giant in petrochemicals. It does not have sufficient capital and has to resort to massive direct and contingency loans (PIDIREGAS and the Long-Term Productive Infrastructure Project). It does not have a presence in the world electricity industry or in other conventional sources of energy (coal and uranium), much less in alternative sources like aeolian, solar or hydrogen-based energy. Pemex is definitely very far from being an Exxon-Mobil or a Shell, BP-Amoco or Chevron-Texaco. But even so, President Vicente Fox says that without a reform, "Pemex will leave the country."

In summary, the government elite has maintained Pemex as a company specializing in the extraction and export of crude oil. Worse still, for many years now the main place that has received investment and its main source of income has been the exploitation of a single deposit, the Cantarell fields, and selling the oil to the United States. The reason for this specialization is simple: for the governing elite, oil and Pemex represent above all an easy, quick source of fiscal earnings that allows them to stabilize the economy as a whole and tax the rich less. It is also an instrument for collaborating and negotiating with the United States.

The most tragic part of the matter is that Pemex's current directors do not propose taking it off the narrow path it is on. According to their last business plan, the dominant factors in the company's mid-term growth are access and

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replacement of reserves, the ability to exploit and efficiently process oil and natural gas and the ability to obtain financing. This implies concentrating efforts on:

* raising the replacement rate for reserves;
* strengthening exploration and heavy crude production in shallow waters;
* reducing lags in exploration and production of non-associated gas, marginal deposits and deep waters;
* participating in downstream segments of natural gas at the same rate as the private sector;
* continuing to adapt installations to increase refining efficiency and orient production toward light oil products;
* increasing production and improving results in petrochemicals;
* continuing to finance projects by resorting to third parties (contractors, suppliers, banks) and issuing debt paper;
* changing the tax system;
* reducing operating and administration costs;
* taking advantage of other companies' experience in exploration and production as well as in petrochemicals.

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Pemex's general director says that his strategy is based on works that will make it possible to change the shape and dimension of the Mexican oil industry. He adds that they are projects that go from the construction of marine platforms, the exploration and drilling of new areas and investment in duct infrastructure, to the modernization of the refining and petrochemical system. This position needs to be reflected upon.

1) In the first place, the director of Pemex establishes no priorities nor does he state the size of the resources poured into each of the aforementioned actions.

2) In the second place, with the exception of exploration in deep water, Pemex will only be doing more of the same, perhaps more efficiently and more effectively, but at the end of the day more of the same. It will continue to be circumscribed to Mexican territory in an industry project that is no longer the same as what the world saw during the oil crisis of the 1970s.

Pemex is lagging at least 20 years behind the problems facing the big international oil companies today, and the gap will only become wider and deeper if it continues with that entrepreneurial strategy totally lacking in vision and ambition. The vision of the governing team is not to make Pemex a large public company that can compete in world energy markets, but to perfect it as an instrument for generating revenue and stabilizing the economy while privatizing it.

3) In the third place, it is not construction that will change the shape of the oil industry, but the adoption of new policies and their corresponding legal expression. In that sense, the director of Pemex is seeking to cover up the fundamental changes that are going on in the company with volume indicators. The central axis of the changes is the penetration of private capital not only in each and every one of the industrial processes, but also —and this is the most important thing— in decision making.

This is happening through the Long-Term Productive Infrastructure Projects (PIDIREGAS), a veritable Trojan horse, since they undermine Pemex's techni-

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cal capability by outsourcing oil operations to private companies and its financial viability by excessively increasing its debt; if this does not stop, it will lead to an accounting bankruptcy.

The Fox government has wanted to turn Pemex into a mixed-ownership company, allowing the private sector to participate directly in the exploitation of oil and gas. But, since it has not managed to rapidly convince legislators of changing the Constitution, it decided to act in the purest technocratic PRI style: doing it on its own.

The Fox administration, then, has interpreted Article 6 of the law regulating Article 27 of the Constitution in the oil sector to mean that Pemex can outsource any oil-related work or activity to private companies, whether it be geological o seismological exploration; geological modeling; drilling of all kinds; oil and natural gas extraction; transportation and storage of liquid, solid and gaseous oil and gas products; the separation, conditioning and treatment of natural gas; or the fabrication of basic petrochemicals. In fact, there are already private companies carrying out these activities not only in Burgos, but also in the Southeast and offshore. What is more, the current administration thinks that it can use multiple service contracts to hire a multinational company to take charge of the entire industrial process except direct sales. And that one restriction is not because they want to obey the law but for purely pragmatic considerations: maintaining the monopoly on sales is used as a mechanism to control the contractor and make sure it does not lie about the amount of gas and oil it pumped and produced.

Not a few constitutional attorneys have pointed out that this interpretation of the law is unconstitutional. However, the government neither sees nor hears them; it prefers to take its chances in the courts than to retreat. The bad thing about this kamikaze attitude is that Mexico's position will be very weakened *vis-à-vis* the investors when the Supreme Court voids the contracts that it will have to void.

THE POLITICAL SCENE

Even though energy legislation has been amended to include the private sector, up until now the main demand of private investors has not been granted: changing the Constitution to guarantee the permanence and security of their capital in Mexico. Congress has consistently opposed this, with the Institutional Revolutionary Party (PRI) and Party of the Democratic Revolution (PRD) caucuses impeding changes to the Constitution. However, after the strong pressure inside the PRI, it seems that this party's position about the energy sector is changing, even though on the recent anniversary of the expropriation of the oil industry its leaders said that PRI principles defending oil sovereignty remained untouched and urged President Fox to reverse the process of defunding Pemex. Finally, in the PRI's Nineteenth National Assembly March 2 to March 4, 2005, the party made an about-face to echo administration rhetoric. Assembly delegates blocked adding the defense of constitutional articles 25, 27 and 28 to the party's plan of action, virtually eliminating obstacles in their by-laws to the entry of private capital into the energy sector and ousting the commitment to defend the state's exclusive right to exploiting energy sources.

PRI Senator Manuel Bartlett, the leader of deputies opposing Pemex privatization, emphasized that it is false that Pemex has no resources. PRI leader Ricardo Aldana from the oil workers' union also considered the government argument that only private capital could save Pemex from imminent collapse a fallacy. Both men said that the real intention is to pawn the country's most valuable energy resources through financial means that will only lead to the sale of Pemex and the Federal Electricity Commission using the argument that they are unproductive. The money coming in will be badly disguised foreign investment. They proposed instead creating a new energy policy that would include modernizing the regulatory framework and a profound fiscal reform of public companies.

Manipulating the assembly, party president Roberto Madrazo Pintado favored privatization by getting delegates to approve the exclusion of the constitutional articles from their plan of action. This is the result of commitments he has made to businessmen and other power groups about his political platform in his eventual bid for the presidency in 2006. Governors from northern states also came out in favor of privatization. A group of delegates from the North, together with those from Oaxaca, defended Madrazo's position of not even debating the issue in the assembly, and the plenary voted an energy plank that left the door open to private capital. Natividad González Parás, the governor of Nuevo León, supported Madrazo's position because the Monterrey Group is interested in getting directly into the energy sector, though it already fosters multiple services contracts and, in practice, is in the business of generating and selling electricity through supposedly self-supplying companies.

The reversal of the PRI's position in the assembly sparked all kinds of opinions. The most critical voices are from the PRD, which predicted that the reform of the PRI's by-laws would not only precipitate its split, but also represents a grave risk for the country's economic stability. Mexico City Mayor Andrés Manuel López Obrador reminded PRI members that Pemex and Mexico's oil belong to the nation and that he therefore roundly opposes privatization of the oil industry.

Those who within the PRI will surely join their voices to the party in power (the PAN) should not be sure of their victory just yet. As Senator Bartlett said, the PRI could pay the consequences in 2006 since its rank and file and the people of Mexico in general are against privatization of energy resources and the company that exploits them.

Despite the heavy media campaign favoring the government's position and the interests of the groups in power, the people's common sense and nationalism as part of Mexicans' identity are factors that should not be underestimated since they may well produce surprises in next year's presidential campaign. VM