

2007

Privatization of Pemex

Jonathan Howell

Follow this and additional works at: <https://scholar.smu.edu/lbra>

Recommended Citation

Jonathan Howell, *Privatization of Pemex*, 13 Law & Bus. Rev. Am. 461 (2007).

Available at: <https://scholar.smu.edu/lbra/vol13/iss2/10>

This Comment and Case Note is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

PRIVATIZATION OF PEMEX

Jonathan Howell*

I. INTRODUCTION

OVER the past ten years, Mexico has enacted legislation privatizing many of its formerly state-owned industries. Nevertheless, Mexico has continually rejected legislation that would privatize its oil behemoth, Petroleos Mexicanos (Pemex). This article discusses the history of Mexico's oil industry, the successful privatization of Argentina's formerly state-owned oil company, Yacimientos Petroleros Fiscales (YPF), and why Mexico, like Argentina, should privatize its oil industry.

II. HISTORY OF MEXICO'S OIL INDUSTRY

Before Mexico's nationalist movement, Mexico's laws granted landowners ownership rights in oil found beneath their land.¹ Consequently, by the early 1900s, many foreigners began investing in Mexico and its oil.² As a result, Mexico's oil proceeds ran mostly to foreign investors and away from Mexico's citizens.³ But the idea that foreign investors were becoming rich off of Mexico's natural resources promptly fueled a nationalist movement.⁴ In response, Mexico ratified article 27 of the 1917 Constitution, repealing the former law and declaring subsurface minerals to be the property of Mexico's government.⁵

After article 27 was ratified, Mexico merged its oil industry into a single state-owned entity that subsequently became Pemex.⁶ In light of the circumstances surrounding its formation, Pemex became a symbol of Mexico's sovereignty and economic independence from foreign

* J.D. Candidate, May 2007, SMU's Dedman School of Law; Articles Editor of the International Law Review Association; Law Clerk to the Honorable D. Michael Lynn, U.S. Bankruptcy Court, Northern District of Texas, 2007-08. I would like to thank S.M.U.'s Dedman School of Law, the International Law Review Association, and four amazing professors—David G. Epstein, William V. Dorsaneo, III, Elizabeth G. Thornburg, and the Honorable D. Michael Lynn—for all of their support.

1. Ewell E. Murphy, Jr., *The Prospect for Further Energy Privatization in Mexico*, 36 TEX. INT'L L.J. 75, 76 (2001) (discussing Mexico's Mining Law of 1884).

2. J. Keith Russell, Comment, *The Time is Now for Full Privatization of Pemex*, 20 HOUS. J. INT'L L. 173, 186-87 (1997) (describing foreign investment as "a massive influx").

3. *Id.* at 187.

4. *Id.* ("Expropriation of the oil companies was thus seen as a national defense against capitalistic foreign threats to Mexican sovereignty.")

5. Murphy, *supra* note 1, at 76.

6. Russell, *supra* note 2, at 187.

ownership.⁷

In the 1990s, however, a movement toward trade liberalization began with the privatization of many of Mexico's formerly state-owned industries and the adoption of the North America Free Trade Agreement.⁸ Accordingly, a movement toward the privatization of Pemex has gained momentum as well.⁹ Among those who support privatization of Pemex are Mexico's former President, Ernesto Zedillo Ponce, his successor, Vicente Fox, and high-ranking Pemex officials.¹⁰ Because of their efforts, Mexico amended its petroleum laws so private entities can "transport, store, and distribute natural gas, and . . . build, operate, and own [natural gas] pipelines and [natural gas] installations" through multiple service contracts.¹¹

Despite the momentum privatization has gained, Mexican nationalists, including many Congress members and union officials, despise the idea of Pemex's privatization.¹² Such staunch opposition has caused Mexico to continually reject legislation intended to solidify Pemex's privatization.¹³

In addition, certain Congress members have criticized the use of multiple service contracts, despite their limited use in natural gas production.¹⁴ Specifically, these Congress members argue that multiple service contracts violate article 27 by allowing foreign companies to benefit in the production of subsurface minerals.¹⁵ Conversely, proponents of multiple service contracts contend that these contracts are constitutional because Pemex retains both ownership of the gas and control of the projects.¹⁶ Regardless of the merits of either argument, Mexico has continued to

7. *Id.* at 188.

8. See Edward C. Snyder, Comment, *The Menem Revolution in Argentina: Progress Toward a Hemispheric Free Trade Area*, 29 TEX. INT'L L.J. 95, 96-99 (1994) (describing NAFTA and Mexico's privatization efforts).

9. See Michael Tanzer, *The International Oil Industry: Recent Changes and Their Implications for Mexico*, 46 MONTHLY REV. 2, 3-4 (1994) (explaining the pressure major oil companies are placing on Mexico to privatize Pemex); *Pemex May Offer Shares*, OIL DAILY, June 3, 2004 (demonstrating Pemex officials' desire to privatize through a limited stock offering).

10. See *Main Opposition Party Rejects Fox's Plans for Oil Industry*, FIN. TIMES, Mar. 7, 2005 (explaining that President Vicente Fox and Pemex officials argue that foreign capital is necessary to fully exploit offshore reserves); Murphy, *supra* note 1, at 77 (discussing the Zedillo administration's efforts).

11. See Murphy, *supra* note 1, at 77.

12. See George W. Grayson, *Why Mexican Labor Fights a Petrochemical Selloff*, WALL ST. J., June 14, 1996, at A15 (demonstrating labor opposition to privatization); Joseph Contreras et al., *Energy Crunch: Is Latin America Too Protective of its Power Sector?*, NEWSWEEK INT'L, May 31, 2004 (stating that the Mexican Congress blocked initiatives to open up Mexico's petrochemical industries to private investment).

13. See *Main Opposition Party Rejects Fox's Plans for Oil Industry*, *supra* note 10; *Pemex May Offer Shares*, *supra* note 9.

14. See *Pemex Runs into Senate Trouble Over New Contracts*, ENERGY COMPASS, Jan. 17, 2002.

15. See *id.* (stating Mexican Senate members want to prevent illegal privatization).

16. Bob Williams, *Pemex Official: Mexican MSC Round Just First Step*, OIL & GAS J., July 21, 2003, at 34; Contreras et al., *supra* note 12 (stating that "[t]he physical assets still belong to the government").

allow Pemex to issue multiple service contracts, and foreign companies continue to participate and benefit in the development of Mexico's natural gas reserves.¹⁷

Although Mexico has allowed foreign companies to participate in natural gas production through multiple service contracts, Pemex has not issued multiple service contracts for oil production.¹⁸ One obvious reason why Pemex has been reluctant to issue multiple service contracts for oil production is that Mexico views oil as a symbol of its sovereignty and economic independence.¹⁹ Another reason is that multiple service contracts are still under a tremendous amount of scrutiny themselves.²⁰ In essence, Pemex is reluctant to issue oil-related multiple service contracts because it fears that doing so would create a public uproar, enabling nationalists to eliminate multiple service contracts altogether.

III. PRIVATIZATION OF ARGENTINA'S OIL INDUSTRY

Argentina's privatization of YPF, its formerly state-owned oil company, is a prime example of the long-term benefits of privatization. For nearly eight decades, Argentina's government owned and operated the nation's oil supply under a state-controlled entity, YPF.²¹ Like Pemex, YPF was inefficient, undercapitalized, and the cause of a national budget deficit.²² Finally, in 1992, the Argentine government privatized YPF and adopted new legislation to support the process.²³

Within one year, YPF's privatization was almost complete, and Argentina's oil industry became a free market economy.²⁴ Yet, YPF was carefully privatized by a process that began with a presidential decree, privatizing "all secondary, marginal-production areas and offer[ing] private companies [partnership opportunities] with YPF in primary areas."²⁵ The same decree made crude oil, extracted from both primary and secondary areas, freely marketable.²⁶ Government price controls were eradicated, which enabled free market forces to determine oil prices.²⁷ Export

17. See *Pemex Awards Olmos Block to Lewis Energy Company*, BUS. NEWS AMERICAS, Jan. 16, 2004; *Pemex Receives Two Bids for Pandura-Anahuac Block*, BUS. NEWS AMERICAS, Oct. 26, 2004.

18. See Terrence Murray, *Mexico's Fox to Push for Private-Sector Gas Development*, INT'L OIL DAILY, Sept. 13, 2005; David Knapp, *Fox Tries to Ease Tax Burden on Faltering Pemex*, OIL DAILY, Aug. 20, 2004.

19. See *Burlington Looks at Burgos Basin Natural Gas Reserves*, ENERGY DAY, July 18, 2002, at 3.

20. *Main Opposition Party Rejects Fox's Plans for Oil Industry*, *supra* note 10; Peter Gall, *Oil Firms Line Up to Hear Mexico Pitch Multiple-Service Contracts*, INT'L OIL DAILY, June 19, 2002.

21. Interview with Pedro Nicholas Baridon, Vice President, World Petroleum Congress (2003), <http://www.world-petroleum.org/first/first2003/48-49.pdf>.

22. Russell, *supra* note 2, at 179.

23. *Argentina's Lower House Approves Privatization of YPF*, BLOOMBERG NEWS, Sept. 25, 1992.

24. Russell, *supra* note 2, at 180.

25. Snyder, *supra* note 8, at 107.

26. *Id.*

27. *Id.*

duties and foreign exchange remittances were removed.²⁸ And Argentina's government implemented the "Argentina Plan," allowing the removal of any further obstacles to developing private oil and gas reserves.²⁹

In his article, *The Time is Now for Full Privatization of Pemex*, J. Keith Russell explains four additional strategies that contributed to Argentina's successful privatization of YPF:

First, foreign law firms with expertise in the [privatization process] were consulted Second, . . . [Argentina's] government pursued a policy of swift, outright sales whenever possible, and granted concessions when outright sale was either prohibited by law or otherwise unattainable. Third, . . . [Argentina's] government ensured that potential investors . . . were financially solvent and possessed the technical ability to assume control of the enterprise before allowing the transfer to go forward. Finally, the government implemented a series of measures to ensure that former government workers were not unduly jeopardized in the transition.³⁰

By 1993, YPF was fully privatized.³¹ Shortly thereafter, Argentina experienced a 70 percent increase in its oil production.³² Once a net importer of oil, Argentina quickly became a net exporter.³³ Although the newly private companies initially cut employment by 90 percent, Argentina's oil industry is now growing efficiently with 130 new upstream businesses.³⁴

Additionally, foreign investors who took part in the securitization of the newly formed companies were not directly affected by Argentina's sometimes unstable economy because their revenues were hard currency and because they were creditors, not to Argentina, but to offshore, corporate obligors.³⁵ Moreover, when Argentina entered into an economic recession nine months later, these newly formed companies acted as a

28. *Id.*

29. *Id.*

30. Russell, *supra* note 2, at 181-82 (citing Julio C. Cueto-Rua, *Privatization in Argentina*, 1 Sw. J.L. & TRADE AM. 63, 71-75 (1994)).

31. Snyder, *supra* note 8, at 104.

32. Ali Moshiri, Managing Director, Upstream Latin America Business Unit in ChevronTexaco Overseas Petroleum, Inc., Latin American Upstream: Progress and Pitfalls, Speech to the Cambridge Energy Research Associates Conference (Feb. 12, 2002), http://www.chevron.com/news/speeches/2002/12feb2002_moshiri.asp.

33. *Id.*

34. Russell, *supra* note 2, at 181 (citing Bill White, *Latin America's Trump Card is Oil and Gas*, HOUS. CHRON., June 4, 1995, at 5C; Mary M. Shirley, *Privatization and Performance*, 17 HASTINGS INT'L & COMP. L. REV. 669, 675 (1994)).

35. Juan Pablo De Molleín et al., *Argentine Cross-Border Structured Market Still Waging Uphill Battle*, STANDARD & POOR'S, Sept. 12, 2002, http://www.securitization.net/pdf/sp_cross_091202.pdf. Repsol, now known as Repsol YPF, a Spanish oil and gas company, was the most heavily securitized foreign company involved in Argentina's privatization. Repsol YPF has revenue of \$48.82 billion and debt equaling \$14.92 billion. Currently, most research firms suggest the company is highly undervalued. Finance.Yahoo.com, *Repsol YPF SA (REP)*, <http://finance.yahoo.com/q/ao?s=REP> (last visited Nov. 3, 2005).

source of financial stability in the country, maintaining AAA credit ratings.³⁶ Thus, in determining whether privatization of Argentina's oil market was the correct course of action, the short-term difficulties, including loss of employment and reduction in salaries, seem relatively insignificant when compared to the long-term benefits. Because privatization of YPF reduced the government's budget deficit, created room for an efficient oil market, and became a bedrock of financial stability, privatization of Argentina's oil market is a wonderful example of the benefits of privatization.

IV. PRIVATIZATION OF MEXICO'S OIL INDUSTRY

If handled properly, privatization of Mexico's oil industry could have a tremendous impact on Mexico's economy. Similar to Argentina's formerly state-owned YPF, Pemex owns and controls Mexico's oil industry.³⁷ Like YPF, Pemex has a great number of financial problems, and, as a result, the government has incurred an enormous budget deficit.³⁸ Although there has been much debate over whether or not to privatize Pemex, Mexico's Congress continues to reject what ultimately seems inevitable—the privatization of Pemex.³⁹

Generally, advocates of privatization argue that without privatization Pemex's oil production will continually fail to meet demand and thus continue to cause a government budget deficit.⁴⁰ In contrast, opponents of privatization express concern about foreign profiteering and do not believe that foreign investment would trickle down to the working class.⁴¹

A. ARGUMENTS IN FAVOR OF PRIVATIZATION OF MEXICO'S OIL INDUSTRY

Proponents of privatization contend that Mexico's excess oil reserves remain untapped because Pemex lacks the financial backing and technology to develop its reserves.⁴² This is especially frustrating, proponents argue, because Pemex's excess reserves are sufficient to keep thirty oil companies busy for the next five years.⁴³

36. *Id.*

37. Kenneth D. Jensen, Comment, *Chapatome: Interdependence and the Liberalization of the Oil Industry in Mexico*, 24 CAL. W. INT'L L.J. 81 (1993).

38. *See id.*; Snyder, *supra* note 8, at 105.

39. *See* Adriana Arai, *Slim, Mexico Businessmen Call for Pact to Spur Growth*, BLOOMBERG NEWS, Sept. 29, 2005; Contreras et al., *supra* note 12.

40. *See* Enrique Rangel & Tracey Eaton, *Oil Plan Called Threat to National Treasure*, DALLAS MORNING NEWS, Jan. 14, 1995, at 17A; Arai, *supra* note 39.

41. *See* Tanzer, *supra* note 9.

42. Perhaps the most illustrative example of Mexico's failure to develop excess reserves is its inability to effectively deep-water drill. *See* James Irwin, *Fox Initiative Could Open Mexican Gas Plays*, NATURAL GAS WEEK, Sept. 26, 2005; *Mexico: A Shrinking Giant*, PETROLEUM ECONOMIST, Mar. 7, 2005, at 4.

43. George Baker, *Pemex Development Tracking Fiscal, Technological Strategies*, OIL & GAS J., May 7, 2001, at 58.

Furthering proponents' arguments is the fact that Mexico has generated revenue, increased its gross domestic product, and paid down its debt with relative ease, by successfully privatizing other formerly state-owned industries. Mexico's essential goal in privatizing these industries was "to raise revenue and ease some of the fiscal problems of the government."⁴⁴ During this period of privatization, revenue "totaled more than \$22 billion . . . [and] more than double[d] the revenues from privatization of any other developing country in the same period."⁴⁵ Additionally, during the last few years, "Mexico saved an estimated \$1.3 billion a year in interest payments from its debt restructuring."⁴⁶ Also, inflation dropped from 180 percent to less than 20 percent over the course of four years.⁴⁷ And Mexico's gross domestic product more than doubled from 1.7 percent to 4 percent after Mexico sold its state-owned telecommunications company, Telemex.⁴⁸

B. ARGUMENTS AGAINST PRIVATIZATION OF MEXICO'S OIL INDUSTRY

Opponents of privatization use their stance as more of a political ploy.⁴⁹ Leading the charge against privatization are nationalist Congress members and union bosses.⁵⁰ The unions generate political support for nationalist Congress members in exchange for the power granted to union leaders.⁵¹

These opponents of privatization choose to politically exploit the fact that many Mexicans view Pemex as a sacred symbol of sovereignty, instead of facing the harsh reality of Mexico's unstable economic conditions.⁵² Specifically, union bosses reinforce this national sentiment by using government funds to provide public services to Pemex workers.⁵³ Consequently, Mexico's citizens are compelled to support the union bosses in order to insure the continued receipt of the union benefits.⁵⁴ Ignoring the long-term effects, opponents of privatization point out the short-term hardships that privatization of Pemex would bring, including

44. Pankaj Tandon, *Welfare Effects of Privatization: Some Evidence From Mexico*, 13 B.U. INT'L L.J. 329, 334 (1995).

45. *Id.*

46. *Id.* at 335.

47. Snyder, *supra* note 8, at 99.

48. Shirley, *supra* note 34, at 675 & 677 fig. 4.

49. See Marla Dickerson, *Fear of Political Unrest Roils Mexican Markets*, L.A. TIMES, Apr. 7, 2005, at C1 (stating that Mexico City's mayor is against privatization of Pemex, which many Mexicans view as a sacred patrimony, despite Pemex's woeful inefficiency); Grayson, *supra* note 12.

50. See Murphy, *supra* note 1, at 77 (discussing labor demonstrations and congressional opposition in response to plans for privatization); Russell, *supra* note 2, at 200-01.

51. See Jensen, *supra* note 37; Russell, *supra* note 2, at 200-01.

52. See Dickerson, *supra* note 49; *Pemex May Offer Shares*, *supra* note 9.

53. Russell, *supra* note 2, at 200-01.

54. *Id.* at 201.

job loss, salary reductions, price increases, and foreign profiteering.⁵⁵ Nevertheless, even some nationalist Congress members have admitted that some type of foreign investment in Mexico's oil market will be necessary in the future.⁵⁶

Despite Mexico's adoption and implementation of free market reforms throughout most of its economy, Pemex has been trapped in a political whirlwind and remains outside of the privatization process.⁵⁷ As long as Pemex controls Mexico's oil, Mexico's privatization process remains far from complete.

C. MULTIPLE SERVICE CONTRACTS FOR OIL PRODUCTION

Although multiple service contracts for oil production are not an adequate substitute for privatization, these contracts are a positive step in the right direction. Due to Pemex's inefficiency, Mexico's oil demand will soon outweigh its production.⁵⁸ This reality will force Mexico to open up its oil industry if it wants to avoid incurring billions of dollars of debt.

Mexico's economy would benefit greatly if the Mexican government implemented an outright privatization of Pemex. But proponents of privatization have failed to overcome its critics, let alone gain enough support to amend Mexico's Constitution. Thus, Mexico is much more likely to allow the issuance of multiple service contracts than to implement outright privatization in the near future.

Pemex's issuance of multiple service contracts, however, has many of the same benefits as privatization. First, foreign participation in the development of Mexico's oil would create significantly greater efficiency and increased revenue. In addition, foreign contractors would be capable of introducing new technologies to Mexico's oil industry, allowing for increased production. And, most importantly, Mexico's government and citizens will become more receptive to the idea of total privatization after the benefits of foreign investment manifest by way of a healthier, more stable Mexican economy.

V. CONCLUSION

In sum, the obstacles that must be overcome in order to achieve the privatization of Pemex are Mexico's archaic attitude of national patrimony and, in particular, the idea that Pemex is a symbol of Mexico's sov-

55. See Al Bassano, *Mexico's Pemex Scheduled for Reshaping, Privatization*, BLOOMBERG NEWS, July 10, 1992; James Petras, *Anti-Imperialist Politics: Class Formation and Socio-Political Action*, 34 J. OF CONTEMP. ASIA 186 (2004).

56. See Mike Zellner, *Pemex Takes Stock*, LATIN TRADE, May 2003; Nick Benequista & Loren Steffy, *Mexico's Pemex Torn as History Clashes With Foreign Investment*, BLOOMBERG NEWS, Apr. 26, 2004.

57. Russell, *supra* note 2, at 196.

58. See Catherine Bremer, *Mexico Says Welcomes Natgas Storage Hub Proposals*, REUTERS NEWS, Oct. 31, 2005; *Mexico Says Could Pump Extra 100,000 bpd if Needed*, REUTERS NEWS, Feb. 19, 2003.

ereignty.⁵⁹ It is this ideology of nationalist petro-pride—expressed through Mexico's oil unions and opportunistic politicians—that has blocked privatization legislation and sought to maintain status quo at the expense of Mexico's citizens.⁶⁰ As a consequence, the inefficient oil industry is both dragging the rest of Mexico's economy down and suppressing Mexico's working class.⁶¹

While the issuance of multiple service contracts is encouraging, full privatization is the only economic policy that has proven to be successful in Latin American countries such as Argentina and Mexico itself.⁶² Mexico would undoubtedly benefit from Pemex's privatization because it would reduce its budget deficit and increase capital investment.⁶³ By increasing capital investment, Mexico could develop the technologies necessary to make use of its excess oil reserves, including technologies that would allow for deep-water drilling.⁶⁴ Arguments against privatization, like those emphasizing short-term unemployment, obviously ignore privatization's long-term benefits.⁶⁵

Once Mexico does decide to privatize Pemex, and it ultimately will, it is important that Mexico follows Argentina's methodology. Therefore, Mexico's government should hire foreign law firms with expertise in the privatization process as consultants.⁶⁶ Additionally, Mexico's government should pursue a policy of swift, outright sales whenever possible, and grant concessions whenever an outright sale is either prohibited by law or some other obstacle.⁶⁷ Furthermore, Mexico's government should make sure that foreign investors are solvent and have the capacity to assume control of the enterprise before allowing a sale to take place.⁶⁸ Finally, Mexico's government must implement a policy to ensure that former government workers are not unduly jeopardized in the transition.⁶⁹

Because Mexico would benefit from a stronger economy if it privatized Pemex, it is up to proponents of privatization to inform Mexico's citizens about the benefits of privatization. Without an understanding of these benefits, Mexico's citizens will continue to view the idea of privatizing Pemex as handing over Mexico's oil to foreign investors.

59. Russell, *supra* note 2, at 201.

60. See *Pemex May Offer Shares*, *supra* note 9; Murphy, *supra* note 1, at 96.

61. See Russell, *supra* note 2, at 201-02 (citing Dudley Althaus, *Mexico's State of Gloom*, HOUS. CHRON., July 14, 1996, at 1A; George W. Grayson, *Pemex Chief's Successful Innovations Keeping Detractors at Bay*, HOUS. CHRON., Aug. 11, 1996, at 5C).

62. See Tandon, *supra* note 44, at 334-37; See Snyder, *supra* note 8, at 98-99 & 107-08.

63. Russell, *supra* note 2, at 202 (citing Thomas J. Casey & Simone Wu, *Telecommunications Privatizations: An Overview*, 17 HASTINGS INT'L & COMP. L. REV. 781, 786 (1994)).

64. See Irwin, *supra* note 42; *Mexico; A Shrinking Giant*, *supra* note 42.

65. See Bassano, *supra* note 55; *Mexico; A Shrinking Giant*, *supra* note 42.

66. See Russell, *supra* note 2, at 181-82.

67. See *id.*

68. See *id.*

69. See *id.*