

Pemex at the end of the 20th century
Pemex al fin del siglo

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Summary of arguments

This paper offers arguments about the state of Pemex in and around the year 2000. If, by the term “end of century” (*fin del siglo*) we intuitively mean the end of an historical process or period, a moment analogous to a rest note in music, then in Pemex and the Mexican oil sector the twentieth century has not yet ended. In four areas—law, labor, industrial organization, and regulatory framework and public oversight—the surge and movement of the events that started in the 1930s have not yet reached an inflection point. The dynamics in each case obey distinct forces, and each area seems to develop by different rules.

1) In the legal area, the controversial return to Mexican oilfields in 2003 of international oil companies shows that the fundamental meaning of Article 27 of the Constitution is not yet settled.

2) In relation to industrial organization, Pemex is not yet organized like a business. Examples: Pemex is taxed on revenue, not on profits. Pemex’s CEO has no hiring-and-firing authority of senior executives who are appointed by friends in power in the Office of the President. Pemex’s structure of four operating units lacks coordination, as each unit strives for profit- and power-maximization. Pemex’s director of public relations is a third-level official who has little input to the CEO and no control over the public affairs of the operating units.

3) In labor relations, the Oil Union in size and political influence has grown into an organization that neither the executives of Pemex nor elected officials know how to manage. Public sector unions in Mexico have virtually become a fourth branch of government.

4) Finally, in relation to the regulatory framework and public oversight, Pemex is seen as self-regulating for all but a tiny fraction of its activities. An Energy Regulatory Commission (CRE), for example, has authority over natural gas tariffs, but not over the 100% monopoly enjoyed by Pemex Gas in pipeline transportation. Lacking is an upstream regulatory authority like those of Norway or Brazil.

The conclusion that follows is that the historical, ideological and institutional forces that were unleashed at the beginning of the twentieth century have not yet come together in a sustainable model of a state-owned oil company.

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Introduction

For historians, the term "century" refers less to a counted number of years as an elastic, qualitative concept. In this spirit, historians sometimes have said that the nineteenth century—an era that, in its final phase was one of materialistic optimism—ended in 1912 with the counterintuitive sinking of the Titanic.

In this same spirit, we may ask, when did the twentieth century end in Mexico? Or, has it yet? Coming to terms with this question is necessary to evaluate the state of Pemex at the century's end. There is not a straightforward methodology, however, for such computations, and an ad-hoc (and hopefully not ad hominem) approach is needed.

1) LEGAL FRAMEWORK

The meaning of the Mexican Constitution of 1917 in matters of petroleum policy is still not clear—nearly a century later.

Looking at the beginning of the twentieth century through the optics of the international oil industry, we see the beginnings of industrial development taking place as a result of the exploration, development and investments of British and American companies. Drawing on the American business model, which required that the owner of surface rights automatically have access to mineral rights, Porfirio Díaz, had set in place a legal and contractual framework that was irresistible for international companies. In 1917, the legal framework was changed back to the earlier Spanish colonial model: the State had original ownership of minerals the exploitation of which was allowed only by concession. At the time, no one foresaw the possibility that within a half-century this framework would become standard throughout the world—that is, outside the

Lower 48 of the United States. No one could imagine that international oil companies (IOCs) would one day operate in countries as different as Norway, Iraq and Vietnam within the rough constitutional framework that Mexican lawmakers adopted in 1917.

Insisting on their pre-1917 rights, the oil companies engaged in a futile, decade-long debate with the Mexican government over the retroactivity of Article 27. The companies argued that their rights were grandfathered under the old system, while the successive Mexican presidents argued that the companies needed to adhere to the rules of the new system. Had the companies understood that their business did not require ownership of the hydrocarbons to be successful, the dynamics of oil history of Mexico after 1917 would have been profoundly different. The history might have played out as it did in Venezuela with the expropriation of oil company assets a half-century later. Or, as in Canada, Norway, Great Britain and many other countries, the history could have played out with the discovery of a *modus vivendi* between the rights of the State and the commercial and legal requirements of the oil companies.

What is certain is that in 1937-38 the Mexican State did not have today's tools to monitor oil company activities-computers were a decade away and advanced, cost-accounting software was forty years in the future. Something else missing in the landscape of the 1930s was a modern fiscal system for oil company concessions in any of its many permutations from a Production Sharing Agreement (PSA) to the myriad of contractual models based purely on costs and revenues. Had such technological, software and contractual capabilities existed in the 1930s the Mexican government would have had all the information it needed to evaluate-in real time, if necessary-the economics of the oil companies in Mexico. Additionally, with alternative, but acceptable, contractual models, the entire expropriation of 1938 would have been unnecessary.

Nov. 27, 1958

As a strategy for overcoming the problem of a shortage of equipment and spare parts caused by the international embargo of the post-expropriation period, Pemex CEO Antonio J. Bermudez approached the U.S. Government with a proposal to seek American financing for expanded oil production. The request came at the right time, as in 1947 the American government,

focused on postwar Europe, wanted the American republics to be self-sufficient in crude-oil production. The proposal of Bermudez therefore made sense; it only needed a little tweaking.

The Wolverton Commission was formed to study and make recommendations on credits for Pemex. In the process it was explained to Bermudez that it was the practice of the United States government to let private oil companies make the investments in exploration and production. Bermudez, who faced hostility from the State Department, eventually came to an agreement with the Americans. In the course of 1949-50 a dozen production-sharing contracts were signed with small, independent American oil companies.¹

When the Mexican senate learned of these contracts, however, there was an upwelling of anger at what was perceived as a violation of the Petroleum Law of 1941 and of the spirit, if not the precepts, of Article 27 of the Constitution. Senators for eight years demanded to see copies of the contracts-but Bermudez refused (and they have never been made public).

In late November 1958, in the final days of the administration of Adolfo Ruiz Cortines, the Mexican Congress retaliated by passing a new version of the Petroleum Law. Article 6 of the new text clearly-if only implicitly-was aimed at keeping oil companies out of Mexico. The article seemed to be about contractors to Pemex as a general class, but its provisions were pointed against the business model of an oil company. In the new scheme,

- 1) a contractor would be paid in cash,
- 2) a contractor could not be paid as a percentage of production (thereby preventing production-sharing agreements);
- 3) The contractor could not participate in the commercial results of his services-- another way of saying that oil companies could neither be credited at market prices for its production nor obtain commercial advantage by reserve postings for discoveries of oil and gas deposits.

Forty-three years pass.

Dec. 6, 2001

In the interest of time, we may move the clock forward to Dec. 6, 2001. Some 600 people eagerly assembled in the main ballroom of the Hotel Nikko in the upscale neighborhood of Polanco in Mexico City. On that occasion, a Pemex-sponsored program for inviting oil companies back to Mexico would be unveiled.

Senior Pemex officials (with cameo appearances by two cabinet members, finance and energy) explained the logic of what would become known as Multiple Services Contracts (MSCs). According to the speakers, there was an impending shortage of natural gas in Mexico, especially in the electric sector where demand was growing annually at upwards of 7%. Having studied the matter carefully-and having retained outside consultants, the Calgary-based law firm of Dixon, McLeod and the oil consultant Pedro Van Meurs-Pemex had come to the conclusion that by means of a series of public tenders contractors would bid on concession-like blocks in which, for up to twenty years, would have exploration and production rights on an exclusive basis. That was the good news. The bad news was the following:

- 1) The contracts would be compensated only according to a long list of unit prices, from drilling to maintenance.
- 2) The contractor would have no commercial rights to its production.
- 3) The contractor would not be permitted to post on his account the discoveries that he would be required to make to make the contract profitable.
- 4) The contractor would be paid on a contingency basis: the market value of incremental gas (or gas deliverability, as might be the case) would be credited to a master trust in the name of the contractor. Invoices would be paid from monies in this account; where there were insufficient funds, payment on invoices would be deferred until the next month.

Pemex explained to oil company representatives that this economic model was the only way-at present-that the strict requirements of the Oil Law (that of 1958) could be complied with.

The general disappointment in the room was palpable: what was being proposed model fit no one's business model. Oilfield service contractors would not bid on any contract with payment

contingent on new production, and oil companies would not bid on concessions that gave them no upside potential from the possibility of large discoveries or higher market prices. On the other hand, among representatives of the major oil companies—who, by character and market position, tend to take a long-term view of such matters—saw the new Pemex proposal in a positive light. True, there would be no current business opportunities (and, subsequently, in the summer and fall of 2003 no major oil company bid in the first round of MSC tenders), but the policy direction was clear: Mexico (or at least the Fox administration) wanted the oil companies back.

This prospect alarmed traditionalists in the same way that traditionalists in the Senate had been alarmed in the 1950s: maneuvers to bring back the oil companies were in violation of the law and the Constitution. As before, they immediately asked for copies of the model contracts. Unlike his predecessor, Raul Munoz, the Pemex CEO, in his appearances before the Congress, was all smiles and promises; still, it would be two years before the first contract, that with Repsol, contract was delivered to the Senate.

The earliest and most-sustained voice of opposition was that of PRD Senate advisor (and UNAM engineering professor) Victor Rodriguez-Padilla, whose fierce, initial criticism had been published in opposition paper *La Jornada* on Nov. 19, 2001. In the Senate the voice that would speak out most stridently against the MSCs would be that of Sen. Manuel Bartlett, known in Mexican politics as the former Interior Minister who, in the most generous of interpretations, handled the counting of the votes in the presidential elections of July 6, 1988, in a controversial manner.

Sept. 27, 2004

Push the clock forward to Sept. 27, 2004. At a public forum on the Multiple Service Contracts was scheduled for 7 p.m. at Casa Lamm, a cultural center in the Roma District of Mexico City. The main speakers were Sen. Bartlett and Dr. Rodriguez-Padilla. About 200 people sat tightly together in rows of folding chairs in an upstairs room.

Sen. Bartlett spoke in general terms against the neoliberal policies of the current administration. He was optimistic that the federal court that had accepted his petition to review the legality and

constitutionality of the first MSC contract awarded to Repsol would declare the contract null and void. The senator spoke of Mexico's "unhappy experiences with the oil companies, whose values and priorities differed from those of the nation."

Toward the end of his remarks Sen. Bartlett spoke of the nature and history of "golpes" (coups) against the State and the rule of law and order. In his view, the Fox administration by means of the Multiple Services Contracts was acting against the rule of constitutional order in Mexico. For this reason, "Fox is a golpista," he concluded.ⁱⁱ

In contrast to the mild-mannered delivery of Sen. Bartlett, that of Dr. Rodriguez was harsh and angry. He criticized what he characterized as the deception and simulation of the Fox administration. In a contract with Repsol the rewards for which could only come by successful exploration and production, how could it be that out of 300,000 words in the contracts each of the terms "exploration" and "exploitation" occurred fewer than ten times, he asked, sarcastically. For the speaker the MSCs were both illegal and unwise.

A third speaker, Jose Luis Manso, a one-time whistle-blower in Pemex, reminded the audience of the long history of successful legal defenses against the pretensions of the neoliberal governments, citing in particular the blocking of the attempts in 1995-96 by the Zedillo administration to privatize Pemex's petrochemical complexes.ⁱⁱⁱ

In the raucous question-and-answer session Sen. Bartlett was repeatedly praised for being the only political leader who was defending the Constitutional order in oil matters. Suddenly, a question from the floor rang out with unexpected clarity:

Sen. Bartlett, you complain about the abuses of the neoliberal administrations over the past fourteen years-Salinas, Zedillo, and now Fox; but you were the one who opened the door in Mexico to neoliberalism by your crashing the computer system that was counting the votes of the presidential elections of July 6, 1988.

For some members in the audience the question was the moral equivalent of the shout by boy in the fairly tale about the Emperor New Clothes.

When, after a lengthy series of mini-discourses presented as questions, the chairman turned to Sen. Bartlett for his observations about any of the points or questions that had been raised.

"One point was raised about the 'system crash' of 1968," he began.

"It was 1988," several people in the audience shouted.

Unruffled, the senator continued. "In regard to this event--," he began. But, in mid-thought, he changed directions, "I should tell you that [in 1937] it was my father who was the judge that issued the finding against the oil companies." The implication seemed to be that it was in memory of his father's ruling that his own opposition to the MSCs lay; but, just at this critical moment in his remarks, an unruly outsider barged into the room from the side door near the front of the table. Suddenly the discussion had turned into a volley of shouts between the intruder and members of the head table, including Sen. Bartlett. "Fuera, fuera" [Get out, get out] the crowd shouted with increasing volume.

After this storm had subsided, the senator apologized to the audience for having been taken up by the memory of his father, and nothing further was said. The microphone was passed to the other speakers.

Federal court review of MSCs

The federal court that accepted the petition of Sen. Bartlett and colleagues subsequently asked both Pemex and Repsol to respond to each allegation in the complaint. For Repsol the matter meant a significant dedication of human and financial resources that were not contemplated in the bid-and the cost of which were certainly not billable to Pemex.

For years, if not decades, voices in favor of and against private participation in the upstream end of Mexico's oil industry have argued that Articles 27 and 28 of the Constitution need to be either respected or changed. These articles in matters of petroleum say that hydrocarbons belong to the Nation, that only the Nation may exploit them and that the oil industry has strategic importance for

Mexico. "Fine," industry observers say. "This is the standard worldwide—that is, outside the Lower 48 in the United States." In the view of the Oil Companies, therefore, the Mexican Constitution needs no changes whatsoever to be compatible with a dozen or more forms of their doing business in Mexico. Only laws, regulations and the political debate need changing.

The case against Repsol brought forward by Sen. Bartlett will not be resolved until the matter goes to the Supreme Court. There, the Court has to decide if the requirement that the State be the exclusive authority for the development of Mexico's hydrocarbon resources (as required by the Constitution) means that

a) the State may establish through laws, regulations and procedures the best practices by which those resources are to be developed, adhering in the matter to worldwide international practices and the best interest of the country, or

b) The State's options have already been closed by the Constitution, and only a state agency (such as Pemex) may engage in the activities of exploration and production. In such a ruling, a critical clause of the MSCs would be ruled unconstitutional: the provision of contingency payment would be disallowed on the grounds that, indirectly, the private party was at risk in relation to market conditions, a feature prohibited by Art. 6 of the Oil Law of 1958.

In the first case, the Court would doubtless urge the Congress to rewrite the controversial Article 6, eliminating the ambiguous language and specifically authorizing those contractual modalities that best suited Pemex and the State.

In the second case, all of Pemex's half-dozen awards to private oil companies would be declared null and void. Oil companies would leave Mexico for at least six years, and there might be claims against Pemex at the International Court of Arbitration in Paris.

Hence, the first main conclusion that we reach is that the twentieth century in Mexico has not yet closed-and will not be closed until this vital question having to do with the interpretation of Article 27 and related provisions is answered by the Mexican Supreme Court. Such a finding cannot be expected before 2007.

2. INDUSTRIAL ORGANIZATION

Making Pemex an oil company

Pemex today is not so much a professional oil company as it is a government-administered oil supply agency and the source of a third of the federal government's budget. A dozen outside government agencies have involvement in the day-to-day operations as well as in the strategic planning of the company. The leading micro- and macro-managing agency is the finance ministry. (The energy ministry is also involved, but principally for cosmetic purposes.)

Few international oil companies would want to make a joint venture with Pemex and an unlisted number of state agencies and ministry, each with a scope of authority that is, at best, under-documented in the public domain.

The Office of the President of Mexico—not the CEO of Pemex—has the authority to name and replace corporate vice presidents of the operating units, as well as selected lower-level officials such as the Director of Public Relations. There is no public accountability for such decisions, and Pemex's Board of Directors has no independent authority.

The lamentations over the past decade from the Executive Offices on the 44th floor of the Pemex headquarters tower have been couched in the code language of “greater fiscal autonomy,” “less bureaucracy and federal interference”; but, translated, the language may be read as voicing the urgent need to make Pemex a real, state-owned oil company. Transformed, the CEO of Pemex—not advisors and lobbyists in the kitchen cabinet of the President—would have hiring and firing authority over senior Pemex executives.

Bottlenecks in federal procurement philosophy

Many of the shortcomings of Pemex arise from the federal rules and regulations that govern—choke, some would say—its operations. One of these items is the federal public works law.

Critics say that this law is fine for buying pencils, but terrible for contracting for drilling rigs or awarding tenders for oil platforms.

At the heart of the matter is the requirement that Pemex accept the lowest price of qualified bidders. Critics say that the procurement process applicable to Pemex major projects should be changed to a Best Value Procurement methodology, one which allows the sponsor of a tender to take into account qualities of the plan, team, schedule, safety program and other factors.

Bottlenecks in federal fiscal policy toward Pemex

Pemex is taxed on revenue, not on profits. During 2002 and 2003 Pemex has had to borrow money to pay federal taxes. There are also bottlenecks in financial accountability: Pemex provides financial results only in terms of cash flow, not in terms of profits and losses. As a result, the most conventional measure of management performance—increased profits—does not exist. Making Pemex a real company—Pemex, S.A.—would help to make senior managers accountable to the public and the State for their energy, vision and managerial skill.

3. LABOR RELATIONS

The reorganization of the Mexican state in the first four years of the Fox administration was limited to the renaming of a few ministries; what had been the Comptroller General was the Ministry of the Public Function. In the air are ideas for breaking the taboo against reelection, at least for municipal officials.^{iv}

As for labor reform, the topic has meant different things to different constituencies and authorities. Carlos Salinas as president believed that excessive political power had accrued to public-sector unions, and he for himself as an early goal of his administration the crushing of executive leadership of the oil workers' and teachers' unions.

The leader of the teachers' union was Carlos Jongitud; the leader of the Oil Union was Joaquín Hernández Galicia. Within months of taking office both of these leaders had been deposed—the

latter within forty days. The reasons for the actions taken by President Salinas were mainly related to the allocation of political power within the Mexican system, not with reforms to the system of worker rights, benefits, pensions or the like. Nor the actions result in any democratization of worker organizations.

The special antipathy shown by President Salinas toward the leadership of the Oil Union had a long history, one going back to confrontations that Salinas had had with the Oil Union when he was an official in the Finance Ministry in the administration of Miguel de la Madrid.

For his part, the mild mannered, vegetarian Oil Union leader ran an empire within Pemex: he controlled some 200,000 jobs in the fall of 1988, and exercised power absolutely. On Jan. 10, 1989, a special military strike force raided the home of Hernández Galicia at his home near Cd. Madero in Tamaulipas. He, and about two-dozen employees (including a recently hired gardener)—plus a few by-standers—were flown by military aircraft to a prison in Mexico City. There they stayed until 1997, when pressure from Amnesty International forced the government of Ernesto Zedillo to release the political prisoners.^v

4. REGULATORY FRAMEWORK

The transformation would have to be done by a change in laws governing state-owned companies, foreign investment and government procurement. Changes would also be needed in the implementing regulations. In the view of many, a new independent upstream regulatory authority is urgently needed—a regulatory authority in addition to the Energy Regulatory Commission (CRE), which is dedicated to midstream issues relating to franchises and permits but without the staff or appetite to take on upstream issues. One of the benefits of an upstream regulator would be that Congress could delegate oversight authority that, in the Fox administration, it has arrogated to itself in matters relating to upstream energy policy.

Congress would have to define its own role in a strictly oversight capacity—not over specific contracts—but of law, its compliance and the political culture and rhetoric in which oil matters are discussed. To implement idea that deep-water, strategic associations would have to be approved by the Congress (as is proposed in the list of 30 reforms) would be to continue with an anti-market tradition of oil-sector management.

Support for this change in perspective in Mexican political society toward the International Oil Companies (IOCs) would be gained by the creation of an upstream regulatory authority, modeled, perhaps on that of Norway. During the period 2001-04 a special committee in the Energy Ministry in Mexico has studied the suitability of such an institution, but there have been no public comments.

CONCLUSIONS

While it may be true that the collateral benefits of an expropriation in 1938 outweighed the benefits of avoiding the policy stem altogether--or delaying it until some time in the future. Taking place in 1938, the measure led to three costs, some of which continue to the present. One cost was that of the financial indemnification of the oil companies for the expropriation of their

assets. A second cost was that associated with the international ill will that Mexico received from countries, oil companies and suppliers of equipment and spare parts. A third cost was that derived from the creation and empowerment of a political culture of petronationalism.

Some parties benefited from Mexico having incurred these costs: Everett DeGolyer, a consulting geologist, made his fortune in Mexico advising Pemex in the post-expropriation period.^{vi} Schlumberger, the French oilfield services company, got its start in Mexico in the 1930s, and today this company's position in Pemex is unrivaled. By one estimate, the company in 2004 earned more money from operations in Pemex's North Region than it did in Brazil and Argentina combined.

But the big winner (albeit on a different playing field) was the Oil Union: Its prominent activities leading up to and immediately following the expropriation earned for it--at least by its political calculations--a permanent claim on the budget of Pemex, the attention of the President of Mexico and the full faith and credit of Mexico's political system at large.

Pemex's current E&P management deserves the strongest credit for elevating the topic of deepwater exploration and development to the highest priority for the future of Pemex.

The commercial model of the Multiple Services Contract--should it survive in the federal courts--is wholly inappropriate for deep-water exploration and production. No "association" agreement will be attractive to a qualified oil company unless--and in addition to commercial issues like reserve recognition and market-based compensation--its political and legal viability is assured. None of this will be easy.

Given the historical and ideological baggage that Pemex is forced to carry, the commercial tables of prospective strategic associations are slightly tilted toward those deep-water-qualified companies that at present (or previously) were state-owned. Others in this category include Statoil and BP. (Elf Aquitaine until the merger with Total in 2000 was also state-owned.)

Petrobras and Statoil are alike in that their governments developed an upstream regulatory authority--the need for which grows daily in Mexico. Perhaps for this reason Norway and Brazil

have been visited repeatedly by officials in the executive and legislative branches during the Fox administration.

With the expected—and widely heralded—decline of the giant Cantarell field sometime in the period 2006-10, Pemex must move to the yet unexplored deepwater resources, the potential of which has been estimated to be upwards of 50 billion barrels of oil equivalent (BOE). Most analysts are convinced that the deep-water future of Pemex is clear and inevitable.

The development of these resources is the essential task of the 21st century for Pemex and the Mexican oil industry. That task would be made substantially easier if the unfinished oil business of the 20th century could be put to rest.

XX

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ⁱⁱ "Fox, un "golpista" que intenta entregar Pemex a las trasnacionales: Bartlett," *La Jornada*, Sept. 29, 2004.

ⁱⁱⁱ A fourth speaker, Ricardo Declé López (Unión de Trabajadores de Confianza de Pemex), represented a struggling organization, the Association of Non-Union Workers in Pemex. He told how the organization had been deceived by the Labor Ministry, and how its leaders in Pemex had been forced to retire. (The organization's website is www.untcip.net).

^{iv} The perception is gaining ground that the PRI-imposed system of nonreelection makes for poor government; so the future is likely to bring changes to permit the reelection of members of Congress, governors and ultimately the president.

^v Hernández Galicia was charged with homicide and illegal arms possession, but these charges were fictitious. The author was in contact with Hernández Galicia's lawyers from 1992-95, and visited him in the federal prison on three occasions. He was the source of the advice to seek help from human rights organizations; these organizations, at first, refused to consider the case. The London headquarters office of Amnesty International was persuaded, however, with the visit of Hernández's Galicia's daughter in 1996.

^{vi} In the late 1990s his Dallas-based firm, DeGolyer and MacNaughton, was awarded major contracts to verify Pemex's reserve figures for several basins. The DeGolyer Collection at SMU is an archive with abundant materials relating to the early period.