

THE FUTURE OF OIL IN MEXICO

/ EL FUTURO DEL SECTOR PETROLERO EN MÉXICO



The Energy Factor in Mexico–U.S. Relations

Isidro Morales, Ph.D.



JAMES A. BAKER III
INSTITUTE FOR
PUBLIC POLICY
RICE UNIVERSITY





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RICE UNIVERSITY

THE ENERGY FACTOR IN MEXICO-U.S. RELATIONS

BY

ISIDRO MORALES, PH.D.

PROFESSOR
MONTERREY INSTITUTE OF TECHNOLOGY AND HIGHER EDUCATION (ITESM)
SANTA FE CAMPUS

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**ABOUT THE STUDY:
THE FUTURE OF OIL IN MEXICO/
EL FUTURO DEL SECTOR PETROLERO EN MÉXICO**

The energy industry plays an important role in the Mexican economy, and energy trade is a major component to the U.S.-Mexico relationship. The Mexican government relies on the oil industry for 35 percent of total government revenues, including taxes and direct payments from Petróleos Mexicanos (Pemex), the state oil company. Mexico is the third-largest foreign crude oil supplier to the United States. However, with declining production and rising demand, Mexico could become a net oil importer in the coming decade. President Calderón pushed for energy sector reform in Mexico, but more reforms will be needed for Mexico to reverse its current path toward importer status. This study identifies the dynamics of the political trends in Mexico that will impact future energy policy. The aim of this study is to promote a better understanding of the challenges facing Mexico's oil sector and to enhance the debate among policymakers, the media and industry on these important issues.

STUDY AUTHORS

CRISTOPHER BALLINAS VALDÉS
JOE BARNES
CARLOS DOMÍNGUEZ
CARLOS ELIZONDO MAYER-SERRA
PETER R. HARTLEY
AMY MYERS JAFFE
DAVID R. MARES
KENNETH B. MEDLOCK III
ISIDRO MORALES
JAIME ROS
PAUL SEGAL
RONALD SOLIGO
MANIK TALWANI
LAURENCE WHITEHEAD

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**JAMES A. BAKER III INSTITUTE FOR PUBLIC POLICY
RICE UNIVERSITY - MS 40
P.O. BOX 1892
HOUSTON, TX 77251-1892 USA**

**[HTTP://WWW.BAKERINSTITUTE.ORG](http://www.bakerinstitute.org)
BIPP@RICE.EDU**

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NUFFIELD COLLEGE
OXFORD UNIVERSITY
NUFFIELD COLLEGE NEW ROAD
OXFORD OX1 1NF, UNITED KINGDOM

[HTTP://WWW.NUFFIELD.OX.AC.UK/](http://www.nuffield.ox.ac.uk/)

ABOUT THE AUTHOR

ISIDRO MORALES, PH.D.

PROFESSOR

MONTERREY INSTITUTE OF TECHNOLOGY AND HIGHER EDUCATION (ITESM)

SANTA FE CAMPUS

Isidro Morales, Ph.D., is a professor at the Monterrey Institute of Technology and Higher Education (ITESM), Santa Fe Campus, in Mexico City. Morales' main research areas are the geopolitics and geo-economics of energy, trade, and investment markets; the political economy of regional integration; Mexico-U.S. trade and security relations; and U.S.-Latin American relations. He has also worked as a researcher at El Colegio de México and other Mexican universities. Morales was a lecturer at the University of Copenhagen and guest researcher at the Danish Center for Development Research, the Watson Institute for International Studies at Brown University, and the John W. Kluge Center at the Library of Congress in Washington, D.C. From 2001 to 2005, he was dean of the School of Social Sciences at the Universidad de las Américas Puebla in Mexico. During the 2005-2006 academic year, he was a Fulbright Visiting Professor at American University and a senior fellow of the Center for North American Studies in Washington, D.C. Morales has published extensively on energy, integration, and trade-related topics. His most recent work includes the books *Post-NAFTA North America: Reshaping the Economic and Political Governance of a Changing Region* (Palgrave/Macmillan U.K., 2008), which he authored, and *National Solutions to Trans-Border Problems? The Governance of Security and Risk in a Post-NAFTA North America* (Ashgate U.K., March, 2011), which he edited. Morales is a member of Mexico's National Research System, the Latin American Studies Association (LASA), and the Mexican Council for Foreign Affairs (COMEXI). He is currently editor-in-chief of *Latin American Policy*, a biannual journal distributed worldwide by Wiley-Blackwell. He received his Ph.D. in France from the Paris-based Institut d'Études Politiques.

I. Introduction

This essay contends that from the Second World War (WWII) to the present, Mexico has functioned as a critical partner for the United States' (U.S.) strategic and geopolitical interests. Energy¹ relations between the two countries emerged as a major element in the geostrategic relationship of the two countries over the last few decades but may wane as an issue of importance in the coming years. The first part of this essay reviews how Mexico-U.S. energy relations have evolved since the three-tier agreement signed in 1942 between the two countries, and explains Mexico's oil diplomacy deployed during the López Portillo years (1976-1982). During that time, Mexico functioned as a "buffer zone" through which the U.S. could get critical resources (not only oil, but labor, either legal or not) and deter or filter any possible physical attacks or social unrest that could potentially affect U.S. interests.

In the second part of the essay, I argue that the North American Free Trade Agreement (NAFTA) signaled a new accommodation of overall Mexico-U.S. interests, radically altering the institutional setting of the investment climate within Mexico's energy sector. Private investment was legalized in cross-border trade operations for natural gas and electricity, as well as for mid-stream activities in the gas sector and for production in the power sector. From that time, service contracts with foreign firms became a formula for upgrading energy operations in Mexico's two monopolies, *Petróleos Mexicanos* (Pemex) and *Compañía Federal de Electricidad* (CFE). In principle, the outsourcing to private contractors is ruled by the NAFTA agreement. Since the inception of NAFTA, Mexico has been considered a pivotal state to the U.S.; that is, more than a simple buffer zone. Pivotal states, or pivots, are strategic to the U.S. since their geopolitical positioning, political and economic evolution, and regional and international policies potentially reinforce—or jeopardize—the pursuit of Washington's priorities. Accordingly, the commencement of the North American Security and Prosperity Partnership (SPP) in 2005 reinforced the notion of continental integration of energy markets in the region and reconfigured the strategic positioning of Mexico for Washington's key interests—this time under a new conception of regional security and protection of the border.

¹ Though what was at stake at that time was the future evolution of oil resources, I prefer to analyze overall energy relations between the two countries, since production and exchanges of natural gas and electricity have become increasingly important during the past 15 years.

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In the final part of the essay, I contend that energy, within this new geopolitical and geo-economic reconfiguration (NAFTA, the SPP, and the Mérida Initiative), is no longer a major focus between the two countries, though it remains strategic in the bilateral relationship.² What is at stake is Mexico's capability to consolidate its political, energy, and public safety reforms, as well as a new understanding through which U.S. strategic and security interests are preserved, and Mexican interests are understood and respected simultaneously.

II. Mexico-U.S. Energy Relations before NAFTA

According to the Mexican Constitution and energy-related regulatory legislation, overall hydrocarbon resources belong to the state, which means that the latter is the only entity allowed to explore, develop, and produce hydrocarbon resources. This also includes the generation and distribution of electricity nationally and downstream activities in the case of crude oil. Until 1994, when NAFTA came into law, no private participation—either by Mexican or international companies—was allowed in Mexico's energy sector. The only exceptions were turnkey projects and subcontractors providing specific services to one of the two major state monopolies: *Petróleos Mexicanos* (Pemex) and *Comisión Federal de Electricidad* (CFE).

Mexico's legislation reflects its own history, in which state energy monopolies have played a major role in industrializing the country for most of the 20th century. By keeping domestic energy prices below international levels, Pemex and CFE have become icons of nationalism and state-led policies promoting growth and welfare during the second part of the 20th century. Starting in the early 1980s, Pemex has been a major oil exporting company and a significant source of fiscal income for government, currently accounting for 35% of overall government income (Ros 2011). Since then, all succeeding governments have used this oil rent³ for state purposes, the value of which fluctuates with international oil prices.

² According to the U.S. State Department, the Mérida Initiative is designed “to confront criminal organizations” by providing “equipment and training in support of law enforcement operations and technical assistance to promote the long-term reform, oversight and professionalization” of security agencies in certain Latin American countries, including Mexico (U.S. Department of State, “Merida”).

³ According to the Ministry of Energy, the oil rent is defined as the income obtained from the value of oil wealth at international market prices minus supply costs (SENER 2008).

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In the hands of the state, this monopoly over hydrocarbon resources became a strategic tool and income source for pursuing ambitious social and macroeconomic policies. However, Mexico never framed the nature of this monopoly as a national security priority until the Calderón administration, which in 2008 made it a priority to halt the decline in hydrocarbon reserves and to boost production back to historical levels. Nonetheless, since the expropriation of foreign oil companies in 1938 by President Lázaro Cárdenas, up until the signing and enforcement of NAFTA, the strategic management of energy resources by government monopolies has been a sort of *raison d'état* through which the state ensured its own political, economic, and ideological construction and expansion, as well as its own survival. By strategically managing the oil rent, Mexico's political elite had a powerful policy tool for impacting industrialization policies and for ensuring social control, mainly by having the last word over energy supply and prices, as well as over the redistribution of fringe benefits derived from oil rents. Some examples included providing subsidized energy resources to industrial centers and cities and launching sectoral policies such as the development of the petrochemical industry, which until the mid-1980s, was heavily protected by the state. The biggest beneficiaries of this "welfare" tool were the middle classes, entrepreneurs, and trade unions—especially oil workers—and, to a lesser degree, rural and poor people. State building, policy management, and social control through the redistribution of privileges and benefits were thus accomplished, thanks to the strategic governance of the oil rent.

The administration of oil resources under the Pemex monopoly was also heralded as a triumph of Mexican nationalism in response to opposition from foreign companies or governments, including the U.S., to retroactive and/or radical enforcement of Article 27 of the Mexican Constitution, which claims public interest over all types of property in the country, including the natural resources located in the subsoil. Indeed, private oil companies working in the fields prior to the expropriation, through the mechanism of concessions, were the major victims of government's rent-seeking interests and nationalistic banners.

Even so, the U.S. government has been able to accommodate its priorities with Mexico's energy interests from the expropriation years to the present, despite periods of tensions and conflicts. This long-term period of bilateral energy understanding and accommodation may be divided into

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two phases. The first one features a sort of implicit, non-written undertaking, which prevailed from the WWII years to the signing of NAFTA in 1994. At that point, energy relations between the two countries became continental, and cross-border energy flows formally liberalized. This first part of the essay explores the initial phase of the bilateral energy accommodation.

The Geopolitical Positioning of Mexico's Energy Resources

World War II highlighted Mexico's geopolitical importance to U.S. global interests, and made clear the significance of the country's oil resources. When Mexico's oil expropriation took place in March 1938, China and Japan were at war and Italy had manifested its expansionist ambitions in Ethiopia. Spain was in the midst of a major civil war and Hitler had already launched an aggressive German rearming that threatened surrounding democracies. Ideologically, the Western world was already divided between "fascists" and "liberals."

Private companies and foreign governments, including the United Kingdom, the Netherlands, and the U.S., reacted to the Mexican expropriation by condemning and seeking the reversal of the decision. The UK cut diplomatic relations, but the U.S. government maintained a window of negotiation with the Cardenas government and subsequently with the Avila Camacho administration (1940-1946), even while supporting the embargo launched by most private firms that operated in Mexico prior the nationalization.⁴

When it became evident that a new global war was brewing in Europe, Washington promptly accepted the oil expropriation as a *fait accompli* and made Mexico a "buffer zone" for reducing armed aggression from Japan via the Pacific. The U.S. joined the war after the Pearl Harbor attack at the end of 1941, and, in 1942, established with Mexico the bilateral Joint Mexican-United States Defense Commission. The commission's purpose was to formalize Mexico's military, political, and economic support to the American war effort, as well as to define Mexico's role in major conflicts involving the U.S. Under American assistance and financial sponsorship, military bases were established in Mexican territory with the purpose to repel a possible Japanese attack coming from the Pacific. In May of the same year, Mexico joined the

⁴ According to Yergin (1992), the embargo was British-led and attempted to close traditional markets for Mexican oil. However, this had a perverse impact of making Nazi Germany the top importer of Mexican oil in the immediate aftermath of nationalization, followed by Fascist Italy.

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war, became part of the Allies coalition, and conceded to the U.S. army the right of transit across Mexico's air space. Additionally, the U.S. government gave significant loans to Mexico to upgrade communications infrastructure and to ensure macroeconomic stability. These loans signaled the reintegration of Mexico into international financial markets, from which Mexico had been excluded since 1914 amid revolutionary upheaval and the radical reforms introduced by its new constitution.

As part of this military initiative, the U.S. and Mexican governments negotiated the terms and conditions for compensating the oil companies expropriated in 1938, and, against the will of major oil companies, the U.S. formally lifted the oil embargo. The U.S. government also extended a first oil loan in 1944, through the Eximbank, specifically for increasing the production of the gasoline and eventually crude oil that was urgently needed by the U.S. army (Meyer and Morales 1990, 88-89; Vázquez and Meyer 2003, 148-176). The imperatives of WWII clearly made Mexico's oil resources a strategic asset for U.S. military and geopolitical interests, especially because Mexico had had to sell to Germany crude oil cargoes prior to the war.

To ensure military, political, and economic cooperation from Mexico in the war efforts, Washington sought a middle ground between Mexico and private oil companies, laying the groundwork for a mutually satisfactory compensation deal with the Mexican government. Between 1940 and 1947, Mexico reached different pacts with all foreign companies operating before the expropriation, making irreversible the nationalization of the industry. Besides the pressures of the war effort, the subordination of private interests to U.S. national interests is also explained by the inception of U.S. President Franklin D. Roosevelt's "Good Neighbor Policy." This policy's main goal was to build geostrategic and economic support for U.S. interests in the Western hemisphere without military intervention during a period of major geopolitical changes. Consequently, the Mexico-U.S. alliance went beyond the military and oil calculations. In addition to establishing the bilateral defense joint commission and oil bilateral cooperation in 1942, the U.S. also negotiated a guest workers program. This allowed Mexican workers to be employed in the U.S. on a seasonal basis, ensuring a sufficient labor force as required by the

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wartime economy.⁵ At the end of that year, Mexico's foreign debt was rescheduled and renegotiated. A trade agreement was also reached that lowered tariffs for key products such as minerals, metals, and agricultural and livestock products (Chacón 2008). In this way, Mexico made significant economic contributions to the U.S. war effort, strengthening the importance of Mexico in U.S. eyes.

Mexican analysts have perceived this series of deals, most of them struck in 1942, as a “win-win” package that leveled the playing field, despite the asymmetries. Mexico functioned as a buffer zone and as a reservoir for critical labor, oil, and minerals for the U.S. during the war years. Simultaneously, Mexico consolidated its state monopoly on energy resources—against the will and interests of private companies—and regained foreign credit markets by renegotiating its foreign debt and having access to new “fresh” loans. The guest workers program with the U.S. government guaranteed the protection and rights of Mexican workers.⁶ In other words, Mexico's leverage vis-à-vis the U.S. was skillfully exploited by the Mexican political class of the time, which benefited from the increased geopolitical importance of the country due to the war, as well as the Roosevelt administration's priority in having a friend south of the border during a critical time (Chacón 2008, Meyer 2010).

Though Mexico's contiguity with the U.S. continued to be a strategic asset following World War II, Mexico became less critical within the new bipolar order of the Cold War. Since global peace relied upon the capacity to balance nuclear forces and strike capabilities between rival blocs, Canada and North Atlantic Treaty Organisation members in Europe became more critical than Mexico for guaranteeing U.S. geopolitical and strategic interests worldwide. Furthermore, Mexico ceased to be a major oil exporting country, as it was prior to the expropriation years, since resource nationalism put priority in ensuring the domestic supply of energy resources at subsidized prices in support of the import substitution industrialization policies undertaken by

⁵ The deal, also called the “Bracero Program” in reference to cheap human arms (brazos), ensured the legal transit of a labor force highly needed by the US wartime economy, was extended, though with major modifications, until 1964.

⁶ Lázaro Cárdenas, the same leader who nationalized foreign oil companies when he was head of the state, negotiated the military agreement, which included a provision that all military bases established in Mexico during wartime would be operated by Mexican military forces. The association of President Cárdenas with the oil expropriation and the defense of Mexican interests during the negotiation of military bases during WWII has made him an icon of Mexico's nationalism.

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the Mexican political class until the turn of the 1980s.⁷ Oil certainly remained a strategic input to the U.S. economy, and for the rest of the Western world, as most countries shifted their energy mix to hydrocarbons. But international markets remained under the control of private oil firms that sought to diversify sources of production and increase world supply according to demand behavior. Indeed, oil behaved more as a commodity, rather than a strategic resource, with prices that progressively declined in real terms as long as new fields came on stream. This prompted oil-producing nations to create the Organization of the Petroleum Exporting Countries (OPEC) in 1961 with the aim of preventing the secular decline of prices by strategically manipulating production policies. At the end of the day, OPEC challenged the hegemony of private cartels in oil markets and skillfully exploited production targets as a political weapon in the 1970s.

Though Mexican oil was not an issue in Mexico-U.S. relations after WWII until the mid 1970s, Mexico continued to function as a sort of “buffer zone” for the U.S. during the Cold War years. Mexico’s role was not to repel a conventional or nuclear attack coming from the Soviet bloc, but to remain a stable and effectively governed country—regardless of the level of authoritarianism of the political regime—always able to cooperate with the U.S. as an ally in the East-West confrontation and free of communist temptations within the political class. As long as this helped Mexico’s ruling class, including the political party the PRI,⁸ to consolidate its power and legitimacy vis-à-vis perceived radical domestic groups and movements (Ojeda 1976, 35-76 and 93-94), Mexicans viewed this implicit understanding as the benefit of enjoying a “special relationship” through which “strategic dissent” was tolerated by Washington in foreign policy matters. The strategic dissent included nationalist and non-interventionist rhetoric, which Mexico’s ruling class skillfully exploited as a tool for legitimacy by refusing to participate in U.S.-led “collective action” missions under the coverage of the Organization of American States (OAS) against supposed “communist” revolts in specific countries (Guatemala, Cuba, and the Dominican Republic). During the two decades following WWII, Mexico’s foreign policy remained anchored on sovereignty protection principles in order to maintain an autonomous

⁷ From the early 1950s until 1982, Mexico pursued inward looking protectionist policies in order to substitute imports of consumer and capital goods with domestic industrial production. By keeping energy prices subsidized by the government, protectionist policies ensured the industrialization of the country and the emergence of a modern entrepreneurial class.

⁸ For most of the 20th century, Mexico’s political bosses were clustered around a hegemonic authoritarian party, the Partido Revolucionario Institucional (PRI), which continuously ruled the country from 1929 until 2000, when the opposition party, the Partido Acción Nacional (PAN), won the presidency in competitive and clean elections.

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profile in international forums and at home. However, the scope and limits of this sovereignty-centered nationalism were tested during the late 1970s and early 1980s, when oil once again became a strategic commodity that could be skillfully exploited for additional political gains.

The Scope and Limits of Mexico's Oil Diplomacy

October 6, 1973, signaled a structural transformation of oil markets hitherto managed under the commercial strategies and interests of private oil firms. On that day, Egypt and Syria launched a war against Israel to regain the territories occupied by the latter following the 1967 war. OPEC's Arab members profited from the occasion by imposing an oil embargo on the U.S. and the Netherlands for their support of Israel. From that time until mid-1986, OPEC-leading countries—Saudi Arabia, Iraq, Iran, the Emirates, and Venezuela—managed oil production in order to maintain oil prices far above market levels. At the end of 1973, Arabian light, the crude of reference at the time, was US\$2.83 per barrel (bbl). A year later, the price had jumped to US\$10.41/bbl, a more than threefold increase. OPEC politics—combined with major geopolitical changes in the Middle East, most notably the overthrow of the Pahlevi family in Iran and the ascendance to power of radical Islamist groups in 1979—created an oil price bubble which was exploited for different policy and political purposes by oil-producing and consuming countries. In 1980, oil prices peaked at more than US\$35/bbl, an equivalent to US\$100/bbl at 2009 prices—more or less the same price reached during the recent 2008 price run-up (British Petroleum, 2010, 16).

In 1981, prices started to wane and, by 1986, following an OPEC split that saw Saudi Arabia flood the market with oil to gain market share, prices collapsed to US\$13/bbl or less. Oil would behave as a normal commodity until the early 21st century, when prices surged to levels similar to the early 1980s amid significant geopolitical transformations, including the U.S. invasion of Iraq in 2003, and important structural changes, such as the market entrances of Canadian bitumen and of renewable and non-conventional fuels.

Washington labeled the late 1970s as an “energy crisis,” and Mexico's oil resources became once again strategic for U.S. interests. Describing the situation as the “moral equivalent of war,” U.S. President James Carter (1977-1981) launched an energy security program in order to curb

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and diversify imports (Yergin 1992, 659-667). The timing was fortuitous for Mexico. By 1974, Mexico was producing enough oil to both satisfy domestic demand and export significant volumes to international markets. At the same time, the country announced the discovery of a huge amount of reserves notably in the Bay of Campeche. This period, known to Mexicans as the oil boom years, featured a rapid increase in domestic oil and gas production and oil exports. Mexico's oil production jumped from 451,800 barrels daily (b/d) in 1973 to 2.746 million b/d⁹ in 1982, more than five times the amount produced just nine years before. Natural gas extraction increased from 1.854 billion cubic feet (bcf) to 4.246 bcf during the same years, while crude oil exports went from 15,900 b/d in 1974 to 1.492 million b/d in 1982. In other words, Mexico was once again a major exporter of oil, much as it had been in the second decade of the 20th century, but this time, the state—rather than private or foreign companies— controlled the oil rent.¹⁰

Mexico's strategic importance as a new reliable oil supplier to the U.S. unleashed nationalist pressures and foreign policy ambitions within and throughout the ruling class. Mexico's nationalist feelings rapidly manifested when Mexico's President López Portillo (1976-1982) decided to export gas surpluses to the U.S. in 1977 with a new gas line funded primarily with U.S. money and with U.S. pipe materials (Ediciones Proceso 1999). The first attempt to sell the gas surpluses was a fiasco for Pemex, mainly because the Carter administration refused to buy Mexican gas at the price envisioned by Mexican authorities. The debacle was exploited by the López Portillo administration as proof of Mexico's resolve to obtain the highest price possible for its energy resources, even in the U.S. market. In 1979, negotiations restarted and yielded an agreement to sell small symbolic volumes. Once again, the Mexican government presented the deal as evidence of its ability to negotiate the highest price possible for its product (Morales 1986).

Initially, most of Mexico's oil exports went to the U.S. market because of transport and geographic proximity. But as Mexico consolidated as a major exporter, its official policies targeted the diversification of markets. The country was eager to exploit the geopolitical value of

⁹ All figures for Pemex hydrocarbon production, unless otherwise stated, come from official figures (Pemex 1990).

¹⁰ In 1978 Pemex earned US\$1.760 billion from oil exports, and in 1982 the amount peaked at US\$16.304 billion (Snoeck 1987:196, and Pemex 1990). While oil represented only 5% of overall government fiscal income in 1974, in 1981 it amounted to 26.3% (Meyer and Morales 1990, 212). This "oil addiction" to petroleum income still exists. See also Morales 2011.

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its new oil resources to open markets in Japan, Europe, and South America. Mexico's energy strategy established a cap of 50% of its total exports to any single country, which, in reality, meant the U.S. This cap was symbolically reached in 1982, but eventually was abandoned because the policy failed to make commercial sense. Mexico rapidly resumed shipping most of its oil to the U.S., providing 16.35% of overall American crude oil imports in 1983 (Morales et al. 1988, 260).

Despite internal nationalist pressures, Mexico never really used its new oil potential as a "strategic weapon" for getting something in exchange from the U.S. or other trade partners, unlike Iran, Saudi Arabia and some other Arab suppliers. During a visit to Mexico by U.S. President Carter in 1979, the López Portillo administration proposed a new guest workers program, though with major changes less favorable to Mexican workers than the version in force from 1942 until 1964. But no substantive plans were implemented. Instead, Mexico asserted its rhetorical, nationalist positions and policies followed the continuum—with no possibility of "linkages" with other issues in Mexico's bilateral agenda (Morales et al 1988, 134-144; García y Griego 2006, 567-571). It was clear that in spite of the perception of an "energy crisis" prevailing in the Carter administration, Mexico's oil resources—though once again strategically important for the U.S.—were not significant enough to win concessions from the U.S., as was the case during WWII. As President Carter's Secretary of Energy James Schlesinger assessed the situation: Mexicans had little choice but to export their surpluses because they desperately needed the oil income (Morales 1986).

Indeed, the so-called "oil boom" years were nested in the midst of a major financial crisis at the end of the Echeverría administration (1972-1976) that resulted in a bailout by the International Monetary Fund (IMF), which imposed serious constraints on Mexico's government spending and, hence, public debt. To circumvent the financial constraints, President López Portillo accelerated the development and exploitation of the new fields discovered in the Mexican south. His goal was to obtain new credits for funding the expansion of the oil industry and to restore state dirigisme as a tool of economic, political, and social control in the country. Pemex was used as collateral for accessing foreign credit markets whose institutional actors were interested in channeling surplus Arab "petrodollars" to the Mexican economy. Hence, Pemex's foreign debt

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rose from US\$925 million in 1974 to US\$19.22 billion in 1982, along with a sharp increase of total public foreign debt from US\$9.975 billion to US\$58.8 billion during the same years (Meyer and Morales 1990, 214).

With such financial commitments, Pemex was obliged to sell all the surpluses it could to the international oil market. This would have undermined Mexico's case to join OPEC, which was juggling production quotas among state members with the goal of keeping prices as high as possible. There is no evidence however, that the López Portillo administration considered the possibility of joining the cartel. Even if the possibility had been considered by his cabinet, the liabilities would have likely outweighed any benefits, since key OPEC members had a regional agenda in the Middle East in which Mexico was not ready to have a stake.¹¹ At any rate, Mexico became a de facto external pressure for the cartel—in parallel with increased oil production coming from the North Sea and former Soviet Union. The extra oil available from non-OPEC countries like Mexico meant that OPEC had to cut its own production to support global oil prices. The result was that OPEC lost significant market share in the 1980s. In mid-1981, Mexico became one of the first countries to offer discount prices in order to keep its market share. The subsequent collapse in global oil prices by 1983 provoked a major domestic political crisis in the country and unleashed a new financial breakdown, which ultimately was politically and socially more costly to the country than the previous crisis in which the “oil boom” was born.

In the early 1980s, as international oil prices started to dwindle, it became clear that Mexico was far from being a “price setter” in the market and that, worst of all, it was extremely vulnerable to oil price fluctuations since most of its foreign debt commitments were anchored in an optimistic perception of the international oil market.¹² By August 1982, Mexico had declared a unilateral moratorium for the service of its foreign debt, provoking a major international financial crisis that would last until the end of the decade. A month later, Mexican banks were expropriated, private accounts held in dollars frozen, and foreign exchange controls imposed.

¹¹ According to Carlos Rico (2010, 58), this possibility was discussed at the end of the Echeverría administration, whose foreign policy rhetoric leaned toward Third World advocacy. However, Mexico never joined OPEC.

¹² In all official programs and documents of the time, the López Portillo administration never considered the possibility of a potential decline in international oil prices in the mid to long term, which is what happened from 1981 until the collapse of the market in mid-1986 (Morales et al. 1988, 97-111; Meyer and Morales 1990, 189-193).

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In the midst of the 1981-1982 crisis, Mexico received advance payments from the U.S. Treasury for selling additional crude oil to fill the U.S. government-owned Strategic Oil Reserve, which had been created by Washington in the mid-1970s for stockpiling oil to be used for abating sharp price hikes. By so doing, Mexico proved once again that its oil resources, regardless of its government's nationalistic rhetoric, functioned as a "buffer" for U.S. interests and calculations (Morales et al 1988, 167-179; Rico 2010, 106-112).¹³

By contrast, Mexico was more successful in articulating oil diplomacy at the regional level, when key Central American countries witnessed revolutionary changes. In 1979, President López Portillo travelled to Managua to support the triumph of Sandinista revolutionaries in Nicaragua and, in 1981, Mexico and France mutually recognized the National Liberation Movement Frente Farabundo Martí (FMLN), as an insurgency group with whom the established military junta had to politically negotiate in El Salvador.¹⁴ These sudden changes became rapidly politicized. U.S. President Ronald Reagan (1981-1988) framed the shifts in a Cold War confrontation, since Cubans were also supportive of the revolutionary changes. Mexico successfully defused an eventual military confrontation between local forces supported by the U.S. against revolutionary rebels. Mexico also joined Venezuela in devising the San José Agreement in August 1980, which provided for the regular supply of oil to Central American countries, on a credit basis, to help them economically. As part of this agreement, from 1981 to 1989, Mexico shipped on average 50,000 b/d to nine Central American and Caribbean countries, of which Nicaragua, the Dominican Republic, and Panama benefitted from the highest volume (Pemex 1990). The agreement established the foundation for the future participation of Mexico in the Contadora Group, created in 1983 along with Venezuela, Panama, and Colombia. The group promoted stabilization, demilitarization, and economic development in the region by providing a midway for defusing tensions among local governments in Central America, as well as U.S. or foreign military escalation. Though Contadora was not successful in achieving these goals, it became crucial in averting the escalation of military conflicts in the region and strengthened Mexico's economic assistance to Nicaragua (Sepúlveda Amor 1994, 72-86; Ojeda

¹³ It is worth highlighting that these strategic stockpiles were skillfully used by the George H.W. Bush administration just before the launching of the Gulf War in 1990, successfully averting any out-of-control increase in prices (Yergin 1992, 774-775).

¹⁴ Eventually, the FMLN became an opposition party whose candidate, Mauricio Funes, became president of El Salvador in 2009.

2007; Rico 2010, 120-141). Contadora was also at the grounds of the creation of the Rio Group, a consultancy mechanism among Latin American countries in which the U.S. does not participate, that has become more relevant in current times.

Mexico's oil diplomacy toward Central America was not disinterested at all. During the Cold War, and especially with the "Sovietization" of the Cuban Revolution, Mexican political elites were keen on avoiding any revolutionary spillover to their own country, which has witnessed clandestine anti-systemic movements from the 1960s¹⁵ until the present. By supporting next-door revolutionary upheavals—either rhetorically as in the Cuban case or with "hard" resources as in the Nicaraguan and Salvadorian cases—Mexico has attempted to neutralize the military escalation of those conflicts and limit any foreign-sponsored radical movements within its own borders. In doing so, Mexico also reinforced its role as a buffer zone free of radical or communist-inspired movements capable of challenging the status quo and the country's implicit geopolitical understanding with the

III. Mexico's Energy Investment and Cooperation Regime after NAFTA

Toward a Continental Energy Regime

Mexico's policy options from an international perspective were greatly changed with the end of the Cold War, the fall of the Berlin Wall (1989), the implosion of the Soviet Union (1990), and the emergence of the "informational society," which progressively reconfigured state and society capabilities across territorialities and networks (Castells 1997). These historic international shifts came at a time when the Carlos Salinas administration (1988-2004) was attempting to renovate Mexico's economic model for growth according to the Washington consensus formula, in which the privatization of former state-owned enterprises and the incentives of market competition are the cornerstones of reforms. President Salinas started his administration following piecemeal reforms, similar to the approach followed by his antecessor, but then decided that a significant policy shift was needed to adapt Mexico's economy to the realities of a post-Cold War global

¹⁵ In January 1994, the National Liberation Zapatista Army (EZLN) entered into Mexico's political scene, challenging the legitimacy of the economic reforms that the Salinas administration (1988-2004) implemented in order to pave the road to NAFTA, which came into effect at the beginning of that year. The EZLN uprising showed how this new generation of revolts learned from the Central American revolutionary movements of the 1980s (Díaz Polanco 2007).

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world. This prompted him to negotiate, sign, and implement the North American Free Trade Agreement (NAFTA) with the U.S. and Canada (Salinas de Gortari 2000, 39-119).

NAFTA became a revolution in Mexico's economic organization and marked the end of state dirigisme, which had become a sort of *raison d'état* for all Partido Revolucionario Institucional (PRI) governments who had anchored their legitimacy on the principles, rulings, and practices of the 1910 Mexican Revolution. The negotiation and implementation of the agreement accelerated major constitutional reforms to liberalize hitherto protected sectors such as agriculture, foreign direct investment, foreign trade, intellectual property rights, government procurement, and services (Vega 2010). The fact that these reforms were anchored in a binding legal, trilateral agreement signed with the U.S. and Canada, effectively locked in a state economic reform that transcended the Salinas administration. In many ways, Mexico's economy and politics are still adapting to these long-term reforms.¹⁶

Mexico's hydrocarbon sector was left out of this major state reform, however, as a concession to gain the support of domestic groups with nationalistic orientations against allowing foreign investment and privatization to take place in the sector (Mayer 1998, 140-141). Mexico's constitution regarding the hydrocarbon sector was not modified and the industry remained a "strategic sector" only to be exploited by the state. Even so, Chapter 6 of NAFTA established principles and conditions for a gradual liberalization of Mexico's overall energy sector.

Indeed, NAFTA incorporates disciplines for energy trade on energy resources from the General Agreement on Tariffs and Trade (GATT), by prohibiting the imposition of quantitative restrictions, or the imposition of minimum/maximum price requirements, either for imports or exports. No exports taxes are allowed, and restrictions taken under "national security" concerns are heavily restrained (Articles 603, 604, 605, and 607¹⁷). Article 607 of NAFTA specified that energy regulatory measures are subject to the principle of "National Treatment," which means that any further liberalization of the energy sector cannot discriminate against another country. It is important to highlight that NAFTA was undertaken under the principle of the "negative list,"

¹⁶ For an analysis of Mexico's economic foreign policies of that time, see Morales 2008b and Covarrubias 2010.

¹⁷ However, Mexico made important reservations contained in annexes 602.3 and 603.6 of the agreement (SECOFI 1994).

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meaning that overall rules and principles apply to all sectors included in the agreement, and that parties are allowed to agree on exceptions by including them explicitly in the agreement. Once these sectors become liberalized for any reason, they become subject of NAFTA treatment.

As a principle, NAFTA's Article 601.2 affirms (SECOFI 1994):

“The Parties recognize that it is desirable to strengthen the important role that trade in energy and basic petrochemical goods plays in the free trade area and to enhance this role through sustained and gradual liberalization.”

And Article 602.1 sets the scope and coverage of the energy chapter:

“This Chapter applies to measures relating to energy and basic petrochemical goods originating in the territories of the Parties and to measures relating to investment and to the cross-border trade in services associated with such goods, as set forth in this Chapter.”

Since the only country that submitted reservations was Mexico, it is understood that as long as those reservations are waived through “gradual liberalization,” as stated in Article 601.2, NAFTA coverage is extended to the new liberalized areas (Cárdenas 2009, 50; Núñez-Rodríguez 2004). It is also important to highlight that Mexico made no exception concerning cross-border trade in services related with the industry, as well as for government procurement. This means the principles of “National Treatment” and “No Discrimination” are extended to both Canadian and American firms participating as service contractors with Pemex. In principle, any disagreement between the Mexican monopoly and those firms regarding their contractual liabilities might be settled under the NAFTA dispute settlement mechanism.¹⁸

Though NAFTA does not compel Mexico to guarantee energy supplies to the U.S.,¹⁹ it clearly liberalized Mexico's power sector by making a distinction between the supply of electricity as a public service—reserved solely to the state—and that produced by private firms—including

¹⁸ Chapter 11 of NAFTA, concerning investment and providing for an ad hoc dispute settlement mechanism, does not apply to Mexico's hydrocarbon sector, since Chapter 6 has explicitly barred any foreign investment in oil and gas (Núñez-Rodríguez 2004). This is not the case with private firms supplying electricity, since they were explicitly recognized by the agreement.

¹⁹ Canada and the U.S. agreed in their bilateral trade agreement of 1988 to keep the proportion of energy exports relative to total supply. Mexico refused to accept this under Chapter 6 of NAFTA.

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foreign firms—under the following categories: 1) production for own use 2) co-generation and 3) independent power producers (IPP). However, Mexico’s power utilities—at the time, there were two: Comisión Federal de Electricidad (CFE) and Luz y Fuerza del Centro (LFC), though they merged in 2009—maintained the monopoly of transmission, so that private producers, regardless of their category, were compelled to sell their production or surpluses to CFE. NAFTA electricity liberalization was preceded by changes in regulatory bills, which allowed IPP to generate and sell electricity to CFE to supply it under the category of “public service.”

Last, but not least, NAFTA privatized most of the petrochemical industry (Morales 1997), liberalized cross-border trade in electricity, and set the grounds for doing the same for natural gas. This was expanded during the Ernesto Zedillo administration (1994-2000), which introduced changes in regulatory bills—without making constitutional changes—to let private firms participate in natural gas cross-border trade and in the construction of transport lines, distribution, and storage facilities. It is also important to highlight that President Zedillo made regulatory modifications that allowed private firms to take part in the extraction of gas from mineral coal, an energy source that has become increasingly important.

Even though Mexico attached many explicit exceptions to Chapter 6 of NAFTA, the latter became the major framework from which “gradual liberalization” of the sector would evolve. This would, and could be done, without necessarily making constitutional reforms, by introducing “tactic modifications” in regulatory bills, as in the case of electricity and gas. But President Zedillo’s failure to achieve constitutional reform further privatizing the power sector, for example, undermined the possibility of a regulatory reform submitted by President Vicente Fox (2000-2006). Current President Felipe Calderón (2006-2012) submitted an energy reform that attempted to allow the participation of private firms in the refinery of crude oil and in the transportation, distribution, and storage of petroleum products without making constitutional reforms. Congress rejected the effort, and the final regulatory changes remained restrained to the modification of the corporate governance of Pemex and to a further clarification of the role of private firms as suppliers and service contractors of the state monopoly.

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In other words, for the past 16 years, NAFTA's regulatory body (contained in Chapter 6 but also including principles regarding services, government procurement, dispute settlement, and investments in the case of private electric utilities) has been the major energy reform implemented in the country, affecting the monopolies of the state over the sector and the scope of participation by private firms. The last "energy reform" passed by Mexican lawmakers in 2008 made major changes in the corporate governance of Pemex, but did not substantially modify, as NAFTA did, the role of state and firms in the overall sector. It is telling that only these minor changes could be made despite the fact that the PRI still dominated Congress and most of governorships at the state level, and that the president remained the strongest head of the party.

NAFTA also modified the setting in which resource nationalism had evolved since the expropriation years (1938) until the end of the de la Madrid administration (1982-1988). While recognizing that the energy sector remains strategic for the country—meaning that only public enterprises are allowed to exploit this sector in order to fulfill public interests—the treaty challenged the taboo that this could be done while allowing the participation of private firms, including foreign ones. The privatization of electricity production not intended for public service, the opening of foreign trade in electricity and gas, and the further liberalization of downstream gas activities (transportation, distribution, storage, and commercialization) reflect this paradigm shift in the public governance of energy resources. During the Fox administration, foreign and private contractors participated in the development of the Burgos Basin in northern Mexico. This has been the case for the development of the Chicontepec fields during the Calderón administration. Though there were uncertainties during the Fox administration about the scope and legal limits of contractor participation, the Calderón reforms ultimately clarified the issue by explicitly allowing outsource operations in the overall sector in which private firms—foreign or national—might operate. The conditions for contractor-qualifying operations vary, since payment for services may be attached to the efficiency of activities, the scope and amount of resources incorporated to a field, or the cash flow generated by a project.²⁰

²⁰ These types of "incentives" for estimating the value of outsourcing operations were clearly established by Article 62 of the *Reglamento de la Ley de Petróleos Mexicanos* issued in September 2009 (DOF 2009). This article was challenged by opposition parties in Congress for supposedly breaching constitutional norms. But on December 2,

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Last, but not least, NAFTA framed Mexico's energy sector as an integrated part of the North American network. Though during the oil boom years Mexico attempted to diversify its exports from the U.S., contiguity and geology played in favor of a continental integration with the U.S. Since a cluster of refineries are located along the U.S. Gulf of Mexico Coast, mainly in Texas, Mexico's crude oil production coming from the south is "gravitationally" attracted to those refinery outlets. Pemex has co-invested in a refinery with Royal Dutch Shell in Deer Park, Texas, from which gasoline processed with Mexican crude is exported to Mexico. Furthermore, most of Pemex export mix is heavy crude oil (Maya), and American refineries are well suited technically and economically for processing this type of product. By liberalizing foreign trade in fuels, NAFTA made possible the potential of exploiting economies of scale in the energy sectors of the two countries—as is the case between Canada and the U.S.—as well as the emergence of cross-border regional markets for some products that improved efficiency and security in exploitation and distribution.

Toward a Renewed Energy Security Approach

Energy security returned to the forefront of U.S. energy and foreign policies in May 2001, when then- U.S. Vice President Richard Cheney released the so-called National Energy Policy (NEP) of the George W. Bush administration (2000-2008). Energy challenges were defined as the threat posed to America's prosperity and standard of living if the growing imbalance between the country's energy production and consumption was not tackled. The Cheney report advocated conservation through technological innovation, infrastructure development, the increase of domestic energy supplies (other than oil and gas), and stronger links with both Canada and Mexico as major policy steps to enhance U.S. security (NEPDG 2001). After the September 11 terrorist attacks in New York and Washington, D.C., President Bush's policy shifted from deterrence to the notion of preventive war in order to justify the U.S.-led war against Afghanistan and thereafter against Iraq. It also became clear that energy security was again a major component of both U.S. domestic and foreign policies.

2010, Mexico's Supreme Court of Justice ruled that these types of contracts, allowed by the new Pemex legislation, did not breach any constitutional norm (Fuentes 2010). See also, Morales 2011.

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In many ways, the concerns involved in U.S. energy security policies remain the same today as those of the past. U.S. policy makers still worry about the risks of unexpected shocks affecting the stability of energy supply (mainly oil and gas), which might be unleashed by natural depletion (the decline in the amount of remaining oil and gas reserves), natural disasters (i.e. Hurricanes Katrina and Rita which prompted oil prices to skyrocket above US\$50/bbl in 2005), or geopolitical changes (political instability in oil-producing countries, war in the Gulf, proliferation of so-called weapons of mass destruction in a sensitive country and/or region, social revolts in key Middle East and/or oil producing countries, such as those witnessed in early 2011, etc.).

What is new, however, is the strategy of energy adaptation. In contrast to the Nixon or Carter years, recent energy policies are not betting on the “independence” of the U.S. economy from foreign supplies, but rather on the production of non-conventional, carbon-free fuels and the reduction in politicization of global energy markets (oil and gas). Furthermore, new energy proposals discussed by Congress during the Obama administration (2008-2012) promote “green” or renewable fuels as a substitute for oil in the transport sector, and as a means to reduce climate change’s negative consequences.

In fact, the way in which Washington currently perceives and deals with the sensitive issue of oil prices is a major departure from past administrations. High oil prices are no longer viewed as fueling inflation and hampering economic growth. Instead, Washington is anticipating a new era of “expensive oil” (ranging above US\$100/bbl in real terms after year 2015), during which several energy options could become possible: the development of “non-conventional” hydrocarbon resources (tar sands, synthetic oil, shale oil, coal bed methane, shale gas, etc); a new boost to coal consumption as an input for electricity, thanks to technological changes that have reduced damages to the environment; and the growth of renewable sources of energy and the technological feasibility of biofuels. In other words, the U.S. is currently betting on the transition from the oil era of the past century to a new era in which oil begins to lose its place as the main energy commodity and renewable fuels and synthetic oil and renewable fuels make a breakthrough (Senate 2005, EIA 2006 and 2010). This is probably not realistic but remains the focus of U.S. energy policy debate. Still, through conservation and automobile fleet efficiency

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policies, the U.S. Department of Energy (DOE) is anticipating a drastic reduction in U.S. oil imports in relation to overall fuel liquids consumption.

The rationale by which expensive oil is perceived as an advantage that will propel new energy technologies rather than a vulnerability (as in the past) reflects the fact that the U.S. economy is less and less dependent on energy-intensive industries, such as cement, steel, paper, chemicals, and the like. According to DOE estimates, growth in the coming years will come from service industries (currently 80% of U.S. GDP) and non-energy intensive manufacturing. This, combined with a secular decline in energy-intensity ratios (i.e. less and less energy is needed per unit of GDP), technological innovation, a growing population, and labor productivity, suggest that the U.S. economy will keep growing at rates above 2% in real terms over the next 25 years despite high oil prices.²¹

Finally, concern about a terrorist attack to the energy network has become a new element of the energy agenda since the September 11 attacks. Technology and the market mechanisms alone will not guarantee the security of energy flows and interconnections. This definitely underscored a theme in the 2001 Cheney report; the need to strengthen U.S. links with strategic partners in the Americas. Thus, in that same year, Presidents Bush and Fox, and Canadian Prime Minister Jean Chrétien created the North American Energy Working Group (NAEWG), an interministerial task force with the goal of sharing information and data for improving and enhancing energy trade and interconnections within North America. Though NAEWG published four major reports comparing the oil and gas outlook of the three countries, as well as the different regulatory mechanisms prevailing in their respective power sectors, the intergovernmental group failed to become a trilateral policy task force on energy issues (Hufbauer and Schott 2005, 426). However, a new trilateral initiative launched in 2005, the

²¹ Before the financial crisis of 2007, DOE forecast rates of growth of 3% (EIA 2006, 63). The estimate has been adjusted in recent reports to take into account the financial shock and the gradual recovery of the U.S. economy, so the new rate of growth is forecasted at 2.5% in real terms from 2008 to 2035 (EIA 2010, 52). It is important to highlight that according to DOE scenarios, oil prices are driven by consumption in the U.S., China, and India, all of which are supposed to keep growing due to strong economic performances. Since OPEC countries remain the residual suppliers, the development of additional spare capacity of these countries is crucial for the evolution of prices. However, EIA estimates do not take into account the de facto embargo that the US has with key oil-producing countries, such as Iran, and, to a lesser extent, Libya. If production comes back to pre-crisis years, and Gulf countries increase spare capacity, there will be a downward impact in oil prices, putting pressure in OPEC production policies, as it was the case during the mid-1980s.

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North American Security and Prosperity Partnership (SPP), embraced energy cooperation as one of its major pillars (Dukert 2005). SPP aimed at enhancing trade and business mobility with the imperatives of security, in order to prevent U.S. security concerns following September 11 from becoming a barrier to trade and the economic performance of overall North America. One of the major pillars of this security partnership was the inception of “intelligent borders” as moving check points for collecting sensitive information to mitigate risk and avert crime.²² The partnership was not a military alliance, however, like the one between the U.S. and Mexico in 1942 (Morales 2008a, 147-168).

The SPP report of June 2005²³ called as well for the creation of a “policy environment” in which a sustainable supply and efficient use of energy could be promoted. The report also recognized that energy had become “critical to the prosperity and security” of the nations. The major goal of this North American strategic partnership, in terms of energy security, was, of course, to keep both Canada and Mexico as reliable and safe partners for the U.S.. Canada had become a major “energy powerhouse” for North America, thanks to vast reserves of non-conventional oil (tar sands) and the technological feasibility of synthetic oil production.²⁴ In 2005, Canada supplied 16.3% of U.S. gross oil imports, and Mexico, 15.4%. Canada was the major exporter of gas to the U.S., providing around 15% of its domestic consumption. In 2010, Canada and Mexico remained the major providers of crude oil to the U.S., despite the decline in Mexican reserves during recent years.²⁵ Furthermore, the decline of Mexico’s imports may be temporary depending on the success of new legislation enacted by the Calderón administration in 2008 aimed at enhancing oil reserves and restoring production to historic levels (Morales 2011). However, the recovery of the Mexican oil industry could be delayed, due to uncertainties pending within the industry, including the need to attract foreign capital and questions about

²² According to Latapi and Martin (2008, 148), intelligent borders attempt to favor “efficient legal crossings, while detaining potential terrorists and smugglers.” Between the U.S. and Canada, it has been described as “encompassing a broad range of sensing, communications, information, control and electronics technologies” in order to “improve the flow of people and goods across the borders while respecting security requirements” (http://www.itsmichigan.org/pdf/IBC%20Discussion%20Paper_May%202006.pdf).

²³ “Security and Prosperity Partnership of North America: Report to Leaders,” Trilingual Version. June 2005. www.spp.gov/spp/report_to_leaders/Trilingual_Report_to_Leaders.pdf, accessed December 6, 2005.

²⁴ Tar sands endowment has ranked Canada as the second oil reservoir after the conventional oil reserves of Saudi Arabia (Morales 2006).

²⁵ Canada exported 2.018 mb/d and Mexico 951,000 b/d to the US in 2009, representing 33% of overall imports (EIA 2011b).

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organized crime impacting the industry. This will undoubtedly affect imports going to the U.S. at a time when the Middle East has become the theatre of political change and social unrest. Consequently, the evolution of Mexico's renewable resources, especially for the production of electricity and liquid fuels, will progressively become more strategic for the U.S. as its energy mix transitions.

With the commercial and security partnerships created by NAFTA and SPP, Mexico's geopolitical position is in some ways reminiscent of the military, commercial, and labor alliances of World War II that were intended to support American leadership during the military confrontation. At the turn of the 21st-century, amid territorialized and de-territorialized enemies and a mix of conventional and non-conventional weapons and tactics, Mexican space is once again geopolitically and economically important to U.S. interests. A military alliance has not yet been established, but with the creation of a U.S. Northern Command, and the restructuring of U.S. security policies under the aegis of the Department of Homeland Security, Mexican territory has become a de facto part of the U.S. homeland to protect; a sort of thick and extended border, through which potential or suspicious enemies, illegal goods, and people, ought to be detected and deterred in order to prevent harm to the U.S. (Morales 2008a, 147-68).²⁶ Similar to the situation witnessed during WWII, oil and energy resources are part of this renewed geopolitical alliance, but not necessarily its core. Once again, Mexico is functioning as a sort of buffer space—providing strategic resources to the U.S. while helping to filter and deter threats and possible attacks.

Since the implementation of NAFTA, however, some American scholars prefer to consider Mexico a “pivotal” or “critical” state rather than a simple buffer zone. Pivotal states are to be understood as those nations that are not “great powers,” per se, but rather emerging or developing economies that are critical to U.S. interests. They are strategic and important for

²⁶ Established Oct. 1, 2002, the U.S. Northern Command (USNORTHCOM) provides command and control of Department of Defense (DOD) homeland defense efforts and coordinates defense support of civil authorities. USNORTHCOM's area of monitoring includes air, land and sea approaches and encompasses the continental United States, Alaska, Canada, Mexico and the surrounding water out to approximately 500 nautical miles. It also includes the Gulf of Mexico, the Straits of Florida, portions of the Caribbean region to include The Bahamas, Puerto Rico and the U.S. Virgin Islands. Furthermore, the commander of USNORTHCOM is responsible for theater security cooperation with Canada, Mexico, and The Bahamas (See: <http://www.northcom.mil/home.html>). It is in this sense, that Canada, Mexico and the Bahamas have become a critical surrounding of the U.S. homeland to be protected.

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American interests and regional and international stability due to a confluence of factors, not all of which have to be present, such as: 1) geostrategic importance; 2) uncertain evolution; 3) potentially conveying significant beneficial or harmful effects on their regions; and 4) the possibilities for playing a key role on cross-cutting multilateral negotiations (Chase et al. 1999, 6-7).

Mexican scholars and practitioners prefer to conceive of Mexico as a “middle power” or a “commercial power” (Rico 2010, 112; González 2010; Espinosa 2010), but in recent decades, the country has become pivotal for enhancing or jeopardizing American interests. NAFTA has transformed Mexico’s economy and the pattern of trade specialization with the U.S. and Canada, and the SPP has made the country a strategic U.S. partner for combating old and new foes. While Mexico’s geopolitical and geo-economical positions of the country were evident, there was uncertainty about how the country would develop and what the impact on the region would be. Pivots are by definition “wobbly” or “tippy,” that is, they could evolve toward confident, stable regional powers or, to the contrary, become unstable, unable to maintain local or regional order, and lapse into chaos (Chase et al. 1999, 7). Unfortunately, since the inception of SPP, Mexico has moved to an unstable and problematic scenario, which has prompted the U.S. to treat security with its southern neighbor on a bilateral basis.

Indeed, the trilateral approach envisioned by SPP in both energy issues and security concerns faded out with the Obama administration (2008-2012). Trade, energy, and security concerns remain on the North American agenda but not as a trilateral policy issue, as originally envisioned by SPP. A new era of bilateralism has emerged in which the violence and security concerns related to the activities of transnational criminal organizations dominate the U.S.-Mexico agenda. For the past two years, “border security” has been the top priority between the two countries, while trade and energy issues have become secondary.

Today, Mexico is an unstable and uncertain pivot. At risk is not only the decline of Mexico’s oil output and consequently of exports, but the proliferation of “lawless spaces” ruled by local and international organized crime organizations. During WWII and the Cold War years, Mexico became a reliable buffer to U.S. interests, despite government nationalistic and revolutionary

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rhetoric, which the U.S. accepted and tolerated even when it transcended Mexico's international and regional positions. At present, the domestic political situation of the country seems to be more fragile and complicated, and the entanglement of the country with U.S. international interests and concerns much more complex. As Peter Smith, a respected American scholar on Mexico, put it some years ago: If Mexico functions as a "critical state" to U.S. interests, the ultimate goal of Washington is to support development and political stability south of the border. This could be done—as hypothesized by Smith—by lifting all cross-border restrictions to labor migration and by legalizing the sale and consumption of drugs. Smith, of course, realizes that these two policy options are not feasible at present times, so he envisions a cooperative scenario between the two nations building on NAFTA and other bilateral commitments (Smith 2009, 240-243). The worst scenario would be, of course, an escalation of violence and instability in the country, with a more aggressive capture of political elites by organized crime interests, and with the cancellation of Mexico's democratic and civic liberties. Amid such pessimism, there is hope in that both Mexican and American civil societies share the same interests, since neither desires a further degradation of the political situation in Mexico. The challenge is to construct new institutional architecture through which the two countries can work for both their own and mutual interests in the near future.

IV. Conclusions

From the turn of the 20th century to the present, Mexican oil and energy resources have remained strategic for U.S. interests. Mexico has functioned as a buffer zone—or pivot—because of the U.S. need for a reliable energy supply south of the border, mainly in oil and petroleum products, particularly during periods when world energy resources are at stake, including the First World War, WWII, the oil shocks of the 1970s, and the current transition phase of "expensive oil." However, oil and energy resources alone do not account for Mexico's strategic value. As witnessed by the military, commercial, and labor alliances built by the two countries during WWII, Mexico is much more than an oil well to the U.S. in times of distress. Mexico has functioned as a sort of "thick border" from which to filter threats and risks and to access vital resources, such as people and goods. Mexico's buffering properties have made the country's political regime—and its capacity to manage its risks and resources—major priorities for

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American interests. This explains why Washington has traditionally tolerated and accepted Mexico's nationalistic rhetoric and dirigisme in the governance of oil and energy resources.

For more than a century, Washington has indeed put pressure on Mexico's political elite to grant concessions for energy resource exploitation to private investors, including, of course, American investors. However, when these pressures risk alienation of Mexico's political class, or threaten the stability of the political regime—regardless of how democratic that regime might be—Washington compromises, even if the final outcome is not entirely favorable to private American firms.

With the inception of NAFTA in 1994, and the emergence of a new security alliance between the two countries with the establishment of SPP (2005) and the Mérida Initiative (2007), the bilateral relationship between Mexico and the U.S. might evoke memories of WWII. However, in this new edition of global warfare, conventional oil resources are not as crucial as 70 years ago. Instead, technology, intelligence gathering, critical infrastructure, competitiveness, and a more diversified mix of energy resources, in which non-conventional and renewable fuels are critical, have become much more important devices for coping with the security challenges of the 21st century. In this regard, Mexico's assets in terms of territory, people, natural resources, and governance capabilities have moved the country from being a simple buffer zone to a critical pivot. If the pivot turns unstable, unsafe, and unpredictable, this will directly impact the U.S.

This explains why, at present time, the top priority in the agenda of the two countries is the escalation of violence in Mexico, and the political challenges unleashed by the activities of organized crime. Mexico's public safety has become a part of U.S. security, that is, it has become an "intermestic" problem,²⁷ and this explains why security trumps other issues on the agenda. As long as Mexico remains a major exporter of crude oil to the U.S.—something that is in Mexico's economic and political interests— U.S. energy interests will be fulfilled, despite limited opportunities for private participation in Mexico's energy industry. If Mexican exports decline dramatically, this will negatively impact Mexico's economic opportunities and intensify

²⁷ "Intermestic" means that Mexican security has become both an international and domestic issue to the United States.

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tensions in a bilateral relationship already under stress. Furthermore, Mexico has the potential of strengthening its energy relationship with the U.S. as non-conventional and renewable fuels become higher profile. The production of energy from solar, wind, and biomass sources, as well as biofuels, escapes the nationalistic and sovereign-based governance of conventional energy resources in Mexico. That is why it is crucial that Mexicans define the new cooperative architecture under which Mexico and the U.S. will pursue their mutual interests while equally reaping the benefits.

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