

PEMEX, PEÑA NIETO AND PETRO-CANADA: NAFTA AND MEXICAN ENERGY REFORM WITHIN THE CHANGING NORTH AMERICAN CRUDE LANDSCAPE

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I. Introduction

On January 1, 1994, the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico took effect.^[1] By the end of 1993, Canada produced 1.68 million barrels of crude oil per day (MBPD),^[2] exported 0.516 MBPD,^[3] and sent 83.5 percent of its crude oil exports to the United States.^[4] Nineteen years later, Canada's crude oil production rose to 3.14 MBPD,^[5] exports rose to 1.58 MBPD,^[6] and 99 percent of its exported crude oil went to the United States.^[7] This progression equates to an 86 percent increase in total crude oil production, a 201 percent increase in crude oil exports, and a 260 percent increase in the number of barrels sent to the United States since NAFTA's enactment.

Similarly, in 1993, Mexico produced 2.67 MBPD^[8] of crude oil, exported 1.32 MBPD,^[9] and sent 25 percent of its crude oil exports to the United States.^[10] Yet in 2012, Mexico's crude oil production fell to 2.59 MBPD,^[11] exports fell to 0.79 MBPD,^[12] and 48 percent of its crude oil exports went to the United States.^[13] These developments equate to a three percent decline in total crude oil production; a 40 percent decline in crude oil exports and a 15 percent increase in the number of barrels sent to the United States. To summarize the juxtaposition, since NAFTA's enactment, Canada increased its U.S. crude oil exports by 260 percent while Mexico, in the same period, only increased its U.S. crude oil exports by 15 percent.

Explanations for the disparity are multifarious. The factors contributing to this difference include history, culture, geology, law, and technology. In addition to analyzing these factors, this article names certain current consequences and potential implications of NAFTA within the changing North American crude oil landscape. Within this context, Mexican President Enrique Peña Nieto's proposed energy reform is introduced and discussed. A meaningful discourse on these topics begins with an introduction to state-owned oil companies in Canada and Mexico.

II. Petro-Canada

Petro-Canada was Canada's state-owned oil company from 1975 to 2004.^[14] Petro-Canada has been entirely privately-owned for a decade, has a short history, and is not particularly significant in the current North American crude oil landscape. With these caveats noted, an introduction to Petro-Canada serves as useful context, particularly when considering potential long-term implications of Peña Nieto's proposed reform of the Mexican state-owned oil company, Pemex.

In 1973, world oil prices quadrupled due to the Arab oil embargo following the Yom Kippur War.^[15] In response, the Canadian government turned its focus to energy security.^[16] In addition to external motivation, the Canadian government faced two internal pressures to act: 1) foreign (e.g., U.S.) companies predominantly controlled its oil sector and; 2) the Canadian Arctic appeared increasingly attractive as large amounts of oil were recently discovered in Alaska.^[17] In order to stave off rising oil prices, deliver secure energy to its citizens, and participate in the development of its own resources, the Canadian government created Petro-Canada as a Crown Corporation in 1975.^[18]

The company received \$1.5 billion in start-up capital to implement broad powers for exploration, research and development, and refining and marketing of Canadian oil.^[19] Petro-Canada received federal subsidies and enjoyed special exploration rights. The Canadian government also

instituted a “made in Canada” price for oil which was substantially below world market prices.^[20] Canadian oil exports were taxed to pay for the consumer and corporate subsidies.^[21]

Petro-Canada quickly became popular as a symbol of Canadian nationalism.^[22] However, in 1991, plummeting oil prices and new government leadership led the Canadian government to sell 30 percent of the state-owned company.^[23] Over the next decade, the government slowly sold its ownership in installments. By 1995, Canadian government owned only 19 percent of the company and Petro-Canada was listed on the New York Stock Exchange.^[24] In 2004, the Canadian government sold its remaining share of the company for \$3.2 billion, completing the privatization of Petro-Canada.^[25]

Petro-Canada’s sale yielded over \$5.7 billion, and was the largest Canadian governmental privatization to date.^[26] The Canadian Parliament’s website states: “The total gross proceeds . . . from the sale . . . are estimated to have exceeded taxpayers’ total investment by almost \$750 million.”^[27] The Canadian government views the sale of the company as a necessary action, characterizing Petro-Canada as having grown “inefficient, oversized and debt-ridden.”^[28] But not all Canadians are happy to have seen Petro-Canada privatized. Some Canadians would have preferred to keep Petro-Canada under state control. This is because in addition to the loss of secure jobs for Canadians, the profits from oil price increases are accruing to foreign investors rather than the Canadian citizens.

Further to this analysis is the idea that Petro-Canada’s privatization combined with the regulations of NAFTA act as the “one-two punch” for Canada’s sovereignty over its oil resources. There is some legitimacy to this analysis and, admittedly, national policies with consequences for sovereignty should be considered with the utmost scrutiny.

With these concessions noted, globalization and free trade are not passing trends. In fact, the adoption of free trade policies is gaining momentum around the globe. Globalization and free trade inherently have a homogenizing effect on national policies and frequently require renunciation of sovereignty. Further, homogenization and renunciation of sovereignty are part and parcel of globalization and free trade. The goal of free trade, and a requirement of globalization, is to provide the private sector with a uniform predictable legal and investment climate free of individual nations’ protectionist preferences. The energy industry, although an area of entrenched interests, is no exception.

While it is accurate to say that Canada forfeited sovereignty over its oil, this negative treatment is not the only valid analysis. Rather, Canada should be considered an early-adopter of free trade energy policy. It was on the front end of a trend. Early-adoption has its benefits. Canada has, and will continue to, accrue the benefits of its early-adoption.

Canada gained the “first-mover advantage” in free trade oil. A “first mover” has a “form of competitive advantage that a company [or in this case, country] earns by being the first to enter a specific market or industry.”^[29] Central to the first-mover advantage is the concept that the “first-mover” usually accumulates enough market share, expertise, and customer loyalty to remain “on top” of the particular market segment.^[30]

Specifically, as the “first-mover,” Canada increased its access to, and preference within, the United States crude oil market. Generally, early-adopters of free trade enjoy a “head start” over subsequent developing nations that will eventually gain access to the free trade sphere and increase competition. As the “first-mover,” Canada enjoyed a decade-long “head start” before the next “class” of free trade countries entered the free trade marketplace.^[31] Other countries have, and will continue to adopt free trade policies. As they do, these countries will also concede sovereignty in exchange for increased access to international trade and investment. Canada was the first country to complete this process. As a result, it has an advantage.

III. Free Trade

As of 2013, the United States has Free Trade Agreements (FTAs) with twenty countries.^[32] The United States is currently negotiating the Trans-Pacific Partnership (TPP), a regional FTA, with Australia, Vietnam, and ten other Asia-Pacific countries. As recently as November 2013, the TPP negotiators unanimously reported “significant progress after six days of intensive meetings.”^[33] NAFTA’s influence also spread south in the form of the Dominican Republic - Central America - United States Free Trade Agreement of 2004 (CAFTA-DR).^[34] With this introduction to Petro-Canada and free trade, the discussion turns to Mexico’s oil giant, Pemex.

IV. Pemex

Pemex is Mexico’s state-owned oil monopoly. Pemex played a significant role in the NAFTA negotiations and continues to play a large role in the North American crude oil landscape. This is because Pemex remains under state-control today and is among the largest oil producers in the world. Pemex has a large workforce, is an icon in Mexican politics and culture, and is the target of Peña Nieto’s proposed Energy Reform Initiative (ERI). As such, Pemex requires a more complete introduction than Petro-Canada.

By 1911, British and American companies were extracting commercial quantities of crude oil in Mexico.^[35] This attracted the attention of the Mexican government, which claimed all mineral rights for the state as part of its 1917 Constitution.^[36] Twenty years after the Constitution was signed, strife between Mexican oil workers and their foreign managers resulted in a protracted labor strike.^[37] In 1938, Mexican President Lázaro Cárdenas, citing the 1917 Constitution, responded by expropriating all oil resources and facilities of foreign companies to create Pemex.^[38]

Seventy-five years after its creation, Pemex has become a giant. It is one of the top eight oil producers in the world. In 2012, Pemex employed 151,000 Mexicans^[39] and recorded \$126.6 billion in revenue.^[40] Pemex is the second largest company in Latin America, second only to Brazil’s Petrobras.^[41] As a result of its cultural importance and the size of its union and revenue, Pemex wields significant clout as a Mexican employer, a political force, and a source of national pride.

As there is no Canadian or United States equivalent, it is difficult for the rest of North America to appreciate Pemex’s iconic status within Mexican culture and politics. In May 2013, the Center for Economic Research and Teaching published a survey entitled *Mexico, the Americas and the*

World.^[42] The survey consulted 535 business and governmental leaders, academics, media organizations, and 2,400 ordinary citizens.^[43] The survey concluded that 65 percent of Mexicans were opposed to foreign involvement in Pemex.^[44] The study provided the following commentary:

... 21st Century Mexico. . . is not opposed to opening up to the world, with the exception of the oil sector. Mexicans show strong and growing feelings of pride, identification with and attachment to their nationality. . . . The high level of national pride is not opposed to cultural and economic openness. . . . with the sole exception being the oil industry.^[45]

Despite its prowess and revenue, Pemex struggles to be profitable. In 2010, with revenues in excess of \$120 billion, Pemex lost \$3.8 billion.^[46] There are a number of factors contributing to the company's unprofitability. The most important factors are organization, culture, and technology.

First, Pemex has an organizational problem. Despite the fact that Pemex spends only seven dollars to drill one barrel of crude, and that same barrel sells for around 100 dollars, Pemex lost \$29 billion dollars from 2007 to 2012.^[47] This is because Pemex was never treated as a profit-making endeavor.^[48] Some experts estimate that Pemex is over-staffed by as much as five-fold.^[49] Structurally, the production side of the company turns a profit but the refining business does not. If Pemex were a private company accountable to shareholders, the company would not have been allowed to maintain these inefficiencies.

Second, Pemex has a tax problem. Again, Pemex is not viewed as a profit-making expedition. Pemex's taxes compensate for the lack of taxes collected from the rest of the Mexican economy. As a result, Pemex has a disproportionate tax burden. In fact, Pemex's tax revenue makes up about one third of Mexico's federal budget.^[50] Pemex currently hands over around 55 percent of its earnings to the federal government.^[51] In 2012, Pemex paid a record \$69.4 billion in taxes on \$69.6 billion in pre-tax profits, effectively a 99.7 percent tax rate.^[52]

In comparison, Venezuela's state-owned oil company is taxed at 69 percent, Brazil's Petrobras at 25 percent, and Royal Dutch Shell at 31 percent.^[53] In the United States, the largest taxpayer in 2012 was ExxonMobil. Exxon recorded \$452.9 billion in revenue^[54] and paid \$31.05 billion in taxes.^[55] While Exxon had three and half times the revenue of Pemex, the company had a 55 percent smaller tax burden, a \$38.4 billion difference. As a result of its disproportionate tax burden, Pemex reinvests a much smaller amount in exploration activities than its peers.

Third, Pemex has a technology deficiency. Annual crude oil production has dropped each year since 2004.^[56] In 2013, Pemex is estimated to produce just 2.54 MBPD.^[57] This equates to a 34 percent decrease in total production in under a decade. In September 2013, Pemex's Deputy Director of Exploration, José Escalera, stated that, "insufficient investment in technology is the main reason for Mexico's declining oil production."^[58] Most of the downturn can be attributed to a single field, Cantarell, which once produced 2.1 MBPD.^[59] In 2012, Cantarell produced 0.40 MBPD,^[60] an 81 percent decrease in just a few years.

Pemex has experienced significant growth in production and political influence since its creation. At times, leaders within the Mexican government have attempted to reform Pemex. The reforms face the challenge of addressing an unwieldy issue with entrenched and well-connected interests. In general, the reformers have not been up to the task. Previous reforms were blocked by other factions in the government, resisted during implementation, or simply inadequate from conception.^[61] For this article, an introduction to the reforms of the twenty-first century is sufficient.

V. Previous Reforms Of Pemex

In 2000, Mexican President Vicente Fox promised to modernize Pemex.^[62] Fox took a number of steps to curb the company's influence. He introduced a revised tax code to reduce the government's reliance on Pemex, but this reform was blocked in Congress.^[63] Fox appointed an external board of businessman to oversee Pemex, however, Congress objected and the board was dissolved.^[64] Fox's government also criminally charged PRI (the opposition party) with diverting \$120 million from Pemex to illegal campaign funds.^[65]

Fox attempted to improve the company and reduce his government's overdependence on the monopoly.^[66] Ultimately, Fox was unsuccessful at substantive reform. However, Fox did bring attention to Pemex's entrenchment and introduced the idea of tangible changes. Fox should be given additional credit as he pursued reform during the "boom years" of Pemex. Now that Pemex's production has declined for eight consecutive years, the idea of reform is more palatable.

After Fox, came Felipe Calderone. The Calderone government successfully reformed Pemex with the 2008 Energy Reform. The 2008 Reform changed Pemex's organizational structure to more closely mimic the organization of other oil giants worldwide.^[67] The most important change was the four new independent, professional positions added to the board of directors.^[68] The new board seats require private sector experience as a means to increase the lacking technical qualification of the board.^[69] Prior to the reform, five of eleven board seats were reserved to the Pemex union.^[70] Now the union holds five of fifteen total seats. Although the union's influence on the board was reduced, reserving seats for the union is a feature unique to Pemex.^[71]

In sum, Mexico has one of the most, if not the most, closed arrangements in the oil industry. It is largely accepted that the lack of outside involvement in Pemex has hindered innovation, technological advancement, and annual production. With this introduction to the North American state-owned oil companies, the discussion turns to the contrasting Canadian and Mexican energy regulatory schemes under NAFTA. The differences between the two countries' energy outcomes are the largest variances in the treaty.

VI. NAFTA

NAFTA was enacted to promote economic competitiveness and growth by easing the movement of goods and services between its member countries.^[72] NAFTA created the world's largest free trade area, encompassing over 450 million people who produce 17 trillion dollars of goods and

services.^[73] NAFTA was largely an extension of the Canadian - United States Free Trade Agreement (CUSFTA) of 1988 and incorporated the terms of General Agreement on Tariffs and Trade.^[74]

NAFTA took effect in 1994 and saw the last of its policies implemented by 2008. It removed most tariffs and restrictions on trade between the member nations.

NAFTA contemplated a wide range of topics including agriculture, investments, textile, automobiles, telecommunications, intellectual property, and energy. Nineteen years after its enactment, economists are calling NAFTA a resounding success.^[75] However, there is still some tension surrounding NAFTA within unions and consumer advocacy groups.^[76] These groups argue that NAFTA has resulted in outsourcing and lower wages.^[77] The following section introduces NAFTA's provisions governing energy and foreign investment.

VII. Energy Under NAFTA

Each NAFTA country relies significantly on the other member countries to buy and sell oil and gas. Canada and Mexico supply about one-third of the total United States oil imports.^[78] Despite this natural interdependence, NAFTA's Chapter Six, which regulates energy trade, perpetuated two distinct bilateralisms rather than creating a unified regulatory scheme. This is because Mexico negotiated significant exemptions to the energy and investment regulations.

Under Chapter Six, NAFTA imposes two broad constraints on energy law. The first constraint is Article 604 which prohibits export taxes on all energy goods, unless that same tax is placed upon energy goods for domestic use.^[79] This provision bars the United States and Canada from adopting a two-price energy scheme to shield its citizens from volatile world oil prices – a tactic previously employed under Petro-Canada. The second constraint is Article 603, which imposes a blanket prohibition on all energy export controls with limited circumstances.^[80] Article 605 restricts Canada and the U.S. from imposing export controls on energy resources.^[81] In other words, Canada and the United States must maintain a proportionate supply of oil to be available for export purchase.^[82]

At this point, it is important to note that the Canadian government officially refutes this reading of the “Proportionality Clause.” Canada unilaterally issued a declaration interpreting Article 605 as not requiring Canada to export energy resources at “any given level or proportion.”^[83] The “Proportionality Clause” and its implications are discussed in greater depth in a later section of this article.

VIII. Foreign Investors Under NAFTA

The goal of NAFTA's Chapter Eleven is to provide investors of member countries with a predictable legal climate.^[84] The Chapter contains a variety of new rights and protections for investors and investments within NAFTA countries. Section A of the Chapter guarantees investors a minimum standard of treatment in the judicial system of a foreign country and other rights and prohibitions.^[85]

Section B of Chapter Eleven “establishes a mechanism for the settlement of . . . disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal.”^[86] The ability to initiate a binding dispute resolution process against a member government if it allegedly fails to adhere to the Agreement’s regulations^[87] is the most powerful and controversial right accorded to foreign investors in NAFTA.

The ability to initiate binding dispute resolution against a sovereign nation is controversial because when a foreign corporation is awarded damages in such a tribunal, the taxpayers of the losing nation “foot the bill.” This is a novel right and not unanimously welcomed. While this new right is applauded by the private sector, others submit that companies allowed to operate and invest in another country are enjoying a privilege and should be deferential to their host nation rather than having the ability to “twist the arm” of a foreign government in a closed-door arbitration.

IX. The Canadian Energy Scheme Under NAFTA

The “Proportionality Clause” in Article 605 requires that the share of total supply available for export purchase may not fall below the average level in the previous 36 months.^[88] In other words, Canada may not reduce the *proportion* of the energy resources it exports. During the NAFTA negotiations, Canada had little choice when it came to the “Proportionality Clause,” as it had previously agreed this term under CUSFTA. The “Proportionality Clause” was an important term for the United States to secure as its appetite for oil continued to rise and energy security was a popular priority.^[89]

Hypothetically, if Canada raises energy production in an effort to meet its own shortages, Canada would be forced to increase exports in order to *maintain the proportion*. Likewise, if Canada decided to increase energy conservation, it would be unable to cut exports by a greater proportion than the reduction of its own domestic usage. To be clear, the Proportionality Clause only governs government action to restrain export activity, not “market forces.” Conceivably, this means that the Canadian, or another, market could out-bid Americans for more than their proportion of Canadian energy resources.

As noted above, the Canadian government has refuted this interpretation of the “Proportionality Clause.” Canada unilaterally issued a declaration interpreting NAFTA Article 605 as not requiring Canadian energy crisis exports at “any given level or proportion.”^[90] The Canadian Parliament’s website provides its interpretation of the clause:

Contrary to some claims, NAFTA does not commit Canada to exporting a certain share of its energy supply to the United States regardless of Canadian needs . . . the only significant limitation NAFTA places on Canada is that it prevents the Canadian government from implementing policies that interfere with the normal functioning of energy markets in North America. Provided they have the demand and can pay the price, Canadian consumers could conceivably buy 100% of all energy produced in the country without violating NAFTA.^[91]

With Canada's official interpretation noted, it is peculiar that while Canada currently exports more than half of the total crude oil it produces to the U.S., it imports crude oil from abroad to meet its own increased domestic needs.^[92] In 2007, while Canada produced 1,014 million barrels of crude oil and exported 658 million barrels to the United States, it also imported 313 million barrels.^[93] This is because, while western Canada produces significant amounts of crude oil, eastern Canada does not. To the casual observer, western Canadian crude oil would be shipped to eastern Canada. The opportunities (i.e. regulations) of NAFTA leave eastern Canada with an increased reliance on imports.^[94]

Prior to CUSFTA, a greater percentage of western Canadian crude oil was shipped to eastern Canada where it met a greater percentage of the crude oil demand in these provinces.^[95] The energy export provisions of NAFTA resulted in the rapid growth in crude oil exports to the United States and a reduction of inter-provincial crude oil shipments.^[96] In effect, CUSFTA and NAFTA redirected the western Canadian crude oil from flowing east to flowing south.^[97] Eastern Canada has historically relied on crude oil imports to some degree, but tellingly, the increase in crude oil exports to the United States is accompanied by a similar increase in crude oil imports to eastern Canada.^[98]

Under a non-Canadian interpretation of the "Proportionality Clause," it is theoretically possible that Canada, one of the most resource-wealthy nations in the world, could experience oil shortages because under NAFTA the country is compelled to export. To make matters more interesting, Canada does not have significant strategic petroleum reserves, thus increasing the country's energy vulnerability.^[99]

X. The Mexican Energy Regime Under NAFTA

As noted above, NAFTA's Chapter Six perpetuated two separate bilateralisms. Mexico negotiated important exemptions to NAFTA's energy and investment regulations. Chapter Six reiterated Canada's CUSFTA commitments to a deregulated, integrated, free-market economy.^[100] However, the laws governing energy trade south of the Rio Grande remain Mexican. The other NAFTA parties failed to loosen the Pemex monopoly over Mexican oil.^[101]

Energy was non-negotiable for Mexico.^[102] Chapter Six of NAFTA is titled "Energy and Basic Petrochemicals," yet the opening sentence of the chapter is an unusual one: "The Parties confirm their full respect for their Constitutions."^[103] This was an appeasement directed at Mexico. It was a coded recognition of the Mexican government's constitutional exclusivity to mineral rights.^[104]

NAFTA Annex 602.3 explains "full respect" for the Mexican Constitution, and reserves a list of activities including "exploration, exploitation and refining of crude oil . . . production of artificial gas and basic petrochemicals."^[105] No private investment or participation is allowed in these industries.^[106] Some private participation was accepted by the Mexican government subject to its approval.^[107] With this introduction to the country-specific outcomes under NAFTA, the discussion can return to Pemex.

XI. The Need To Reform Pemex

With all due respect and at the risk of seeming overbroad, Pemex is hindered by bureaucratic practices,^[108] passé, and approaching a decade of production declines.^[109] Despite its plentiful crude oil supply, Mexico imports 80 percent of the petrochemicals used in the country.^[110] Without reform bringing new investment and technology, Mexico will become a net importer of petrochemicals in the next decade.^[111] This possibility should serve as an admonition to Mexican traditionalists clinging to the nationalistic fervor of the days of expropriation long ago. Peña Nieto's proposed Energy Reform Initiative (ERI) is a unilateral action by the Mexican government for the benefit of Mexico. It is not required by NAFTA or any other international agreement. Assuming current trends continue, Pemex will decline in domestic and international influence, as well as production and revenue. The ERI is, first and foremost, in the best interest of Pemex, the Mexican government, and Mexican people. Some protectionists are resistant, but reform is required for the ultimate longevity of Pemex and union jobs. Without reform, Mexico will see a waning in tax revenue, exports, and well-paying jobs. Without reform, Pemex is unsustainable.

XII. North American Pressures To Reform Pemex

The proposed ERI is a Mexican creation. However, it is important to note two North American forces increasing the pressure to reform Pemex. The first pressure is the expansion of hydraulic fracturing as a technique to extract previously out-of-reach oil. A second, lesser pressure is the proposed Keystone XL Pipeline.

XIII. Hydraulic Fracturing

The recent boom in United States oil production has set the nation on a path to displace Russia as the world's top oil-producing country by the end of 2014.^[112] This idea was unheard of just a few years ago.^[113] The production boom has been driven by the oil and gas industry's use of hydraulic fracturing or "fracking" to reach previously inaccessible oil.^[114] Fracking is a complicated technological feat. It involves injecting a chemical mixture deep into the ground at high pressure to crack rock and allow oil or gas to flow.^[115]

The expansion of fracking has significantly aided the United States' economic recovery.^[116] It also reduces the United States' dependency on oil imports.^[117] Still, fracking is controversial. Many submit that the technique contaminates ground water and can cause small earthquakes.^[118] France and Bulgaria are the only countries with national bans on fracking.^[119] However, there is regional resistance to the technique in Western Europe and the northeastern United States.^[120] Still, many countries are eager to jump on the fracking bandwagon as a means to grow their economies and energy production.^[121]

Fracking has opened significant new supplies of oil in the U.S. and changed the domestic market.^[122] In California, fracking has led to what is being called a "new gold rush."^[123] The massive, untapped oil reserves of the Monterey Shale formation in Central California are estimated to contain over 15 billion barrels of oil.^[124] This is five times as much as the Bakken Shale formation in North Dakota.^[125] The California legislature responded with the state's first piece of fracking legislation.^[126]

The new California law requires monitoring of well water before and after companies drill, and mandates that the names and concentrations of the chemicals used in the process are made public.^[127] This is not the case on the federal level as chemicals used in fracking are exempt from water disclosure law following the 2005 legislation on the matter.^[128]

While the public debate on fracking is far from over and legislative landscape attempts to keep up with the private sector, many countries and companies are betting big on fracking.^[129] U.S. technological and geological expertise is required if Pemex wishes to frack safely and successfully. On its face, fracking appears to be a feasible option to reverse Mexico's production declines.

XIV. Keystone XL

The Keystone XL Pipeline is a proposed 1,179-mile, 36-inch-diameter crude oil pipeline beginning in Alberta and extending to Nebraska.^[130] With a Presidential Permit in 2013, the Keystone XL Pipeline could be operational by 2015.^[131] The pipeline will have capacity to transport 830,000 barrels of crude oil per day to Gulf Coast and Midwest refineries.^[132] This would reduce U.S. dependence on oil from South America and the Middle East by up to 40 percent.^[133]

The U.S. Department of State's *Draft Supplementary Environmental Impact Statement* regarding Keystone XL concluded that the pipeline would have "no material impact" on carbon emissions."^[134] While Keystone has environmental opposition, it is widely speculated that the proposed pipeline is inevitable. The Keystone proposal does not include Mexico or Pemex. But it is not difficult to deduce why the pipeline increases the need for reform. An increase in Canadian oil sent to the United States would mean a reduction in the need for Mexican oil. Some experts believe that after Keystone XL is built, the U.S. will see oil prices go up.^[135] This argument rests on the premise that oil is traded on a global market. The counterargument is that building Keystone XL will create a surplus of oil on the Gulf Coast and allow for increased exports into the world market.^[136] TransCanada, the company behind Keystone, has projected that the incremental supply of Canadian crude oil brought into the United States will put "downward pressure on [prices for] refined products."^[137] Regardless of whether the price for oil goes down for Americans or not, it can be reasonably surmised that if Keystone is built it will decrease the U.S. demand for Mexican oil.

With this introduction to the internal and external pressures to reform, the discussion turns to Peña Nieto's proposed Energy Reform. Inevitably, this article, like any examining proposed legislation, may fall behind the most current iteration as the legislation will likely undergo a series of revisions until it is passed. Noting this liability, this article analyzes Peña Nieto's original Energy Reform proposal of August 2013.

XV. Peña Nieto's Proposed Reform of Pemex

On August 12, 2013, Mexican President Peña Nieto presented his Energy Reform Initiative.^[138] The ERI aims to improve Pemex's transparency, increase competitiveness, and leverage the best practices and technology of private companies.^[139] For this discussion, the four most important

elements of the proposed ERI are introduced. The aspects include: the permitting of profit-sharing contracts with private companies; a revised tax scheme; an organizational restructuring; and processes for improved transparency.^[140] The first element of the ERI permits Pemex to sign profit sharing contracts with the private sector “where appropriate to the national interest.”^[141] The goal is to leverage private companies’ best practices and technologies.^[142] This reform will help Pemex “generate cheaper energy for all Mexican families” while the state maintains “absolute control of the oil.”^[143] The private contracts are profit-sharing only.^[144] All ownership of the oil would remain Mexican.^[145] Private industry commentators welcome the proposed change but believe the reform does not go far enough.^[146] Private companies would prefer ownership rights over profit-sharing; presumably because they think they can turn a greater profit with the oil than Pemex can. This reform is the primary source of contention for the Mexican people, as it would open Pemex to “foreign influence.”^[147] As previously noted, private involvement in Pemex is opposed by 65 percent of Mexican citizens.^[148] The fear is that the private partners will eventually increase their influence. Conceptually, with continued liberalization, foreign companies could gain ownership rights over oil or undue influence within the Pemex organization. This reform is feared to be the first “splinter” in the once-impenetrable shield for Mexican interests that Pemex shouldered for 75 years. This reform also opens Pemex to increased NAFTA Chapter Eleven liability. This is discussed in a later section of this article.

The second element of the ERI proposes a new tax scheme for Pemex. The tax reform’s stated goal is to allow Pemex to be “fully competitive by international standards.”^[149] As noted above, Pemex is taxed at a much higher rate than other private and state-owned oil companies.^[150] The official rhetoric is that new tax regime changes the Mexican state’s posture from “a tax collector for short-term needs” to an “owner of the oil wealth with a long-term vision.”^[151]

Currently, over half of Pemex’s tax bill comes as an annual fee based on oil and gas proceeds.^[152] “The proposed reform would reduce [that] rate from 71.5 percent to 60 percent in 2015 and then to ten percent in succeeding years.”^[153] The ERI introduces a new royalty scheme indexed to market fluctuations and shifts Pemex onto Mexico’s 30 percent corporate income tax rate.^[154]

The ERI’s stated aim is to reduce Pemex’s total tax burden. Yet, the details of the Reform do not leave many with confidence that this will be the result. In fact, former Pemex CEO, Jesus Reyes Heróles, said “in effect, . . . the plan was tantamount to maintaining the status quo under a different name,” further stating, “[a]ctually, they don’t reduce the tax burden on Pemex, . . . [t]hey change the structure.”^[155] Critics fear that Mexico’s fiscal reform will not collect as much tax revenue as estimated. This scenario could lead the Mexican government to take additional fees from Pemex to make up for shortfalls, an ability the government retains under Peña Nieto’s proposal.

The third element of the ERI reorganizes Pemex into two divisions: 1) Exploration and Production, which focuses on oil and gas extraction; and 2) Industrial Transformation, which includes the refining business. This element attempts to address Pemex’s structural inefficiencies.

The fourth element of the ERI sets to improve processes and conditions for transparency and accountability at Pemex. Pemex will adopt the “best practices for transparency to the Mexican people concerning projects, domestic procurement, and shared utility contracts.”^[156] This element attempts to address the pervasive perception that Pemex is plagued with inefficiency and corruption. On its surface, the proposed ERI addresses Pemex’s largest challenges of structure, taxation, and technology. While the proposed Reform is less extensive than private oil conglomerates would have preferred, the proposal has enjoyed a positive reception in the private sector.^[157] Chevron stated that it welcomes any decision by Mexico that provides new investment possibilities.^[158] Shell also expressed measured optimism stating that “Mexico could benefit from working with energy companies.”^[159] This brings the discussion to the reception of the proposed ERI in Mexico.

XVI. Peña Nieto’s Reform’s Reception In Mexico

Peña Nieto was elected on a promise to put Mexico back in “the big leagues” of global emerging markets,^[160] a position it lost in the past decade with the rise of China and Brazil.^[161] In the “honeymoon” phase of his six-year term, Peña Nieto has taken advantage of his popularity and political capital.^[162] Peña Nieto has already taken on entrenched interests and powerful unions through his Education Reform.^[163] The education reforms were signed into law on February 25, 2013, despite opposition from the teacher’s union.^[164] The teacher’s union is the second most powerful union in Mexico, second only to Pemex.^[165]

Like the Education Reform, Peña Nieto’s the greatest resistance for Energy Reform does not come from Congress, but from working-class Mexican citizens. Peña Nieto must convince the Mexican people that reform is best for Pemex and their country. Peña Nieto’s proposal is likely to get congressional approval but has already caused nationalistic demonstrations.^[166] Andrés López Obrador, who lost the past two presidential elections, has called the Energy Reform “treason” and “pledge[d] to mobilize his supporters to stop it.”^[167]

On Peña Nieto’s inauguration anniversary in December 2013, tens of thousands of people were reported to have taken to Mexico City’s streets to protest Peña Nieto’s Energy Reform.^[168] The crowd made up of teachers, union members, and activists was joined by López Obrador, who said, “we are here to avoid a big robbery.”^[169] Although some of the rank and file within the Pemex union oppose Peña Nieto’s proposal, he can ultimately rely on the union’s support.^[170] This is because Peña Nieto’s PRI party and the Pemex union are historical political allies.^[171] Perhaps more importantly, the competing PAN energy reform proposal, seeks to dissolve the Pemex Union.^[172] This leaves Peña Nieto’s proposal as the most viable option for the Pemex union.

At bottom, political observers speculate that Peña Nieto’s proposed Energy Reform will receive Congressional approval as it likely has the two-thirds majority support required to pass. Enrique Kraze, a prominent Mexican historian, summarized the importance of the proposed Energy Reform, stating: “If Mexico passes this bill, and we have peace in the streets, then the country will make an important leap forward[.]”^[173]

XVII. An Unanticipated Ally

Environmentalists should support Peña Nieto's proposed Reform of Pemex. The process of extracting oil from tar sands produces higher rates of greenhouse gas emissions when compared to oil extracted from traditional oil fields.^[174] These additional emissions are present before the oil traverses thousands of miles of sensitive terrain across the United States to refineries on the Gulf of Mexico.^[175] The main risk of the current model, and Keystone XL future, is the possibility of oil spills along pipelines and railways.^[176] A pipeline spill would pollute air and water supplies and harm migratory birds and other wildlife.^[177] "The [U.S.] Department of Interior has expressed [its] concerns that the [U.S.] State Department is ignoring the potential impact the proposed Keystone XL Pipeline could have on wildlife, waterways and national parks."^[178]

Together, this presents Mexican oil as a more environmentally-sensitive alternative to Canadian tar sands oil. With the infusion of private companies' technology and expertise, Pemex should argue that its oil, which travels by tanker,^[179] provides the U.S. and global markets with "cleaner" crude oil when compared to the Canadian alternative.

XVIII. Peña Nieto's Reform's Intersections With NAFTA

NAFTA's Chapter Eleven permits a private investor of one NAFTA party to seek damages from another NAFTA party that allegedly violated a NAFTA provision. Peña Nieto's proposed ERI creates a new area for NAFTA Chapter Eleven claims. Under the ERI, more private companies will be partnering more frequently and more significantly with Pemex. The greater number of partnerships and the more significant the partnerships, the greater stakes and likelihood of disputes.

Previously, Pemex had enjoyed a bright line separation from NAFTA-style liabilities. The proposed ERI blurs this bright-line barrier. How private firms and Pemex operate together in this newly created space will determine if the Mexican taxpayers could be "on the hook" paying damages to a foreign company for violations of NAFTA.

Pemex has over \$120 billion in revenue. Even a few hundred million dollars lost in arbitration would only be nominally damaging to the company or Mexican citizens, fiscally-speaking. However, NAFTA arbitration would be culturally and politically harmful for Pemex and Peña Nieto. The idea of Mexican citizens paying for an alleged breach of NAFTA because Pemex partnered with a foreign company would be a difficult pill for many Mexicans to swallow. Another analysis of Peña Nieto's proposal is that within the NAFTA context, the Energy Reform is the first splinter that could, in the long-term, lead to the breaking of Pemex as a state-owned company. Private companies, through superior technology, experience, and capital could gain increased influence in Pemex or the Mexican government. If the private-public partnerships succeed, the private companies with a new foothold in Pemex could seek ownership of the oil produced. Then, once private ownership or additional influence is established, perhaps over the decades Pemex could eventually go the way of Petro-Canada; and be sold in pieces on the open market.

XIX. Conclusion

Mexican economic liberalization has been a slow process and is far from complete. It would be naïve for Mexico and other developing nations to ignore the macroeconomic implications of free trade. Under NAFTA, the value of Mexican exports to the United States “grew from \$39.9 billion in 1993 to \$210.8 billion in 2007, an increase of 437 percent.”^[180] Over this period, the Mexican gross domestic product grew by 46 percent.^[181] With an increasingly open environment for foreign trade and investment, and a large and growing domestic market, Mexico will grow increasingly attractive as a destination for foreign investment and trade.

Turning to the North American crude oil landscape, the United States and Canada have successfully created complementary systems for efficient integrated distribution of oil and gas between the two countries. While both the United States and Canada are ready and willing to include Mexico in an integrated market, Mexico has elected to take a more cautious approach. This approach has tradeoffs. Mexico’s hesitation in regards to energy integration was not unexpected given the cultural and political significance of Pemex. As a result of Mexico’s NAFTA reservations, its energy industry remains entirely in its own control. However, it can be surmised that this approach also played a large role in Pemex’s eight-year production decline.

It is easy to suggest that Mexico’s energy reservations are a major flaw in NAFTA. Yet, perhaps the NAFTA drafters did not expect the agreement to trigger immediate across-the-board changes to Mexican oil. Perhaps, taking a longer view, NAFTA should be seen as a lever to pry open the Mexican oil sector over time. It can be safely said that some loosening has been achieved. Peña Nieto’s proposed ERI is hailed as the most significant change to Pemex in its 75-year history. With all of this taken into account, NAFTA should be considered a success in the energy sector. Indeed, the “Principles” of NAFTA Article 601 cite to the goal of enhancing the role of energy “through sustained and gradual liberalization.”^[182] Perhaps, the liberalization of the Mexican oil industry is playing out just as, or even better than, the NAFTA drafters expected.

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