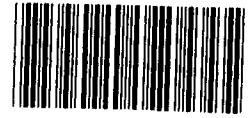


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MEXICAN OIL

**Mexican Policies Affect U.S.
Trade and Investment
Opportunities**

Statement of
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International Trade and Finance Issues
General Government Division



MEXICAN OIL
MEXICAN POLICIES AFFECT U.S. TRADE AND INVESTMENT OPPORTUNITIES

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ
DIRECTOR, INTERNATIONAL TRADE AND FINANCE ISSUES
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GAO's testimony deals with issues affecting potential future U.S. trade with and investment in Mexico's petroleum industry.

After declining through 1986 from a 1982 peak, Mexico's oil production and exports have remained relatively constant. Yet, Mexico's energy needs have increased. The primary factors affecting Mexico's ability to meet current government oil production and export goals include (1) the ability of the Mexican government-controlled oil company Petroleos Mexicanos (PEMEX) to obtain investment capital for further exploration and production and (2) PEMEX's strategy to modernize its operations. However, PEMEX has limitations on its ability to raise the necessary capital, and its modernization efforts have not been completed.

Mexican government policies continue to restrict private and foreign investment in Mexico's oil sector. Since 1938, when Mexico nationalized its oil industry, the Mexican government has not allowed foreigners or private oil companies to invest in oil exploration and production in Mexico. Should this investment barrier be removed, several U.S. oil-producing companies that we spoke to indicated an interest in investing in Mexico. However, U.S. oil-producing companies and Mexican officials differ over the benefits of investment by U.S. companies in Mexico's oil industry.

Mexican government policies impede foreign involvement in Mexico's oil service contracting industry as well. We interviewed representatives of 30 U.S. oil service contracting companies who provide services such as oil well drilling, maintenance, and transportation. They told us that barriers to trade include Mexico's unclear tariff system and PEMEX's use of procurement practices that favor Mexican suppliers and contractors. Despite these barriers, both U.S. oil service contracting companies and PEMEX officials told us they saw mutual benefits to having U.S. firms contract to provide goods and services to Mexico. Modernization efforts by PEMEX may further increase business opportunities for U.S. oil service contracting companies.

U.S. agencies have undertaken several efforts to support Mexico's petroleum sector. For example, the U.S. Export-Import Bank has agreed to provide loan guarantees for large purchases of U.S. oil and gas equipment and related services, and similar loan guarantees could provide a significant percentage of investment capital PEMEX plans to obtain from foreign sources. Also, the U.S. Trade and Development Program has funded a feasibility study to upgrade two petrochemical plants in Mexico. In addition, to enhance energy cooperation the Department of Energy has held bilateral consultations with its Mexican counterpart since 1982.

Mr. Chairmen and Members of the Subcommittees:

I am pleased to be here today to testify about our report on trade and investment issues relating to the Mexican oil industry.¹

Our report, which was issued on March 18, was prepared at the request of the Chairman of the Subcommittee on International Economic Policy and Trade, House Committee on Foreign Affairs. For the report, we obtained information on (1) recent trends in Mexican oil production and exports and the primary factors affecting Mexico's ability to meet current production and export goals, (2) the views of U.S. oil-producing and oil service contracting companies regarding principal barriers to and potential benefits of U.S. trade with and investment in Mexico's petroleum sector and the response of Mexican officials to those views, and (3) U.S. government efforts to assist Mexico's petroleum sector. (See app. I for a profile of selected U.S. oil producers and oil service contractors.)

BACKGROUND

Oil has been an extremely sensitive issue in U.S.-Mexico relations. Mexican oil plays an important role in the U.S. energy strategy. During 1990 Mexico provided about 12 percent of the net crude oil

¹Mexican Oil: Issues Affecting Potential U.S. Trade and Investment (GAO/NSIAD-92-169, Mar. 18, 1992).

imported by the United States; it ranked third behind Saudi Arabia and Nigeria as a source of net U.S. crude oil imports.

Mexico's oil industry was initially developed by foreign oil producers in the early 1900s. However, conflict between foreign producers and the Mexican government eventually led to the nationalization of the oil industry in 1938, a move that has since become a powerful national symbol of Mexican sovereignty. Since that time, the Mexican government has controlled the right to explore, produce, transport, market, and refine all crude oil in Mexico. Petroleos Mexicanos (PEMEX), a government-owned company, is responsible for managing all of Mexico's petroleum operations.

The discovery of vast new petroleum reserves in Mexico during the 1970s allowed the Mexican government to pursue a debt-led strategy for economic development. Anticipating substantial increases in revenues from its oil exports, Mexico borrowed heavily from foreign sources to finance industrial development. In 1982, however, oil prices declined, leading to a shortfall in expected revenues, and Mexico was saddled with an external debt of about \$80 billion without the anticipated means to service it. Since this crisis, Mexico has diversified its economy to protect itself against the volatility of the world oil market. However, the government-controlled oil industry continues to play an important role in the economy in part because it is a significant source of foreign currency earnings.

FACTORS AFFECTING MEXICO'S CONTINUED

OIL PRODUCTION AND EXPORTS

Mexico's ability to increase its oil production is affected by a number of factors. In terms of recent trends, Mexico's oil production peaked in 1982 at 2.7-million barrels per day, declined through 1986, and has since remained at an average of about 2.5-million barrels per day through 1991. Oil exports also have remained constant, averaging about 1.3-million barrels per day from 1986 through 1991. (See app. II for an overview of Mexican oil production and exports, 1980-1991.)

Mexico's current National Energy Modernization Program calls for oil production to meet projected annual internal demand increases of about 5 percent while keeping exports constant at about 1.3-million barrels per day. To meet the goals of the energy program, PEMEX estimates that it will need a minimum of \$20 billion in new investment over a 5-year period and must modernize its operations to increase its efficiency.

However, PEMEX faces limitations on its ability to raise the necessary capital. For example, the government has placed a ceiling on PEMEX's annual budgetary expenditures. Also, PEMEX's plans for obtaining funds through foreign capital markets have not been fully realized. Although oil production is the highest PEMEX investment priority for PEMEX, it faces competing investment

demands in such areas as construction of refineries, gasoline stations, and petrochemical plants. Finally, PEMEX's modernization efforts have not yet led to increased oil production and may be difficult to implement fully.

U.S. OIL COMPANIES' VIEWS AND
MEXICAN OFFICIALS' RESPONSES

PEMEX continues to be solely responsible for petroleum operations in Mexico. These circumstances make Mexico an unlikely place for the major U.S. oil-producing companies to put resources. These companies invest in and manage crude oil and gas exploration and extraction projects in many locations around the world. However, they do so in return for an equity interest in projects, or at least a share of the output. Mexico currently offers neither to foreign firms interested in involvement in the Mexican petroleum industry.

Major U.S. oil-producing companies told us that both they and Mexico could benefit should they be allowed to invest in Mexico's oil industry. For example, some U.S. oil-producing companies said they have the capital and management expertise needed to maximize Mexico's oil production. In response, Mexican officials we interviewed said that Mexico does not need investment by U.S. oil-producing companies because there is virtually no risk in exploring

and developing Mexico's oil reserves since the location of the oil is well known.

Many oil service contractors told us that they also face barriers to selling goods and services in Mexico. Oil service contracting companies provide services such as oil well drilling, maintenance, and transportation. These companies said that they do have opportunities for some business there. However, they told us that Mexico's unclear tariff system, which may effectively assess their equipment and supplies at a combined tariff and tax rate as high as 33 percent, makes operations in Mexico difficult. They also added that PEMEX gives preference to Mexican-owned companies over foreign companies when hiring contractors and suppliers. According to Mexican officials, this practice is consistent with Mexican procurement law.

U.S. oil service contractors and PEMEX both cited benefits to their business relationships. According to virtually all of the 30 U.S. oil service contractors we interviewed, contracts in Mexico may help compensate for declining oil service business in the United States. Most of these U.S. oil service contractors told us that on a level playing field they would have a competitive edge in Mexico and that Mexico offers strong prospects as a long-term market. U.S. contractors said that they can provide technology that PEMEX cannot, such as the use of three-dimensional imaging to find underground oil deposits. PEMEX officials added that PEMEX now is

using U.S. service contractors to improve its drilling operations as part of its modernization efforts. Similar projects now planned by PEMEX are likely to increase business opportunities for U.S. oil service contractors, according to Mexican government officials.

U.S. GOVERNMENT EFFORTS TO ASSIST
MEXICO'S PETROLEUM SECTOR

Several U.S. government agencies are currently involved in projects that assist Mexico's petroleum sector. The U.S. Export-Import Bank recently agreed to authorize a guarantee of \$1.3 billion in loans to PEMEX to purchase U.S. oil and gas equipment and related services. This program could eventually expand into a \$6-billion loan guarantee, which would represent 75 percent of the investment capital PEMEX estimates it will seek from foreign sources.

Furthermore, the U.S. Trade and Development Program is financing a \$350,000 study to upgrade two Mexican petrochemical plants. In addition, since 1982 the Department of Energy has cosponsored bilateral energy meetings with Mexican government officials to exchange technical information and discuss topics of mutual interest.

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Mr. Chairmen and Members of the Subcommittees, this concludes my prepared statement. I will be happy to try to answer any questions you may have.

PROFILE OF SELECTED U.S. OIL PRODUCERS AND OIL SERVICE CONTRACTORS

<u>Industry group</u>	<u>Industry group definition</u>	<u>Estimated 1990 U.S. employment</u>	<u>Estimated 1990 value of output</u>
<u>Oil producers</u>	Invest in and manage crude oil and gas exploration and extraction projects	394,123	\$85.5 billion
<u>Oil service contractors</u>			
Geophysical contractors	Explore for underground oil and gas deposits using geological maps and specialized equipment	20,000- 22,000	\$530 million
Drilling contractors	Drill wells to explore for and produce oil and gas from underground deposits	408,000 ^a	\$3.3 billion
Petroleum equipment suppliers	Produce equipment used in oil and gas drilling, production, and processing	240,000	\$35.2 billion
Marine service contractors	Transport supplies, equipment, and personnel between the shore and offshore oil and gas platforms	25,000	\$500 million

APPENDIX I

APPENDIX I

<u>Industry group</u>	<u>Industry group definition</u>	<u>Estimated 1990 employment</u>	<u>Estimated 1990 value of output</u>
Oil well servicing contractors	Conduct maintenance on oil wells to ensure efficient operation	35,000	\$650 million

*1989 estimate.

Source: GAO

MEXICAN OIL PRODUCTION AND EXPORTS, 1980-1991
Barrels in millions

<u>Year</u>	<u>Average production per day</u>	<u>Average exports per day</u>
1980	1.9	0.8
1981	2.3	1.1
1982	2.7	1.5
1983	2.7	1.5
1984	2.7	1.5
1985	2.6	1.4
1986	2.4	1.3
1987	2.5	1.3
1988	2.5	1.3
1989	2.5	1.3
1990	2.5	1.3
1991	2.7	1.4

Source: PEMEX.

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