THE TIME IS NOW FOR FULL PRIVATIZATION OF PEMEX

TABLE OF CONTENTS

I. INTRODUCTION

During the administration of former President Carlos Salinas, a series of far-reaching free market reforms were implemented throughout the Mexican economy.[1] However, the Mexican oil industry has been largely excluded from privatization efforts.[2] Petróleos Mexicanos, or Pemex, was

1. *See* Wesley R. Smith, *Liberalizing the Mexican Oil Industry*, MEX. TRADE & L. REP., Dec. 1992, at 5 [hereinafter Smith, *Liberalizing*] (describing these reforms as "modest administrative measures . . . insufficient to correct the monopoly's many failings"). Some of these reforms include the privatization of state-owned industries and the introduction of foreign direct investment. *See* Wesley R. Smith, *Oil and Prosperity: Reforming Mexico's Petroleum Monopoly*, MEX. TRADE & L. REP., Nov. 1992, at 5 [hereinafter Smith, *Oil and Prosperity*]. For example, the *Ley Federal de Competencia Económica* was "intended to implement a comprehensive modern competition policy" through "'privatization, deregulation, price liberalization and international trade liberalization.'" Allan Van Fleet, *Mexico's Federal Economic Competition Law: The Dawn of a New Antitrust Era*, 64 ANTITRUST L.J. 183, 183 (1995) (quoting *Economic and Legal Background for Mexico's New Competition Law*, OECD Doc. DAFFE/CLP(93)10, at 2 (Apr. 30, 1993)).

2. *See* Kenneth D. Jensen, Comment, *Chapapote: Interdependence and the Liberalization of the Oil Industry in Mexico*, 24 CAL. W. INT'L L.J. 81, 82 (1993) (noting the "pervasive nationalism associated with the state-controlled oil" and President Salinas's desire to continue state control of the Mexican oil industry).

formed in 1938[3] when then President Lázaro Cárdenas expropriated and nationalized the foreign-dominated oil fields, consolidating all petroleum operations into one state-owned enterprise.[4]

An oft-advanced explanation for the failure to include Pemex in privatization efforts is Article 27 of the Mexican Constitution which grants control over the petroleum industry to the state.[5] Some efforts have been made recently to achieve a measure of privatization of Pemex; for example, the Mexican government has recently agreed to sell up to 49% ownership in Mexico's 61 petrochemical plants with the state retaining 51% ownership.[6] But the Mexican government has continued to resist completely relinquishing control over this politically profitable,[7] but economically volatile industry.[8]

---

3. *See* "Decreto que crea la Institución Petróleos Mexicanos" [Decree that creates the Institution Petróleos Mexicanos], D.O., 7 de junio de 1938, *superseded by* "Ley Orgánica de Petróleos Mexicanos" [Organic Law of Petróleos Mexicanos], D.O., 6 de febrero de 1971, *amended by* "Reglamento de la Ley Orgánica de Petróleos Mexicanos" [Regulations to the Organic Law of Petróleos Mexicanos], D.O., 10 de agosto de 1972 (creating the National Petroleum Company). For a discussion of the historical origins, development, and organizational structure of Pemex, see Christopher C. Joyner, *Petróleos Mexicanos in a Developing Society: The Political Economy of Mexico's National Oil Industry*, 17 GEO. WASH. J. INT'L L. & ECON. 63, 66–77 (1982).

4. *See* Jensen, *supra* note 2, at 81. Oil is "symbolically linked to the Mexican Revolution" and remains a source of intense national pride among the Mexican population. *Id.* at 81–82. President Cárdenas's expropriation was a largely symbolic move representing Mexican sovereignty. *See id.* at 81. For a discussion of the history of the Mexican oil industry and its impact on Mexican domestic and foreign affairs, see GEORGE W. GRAYSON, THE POLITICS OF MEXICAN OIL (1980).

5. Article 27 provides in pertinent part: "In the Nation is vested the direct ownership of all . . . petroleum and all solid, liquid, and gaseous hydrocarbons . . . ." MEX. CONST. art. 27, *translated in* Gisbert H. Flanz & Louise Moreno, *Mexico*, *in* CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 1, 23 (Albert P. Blaustein & Gisbert H. Flanz eds., 1988) [hereinafter CONSTITUTIONS]. No "concessions or contracts" are to be granted, and the "[n]ation shall carry out the exploitation of these products." *Id.* at 24–25.

6. *See, e.g.*, *Mexico Will Limit Sales of Petrochemical Plants*, WALL ST. J., Oct. 14, 1996, at A15 [hereinafter *Mexico Will Limit*] (discussing plan to redraft President Ernesto Zedillo's privatization plans for the oil industry). Some within the Mexican government are advocating the outright sale of plants which process petroleum by-products rather than crude oil. *See id.*

7. Privatization of the oil industry is often challenged by union-backed nationalists as an assault on national sovereignty. *See* George W. Grayson, *Why Mexican Labor Fights a Petrochemical Selloff*, WALL ST. J., June 14, 1996, at A15. This tactic is effective in stirring up public support for the Mexican Oil Workers' Union, *Sindicato de Trabajadores Petroleros de la Republica Mexicana* (STPRM), and animosity toward potential foreign investors and privatization efforts. *See id.* Privatization has been likened to a farmer "'selling one of his last productive cows to purchase milk, butter, cheese and yogurt.'" *See id.* (quoting union leader Carlos Romero Deschamps).

II. PRIVATIZATION HAS BEEN SUCCESSFUL ELSEWHERE IN LATIN AMERICA

A. *Overview of Other Latin American Privatizations*

Several definitions have been advanced for the concept of privatization.[9] A good, general definition is "the transfer of asset ownership from the government to the private sector" in an attempt to remove from political considerations "the commercial, financial, and strategic decisions of the business."[10] The worldwide pace of privatization, especially in developing countries, is rapidly increasing.[11] In Latin America alone, 694 divestitures have resulted in over US$59 billion in revenue for these developing countries, a figure that represents more than half of the total revenue from such transactions in all developing countries world-wide.[12] Privatization in the developing world has been praised as a means of establishing a government's commitment to

---

8. More than US$20 billion may be needed to upgrade exploration and production efforts just to maintain Mexico's current 3.3 million barrel per day output. *See id.* Although Pemex's profits are up US$5.33 billion from a year ago, *see* Richard L. Holman, *Pemex Pumps Up Its Profit*, WALL ST. J., Oct. 31, 1996, at A18, limited new investment has been made in this sector from 1992 to 1996. *See Mexico Will Limit*, *supra* note 6.

9. Privatization has been referred to as "the transfer of majority ownership of [state-owned enterprises] to the private sector by the sale of ongoing concerns or of assets following liquidation," Sunita Kikeri et al., *Privatization: Lessons from Market Economies*, 9 WORLD BANK RES. OBSERVER 241, 242 (1994) (emphasis omitted); "the ending of state ownership and, consequently, of a form of state control different from that applied to the general run of business enterprises," Ronald A. Cass, *The Optimal Pace of Privatization*, 13 B.U. INT'L L.J. 413, 415 (1995); "the transfer of ownership or control of assets from the public to the private sector," Amy L. Chua, *The Privatization-Nationalization Cycle: The Link Between Markets and Ethnicity in Developing Countries*, 95 COLUM. L. REV. 223, 226 (1995); and "the outright sale to private investors" of a formerly state-owned enterprise, Julio C. Cueto-Rua, 1 SW. J.L. & TRADE AM. 63, 72 (1994).

10. Thomas J. Casey & Simone Wu, *Telecommunications Privatizations: An Overview*, 17 HASTINGS INT'L & COMP. L. REV. 781, 786 (1994).

11. *See* Mary M. Shirley, *Privatization and Performance*, 17 HASTINGS INT'L & COMP. L. REV. 669, 671 (1994); *see also* Chua, *supra* note 9, at 223–56 (discussing privatization in Latin America and Southeast Asia and noting the cycle between privatization and nationalization that has taken place since the independence of these countries); Ricardo Hausmann, *Latin America Reaping Rewards of Privatization*, HOUS. CHRON., Dec. 17, 1996, at 23A (discussing Latin American privatization programs in the oil and gas and electricity sectors).

12. *See* Hausmann, *supra* note 11. In Argentina, the privatization of 45% of the state oil sector in 1993 was interpreted as a sign of reception to foreign capital. *See id.* In Bolivia, privatization efforts in the state oil and gas industry were interpreted as indicating strong investor interest. *See id.*

liberalization,[13] as well as promoting economic development and modernization.[14]

The scope of privatization, however, has not always extended to state-owned petroleum enterprises.[15] While several countries have formulated pre-privatization policies for state-owned petroleum enterprises, this sector has remained largely immune from the privatization trend.[16] However, the benefits of privatization are themselves creating pressures to complete the privatization movement by freeing the state-owned petroleum enterprises.[17] For example, international investors demanding the break-up of state monopolies before engaging in business have developed a major natural gas project in Brazil and Bolivia.[18] By selling off their often dilapidated oil refineries and gas plants, these governments hope to attract much needed private investment capital to improve the quality of services.[19]

Another example of Latin American success with privatization is found in the policies of Chile.[20] In addition to

---

13. *See* Shirley, *supra* note 11, at 675.

14. *See* Chua, *supra* note 9, at 223–24.

15. *See* Thomas W. Waelde, *International Energy Investment*, 17 ENERGY L.J. 191, 196 (1996).

16. *See id.* Countries undergoing recent privatization efforts include Canada, France, Italy, Argentina, Bolivia, and Peru. *See id.* The major petroleum producers have thus far failed to achieve outright privatization. *See id.* These countries include Saudi Arabia, Kuwait, Iraq, Iran, Abu Dhabi, Qatar, Indonesia, Malaysia, Mexico, Brazil, Venezuela, Egypt, Colombia, Ecuador, Angola, and Nigeria. *See id.*

17. *Cf.* Shirley, *supra* note 11, at 675 (stating that "privatization means a major rewrite of the economic rules of the game" as opposed to trade reforms or price liberalization, which are often transitory changes). Privatization programs in Mexico have generated over US$20 billion in revenues as of 1993. *See id.* Over US$6 billion was earned from the sale of the government run telecommunications company, *Teléfonos de México* (Telmex). *See id.* Privatization is also emerging as a sensible alternative to public debt funding of further energy development needs. *See* Bill White, *Latin America's Trump Card Is Oil and Gas*, HOUS. CHRON., June 4, 1995, at 5C; *cf.* Shirley, *supra* note 11, at 675 (noting that funds from the sale of state-owned enterprises have been used to reduce domestic debt and thereby restore confidence in the economy, encourage new investment, and enhance economic growth).

18. *See* White, *supra* note 17.

19. *See* Debra Beachy, *Latin Reforms Will Take Time, Bank Execs Say*, HOUS. CHRON., Feb. 9, 1996, at 3C. Another way to attract foreign investors is to implement legal and regulatory reforms; however, such reforms are often met with political resistance. *See, e.g., id.*

20. *See* Edward C. Snyder, Comment, *The Menem Revolution in Argentina: Progress Toward a Hemispheric Free Trade Area*, 29 TEX. INT'L L.J. 95, 97–98 (1994) (discussing Chilean reforms during the 1970s which served as a model for privatization, deregulation and liberalization of trade, and investment in Latin America).

privatizing many of its state-owned enterprises, the Chilean government implemented free market economic principles through reduced import tariffs and the elimination of both subsidies and price controls.[21] As a result, the average rate of growth for the national gross domestic product was 7.1% from 1975 to 1981,[22] and with a government committed to the continuance of free market reforms, the average has continued at over 5% from 1985–1996.[23] An additional benefit to Chile has been entry into a trade and investment agreement with the United States[24] and the probable accession of Chile into the framework of the North American Free Trade Agreement (NAFTA)[25] or other free trade agreements.[26]

Latin America has become recognized as the fastest growing regional market for exports from the United States.[27] As a result, the Enterprise for the Americas Initiative (EAI)[28] has been formed to encourage the further liberalization of Latin American economies.[29] Latin American countries that

---

21. *See id.*; *see also* PAMELA CONSTABLE & ARTURO VALENZUELA, A NATION OF ENEMIES: CHILE UNDER PINOCHET 166–97 (1991) (discussing the historical and political climate surrounding the implementation of monetarist economic policies in the Chilean economy).

22. *See* Snyder, *supra* note 20, at 98; *see also Pinochet Sends the Chicago Boys Back to School*, ECONOMIST, Aug. 10, 1985, at 60.

23. *See* Snyder, *supra* note 20, at 98. President Patricio Aylwin was elected president in March 1990. *See id.*

24. Agreement Concerning a United States-Chile Council on Trade and Investment, Oct. 1, 1990, U.S.-Chile, 29 I.L.M. 1404 [hereinafter Agreement].

25. North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 289, 605 [hereinafter NAFTA].

26. For a discussion of Chilean accession to the NAFTA in light of its recent accession to MERCOSUR, negotiation of a trade agreement with Canada, and continued negotiations with Mexico, see Thomas Andrew O'Keefe, *Potential Conflict Areas in Any Future Negotiations Between MERCOSUR and the NAFTA to Create a Free Trade Area of the Americas*, 14 ARIZ. J. INT'L & COMP. L. 305 (1997).

27. *See* Snyder, *supra* note 20, at 100; *see also Latin America Fastest Growing Market for U.S. Exports, Treasury Official Says*, 9 Int'l Trade Rep. (BNA) No. 26, at 1101 (June 24, 1992) [hereinafter *Fastest Growing*] (predicting this trend would continue into the 1990s).

28. *Enterprise for the Americas Initiative*, AG/RES. 1222, OAS GAOR, 23d Reg. Sess., 9th Plen. Sess., at 56, OEA/ser. P/XXIII.O.2 (1993).

29. *See Support to the Enterprise for the Americas Initiative*, AG/RES. 1156, OAS GAOR, 22d Reg. Sess., 7th Plen. Sess., at 27; OEA/ser. P/XXII.O.2 (1992) (urging the "expansion of regional trade and investment"); *Support to the Enterprise for the Americas Initiative*, AG/RES. 1109, OAS GAOR, 21st Reg. Sess., 11th Plen. Sess., at 73, OEA/ser. P/XXI.O.2 (1991) (noting the need for "increas[ed] trade and investment in the hemisphere"); *cf.* Agreement, *supra* note 24, para. 2, at 1405 (noting that the Agreement was formed in part due to the EAI); *Fastest Growing, supra* note 27, at 1101 (attributing predicted continued growth of the Latin American market for U.S. exports to the EAI). For

institute free market reforms are rewarded by the EAI with loans, investment programs, and opportunities to join trade agreements.[30] These positive reinforcement measures are designed to counteract the destructive effect of nationalist resistance to foreign influences, such as capital investment.[31] But resistance to the foreigner may also eliminate much needed foreign investment capital.[32] This can, in turn, create an economic crisis that may ultimately only be resolved by turning again to foreign capital sources.[33]

B. Argentina's Successful Privatization Experience

By the end of the 1980s, the government of Argentina controlled over 25% of the country's gross domestic product,[34] and the state employed 20% of the total national labor force.[35] By 1989 these state-owned enterprises were incurring huge budget deficits and suffering from inept management.[36] The government, saddled with enormous budget deficits,[37] was also unable to make necessary new investments for modernizing the country's infrastructure.[38] Absent timely and reliable capital investment from the central government, performance could only fall among state-owned firms in these sectors.[39]

Amid hyperinflation,[40] and strong political pressure from the government workers' unions to perpetuate the state-

---

a summary of the EAI, see Jeffrey Schott & Gary Hufbauer, *Free Trade Areas, the Enterprise for the Americas Initiative*, *in* STRATEGIC OPTIONS FOR LATIN AMERICA IN THE 1990S 249, 256–59 (Colin I. Bradford, Jr., ed., 1992).

30. *See* Snyder, *supra* note 20, at 100.

31. *Cf.* Chua, *supra* note 9, at 266.

32. *See id.*

33. *See id.* Former Argentinian President Arturo Frondizi once wrote: "'In our country, the problem shared by the industrial and the agricultural sectors is insufficiency of capital.'" *Id.* (quoting from Rogelio Frigerio, *El Programa Agrario del MID*, *in* EL PROBLEMA AGRARIO ARGENTINO 33, 41 (Arturo Frondizo ed., 1965). In a similar vein, former Philippine President Corazon Aquino declared in 1987: "'The foreign investor is critical to our plans, . . . we need foreign investment and we have set the climate for it.'" *Id.* (quoting Zinnia F. Godinez, *Privatization and Deregulation in the Philippines*, ASEAN Econ. Bull., Mar. 1989, at 267).

34. *See* Cueto-Rua, *supra* note 9, at 63.

35. *See* Snyder, *supra* note 20, at 102.

36. *See* Cueto-Rua, *supra* note 9, at 66; *see also* Leslie Elliott Armijo, *Menem's Mania?: The Timing of Privatization in Argentina*, 1 SW. J.L. & TRADE AM. 1, 9 (1994).

37. *See* Cueto-Rua, *supra* note 9, at 66.

38. *See* Armijo, *supra* note 36, at 9.

39. *See id.*

40. *See* Cueto-Rua, *supra* note 9, at 67. In 1989 prices rose by 5,000%. *See id.* Argentine paper currency was changed from 10 peso denominations to

dominated situation,[41] President Carlos Menem assumed office in July 1989.[42] Because President Menem had not advocated any liberalization of the economy as a candidate for president, and because he was dependent upon the support of the government workers' unions for his election,[43] it was not expected that he would pursue privatization policies as president.[44] However, shortly after assuming office, President Menem issued a warning to the Argentine people to prepare for "'major surgery without anesthesia,'"[45] and directed the enactment of legislation that gave him the authority to begin privatizing the economy.[46] Within the following three-year period, the privatization process was largely completed,[47] and a capitalist, free market economy had been formed.[48]

The preferred method of privatization in Argentina has been the outright sale of the state-owned enterprise to private investors who immediately assume control of the venture.[49] Importantly, the oil companies in Argentina were not excluded from privatization efforts.[50] By 1991, sales of state-owned enterprises resulted in US$4.6 billion in revenues, and an additional US$7.1 billion in debt conversion.[51]

5,000 and 100,000 denominations. *See id.* Although Argentineans were accustomed to steady increases in inflation, they were not prepared for the price fluctuations of 1989–1991. *See id.*

41. *Cf. id.* at 66.
42. *See* Armijo, *supra* note 36, at 17.
43. *See* Cueto-Rua, *supra* note 9, at 66.
44. *See id.*; Armijo, *supra* note 36, at 17.
45. Snyder, *supra* note 20, at 103.
46. *See* Cueto-Rua, *supra* note 9, at 69. Among the industries to be privatized under A.D.L.A. Law 23.696, titled "Administrative Emergency and Reorganization of the State," were the following: "airlines, travel agencies, road building and maintenance companies, shipping lines, catering companies, coal mines, oil companies, steel mills, consulting firms, postal services, insurance companies, telecommunication companies, radio and television stations, power companies, elevators and warehouses, piers, drydocks, printing companies, sugar refineries, pipelines, gas lines, chemical and petrochemical companies." *Id.*
47. *See id.*
48. *See id.* at 64.
49. *See id.* at 72.
50. *See* Armijo, *supra* note 36, at 17.
51. *See id.* Among the state-owned companies privatized through 1992 were

> ENTEL (sold for $7.6 billion in cash and retired government debt), *Aerolineas Argentinas* (which fetched $2.3 billion), YPF oil fields ($1.1 billion), railroads ($155 million), radio and television stations ($16 million), petrochemical firms ($177 million), *Tandanor* ($8 million), power generation centers ($182 million), and SEGBA, the electricity

The state's monopoly in the oil industry was methodically eliminated through a course of action that began with a presidential decree that privatized all secondary marginal-production areas and offered private companies the option to join as partners with the state-owned YPF oil company in the remaining primary areas.[52] Crude oil extracted from primary and secondary areas was decreed freely marketable, and export duties as well as foreign exchange remittances were removed.[53] Government price controls were likewise eliminated, allowing oil prices to be determined by free market forces.[54] Finally, in 1991, President Menem implemented the Argentina Plan, which removed the remaining obstacles to full private exploitation of oil and gas reserves.[55]

Argentina's national oil company, YPF, was fully privatized by June of 1993.[56] The sale of YPF was the first divestiture of a national oil company by a Latin American country.[57] The privatization of YPF stands as a sterling example of how free market reforms can increase productivity and profitability while enhancing overall economic welfare.[58] Although employment in the new private companies was initially cut by 90%, it is now growing efficiently with 130 new upstream businesses.[59] In addition to converting a large portion of the public's automobiles to natural gas, the Argentine economy has also benefited from increased sales transactions such as purchases of oil tools from American companies for YPF use.[60]

---

giant serving greater Buenos Aires ($939 million), all for a grand total of $4.4 billion in cash plus $8 billion in foreign debt securities.

Id.

52. *See* Snyder, *supra* note 20, at 107–08.
53. *See id.* at 107.
54. *See id.*
55. *See id.*
56. *See id.* at 104.
57. *See id.* at 105; *see also Oil in Latin America: A Sacred Limping Cow*, ECONOMIST, May 15, 1993, at 50. "YPF assets were sold to private companies, YPF itself to investors, and access to exploration acreage is now available without mandatory association with the state company." Waelde, *supra* note 15, at 196.
58. *See* White, *supra* note 17.
59. *See id.* Privatization is expected to result in initial layoffs because of previous overstaffing by government agencies. *See* Shirley, *supra* note 11, at 678. Privatization makes layoffs more likely because of decreased government funding, leading to increased pressures for productivity. *See id.* One study reports that two-thirds of the sixty-one companies surveyed employed more workers after privatization than before. *See id.* at 678–79.
60. *See* White, *supra* note 17.

Argentina's privatization process was successful because it was implemented as part of an overall market reform process.[61] Specifically, four main areas were stressed to ensure the success of the privatization process.[62] First, foreign law firms with expertise in the legal transactions necessary to the process were consulted to plan the legal framework necessary for selling the state-owned enterprises.[63] Second, the government pursued a policy of swift, outright sales whenever possible, and granted concessions when outright sale was either prohibited by law or otherwise unattainable.[64] Third, the government ensured that potential investors, including foreign investors, were financially solvent and possessed the technical ability to assume control of the enterprise before allowing the transfer to go forward.[65] Finally, the government implemented a series of measures to ensure that the former government workers were not unduly jeopardized in the transition.[66] By implementing this principled procedure to guide the sale of state-owned enterprises, Argentina ultimately realized an astonishing drop in its inflation rate from 1,400% in 1990 to only 6% in 1993.[67]

C. *Why Privatization Is a Preferred Economic Policy*

There are many reasons why a government would want to privatize state-owned enterprises. Private ownership may be ideologically preferred,[68] or it may simply be a means of

61. *See* Snyder, *supra* note 20, at 103–10 (detailing the reforms of President Menem beginning in 1989).

62. *See* Cueto-Rua, *supra* note 9, at 71–75.

63. *See id.* at 71.

64. *See id.* at 72. Private ownership of lakes is prohibited by law, so the government had to achieve privatization through concessions for the transfer of interest in hydroelectric plants. *See id.* This policy of swift outright sales also included selling only the assets of the enterprise and not its debts. *See id.* at 72–73.

65. *See id.* at 73.

66. *See id.* at 74–75. Among those measures were the following: retirement age workers were requested to retire; other workers who wanted to acquire a stake in the new enterprise were allowed to do so; the government agreed to make severance payments to those willing to resign; and unions were allowed to purchase shares in the new company. *See id.*

67. *See id.* at 71. This reduction in inflation is attributable, in part, to ending the increased budget deficits that continued operation of the state-owned enterprises placed on the national treasury. *See id.*; *see also* Gary Marx, *Latin America's Reforms Begin to Bear Fruit*, CHI. TRIB., Jan. 19, 1992, at 4-1, *available in* LEXIS, News Library, Chtrib File.

68. *See* Shirley, *supra* note 11, at 671–72 (referring to privatizations in the United Kingdom, Chile, and Czechoslovakia). Some of the industries privatized

reducing the public debt that is routinely incurred by operating state-owned enterprises.[69] Privatization may also be founded upon the assumption that a privatized firm will operate more efficiently.[70] Economically, privatization is desirable because a private enterprise functioning in a competitive environment will be compelled to make better use of scarce resources to achieve efficiency.[71] This efficiency standard, in effect, gauges the nation's economic welfare.[72]

Privatization of state-owned enterprises can also be a way to attract the investment capital and trained personnel necessary to modernize a country's infrastructure.[73] In addition to removing the operating costs of the state-owned enterprise from the general government budget, privatization can actually generate funds through sales of assets and from the influx of foreign investment capital which can be applied to reduce budget deficits.[74]

Each government will set privatization priorities based on its own objectives which will be driven by a unique combination of these motives.[75] In general, there are three

---

in the United Kingdom include the British National Oil Corporation, British Telecom, Rolls-Royce, Jaguar, British Gas, British Steel, British Airways, British Airports Authority, and British Associated Ports. *See* John Lawless, *The Sale of the Century: Great Britain's Privatization Program*, INT'L MGMT., Dec. 1991, at 35, *available in* LEXIS, News Library, Asapii File.

69. *See* Shirley, *supra* note 11, at 671–72. This rationale has been advanced to support privatizations in Mexico and Argentina. *See id.*

70. *See id.* After privatizing, one Latin American company saved US$10 million simply by requiring workers to produce photo identification when picking up pay checks. *See* Mary M. Shirley, *The What, Why, and How of Privatization: A World Bank Perspective*, 60 FORDHAM L. REV. S23, S26 (1992).

71. *See* Shirley, *supra* note 70, at S25–27; *see also* Casey & Wu, *supra* note 10, at 782.

72. *See, e.g.*, Shirley, *supra* note 70, at S26 (noting that privatization restores the competition stifled by public subsidies and resultant public debt from public enterprises).

73. *See* Casey & Wu, *supra* note 10, at 782–83. This is critical in developing countries where capital and competent management are in short supply. *See id.* Investment in privatized firms would be conducted by experienced and competent firms, resulting in a modernization of the privatized sector. *See id.* at 783.

74. *See id.*; *see also* Shirley, *supra* note 70, at S27. The sale of a state-owned enterprise generates revenue equal to the discounted net present value of future earnings plus the scrap value of the enterprise. *See id.* Additionally, although future revenues are forfeited, the taxes collected from the more profitable private enterprise may well surpass the revenue expected from a public enterprise. *See id.* In another example of funds generated through sales proceeds, the sale of Telmex, the state-owned telecommunications company, generated over US$6 billion dollars. *See* Shirley, *supra* note 11, at 675.

75. *See* Shirley, *supra* note 11, at 671–72.

reasons why privatization is an economically sound policy.[76] First, privatization improves the use of public resources and frees those resources for more important uses.[77] Second, the operational efficiency of privatized entities is usually greater and results in the more efficient use of resources.[78] Finally, privatization has a positive effect on dynamic efficiency.[79] Dynamic efficiency simply means that the economy as a whole realizes an increase in investment capital and technological innovation.[80]

Professor Cass has offered a useful metaphor to help visualize the potentially different operating philosophies of state-owned enterprises and privately-owned enterprises.[81] A state-owned enterprise whose purpose is to produce 10,000 pounds of nails annually can easily satisfy that goal by producing a single nail that weighs 10,000 pounds.[82] While obviously wasteful and inefficient, the question of whether it is better to cease production of the 10,000 pound nail immediately or gradually over time is debatable.[83] As in the cases of Argentina and Mexico, for example, the government workers' unions often wield tremendous political influence to continue the state-dominated situation.[84] However, two fundamental economic principles illustrate the need to quickly cease the inefficient activity: (1) continued production of the useless 10,000 pound nail can only lower the nation's overall economic welfare;[85] and (2) continued employment of a large proportion of the nation's workforce in the inefficient

76. *See* Shirley, *supra* note 70, at S25.

77. *See id.* Alternative uses include education, health, and nutrition. *See id.*

78. *See id.* at S26. A World Bank study has found consistent net improvements in efficiency within the privatized companies studied in Mexico, Malaysia, Chile, and Great Britain. *See id.*

79. *See id.* at S27. For example, after privatization the Chilean telephone company was able to increase the number of phone lines by 72%. *See id.*

80. *See id.* State-owned enterprises are often saddled by political constraints that make it hard to obtain investment capital. *See id.*

81. *See* Cass, *supra* note 9, at 419–22.

82. *See id.*

83. *See id.* at 419.

84. *See, e.g.*, Cueto-Rua, *supra* note 9, at 66 (noting that President Menem was supported by union factions in part because of his nonendorsement of economic reforms); Grayson, *supra* note 7 (discussing union resistance to privatization of the oil industry in Mexico).

85. *See* Cass, *supra* note 9, at 420. State-owned enterprises generally suffer from a lack of competition. *See* Shirley, *supra* note 70, at S26. Yet governments are reluctant to let them go bankrupt. *See id.* To prevent that from occurring, funds must be transferred from the national budget. *See id.* Privatization ends this by allowing for competition which, in turn, demands that the enterprise either perform efficiently or fail. *See id.*

activity can also only lower the nation's overall economic welfare.[86]

The imaginary 10,000 pound nail illustrates, in part, that privatization of state-owned enterprises cannot be accomplished without giving due regard to the potential effects on employment.[87] Studies have shown, however, that post-privatization employment is often higher than pre-privatization employment, and at most, suffers only a slight, temporary setback.[88] When unemployment does occur, it tends to be regionally concentrated[89] and reflects the excessive overstaffing by, and nonproductivity of, the state-owned enterprise.[90] Unemployment results from reducing this overstaffing and shutting down non-viable enterprises rather than merely from privatization itself.[91] One alternative is for the government to continue to pay the unemployed until they can find replacement work.[92]

Although an initial burden, these layoffs reflect productivity pressures that are created because the enterprise no longer has access to general government funds to make up for operational inefficiencies.[93] There is some evidence that reductions in the workforce often result from attrition rather than from layoffs.[94] Other evidence indicates that workers actually benefit more from the overall economic stimulation that privatization creates than the initial losses

---

86. *See* Cass, *supra* note 9, at 420.

87. *See id.*; Shirley, *supra* note 11, at 675–82.

88. *See* Shirley, *supra* note 11, at 678–79. In Mexico, only 5% of the workforce from firms privatized in 1988 had been laid off, and some increases in employment were reported. *See id.* at 679. The Mexican auto parts industry reportedly expanded by 35% after privatization. *See id.*

89. *See id.* at 677.

90. *See id.* at 678. Some examples of overstaffing include: 64% overstaffed public ports in Uruguay, the inefficient use of workers in Sri Lanka Cement Corporation (189 tons per employee compared to a world average of between 1200 and 1500 tons), the Argentine steel company, Somisa (2.5 times the number of man hours to produce a ton of steel as the international industry average), and Mexico's Telmex (2 times the number of workers per line as U.S. telephone companies). *See id.*

91. *See* Shirley, *supra* note 70, at S31. This is a problem with any program that seeks to increase economic efficiency. *See id.*

92. *See* Cass, *supra* note 9, at 425. Another alternative is that the purchasing entity be required to continue paying the displaced workers, or be required to continue employing them in the nonproductive activity. *See id.* Professor Cass argues that continued government compensation is more desirable because it is less costly in the long run. *See id.*

93. *See* Shirley, *supra* note 11, at 678.

94. *See id.* at 679.

caused by reductions in the workforce.[95] Although not everyone necessarily benefits, or shares evenly in the realized gains, privatization generally increases economic welfare.[96]

Privatization should, as a general rule, be accomplished as quickly as possible in order to eliminate the drag on the economy that an unproductive sector can create.[97] Rapid privatization is the better policy because transitional costs will tend to grow over time.[98] Rapid privatization can also demonstrate a government's dedication to free market reforms and liberalism.[99] The reforms achieved in Argentina, for example, clearly show the country's resolve to make a clean break with its statist past while basing the future on free market principles.[100]

III. THE CASE FOR FULL PRIVATIZATION OF PEMEX

A. *Historical Context*

Modern Mexico came into being in 1867 when the French Archduke Maximilian of Hapsburg was executed in Queretaro.[101] The predominant political figure of the ensuing era was Porfirio Díaz.[102] During the Díaz administration, oil was discovered by an American, Edward L. Doheny, in Tampico, Vera Cruz.[103] A favorable investment climate sponsored by the new administration resulted in a massive influx of foreign investment capital.[104] By 1911, foreigners owned large percentages of Mexico's key economic sectors,

---

95. *See* Shirley, *supra* note 11, at 680. Although Argentina laid off 125,000 workers from public enterprises and another 125,000 civil servants, the overall unemployment rate fell from 8.8% to 5.4%. *See id.* Job gains which came about from increased private investment seemingly offset the layoffs. *See id.*

96. *See id.*

97. *See* Cass, *supra* note 9, at 432.

98. *See id.*

99. *See, e.g.*, Snyder, *supra* note 20, at 120.

100. *See id.*

101. *See* Chua, *supra* note 9, at 228. Mexico achieved independence from Spain in 1821, but was under the influence of French intervention until Maximilian's execution. *See id.*

102. *See id.* at 228–29. The Díaz administration was in power from 1876–1880 and 1884–1911. *See id.* at 228.

103. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 7. This discovery was followed by other discoveries along Mexico's coast by major oil companies such as Gulf, Standard Oil, and Royal Dutch Shell. *See id.* By 1921, Mexico was producing one-quarter of the world's output of oil. *See id.*

104. *See* Chua, *supra* note 9, at 229. Díaz promised high returns on investment, tax exempt income, and court protection for foreign investment. *See id.*

including the oil and power industries.[105] Profits from these industries, however, ran primarily to the foreign investors, in part because of generous concessions granted by the Mexican government to encourage foreign capital investment.[106]

The end of the Díaz administration and the beginning of the presidency of General Lázaro Cárdenas marked the culmination of the Mexican Revolution.[107] Swept into power by nationalists who viewed the foreign exploitation of Mexican oil as equal to Spain's looting of the Aztec gold,[108] President Cárdenas acted immediately and expropriated and nationalized the country's oil industry.[109] All aspects of petroleum production were consolidated into one state-owned enterprise which later became known as Petróleos Mexicanos, or Pemex.[110] Expropriation of the oil companies was thus seen as a national defense against capitalist foreign threats to Mexican sovereignty.[111] In a much celebrated speech that has been called the Declaration of Mexico's Economic Independence, President Cárdenas declared: "'It is the sovereignty of the nation which is thwarted through the maneuvers of foreign capitalists who, forgetting that they have formed themselves into Mexican companies, now

105. *See id.* In addition, foreigners owned or controlled three-quarters of all mines, as well as the railway and banking industries. *See id.*

106. *See, e.g.*, *id.* at 228–29 (noting that Díaz expropriated the land of Indian peasants, claiming their title was unclear, and sold the land to foreign investors and other interests). Diversion of the benefits of oil production is important because the oil itself was historically important to the "native peoples' worship and livelihood." Jensen, *supra* note 2, at 81.

107. *See* Chua, *supra* note 9, at 230. The Mexican Revolution began in 1910 and continued for three decades. *See id.*

108. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 7.

109. *See* Chua, *supra* note 9, at 231; *see also* Smith, *Oil and Prosperity*, *supra* note 1, at 7.

110. *See* Chua, *supra* note 9, at 231. President Cárdenas justified the measure against foreign interests based on "'their defamation, disobedience, and challenge.'" Smith, *Oil and Prosperity*, *supra* note 1, at 7. President Cárdenas is also remembered for establishing the connection between nationalistic policies and organized labor when he created the Mexican Workers Confederation, or CTM (*Confederación de Trabajadores de Mexico*). *See* Jensen, *supra* note 2, at 90. The government entrusted these unions with managing the operations of the newly formed state-owned enterprises. *See id.*

111. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 8. It is estimated that by the end of Díaz's rein, over half of Mexico's total wealth was owned by foreigners, with foreign corporations dominating productive enterprises. *See* Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 280–81 (1994).

attempt to elude the mandates and avoid the obligations placed upon them by the authorities of this country.'"[112]

The nationalization of Mexico's oil industry has come to symbolize for many Mexicans both their national identity and their collective economic aspirations.[113] This act of expropriation, which occurred in 1938,[114] is still celebrated as an assertion of Mexican sovereignty and economic independence.[115]

Reflecting the nationalist, anti-foreign principles of the Mexican Revolution, a new constitution was promulgated in 1917.[116] The dominance of foreign investors was blamed for Mexico's poor economic situation and fueled this anti-foreign sentiment, and independence from foreign economic control was a central theme in the new constitution.[117] The new constitution reserved to the national government exclusive control over most of the economy and greatly restricted foreign control.[118]

The most important provisions for limiting foreign direct investment in Mexico have been Articles 27 and 28 of the 1917 constitution.[119] Article 27 provides for national sovereignty over all natural resources, and vests land ownership as well as water and subsoil mineral rights in the state.[120] Only Mexican nationals may own land, waters, and their appurtenances.[121] Foreigners may only be granted the same ownership rights a national enjoys if they agree to consider themselves Mexican nationals with respect to the property and promise not to seek protection from their own government.[122] Article 28 further reserves exclusive control

---

112. GRAYSON, *supra* note 4, at 15.

113. S*ee* Dudley Althaus, *Plan to Privatize Pemex Still Political Flash Point*, HOUS. CHRON., July 14, 1996, at 23A; *see also* Jensen, *supra* note 2, at 81 (noting that in Mexico, oil symbolizes the restoration of natural resources and national sovereignty).

114. *See* Jensen, *supra* note 2, at 81.

115. *See* Debra Beachy, *Mexican Official's Balancing Act: Energy Chief Must Guard Oil Legacy, Encourage Growth*, HOUS. CHRON., Mar. 6, 1996, at 1B (noting that Mexican children sing songs reminiscent of the nationalization of the oil industry in the 1930s).

116. *See* Sandrino, *supra* note 111, at 283.

117. *See id.* at 281, 283–84.

118. *See id.* at 281, 284.

119. *See id.* at 285–86.

120. *See* MEX. CONST. art. 27.

121. *See id.* art. 27, § 1.

122. *See id.* Section I of Article 27 is also referred to as the Calvo Clause. *See* Sandrino, *supra* note 111, at 286. For a discussion of the origins and development of the Calvo Clause, see DONALD R. SHEA, THE CALVO CLAUSE (1955).

over specified economic sectors to the Mexican government.[123] Included among these "strategic" sectors are oil refining operations and ownership of pipelines.[124] As a result of this new anti-foreign constitutional framework, direct foreign investment in the petroleum industry quickly fell, and the level of investment in other sectors of the economy, such as public utilities, also fell sharply.[125]

During the last two years of President Cárdenas's term in office, inflation and the national debt rose and the new national oil company began to encounter operating difficulties.[126] Cárdenas resigned the presidency in 1940, and a new era, more favorable to foreign investment, was ushered in with the election of Manuel Ávila Camacho.[127] Expropriations of foreign and privately owned companies were halted in an effort to promote private capital investment, including foreign capital investment, and a period noted for its return to free market policies began.[128] Between 1946 and 1952, direct foreign investment in Mexico rose from US$575 million to approximately US$730 million.[129]

This positive new era was not to last, however, and was soon replaced by another wave of anti-foreign nationalism with the election of Adolfo López Mateos in 1958.[130] The national telephone company, Teléfonos de México (Telmex), was promptly returned to government control, and concessions that had previously been granted within the oil industry were withdrawn.[131] All foreign-owned power companies were nationalized in 1960.[132] Mateos's successors continued his nationalist policies, and by 1982 inflation neared 100%, and external debt was over US$87 billion.[133]

---

123. *See* MEX. CONST. art. 28.

124. *See id.*

125. *See* Sandrino, *supra* note 111, at 292–93.

126. *See* Chua, *supra* note 9, at 231–32.

127. *See id.* at 232–33; *see also* Sandrino, *supra* note 111, at 293–94.

128. *See* Chua, *supra* note 9, at 232–33.

129. *See id.* Another source estimates that foreign direct investment nearly quadrupled from 1940–1965. *See* Sandrino, *supra* note 111, at 294.

130. *See* Chua, *supra* note 9, at 234–35; *see also* Sandrino, *supra* note 111, at 294–95.

131. *See* Chua, *supra* note 9, at 234–35.

132. *See id.* President Mateos's slogan during the movement to nationalize these industries was "*la electricidad es nuestra*," which means "electricity is ours." *See id.* at 235 & n.110.

133. *See id.* at 236. During the administration of Luis Echeverría (1970–1976), state control of foreign interests continued. *See id.* Public funds were used for development programs such as housing and education, as well as to buy out failing television, telecommunication, and financial businesses, and the

Capital investment from government funds in state-owned enterprises grew while foreign capital investment had sharply declined by the early 1980s.[134]

A new era of Mexican governance began with the election of President Miguel de la Madrid in 1982 and a renewed emphasis on liberalization of the economy.[135] Between 1983 and 1988, 358 state-owned enterprises were privatized as part of a program to liberalize the economy.[136] Three hundred and sixty-two more state-owned enterprises were sold or shut down by 1994, and the Mexican government announced plans to privatize the ports and airports, secondary petrochemical plants, and numerous other state-owned enterprises.[137] In 1992 Pemex announced plans to sell off assets worth over US$2 billion,[138] as well as to sell petrochemical plants to both foreign and domestic investors.[139]

Former President Carlos Salinas continued to follow the liberalization process,[140] and until 1994, the country enjoyed another brief period of economic prosperity.[141] Foreign investment capital flows were an important part of that prosperity, but late in 1994, Mexico suddenly experienced large-scale capital flight.[142] Capital flight occurs when

---

entire tobacco industry was nationalized. *See id.* It is estimated that the number of state-owned industries grew from 86 to 740. *See id.* During the administration of José López Portillo (1976–1982) the entire private banking system was nationalized and strict foreign exchange controls were implemented. *See id.* These nationalist administrations created heightened tension between the public and private sectors. *See id.* By the end of the 1970s, public debt exceeded US$100 billion—half the nation's GNP. *See* Jensen, *supra* note 2, at 96.

134. *See* Chua, *supra* note 9, at 236–37.

135. *See id.* at 237.

136. *See id.*

137. *See id.* Other targets of privatization and closure were television stations, the state-owned insurance company, warehousing and natural gas operations, cinemas, and more recently, steel and mining operations, and the telecommunications, automotive, pharmaceutical, and financial sectors. *See id.*

138. *See* Jensen, *supra* note 2, at 104.

139. *See* Chua, *supra* note 9, at 238.

140. *See id.* at 237.

141. *See* S. Neal McKnight, Note, *Stepping Stones to Reform: The Use of Capital Controls in Economic Liberalization*, 82 VA. L. REV. 859, 860–61 (1996) (discussing Salinas's programs of liberalization based on the "Washington consensus," which allowed Mexico to reduce inflation and achieve economic stability); *see also* William A. Lovett, *Lessons From the Recent Peso Crisis in Mexico*, 4 TUL. J. INT'L & COMP. L. 143, 151–53 (noting the correlation between Mexico's economic success from 1990–1993 and the stabilization of exchange rates).

142. *See* Lovett, *supra* note 141, at 150–51; *see also* McKnight, *supra* note 141, at 861–62 (stating that the Mexican peso crisis of December 1994 caused

confidence in an investment dwindles and numerous investors simultaneously withdraw their capital from the country.[143] Although private foreign investment is very important in stimulating a country's economic growth, when large-scale capital flight occurs, developing countries such as Mexico may be unable to handle the market volatility that results.[144] For example, a result of massive capital flight in Mexico was the disastrous peso devaluation of 1994.[145]

A number of events occurred in 1994, beginning with an armed uprising in Chiapas in January, that denoted the disastrous peso devaluation.[146] Ernesto Zedillo was elected president in August, following the assassination of leading candidate Luis Donaldo Colosio.[147] In September, a top government official was shot, and high ranking members of the ruling party were soon implicated in that shooting.[148] Meanwhile, the peso had lost 10% of its value since March.[149] In December, another series of uprisings resulted in the occupation of 38 towns by armed rebel groups, and by the end of that month, the peso had fallen 40% from its March value.[150] Only after a US$50 million bailout, orchestrated by the United States, did the peso finally begin to stabilize, but the ultimate devaluation was 60% from early 1994 to late 1995.[151]

To reduce the ensuing risk of capital flight, the Mexican government raised interest rates in an effort to stimulate domestic saving.[152] Increasing interest rates, while successful in reducing the risk of capital flight, made the cost of doing business higher for Mexican businesses.[153] As a result, more businesses failed, and unemployment increased

---

capital flight in other countries similarly suffering from large deficits and low investment and savings rates).

143. *See* McKnight, *supra* note 141, at 866.

144. *See id.* at 861–63 (noting the effects of capital flight from developing countries such as Mexico, Brazil, and Hungary and potential solutions such as capital controls and liberalization).

145. *See* Lovett, *supra* note 141, at 151–55 (discussing the period of economic prosperity during 1990–1993 and the political climate surrounding the subsequent peso crisis).

146. *See id.* at 153.

147. *See id.* at 153–54.

148. *See id.* at 154.

149. *See id.*

150. *See id.*

151. *See id.* at 154–55. The peso was trading at 3.578 (pesos per U.S. dollar) in March 1994 and fell to 7.50 by December 1995. *See id.* at 153–55.

152. *See id.* at 156.

153. *See id.*

substantially.[154] The overall effect of the peso devaluation on the Mexican government has been less control over its own economic future and an unreliable growth path marked by surges of dependence on foreign capital investment.[155] The effects of the peso devaluation have naturally reached almost all sectors of the Mexican economy.[156] Pemex, for example, realized a sharp operating profit in 1995, but had to turn over approximately 70% of its revenue to the general government budget.[157]

B. Mexican Privatization Efforts in Non-Petroleum Sectors

Former President Carlos Salinas undertook expansive efforts to restructure the Mexican economy beginning in December 1988.[158] In addition to following a free market approach, which included privatizing numerous state-owned enterprises, other obstacles to free trade were removed in a process of economic liberalization.[159] Foreign investment rules were "dramatically liberalized" through implementation of new regulations.[160] Privatization occurred at a rapid pace with the number of state-owned enterprises dropping from 1,155 to 210 at the end of 1993.[161]

The primary motive of the Mexican government in undertaking such large-scale privatization was revenue.[162]

---

154. *See id.* Some projections put unemployment figures at 1 million jobs lost out of 26 million employed. *See id.*

155. *See id.* at 157.

156. *See id.* at 156; *see also* Chiang-feng Lin, *Investment in Mexico: A Springboard Toward the NAFTA Market—An Asian Perspective*, 22 N.C. J. INT'L L. & COM. REG. 73, 82 (1996) ("Investors responded to the devaluation with panic sales of the peso . . . . Mexico's economy [was] fragile because it [had] a collapsing currency, which usually indicates an inflationary spiral and an uncontrolled fiscal deficit in the economy.").

157. *See Pemex Profit Rises 21% Amid Higher Oil Prices*, WALL ST. J., Mar. 1, 1996, at A11.

158. *See* Snyder, *supra* note 20, at 99. Salinas became president in 1988. *See id.*

159. *See id.*

160. *See id.* at 99–101 (discussing the Salinas reforms and the U.S. response); *see also* Lawrence E. Koslow, *Mexican Foreign Investment Laws: An Overview*, 18 WM. MITCHELL L. REV. 441, 447–53 (1992) (discussing the economic reforms of the Salinas administration, particularly the 1989 Regulations). One of these reforms was the 1989 Regulations, designed to increase foreign investment and reduce public debt with private equity. *See id.* at 448.

161. *See* Pankaj Tandon, *Welfare Effects of Privatization: Some Evidence From Mexico*, 13 B.U. INT'L L.J. 329, 334–35 (1995).

162. *See id.* at 334; *see also supra* note 78 and accompanying text; *cf.* Jensen, *supra* note 2, at 102–03 (noting that, in reaction to falling oil prices,

During the period 1984 to 1993, revenues from privatization sales exceeded US$22 billion, more than twice the revenues realized by any other developing country from privatization sales during the same period.[163] By selling the state-owned enterprises, the government not only received the sales price as revenue, but also gained from taxes levied against the now private company.[164] In the long run, these taxes will exceed the operating profits that the government would have realized by maintaining the state-owned enterprise.[165]

In addition to reducing the government's debt, this additional revenue helped bring about a reduction in interest rates and inflation, and a renewed sense of confidence in the Mexican economy which resulted in the return of investment capital, including direct foreign investment previously lost to capital flight.[166] Mexico's rate of gross domestic product growth also more than doubled, from 1.7% to 4% after the sale of Telmex alone.[167] The Mexican government's success in the privatization process is due in part to its simplified approach.[168] The actual sale of the state-owned enterprise was accomplished by auction, and only seven people were responsible for conducting the transactions which resulted in the privatization of literally thousands of enterprises.[169]

In addition to the privatization of Telmex, Mexico's state-owned airline industry was also sold.[170] In the case of Mexicana Airline, the government did not directly receive revenue for the transfer, but instead required the purchasers to make a direct equity investment into the airline.[171] The new owners invested an additional US$1.6 billion in the

---

Mexico privatized to raise the foreign exchange rate and rely less on oil for revenues).

163. *See* Tandon, *supra* note 161, at 334–35; *see also* Shirley, *supra* note 11, at 675 (estimating that the privatization raised $20 billion, with over $6 billion in revenues from the sale of Telmex alone).

164. *Cf.* Shirley, *supra* note 70, at S27 (noting the trade-off between lost revenue from public enterprises and revenue gained from taxes on private enterprises).

165. *See id.* (noting that this trade-off counters the perception that privatization creates additional public resources).

166. *See* Shirley, *supra* note 11, at 675.

167. *See id.* at 677.

168. *See* Shirley, *supra* note 70, at S29 (attributing Mexico's success in the sale of public enterprises to "a clear central focal point with responsibility for the sale, the power to match that responsibility, a lean process without a lot of actors, and a transparent process that cannot be easily corrupted or diverted").

169. *See id.*

170. *See* Tandon, *supra* note 161, at 336–38 (discussing the sale of Mexicana Airline and Aeromexico).

171. *See id.* at 336–37.

company to modernize the fleet by refurbishing existing aircraft and purchasing twenty-two additional new aircraft.[172] However, the investment program turned out to be a financial disaster with the market value of the airline falling from US$700 million to about US$200 million.[173] This loss was not due exclusively to the privatization process itself, however, but to a series of poor financial decisions and a worldwide drop in tourist traffic following the Persian Gulf War.[174] For example, US$1.2 million per plane was spent to repaint the entire fleet,[175] and this at a time when the average aircraft was over 10 years old and in need of more substantive repairs.[176]

Mexico's other state-owned airline, Aeromexico, was privatized in 1988.[177] Although the state-owned Aeromexico had only experienced three profitable years during the thirty years prior to 1988, it managed to produce a profit during each of its first three years as a privately-owned company.[178] Much of this gain, however, is attributable to a dramatic cut in the labor force from 11,500 to 6,500.[179]

---

172. *See id.* at 336. The Xabre Group, a private investment group, bought Mexicana. *See Mexicana Airlines Launches Expansion with Airbus A320s*, AVIATION WK. & SPACE TECH., June 4, 1990, at 105. After an initial investment of US$140 million, the privatization agreement required Xabre to make an additional US$2.5 billion investment over a 10-year period for service and system improvements. *See id.*

173. *See* Tandon, *supra* note 161, at 336–37. The privatization of Mexicana allowed the government to retain a 40% interest in the company during the first year of privatization, but it would have no ownership interest by the third year of privatization. *See* Majorie Miller, *Mexico to Sell Largest Airline to Consortium: Will Maintain Minority Interest in Mexicana*, L.A. TIMES, Aug. 23, 1989, at 2.

174. *See* Tandon, *supra* note 161, at 336–37 (noting that the airline industry was in a "prolonged slump"); *see also Mexicana Airlines' Finances Decline Since Privatization*, AIRLINE FIN. NEWS, Dec. 9, 1991, *available in* LEXIS, Market Library, Iacnws File [hereinafter *Mexicana*] (attributing the airline's privatization problems, in part, to the recession and the 15% decline in international travel that occurred during the Gulf War).

175. *See* Tandon, *supra* note 161, at 336–37 (noting that the added weight reduced the fuel economy of the planes); *see also Mexicana, supra* note 174 (noting that while Mexicana made efforts to upgrade its fleet, poor customer service and an untimely flight schedule, among other problems, resulted in a decreased market share).

176. *See Mexicana*, *supra* note 174. In addition to spending US$1.2 million per plane to paint a 62-plane fleet, television screens were placed in every first class seat. *See id.* The added weight of the new paint reduced fuel economy, causing a further financial drain. *See* Tandon, *supra* note 161, at 337.

177. *See* Tandon, *supra* note 161, at 338.

178. *See id.* at 338, 340.

179. *See* Tandon, *supra* note 161, at 338.

Foreign participation has also played a key role in Mexico's privatization process.[180] The former national telephone company, Telmex, is now partially controlled by both American and French telephone companies, and the government's remaining interest is further curbed by American stock ownership.[181] By April 1993, "[F]oreigners, principally from the United States, account[ed] for almost 20 percent of the total capitalization of the Mexican stock market and for more than half of its total trading volume."[182] By 1993, foreign capital investment in Mexico reached 40% over the previous historical high, and by May 1994, it was almost 90% higher than the same period a year earlier.[183]

C. *Why Pemex Should Be Privatized*

Although far-reaching free market reforms have been implemented throughout most of the Mexican economy,[184] Pemex has remained trapped in an inefficient political nightmare ever since it was created in 1938.[185] Although the company posts gains in revenue from time to time,[186] production is well below what is necessary[187] and there is currently not enough funding to operate all of the petrochemical plants.[188] Mexican resistance to the full

---

180. *See* Chua, *supra* note 9, at 238.

181. *See* Tandon, *supra* note 161, at 343–44. Southwestern Bell and France Cable et Radio split 49% of the initial interest. *See id.* The Mexican government then sold 15% of its remaining interest on the international stock market. *See id.*

182. Chua, *supra* note 9, at 238 & n.141; *see also* Anthony DePalma, *Fortunes and Fear in Mexican Stocks*, N.Y. TIMES, Apr. 12, 1993, at D1 (noting that foreign investment in Mexico increased from US$4.2 billion in 1991 to US$27 billion in 1992).

183. *See* Chua, *supra* note 9, at 238; *see also Foreign Investment Surges 89 Percent in Mexico,* J. COM., May 2, 1994, at 5A, *available in* WESTLAW, JOC Database (noting that during this period, Mexican exports to the United States increased by 22.6%); Kevin G. Hall, *Unrest Fails to Deter Investment in Mexico,* J. COM., Feb. 7, 1994, at 3A, *available in* WESTLAW, JOC Database (noting that uprisings in Chiapas had no effect on foreign investments and would not prevent the economic reforms of the Salinas administration).

184. *See* Chua, *supra* note 9, at 237.

185. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 5–8 (discussing the history and problems of Pemex); *see also* Smith, *Liberalizing*, *supra* note 1 (suggesting possible methods of reform for Pemex).

186. *See* Holman, *supra* note 8 (noting that pretax profit for the third quarter of 1996 was up 63% from 1995).

187. *See Pemex Director Calls for Independence to Act Like a Company and Be Competitive,* CORP. MEX., Oct. 8, 1997, *available in* LEXIS, World Library, Allwld File.

188. *See Pemex's Profitability Belies the Need to Privatize: Mario Willars,* CORP. MEX., Sept. 2, 1997, *available in* LEXIS, World Library, Allwld File (noting

privatization of Pemex stems from the forces behind the 1917 constitution and the national pride associated with the Mexican Revolution.[189] The administration of Ernesto Zedillo appears inclined to continue this costly tradition.[190]

Article 27 of the Mexican constitution places the government in exclusive control of all subsurface minerals, including "petroleum and all solid, liquid, and gaseous hydrocarbons."[191] However, a distinction has been drawn between primary, secondary, and tertiary petrochemicals, with foreign investment being allowed in all but the primary areas.[192] While still clinging to the notion that foreign investment should not be allowed in the primary petrochemical sector, the government has redefined substances to qualify as nonprimary such that the number of primary petrochemicals fell from seventy in 1988 to only eight in 1992.[193]

This is especially important in light of the NAFTA's recognition of a constitutional reservation that allows Mexico to retain control over its primary petrochemicals based on whatever definition it incorporates.[194] The Mexican

---

the wide profit margins on crude oil, but low margins in other areas of production and urging privatization based on these figures); *cf. Lower Prices Counteract Higher Oil Exports*, CORP. MEX., Aug. 25, 1997, *available in* LEXIS, World Library, Allwld File (noting that while exports increased in the first half of 1997, crude oil prices fell).

189. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 7; *see also supra* notes 107–13 and accompanying text.

190. *See, e.g.*, George Grayson, *Worst of All Outcomes for Mexico's Oil Privatization*, HOUS. CHRON., Nov. 17, 1996, at 4C (noting the Zedillo administration's departure from full privatization of the oil industry to a mere 49% privatization); *Mexico Will Limit*, *supra* note 6 (same); *see also* Debra Beachy, *Mexico Seeks Chemical Investors: But Plan May Put Off Foreign Firms*, HOUS. CHRON., Oct. 15, 1996, at 1C (noting the scaled back plans for privatization and speculating that local, and foreign investors with plans to become full owners, would be the most likely participants in the partially privatized oil industry); Hausmann, *supra* note 11 (contrasting Mexico's retreat from planned privatization in the petrochemicals sector with advances made in the electricity sector via the privately owned Samalayuca II).

191. MEX. CONST. art. 27, *translated in* CONSTITUTIONS, *supra* note 5, at 23; *see also* Jensen, *supra* note 2, at 104–05.

192. *See* Dale A. Kimball, Jr., *Secondary and Tertiary Petroleum Operations in Mexico: New Foreign Investment Opportunities*, 25 TEX. INT'L L.J. 411, 412 (1990).

193. *See* Jensen, *supra* note 2, at 104–05.

194. Some of these market-opening provisions of the NAFTA include articles 301 and 1102 (providing for national treatment), 302 (eliminating tariffs), 309 (eliminating import restrictions), 310 (eliminating custom user fees), and 314 (eliminating export taxes). *See* NAFTA, *supra* note 25, 32 I.L.M. at 299–300, 303, 639. For a concise summary of these provisions, see Jensen, *supra* note 2, at 108–12.

government has adopted a narrow reading of Article 27; that is, that all primary petrochemicals are under the exclusive domain of the state; but a broad reading is also possible that would result in the state retaining exclusive dominion over petrochemicals only while they are still in the ground.[195] Former President Salinas justified Mexico's constitutional reservation to the NAFTA by stating: "'Our constitution will not adjust itself to the Free Trade Agreement. The oil industry will continue to be the exclusive patrimony of Mexicans.'"[196]

Mexico's desire to maintain absolute control over this sector has resulted in another exclusion from the market-opening provisions of the NAFTA. Contracts between the national oil company and private drilling companies may not take the form of risk contracts in Mexico,[197] but must rather be fixed-fee or service contracts.[198] A risk contract allows the private drilling company to assume the risk of nonproduction while sharing in a percentage of the oil, if any, that is discovered.[199]

Under a fixed-fee contract, Pemex pays the private drilling company a flat rate, to be paid whether the well is productive or unproductive.[200] The private drilling company does not provide any of its own operating capital under the fixed-fee contract, and Pemex effectively assumes all risks.[201] By contracting with private drilling companies, the national oil company seeks to overcome its inability to develop the

195. *See* Jensen, *supra* note 2, at 106 (noting that under a broad constitutional reading, the state would lose exclusive control of extracted subsoil products after they are sold).

196. *Oil's Role in Free Trade Agreement Crux of Mexico's Petroleum Sector Dilemma*, OIL & GAS J., Feb. 3, 1992, at 16, 17 (quoting President Salinas).

197. Annex I to the NAFTA excludes risk contracts. *See* NAFTA, *supra* note 25, 32 I.L.M. at 724–25.

198. Annex 602.3 allows for performance or "turnkey" contracts. *See id.* at 366–67 ("Each Party shall allow state enterprises to negotiate performance clauses in their service contracts."); *see also* Jensen, *supra* note 2, at 112 (discussing risk and performance contracts under the NAFTA). Under a performance contract, a foreign company drills for a flat fee and then Pemex regains control of the operation. *See id.* For a discussion of the NAFTA and its interaction with the Mexican oil industry, see *NAFTA Effects on Energy Sector Likely to Be Limited*, MEX. TRADE & L. REP., May 1, 1993.

199. *See* Jensen, *supra* note 2, at 112–13; Smith, *Liberalizing*, *supra* note 1, at 5–6.

200. *See* Jensen, *supra* note 2, at 112–13; Smith, *Liberalizing*, *supra* note 1, at 5–6.

201. *See* Jensen, *supra* note 2, at 112; Smith, *Liberalizing*, *supra* note 1, at 5–6.

nation's oil reserves.[202] However, by eliminating the risk contract, the government assumes full responsibility to fund the drilling operation and to pay a fixed-fee, even if no oil is ever produced.[203]

The result in one instance was an agreement between Pemex and Triton Engineering whereby Triton was paid US$20 million to drill a well that thereafter was expected to produce only 50 barrels per day in an oil field that could potentially produce 500,000 barrels per day.[204] Under the fixed-fee contract, Triton operated free from any risk, even the risk of total nonproduction, with no investment of its own capital in the project.[205] If risk contracts were allowed, Triton would only be compensated with a percentage of the oil they actually found.[206]

That Pemex is not effective as a petrochemical enterprise is easily demonstrated—although once the world's fourth largest exporter of oil, Mexico will likely be a net importer of oil by the year 2004.[207] Mexican law allows foreign companies to invest in secondary and tertiary petrochemical operations.[208] However, foreign companies are reluctant to do so because Pemex controls the basic substances necessary for the operation of petrochemical plants, and they cannot be sure that a constant supply of oil will be available at a price established by market forces.[209]

Some efforts, short of privatization, have been made to liberalize Pemex.[210] Former President Salinas reorganized the

---

202. *See, e.g.*, Jensen, *supra* note 2, at 113 (noting that service or turnkey contracts allow Pemex to operate more efficiently and provide much needed technology).

203. *See id.* at 112–13. Although risk contracts are prohibited, bonuses to supplement a flat fee have been allowed. *See id.* at 113. These bonuses may be based on timely completion of the work or on the amount of oil found. *See id.* In effect, these bonuses may circumvent the prohibition on risk contracts. *See id.*

204. *See* Smith, *Liberalizing*, *supra* note 1, at 5.

205. *See id.*

206. *See id.*

207. *See* Smith, *Oil and Prosperity*, *supra* note 1, at 6.

208. *See* Smith, *Liberalizing*, *supra* note 1, at 6.

209. *See id.*

210. *See*, *e.g.*, Andrew Downie, *Mexico Alters Sale of Pemex: Foreign Firms Can't Buy Majority Stake in Plants*, HOUS. CHRON., Oct. 14, 1996, at 1A (noting that pressures from "nationalist politicians and leftist groups" caused the Mexican government to retreat from its privatization plans); *Mexico Will Limit, supra* note 6 (noting that plans for only 49% privatization were to appease critics of complete privatization); *Petróleos Mexicanos SA: Split Into 10 Units Backed for Petrochemical Division*, WALL ST. J., Dec. 16, 1996, at B11C [hereinafter *Petróleos Mexicanos*] (noting that Mexican government plans to sell 49% interests was a retreat from its initial plan of full privatization).

company into four independent sectors[211] classified according to function,[212] all governed by a central holding company.[213] One of those sectors, the secondary petrochemical division, was seen as the "crown jewel" of the privatization movement.[214] In addition to bringing over US$1 billion into the Mexican treasury, the privatization of that one sector, it was believed, would bring Mexico into the modern world economy.[215] However, privatization did not come to the secondary petrochemical plants.[216] Instead, the government decided to allow the sale of only 49% equity ownership in the plants, with the government retaining 51% majority ownership.[217] Pemex was further reorganized into ten subsidiary companies to facilitate the anticipated investment process.[218]

This measure was adopted as a compromise to appease nationalist critics of the proposed privatization plans.[219] However, there has been minimal investment in the petrochemical industry since 1992,[220] and some critics have characterized the measure as "'privatization lite.'"[221] International investors were not fooled, however, and as one securities broker stated: "'There was quite a bit of foreign investment that pulled out after this Mickey Mouse petrochemical arrangement was announced.'"[222] President Zedillo had promised to support privatization of the petrochemical plants in an attempt to lure much needed foreign investment into the energy sector, but pressure from the government workers' union carried the day.[223]

Mexico's Oil Workers' Union, STPRM, wields enormous political and social clout.[224] One example of the tremendous influence exerted by this group is that the leader of STPRM,

---

211. *See* Jensen, *supra* note 2, at 105.
212. *See id.*; *see also Restructuring Proposed for Mexico's Pemex*, OIL & GAS J., June 22, 1992, at 34.
213. *See* Smith, *Liberalizing*, *supra* note 1, at 7.
214. *See id.*; Althaus, *supra* note 113.
215. *See* Althaus, *supra* note 113.
216. *See* Downie, *supra* note 210.
217. *See id.*
218. *See Petróleos Mexicanos, supra* note 210.
219. *See Mexico Will Limit, supra* note 6.
220. *See id.*
221. *See* Grayson, *supra* note 190.
222. Sam Dillon, *Mexican Peso Continues to Erode, Falls to 11–Month Low*, HOUS. CHRON., Oct. 17, 1996, at 4C (quoting Jaime A. Campbell, CBI securities broker, Mexico City).
223. *See* Beachy, *supra* note 190.
224. *See* Jensen, *supra* note 2, at 90–91.

Carlos Romero Deschamps, was given a senate seat by the ruling Institutional Revolutionary Party (PRI) in 1994.[225] In return for the power granted to the union bosses from the ruling party, the union generates political support for the party.[226] This delegation of power to union officials has been accomplished through a contract with Pemex management which provides that the union fully controls 90% of the workforce.[227] Union bosses like Romero Deschamps maintain their positions by exploiting popular nationalist sentiment and using government funds to provide public services to Pemex workers.[228] By integrating the union into society in this manner, individuals become compelled to support the political welfare of union bosses to insure that local benefits continue to accrue.[229] This support is usually manifested by attending political rallies.[230]

In another move sure to further compromise the government's position with potential foreign investors, a US$700 million investment by General Electric Company in a proposed power plant south of El Paso, Texas, was stalled because of needed changes in Mexican debt law.[231] The project, which was to be built in Samalayuca, is now being chided as "'*Samala-nunca*,'" with "'*nunca*'" meaning never in Spanish.[232] Even while fostering such a negative investment climate over Mexico's privatization process, Energy Minister Reyes Heroles acknowledges that foreign capital investment in the petrochemical industry is crucial for the Mexican economy.[233] The government's handling of the General Electric project shows other potential investors that the Mexican government may not have the ability to carry through with the deal.[234]

---

225. *See* Grayson, *supra* note 7.
226. *See* Jensen, *supra* note 2, at 90.
227. *See id.* at 90–91.
228. *See generally* Debra Beachy, *To Workers, Pemex Plan a Betrayal: Petrochemical Plants' Auction Raises Alarm*, HOUS. CHRON., Dec. 26, 1995, at 1B (describing the many benefits average workers derive from Pemex, such as public schools, medical care, dance lessons, and recreation centers).
229. *See* Jensen, *supra* note 2, at 91–92.
230. *See id.* at 92. Union members are actually required to sign a contract obligating them to attend PRI rallies under threat of sanctions. *See id.*
231. *See* Dianne Solis, *Mexico Doesn't Plan to Privatize Pemex: New Minister Seeks Foreign Funds for Other Projects*, WALL ST. J., Feb. 20, 1996, at A14.
232. *See id.* (emphasis omitted). Construction on the project, called Samalayuca II, finally began in May 1996. *See* Andrew Downie, *Power Plant Near Juarez Gets Go-Ahead,* HOUS. CHRON., May 4, 1996, at 1C.
233. *See* Beachy, *supra* note 115.
234. *See* Solis, *supra* note 231.

IV. CONCLUSION

The only thing standing in the way of full privatization of Pemex is an outdated notion about national sovereignty being dependent upon the existence of a national oil company.[235] This sentiment is further being exploited by self-serving, clever politicians at the expense of the very people Pemex was supposed to help: the working people of Mexico.[236] A run-down government bureaucracy has resulted in an inefficient oil and gas sector that is dragging the rest of the economy down and injuring workers at the plants.[237]

Privatization is a sound economic policy that has proven successful in application throughout Latin America, including Mexico itself.[238] Mexico would benefit from the privatization of Pemex, not only from reductions in its government budget deficit, but also from increased capital investment in its infrastructure.[239] Arguments from those opposed to privatization efforts that privatization will cause unemployment to run rampant are empirically unfounded.[240] Examples of overall economic enhancement as a result of privatization are readily available in, for example, the case of Argentina,[241] and in Mexico's own experiences outside the petroleum sector.[242] In contrast to these success stories stands the Mexican peso devaluation of 1994.[243] One of the many lessons of the peso devaluation is that sustained

---

235. *See supra* notes 111–13 and accompanying text; *see also* Grayson, *supra* note 7 (asserting that Pemex is viewed as a symbol of Mexican national unity).

236. *See*, *e.g.*, Grayson, *supra* note 7. Pemex oil workers' union leader Carlos Romero Deschamps "savaged privatization as an assault on the nation's sovereignty, [and] challenged its constitutionality." *Id.*

237. *See*, *e.g.*, Dudley Althaus, *Mexico's State of Gloom*, HOUS. CHRON., July 14, 1996, at 1A (noting that acid rain from processing plants has rotted workers' tin roofs, runoffs from petrochemical processing have been dumped into the town's waters, pipelines have burst and been left unrepaired, and vibrations from machinery have cracked home foundations); George W. Grayson, *Pemex Chief's Successful Innovations Keeping Detractors at Bay*, HOUS. CHRON., Aug. 11, 1996, at 5C (noting seven workers dead and nine injured in a series of explosions at the Pemex complex in Cactus, Chiapas); *What's News—World-Wide*, WALL ST. J., July 29, 1996, at A1 (noting an explosion at a natural gas plant owned by Pemex that resulted in 6 killed and 39 injured).

238. *See supra* Parts II.A–B, III.B.

239. *See supra* notes 71–73 and accompanying text.

240. *See supra* notes 86–93 and accompanying text.

241. *See supra* Part II.B.

242. *See supra* Part III.B.

243. *See supra* notes 138–55 and accompanying text.

economic growth cannot occur absent steady, modern, and economically sensible political leadership.[244]

Keeping Mexico free from the perceived threat of foreign dominance comes at a high price for some. Jorge Zapata lives on the American side of the border in Falcon, Texas.[245] When natural gas was discovered under his land he became a wealthy man, along with many other property owners in that rural area.[246] On the other side of the border, under which extend the same reserves of natural gas, Antonio Flores Gonzales will not see the wealth a free economy can bring.[247] Pemex has been producing natural gas from wells on his property for the past twenty years without making any payment to him whatsoever.[248] In fact, production of the gas has cost him money because Pemex crews tear down his fences and dump waste products into his water supply.[249]

In America, if you own land but not mineral rights, you still get royalty payments when oil is discovered under your property.[250] In Mexico, there are no royalty payments and no private property rights in the gas and oil.[251] In fact, in the state of Tabasco, the primary production site for Pemex, over US$130 billion worth of petrochemicals has been pumped out in the past 20 years, but many of the 1.8 million people who live there exist in utter poverty.[252]

The people of Mexico would be best served by their government bringing about a full privatization of Pemex as quickly as possible.

J. Keith Russell

244. *See, e.g., id.*
245. *See* Dudley Althaus, *So Near, Yet So Far: A Huge Source of Natural Gas Underneath a Border Town Benefits Only a Few Landowners in Texas and Almost None in Mexico*, HOUS. CHRON., Dec. 29, 1996, at 1A.
246. *See id.*
247. *See id.*
248. *See id.*
249. *See id.*
250. *See id.*
251. *See id.*
252. *See* Althaus, *supra* note 237 ("'We need so much. We are so poor. We see that there is oil, but it is all for foreigners, for the political bosses.'") (quoting Domitila Rodriguez, grandmother, Mexican resident).