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Mexico, Brazil Propose Alliance Between State-run Oil Companies

In recent years, Brazil and Mexico have discussed forming a full alliance between their state-run petroleum companies. But now it seems like the two countries are ready to move beyond just talk and minor cooperation accords and develop a more permanent relationship between PEMEX and Petrobras. Presidents Felipe Calderon and Luiz Inacio Lula da Silva discussed creating joint opportunities for the two companies during Calderon's visit to Brazil in mid-August. The proposal to cooperate in the energy sector is the centerpiece of a major trade and economic agreement that Brazil and Mexico are discussing.

Mexican Energy Secretary Georgina Kessel, who accompanied Calderon to Brazil, said the two countries discussed increased cooperation in refining, petrochemical, exploration, and production. While the alliance would provide benefits for both PEMEX and Petrobras, the Mexican company stands to gain the most from a long-term cooperation scheme with its Brazilian counterpart. The two companies have already entered into some technical-cooperation agreements, including one in which Petrobras is offering PEMEX assistance with deep-sea drilling (see SourceMex, 2007-03-07). This need to access deep-sea reserves is partly behind Calderon's urgency to expand the relationship between PEMEX and Petrobras. "I am very interested in concluding a cooperation agreement as soon as possible," Calderon said in a press conference in Rio de Janeiro. "We are looking not only for a commitment to cooperate between Petrobras and PEMEX, but also between Brazil and Mexico so we can expand the two countries' productive capacities. This would benefit our countries as well as the region as a whole." Calderon said Petrobras offers significant technological expertise for PEMEX as well as an operational blueprint. "Only 10 years ago, Petrobras was producing 800,000 barrels per day, and PEMEX output was at 2 million bpd," said the Mexican president. "This year, PEMEX and Petrobras anticipate production of 2.5 million bpd." Mexico's production estimate is down significantly from the 3.3 million bpd produced in 2004.

The production forecasts for PEMEX are not encouraging unless the Mexican oil company is able to tap into new reserves (see SourceMex, 2007-03-07 and 2008-09-24). In contrast, Petrobras expects to produce about 5.7 million bpd by 2020. "My objective is very clear," said Calderon. "We want PEMEX to benefit from Petrobras' success." Lula also paid lip service to an agreement between the giant oil companies, which would allow them to become "even greater." For example, he said they could embark on joint projects in third countries. The Brazilian president also mentioned the possibility that PEMEX and Petrobras could work cooperatively in renewable energy. "I never tire of talking about Brazil's [positive] experience with biofuels," said Lula. "They will increasingly play a role in the global energy sector."

PRI, PRD offer conditional support a major reason for optimism for a PEMEX-Petrobras deal is that the three major parties have to some extent endorsed the move. Calderon attempted to cement this support by bringing the leaders of most parties represented in the Mexican Congress with him on his trip to Brazil, which included visits to key Petrobras installations. The three major parties have supported an alliance between the two oil giants, but there is a caveat. The opposition parties Partido de la Revolucion Democratica (PRD) and Partido Revolucionario Institucional (PRI) have made it known they would oppose any move that would allow Petrobras to assume risk contracts, which in effect would allow the Brazilian company an ownership stake in the extracted resources. This could pose a problem because risk contracts have been the preferred method of joint ventures for Petrobras for more that two decades. "I would be the first to celebrate an agreement of this type, but we reject the concept of risk contracts because Mexican law strictly prohibits risk contracts with private companies or with public companies in any national state," said Sen. Carlos Navarrete, PRD floor leader in the upper house. Similar statements came from Sen. Manlio Fabio Beltrones, coordinator of the PRI delegation in the upper house, who said he considered the discussions between Brazil and Mexico a positive development but also warned against any move that would allow Brazil to assume risk contracts. But Sen. Gustavo Madero, who leads the PAN delegation in the Senate, noted that the parameters of an agreement that have been discussed thus far between PEMEX and Petrobras do not violate the legal framework of the Mexican Constitution. "I think that this agreement is well within the framework of approved reforms and that we can establish a win-win situation between the two leading oil-production companies in Latin America," said Madero. Still, the flexibility of the PRD in the Senate is a stark contrast to statements by the PRD's ex-presidential candidate Andres Manuel Lopez Obrador, who during Lula's visit to Mexico City in 2007 rejected any opening of PEMEX to outside interests. "We are not going to allow the privatization of PEMEX in any form," Lopez Obrador said shortly after the Brazilian president suggested a Petrobras-PEMEX alliance during that visit. And there are some strong voices in the PRI who are open to direct foreign investment in Mexico. "I personally believe that we must open this state-run company to private investment, just as is done everywhere else in the world," Tamaulipas Gov. Eugenio Hernandez Flores said at a conference in mid-August. He noted that PEMEX's production and export capabilities have diminished significantly because of a lack of capital.

Tamaulipas sits on huge deposits of natural gas, which cannot be accessed because Mexico lacks technological expertise and capital to extract the fuel (see SourceMex, 2004-01-28). Hernandez suggested that a major emphasis be placed on strengthening PEMEX, since oil exports could be a key factor in helping Mexico emerge from its economic crisis. This view is also held by many in the PAN. "If PEMEX and Petrobras do not enter into this agreement, our oil industry could take 20 years to develop the same technology [offered by Petrobras]," said PAN Deputy Alonso Lizaola. PEMEX seeks access to Petrobras technology, expertise Calderon and the PAN have made no secret of their desire for some opening to allow private capital into PEMEX, which they say would go a long way toward making the company viable. The Mexican president noted during his speech in Brazil that Petrobras has already conducted extensive exploration activities in the Gulf of Mexico, drilling in depths of 10,000 feet, while PEMEX's technological and capital limitations only allow drilling in depths of 3,000 feet. Petrobras has conducted some of those explorations activities through its Houston-based US subsidiary Petrobras Americas.

Syndicated columnist Sergio Sarmiento noted the irony of PEMEX trying to emulate the Brazilian company. "When the administration of ex-President Getulio Vargas [1930-1945, 1951-1954] founded Petrobras in 1953, it wanted to emulate PEMEX," said Sarmiento. "But since 1997, after [former President] Fernando Henrique Cardoso [1995-2003} modernized Petrobras, it has surpassed the Mexican company by leaps and bounds." Sarmiento pointed out that Petrobras, which is structured similarly to Norway's state-run oil company Statoil, has managed to grow because it allows private investment, which is prohibited for PEMEX by the Mexican Constitution.

"Because of this, Petrobras is able to obtain much more capital than PEMEX without the state ceding control of the country's oil resources," said the columnist. "PEMEX began exporting gasoline when Brazil was a net importer." PRI Sen. Francisco Labastida Ochoa, who chairs the energy committee (Comision de Energeticos) in the upper house, mentioned a different obstacle to an agreement between the two oil companies. He said an agreement could be thwarted by Mexico's tax-structure, by which the government continues to rely heavily on oil-export revenues despite recent reforms. "We have a very significant problem with the system we have in place...which leaves PEMEX without resources," Labastida said in a radio interview. Labastida noted that most oil companies around the world pay taxes on about 30% of the value of oil extracted. Even after the tax reforms approved in 2007 (see SourceMex, 2007-09-19), PEMEX still pays 71% of the value of oil and gas extracted, plus another 10% from oil exports. "We tried to fix it in 2007 with a tax reform, but this action has proven insufficient," said Labastida. Brazil, Mexico also discuss bilateral trade agreement While the focus of the conversations between Calderon and Lula was on cooperation in their energy sectors, they also discussed extending their trade relationship.

The two countries have a series of minor tariff-reduction agreements and also have a relationship through the Southern Cone Common Market (MERCOSUR). Brazil is a full member of the trade bloc, while Mexico is an associate member with limited privileges (see SourceMex, 2008-04-04). In 2007, Brazil and Argentina proposed that Mexico become a full member of MERCOSUR (see SourceMex, 2007-08-08), but no action has been taken in this regard. Lula and Calderon said they discussed the possibility of negotiating a full bilateral trade agreement during the Mexican president's recent visit to Brazil. "It is inconceivable that the Mexican and Brazilian economies, which represent about 70% of Latin America's GDP, only have US$7.4 billion in trade," said Lula. Lula said a bilateral trade agreement would be extremely beneficial for his country, giving Brazilian companies access to a huge consumer market, now served primarily by the US. He noted that Mexico, in turn, could greatly expand sales from strategic sectors such as petrochemicals to Brazil. A bilateral accord would give Brazilian companies increased opportunities to invest in Mexico. "Mexican companies have about US$15 billion of investments in Brazil," said Lula. "In contrast, Brazilian companies have only invested about US$1 billion in Mexico." The two leaders said they would each appoint a team of experts to explore areas where the countries could expand trade and investment. Calderon said the teams would be instructed to develop a framework and a timetable for an eventual bilateral agreement. Lula acknowledged that the countries have to overcome another important obstacle before they can enter into a comprehensive bilateral agreement. They must first obtain the full endorsement of MERCOSUR partners, which is not necessarily assured.