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Government Announces New Details for Privatization Of State-Run Railroad

by LADB Staff

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In mid-November, President Ernesto Zedillo's administration announced a timetable and new terms for the partial privatization of the state-run railroad (Ferrocarriles Nacionales, FERRONALES). Speaking to reporters, Communications and Transportation Secretary Carlos Ruiz Sacristan said the Zedillo administration will begin accepting formal bids for FERRONALES in the first half of 1996. As was the case with the privatization of Mexico's seaports, the successful bidders will receive concessions for a designated period.

In the case of FERRONALES, concessions will be awarded for 50 years. According to the terms of privatization, concessions for FERRONALES will be awarded to private investors in three separate units:

*The northeastern routes, which will cover the area spanning from the Texas-Mexico border to Mexico City.

*The northwestern routes, which will connect key seaports on the Pacific Coast with Guadalajara, Queretaro, and Mexico City.

*The southern routes, which will include all rail lines south of Mexico City. The main line in this region connects Mexico City with Veracruz and Merida.

In addition to the three designated areas, the Zedillo administration will offer concessions for a handful of short- distance routes. The short routes are located within the three regions but will be offered as separate concessions. SCT sources said they expected industry-specific groups to bid for the concessions on the short routes. For example, mining companies are expected to compete heavily for the rail lines connecting Chihuahua and the Pacific Ocean.

Additionally, the SCT plans to offer a separate concession for operation of the huge rail cargo terminal in Mexico City, which will serve as a transfer point for cargo shipments moving among the rail lines serving the three regions. According to the New York Times, the Zedillo administration decided to offer FERRONALES in three separate units because of concern that US and other foreign investors would be reluctant to bid for the entire system, especially if this meant having to invest in unprofitable routes south of Mexico City. On the other hand, the northeastern and the northwestern routes are expected to attract strong interest from US railroads. These routes connect the heavily industrialized areas of Monterrey, Guadalajara, Saltillo, and Mexico City, with the Mexico-US border communities of Mexicali, Ciudad Juarez, Piedras Negras, and Nuevo Laredo.

In addition, both the northern routes offer access to the key ports of Lazaro Cardenas on the Pacific Ocean, and Tampico and Veracruz on the Gulf of Mexico. According to transportation industry

sources, the main purpose of the privatization is to attract foreign capital to Mexico's railroad system, which is obsolete and needs significant upgrade. Indeed, of the total 26,000 km. of track existing in Mexico, roughly 20,000 km. were laid down before 1910. Because of the poor condition of tracks, only about 15% of all the cargo shipped in Mexico is sent by rail. In fact, industry analysts note that the Mexican government in recent years has conducted regular maintenance on less than 10% of the entire rail system, focusing primarily on the three profitable routes: Mexico City-Nuevo Laredo, Mexico City- Veracruz, and Queretaro-Guadalajara-Manzanillo.

In an interview with the weekly business newspaper *El Financiero International*, FERRONALES's assistant general manager Emilio Sacristan Roy said the primary purpose of the privatization is to create a competitive, reliable, and efficient railroad network. "We are more concerned about efficiency than we are about the actual amount of money that we'll receive from the concessions," Sacristan said. Still, Sacristan said the Zedillo administration has hired US-based company First Boston as its consultant to determine the price that will be asked from private investors. The cost of each concession will vary by region. Among the factors that will be considered are volume of cars and equipment.

On the other hand, the SCT is expected to take a flexible stance in the privatization in order to encourage participation by foreign investors. The potential entry of US railroad companies into the Mexican rail business has attracted opposition in both the US and Mexico. In the US, some members of the US Congress and the US transportation industry have expressed concerns about the possibility that recent or proposed mergers between US railroad companies are creating "megacompanies," which could in effect gain a monopoly over rail traffic moving between the US and Mexico.

According to *El Financiero International*, one of these two "megacompanies" was formed earlier this year through the merger of Burlington Northern and Santa Fe railroads. US government approval is pending for the proposed merger of two other railroads: Union Pacific and Southern Pacific. Still, despite direct competition from foreign interests, a number of Mexican companies have formed partnerships with US-based partners to bid for the concessions. The most recent of these partnerships, announced in October, is comprised of a joint venture formed by Grupo Tribasa, Impulsora Tlaxcalteca de Industrias (Itisa), and US-based Rail-Tex. This partnership is expected to compete with a joint venture formed by the giant ocean shipping company Transportacion Maritima Mexicana (TMM) and US-based Kansas City Southern Industries. Union Pacific, which is awaiting approval on its merger with Southern Pacific, has formed a separate joint venture with Mexico's engineering and construction company Empresas ICA.

Meantime, the privatization particularly the participation of US companies in FERRONALES has been met with opposition from some members of the railroad workers union (Sindicato de Trabajadores Ferrocarrileros de la Republica Mexicana, STFRM), who are concerned about the loss of jobs. Opponents have also raised the constitutional argument, suggesting that the government, and not private companies, should own the means of transportation to benefit all Mexicans. For example, some members of the STFRM have launched a letter-writing campaign seeking to suspend the privatization of FERRONALES. The letters, directed to Zedillo and to the embassies of the home countries of prospective bidders, suggest that the administration has no right to approve

the privatization, since the "Mexican government is not the owner of the railroad, but simply the administrator."

The campaign is expected to gain little support from the administration, since the FERRONALES privatization has been endorsed by STFRM leader Victor Flores Morales. In an article in the weekly news magazine *Proceso*, former STFRM leader and FERRONALES historian Salvador Zarco accused the current government and former president Carlos Salinas de Gortari's administration of moving ahead with the privatization of the railroad "against the will" of the Mexican people. Zarco said the decision by the Zedillo administration and the Mexican Congress to remove the designation of "strategic industry" from the national railroad in January of this year was based in part on a recommendation by the US financial analysis company J.P. Morgan in October 1994. The changes approved by the Chamber of Deputies in effect modify Article 28 of the Mexican Constitution to allow participation of domestic and foreign private companies in FERRONALES (see SourceMex, 02/01/95).

Under the Salinas administration (1988-1994), the government opened the door for foreign investment in support services for the railroad, including maintenance of tracks, rail cars, and locomotives. Zarco said the Salinas administration's decision was based on a recommendation from the World Bank in May 1992. Meantime, Zarco noted that despite the apparent lack of appeal of the lines south of Mexico City, the east-west routes south of Mexico City could have strategic value for US shipping companies. Zarco suggests that the US government will be urging US railroad companies to bid for these concessions in order to gain a new alternative to the Panama Canal.

The US is due to return control of the Panama Canal to the Panamanian government in 1999. According to Zarco, there will be keen interest by US companies in gaining some control over the rail lines that link the ports of Salina Cruz, Oaxaca state, with Coatzacoalcos, Veracruz state. The two ports have increased their capacity to handle shipping containers. Indeed, a report released by Banamex-Accival in 1994 said Salina Cruz and Coatzacoalcos were among the eight most economically viable ports in Mexico (see SourceMex, 04/06/94). [Sources: *Excelsior*, 10/11/95, 10/14/95; *Journal of Commerce*, 10/16/95; *Reforma*, 10/17/95; *Proceso*, 10/23/95; *El Financiero International*, 10/09/95, 11/13/95; AP Dow-Jones, *New York Times*, 11/14/95]

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