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USMCA and the Risk of Energy Expropriation in Mexico

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Problem

Mexico's 2013 constitutional reforms allowed private participation in the Mexican energy sector. As a result, U.S. companies, among others, invested billions of dollars to develop energy infrastructure in Mexico. These investments resulted in employment growth on both sides of the border. However, since the election of Andres Manuel Lopez Obrador (AMLO) foreign investments have been met by renewed calls from energy nationalists to nationalize the energy industry. Much like Lazaro Cardenas before him AMLO's push for "energy sovereignty" have given foreign investors a cause for concern.

The proposed legislative changes not only call into question Mexico's commitment to USMCA, however the biggest issue with this policy change is the environmental impact that these changes will have. According to Mike Sommers of the American Petroleum Institute research from "environmental organizations estimate the impact of the new Power Industry Law as an increase in CO_2 emissions of 15 -20% and in SO_2 emissions of 150% (Sommers)."

Executive Summary

The energy industry is one of Mexico's biggest contributors in terms of revenue for the state. During the Pena Nieto administration, PEMEX was taxed at a rate of almost 100% (Garcia). As the 11th largest producer of oil, Mexico, which is not an OPEC member, has been one of the biggest beneficiaries of oil and gas exports to the United States. According to the Energy Information Administration (EIA), energy accounted for 5% of all U.S. imports from Mexico in 2018 (Kempkey). Because of the lack of investment in innovative technologies Recent efforts by the Mexican government to stabilize their highly indebted energy industry has led to calls from American companies and lawmakers that Mexico is in violation of the spirit of the USMCA. Fears of environmental degradation come from the fact that recent measures benefit older, more polluting fossil fuel power plants (Viscidi, Graham and Phillips). Specifically, these CFE plants must use oil produced by Mexico which is high in sulfur.

Unlike PEMEX whose revenues are wholly coopted by the government, private foreign investors can use revenue to fund investment in renewable energy. Private energy companies directly and indirectly employ more than 81,500 people in Mexico, of which around 12,000 are employed in the wind industry and around 56,000 in solar (including distributed generation), according to a group of Mexican energy industry associations (Viscidi, Graham and Phillips). Since Peña Nieto's opening of the energy industry in 2013, renewable energy investment in Mexico quadrupled from $1.5 billion to $6 billion, and cumulative investment since 2013 exceeds $22 billion (Viscidi, Graham and Phillips).

Much like other developing nations that have questioned the legitimacy of climate talks from nations that have historically contributed the most to greenhouse gas emissions. AMLO's decision to push for these reforms brings into conflict competing interests. On one hand AMLO knows that allowing for foreign investments gives Mexico the opportunity to slowly move away from fossil fuels and thus prepare Mexico for the future. On the other hand, there are historical reasons for why he is pushing these reforms. As we will discuss later, Cardenas' decision to nationalize the oil and gas industry proved to be a symbol of Mexican defiance in the face of outside corporate interest. Furthermore, PEMEX is known for its unique corporate structure. PEMEX managers do not hire new workers, that privilege is extended to the union that represents PEMEX's workers. The union wields enormous amount of influence. "In most oil companies, average em-

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ployment at a refinery that processes 200,000 barrels of oil per day is 800 people. But a PEMEX refinery of the same size and capacity employs more than 4,000 workers (Victor, Hults and Thurber 310)." While foreign investments will help funnel excess workers at other plants, the point of the reforms is to highlight to the Mexican people that AMLO and by extension Mexico is pushing for a self-sustainable future.

Background

The 1917 Constitution was a result of the Mexican revolution and replaced the liberal Constitution of 1857. Article 27 of the Constitution of 1917 granted the Mexican government complete control of all subsoil resources. Following the labor unrest of 1937 and a failure of foreign businesses coming to an agreement with the union, Lorenzo Cardenas expropriated land owned by foreign interests in the energy industry. The move proved to be popular, as many saw Cardenas as the Mexican leader that kept his word when it came to the promises of the Mexican Revolution. Following the 1938 decision to nationalize the oil industry, Mexico announced the formation of the state-owned Petroleos Mexicanos (PEMEX). After 75 years of state control, then President Peña Nieto threw his support around opening the energy industry for foreign investments and companies. The move came after decades of declined production for PEMEX, and lack of investments into newer technologies.

At the urging of AMLO, the ruling Morena Party introduced reforms in the Mexican legislature to the Power Industry Law that modified the dispatch rules to put CFE power generating plants at the top of the dispatch order, instead of the less costly and less polluting private units, which include significant U.S. investments (Sommers). The resulting effect from this change is that electricity will become more expensive and more polluting. The reforms essentially reassert the government's right to expropriate facilities and turn their operations over to Pemex if the government decides to suspend or revoke their permits. In September of 2021, Mexican National Guard troops sealed the gates at a major fuel terminal operated by Houston based Monterra Energy. The Wall Street Journal reported that the terminal is part of about half a billion dollars in investments in Mexican diesel and gasoline storage facilities (Blackmon).

On 11 June 2021 Mexico's finance minister amended customs laws to allow only state-owned firms, such as PEMEX, to import and export Liquefied petroleum gas (LPG). This policy shift was followed by AMLO's announcement of the creation of a state-owned LPG distributor named Gas Bienestar. Gas Bienestar is to be exclusively supplied by PEMEX. To date, 82 firms have been suspended from the import registry (Meana).

Recommendation

Given the current administration's current goals on tackling climate change, the administration's willingness to engage in a trade dispute over oil and gas seems unlikely. However, I believe there is an avenue for the administration to engage in the matter without seeming like they are betraying their current goals. Currently, we do know that if Mexico continues with their new Power Industry Law that CO2 emissions will increase. This presents an opportunity to tout the technological expertise American companies can provide at a significantly less cost to the environment and consumers.

While Chapter 8 of the USMCA agreement recognizes Mexico's sovereign right to claim ownership of all subsoil hydrocarbons within its national territory, in Chapter 15 all signatory parties agreed to basic protections for foreign investments. Chapter 22 goes further in placing restrictions on state-owned enterprises (SOEs) and designated USMCA parties are prohibited from discriminating against foreign enterprises. Current solutions include the formation of a panel to discuss grievances in front of a mediating body such as the World Trade Organization.

Currently, the petrochemical industry has opted for more direct action. As of now the industry has pushed for bipartisan and bicameral letters pushing the administration for dialogue with Mexico. The current ambassador to Mexico, Ken Salazar, had previously served as Secretary of the Interior during the Obama administration. As Secretary, Salazar has pushed for responsible oil and gas exploration. During his tenure he approved plans for offshore drilling. Conversely, he also pushed for the development of renewable energy on public lands.

As someone who is knowledgeable on the industry, Ken Salazar is in a unique position to speak to his Mexican counterpart about the emission efficient standards of American companies. The Biden administration's only course is to reframe the problem not from an expropriation point of view, but rather from a climate conscience view. American companies provide access to the technology for cleaner burning fuel. Furthermore, labor standards tend to be better at American facilities. In August of 2020 five workers perished at a platform fire at a PEMEX ran facility. While workers for PEMEX are unionized it is important to note that Mexico's reliance on raiding PEMEX's coffers to fund government programs leads to a lack of funds to invest in better training, and equipment. Clearly there is a role American companies can play in ensuring that workers are safe, while ensuring that Mexico is doing their part in lowering emissions.

Salazar has brought up the issue with his Mexican counterpart to no avail. Prior to November's trilateral summit between the US, Mexico, and Canada, AMLO affirmed he was not interested in discussing the topic further. The US should continue to pressure Mexico and ensure that trade deals are providing all parties fair access to markets.

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