



# Oil and World Power. The 1980s and the International Debt Crisis

## El petróleo y el poder mundial. La década de 1980 y la crisis de la deuda internacional

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### Abstract

The 1980s were the result of the organizational design and rearrangements that took place in the 1970s in both countries. The distinctive feature of this decade was an economic crisis in the region that resulted from the sovereign debt of many countries and the surge of the international interest rates, accompanied by a deterioration of the terms of trade of some commodity exporting nations. In fact the crisis was so severe in Latin America that the period is better known as the "lost decade" to illustrate the stagnant growth rates of most countries in the region. In Mexico the economic crisis was partly the result of the sudden increase in the international interest rates, capital flight, the foreign debt, and concentration of income. To solve some of these problems, the Mexican government relied on oil exports to obtain foreign exchange and service its debt obligations, as well as to cover the costs of some strategic imports (Randall 1989, 132). The debt of the government had increased from 46.6% in 1960 to an outstanding 292.2% in 1982, attributable mainly to infrastructure and expansion projects initiated during the period of oil abundance of the 1970s. In fact, great part of the debt was directly acquired through Pemex, because it provided less credit risk than the Mexican government because the company was able to back its credits with oil (Randall 1989, 22).

**Keywords :** oil; power; Mexican government

### Resumen

La década de 1980 fue el resultado del diseño organizacional y los reordenamientos que tuvieron lugar en la década de 1970 en ambos países. La característica distintiva de esta década fue una crisis económica en la región que resultó de la deuda soberana de muchos países y el aumento de las tasas de interés internacionales, acompañado por un deterioro de los términos de intercambio de algunos países exportadores de productos básicos. De hecho, la crisis fue tan severa en América Latina que el período se conoce mejor como la "década perdida" para ilustrar las tasas de crecimiento estancadas de la mayoría de los países de la región. En México, la crisis económica fue en parte el resultado del repentino aumento de las tasas de interés internacionales, la fuga de capitales, la deuda externa y la concentración de los ingresos. Para resolver algunos de estos problemas, el gobierno mexicano se basó en las exportaciones de petróleo para obtener divisas y pagar sus obligaciones de deuda, así como para cubrir los costos de algunas importaciones estratégicas (Randall 1989, 132). La deuda del gobierno había aumentado del 46,6% en 1960 a un 292,2% pendiente en 1982, atribuible principalmente a proyectos de infraestructura y expansión iniciados durante el período de abundancia de petróleo de los años setenta. De hecho, gran parte de la deuda se adquirió directamente a través de Pemex, ya que proporcionaba menos riesgo crediticio que el gobierno mexicano porque la empresa podía respaldar sus créditos con petróleo (Randall 1989, 22).

**Palabras clave :** petróleo; energía; gobierno mexicano

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In addition to the deterioration of the petrochemical industry, Pemex had to face serious problem of overstaffing and corruption. Pemex size became a problem after the oil boom, when the state overemployed thousands of workers to perform oil-extracting activities. As a consequence of the growing number of employees, the union of workers became more important for the operations of the company to the point that it was represented in the Board of Directors (Randall 1989, 34). Corruption in the union was one of the most important problems of Pemex throughout its history, but it reached a peak under the union’s leadership of Joaquín Hernández Galicia “La Quina” (Randall 1989, 149). To face all these problems, the government continued to rely on oil exports and tried to open its economy to the international markets by joining the GATT in 1986 and continued to be a recipient to the U.S. Generalized System of Preferences (Randall, 1989, 181). Nonetheless, and despite all the efforts to solve its structural problems, the enormous dependency of the government on oil exports made it very difficult to diversify production and increase the output of value added liquids to improve the country’s terms of trade. The growing corruption and lack of transparency led the company to have serious maintenance problems in the 1990s, which led to a number of environmental and safety disasters in the communities where Pemex operates.

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For Brazil the 1980s was neither an easy decade, but the institutional structure developed in the 1970s helped the company to continue growing. According to Laura Randall the period between 1978 and 1989 could be labeled as the years of “continuing operations”, mainly because of the emphasis of the company to continue growing despite its internal and external limitations (Randall 1993, 21). One of the most important events was that in 1988 Braspetro, the subsidiary in charge of overseas oil exploration, prioritized decentralization and nationalization, as a result of its reported losses from 1986 to 1988. The new scheme considered investments in the U.S., U.K., Norway, Angola, Libya, Colombia, Ecuador and Argentina, which helped to gain profits worth \$22 million in 1989 (Randall 1993, 34). In 1982 when the Brazilian economy had limited access to credit, Iraq provided oil on trust to Brazil as the result of a pro-Iraqi policy based on the purchase of oil to Iraq when no other company had the courage to do it. As a consequence of the intensification of oil trade relations Iraq supplied almost half of the oil requirements of Brazil by 1990. Nonetheless, this trend did not last for long. As the Iraq-Kuwait war led to an embargo of Iraq, Petrobras was forced to look for more oil contracts in Iran, Venezuela, Saudi Arabia, Qatar, Angola and China to continue meeting its domestic demands (Randall 1993, 264).

Petrobras also ventured in new activities such as the distribution of fuel alcohol as part of the implementation of the second phase of the Proalcool program, but the collapse of prices of the sugar cane led to partially reduce government benefits to the industry (Randall 1993, 35). Another relevant activity aimed at improving the performance of Petrobras was to reduce its costs in transportation. In this sense, Petrobras’ tanker fleet (FRONAPE) quadrupled its size from 1973 to 1983 and by 1984 the company had a larger fleet than Exxon or Shell, mainly due to the subsidies granted by the Merchant Marine Fund (Randall 1993, 153). The support for the transportation and distribution activities were part of a strategy that had the purpose of improving its competitiveness, but starker reforms were proposed under the government of President Fernando Collor de Melo in the 1990s. Finally, unlike Mexico, where the oil companies had to deposit their earnings in foreign currency to the Central banks in order to be “sterilized” and avoid increases in the monetary base, in Brazil oil imports were paid with foreign currency, avoiding increases in the monetary supply as the government subsidized imports to cover the losses of preferential exchange rates (Randall 1993, 257).

By the end of the decade Petrobras’ strategies of internationalization, transportation, distribution and monetary policy had a mixed impact that overall enabled the company to continue growing in a modest way. However, when compared to Pemex, Petrobras was better off in general terms than the Mexican company. Mexico became too dependent on oil exports to service its debt obligations and overstaffing led to inefficiencies and corruption scandals. Some of these problems were amplified in the 1990s causing greater environmental damage, and inefficient oil production.

## **The 1990s Economic Liberalization and Environmental Concerns**

The 1990s was a decade that brought important changes to the Brazilian and Mexican economies. Both countries started a process of economic liberalization through the privatization of some of its domestic industries, and signed a number of Free Trade Agreements that had the purpose of

encouraging investment and promoting economic growth, at least in theory. In those years Mexico and Brazil continued to take divergent energy policies. For instance Mexico continued to support energy consumption whereas Brazil tried to control oil demand to reduce greenhouse emissions. In that vein, Mexico had virtually no energy conservation or effective environmental policy during the 1990s (Randall 1989, 9). Environmental concerns begun in Mexico in 1979 when the offshore well Ixtoc I spilled 30 thousand barrels of crude a day in the Gulf of Mexico close to the shores of Campeche. The event was one of the most catastrophic oil spills in the region, comparable to the damage caused by the Exxon Valdez spill in Alaska ten years later (Simon, 159). However, Pemex had not granted importance to the environmental consequences of oil extraction because the benefits for the economy had priority over the environment. High-government officials even declared that environment protection was a luxury of developed countries and that if Mexico wanted to develop its industry, it should not restrict its activities with environment protection laws (Simon, 160). Furthermore, maintenance was also curtailed by the early 1990s, causing a series of industrial accidents all over the country, but it was the burning of combustol to produce electricity that positioned CO<sub>2</sub> emissions as the most serious problem in the country (Simon, 162). In an effort to reduce the pollution in the generation of electricity, the Mexican government proposed the construction of a nuclear plan in Laguna Verde, Veracruz, but the construction took ten years more than scheduled and the initial cost of \$128 million increased to \$3.5 billion (Simon, 171).

The public discussion about how to solve the environmental issues included privatization because it was believed that private companies would now assume legal responsibility over pollution (Simon, 173). However, privatization of Pemex did not occur and the strategy of the company was to give monetary compensations to those who were affected by pollution or industrial accidents. This policy generated a corruption cycle in which Pemex managers were involved in intentional disasters so that members of the community would be compensated and they would receive a share of the benefits. The main concern, however, was how to allow Pemex more management autonomy to improve its operations. For this reason in 1994 the government granted Pemex official control over its four subsidiaries and the strategic management over all the new organisms (Gutiérrez, 23). In 1997 the international economic crisis and the collapse of the oil prices highlighted the stark dependence of the federal government, the states, and municipalities to the revenues obtained through the heavy tax burden imposed on Pemex (Gutiérrez, 29). As a result, a fiscal reform was discussed in 2005, but if the country was meant to reduce the taxes on Pemex, then it should increase other taxes, like the Value Added Tax (IVA) and the Income Tax (ISR) (Gutiérrez, 38). Additionally, a reduction on the taxes should be compensated with additional income to states and municipalities (Calzada, 38). Nonetheless, the governor's association (CONAGO) strongly lobbied against the reduction of the tax burden of Pemex because an increase on the IVA and the ISR was not politically feasible due to the upcoming presidential elections of 2006 (Calzada, 65). The fiscal reform did not take place and since year 2004 the domestic oil output has steadily decreased.

The 1990s was a decade of painful reorganization for Petrobras. The new president of Petrobras, Ernesto Weber decided that the company should privatize those areas that were less profitable to the state and improve their efficiency through the inclusion of private management and capital. For that reason, President Fernando Collor de Melo started the privatization of some of the subsidiaries of Petrobras, like Petroquisa in charge of the petrochemical segment, as an effort to

focus on more profitable operations. Yet, external factors also affected Petrobras. The war in Iraq in 1990 led to the suspension of payments worth \$150 million to the company, forcing the country to look for alternative partners. The privatization of some segments of the company and the bad economic performance abroad led to a reduction of 2,868 employees, whose jobs were eliminated and not reincorporated by the new Petrobras (Randall 1993, 43). Unlike Pemex, Petrobras began to reduce its size under the assumption that it was easier to reduce the administrative burden within the firm than the one imposed by the government.

In 1992 Brazil announced its abandonment of its self-sufficiency goals and acknowledged an increase on its oil imports in order to preserve its reserves for future needs (Randall 1993, 56). At that time the country also improved its environmental regulations that taxed polluting industries in the states where oil production was important: Rio de Janeiro, Sao Paulo, Bahia, Sergipe, and Rio Grande do Norte. However, the great bulk of contamination was emitted by passenger cars, which accounted to 70% of the total emitted pollution. Anticipating stricter environmental regulations, Shell announced in 1993 that it would invest between \$5 million to \$10 million in installations for compressed natural gas, in the eve of the conversion from diesel to cleaner fuels (Randall 1993, 272). During the 1990s Mexico had a more rigid institutional organization that caused environmental problems and increased the dependency of the government to oil revenues. On the contrary Brazil passed through difficult times of readjustment, including the private participation of foreign companies, abandoning its aspirations of self-sufficiency and addressing environmental issues.

## Conclusion

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Pemex and Petrobras have been different companies since their very creation. On the one hand, Pemex started running on the basis of a preexistent oil industry, whereas Petrobras was designed to improve the production already achieved by the NPC since 1938. The difference in their origin led to different interpretations of nationalism and the role that the companies should play in their countries. In the case of Mexico, Pemex was conceived as a state company that should support the country's economic development. Brazil on the contrary established Petrobras with the objective of securing oil supply and achieving self-sufficiency. Those different notions about nationalism had a repercussion in the concept of ownership and monopoly, which in the case of Brazil was more dynamic and open to find solutions even with the private sector. In Mexico the rigidity of nationalism plus a period of considerable economic growth by the end of the 1970 resulted in an increased dependency on oil exports, debt, inflation, and a legacy of corruption and lack of transparency. The country suffered for its mistakes in 1982 when the international interest rates skyrocketed, leading to a non-payable debt and a severe economic crisis. Petrobras in turn had developed a diversified strategy during the 1970s including an ethanol program, the exploration of oil overseas and improving management. The 1980s was a difficult decade for both companies, but Petrobras continued to grow whereas Pemex continued to decline, mainly due to labor problems with the Union and the imposition of a 49% tax burden. Finally, the 1990s were the result of the previous decades, which in the case of Mexico resulted in environmental problems and inefficient production. In Brazil the 1990s were the period of privatization of some subsidiaries and the improvement of some environmental regulations. As shown in this essay, it was during the 1970s that both companies really established the framework that would determine

most of its actions for the following decades. The biggest mistake for Mexico was to plan its strategy under the assumption that oil was eternal. I hope that with the approval of the energy reform approved today December 13, 2013 the government does not commit the same mistake and learns whatever is useful from the experience of Petrobras in the 1980s and 1990s.

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