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How Could Pemex be Reformed? An Analytical Framework Based on Congressional Politics

Importante

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Abstract

We analyze the feasibility of legal reforms to the Mexican oil industry. We do so by studying the politics of energy reform as they occur in Congressional negotiations. The main contribution of the paper is to offer an analytical framework based on the following elements: identifying the main issues regarding Pemex; identifying the main political agents in charge of reform; and locating the positions of these agents on those issues. Our analysis is aided by a series of original graphs that help us visualize the kind of coalitions that are conducive to change. We claim that three issues will tend to dominate the debate: private investment, labor accountability, and fiscal autonomy. The agents that we identify as being pivotal in creating a new legislation are: the Chief Executive; the three major parties, namely the PAN, the PRD, and the PRI; and the internal factions within each party. We use this framework to understand past reforms such as those of 2008, and to speculate about future reforms that might be attempted in the period 2012-2018.

Keywords: PEMEX, oil, Mexico, Congress.

Resumen

Analizamos la posibilidad de que se realicen reformas legales a la industria mexicana del petróleo. Para ello, estudiamos la política detrás de las reformas energéticas, especialmente durante las negociaciones en el Congreso. La contribución principal de este ensayo es ofrecer un marco analítico basado en los siguientes elementos: identificar los temas principales con respecto a Pemex; identificar a los actores principales a cargo de las reformas; y ubicar las posiciones de estos agentes en esos temas. Nuestro análisis se ayuda de una serie de gráficas originales que nos permiten visualizar los tipos de coaliciones que podrían llevar al cambio. Argumentamos que son tres los temas que tenderán a dominar el debate: la inversión privada, la redición de cuentas laborales y la autonomía fiscal. Los actores que hemos identificado como determinantes para crear legislación nueva son: el jefe del ejecutivo; los tres partidos principales, es decir el PAN, el PRD y el PRI; y las facciones internas de cada partido. Usamos este marco analítico para entender reformas pasadas tales como la de 2008, y para especular acerca de reformas futuras que podrían intentarse en el periodo 2012-2018.

Palabras clave: PEMEX, petróleo, México, Congreso.

Introduction

Today Pemex seems exceptionally difficult to reform. Mexico's giant oil company is facing daunting challenges as it struggles to maintain its levels of productivity. Most worryingly, its production of oil has steadily decreased for several years in a row, and although official figures recently show some stability, deep structural changes would be needed to restore production growth. There is disagreement on specific proposals, but most policymakers agree that an overhaul of some kind is necessary.¹ Most proposals require revisions to the legal framework, management structure or fiscal regime of Pemex. Accordingly, several high-ranking politicians (including the last three Presidents) have sought to modernize the oil company. Progress has been elusive, however. Reforms were passed in 1993 and 1995, but subsequent attempts to implement significant changes have largely failed. A reform did pass in 2008 but, as we mention later, the new legislation was far less ambitious than originally planned. The polarization of ideological positions among governing elites has made any consensus virtually impossible to reach. In particular, a strict interpretation of *resource nationalism* has seriously narrowed the range of changes that are politically acceptable (Mares, 2011). In the meantime, as we document below, the oil industry in Mexico is showing three worrisome trends: a decline in production, a decline in reserves, and a decline in exports.

The goal of this paper is to analyze the possibility of reform in the Mexican oil industry: Why is it so hard to achieve? Why was the last reform so modest? And what needs to happen for profound changes, in any of the proposed directions, to be achieved in the future? We pay special attention to the political factors underlying the reform process: the main stakeholders, their interests, their ideologies, and their negotiations in Congress. We hope this analysis will clarify the steps that need to be taken for reform-minded policymakers to succeed in modernizing a company of such significance.

The stakes are large for the Mexican people whose well-being is still linked to oil revenues. Indeed, petroleum and its derivatives are a fundamental part of the Mexican economy. Any decline in oil production can be expected to have a negative effect on the economy. Furthermore, the government remains highly dependent on taxes levied on the oil industry: in the past eight years, between 22 and 44% of the Federal Government Revenue has come

¹ As we describe in much detail later, by "reform" we understand one of the three most mentioned initiatives: increasing the participation of private capital (most mentioned by PAN politicians); or increasing the public funds for research and investment (most mentioned by PRD and PRI politicians); or making labor and management more efficient at Pemex (mentioned by both PAN and PRD politicians but not so much by PRI politicians). There exist, of course, other less-publicized reforms that we do not focus on here.

from royalties paid by Pemex.² So, if Pemex continues to slow down, the government's long-run fiscal balance will be in doubt.

The stakes are high for the global market as well. Among oil companies in the world, Pemex is the eleventh largest overall, and the fifth largest state-owned company.³ Thus an absence of Mexican oil could lead to further increases in international prices. This would be particularly hurtful to American consumers since the United States relies on oil supplies from its southern neighbor, which is one of its three largest suppliers. Such being the stakes, it is worth asking why changes to the oil industry in Mexico are so slow to come about.

We claim that any solution to Pemex's situation is ultimately political. Without able political maneuvering, the status quo will prevail indefinitely. Pemex will stagnate and oil production will continue to decline. Therefore, a good understanding of the political process in Mexico is crucial for improving the odds of a future reform of the energy sector. Note that any reform must be the product of legislative negotiations in Congress. So the crucial role of political elites and government institutions should not be underestimated. Public opinion is decisive as well.

And yet, political analyses of energy reform are hard to find. In spite of an active debate in terms of policy advocacy, little analysis has been done about the political constraints. A notable exception is Elizondo (2011) who describes all the attempted energy reforms of the last five administrations, from President De la Madrid to President Calderón. More research of this kind is worth doing if we are to understand the barriers to modernization.

With that purpose in mind, this paper develops a new framework to study the politics of energy reform in Mexico. We use concepts from several theoretical traditions in political science.⁴ In particular, we will suggest a way to analyze the formation of congressional coalitions based on specific graphs to visualize the positions of different political actors.

The contribution of this paper is fourfold. First, we identify the main issues of contention that systematically arise in debates and negotiations to reform Pemex. We claim that three issues capture most of the tension between the main political actors: the involvement of private capital in the oil industry; the accountability of the labor union; and the fiscal burden on Pemex. Second, we identify the positions of the main stakeholders on those issues. Political parties, the Executive, and other key players have strong preferences on those three dimensions that will determine the type of commitments they are willing to agree to. Third, we study the types of

² For instance, in 2010 the revenue from "rights to oil" as a percentage of the federal government's revenue was 30.8%.

³ According to the list of largest oil companies created by Petroleum Intelligence Weekly based on 2009 data. See www.energyintel.com/Pages/About_PIW.aspx.

⁴ We mainly use concepts from the *spatial voting model*, which characterizes policy issues as linear dimensions, and depicts ideological positions as points in space.

coalitions that have been formed in the past and might be formed in the future in order to pass new legislation. The need for coalitions, and the type of coalitions that can be formed, hinge on the structure of Congress and the specific lawmaking rules in Mexico. And fourth, we analyze the possibility of future reforms. Based on our conceptual framework, we suggest some of the events that could allow significant agreements to be reached in future administrations. But we start by providing some context about the situation of Pemex.

The current challenges of Pemex

Pemex is currently facing several hurdles. As other authors have pointed out, the situation of the Mexican oil industry in general is not optimistic (Whitehead, 2011). Notably, oil production has been declining steadily in the past years. It peaked in 2004 with an average of 3.4 millions of barrels per day, but it has decreased year after year since then. The average for the month of June 2011 was only 2.5 millions of barrels per day.⁵

Exports are also falling. In addition to a decrease in production there has been an increase in the domestic demand for gas, oil and petrochemical products in general. Given that Mexico's consumption of hydrocarbons has been increasing as the country has industrialized, a larger fraction of oil production is allocated for internal use. Consequently, the export of oil is also falling at a fast rate (SENER, 2007). In fact, if Mexico fails to acquire the technology necessary for new discoveries, it will become a net oil *importer* within ten years (Medlock and Soligo, 2011).

In addition, the pace of new discoveries is no longer enough to replace the exploitation of existing reserves. Pemex's replacement ratio is lower than most other oil companies in the world. As a consequence, the oil reserves that Mexico can count on have declined year after year. The total reserves were 62.1 billion barrels in 1995, but they have decreased to 43.1 billion in 2010. Based on those figures, President Calderón famously disclosed that Mexico's existing reserves could only last nine more years.⁶

Such decline is mainly a consequence of new geological constraints. The easy reserves to be found and exploited are becoming rare. And the areas that are known or suspected to have large reserves are difficult to explore and exploit. Much oil is suspected to exist in the Gulf of Mexico, buried under 1,500 meters of water. But those reserves are hard to reach as they require modern technology for deep-water exploration. Currently the Mexican State lacks both the technology and the expertise to explore beyond the shallow waters where it knows how to operate. Furthermore, for those ventures to be

⁵ According to Pemex figures consulted at www.ri.pemex.com/files/dcpe/petro/eprohidro_esp.pdf.

⁶ Strictly speaking, Calderón's remark applies only to *proved* reserves. If we add the *probable* and *possible* reserves, Mexico has enough oil until the year 2035 (Alberro, 2007).

financially viable they require a proper allocation of risk among multiple partners. However, as we discuss in detail later, the current legal framework hampers Pemex's ability to partner with service providers that have the technological knowhow. Indeed, the Mexican regulation is one of the most restrictive in the world as it precludes most types of joint ventures with other oil companies (Grunstein, 2011b).

In addition to these geological challenges, Pemex faces a number of structural problems. The company's operation is far from efficient. Pemex has a powerful union that exerts much influence in the company's management. Employees are nearly impossible to layoff, and the union serves as gatekeeper for new hiring (De la Calle, 2007). Another source of inefficiency is the degree of clientelism that pervades the company. Many of its economic activities are captured by interest groups and rent seekers of different sorts. Corruption is common both in downstream activities, such as transportation, and upstream activities where juicy contracts are granted in less than transparent ways (Elizondo, 2011).

On top of its internal problems, Pemex is burdened by an excessive bureaucratic oversight. Nearly all financial decisions, large and small, need to be officially approved by the Secretary of Treasury.⁷ This includes most decisions about investment and debt. The Secretary of Treasury also imposes a large tax levy on the company. Royalties and sales taxes tend to deplete Pemex's revenues leaving little scope for reinvestment and recapitalization.⁸

There is a consensus among experts that changes are needed in Pemex. But there are drastically different views on what those changes should be. Ideology tends to play a big role in the types of reforms that different politicians are willing to support. Those differences need to be reckoned with if any change is to happen. In particular, any significant reform will entail changes to the law. Those changes will need approval from Congress and therefore will require negotiations between the Executive and the Legislative branches, as well as between the different political parties. Reformers will also have to confront highly mobilized groups whose interests are affected.

For those reasons, we claim that any solution to Pemex's situation is ultimately political. Our analysis of the process of energy reform starts with a brief overview of the rules and institutions governing lawmaking in Mexico. Subsequently, we proceed to analyze the main actors and the main issues behind the oil industry.

⁷ Interview with an official in the department of Finance and Treasury of Pemex (*Financiamientos y Tesorería*).

⁸ It can actually be argued that the Secretary of the Treasury has an even tighter control over Pemex than the secretary of Energy (I thank Ignacio Marván for this remark).

Legislative rules and institutions

Congressional gridlock has been one of the major obstacles for any structural reform in Mexico, including energy reform. The Executive is quite limited in what it can accomplish on its own, given that changing the regulatory framework requires passing new legislation through Congress. Regarding the oil industry, the Executive could implement some administrative and managerial modifications by decree, but any substantive change to the industrial model would require passing new legislation through Congress. The statutes that need modification are well known: some reforms require modifying ordinary laws; other reforms require amending the Constitution. Either way, difficult negotiations and major concessions are needed.

Even during the hegemonic period of the Party of the Institutional Revolution (PRI), reform-minded executives found it difficult to open up Pemex. Presidents still had to negotiate with internal factions within the party, such as the Pemex union and other PRI members of nationalist ideologies (for a detailed survey of those reform attempts, see Elizondo, 2011).

With democratization in the 1990s, opposition parties became assertive players in Mexican politics and Congress became a central institution in Mexico's governance. Hence it is worth understanding how laws are made in Mexico. This section describes briefly some of the relevant rules and institutions governing this legislative process.

Legislative bills can be initiated by Congress or the Executive. Either way, any new legislation needs to be approved in both chambers: the Senate, i.e. the Upper House, and the Chamber of Deputies, i.e. the Lower House. Importantly, legislators are not allowed to seek reelection in consecutive terms. Hence, Senators and Deputies are highly dependent on their parties for subsequent promotions. This no-reelection rule is one of the sources of the exceptional discipline that party leaders can exert on their delegates in Congress.

Negotiations about Pemex and the oil industry have usually been spurred by two kinds of initiatives: fiscal and budget initiatives, and energy initiatives. Both types of negotiations will be analyzed in this paper.

Changes to an ordinary law require a simple majority in Congress, namely 50% of the votes cast. In contrast, changes to the Constitution require a supermajority of votes in Congress, namely two thirds of the votes in each chamber plus the approval of a majority of state legislatures.⁹ These calculations must enter the strategy of any reformer.

The oil industry is regulated at both levels. At the Constitutional level, a strict ownership of petroleum and other natural resources is granted to the

⁹ Article 135 of the Mexican Constitution.

State.¹⁰ More importantly, the Constitution puts the State *exclusively* in charge of the economic activities deemed strategic.¹¹ The strategic areas include petroleum and all other hydrocarbons as well as basic petrochemicals.¹² In effect, these Constitutional articles establish a state-monopoly in most activities related to oil. At the ordinary-law level, the statutes accompanying the Constitution reinforce the State's monopoly in oil-related activities.¹³ Reformers need to choose their goals carefully: a legal battle to change the Constitution would presumably be more meaningful, but tougher, than changing ordinary laws.¹⁴ In 2008, President Calderón chose the latter: he explicitly ruled out any Constitutional amendments, and therefore the initiative he sent to Congress pertained only to statutory laws (Riva Palacio, 2009). Indeed, he calculated this was the only kind of reform that could get past the major political parties in Congress (Farfán *et al.*, 2009).

Mexico has a stable party system. The three main political parties are the National Action Party (PAN), the Party of the Democratic Revolution (PRD), and the Party of the Institutional Revolution (PRI). We describe the ideologies and preferences of those parties in more detail later, especially in regards to oil issues.

Those three parties are strong, well defined, and hierarchical. Such is the strength of the PAN, the PRD and the PRI, that many observers consider them to be holding a monopoly of power: they compete with each other but they jointly dominate politics (Serra, 2011). They have large memberships and large bases of support. They tend to be exceptionally disciplined in Congress, such that all the legislators nearly always vote the party line (the past six years have been the exception, where the vote of PRD legislators has been divided on some issues). In the past two decades, all three parties have held solid shares of seats in Congress. The following figures depict the configuration of the Legislatures following the 2006 presidential election and the 2009 midterm election.

¹⁰ For example, Article 27 of the Mexican Constitution states that hydrocarbons are owned by the Nation, and such ownership is not transferable (*inalienable*), does not lapse (*imprescriptible*), and is not subject to seizure (*inembargable*).

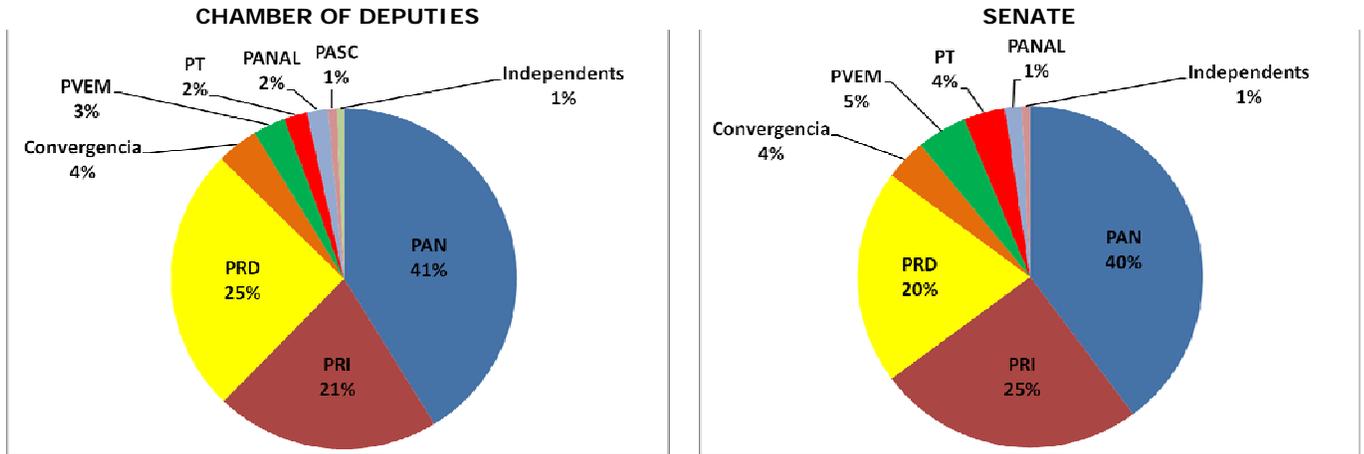
¹¹ Article 25 of the Mexican Constitution.

¹² Article 28 of the Mexican Constitution.

¹³ For example, a well-known ordinary law states that only the Nation is allowed to exploit hydrocarbons, and it should carry out the activities of a petroleum industry as a monopoly (Article 2 of the *Ley Reglamentaria del Artículo 27 Constitucional en el Ramo Petrolero*).

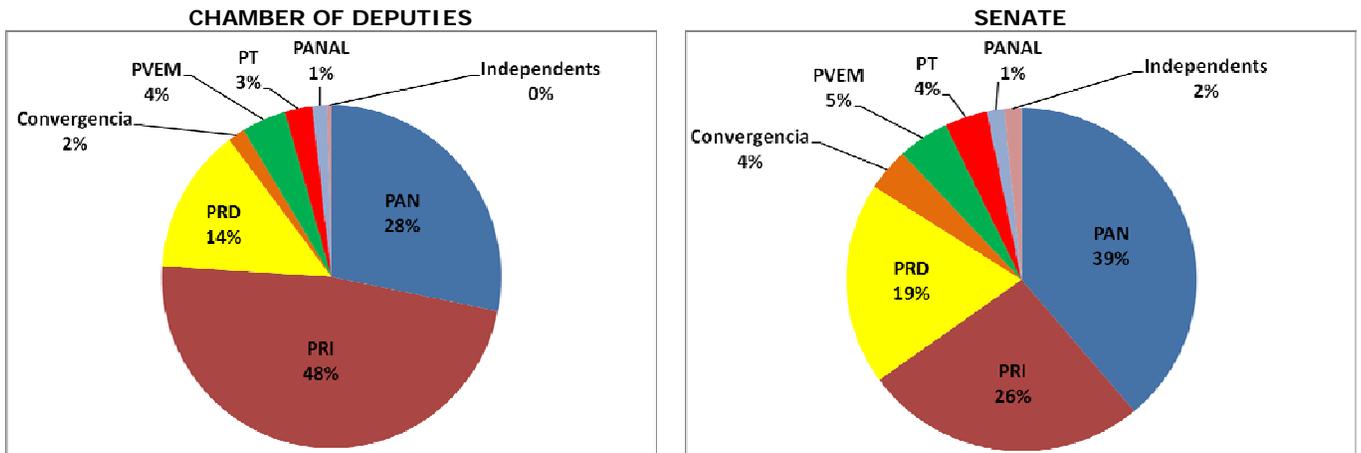
¹⁴ Some fundamental regulation can also occur at lower levels of the law as well. An example is Article 62 of the rulebook accompanying the Pemex law that accompanies Article 27 of the Constitution. That technical statute is in charge of defining the terms of the contracts to service providers, which is one of the most controversial issues in Mexican politics (Grunstein, 2011a).

FIGURE 1. PARTIES' SHARE OF SEATS IN THE LX LEGISLATURE, 2006-2009



Source: Secretaría de Gobernación, Sistema de Información Legislativa: <http://sil.gobernacion.gob.mx/portal>

FIGURE 2. PARTIES' SHARE OF SEATS IN THE LXI LEGISLATURE, 2009-2012



Source: Secretaría de Gobernación, Sistema de Información Legislativa: <http://sil.gobernacion.gob.mx/portal>

As we can tell from those figures, usually no party has more than fifty percent of the seats in Congress. We can also see that any coalition of two of the three major parties can reach a majority of votes, and can thus change ordinary laws. However, all three major parties are needed to reach the supermajority needed to change the Constitution.

Such being the institutional context of energy reforms, now we analyze their possible substance. What are the main issues that parties can be expected to bargain over in Congressional negotiations?

Issue dimensions

The topic of oil production is complex, with countless implications and ramifications. Its regulation is also complex. The Mexican law includes several statutes and clauses relating to the energy sector with a wide array of consequences. However, when it comes to fundamental reforms only a few key issues tend to come to the forefront of discussions. We are aiming to identify what those key issues are.

This is certainly the case in the public debate: of the numerous facets of the oil industry, the public debate has tended to focus mostly on a few hot buttons. We have observed that the media, for example, tends to comment on topics that create passion, such as the privatization of Pemex, while ignoring topics that are less sensational, such as the development of green energy. Political parties, for ideological and practical reasons, also tend to take strong positions on only certain topics but not others. Likewise, ordinary citizens tend to form an opinion on broad problems, such as corruption, rather than forming an opinion on detailed minutiae, such as specific extraction technologies. So we can expect the public debate to center around a handful of hot topics. For empirical accuracy it is thus pertinent to identify the issues that are most salient in the public debate.

We are also interested in pointing out the issues that are most divisive among political actors. Upon studying past energy reforms, it is apparent that politicians spend most of their time debating a few sticking points. For example, the Congressional negotiations to reform Pemex in 2008 were dominated by arguments over risk-sharing contracts, managerial flexibility, and fiscal autonomy. We believe this pattern can be generalized: future negotiations can be expected to center around a handful of issues that deeply separate the ideological positions of the different parties. In order to understand past and future negotiations, it is worth indicating what those core issues could be.

For this paper we have identified three such issues. To be precise, we postulate that most of the contentious points of oil reform in Mexico can be organized in three broad dimensions. Those dimensions are the following: (1) The degree to which private capital can and should participate in exploration and other economic activities of Pemex. We call that dimension *Private Investment*. (2) The degree of benefits and influence granted to Pemex employees and their union. We call that dimension *Labor Accountability*. And (3), the amount of income that Pemex should be allowed to keep rather than being transferred to the government, as well as the freedom granted to Pemex to acquire debt and allocate its funds. We call that dimension *Fiscal Autonomy*. Those three topics are summarized in Table 1. They have created the most tension among political actors in past

negotiations to reform Pemex, and we believe they will capture most of the action in any future negotiation as well.

TABLE 1. THE THREE MAIN ISSUES OF ENERGY REFORM IN MEXICO

PRIVATE INVESTMENT	THE DEGREE TO WHICH PRIVATE CAPITAL CAN AND SHOULD PARTICIPATE IN EXPLORATION AND OTHER ECONOMIC ACTIVITIES OF PEMEX.
LABOR ACCOUNTABILITY	THE DEGREE OF BENEFITS AND INFLUENCE GRANTED TO PEMEX EMPLOYEES AND THEIR UNION.
FISCAL AUTONOMY	THE AMOUNT OF INCOME THAT PEMEX SHOULD BE ALLOWED TO KEEP RATHER THAN BEING TRANSFERRED TO THE GOVERNMENT, AS WELL AS THE FREEDOM GRANTED TO PEMEX TO ACQUIRE DEBT AND ALLOCATE ITS FUNDS.

We now describe those three important topics in more detail.

❖ Private investment

The most sensitive issue is the degree of private participation in Pemex activities. It is also one of the issues that create the most confusion. In Mexico, the issue is often believed to be dichotomous: whether private capital should be allowed or banned. In reality, however, there is a wide range of possibilities for the involvement of private capital (Benton, 2010). As we show below, the involvement of private investment in a country’s oil industry is actually a matter of degree.

There is additional confusion about the real intentions of reformers. Often, they are accused of intending to privatize Pemex. For instance, opponents of the 2008 reform claimed that President Calderón’s initiative was aiming at selling the state oil company (Langston and Pérez, 2009). A cursory reading of Calderón’s initiative, however, reveals that nothing about selling the company was included. In reality, only a trivial number of pundits, if any, are proposing an all-out privatization of the firm. Even the analysts who wish to liberalize the oil sector, such as Alberro (2007) and de la Calle (2007), tend to agree that Pemex should remain a state-managed company and that Mexican oil should remain under control of the government. So we have not found the privatization of Pemex to be one of the principal issues in Congressional negotiations.

Rather, the key issue is whether private capital should be allowed to *partner* with Pemex. For example, a large part of the debate during the 2008 reform revolved around the types of contracts that Pemex should be allowed to celebrate with its private partners. The question is the level of incentives that should be granted to service providers.¹⁵ The reformers ideally would implement risk-sharing and production-sharing contracts with other NOCs and IOCs. They believe that permitting such collaborative schemes would give

¹⁵ For a list of the possible types of incentive contracts see Grunstein (2010).

Pemex access to the technology and expertise it currently lacks for drilling in deep water. On the other hand, the nationalists believe such incentives go too far because they give too much control to non-sovereign entities. They fear this would put energy security at risk (Mares, 2011).

Another sticky point is whether other firms should be allowed to *compete* with Pemex in Mexican territory. For example, some policymakers claim that private firms should be allowed to build and operate refineries.¹⁶ Others suggest that foreign oil companies should be allowed to extract Mexican oil.¹⁷ Another proposal is to allow different brands of gasoline to be sold in Mexico by retail distributors.¹⁸ In all cases, a stronger Energy Regulatory Commission would need to be designed in preparation for external competition.¹⁹ Such external competition, it is believed, would force Pemex to become more efficient.²⁰ But the traditional view is to consider such liberalization to be unconstitutional.²¹ Traditionalists are also wary that sharing the market with other producers would dilute Mexico's sovereignty.²²

TABLE 2. PRIVATE INVESTMENT DIMENSION

THIS DIMENSION MAY INCLUDE:	
IN TERMS OF PARTNERING	<ul style="list-style-type: none"> ▪ PAYING A BONUS TO SERVICE PROVIDERS IF PRODUCTION EXCEEDS THE GOAL; IF DEADLINES ARE MET; IF THERE IS SOME TRANSFER OF TECHNOLOGY. ▪ TYING PAYMENTS FOR SERVICES TO INTERNATIONAL PRICES; TO AGGREGATE PRODUCTION; TO THE PROFITABILITY OF THE WELL; TO THE OVERALL VALUE OF THE PROJECT. ▪ GRANTING RIGHTS TO PARTNERS OVER PRODUCTION; OVER INCOME FROM SALES; OVER RESERVES.
IN TERMS OF COMPETING	<ul style="list-style-type: none"> ▪ ALLOWING PRIVATE FIRMS TO BUILD AND OPERATE REFINERIES; HANDLE GAS AND PETROCHEMICALS; EXTRACT MEXICAN OIL; GIVE MAINTENANCE TO PIPELINES. ▪ ALLOWING MORE COMPETITION IN TRANSPORTATION, STORAGE AND DISTRIBUTION. ▪ BREAKING THE MONOPOLY IN THE TRANSFORMATION AND MARKETING OF HYDROCARBONS. ▪ AUTHORIZING NON-PEMEX GAS STATIONS. ▪ LIFTING TRADE BARRIERS IN ENERGY GOODS (I.E. ALLOWING MORE IMPORTS). ▪ STRENGTHENING REGULATORY AGENCIES.

In sum, what really divides political actors is the degree to which private capital should be allowed to *partner* and *compete* with Pemex. In Table 2

¹⁶ Alberro (2007).

¹⁷ Elizondo (2011).

¹⁸ de la Calle (2007).

¹⁹ Ballinas (2011).

²⁰ Hartley and Medlock (2011).

²¹ Riva-Palacio (2009).

²² Fuentes Berain (2008).

above, we list some of the elements that would increase the overall participation of private capital in the Mexican oil industry. The more of those elements are proposed by a party, the farther that party will be located in the dimension that we have called *Private Investment*.

❖ Labor accountability

There seems to be a wide consensus that the powerful union of Pemex workers is holding the company back. The workers themselves are not necessarily the culprits. There is much respect for Pemex engineers, who get frequently praised by analysts on both sides of the political spectrum. And Mexicans have much sympathy for oil workers, many of whom risk their lives to get us our daily supply of petrochemical products.

But the union is a corporatist structure that exerts a significant influence on Pemex.²³ In fact, workers in the oil industry are among the most untouchable in the public sector. In particular, their labor contracts are exceptionally rigid. It is virtually impossible to fire them, even when their positions become redundant. It is also hard to convince them to transfer to new geographical locations. So, when a well dries out, most of the employees remain in place.²⁴ According to some calculations, about eleven thousand employees (meaning eight percent of the staff) are being paid to do no work at all (Elizondo, 2011). Such rigidities are clearly a cause of inefficiency in Pemex operations. Every refinery in Mexico, for instance, is losing money due to those labor arrangements, according to de la Calle (2007).

Work benefits are also a financial problem. Workers enjoy a number of expensive perquisites such as gasoline stamps and Pemex-exclusive hospitals.²⁵ Pensions and social security are relatively large in comparison with the rest of the public sector and even the private sector. The generous pensions are becoming a particular concern since they are unfunded. They represent a large debt for the company. The lack of funding for current and future pensions is aggravated by the fact that the staff is aging: the average age of Pemex workers is 55, older than the national average (De la Calle, 2007).

The union has created other types of inefficiencies. It serves as gate-keeper for new hiring, which has led to many instances of abuse and corruption. For example, it is known that the union sells new positions in Pemex for lucrative bribes charged on incoming employees. So, if there is a job-opening, the position might not go to the most qualified candidate, but it will probably go instead to someone who is well connected with a union leader and is prepared to pay a large fee. Moreover, many low-level positions

²³ The union's name is *Sindicato de Trabajadores Petroleros de la República Mexicana* (STPRM).

²⁴ Interview with an official in the department of Finance and Treasury of Pemex (*Financiamientos y Tesorería*).

²⁵ Benefits are onerous for non-unionized employees too, especially for high-level officials.

are effectively hereditary as the union ensures they are smoothly transferred from father to son.

Reformers would like workers to be more accountable. They would like labor contracts to be more flexible and agile, and the union's behavior to be more transparent and cooperative. In general terms, policymakers would like the union to take more responsibility for the modernization of Pemex. On the other hand, the current workers benefit from the status quo. Hence the tacit goals of the Pemex union are to preserve its existing prerogatives, expand the number of unionized workers, and increase its influence in the company's decisions.

TABLE 3. LABOR ACCOUNTABILITY DIMENSION

THIS DIMENSION MAY INCLUDE:
<ul style="list-style-type: none"> ▪ ALLOWING MORE FLEXIBLE LABOR CONTRACTS. ▪ ENSURING A MORE TRANSPARENT AND DEMOCRATIC SELECTION OF UNION LEADERS. ▪ RENEGOTIATING THE OUTSTANDING PENSIONS. ▪ DECREASING THE UNION'S INFLUENCE IN THE BOARD OF DIRECTORS. ▪ ELIMINATING CORRUPTION IN HIRING.

In Table 3 above we list some of the elements that would increase the overall accountability of the Pemex union to the government and to the Mexican people. The more of those elements are proposed by a party, the farther that party will be located in the dimension that we have called *Labor Accountability*.

❖ Fiscal autonomy

The amount of taxes and royalties levied on Pemex is also frequently mentioned as a major problem for the company. According to some calculations, the tax burden on Pemex currently amounts to 72% (Starr, 2007). This does not leave much money for exploration and other investments that Pemex needs to make. Moreover, Pemex's budget is quite unpredictable as it needs to be renegotiated every year. The Chamber of Deputies is in charge of approving the spending of all public entities, including Pemex. This makes the Deputies the de facto shareholders of the company.²⁶ It also forces the director of Pemex to lobby Congress for new funds year in and year out.

Therefore, it is not surprising that many politicians have called for a reduction of the tax burden on Pemex. The ideological affiliation of such politicians is not necessarily predictable, however. We claim that ideology plays a secondary role on the position that political actors will take on this

²⁶ Interview with Allyson Benton.

issue. What will matter most, we believe, is whether a politician belongs to the incumbent party holding office, or whether he is in the opposition.²⁷

On one hand, incumbents need resources to run the government and carry out their projects. As such, they will strive to maximize the government's income, and they will resist any significant reduction on Pemex's taxes which have fed the government for decades. As illustrated by the PAN administrations, the incumbent's impulse to resist tax reductions cuts across ideological lineages.

On the other hand, opposition parties have more freedom to advocate for tax reductions, as it is not their program that needs resources for implementation in the immediate future. Hence, they will have more freedom to take popular positions, such as reducing the tax burden on Pemex and giving it more autonomy to make spending decisions. Such was the case during the 2008 energy reform, where the PRD and the PRI argued to increase the company's fiscal autonomy, especially its ability to acquire debt. To the incumbent's chagrin, they also advocated for a reduced oversight from the Treasury Department to make Pemex more agile.

TABLE 4. FISCAL AUTONOMY DIMENSION

THIS DIMENSION MAY INCLUDE:
▪ REDUCING ROYALTIES, VALUE-ADDED TAXES, AND OTHER LEVIES ON THE OIL INDUSTRY.
▪ GRANTING PEMEX MORE AUTONOMY IN SPENDING AND INVESTMENT DECISIONS.
▪ REDUCING THE BUREAUCRATIC OVERSIGHT FROM THE TREASURY DEPARTMENT.
▪ RAISING THE COMPANY'S DEBT CEILING.

In Table 4 above we list some of the elements that would lighten the fiscal load on Pemex. The more of those elements are proposed by a party, the farther that party will be located in the dimension that we have called *Fiscal Autonomy*.

❖ A three-dimensional framework

Taken together, those three topics serve as our conceptual framework. We refer to each of those topics as an "issue-dimension" or a "policy-dimension" because they neatly separate the positions of different political actors as distinct points on a continuous line. We suggest that this three-dimensional framework can serve as a starting point to analyze energy reforms in Mexico.

²⁷ For a similar argument see Farfán *et al.*, (2010, pp. 313-314). They claim that: "La dependencia histórica de los ingresos fiscales sobre los hidrocarburos explica, en gran medida, la oposición a cualquier cambio que implique la pérdida de dichos recursos por parte (...) del presidente en turno, independientemente de su perfil ideológico. (...) La problemática fiscal trasciende incluso las posturas ideológicas sobre el tema. (...) Es decir, mientras que el gobierno establecía las bases para incrementar la recaudación, la oposición (...) trataba de asegurar mayores recursos para Petróleos Mexicanos."

Other subtleties and ramifications of the political process can be incorporated to this initial framework in future research. In particular, we believe other important issues can be added to this policy space as new dimensions. We now mention several important issues that we have decided to exclude for now. We are excluding them in this initial paper because, in spite of being germane, they have played a secondary role in actual negotiations among political actors regarding the oil industry.

❖ Other issues

There are of course many other issues that would be important to include in a comprehensive energy reform. For example, the questions of finding renewable sources of energy as well as minimizing the environmental damage of Pemex activities are crucial, and they were mentioned in 2008. Unfortunately, however, those issues only played a secondary role in the debates and were not even part of the original initiative discussed in Congress.

Some of the other issues that may arise in future negotiations include the following:

1. Changing the management structure of Pemex to operate more efficiently.
2. Ensuring the managerial autonomy of Pemex with respect to Congress (thus reversing the current trend of increasing the influence of political parties).
3. Fine-tuning the controversial plan to issue "citizen bonds", which was approved in 2008 but is still at the design stage.
4. Moving towards sustainability and finding alternative sources of energy and protecting the environment.
5. Including discussions of the electricity sector in addition to the oil sector.

Note that our goal was to identify the issues that have lied at the core of past reforms, and distinguish them from other issues that, in spite of their importance, have actually taken a backseat in Congressional negotiations. As we mentioned before, we believe that three issues tend to capture all the attention, while other issues tend to take a backseat. We now identify the main political actors and the positions they can be expected to take on those issues.

The main actors and their policy positions

The next step in understanding the reform process is to identify the actors that are most influential. Politics in Mexico are dominated by a few individuals and organizations who act as the main powerbrokers when it comes to passing new legislation in Congress. Our goal is to identify them and describe their preferences on the main dimensions of energy reform.

A legal initiative of the magnitude of an energy reform needs to be spearheaded by a determined leader. The President of the country has typically provided such leadership but, in theory at least, a strong congressional boss could also be the promoter of a future reform. In 2008, it was President Calderón who designed and sent an initiative to Congress. Once received, it is up to the major political parties to decide whether to approve, reject or amend an initiative. As we mentioned earlier, Mexico has three large parties that control Congress: the PAN, the PRD and the PRI. Given the pivotal influence they have in passing any reform, those are the main agents to consider, as summarized in the next table.

TABLE 5. THE MAIN POLITICAL ACTORS IN CONGRESSIONAL NEGOTIATIONS

▪ THE PRESIDENT
▪ THE PAN
▪ THE PRD
▪ THE PRI

There are of course several other actors that have, or try to have, some influence in the process. We consider those actors to be secondary because their influence is either smaller (as with smaller parties), or they do not directly vote in Congress in spite of having a strong indirect influence (as with the union). They include:

1. The smaller parties represented in Congress: PVEM, PT, Convergencia, PANAL
2. The Pemex union
3. Academics, intellectuals and the media
4. Public opinion
5. International oil companies

We now analyze the main actors and their positions on the main issues.

❖ The Executive branch and the President

For the foreseeable future, the President of Mexico will be issued from one the three large parties, the PAN, the PRD or the PRI. He or she might not have full control that party, however. The President is likely to be closely identified with a certain faction within his or her party, but he or she might differ from the ideological positions of other internal factions. Thus, to garner support for a government initiative, the President always needs to engage in some internal negotiations in addition to the external negotiations with the other parties.

Consequently, in terms of policy preferences, we will assume that the President is represented in Congress by one of the dominant factions within his or her party, but other legislators in the same party might represent different factions. We describe such factions for each party below.

❖ The PAN

In general terms, the PAN is a center-right party with a long tradition of advocating economically liberal policies. For most of the twentieth century, the PAN was the most prominent opposition to the hegemonic PRI. After democratic reforms in the 1990s that leveled the playing field in elections, the PAN routed the PRI by winning the 2000 election with Vicente Fox as its candidate. The PAN won the presidency again in the subsequent election of 2006. Thus it currently holds power with President Felipe Calderón until 2012. We should note that Mexico does not allow the reelection of presidents, which implies that all administrations, including the current one, can only last for one term.

Of all the major parties, the PAN is usually the least divided. Factions exist, but differences of opinion have tended to be resolved internally such that a unified front can be presented in congressional negotiations. This was patent while preparing the energy reform of 2008. To be sure, it was reported that some divisions existed within the PAN and the government. More specifically, there was an “entrepreneurial” faction who wanted more liberalization than President Calderón considered prudent to fight for at that point in time. On the other hand, there was another faction called the “humanists” who shared the more pragmatic strategy of the President. Ultimately, all factions rallied behind the Executive’s initiative.

On the issue of private investment, the PAN has insisted on the need to partner with big transnational companies to carry out deepwater exploration and other upstream activities for which Pemex lacks expertise. For that purpose, it advocates for more flexible contracts that include economic incentives to service providers. Moreover, consistent with its traditional market-friendly ideology, the PAN would also prefer to delegate to the private

sector the construction of refineries, ducts, storage, and other downstream activities.

On the issue of labor accountability, the PAN has avoided making explicit statements in public as it wishes to avoid a direct confrontation with the union. But we can infer that “Panistas” share the view of many technocrats that Pemex would be better off if the union was weakened. According to this view, the strong grip that union leaders have on the company is blocking the liberalization of the oil sector and is preventing the modernization of Pemex. Consequently, the union should be forced to sit at the negotiating table to make serious concessions. It should be noted, however, that in spite of such views both President Fox and President Calderón were unwilling to oppose the union during their own administrations out of fear of a possible retaliation. In future energy reforms, we can speculate that Panistas will continue to be unwilling to push this issue by themselves: only a large coalition of partners that includes the PRI is likely to convince the PAN to finally challenge the union’s interests.

On the issue of fiscal autonomy, the PAN has had mixed motivations. On one hand, its entrepreneurial instincts would normally be to lower the tax burden on Pemex allowing it to operate as a rational firm. On the other hand, the PAN has been running the federal government since 2000, thus needing to raise fiscal funds to carry out its program. In the end, its ideological views were dwarfed by the very pragmatic desire to have fiscal funds throughout the administration. Such was the case throughout the Calderón administration where the first Secretary of the Treasury, Agustín Carstens, endeavored to quell the sustained pressure from opposition parties to give more funds to Pemex. Future positions on the fiscal issue will depend on whether the PAN is in the opposition or is the incumbent.

❖ The PRD

The PRD was born out of a broad alliance of left wing parties that ranged from left-of-center dissidents of the PRI all the way to smaller communist parties. As a result, it generally supports socially liberal issues, and it advocates distributive policies in favor of the most vulnerable groups in the population. It has never won a presidential election but it came very close in 2006 when it lost by a razor-thin margin.

The PRD is deeply divided. From birth, the party has served as an umbrella organization for a number of subgroups commonly known as “tribes”. Recently, however, two factions have dominated the party. The first one is officially called *Nueva Izquierda*, but is most commonly known as the “Chuchos”. This faction commands most of the bureaucratic positions in the PRD, including the last two Chairmen of the party. It also commands the loyalty of most PRD legislators in Congress. *Nueva Izquierda* is considered the

moderate faction within the party. Indeed, they have been the most willing to engage with President Calderón and negotiate with other parties.

On the other hand, the second dominant faction has explicitly ruled out any communication with the government. This faction is loyal to Andrés Manuel López Obrador (AMLO), who was the PRD candidate in the 2006 election. AMLO never accepted his defeat, however. Since the election, he has used his influence to dissuade the PRD and other leftwing parties from cooperating in any way with the Calderón administration. His faction is more radical than *Nueva Izquierda* both in terms of ideology and tactics (Langston and Pérez, 2009). AMLO only has a minority of loyalists in Congress, but he wields considerable influence on all PRD politicians given his tremendous popularity with the leftwing base of voters. In fact, AMLO's followers spill over well beyond the PRD to include other leftwing groups. He commands the loyalty of two smaller parties: Convergencia and the Partido del Trabajo (PT).

On the issue of private investment, the PRD has espoused the nationalistic view that oil should exclusively be exploited by the State. In a way, the PRD is in competition with the PRI to be the most patriotic defender of strategic resources. For most of the twentieth century there was no doubt that such nationalistic banners were politically owned by the PRI, especially given that it was a PRI president, Lázaro Cárdenas, who initially nationalized the oil industry from foreign firms.²⁸ But nowadays, ownership of the nationalistic banner is very much in doubt with the PRD rising as the fiercest defender of national sovereignty. This is especially true of AMLO's faction who organized massive street demonstrations to stop the 2008 energy reforms. Even symbolically, the PRD has claims over the historic nationalization of the oil industry given that Lázaro Cárdenas' prodigal son, Cuauhtémoc, is the founder and moral leader of the party.

Consequently, the PRD's position is that private firms should not be allowed in strategic activities such as transportation, storage and transformation of hydrocarbons. Moreover, contracts with service providers should not have any privatizing undertones. In particular, contracts should not be tied to the price, quantity or quality of the oil extracted. Service providers should not be allowed to speculate with the rent from oil, and they should certainly not be allowed to add Mexican reserves to their books. And most crucially, Pemex should never sell shares of stock, or be otherwise privatized. The PRD position can be summarized in a few words: No changes to the Constitution. Some difference of opinion exists among its factions, however. While the AMLO faction is unwilling to consider the proposed changes to the ordinary law, the *Nueva Izquierda* faction has been willing to support some degree of incentives to contractors (Starr, 2007).

²⁸ Strictly speaking, Cárdenas was a member of the *Partido Nacional Revolucionario* (PNR), which he renamed *Partido de la Revolución Mexicana* (PRM), which in turn was later renamed PRI.

On the issue of labor accountability, the PRD's position is fairly subtle. Given its progressive nature, the PRD is naturally pro-worker. But that does not mean it will be pro-union in the case of Pemex. The union has a tainted reputation, which contradicts the PRD's desire for more transparency. In addition, the selection of union leaders is not entirely democratic, which feeds the PRD's demands for more accountability. Importantly, the union remains highly loyal to the PRI so it is unlikely that it will change allegiance to the PRD or any other party in the short run. Hence we believe the PRD is likely to support an initiative to decrease the power of the union. An indication of such willingness occurred in 2008 already: during Congressional negotiations, the PRD partnered with the PAN to propose a reduction in the number of union members in the Administrative Board of Pemex (the proposal was eventually brought down by the PRI).

Regarding the fiscal burden on Pemex, the PRD has long argued that it should be dramatically reduced. As a matter of fact, such is the main solution it has proposed to rescue the oil industry. In response to the crisis in production that Pemex is going through, the PRD's proposal is to increase public investment. More public funds should be devoted to exploration. More spending should also be devoted to scientific research of the kind carried out by the *Instituto Mexicano del Petróleo*. It is claimed that Pemex has competent enough engineers and scientists; what it needs is to keep a larger share of its income rather than paying such high royalties. In addition to its ideology, the PRD also has political incentives to advocate for a lower tax burden. First, it is a popular issue with voters. And second, the PRD is an opposition party and, as we argued above, opposition parties have fewer incentives to protect government revenues.

❖ The PRI

The PRI is the party issued from the Mexican revolution. It governed Mexico for more than seventy years, since 1929 until 2000. That year, the PRI lost power to the PAN's candidate, Vicente Fox. It failed again to gain power in 2006, when it came a distant third behind the PAN and the PRD. However, the PRI has garnered significant momentum since 2006. As can be seen in Figures 1 and 2, it did extremely well in the 2009 midterm elections, increasing its share of the Lower House from 21 to 48%. The PRI is currently the best positioned party to win the 2012 presidential election.

A large part of the PRI's renewed popularity is due to the mediating role it has taken during the Calderón administration. Ideologically it has presented itself as the moderate party between the rightist PAN and the leftist PRD. It has also blossomed in the role of ultimate power-broker in a political ambience that has been extremely polarized.

The PRI membership covers a wide political spectrum. So it is no surprise that ideological divisions exist within its large structure. Two factions have emerged as the most influential in discussing the oil industry. One faction consists of the technocrats within the party. It is often referred to as the “neoliberal” faction for its association with economics-trained presidents Carlos Salinas and Ernesto Zedillo. This faction is ideologically close to the PAN, and is willing to consider a partial liberalization of the oil industry. During talks to reform the energy sector in 2008, Francisco Labastida was the main spokesman of the technocratic faction within the PRI.

The members of the other faction call themselves the “nationalists”. They oppose any reform that has privatizing undertones. They are quick to recall that it was a PRI president, Lázaro Cárdenas, who nationalized the oil industry back in 1938. Indeed, the PRI has a strong claim over the symbolism surrounding the Mexican oil: Pemex in particular, which has become symbol of Mexican sovereignty in the struggle to overcome foreign imperialism, is strongly identified with that party. Hence many traditional “Priístas” spoke publicly against the PAN initiative of 2008, and tacitly sided with the PRD in trying to block it. Such was the case of Carlos Rojas and Manuel Bartlett.

On the issue of private investment, the PRI’s position is further complicated by the close ties it has with service providers. The PRI is known to have a clientelistic relationship with trucking companies transporting gasoline and gas LP, as well as other entrenched service providers (Elizondo, 2011). For that reason, in 2008 the PRI opposed the clauses that would have increased transparency in contracting. They also opposed the private management of transport, storage, distribution and other downstream activities that are currently in the hands of rent-seekers.

On the issue of labor accountability, the PRI is the most opposed political party in Congress to changing the status quo. The PRI has a very close link to the Pemex union, which was founded in 1937 with support of President Lázaro Cárdenas. As other trade unions, the Pemex union has historically had a relationship of mutual support with the PRI. During its period in power, the PRI gave ample autonomy to trade unions to manage their funds without oversight, and it ensured that union leaders were recurrently reelected. In exchange, the party has enjoyed the trade unions’ political and economic support during elections. A blatant example occurred in 2000 when the Pemex union channeled massive amounts of funds to the presidential campaign of the PRI’s candidate. Those illegal contributions are estimated in excess of 160 million dollars.²⁹ In sum, the PRI serves as the union’s ally in Congress, and will tend to oppose any measure affecting the union’s interests. In fact, such was a prerequisite to support the PAN’s legislative initiative in 2008: the PRI requested that labor privileges be kept out of the negotiations (Farfán *et al.*).

²⁹ *La Jornada*, “Rogelio Montemayor Seguy, ex-director de Pemex: Cronología del caso”, Friday November 3, 2004.

On the issue of fiscal autonomy, the PRI has advocated for lower taxes on the oil industry, especially while it has been in the opposition. For instance, during discussions for the fiscal reform of 2007 where President Calderón wanted to create new corporate taxes and income taxes, the PRI conditioned its support on reducing the tax burden on Pemex. Initially, President Calderón was resistant to making such tax cuts on the company, but he eventually yielded as he knew he needed the PRI to pass his fiscal reform (Castellanos *et al.*, 2009). If the PRI wins the presidency in the future, however, it might change its position and it might stop advocating a further autonomy of Pemex. The conjecture in this paper is that incumbency will trump ideology, such that any incumbent party will tend to oppose a large reduction in royalties.

Congressional negotiations

We are now in a position to analyze the negotiation process: how can we expect energy reforms to unfold in the Mexican Congress? So far, we have described the players and the rules of the game, that is, the political agents and the legislative institutions. Given this setup, we now describe the type of coalitions that need to be made in order to achieve a reform.

We do so by constructing some useful graphs depicting the political parties and their positions on different issues. Such graphs will serve as visual aids to help us identify the types of coalitions that could be formed, and the types of outcomes that each coalition could bring about. This type of graphical analysis of coalition-making is common in “spatial voting theory”, which is a branch of political science that has acquired prominence in the past three decades (see for example Shepsle, 2010).

Before proceeding, however, we need to distinguish two different types of Congressional negotiations that relate to Pemex. As it turns out, there are two separate types of agendas where issues about Pemex can be included. One type of agenda encompasses the issues of private investment and labor accountability. The set of laws regulating those two issues can be discussed together, particularly in the context of a comprehensive *energy reform* such as the one of 2008. A second type of agenda encompasses fiscal and budgetary issues, which is where Pemex’s fiscal burden would be discussed. Such discussions typically take place in the context of a *fiscal reform* of the kind that President Calderón initiated in 2007, or during the *annual budget negotiations* that must take place at the end of each year. Given that those two types of agendas are fairly independent of each other, we will study them separately. We now proceed to analyze them in turn.

Coalitions for private investment and labor accountability

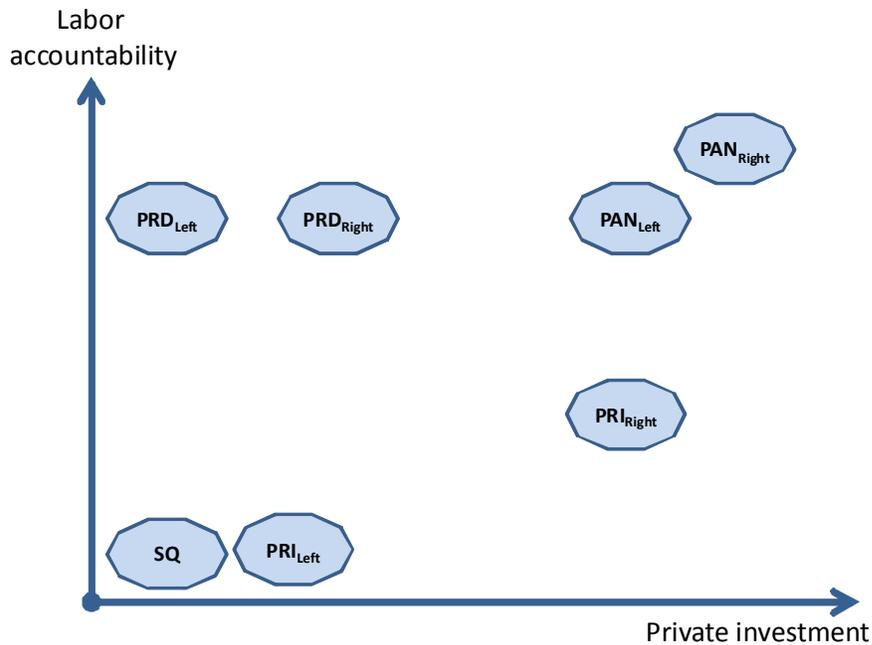
We start by analyzing the negotiations regarding private investment and labor accountability. They tend to occur in the context of an “energy bill”, meaning a comprehensive bill about the oil and gas industries. An example is the initiative introduced by President Calderón in April 2008, which was discussed throughout the summer until it was voted in October of that year, and made into law on November 28th.

Our goal is to construct a graph that will depict the positions of all parties on the two issues at hand. We start by interpreting each issue as a continuous line where each point represents a different level on that issue. In political science jargon, such lines are called *dimensions*. Given that we have two issues –private investment and labor accountability– we will be constructing a graph with two dimensions.³⁰ In that bi-dimensional graph we will place each political actor according to its preferences. We will also place the status quo according to the current situation of Pemex and oil industry.

Figure 3 depicts this policy space: the horizontal axis corresponds to the level of private investment in the economics activities of Pemex, and the vertical axis corresponds to the level of accountability of the Pemex labor union. In that space we have placed six important political groups according to the levels of private investment and labor accountability that they are expected to advocate for. Those six groups are the left-wing faction and the right-wing faction of the three major parties, the PAN, the PRD, and the PRI, as we described in a previous section above. We labeled those factions PAN_{Left} , PAN_{Right} , PRD_{Left} , PRD_{Right} , PRI_{Left} , and PRI_{Right} . The figure has a seventh point corresponding to the status quo of the oil industry in Mexico.

³⁰ A useful illustration of how private investment can be thought of as a linear dimension comes in Benton (2010). That author created a scale of possible energy-sector structures, ranging from completely statist to completely liberal. Benton’s scale is consistent with the dimension we are proposing here.

FIGURE 3. THE AGENDA TO INCREASE PRIVATE INVESTMENT AND LABOR ACCOUNTABILITY

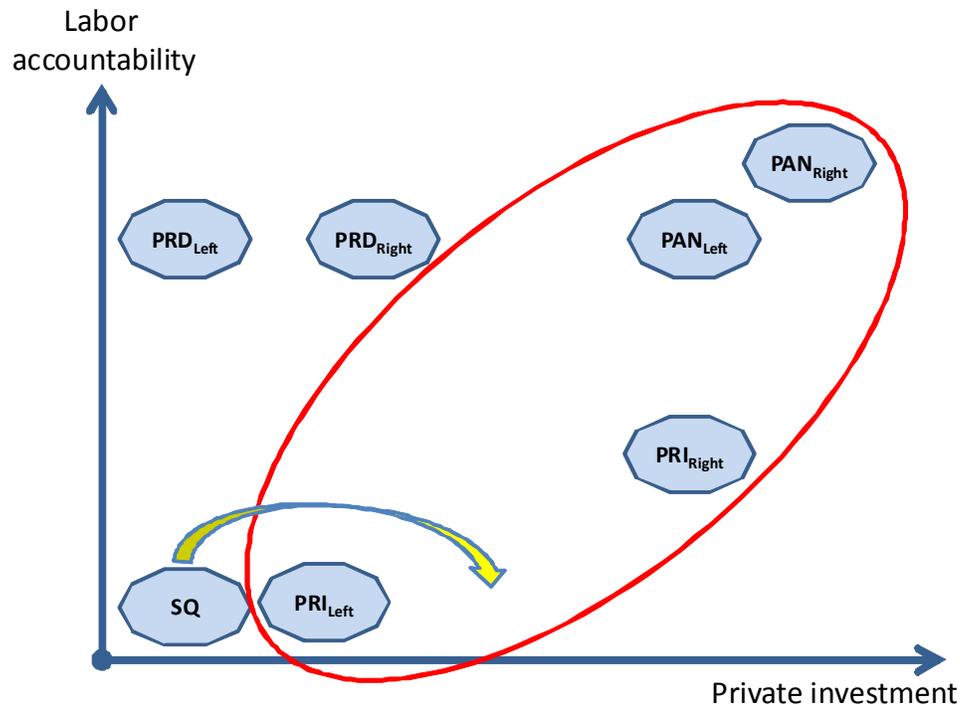


This two-dimensional space allows us to study the possible coalitions that could be formed to implement a reform. What are the coalitions of party factions that would be willing and able to move the status quo to a different location?

We should recall that one party by itself will not have enough votes to change the law (see the most recent shares of seats in Figure 2). Changing an ordinary law requires fifty percent of the votes in Congress, which can only be achieved by at least two parties together. Changing the Constitution requires two thirds of the votes in Congress, which can only be achieved with all three parties together.

We consider two possible coalitions. The first one would be an alliance of the PAN and the PRI. Such a coalition is depicted in Figure 4 below. This alliance would be best suited to liberalize the legal restrictions on private investments in the oil industry. The PAN along with the technocratic leaders of the PRI could exert enough pressure on the nationalist faction of the PRI to accept those changes. In fact, that was exactly the coalition that was initially formed in 2008 by President Calderón and the leaders the PRI. Together, they had agreed on a legislative agenda that would allow more flexible service contracts to create partnerships with other oil companies and service providers. Such changes, they claimed, did not require changes to the Constitution; they only involved changes to ordinary laws. The PRI-PAN coalition had enough seats in Congress to pass the initiative.

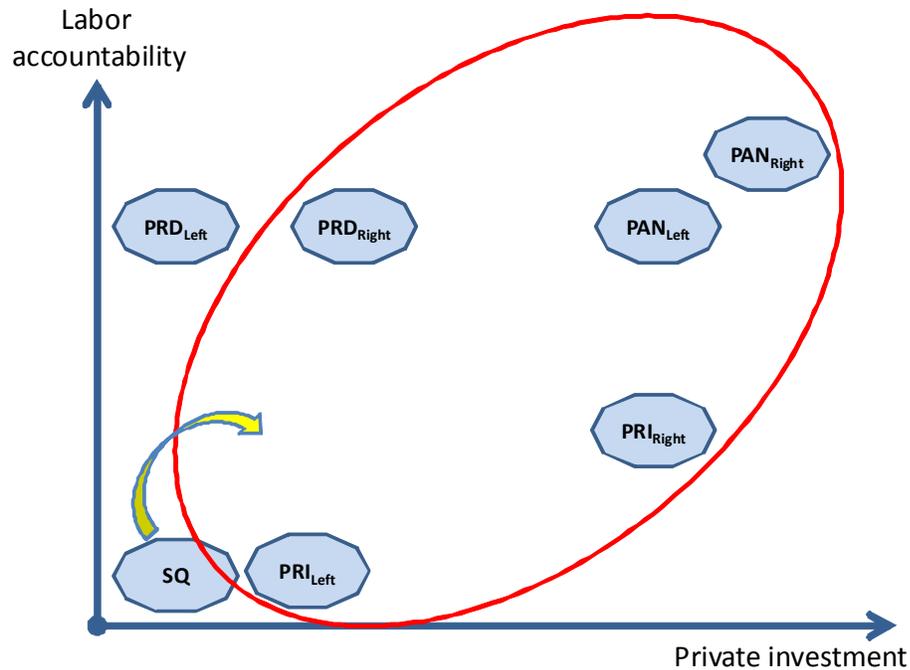
FIGURE 4. A PAN-PRI COALITION



In the event, the PRI-PAN coalition did not endure in 2008. As explained in Langston and Pérez (2010), a group of left-leaning senators forcefully seized the Senate tribune for several days to prevent the vote to take place. In addition, to block the reform, AMLO staged a series of massive street protests that turned out to have broad appeal. Emboldened by AMLO's movement, the nationalist faction of the PRI (namely PRI_{Left}) was threatening to rebel against its technocratic leadership (namely PRI_{Right}). This forced the PAN and the PRI leaders to restart the negotiations, this time including the PRD and its demands.

So the second possible coalition that we analyze is an alliance of the three major parties, the PAN, the PRI and the PRD. It is fair to say, however, that as long as the radical wing of the PRD is dominated by AMLO, it will never accept to join a coalition with the PAN. So the only realistic possibility is to include the moderate wing of the PRD. Such a coalition is depicted in Figure 5 below.

FIGURE 5. A PAN-PRI-PRD COALITION



As we can tell from comparing Figures 4 and 5, a three-way coalition would lead to a more modest change than a two-way coalition. That is because more parties need to agree to that change. This is what happened in 2008, when the PAN and the PRI were forced to include the *Nueva Izquierda* faction of the PRD in the negotiations. The ensuing legislation was a watered down version of the original initiative. On the other hand, this type of coalition is better suited to move along the labor-accountability dimension: by including the PRD, the PAN can gain an ally for pressuring the PRI into weakening the union. This was also seen in 2008: the PRD and the PAN insisted that a set of new independent members of the Administrative Board take control of some of the responsibilities that union representatives would have liked to keep for themselves (Farfán *et al.*, 2010).

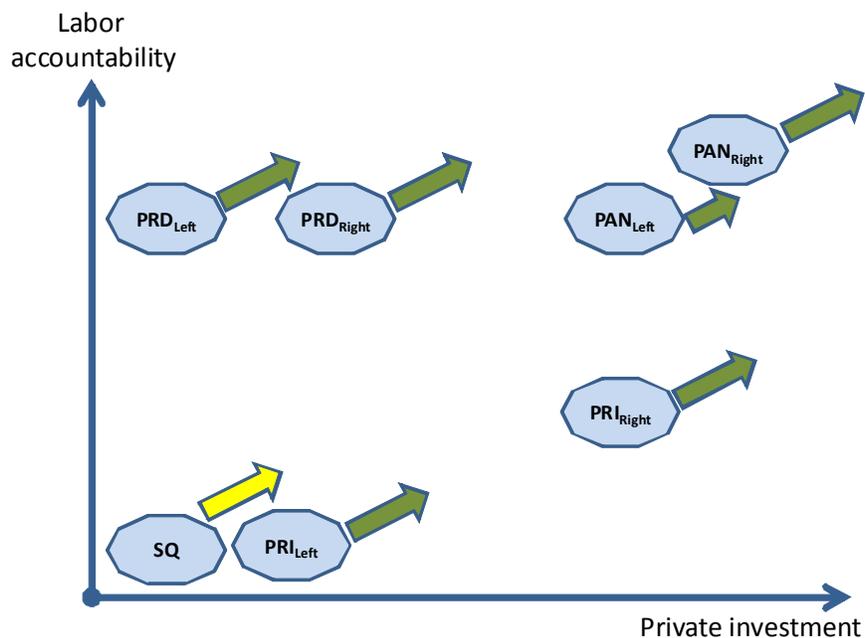
This framework also allows us to speculate about the exogenous shocks that are needed to change the parties' preferences in favor of reform. If there was a major event in the country that convinced political actors of the need to modify the law, their positions would move farther in direction of change: all parties would start advocating more private investment and more labor accountability. What major events could lead to such a shift in politicians' preferences? We offer the following possibilities:

- a) A continued decline in production that would lead to a sense of urgency among the political elite.

- b) A shift in public opinion in favor of liberalization, perhaps due to a better promotion strategy on behalf of the government.
- c) A spectacular accident that would raise doubts about the efficacy of Pemex employees and engineers.
- d) Reaching the threshold to become an importer instead of an exporter of oil. This would have a powerful symbolic effect on the psyche of the Mexican public.
- e) A highly publicized series of corruption scandals that would weaken the union.
- f) A division in the union, perhaps because a rebellious fraction gains importance or wins an internal election.
- g) The United States drilling in the Gulf of Mexico to extract the oil in common territory. This is already possible according to the treaty of *Hoyo de Dona*, and it would instill a sense of urgency among the political class in Mexico.

Any of those exogenous shocks would have the effect of moving the parties' preference in favor of reform. That change is depicted in Figure 6 below.

FIGURE 6. AN EXTERNAL SHOCK THAT MOTIVATES REFORM



As a consequence of parties being more open to change, Congress would eventually pass a reform where the status quo was modified.

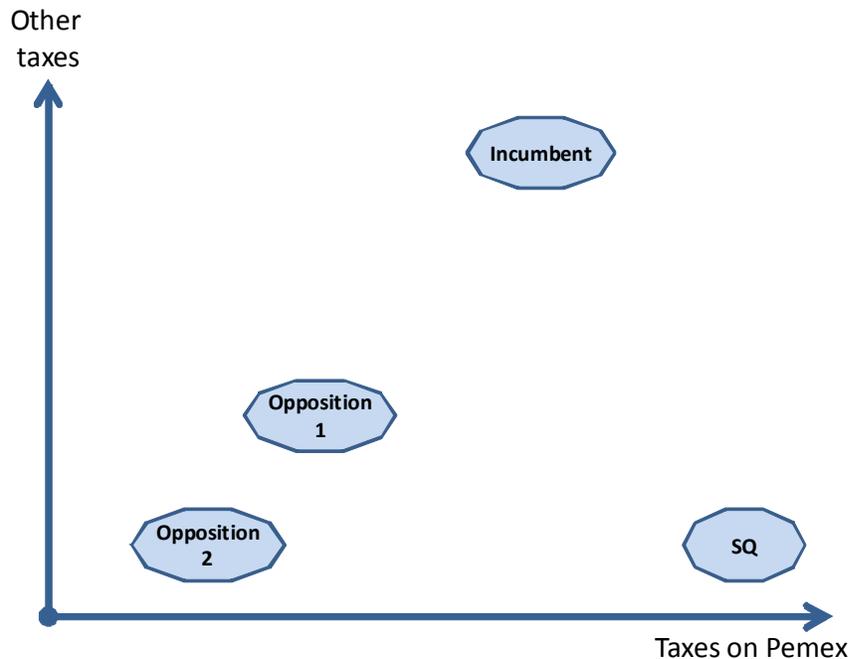
Coalitions for fiscal autonomy

The third important issue in the oil industry is the financial one. The finances of Pemex tend to be discussed in the context of budget and fiscal negotiations. For example, during the Calderón administration, the finances of Pemex were first discussed during the budget law at the end of 2006, and then again during the fiscal reform of 2007. In those negotiations, the taxation of Pemex was pitched against all other taxes to determine an overall level of government revenues.

Several measures can increase the fiscal autonomy of Pemex. Some of those measures, such allowing the company to acquire more debt, were listed in Table 4. But the most direct measure would be to decrease its tax burden. As we mentioned above, the royalties and other levies on Pemex are very high, preventing the company to reinvest its income in research and exploration. So it is no surprise that reducing those taxes is a frequent proposal among politicians who wish to save Pemex. Accordingly, we focus our analysis on whether taxes on Pemex can be decreased as the result of a Congressional negotiation.

Our goal now is to construct a graph that will help us visualize the type of discussions that take place in fiscal and budget negotiations in Congress. As we did in the previous section, we will interpret the possible policy outcomes as a two-dimensional space. In this case, the two dimensions correspond to the following two policy instruments: first, the amount of taxes levied on Pemex; and second, the amount of all other non-Pemex taxes. Each of those two policy instruments will be interpreted as a continuous line, where different points represent different levels of taxation. We do this in Figure 7, where the horizontal axis represents the amount taxes and royalties levied on Pemex, and the vertical axis represents the amount of taxes from all other sources.

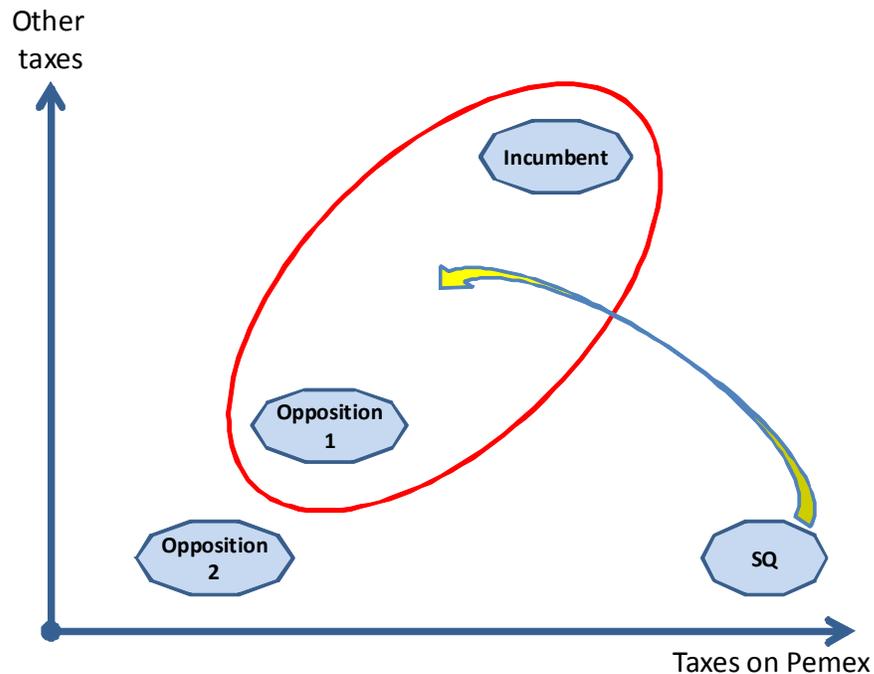
FIGURE 7. THE AGENDA TO DECREASE THE FISCAL BURDEN ON PEMEX



We also aim to depict the positions of all three major political parties according to their preferences on those two dimensions. We assume that an incumbent party will want high taxes on Pemex to be able to carry out its program. It would also like to increase other taxes, given that Mexico's tax revenue is so small. On the other hand, opposition parties can afford to advocate for larger tax cuts, and more so if they do not expect to win the presidency in the short run. Figure 7 depicts three parties, labeled Incumbent, Opposition 1, and Opposition 2. We assume that the party labeled Opposition 1 will be slightly more cooperative with the Incumbent party, perhaps because it believes that it will win the presidency in the near future. We also include a fourth point corresponding to the current level of taxation in the country, labeled Status Quo.

With these graphs we can see the types of coalitions that could be formed to decrease the level of taxation on Pemex. One possible coalition with a sufficient number of votes would be between the incumbent party and the closest opposition party. Such a coalition is depicted in Figure 8 below.

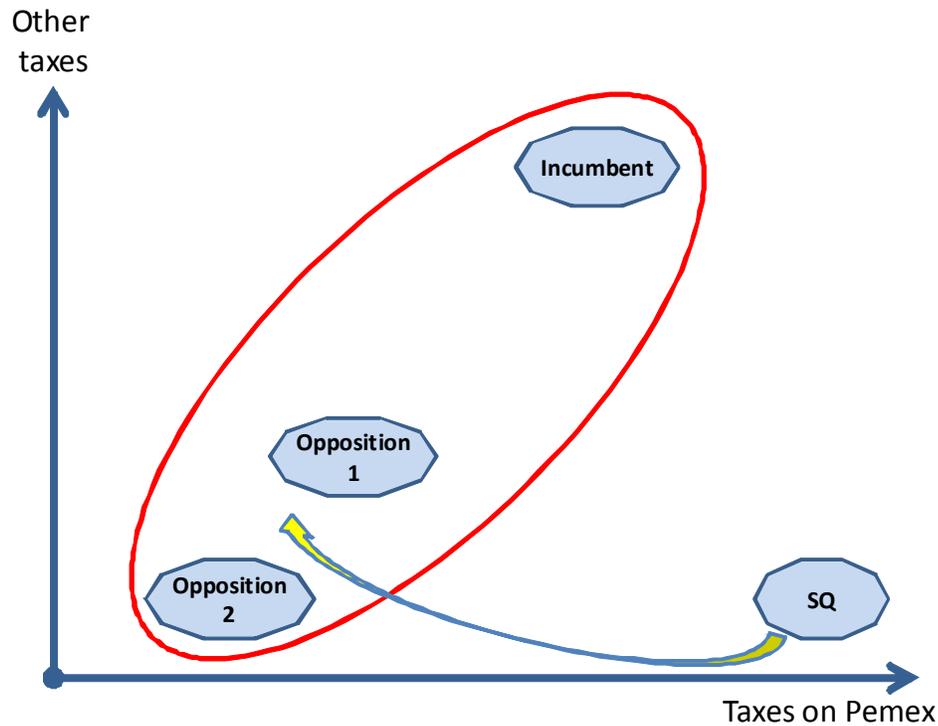
FIGURE 8. AN INCUMBENT-OPPOSITION COALITION



That scenario occurred during the fiscal reform of 2007. The PAN (i.e. the incumbent) proposed the creation of several new taxes, including a corporate tax (the IETU) and a tax on cash deposits in banks (the IDE). The PRI (i.e. the closest opposition) agreed to support those taxes but requested a revision of Pemex's fiscal regime. The PRD (i.e. the farthest opposition) was in favor of reducing taxes on Pemex but decided to take a public stance against any tax raise by voting against the IETU and the IDE (Castellanos *et al.*, 2010). The reform passed with the votes of the PAN and the PRI.

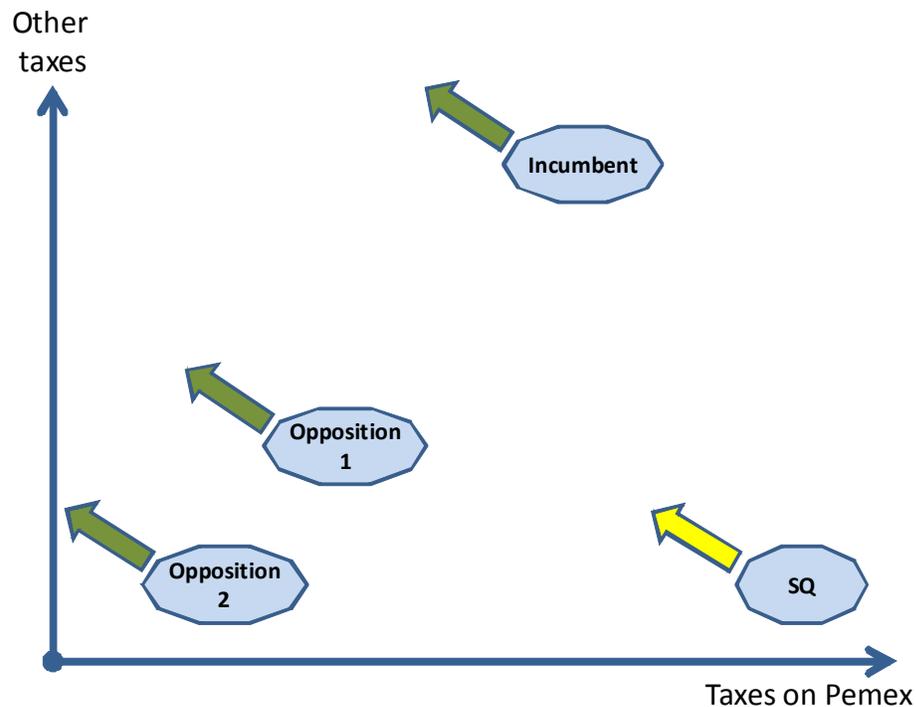
Another possible scenario is broad coalition including all the major parties: the incumbent and the whole opposition. Such coalition can be seen in Figure 9 below. Because it includes the three large parties, we call it a "consensus coalition".

FIGURE 9. A CONSENSUS COALITION



That was the scenario at the end of 2006 during negotiations to approve the following year's budget. Given the contested nature of the previous election, the Calderón administration was eager to show that it was able to build consensus, and thus endeavored to include the PRD as well as the PRI in his first major political bargain. Through compromise on all sides, the budget was approved nearly unanimously. Insisting on a large coalition came at a financial cost to the government, however, as the PRD requested to include some subsidies and pensions for old people in rural areas (Starr, 2007). It also included a larger-than-expected reduction on Pemex's tax burden as requested jointly by the opposition parties.

FIGURE 10. A BETTER TRADEOFF OF PEMEX TAXES FOR OTHER TAXES



We could also ask ourselves what external factors could convince the parties' to reduce Pemex's tax burden. Mexico's government is in a tight fiscal situation: it has the lowest tax revenue as a percentage of GDP among all the OECD countries. Any reduction on Pemex's levy will need to be compensated by other sources income. So, what could make the tradeoff of Pemex taxes for other taxes more acceptable? There are two possibilities: Either creating new taxes becomes more feasible, perhaps through a consensus among ordinary citizens and the political elite that paying more taxes is in everyone's benefit. Or there is a sudden generalized desire to reduce the burden on Pemex, perhaps because the company is coming close to bankruptcy. Either of those scenarios would convince parties to trade off some taxation on Pemex for new taxation on other items. Such a scenario is depicted in Figure 10 above.

Discussion and Conclusions

The historical nationalization of the oil industry in 1938 is a source of great pride to many Mexicans. To date, Pemex continues to symbolize the triumph of the Mexican State over private greed and foreign imperialism. Any mention of reform arouses passions, both among the political elite and ordinary citizens. Accordingly, there is much ideological resistance to changing the legal framework. In addition to an ideological opposition to reform, there also exists an entrenched class of interest groups who oppose any changes to the status quo. For those reasons, recent administrations have avoided a battle to change the legislation regulating the oil industry. Any reformer hesitates to touch Pemex for fear of committing political suicide. In the jargon of political science, we would call it a “third rail” issue, meaning an issue that is so politically sensitive that it will electrocute anyone touching it. We claim that Pemex should be considered the third rail of Mexican politics.

Yet, some changes have been achieved in past years. In particular, the administration of President Calderón was successful in getting a fiscal reform and an energy reform approved that has given Pemex some fresh air to operate in the next few years. Such reforms were criticized by many analysts, however. Some said the reforms went too far, while others said they did not go far enough. It is clear that any change will leave important groups unsatisfied, but such is the nature of political negotiations in a democracy: all parties have to compromise. The actual questions of interest are: Why were some specific compromises reached in the past? And what kind of compromises can we expect in the future?

The goal of this paper was to develop an analytical framework to study those questions. We did so by studying the politics of energy reform in Mexico as they occur in Congressional negotiations. We believe this new framework can help understand past reforms such as those of the Calderón administration in 2006, 2007 and 2008, as well as future reforms such as the ones that will necessarily be attempted in the period 2012-2018.

Our conceptual framework was based on the following elements: identifying the main issues regarding Pemex; identifying the main political agents in charge of reform; and locating the positions of these agents on those issues. Our analysis was aided by a series of original graphs that helped us visualize the kind of coalitions that are conducive to change. We claimed that three issues will tend to dominate the debate: private investment, labor accountability, and fiscal autonomy. We also identified the agents that are pivotal in creating a new legislation: the Chief Executive; the three major parties, namely the PAN, the PRD, and the PRI; and the internal factions within each of those parties. Our graphical analysis led us to conclude that several possible coalitions could implement changes. A PAN-PRI coalition is

best suited to create more flexible contracts for joint explorations with other IOCs or NOCs. If moderate elements of the PRD were included in such a coalition, the resulting contracts would be less flexible but the labor union could be forced to become more accountable. On the fiscal side, a two-party coalition between the incumbent and its closest ally would result in a modest reduction on Pemex's tax burden in exchange for new taxes from other sources. In contrast, a three-party coalition of all major parties would fail to expand the overall tax base, but would be conducive to a larger reduction on the taxes levied on Pemex.

Beyond the analysis provided in this paper, we think this framework can be pushed further. In particular, it can help in the search for negotiation strategies that would lead to reform. Would it help to put other issues on the table, such as environmental regulation and citizen bonds? Could the smaller parties in Congress break a gridlock among the three major parties? If we allow for more conceptual complexity, our analytical framework could be expanded to include new dimensions and new parties. Maybe these strategies could smooth out the political wrangle that needs to take place in order to modernize Pemex and the oil industry in Mexico. Such should be the topics of future research.

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