

NÚMERO 284

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Congressional negotiations with costly voting:
Understanding the reforms to PEMEX in 2006-2008



Importante

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SEPTIEMBRE 2016

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México.
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Acknowledgements

This chapter grew out of a commission to explain the politics of energy reform in Mexico from the Baker Institute for Public Policy at Rice University. The research benefitted from being presented at UC Berkeley, Rice University, the University of Oxford, CIDE, and the annual meetings of American Political Science Association and the Midwest Political Science Association. I benefitted from insightful conversations with Allyson Benton, Carlos Elizondo, Raul Gonzalez, Miriam Grunstein, Gregg Johnson and Ignacio Marván. Cristian Puga provided excellent research assistance. All errors are my responsibility.

Abstract

The state-owned petroleum company in Mexico has played a fundamental role in the economy, but its productivity has been worryingly in decline. Several presidents of Mexico before Felipe Calderón tried to modernize Pemex but they failed to pass any meaningful legal reform through Congress. In this paper I explain why Calderón was successful where other presidents were not. At the same time, I explain why Calderón's successes were not as large as they could have been: indeed, the legal reforms to the Mexican oil industry in 2006-2008 were not as profound as they were expected to be. I claim this was due to the costs that political conditions imposed on congressional negotiations. Irrespective of their preferences, legislators faced punishment by radical political leaders and passionate voters if they supported Calderón's initiatives. At the same time, some pivotal negotiators in Congress were able to extract significant side payments for their support of government initiatives. To clarify these complex dynamics, I use the traditional concepts from spatial voting theory: I identify the main issues regarding Pemex; the main political agents in charge of reform; and the positions of these agents on those issues. I also propose a modeling innovation to the traditional spatial theory of voting, which consists on considering the punishment that legislators may incur from supporting a bill that they like. With these theoretical tools I am able to explain the puzzling coalitions that were formed for the 2006 budget law, the 2007 fiscal reform and the 2008 energy reform. I suggest that these same theoretical tools could be used to understand congressional negotiations in other contexts.

Keywords: Reform, congressional bargaining, oil industry, Mexico, voting

Resumen

La compañía estatal petrolera de México ha jugado un papel fundamental en la economía, pero su productividad ha estado cayendo preocupantemente. Varios presidentes de México antes de Felipe Calderón intentaron modernizar Pemex, pero no lograron pasar alguna reforma de peso en el Congreso. En este ensayo explico por qué Calderón tuvo éxito en lo que otros presidentes no lo tuvieron. Al mismo tiempo explico por qué el éxito de Calderón no fue tan grande como pudo haber sido: en efecto, las reformas legales a la industria mexicana del petróleo en 2006-2008 no fueron tan profundas como se esperaba. Argumento que esto se debió a los costos que las condiciones políticas impusieron en las negociaciones legislativas. Independientemente de sus preferencias, muchos legisladores enfrentaban posibles castigos por parte de líderes políticos o de los votantes si apoyaban las iniciativas de Calderón. Al mismo tiempo, algunos negociadores fundamentales en el Congreso lograr importantes pagos colaterales por su apoyo a las iniciativas. Para aclarar esta compleja dinámica, uso conceptos tradicionales de la teoría espacial de votación: identifiqué las principales cuestiones con respecto a Pemex; los principales actores políticos a cargo de la reforma; y las posturas de estos agentes en esas cuestiones. También propongo una innovación a la manera tradicional de modelar la teoría espacial de la votación, la cual consiste en considerar el castigo que pueden sufrir los legisladores por apoyar alguna iniciativa que ellos favorezcan. Estas herramientas teóricas me permiten explicar las sorprendentes coaliciones que se formaron para las leyes de ingresos y egresos de 2006, la reforma fiscal de 2007 y la reforma energética de 2008. Sugiero que estas mismas herramientas teóricas podrían usarse para entender negociaciones legislativas en otros contextos.

Palabras clave: Reformas, negociaciones legislativas, industria del Petróleo, México, votación

Introduction

For decades until 2008, Pemex seemed impossible to reform. **P**etróleos Mexicanos (Pemex), the Mexican state-owned company in charge of all petrochemical activities in the country, started facing economic difficulties around three decades ago. In particular, the company struggled to maintain high levels of productivity; its production of oil started falling steeply from its peak in 2004; and oil reserves were being depleted. The stakes have been high for the Mexican people whose well-being is still linked to oil production. Although the Mexican industry has been able to diversify into producing many other goods and services, petroleum and its derivatives are still a fundamental part of the economy. Any decline in oil production can be expected to have a negative effect on growth and development. Furthermore, the government remains highly dependent on taxes levied on the oil industry, which still represent about one third of public revenue: for instance, in 2007, during the negotiations studied in this chapter, 32% of the Federal Government's income came from royalties paid by Pemex. If production continued to decline at that pace, the government's fiscal balance would be in imminent jeopardy. The stakes have been 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. Thus an absence of Mexican oil could lead to 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 had been so slow to come about. In spite of many attempts by a series of administrations, the Mexican government had not been able to enact a legal reform that significantly altered the functioning of Mexico's giant oil company. Political gridlock between parties in the Mexican Congress was a main obstacle. Note that any reform must be the product of legislative negotiations, so the crucial role of political elites and government institutions should not be underestimated. Therefore, a good understanding of the political process in Mexico is crucial for explaining the lack of reform for over two decades, as well as the success of the reforms of 2008, which is the focus of this chapter. Nevertheless, political studies of the Mexican oil industry are hard to find. In spite of an active debate in terms of policy recommendations, little analysis has been done about the political constraints. A lot of ink and paper is spent on advocacy, with pundits and politicians making passionate recommendations with varying degrees of expertise. But almost no academic writing can be found about the political negotiations to reform Pemex. More analytical and conceptual research is needed if we are to gain a deep understanding of these problems and their possible solutions.

The energy reforms of 2008 in Mexico are interesting to study for several reasons. First, the fact that they actually occurred is remarkable. Voices calling for deep structural changes had been heard at least since the 1980s, when it started to become evident that an overhaul of some kind was necessary. However, there has always been disagreement on specific proposals on this highly sensitive issue that polarizes Mexicans among ideological lines. Hence an impactful proposal revising the legal framework, management structure, or fiscal regime of Pemex was elusive. Low-impact reforms were passed in 1993 and 1995, but subsequent attempts to implement significant changes had largely failed. Several high-ranking politicians, including Presidents Ernesto Zedillo and Vicente Fox, sought to modernize the oil company but their attempts were ultimately unsuccessful as both presidents failed to pass energy reforms through Congress. So when President Calderón finally succeeded in passing meaningful legislation, he was able to claim with some veracity that “Mexico has accomplished an achievement that can be described as historic, as this is the most important reform in this matter since 1938, when the oil industry was nationalized.”¹

Yet the reforms of 2006-2008 that ended up being approved in Congress were significantly watered-down versions of Calderón’s initial proposals. So a second puzzle is why the enacted reforms were not more profound. As I will document later, there were conditions for much deeper reforms. In fact, a far-reaching initiative was very close to being approved, but unexpected events blocked this initiative in surprising ways that deserve better understanding. Another set of reasons making these reforms interesting is their positive impact. At the economic level, while being considered insufficient, these reforms succeeded in slowing down the fast decline in Pemex’s productivity. Official figures show some stability since 2009, which has been partly attributed to the positive effects of previous legal reforms. At the political level, the negotiations of 2008 can be given significant credit for the success of a subsequent series of profound reforms in 2013 by laying the ground for these new negotiations.

A final reason for studying these reforms is theoretical. I will propose a general analytical framework that will shed light on some of the very complex dynamics occurring in legislative negotiations of the kind seen in Mexico during 2006-2008. I use traditional concepts from the *spatial theory of voting*, which characterizes policy issues as linear dimensions, and depicts ideological positions as points in those dimensions. In particular, I will propose a way to analyze the formation of congressional coalitions in Mexico based on specific graphs to visualize the positions of different political actors. I pay special attention to the main stakeholders, their interests, and their ideologies, all of which influenced their negotiations in the legislature. To this traditional framework, I will add a non-standard element that I believe serves to complement the theory in realistic ways: I propose that legislators face costs and benefits from voting a certain way, independently of their ideology. As will be illustrated below, this simple addition

¹ As quoted by Elizondo (2011, p. 35).

can go a long way in explaining certain decisions by politicians that would otherwise look puzzling.

In sum, the contribution of this chapter will be fourfold. First, I identify the main issues of contention that systematically arise in debates and negotiations to reform Pemex. I claim that three issues create the most tension between the main political actors: the involvement of private capital in the oil industry; the transparency of Pemex's economic transactions; and the fiscal burden on Pemex. Second, I identify the positions of the main stakeholders on those issues. Political parties, the Executive Branch, 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, I study the types of coalitions that were formed in 2006 through 2008 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, I illustrate how the theoretical concepts proposed in this chapter, in particular the existence of voting costs and benefits independent of ideology, help explain the outcomes of these important negotiations. The analysis in this chapter will also suggest the general usefulness of applying this spatial voting framework to other congressional reforms in Mexico and elsewhere.

The economic and political context in 2006-2008

In recent history, Pemex has faced several hurdles. The challenges facing the beleaguered oil company have been geological, managerial, economic and political. In previous research I described in more detail the situation of the oil industry during Felipe Calderón's administration, while he launched his reform processes (see Serra 2011). Here I summarize it succinctly before focusing on the congressional negotiations that are the topic of this chapter.

Geological challenges

By the mid-2000s, the situation was pessimistic: some experts even believed that Mexico would become a net oil *importer* the following decade (Medlock and Soligo 2011). The decline in oil production was mainly a consequence of new geological constraints. The easy reserves to be found and exploited were becoming rare; and the areas that were known or suspected to have large reserves were difficult to explore and exploit. Much oil is suspected to exist in the Gulf of Mexico, underneath five thousand feet of water. But those reserves are hard to reach as they require modern technology for deep-water exploration. The Mexican government has always lacked the technology and the expertise to explore beyond shallow waters. Hence, for those

ventures to be viable they require partnering with other oil companies. However, the Mexican regulation used to be one of the most restrictive in the world as it precluded most types of joint ventures with any type of private or foreign firms (Grunstein 2010).

Managerial inefficiencies

In addition to these geological challenges, Pemex faced a number of structural problems making its operation 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, such as exploration, where juicy contracts are granted in less than transparent ways (Elizondo 2011). On top of its internal problems, the government imposed a large tax levy on the company. Royalties and sales taxes have tended to deplete Pemex's revenues leaving little scope for reinvestment and recapitalization. Hence reformers had to confront highly mobilized groups whose interests would be affected by changes in the status quo.

Legal restrictions

Regarding the oil industry, any substantive change would require passing new legislation. The statutes that needed modification prior to 2006 were well known. Negotiations about Pemex and the oil industry have usually been spurred by two kinds of initiatives: fiscal initiatives and energy initiatives. Some possible changes required modifying ordinary laws; other options required amending the Constitution. Either way, difficult negotiations and major concessions were needed. 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 by simple majority of a majority of state legislatures. It follows that changing the Constitution is more difficult than changing ordinary laws, a fact that must be taken into account by those who wish to initiate any reform.

The oil industry is regulated at both levels. At the Constitutional level, a strict ownership of petroleum and other natural resources was granted to the State. More importantly, the Constitution had put the State *exclusively* in charge of the economic activities deemed strategic. The strategic areas include petroleum and all other hydrocarbons as well as basic petrochemicals. In effect, these Constitutional articles established a state-monopoly in most activities related to oil. At the ordinary-law level, the statutes accompanying the Constitution reinforced the State's monopoly in oil-related activities. Reformers always need to choose their goals carefully: a legal battle to change the Constitution would presumably be more meaningful, but tougher, than

changing ordinary laws. 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. Indeed, he calculated this was the only kind of reform that could get past the major political parties in Congress (Farfán and García 2009).

Congress

Congressional gridlock had 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. The government is divided in three independent branches: Executive, Legislative and Judicial. The legislative branch has two 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, they must find a different appointment at the end of each term. This implies that 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. Legislative bills can be initiated by Congress or the Executive, and they usually need to be approved in both chambers.

Political parties

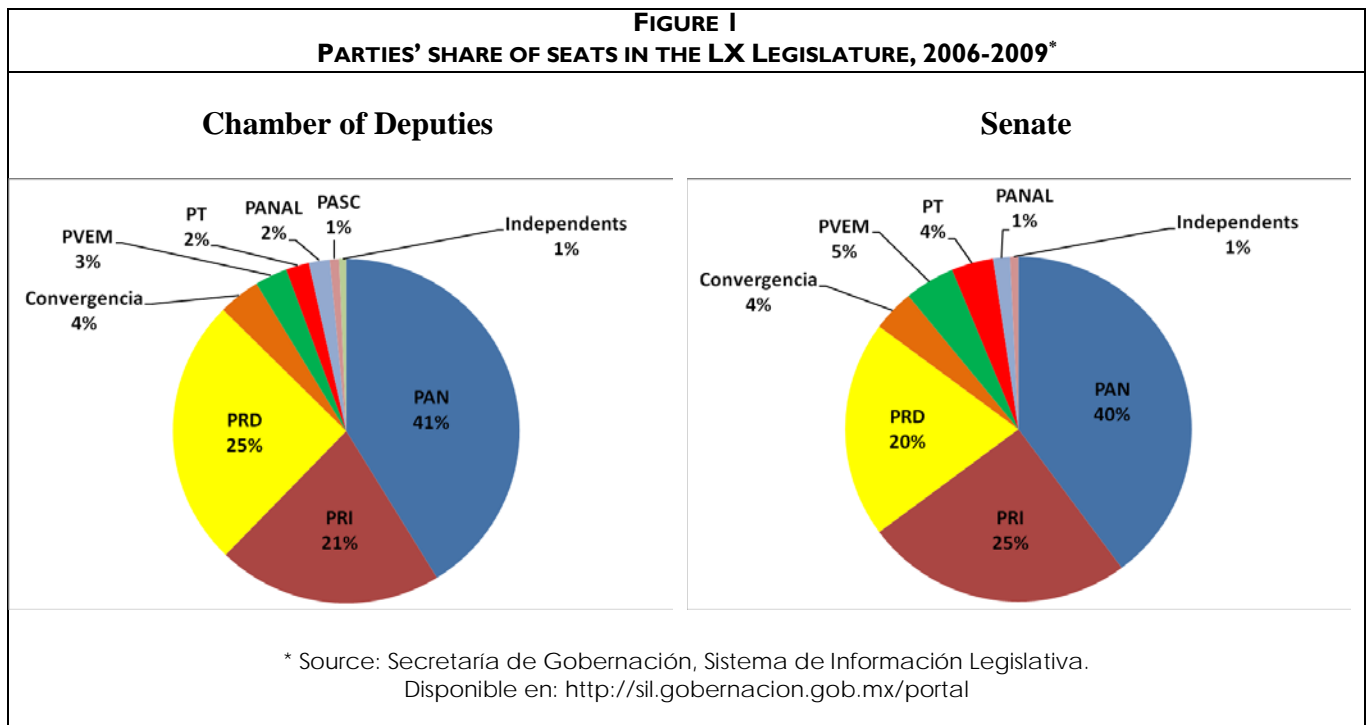
Mexico had three main political parties at the time: the National Action Party (PAN), the Party of the Democratic Revolution (PRD), and the Party of the Institutional Revolution (PRI). In general terms, the PAN is viewed as right-of-center, the PRD is viewed as left-of-center, and the PRI claims to hold the middle ground. In 2008, there were other smaller parties represented in congress. In particular, two leftist parties had made a close alliance with the PRD.² Two other small parties were closely allied with the PRI and the PAN during oil negotiations.³ I describe the ideologies and preferences of those parties in more detail later, especially in regards to oil issues.

These three parties are strong, well defined, and hierarchical. They have large memberships and large bases of support. Such is their dominance of politics that together they are often referred to as a “partyarchy” (Serra 2012). In particular, they tend to be exceptionally disciplined in Congress, meaning that all the legislators nearly always vote the party line. (Interestingly, as we will see, the 2008 energy reforms were

² The Workers Party (PT) and the party Convergencia. Together, the three leftist parties were referred to as the Ample Progressive Front (FAP).

³ The Green Ecological Party of Mexico (PVEM) and the New Alliance Party (PANAL).

an exception where parties faced internal divisions.) In the past two decades, all three parties have held solid shares of seats in Congress. Figure I shows the configuration of the legislatures following the 2006 presidential election.



As we can tell from the figure, in 2008, no party had more than fifty percent of the seats in Congress. We can also see that the governing PAN could make a coalition with either of the big parties to reach a majority of votes for changing ordinary laws. In theory, the PAN could also make a coalition with one big party and several small parties to reach the two-thirds supermajority needed to change the Constitution. As I describe later, both strategies were attempted in order to reform Pemex.

Political polarization

The presidential election held in July 2006 posed an unprecedented challenge to Mexican democracy. The PAN candidate, Felipe Calderón, came in first place while the PRD candidates came in second; but the margin of victory was breathtakingly narrow. The official tally yielded a difference of barely 0.6% between the first-place and second-place candidates (the PRI candidate came in a distant third). The PRD always claimed they had been robbed of their victory by a conspiracy of conservative groups that

orchestrated a fraudulent election. López Obrador proclaimed himself the true winner, calling Calderón an “illegitimate” or “spurious” president. Conservative and progressive forces were more polarized in 2006 than they had ever been in modern Mexican history.⁴

Such being the institutional context for an eventual energy reform, now I analyze its possible substance. What are the main issues that parties could 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 many 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 dominate the discussions. This is certainly the case in the public debate: among the numerous facets of the oil industry, the public debate has tended to focus mostly on a few hot buttons. We can observe that the media, for example, tends to comment on topics that create passion while ignoring topics that are less sensational. 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. For empirical accuracy it is thus pertinent to identify the issues that are usually most salient in the public debate.

I am 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. To be precise, I postulate that most of the contentious points of oil reform in Mexico can be organized in three broad dimensions. (1) The degree to which private capital can and should participate in exploration and other economic activities of Pemex. I call this dimension *Private Investment*. (2) The degree of benefits and influence granted to the union leaders, clientelistic contractors and other non-accountable rent-seekers. I call this dimension *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 manage its funds. I call this dimension *Fiscal Autonomy*. Those three topics have created the most tension among political actors in past negotiations to reform Pemex, including the ones from 2006 until 2008 which are the focus of this chapter.

In Serra (2011) I described these three issues at length – the reader could refer to that paper as a complement to this chapter. In that research I showed that all three issues entail a wide spectrum of possibilities that allow us to think of them as

⁴ For more details on the 2006 post-election crisis and how it influenced legislation in Congress, see Serra (2012).

continuous dimensions. For instance, the law could specify any degree of fiscal autonomy. It could go from complete control of Pemex's expenditure and complete taxation of its income (i.e. no autonomy) to complete freedom to use its resources (i.e. full autonomy). The law could also specify any degree of private participation. It could go from assigning every single stage of the production process exclusively to the state without allowing any delegation to external providers (i.e. no private participation) to complete freedom for other companies to partner or compete with Pemex (i.e. full private participation). Finally, the law could specify any degree of accountability. It could go from leaving large voids by being completely ambiguous in its regulation (i.e. no accountability) to being extremely precise and forceful in its monitoring of economic transactions (i.e. full accountability). In Serra (2011) I describe the moderate, intermediate and extreme states that those three dimensions could possibly take.

Taken together, those three topics serve as the conceptual framework for my analysis. I 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. I will show how this "spatial" framework can help analyze energy reforms. It should be noted, however, that these three issues are not usually negotiated together. In fact, the first two issues, private investment and accountability, are usually negotiated jointly as part of an energy bill while the third issue, fiscal autonomy, is usually negotiated as part of a fiscal bill. Such was the case between 2006 and 2008, which means that we must analyze two sets of negotiations separately.

The main actors and their policy positions in 2006-2008

The next step in understanding the reform process is to identify the actors that were most influential. The legislative process in Mexico is usually dominated by a few individuals and organizations who act as the main dealmakers in Congress. My goal is to identify them and describe their preferences on the main dimensions of energy reform. Legal initiatives of this magnitude need to be spearheaded by a determined leader. In this period, it was President Calderón who designed and sent the relevant initiatives. Once received, it was up to the major political parties to decide whether to approve, reject or amend the initiatives. Given the pivotal influence they have in passing any reform, those are the main agents to consider: the president, the PAN, the PRD and the PRI.

The Executive branch and the President

Felipe Calderón is a lifelong *panista* – his father was one of the founders of the PAN and he joined the party when he was nineteen. As president, he did not have full

control of his party, however. Calderón was closely identified with a certain faction within his party, but he had differences with other members. In particular, he made enemies by sidelining those cadres that were not particularly loyal to him. Thus, to garner support for his initiatives, the President had to engage in internal negotiations within his party in addition to the external negotiations with the other parties. Regarding Pemex, Calderón was very familiar with its challenges since he served as Energy Secretary in the previous administration of Vicente Fox. His preferred solutions very clearly involved liberalizing the oil industry although he was always realistic in how much he could push for. To simplify the analysis, in terms of policy preferences, I will assume that the president was perfectly represented in Congress by one of the dominant factions within his party, but other legislators in the same party were represented by a second faction. I describe such factions within the PAN 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, granting office to Felipe Calderón until 2012. We should keep in mind that Mexico does not allow the reelection of presidents, which implies that all administrations can only last for one term.

Compared to the other major parties, the PAN has traditionally been the most homogenous ideologically. Opposing factions exist, but their discrepancies seem to come from loyalties to different leaders and preferences for different political tactics, rather than fundamental ideological disagreements. Hence conflict between factions tends to arise from power struggles to dominate the party rather than ideological struggles to advocate different policies. In addition, these conflicts have often been 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 ideological 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 (Farfán and García 2009). Ultimately, all factions rallied behind the Executive’s initiative, at least publicly.⁵

On the issue of private investment, the PAN has insisted on the need for Pemex to partner with big transnational companies to carry out deepwater exploration and

⁵ The negotiations did encounter some trouble due to enmities of PAN members with the president, which seemed to stem from personal vendettas rather than fundamental ideological differences (Starr 2009, p. 146).

other upstream activities for which Pemex lacks expertise. For this purpose, it has advocated for more flexible contracts that include economic incentives to service providers, such as risk-sharing or production-sharing contracts. 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 accountability, *panistas* shared 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 had on the company was preventing its modernization – consequently the union should be forced to make serious concessions. It should be noted, however, that in spite of such views, both President Fox and President Calderón were unwilling to confront the union directly fearing a possible retaliation. PAN presidents were unwilling to push this issue by themselves: only a large coalition of partners that included the PRI was likely to challenge the union’s interests. Regarding economic clienteles profiting from doing business with Pemex, the PAN was eager to introduce more transparency in those economic transactions. It should be noted that prominent members of the PAN had themselves been embroiled in high-level scandals of corruption for their lucrative dealings in the oil industry.⁶ But as an institution, the PAN wished to be consistent with its traditional stance for honesty and transparency.

On the issue of fiscal autonomy, the Calderón administration had mixed motivations. On one hand, its entrepreneurial instincts would normally be to decrease the tax burden on Pemex allowing it to operate as a rational profit-maximizing firm. On the other hand, the PAN was running the federal government, 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. Hence the Secretary of the Treasury endeavored to quell the sustained pressure from opposition parties to let Pemex keep more of its income. The conjecture in this chapter is that incumbency will trump ideology, such that any incumbent party will tend to oppose a large reduction in tax income.

The PRD

The PRD was born in the late 1980s out of a broad alliance of leftist groups that ranged from left-of-center dissidents of the PRI all the way to smaller communist organizations. So from birth, the party has served as an umbrella organization for a number of diverse subgroups, sometimes referred to as “the PRD tribes,” which have occasionally engaged in damaging strife. In 2008, two large factions dominated the party. The first one, which was officially called *Nueva Izquierda*, commanded most of

⁶ See the many examples described in Elizondo (2011, fn 73).

the bureaucratic positions in the PRD, including the Chairman position. It also commanded the loyalty of a majority of PRD legislators in Congress. *Nueva Izquierda* was considered the moderate faction within the party because they were the most willing to engage with President Calderón and the other parties in legislative negotiations (Starr 2007).

On the other hand, the second dominant faction had explicitly ruled out any communication with the government. This faction was loyal to Andrés Manuel López Obrador, who was a presidential candidate in 2006. López Obrador never accepted his defeat. Since the election, he used his influence to dissuade the PRD and other left-wing parties from cooperating in any way with the Calderón administration. His faction was more radical than *Nueva Izquierda* both in terms of ideology and tactics (Langston and Pérez 2009, p. 497). Among PRD legislators, López Obrador had a sizeable number of self-identified loyalists, but not a majority. However, as I explain later, he still wielded considerable influence on the totality of PRD politicians given his tremendous popularity with the leftist base of voters. In addition, López Obrador could count on the unconditional support of the other two small parties in the left-wing alliance.

The PRD generally supports socially liberal issues, and it advocates distributive policies in favor of the most vulnerable groups in the population. On the issue of private investment, the PRD espoused the nationalistic view that oil should be exploited exclusively by the State. In a way, the PRD was 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. But then the ownership of the nationalistic banner was very much in doubt with the PRD rising as the fiercest defender of national sovereignty. This was especially true of López Obrador's faction which organized massive street demonstrations to stop the 2008 energy reforms, as I describe later. Even symbolically, the party has claims over the historic nationalization of the oil industry given that Lázaro Cárdenas' prodigal son, Cuauhtémoc, was the founder of the PRD.

Consequently, the PRD's position was 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 in 2008 could be summarized in a few words: No more changes to the Constitution. In fact, many in the PRD felt that recent policies had already violated the spirit of the Constitution, and that PEMEX had already moved too far in the direction of privatization. They pointed out that PEMEX engineers used

to conduct most exploration endeavors, while later many tasks were outsourced to private contractors. So we can safely say that some *perredistas* in 2008 were to the left of the status quo.

Regarding Pemex's labor union, the PRD's position was surprisingly close to the PAN. Given its progressive nature, the PRD is naturally pro-worker. But that does not mean it was pro-union in the case of Pemex. The union had a tainted reputation, which contradicted the PRD's desire for more transparency. In addition, the selection of union leaders was not exactly democratic, which fed the PRD's demands for more accountability. Importantly, the union remained highly loyal to the PRI. Therefore, the PRD was relatively supportive of decreasing the power of the union. On the issue of accountability, the party was even also clearly against corrupt practices among rent-seeking entrepreneurs doing business with Pemex.

Regarding the fiscal burden on Pemex, the PRD has long argued that it should be drastically 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 was going through, the PRD's proposal was to increase public investment. More public funds should be devoted to exploration. More spending should also be devoted to scientific research done by Mexican engineers. Pemex mostly needed to keep a larger share of its income rather than paying such high royalties. In addition to its ideology, the PRD also had political incentives to advocate for a lower tax burden. First, it was a popular issue with voters. And second, the PRD is an opposition party and, as I 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 since 1929 until 2000, at which point it 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 had garnered significant momentum since 2006, being the best positioned party to win the 2012 presidential election. A large part of the PRI's renewed popularity was due to the mediating role it had taken during the Calderón administration. Ideologically it presented itself as the moderate party between the rightist PAN and the leftist PRD. It blossomed in the role of ultimate power-broker in a political ambience that was extremely polarized.

The PRI membership covers a wide political spectrum. So it is no surprise that ideological divisions exist within its large structure. In 2008, two factions emerged as the most influential in discussing the oil industry. One faction consisted of the technocrats within the party. It was often referred to as the "neoliberal" faction for its association with economics-trained presidents Carlos Salinas and Ernesto Zedillo. This faction was ideologically close to the PAN, and was willing to consider a partial liberalization of the oil industry. The members of the other faction called themselves

the “nationalists.” They opposed any reform with privatizing undertones. They were quick to recall that it was a PRI president who nationalized the oil industry back in 1938. Indeed, the PRI has a strong claim over the symbolism surrounding Mexican oil. Pemex in particular, which has become a symbol of Mexican sovereignty in the struggle to overcome foreign imperialism, is strongly identified with that party. Hence many traditional “priistas” spoke publicly against the PAN initiative of 2008, and implicitly sided with the PRD in trying to block it.

On the issue of accountability, the PRI was the most opposed in Congress to changing the status quo. As with other trade unions, the PRI has a very close link to the Pemex one. 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 undemocratically. 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 illegal funds to the presidential campaign of the PRI’s candidate. Given their relationship of mutual support, the PRI served as the union’s ally in Congress, opposing any measure that affected 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 and García 2009).

Regarding transparency, 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, as well as other entrenched rent-seekers (Elizondo 2011). For that reason, in 2008 the PRI opposed the clauses that would have increased transparency in contracting. They also opposed opening transport, storage, distribution and other downstream activities to market competition.

On the issue of fiscal autonomy, the PRI advocated for lower taxes on the oil industry. Its reasons were similar to those of the PRD described above: an ideological preference for strengthening state-owned companies rather than strengthening private competitors; and a high tolerance to reducing the government’s income because it was an opposition party.

Other actors

There are of course several other actors that tried to influence the process. These include: the small parties⁷ and the independent legislators represented in Congress; the Pemex labor union; oil companies and the oil industry around the world; public opinion; the media; pundits; intellectuals; experts and academics. I consider those actors to be secondary in my analysis because their influence was either smaller (as

⁷ PVEM, PANAL, PT, Convergencia, PASC.

with small parties), or they do not directly vote in Congress in spite of having a strong indirect influence (as with the labor union).

Multiparty negotiations

We are now in a position to analyze the negotiation process. How could we expect energy reforms to unfold in the Mexican Congress of 2006? So far, I have described the players, i.e. the political actors, and the rules of the game, i.e. the legislative institutions. Given this setup, the next section describes the type of coalitions that needed to be made in order to achieve a reform. I 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 identify the types of coalitions that could have been 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,” as mentioned in previous sections. While my presentation here will be heuristic and intuitive, the reader can read the appendix to this chapter for a more formal presentation of these theoretical ideas.

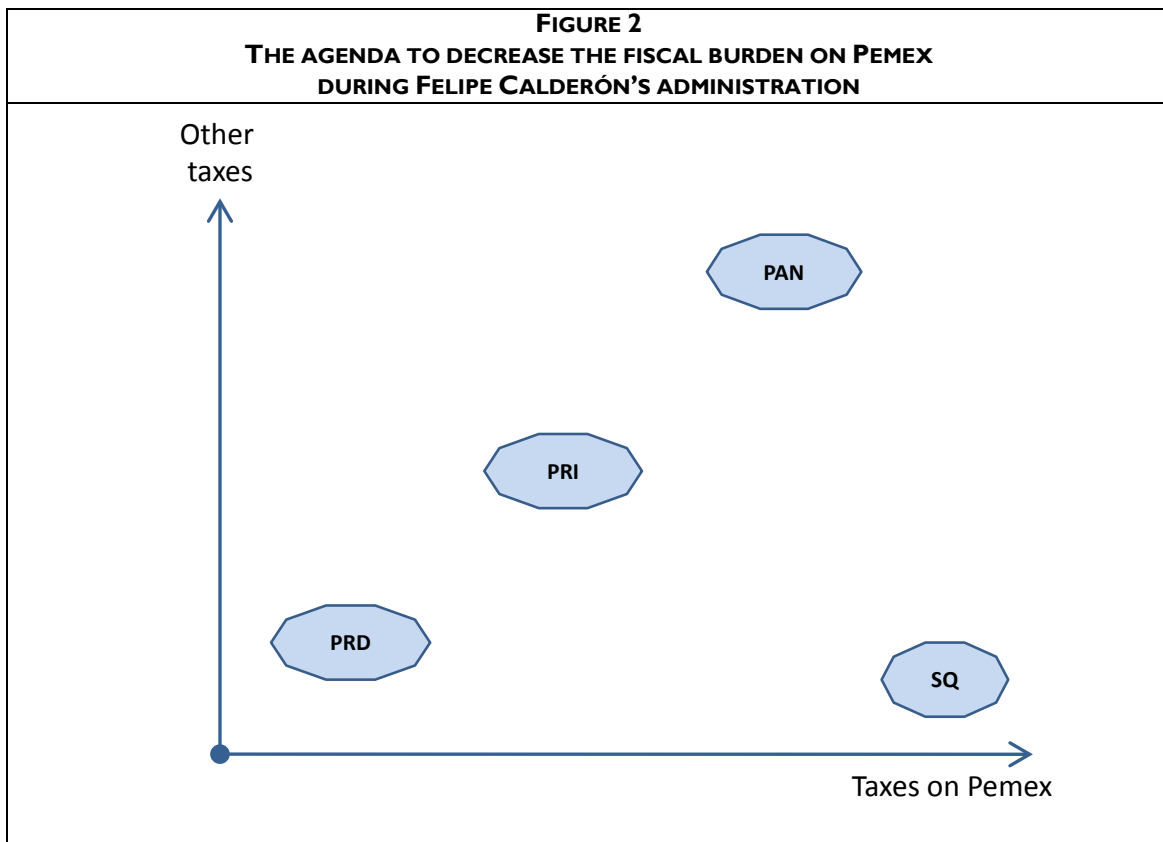
Before proceeding I need to distinguish two different types of Congressional negotiations that relate to Pemex. As it turns out, there are two separate types of agendas where issues about Pemex can be included. One type of agenda encompasses fiscal and budgetary issues, which is where Pemex’s fiscal burden would be discussed. Such discussions typically take place in the context of a *budget law* or a *fiscal reform* of the kind that President Calderón initiated in 2006 and 2007 respectively. A second type of agenda encompasses the issues of private investment and 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. Given that those two types of agendas are fairly independent of each other, I will study them separately.

The negotiations for a fiscal reform of Pemex in 2006 and 2007

One of the most important concerns regarding Pemex is its fiscal health. Several measures can increase the fiscal independence of Pemex such as allowing the company to acquire more debt – but the most direct measure would be to decrease its tax burden. As I 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 from bankruptcy. Accordingly, I focus my analysis on whether taxes on Pemex can be decreased as the result of a Congressional negotiation. How did it occur at the end of 2006 and then again in 2007? 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. Indeed, 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. So any reduction on Pemex's levy would need to be compensated by other sources income.

My 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. In accordance with the theoretical framework that I present in the appendix, I 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. I do this in Figure 2. The horizontal line, meaning the x axis, represents the amount taxes and royalties levied on Pemex, and the vertical line, meaning the y axis, represents the amount of taxes from all other sources. I also aim to depict the positions of all three major political parties during the Calderón administration, according to their ideological preferences on those two dimensions along with their costs and benefits from supporting the government's initiatives.



It turns out that the PAN, being an incumbent party, was willing to entertain a small reduction in Pemex royalties but not a large one since it needed resources to carry out its program. It also wanted to increase other taxes given that Mexico's tax revenue was so small. This led to the paradoxical situation where the most conservative and market-oriented party in Mexico, the PAN, was resisting a decrease in Pemex taxes and fighting for higher taxes on all other possible items. On the other hand, the opposition parties could afford to advocate for tax cuts, and more so if they did not expect to win the presidency in the short run.

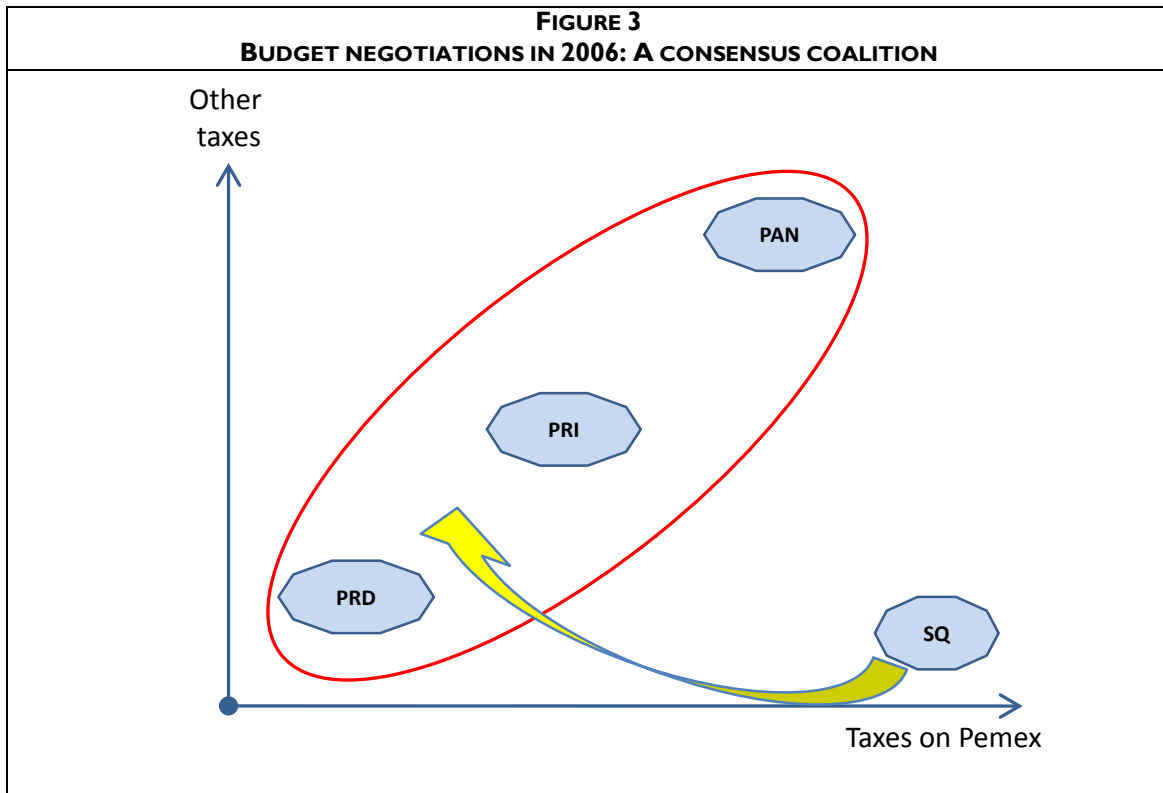
This political logic led the PRD to adopt some surprising positions. It advocated for significantly decreasing the royalties on Pemex, which was consistent with its traditional position. But what about other taxes? Naturally enough, the PRD was against some ostensibly regressive taxes proposed by the PAN, such as increasing the VAT and the gasoline levy. However, paradoxically, the PRD also opposed many of the progressive taxes proposed by Calderón, which included a large corporate tax in addition to closing loopholes on the income tax. In principle, many PRD legislators were ideologically in favor of these progressive measures. Yet, as I will narrate below, they decided to oppose them for several reasons. One reason was purely electoral: the PRD wanted to earn points with businessmen in the middle class. Another important reason was the pressure from López Obrador. Here is how Pamela Starr, professor at ITAM and senior consultant at Eurasia Group at the time, described this dynamic:

My personal conversations with PRD members show that PRD legislators, both Senators and Deputies, are unwilling to defy the spirit of López Obrador's order not to have any contact with the Calderón administration. The left continues to believe that López Obrador lost the 2006 presidential election as a consequence of political machinations, and López Obrador thus continues to insist that the left have nothing to do with a "spurious" president who reached office illegally and unfairly. PRD legislators, however, want to do their job; they want to exploit the left's control of nearly a third of congressional seats to legislate and thereby to advance some of the left's traditional policy demands. This implies working with the government to a certain degree and thus defying López Obrador. Their ability or willingness to do so, however, is limited allowing López Obrador to act like a break on their actions in the legislature. López Obrador controls the heart of the PRD's electoral base. These voters continue to look upon López Obrador as their champion. This influence with the base gives López Obrador the ability to impose limits of acceptable political behavior on most PRD politicians. If López Obrador concludes that his movement has been betrayed by a particular PRD politician, he can denounce that legislator as a traitor to the cause and rally his supporters to defeat that politician. Nor is this an unfounded fear. In July 2006, López Obrador's supporters successfully challenged the Governor of Zacatecas [of the PRD], who openly defied López Obrador, by defeating most of her candidates to the state legislature [by supporting candidates from other leftist parties]. (Starr 2007, p. 15-16)

The PRI was striking a different balance. This party actually had notable chances of winning the presidency the following election. So it had to strike a trade-off between advocating for low taxes, which was immediately popular with voters, and high taxes, which would be useful if it won the presidency in 2012. For these reasons, I believe its ideal point was placed approximately midway between the PAN's and the PRD's ideal points. Figure 2 depicts the ideal points of the three main parties, and also includes a fourth point corresponding to the level of taxation at the time, labeled Status Quo. With these graphs we can see the types of coalitions that could have been formed to decrease the level of taxation on Pemex.

The budget negotiations of 2006

One possible scenario was a broad coalition including all the major parties: the incumbent and the whole opposition. Such coalition can be seen in Figure 3 below. Because it includes the three large parties, I call it a “consensus coalition.”



This was the scenario at the end of 2006 during negotiations to approve the following year's budget. It was the first big negotiation between political parties

following Calderón's highly contested election in July. The political atmosphere was still acrimonious, especially with the many followers of López Obrador. Calderón was eager to legitimize his narrow election with some early victories as president. He knew that approval of his first budget in Congress would go a long way in proving to the Mexican people that his administration could get things done. In addition to being a seasoned politician, Calderón had recently returned from studying a mid-career master's degree at the Harvard Kennedy School where he met many of his future policy advisors. He also took courses from the well-known *Program on Negotiation* where he learned the importance of earning the trust of his negotiation partners early on.⁸ He was also advised that a sequence of negotiations should start with the easy ones, leaving the hardest ones at the end. Calderón heeded those lessons assiduously.

The PAN administration could have chosen to negotiate exclusively with the PRI, which was the opposition party with closest interests; but it did not. Calderón was eager to show that he was able to build a large consensus, and thus he endeavored to include the PRD as well as the PRI in his first major political bargain. By compromising on all fronts, the administration was able to get a smooth approval at the end of 2006. The budget for 2007 was quickly passed on a nearly unanimous vote by enticing (in effect buying) opposition support by including several key PRD budget priorities and increasing federal transfers to the states, which were governed in their majority by the opposition (Starr 2009, 140).

Insisting on a large coalition came at a cost to the government, however, as it included a larger-than-expected reduction on Pemex's tax burden requested jointly by the opposition parties. The PRD requested to include additional items in exchange for their vote. In terms of increasing subsidies, they requested higher old-age pensions for seniors in rural areas. This was a core PRD issue that helped the party justify why it was supporting a president it had so intensely scorned. It coincided with a temporary weakness in López Obrador's political power due to the erosion of his public image following the long street protests he had organized in 2006 trying to prevent the president-elect from taking office. To sweeten the deal, Calderón offered to broker the early exit of the electoral institute's staff, which had become anathema to the left for supposedly carrying out a fraud against the PRD. All this translated in low costs and high benefits for the PRD of supporting the budget. The result was a virtually unanimous vote from all parties in favor of the budget law in 2006.⁹

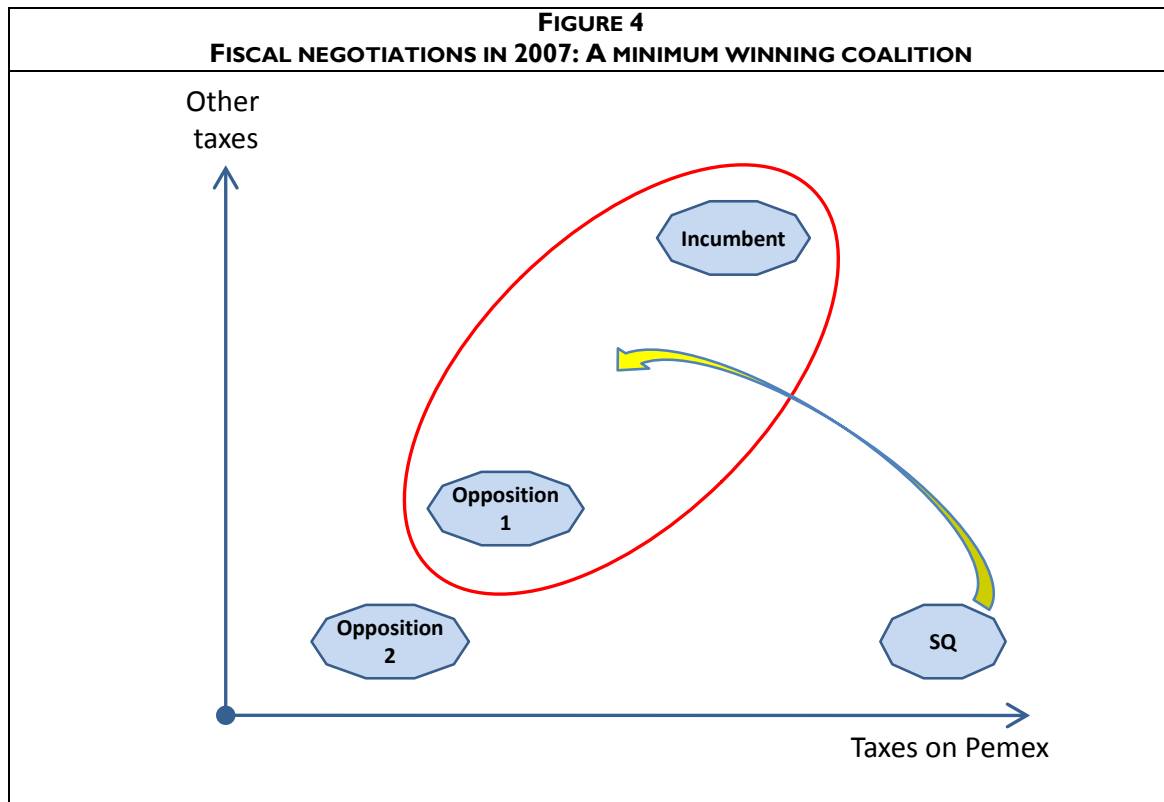
The fiscal negotiations of 2007

Another possible coalition with a sufficient number of votes was between the PAN and the PRI only. Such a coalition is depicted in Figure 4 below. Because it only includes

⁸ I briefly overlapped with Felipe Calderón while taking similar courses in graduate school.

⁹ Technically, there were two laws that needed approval: an income law and an expenditures law, both of which were approved nearly unanimously (Castellanos et al. 2009, p. 157).

enough parties to get the bill approved while excluding other unnecessary parties, I call it a “minimum winning coalition.”



This scenario occurred during the fiscal reform of 2007. The PAN proposed the creation of several new taxes, including a corporate tax (the IETU) and eliminating several deductions from the income tax. The government initially considered increasing another important tax, the VAT, which would have helped its finances; but this tax was highly unpopular. So the government eventually eschewed the VAT, focusing on more progressive taxes instead. In his continued attempt to lure left-wing voters, Calderón chose to propose the IETU which would be levied on corporations, not on individuals. Calderón also promised to devote most of the revenue to his successful poverty alleviation programs. As explained by Magar et al (2009):

The executive went public to persuade citizens that government resources were insufficient to deepen redistributive programs. This was an odd strategy for a center-right party whose bases of support are mostly in the middle and upper classes, but the framing succeeded in leaving left parties without strong arguments against the reform. (Magar et al. 2009, p. 73).

The PRD (i.e. the farthest opposition party) was in favor of reducing taxes on Pemex but decided to take a public stance against any tax raise. In contradiction with its leftist ideology, the PRD even voted against the corporate tax IETU. Many of its legislators were supporting this tax in private but refused to do so publicly (Castellanos et al. 2009, p. 165). It is widely believed they were bowing to strong pressure from López Obrador. This is how Starr (2007) explained this political pressure:

Supporting this legislation was simply a bridge too far—fiscal reform was Calderón's central legislative goal for 2007 and the key to many of his policy objectives. As such, supporting fiscal reform would weaken López Obrador's strategy of weakening the Calderón presidency through a policy of non-recognition; López Obrador would thus not countenance that level of PRD collaboration with *el espurio*. (Starr 2007, p. 16)

So it became eventually clear that the PRD would not support the fiscal reform of 2007, even though it included measures to increase business taxes and income taxes to finance social programs for the poor. To their chagrin, many PRD legislators had to vote against their own preferences.

At this point the PRI (i.e. the closest opposition) became the only viable partner to the PAN for this vote in Congress. Yet the PRI feared being labeled a puppet of the president for repeatedly supporting his reforms. To avoid this cost, it preferred including the PRD in the negotiations to serve as political cover (Starr 2009, p. 141). When the PRD withheld its support for the bill, the PRI demanded higher concessions to stay on board. Being a pivotal player gave the PRI ample scope for its demands. Concretely, the PRI only agreed to support a watered down version of those taxes, namely a lower IETU. The party also conditioned its support of the fiscal package on the inclusion of substantive modifications to the fiscal regime of Pemex, which the government had not contemplated at all. As a side-payment, the party also requested fiscal decentralization by significantly increasing federal transfers to the states. It should be noted, of course, that the large majority of states had PRI governors.

In addition, the PRI also engaged in logrolling with the PAN, whereby the former would support a *fiscal* reform in exchange for the latter supporting an *election* reform. This led to the creation of highly controversial legislation known as the “2007 electoral reform.” This law was in large part designed by PRI senators. It included major requests from the PRI, such as removing most of the staff of the national electoral institute, which was later replaced with new staff that allegedly had a slant in favor of the PRI. Another controversial measure designed by PRI senators was the prohibition of negative campaigning. In effect, the new law prohibited candidates from critiquing each other freely, as they could be accused of slander.¹⁰ It can be conjectured that old-school party bosses from the PRI had the most to benefit from a ban on public critiques, so this measure can be interpreted as a side payment to PRI leaders.

¹⁰ A detailed critique of these measures from the 2007 electoral reform can be found in Serra (2012).

Confirming that logrolling was indeed taking place, both reforms, the fiscal one and the electoral one, were voted on the same day in Congress (Castellanos et al. 2009, pp. 154-155).

The fiscal reform passed on September 14, 2007, with the votes of the PAN and the PRI but without the full support of the PRD.¹¹ The assessment from authors like Magar, Romero and Timmons is consistent with the analysis in this section:

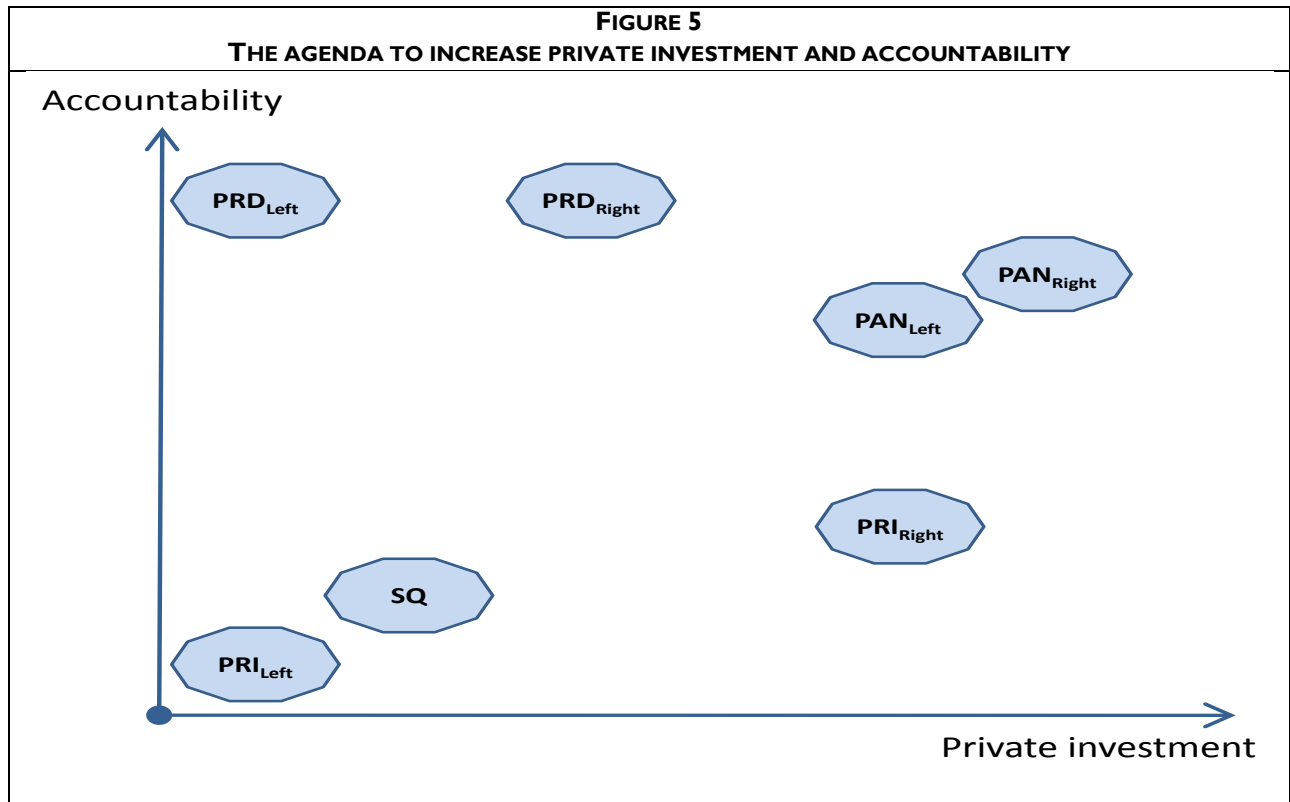
The resulting changes improved the country's fiscal structure; however, it is still far from meeting the country's needs. Moreover, many amendments were side-payments to opposition parties, such as increasing spending decentralization, giving more resources to governors. That is why we deem the reform as partially successful with respect to the limited change over the status quo. (Magar et al. 2009, p. 75)

The 2008 negotiations for an energy reform

President Calderón's most salient legacy in terms of economic reform is undoubtedly the 2008 energy bill. His initiative was introduced in April and was discussed throughout the summer until it was voted in October of that year, becoming law on November 28th. I claim that two broad dimensions can subsume the most important issues that were discussed: the degree of participation of private and foreign firms in the Mexican oil industry; and the degree to which economic transactions would become transparent in detriment of entrenched rent-seeking groups. In accordance with the framework laid out above, I will respectively call those two dimensions *private investment* and *accountability*.

My goal is to construct a graph that will depict the positions of all parties on the two issues at hand – in a bi-dimensional graph I will place each political actor according to its preferences, along with the status quo according to the situation of Pemex and the oil industry in 2008. Figure 5 depicts this policy space. The horizontal line, meaning the x axis, corresponds to the level of private investment in the economic activities of Pemex. The vertical line, meaning the y axis, corresponds to the level of accountability of the Pemex labor union and service providers. In this space I have placed six important political groups according to the levels of private investment and 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 I described in Section 4 above. I 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 at the time.

¹¹ According to Castellanos et al. (2009), the PRD legislators voted in favor of some pieces of the legislation, such as decreasing Pemex royalties, which were going to pass anyway. Rhetorically, though, the PRD came out against the fiscal package in full.

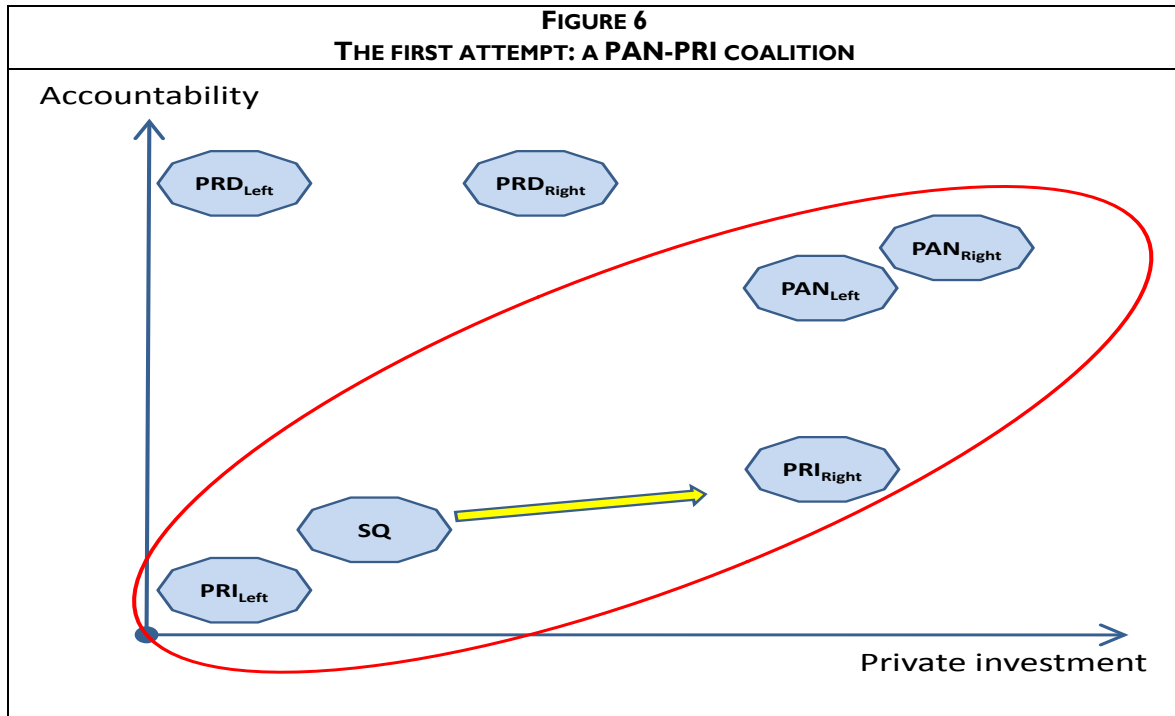


This two-dimensional space allows studying the possible coalitions that could be formed to implement a reform. What are the coalitions of party factions that were willing and able to move the status quo to a different location? How was reform possible in 2008, and what kind of reform was it? We should recall that changing an ordinary law requires fifty percent of the votes in Congress. So the PAN by itself did not have enough votes to change the law (see the shares of seats in Figure 1). It needed to make a coalition with some of the factions represented in Congress.

First round: The PAN-PRI coalition

One possible coalition was an alliance of the PAN and the PRI. Such a coalition is depicted in Figure 6 below. This alliance was best suited to liberalize the legal restrictions on private investments in the oil industry. In fact, this was exactly the coalition that was initially formed: since the beginning of his administration in 2007, President Calderón started talks with top leaders of the PRI to discuss a possible liberalization of the petroleum industry. While PRI leaders belonged largely to the “technocratic” wing of their party, they insisted on limits on such liberalization to avoid a fracture with their “nationalist” wing. Two immediate requests from the PRI was that

any reform should be restricted to ordinary laws instead of the constitutional laws; and to avoid any changes that would significantly affect the labor union's interests (Farfán and García 2009, p. 326). The PRI was also opposed to liberalizing the transport of oil products, presumably because it controlled most of the truck drivers through a patronage network (Elizondo 2011, p. 23).



It should be noted that liberalization was quite unpopular with the population at large. Public opinion was still oblivious to the trend of oil reserves being depleted and the risk of Pemex going bankrupt. So to reduce the political costs of supporting these changes, the PRI requested the government to initiate a public campaign informing Mexicans of the dire situation of the oil industry. As part of this campaign, President Calderón famously told the public that Mexico's existing reserves could only last nine more years.¹² Calderón's dramatic statement succeeded in creating a sense of urgency. The PRI also insisted that the PAN should be the one introducing their bill in Congress, as it was understood that whoever introduced the bill would pay the highest political cost.

Calderón had some early overtures to the PRD, trying to include at least its moderate legislators in the negotiations, but it became clear that such participation

¹² Strictly speaking, Calderón's remark was correct only considering proved reserves. If we add the probable and possible reserves, Mexico had enough oil until the year 2035 (Alberro 2007).

was out of the question at this stage. Since early 2008, when the government announced its plan to discuss a reform to Pemex, opponents had been organizing massive mobilizations against it. López Obrador had positioned himself as the undisputed leader of those opposed to any liberalization of the oil industry, and he was in effect the ultimate organizer of street protests against Calderón's initiatives. His goal with these mass mobilizations was not only to get the media's attention, but also to put enormous pressure on PRD legislators to oppose the reforms in Congress.

López Obrador also found a rhetorical device to raise the costs of voting in favor of Calderón's reform. He and his followers cleverly framed the proposed private-public ventures as a full-blown "privatization of Pemex." This accusation was factually incorrect, since the actual initiative was not proposing the sale of any assets or stocks of Pemex. But it was effective in triggering fear in the Mexican population at large, which saw the state-owned firm as a dear part of their own patrimony (Langston and Pérez 2009, p. 493). Here is how Starr (2009) explained the effects of these strategies.

With Lopez Obrador setting the tone of the debate, PRD moderates were cornered. Some had toyed with the idea of supporting limited private investment outside of Pemex's core activities (exploration, production, and sales), but the political consequences of supporting what was now clearly labeled as a privatization of Pemex were suddenly much greater. (Starr 2009, p. 146)

Consequently PAN and PRI leaders met privately to broker a deal without the PRD. Together, they finally agreed on a legislative agenda that would allow more flexible service contracts to create partnerships with other oil companies and private service providers. Their major achievement was designing a new type of partnership that Pemex could strike with service providers in the exploration of oil fields. Instead of paying a flat fee to contractors irrespective of their results, as used to be done previously, now Pemex would be allowed to pay contractors in accordance to their performance, namely, in proportion to the quantity of oil they found. This so-called "incentivized contract" was the crown-jewel of Calderón's deal with the PRI. In addition, the two parties agreed on allowing private investment in the construction and management of oil refineries. Such plans, they claimed, did not require changes to the Constitution; they only involved changes to ordinary laws, so the PRI-PAN coalition had enough seats in Congress to get the bill approved. Initially, the PAN along with the technocratic leaders of the PRI were able to exert enough pressure on the nationalist faction of the PRI to accept those changes without major complaints. President Calderón sent his initiative to Congress on April 9, 2008, with the presumed goal of carrying out a surprise approval the following days before the PRD could react (Farfán and García, 2009). In the event, this master plan for a fast-track approval of a meaningful liberalization of the oil industry was thwarted.

The shocks that changed the game

The PRI-PAN initiative did not move forward in Congress as expected, as the PRD and the other leftist parties that felt excluded from the process found a way to stop it cold. For different reasons, all the left-wing factions were determined to prevent the energy bill from being approved. The moderate wing of the PRD wanted to influence any subsequent negotiations by including some of its demands; while the more radical factions wanted to block any attempts to change the status quo. However, they all knew the bill would pass if a vote took place since they did not hold enough seats to reach a simple majority. Their only chance was to prevent the vote altogether. So, reacting quickly to rumors that the PAN and the PRI were planning a fast-track approval, the PRD and its allies stormed both houses of Congress to occupy their precincts, effectively preventing any vote from taking place. The left-wing legislators physically seized the pulpits, and then blocked access to the Senate floor with chairs and tables.

In tandem with their occupation of Congress, the leftist parties also flooded several streets and public spaces with thousands of protesters – and López Obrador's calls for civil disobedience intensified. According to some observers, this new assertiveness of leftist parties motivated the left-wing faction in the PRI to be more assertive as well:

Lopez Obrador's discourse strengthened the position of nationalists within the PRI. They began to speak out more loudly and aggressively against the kind of reform favored by Calderon and made it politically much more costly for the PRI legislative leadership to support the President's initiative. Starr (2009, p. 146).

By closing down Congress and taking to the streets, the leftist parties were hoping to prevent Calderón's initiative from being approved. They made several requests in order to vacate the premises: the current bill on the floor should be definitely tabled; new negotiations should start in which they would be included; there should be a ten-week period of broad public debates with academics and the media; and a new vote had to take place after those debates.

Their plan worked. Legally, Congress could have simply selected an alternative venue to take the vote where the PAN and the PRI would have approved their bill. But politically it had become too costly. Emboldened by the PRD's actions, the nationalist faction of the PRI (namely PRI_{Left}) threatened to rebel against its technocratic leadership (namely PRI_{Right}). The nationalist *priistas* repudiated the bill as much as the *perredistas*, so they took this opportunity to express their ideological differences with the top brass. In defiance of their leaders, the nationalist wing of the PRI sided with the PRD demanding the postponement of the vote until a new debate took place. In addition to their ideology, it should be noted that nationalist *priistas* had other reasons for dissent. As argued by Elizondo (2011, p. 33), these legislators probably wanted to

flex their muscles in order to extract side payments such as monetary rewards for supporting the government's bill.

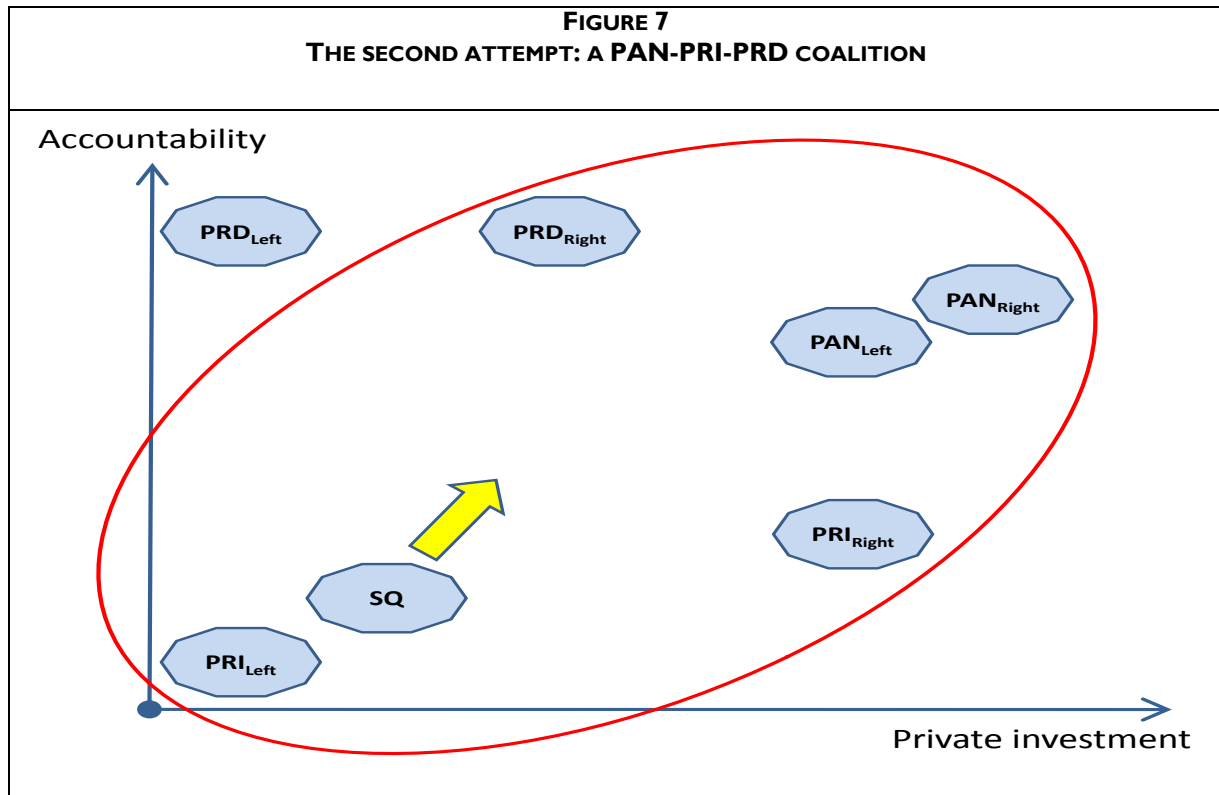
At this point, the previous agreement between PAN and PRI leaders ceased to be viable. The PRI leadership was forced to back out of its previous compromises with the PAN. Bowing to political reality, Calderón agreed to withdraw his initiative allowing a broad national debate leading to new negotiations for a different bill. The Senate organized a series of talks in its precinct, inviting academics, oil experts and public intellectuals of all stripes. Following seventy-one days of inclusive, diverse and publicized debates, a new bill was negotiated and written by the government and the opposition, this time including many PRD legislators.

Second round: The PAN-PRI-PRD coalition

A second type of coalition that could be formed in this context would include a super-majority of legislators from the three major parties, the PAN, the PRI and the PRD. Such a coalition would have more seats than were actually needed to pass legislation, but would include all veto players such as left-wing legislators who had achieved in becoming politically indispensable. Without them, the PAN and the PRI were now too vulnerable to public accusations of being sold to big American corporations and other private interests. The PRI also risked fracture if its leaders did not heed the nationalistic demands. Hence a super-majoritarian coalition was formed in the fall of 2008, when the PAN and the PRI reluctantly agreed to include the PRD as a full negotiating partner.

The so-called radicals within the PRD, along with the two smaller leftist parties were still unwilling to engage in any conversation with Calderón, hence excluding themselves from the bargaining table. But the so-called moderates within the PRD were eager to participate in the negotiations to promote leftist viewpoints. By this time, their political costs and benefits from engaging with the government were pointing in new directions. The no-recognition strategy espoused by López Obrador was seriously backfiring as he and his followers were losing popularity. Even some of his prominent sympathizers, such as leftist intellectuals, started critiquing his lack of engagement complaining that he had not designed an alternative proposal to pitch against the president's one (Farfán and García 2009, p. 333). According to several observers, López Obrador was starting to look like a "subversive politician" with personal interests rather than an earnest defender of the beloved oil company (Langston and Pérez 2009, p. 494). His detractors in the PRD, on the other hand, felt the need to show voters their capacity to influence legislation. Those in the PRD wishing to exert their power in the legislature were numerous – and they were increasingly willing to defy López Obrador by engaging in talks with the PRI and the PAN.

Accordingly, a new bill was jointly designed by the PAN, the PRI, and the moderate wing of the PRD. Such a coalition is depicted in Figure 7 below.



As we can tell from comparing Figures 6 and 7, a three-way coalition was expected to lead to a more modest bill than a two-way coalition. The reason is that more parties needed to agree to this bill. This was indeed the outcome when the PAN and the PRI were forced to include the *Nueva Izquierda* faction of the PRD in their negotiations. In terms of private participation in the oil sector, the ensuing legislation was a watered down version of the April initiative. In particular, a number of restrictions were explicitly imposed on the new “incentivized contracts” to safeguard against the private appropriation of rents from oil exploration. The contractor should be only paid with currency, never with oil barrels; the price paid per found barrel should be fixed ex-ante to prevent the contractor from trying to influence the market price ex-post (i.e. speculation); and barrels found should under no circumstances be included in the books of the contractor as its property. PRD legislators claimed credit for these safeguards, although some observers believe they had actually been brokered by the nationalist wing of the PRI (Farfán and García 2009, p. 337).

On the other hand, this type of coalition was better suited to move along the accountability dimension. When the PRD was included, the PAN gained an ally for pressuring the PRI into weakening the union and other rent-seeking groups. For instance, the PRD insisted that all contracts signed by Pemex should be made publicly available on the internet. It also insisted that contracts should be audited before being enacted. And it insisted on strengthening the regulatory agency in charge of overseeing oil activities. All three requests were supported by the PAN and made into law (Farfán and García 2009, fn. 21).

The PAN and the PRD also sought to weaken the presence of the union in the firm's administrative board. First they proposed to reduce the number of union members on the board, which the PRI vehemently opposed. Then it was proposed to increase the number of non-union members in the board, which the PRI approved. To be concrete, four so-called "professional counselors" would now be added to the administrative board of Pemex. These professional counselors should be external businessmen and industry experts who should take control of some of the responsibilities that union representatives would have liked to keep for themselves. It is likely that the creation of these four external counselors was intended as side payment to the PRI for allowing some weakening of the labor union. Indeed, their selection mechanism seems to be designed as a perk to this party – they need to be named by the Executive and ratified by the Senate, giving the PRI tremendous leverage to staff these four positions with loyalists. Elizondo (2011) believes that these new members of the administrative council were used as a bargaining chip in negotiations with *priistas*.

On October 28, 2008, Mexico's Congress finally passed legislation intended to modernize the state-oil company, Petróleos Mexicanos, and boost declining production. Approval of the energy sector reform was overwhelming: 93% of senators and 83% of deputies were in favor. The PRI and the PAN voted in favor. The two small leftist parties voted against it. The PRD legislators were divided: a majority corresponding to the *Nueva Izquierda* wing voted in favor, while the minority of hard-core loyalists of López Obrador voted against it.

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 has been much ideological resistance to changing the legal framework regulating this highly symbolic industry. For decades, reformers and policymakers failed to pass any profound reforms that would modernize Pemex. 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, many administrations avoided a battle to change the legislation of the oil industry. Reformers hesitated 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. I suggest that Pemex used to be the third rail of Mexican politics.

Yet, significant changes were achieved in the administration of Felipe Calderón. In particular, President Calderón was successful in getting the approval of a government budget in 2006, a fiscal reform in 2007 and an energy reform in 2008 that provided Pemex with fresh resources and tools to operate the following few years. These reforms also laid the ground for a new series of profound reforms carried out by the subsequent administration under President Enrique Peña Nieto. The 2008 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 interesting question to ask is: Why were some specific compromises reached and not others?

The goal of my chapter was to develop an analytical framework to study those questions. I did so by studying the politics of energy reform as they occur in the Mexican Congress. The conceptual framework in this chapter was based on the following elements: postulating the main issues regarding Pemex; identifying the main political agents in charge of reform; and locating the positions of these agents on those issues. The analysis was aided by a series of original graphs that helped us visualize the kind of coalitions that are conducive to change. I claimed that three issues tended to dominate the debate: private investment, accountability, and fiscal autonomy. I also identified the agents that were 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.

The graphical analysis showed that several coalitions could have implemented changes. On the fiscal side, a three-party coalition of all major parties was formed at

the end of 2006; it failed to expand the overall tax base, but it was conducive to a reduction on the taxes levied on Pemex. In 2007, a two-party coalition between the incumbent PAN and its closest ally, the PRI, resulted in a modest reduction on Pemex's tax burden in exchange for some new taxes from other sources. In terms of the comprehensive energy bill that was discussed in 2008, a PAN-PRI coalition was best suited to create more flexible contracts for joint explorations with other international oil companies (IOCs) or national oil companies (NOCs). Yet this coalition could not be sustained as some politicians in the left who were radically opposed to these reforms found effective ways to stop them. Once moderate elements of the PRD were included in a new coalition, the resulting liberalization was milder. In particular, the contracts designed for private investors were less flexible. However, the labor union and service contractors were forced to become somewhat more accountable: once the PRD was on board, the PAN had an ally to force the PRI to weaken these rentier groups.

The appendix presented these theoretical ideas more formally, in particular the idea that the ideological preferences of Congress members should be complemented by the costs and benefits from supporting a bill. I believe such framework can be pushed beyond the analysis provided in this chapter. In particular, the same tools from spatial voting could be applied to other important reforms in Mexico's Congress and other parliaments. It can also serve to speculate about future energy reforms, as I attempted in a companion paper (Serra 2011). This chapter hopefully illustrated the usefulness of such theoretical tools in analyzing important congressional negotiations that seem in principle complex and puzzling.

Appendix

A theory of legislative preferences with costs and benefits of supporting a bill

The theory of spatial voting postulates that policymaking takes place in a “policy space,” by which we understand a series of dimensions where different policies are located. For instance let us assume that a given policy can be represented with a single dimension that we will call x , where x is a number larger than zero. Our assumption is that different policies can be represented by different values of x . This would be the case of a tax levied on Pemex. If the tax rate in the *status quo* is 79% as it was around 2006, we can say that $x_{SQ} = 79$. Three different tax rates, x' , x'' and x''' can be ordered along the tax policy line, for example if $x' < x'' < x'''$. A given legislator i will have a preferred policy in this dimension, which we call the legislators “ideal point” and we denote by x_i . For example, if the legislator belongs to the incumbent party, she might prefer a fairly high tax rate of 85%, such as $x_i = 85$. The theory assumes that legislators are increasingly unhappy with policies that are increasingly farther from their ideal point. In other words, legislator i would want to minimize the distance between a given policy proposal x and her ideal point, which is given by $|x_i - x|$.

Now assume that a given legislative bill has two dimensions that we will call x and y , where x and y are numbers larger than zero. For example, this would be the case of an energy bill introduced in Congress that affects the state-owned firm Pemex on two issues: private investment and accountability. Each bill is then defined by a point called (x, y) in this two-dimensional graph. Three different bills, called (x', y') , (x'', y'') and (x''', y''') , can be placed in a two-dimensional graph with axes x and y , where x' , x'' , x''' are the amounts of private participation and y' , y'' , y''' are the amounts of transparency that each bill is proposing for the state-owned firm, respectively. A given legislator i will have a preferred policy in this two-dimensional space, which we call the legislators “ideal point” and we denote by (x_i, y_i) . As I said above, the theory assumes that legislators are increasingly unhappy with policies that are increasingly farther from their ideal point. In other words, legislator i would want to minimize the distance between a given policy proposal (x, y) and her ideal point, which is given by $\sqrt{[(x_i - x)^2 + (y_i - y)^2]}$.

This framework is standard in political science and political economy (see for example chapter 5 in Shepsle 2010). To this traditional framework I would like to add some elements that will be useful in understanding the type of congressional negotiations that I study in the chapter. In many circumstances, it is quite clear that legislators have payoffs from supporting a bill irrespective of their ideological preferences for this bill. There are several types of costs and benefits, punishments and rewards, to a legislator for voting in favor of a given initiative. For example, if a

powerful political boss repudiates a bill, he might be able to punish legislators who support it by jeopardizing their future political careers. On the other hand, if a certain initiative is popular with the electorate at large, anyone supporting it will gain points with public opinion. I will assume that this type of payoffs may exist for certain legislators in the negotiations studied in this chapter. For a given legislator i , we call b_i and c_i the benefit and the cost she would incur if she voted in favor of the bill being discussed.

To sum up the theory that will be guiding this chapter, I will assume that each legislator would like to minimize the distance between her ideal point and the policy in being discussed, while at the same trying to obtain the benefit and avoiding the cost of supporting this policy. If the bill being negotiated is not accepted, then the status quo (SQ) will remain in place. These preferences can be summarized as follows.

Consider a bill (x', y') that involves two policy dimensions, x and y .

1. If the bill passes, legislator i would receive the following payoff:

$$\sqrt{[(x_i - x')^2 + (y_i - y')^2]} \text{ if she votes against the bill}$$

$$\sqrt{[(x_i - x')^2 + (y_i - y')^2]} + b_i - c_i \text{ if she votes for the bill}$$

2. Otherwise, if the bill does not pass, legislator i would receive the following payoff:

$$\sqrt{[(x_i - x_{SQ})^2 + (y_i - y_{SQ})^2]} \text{ if she votes against the bill}$$

$$\sqrt{[(x_i - x_{SQ})^2 + (y_i - y_{SQ})^2]} + b_i - c_i \text{ if she votes for the bill}$$

With this theoretical framework in mind, the chapter analyzes the negotiations to reform Pemex between 2006 and 2008.

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