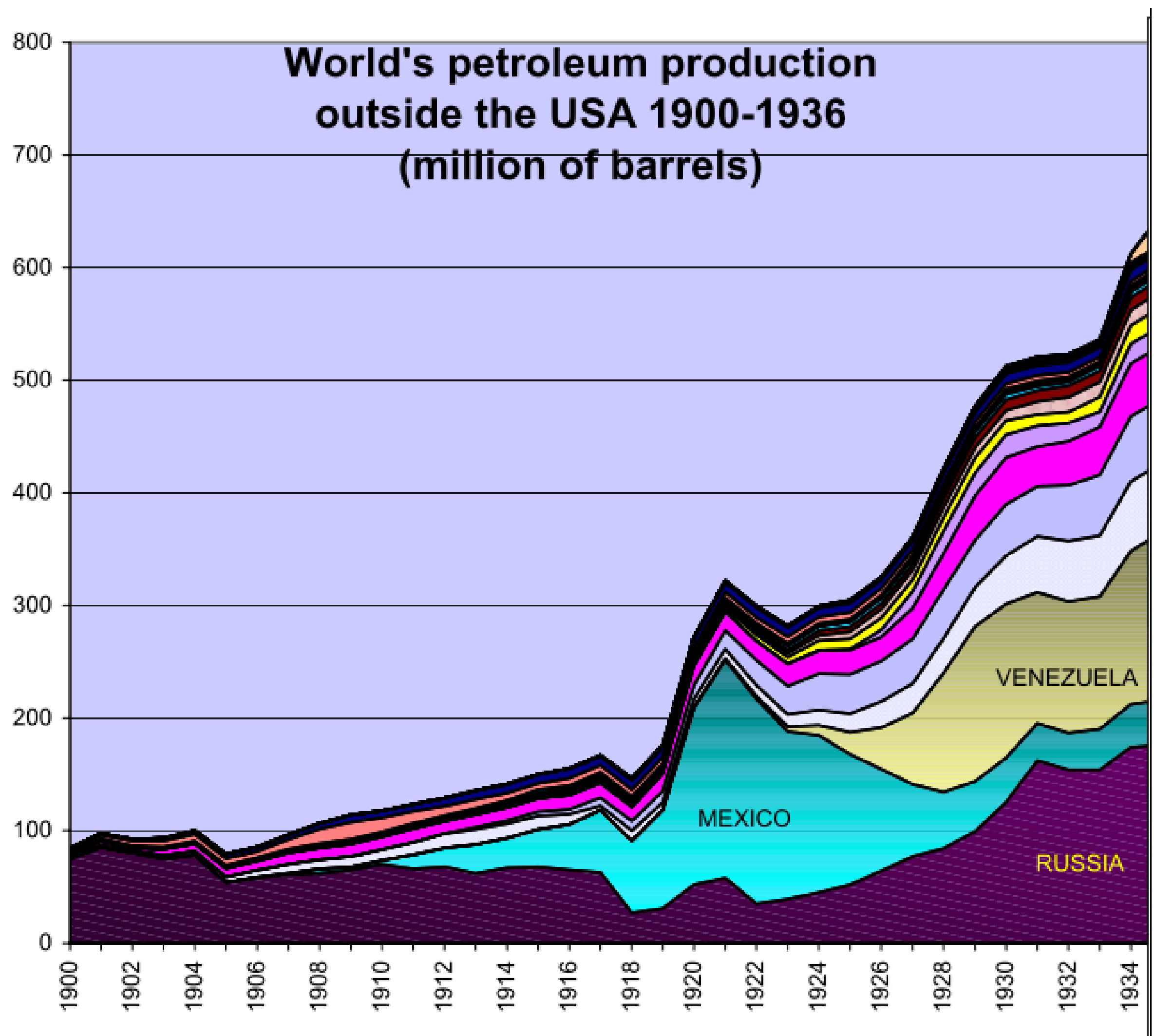
Mexican Oil Expropriation of 1938

History of Oil Industry in Mexico

Mexico's oil industry was almost nonexistent before 1900. Crude oil (petroleum pumped from the ground) had only been used on a large scale, for a short while before that, when whale oil grew more difficult to get, and its price rose. Then, people realized that if you refined crude oil into kerosene, it could be used to light homes. Thus began a worldwide search for crude oil. This only intensified, as people realized that petroleum could also be refined into gasoline and diesel fuel.

In the early 1900s, both consumption and production increased dramatically. From 1905 onward, the US was the largest producer in the world. You can see Mexico's role in the oil export industry in the following chart, for the years 1900-1934:



As you can see, Mexico's production peaks in the early 1920s. During the early and mid 1920s, Mexico was the largest exporter of crude oil in the world, and the second largest producer (behind the United States), with almost a fourth of the world's oil production.

The 1920s started out looking very positive for Mexico. It had a new constitution (written in 1917), and two Presidents were elected and served out their full terms (not always a given in Mexican politics): Álvaro Obregón (1920-24) and Plutarco Elías Calles (1924-28).

Finally, the Mexican Constitution of 1917 was a nationalist document, created in reaction to the Porfiriato, during which foreign companies controlled much of the Mexican economy. Article 27 of the 1917 Constitution states:

> The Nation shall at all times have the right to impose on private property such limitations as the public interest may demand, as well as the right to regulate the utilization of natural resources which are susceptible of appropriation, in order to conserve them and to ensure a more equitable distribution of public wealth.

In other words, the Constitution itself stated that the Mexican government had the right to control and even expropriate natural resources of Mexico. While this passage did not declare that any natural resource *would* be seized, it certainly made any such expropriation constitutional. You could say that while it did not order any confiscation of foreign reserves of Mexican natural resources, it paved the way for it.

Foreign investment in Mexican oil fields shrunk dramatically, from 1910 to 1929. This is especially noticeable when compared to investment in other nations' oil industry:

Nominal investment in Latin America by the US and the UK in 1913 and 1929 (US dollars per capita)

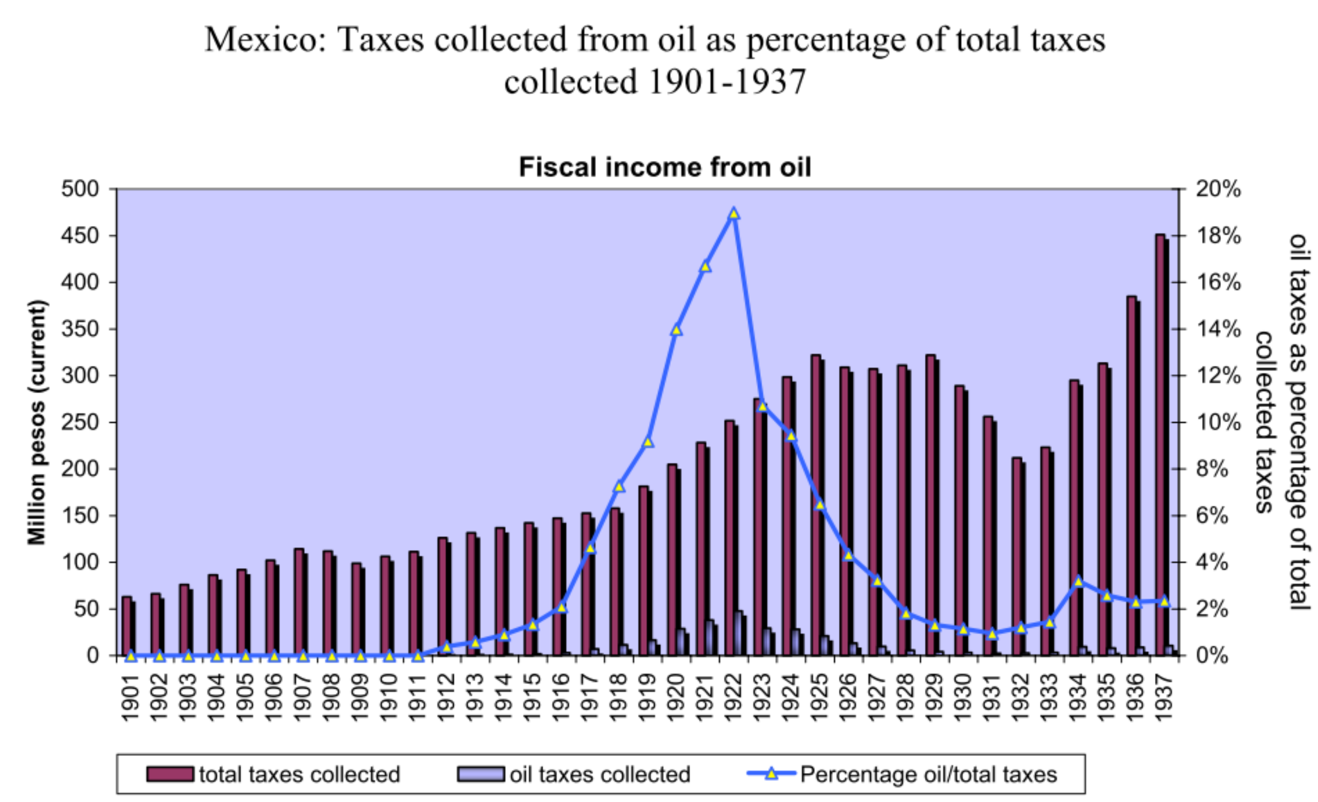
	US investment		UK investment	
	1913	**1929**	**1913**	**1929**
Argentina	5.22	52.70	243.17	184.61
Brazil	2.11	14.47	49.11	42.98
Chile	4.33	91.96	95.87	90.57
Colombia	0.40	36.46	6.96	5.32
Peru	7.76	27.08	29.50	25.28
Uruguay	4.29	40.76	206.0	138.21
Mexico	36.30	41.92	42.53	-
Venezuela	1.15	55.34	15.83	31.45

Sources: Table 1.1-1 in (M.d.M. Rubio Varas, 2002) p. 23

This was simply because the Mexican oil fields were becoming too expensive to explore. The oil companies were finding fewer producing wells. They were more than willing to explore for oil, and their investment in the Mexican oil industry peaked *after* oil production peaked. In other words, the problem with Mexican oil in the late 1920s and early 1930s was that it was becoming too expensive.

Interestingly enough, as Mexican oil production was increasing dramatically, many Mexicans were dreaming of even greater production levels, which would bring untold wealth to the nation. Mexican geologist Miguel Bustamante, in 1917, wrote that even though Mexico's oil production was only 30 million barrels in 1916, that it could rise to 200 million barrels a year.

And so the Mexican oil industry was hit with a very cold, hard dose of reality in the 1920s. First, there were unrealistic expectations that Mexicans had developed about future production of oil, and the future wealth of Mexico. The second was a sharp decline in foreign investment, that was needed to expand Mexico's oil production—and this decline was occuring because exploration was providing for fewer producing wells. When decreasing production met increasing expectations, something had to give. Ultimately, this is what brought about the Mexican expropriation of foreign oil fields in 1938.



As you can see from the graph above, Mexico was not getting that much revenue from its oil exports. At its peak production, in the early 1920s, oil taxes were just under one fifth of federal taxes collected. And it fell sharply from that point onward, to 2% in the early 1930s. Even after the oil expropriation in 1938, it remained below 5% of all federal revenues.

Mexican oil production did not continue to increase, as the charts above indicate. Its 1928 production levels were below 1918; they did not recover the highs from the early 1920s until the 1970s.

The basic issues confronting international oil companies, and the Mexican government, were that production and of course, tax dollars (or pesos!) collected by the Mexican government were declining, when it was expected that they would be increasing.

Mexico soon realized that its oil output was declining, but then blamed exploitation by the oil companies, seeing that the oil reserves should have been used moderately, for the needs of the Mexican people, instead of being used in one large bubble, for the benefit of foreign countries.

Mexican Oil Expropriation of 1938

Excerpts from the speech of President Lazaro Cardenas to the nation of Mexico, 18 March 1938, announcing the oil expropriation:

It has been repeated ad nauseam that the oil industry has brought additional capital for the development and progress of the country. This assertion is an exaggeration. For many years throughout the major period of their existence, oil companies have enjoyed great privileges for development and expansion, including customs and tax exemptions and innumerable prerogatives; it is these factors of special privilege, together with the prodigious productivity of the oil deposits granted them by the Nation often against public will and law, that represent almost the total amount of this so-called capital.

Potential wealth of the Nation; miserably underpaid native labor; tax exemptions; economic privileges; governmental tolerance-these are the factors of the boom of the Mexican oil industry.

Let us now examine the social contributions of the companies. In how many of the villages bordering on the oil fields is there a hospital, or school or social center, or a sanitary water supply, or an athletic field, or even an electric plant fed by the millions of cubic meters of natural gas allowed to go to waste?

What center of oil production, on the other hand, does not have its company police force for the protection of private, selfish, and often illegal interests? These organizations, whether authorized by the Government or not, are charged with innumerable outrages, abuses, and murders, always on behalf of the companies that employ them.

Who is not aware of the irritating discrimination governing construction of the company camps? Comfort for the foreign personnel; misery, drabness, and insalubrity for the Mexicans. Refrigeration and protection against tropical insects for the former; indifference and neglect, 2 medical service and supplies always grudgingly provided, for the latter; lower wages and harder, more exhausting labor for our people…..

Another inevitable consequence of the presence of the oil companies, strongly characterized by their anti-social tendencies, and even more harmful than all those already mentioned, has been their persistent and improper intervention in national affairs.

The oil companies' support to strong rebel factions against the constituted government in the Huasteca region of Veracruz and in the Isthmus of Tehuantepec during the years 1917 to 1920 is no longer a matter for discussion by anyone. Nor is anyone ignorant of the fact that in later periods and even at the present time, the oil companies have almost openly encouraged the ambitions of elements discontented with the country's government, every time their interests were affected either by taxation or by the modification of their privileges or the withdrawal of the customary tolerance. They have had money, arms, and munitions for rebellion, money for the anti-patriotic press which defends them, money with which to enrich their unconditional defenders. But for the progress of the country, for establishing an economic equilibrium with their workers through a just compensation of labor, for maintaining hygienic conditions in the districts where they themselves operate, or for conserving the vast riches of the natural petroleum gases from destruction, they have neither money, nor financial possibilities, nor the desire to subtract the necessary funds from the volume of their profits.

Under a 1935 Expropriation Law and his powers as chief executive of the nation, Cardenas continued, he was expropriating all of the “equipment, installations, buildings, pipelines, refineries, storage tanks, railroad and auto tankers, docks, gas stations, and all other fixed and intangible properties” of the American, English, and Dutch oil companies. Note what he didn’t say was being expropriated: the oil itself. This, Cardenas would maintain, already belonged to the nation.

The British government, whose nationals had a far larger stake than U.S. firms, immediately broke diplomatic relations. American and British oil companies sought to get courts to enforce an embargo on Mexican oil, but in country after country, the courts refused to impose one. After a short delay U.S. President Franklin D. Roosevelt requested that Mexico make prompt and fair payments to the oil companies. This not only provided compensation for expropriated property, but it also removed a pretext for intervention. The Mexican government made certain that the companies received all of their payments on time. In fact, when compared to the market value of the company stock, and taking inflation into account, the oil companies actually received more than the value of what they lost.

Oil Company Activity in Mexico

As the Mexican Eagle Oil Company, the dominant oil company in Mexico in the early 1900s, founded in 1900, drilled for more wells, Mexico's crude oil production increased dramatically, and the price of kerosene in Mexico fell dramatically—from about 40 cents per gallon, to 14 cents. In 1901, Mexico produced only 10,000 barrels of oil; by 1910, it produced 3,632,000 barrels; and by 1916, 40,545,000 barrels.

Wages in the petroleum industry in Mexico were much higher than in other industries. This is clear if you compare the average wage in a given industry, or simply, the exact same job in the petroleum industry, compared to that job in another industry. From a survey the Mexican government took in 1936:

Occupation	Petroleum Industry (pesos/day)	Average for All Mexican Industries (pesos/day)
Blacksmiths	7.25	1.98
Electricians	6.00-7.60	2.74
Masons	5.20-8.40	1.89
Carpenters	4.00-8.40	2.05
Chauffeurs	4.80-6.00	2.26
Stevedores	3.00	2.05
Unskilled	3.00-3.50	1.13

Average Wages in Various Industries in Mexico, c. 1936		
Industry	**Average Daily Wage (pesos)**	**Average Annual Wage (pesos)**
Petroleum	**7.42**	**2671**
Electrical Power	**5.09**	**1832**
Street Railways	**4.55**	**1638**
Mining	**4.32**	**1555**
Textiles	**3.13**	**1127**

And so the oil companies in Mexico were paying wages that were 2-3 times higher than the same jobs would get in other industries. And the average pay in the petroleum industry was 50-100% higher, than the average wage in other industries. Employees in the petroleum industry also had substantial fringe benefits that employees in the other industries did not have. These fringe benefits included: free company housing, free medical benefits for the workers and their immediate families, and schools for the workers' children. These fringe benefits had a value roughly equal to fifty percent of the wage pay.

And the oil business in Mexico was no longer booming, from the mid 1920s onward. The number of new successful wells fell every year from 1926 (318 new successful wells drilled) to 1932 (only 31 new successful wells); while it rose slightly after that, it never rose above the 1931 level of 57 new successful wells. And the overall production peaked in 1921, with 193 million barrels produced that year. In the 1930s, oil production hovered between 32 and 47 million barrels a year.

In the November of 1935, the oil companies in Mexico received a 165 page document which outlined the proposals of the Petroleum Workers Union. If the demands were not met in 10 days, a general strike would be called. These demands included:
(1) a reduction in the work week to 40 hours, with no reduction in pay
(2) increases in the wage rates. For example, unskilled labor's daily wage rate was to be increased to 7 pesos per day, up from about 3.50 pesos per day.
(3) Workers were not to be shifted from one job to another without the consent of the union.
(4) Companies were to provide free medical and dental care for workers and their extended families. The extended family included not only the nuclear family of the workers, but their parents, and grandparents, as well as grandchildren. The companies already provided such care for the workers and their immediate family; i. e., their spouses and children.
(5) About one half of executive positions were to be union members. These positions included the assistants to the company executives.

The oil industry refused. The dispute then went to the Federal Board of Mediation and Arbitration. After weeks of hearings, the Board met privately for 30 days, and then issued a 3000 page report, suggesting that most of this document had been prepared long in advance. The Board disputed profits of the petroleum industry, arguing that instead of 20-30 million pesos a year in profit, claimed by the oil industry, that in reality it was making 63-73 million pesos a year. The oil industry still refused to pay what the Board demanded.

Then, a Group Seven (actually three man, one from the companies, the union, and the government—and the companies were always outvoted) committee met for 2 months. After weeks of further delay, it released its 1000 page report. This added to the union demands: in addition to providing free medical care for the workers and their families, the companies were to provide hospitals wherever a national medical commission specified. All foreign technical employees had to be replaced by Mexican workers within three years. If any three union members complained about an executive, that executive had to be fired.

The oil companies appealed this decision to the Supreme Court of Mexico, which ruled against them in March 1938. Later that month, President Cardenas issued his now famous declaration of the expropriation of the oil companies' assets.
The United States, a week after this announcement, ended purchases of silver from Mexico that were significantly above what Mexico could have gotten on the free market (this was an attempt to help out American silver mining companies).

And the oil industry stagnated in Mexico, until a new deal was worked out with the oil companies. On the one hand, compensation was provided them. In point of fact, the oil companies were paid more than the cost of their stock that was taken from them. On the other hand, a new deal was made with foreign oil companies in 1949, under which they would undertake the costs of exploration and drilling, in exchange for a share of the profits. What Mexico got, in exchange for the money that was paid out, was oil wells that produced for a few more years, and physical plant that wore out and was not always replaced.

Union wages did increase until 1944, when it fell to pre-confiscation levels. Now PEMEX, the new state oil company, did hire an additional 10,000 workers, so those new employees did benefit from all this.

Its not clear who else did. PEMEX did so poorly that the government was forced to grant a 60 million peso subsidy to it in 1940.