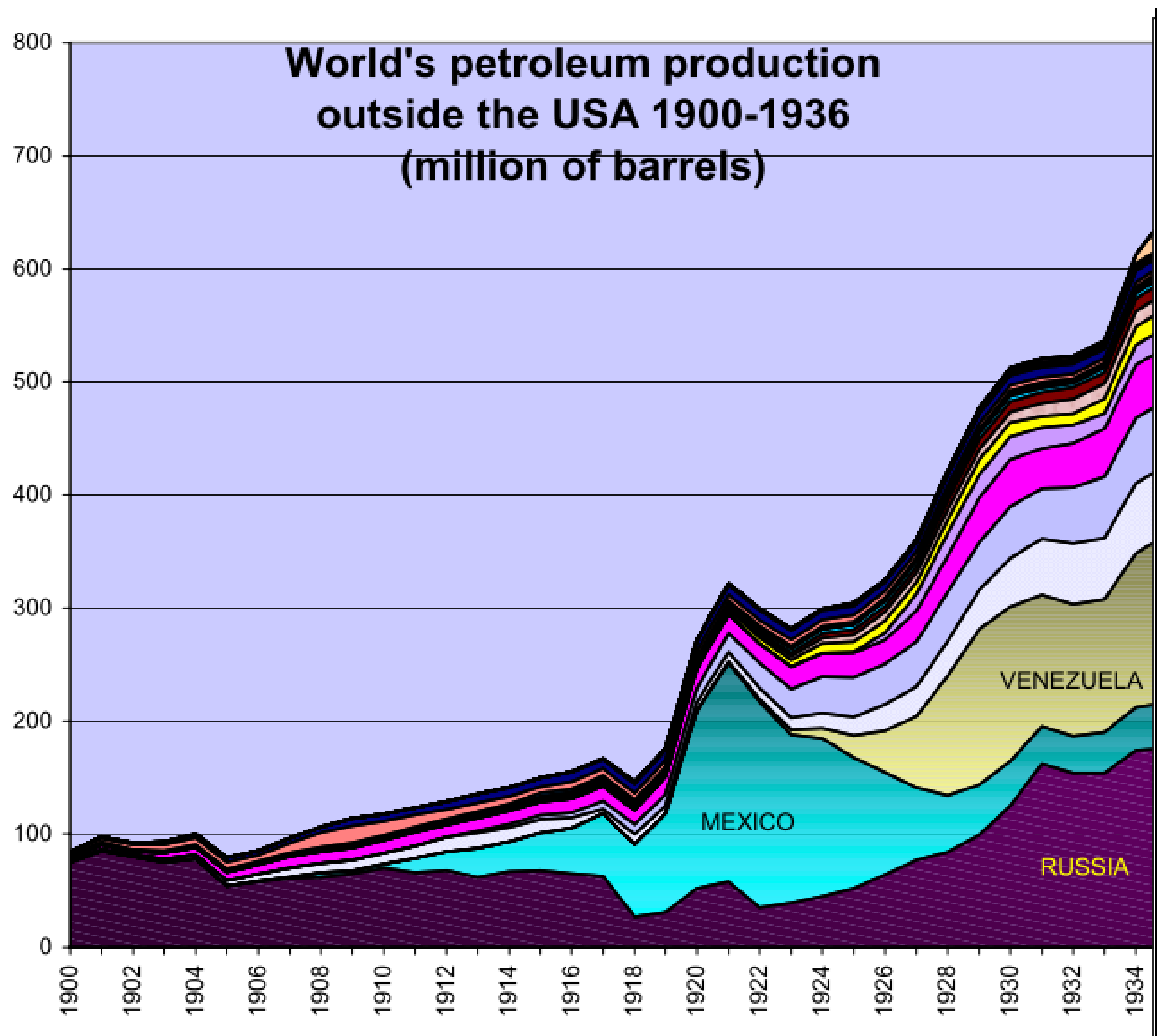
Mexican Oil Expropriation of 1938

PART ONE: 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).

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.

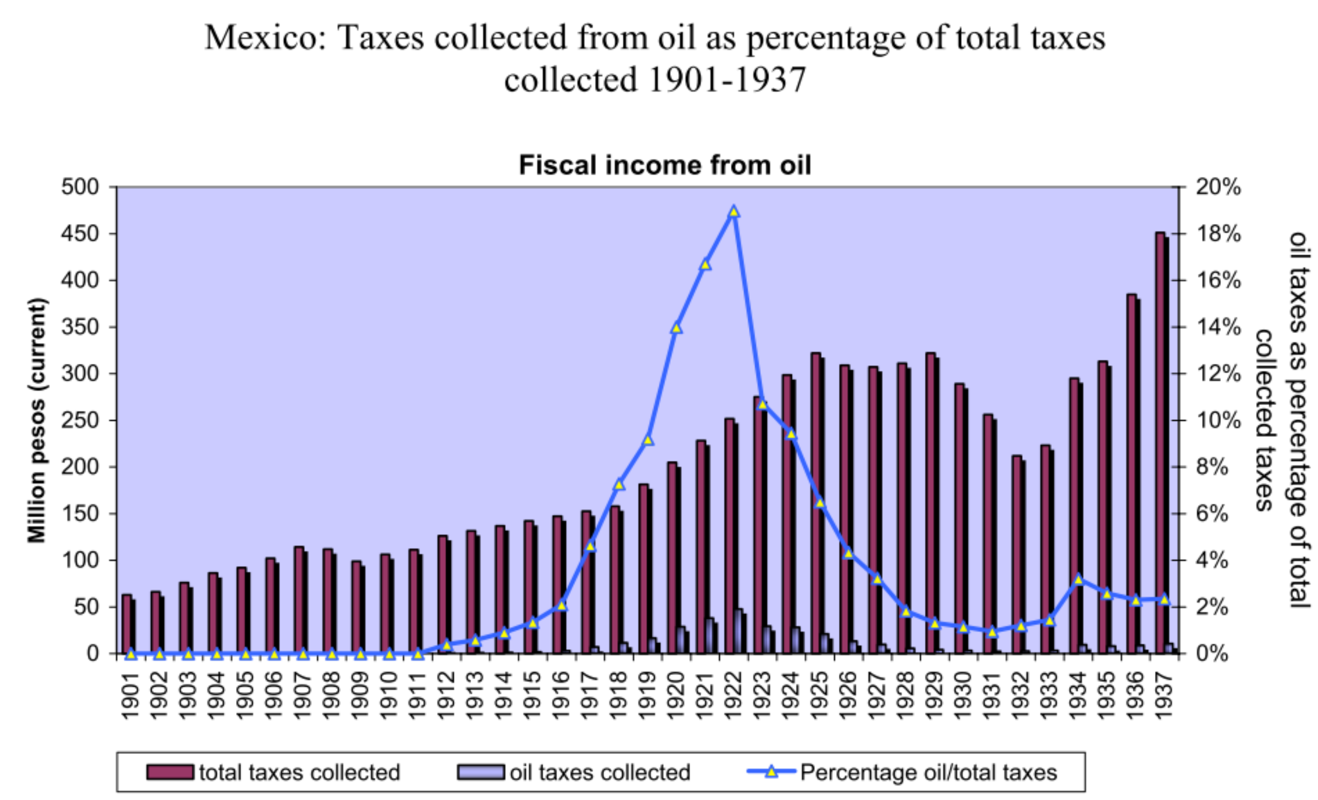
Another factor affecting the relationship between foreign oil companies and the nation of Mexico, was the Mexican Constitution of 1917 was a nationalist document, created in reaction to the Porfiriato, during which foreign companies controlled much of the Mexican economy. Article 27 of the 1917 Constitution 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 expropriation, 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.

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. And as crude oil output surged, the price of kerosene in Mexico fell dramatically—from about 40 cents per gallon, to 14 cents.

But 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.



The thin line peaking in the early 1920s is a percentage of overall revenues that came from oil taxes, measured along the right axis. The bars are total taxes collected (purple) and oil taxes collected (light blue), measured along the left axis. 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 (20%) 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 chart on page one indicates. Its 1928 production levels were below 1918; they did not recover the highs from the early 1920s until the 1970s.

PART TWO: 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, 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.

PART THREE: Foreign Oil Company Contributions to Mexican Economy and the Leadup to the Oil Company Expropriation

In addition to taxes paid by the oil industry to the Mexican government, the oil companies benefited Mexico by paying above average wages to their Mexican employees. 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 same 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

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. 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 wages paid to the workers.

In the November of 1935, the oil companies in Mexico received the proposals of the newly formed oil workers union. These included a reduction in the work week to 40 hours, with no reduction in pay; increases in the wage rates (for instance unskilled labor's daily wage rate was to be increased to 7 pesos per day, up from about 3.50 pesos per day); the free medical and dental care that was already provided to the nuclear families of the workers would be extended to the extended families---parents, grandparents, and grandchildren; about one half of executive positions were to be union members. These positions included the assistants to the company executives.

Late in 1936, President Cardenas imposed a 6 month cooling off period. In mid 1937, the government granted the unions the right to take the labor dispute to forced arbitration. On March

2, 1938 the Federal Labor Board announced that it would grant the unions a wage and benefits increase worth $7.3 million and greater control over personnel decisions.

The oil industry refused. The dispute then went to the Federal Board of Mediation and Arbitration. 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 committee of three representatives (one each from the oil companies, the union, and the government—and the companies were always outvoted) 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. **From these terms, it appears that Mexico was determined to take over the oil industry, whether the terms were accepted by the foreign oil companies or not.**

The Supreme Court upheld the decision the next day. Mexican Petroleum (SIZE) reacted by closing 23 wells, moving oil stored in the fields to Tampico (a port on the eastern coast of Mexico, presumably for quick export), shutting down the Mata Redonda plant, and sending a letter to every employee stating that it would be unable to comply with the board's order.

The union called for a national strike. The March 7 deadline fixed by the Federal Labor Board came and went. On March 14 the Labor Board warned that they needed a response from the company (Mexican Petroleum) by the following day. On March 15 the company reported that it could not comply. The board responded by suspending all contracts. With their pay suspended, and a strike deadline looming, workers began to seize loading terminals and shut down pipelines across all oil firms. Finally, on March 18, President Cardenas announced the expropriation by the Mexican government, of the Mexican oil industry.

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.

Union wages did increase until 1944, when they 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.

Part Four: Analysis of the Oil Expropriation

In all likelihood, the most accurate perspective of this seems to be that the expropriation was simply a misunderstanding on the part of the labor unions, and Mexico's government, as to the profitability of the oil fields (and the ability of the foreign oil companies to afford raises to the workers). Oil prices were falling (making those assets less valuable for Mexico, and less worth the trouble the expropriations would cause), as was the profitability of the oil industry. It it took eight years for the Mexican industry produce as much as it had before the expropriation, and government revenues did not regain their pre-expropriation levels for nine years. Investment in new oil fields by the foreign oil companies, had fallen from the late 1920s, as had oil production itself in Mexico. Reflecting this, share prices of the stock of these Mexican oil companies also declined.

Having said that, there are additional benefits to Mexico (from that of simply making money out of this enterprise)--those of increasing Mexican employment, the wages paid to the Mexican workers, as well as control over the Mexican industry. Without a doubt, Mexico enjoyed benefits in these three areas, apart from any money that was made after the expropriation.

From the oil companies' perspective, they simply could not afford these wage and benefit increases. The reason why the Federal Labor Board awarded the wage increases is that the board felt that the oil companies were understating the profitability of their Mexican oil ventures. For example, the Mexican government and the board, felt that the profits of foreign oil companies in 1936 were $15.3 million; the companies themselves held that their profits were only $3.6 million. The labor settlement imposed by the board and backed up by the Mexican government would have cost $7.3 million. Applying this to the largest oil company operating in Mexico, Mexican Eagle, their increased expenses due to the settlement would have been 102 percent of their revenues for that year (the government insisted that it would only have been 31 percent of its revenues).

Not being an accountant, and with history, not business, as my field of expertise, I am withholding a final judgment on this point. I will only point out that the oil companies were not behaving as if there were lots of money in Mexican oil; and the stock market as a whole, was in accord with this. Both investment in new fields, the amount of oil pumped from Mexican wells, as well as the stock prices of Mexican oil companies, was declining in the 1930s, from the peak levels in the 1920s. So from the outside, regardless of how much money was being reported as profits and revenues to the Mexican government, it looks to me, like the Mexican unions and government were mistaken about how much money the oil companies were making.

One other issue was a concern here, even if the oil companies could afford the settlement--the precedent that other nations might want to follow. In 1927 Spain nationalized Jersey Standard's properties. In 1931 Uruguay established a state-owned oil refining and retailing company that drove down the private share of the market from 100 to 50.2 percent by 1937. In 1932 the Chilean government threatened expropriation, which was headed off only by a military coup. In March 1937 Bolivia nationalized Jersey Standard's unprofitable concessions.

Initially, the Mexican government did not plan to compensate the foreign oil companies at all. But eventually, after negotiations with American President Franklin Roosevelt, Mexico agreed to a fairly generous compensation. The Mexican government paid the foreign companies just over $160 million for their buildings, supplies, pipelines and all other property (Cardenas in his speech, did not mention the expropriation of the oil itself, as this was, legally speaking, the property of the Mexican nation itself).

Now the compensation that the Mexican government gave the oil companies can be compared, in two instances, to the valuations of the companies provided by the market itself. From the market valuations of the two largest oil companies, Mexican Eagle and Mexican Petroleum, it can be clearly seen that the foreign oil companies were well compensated by the Mexican government. The largest, Mexican Eagle, proclaimed in its own record books in 1936, that its market capitalization (the value of all of its stock) was $12.2 million; the book value of its assets (if you simply sold off the entire company, part by part) was $16.5 million. Yet after factoring in interest, and inflation, the 1938 value of the money that Mexico paid (the payments began in 1948 and ended in 1962) was $43.6 million! In the second instance, an American oil company that owned 97% of Mexican Petroleum's stock, was sold in 1932 (and Mexican Petroleum, which traded independently on the New York Stock Exchange, made up 21% of that other company's value). Factoring in interest and inflation, as well as a later 1935 purchase of additional stock, this would equal some $19.5 million in 1938, very close to the $19.37 million in 1938 dollars that was actually paid to the company.