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TOP SECRET

December 29, 1944.

Memorandum of Conversation

On Tuesday, December 26, I had a two-hour conversation with the Minister of Foreign Relations, Dr. Padilla, during the course of which we discussed various matters which had come up during my visit to Washington. We spent a good part of the time on the discussion of the Argentine situation and the desirability of a meeting of foreign ministers of the American states participating in the war effort, in the consultations concerning which Dr. Padilla has been so helpful.

As the President of Mexico and Dr. Padilla know that it was my intention to discuss while I was in Washington the question of Mexican oil policy and the request of the Mexican Government for a loan for oil development made in a note addressed to us some four months ago, it was my intention during this conversation to briefly inform him concerning my conversations with the President, Mr. Stettinius, and others in the Department. I felt under the necessity of making some preliminary statement before the formal instruction comes to me from the Department to the effect that a loan for ordinary oil development is out of the question. Ordinary courtesy demanded that I not delay making at least a preliminary statement to the Minister on this matter, and prior to the receipt of the formal instruction, as the President and the Minister knew that I had this particularly in mind in making this visit, and failure to give them preliminary information would not be in accord with the collaborative and frank relationship which I am privileged to have with the President and the Foreign Minister.

As the conversation on December 26 had lasted for two hours, I suggested to the Minister that I speak to him with regard to oil policy the following day at his convenience, and he suggested that I call at his house at 10 a. m. the 27th. I called at Dr. Padilla's house at 10 a.m. the 27th. I reviewed first briefly the progress of the conversations which we have had on oil policy since I came to Mexico as Ambassador.

I referred finally to the conversation which he had had with President Roosevelt during his visit to the United States about the middle of this year. I said that on study it had been found that a loan by my Government to the Mexican Government for oil development purposes was impracticable and impossible under our legislative procedures and under our general policy. I said that President Roosevelt, like most of us at home, was very much interested in the development of oil reserves which could be used for common defense and for the defense of this hemisphere should there

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be further trouble in the world. I said that President Roosevelt was very much interested in the development of such oil reserves in Mexico, which could be set aside and used for such purpose only. I said that President Roosevelt in his conversation with Dr. Padilla toward the middle of this year had had this in mind and that the misunderstanding with regard to the position of our Government with regard to the possibility of a loan, which misunderstanding had led to the Mexican note requesting a loan, had undoubtedly come about through the emphasis which President Roosevelt had placed on this oil reserve for common defense.

I went on to say that after discussing this matter fully with the President and with Secretary Stettinius and the officers of the Department I found that it was not possible for our Government to make a loan to Mexico or to any other country for the purpose of ordinary oil development. I said that we were still interested in discussing with the Mexican Government the question of finding an area which could be duly explored and developed to the degree necessary so that the oil could be used for common defense and continental defense in case of necessity. For the exploration and development of such a reserve we were prepared to make a loan or to advance funds to be expended together with funds of the Mexican Government for the exploration and adequate development to the degree necessary of such a reserve. The amount of money involved, however, in such an operation was relatively small. I said that I was going to receive instructions which would permit me to continue conversations on this phase of the matter, and in case an understanding could be found there would undoubtedly be some funds available from my Government to participate in the necessary work.

So far as a loan by the Government of the United States to the Government of Mexico or to Petroleos Mexicanos was concerned for ordinary oil development in Mexico, I said that the President had informed me that this was out of the question and that the Department of State concurred fully in this view. I said that I would in due course receive instructions to reply to the note which the Foreign Office had sent, requesting such a loan, to the effect that it was not practicable or feasible under our legislative practice and policy.

I said that I regretted that there was this misunderstanding under which the Mexican Government was resting and under which the note had been sent requesting a loan and that I was sure that all of us regretted this misunderstanding, but that I thought it was a very good thing in the interest of everyone concerned to get this matter cleared up.

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I told the Minister that I was, of course, giving him this information only in a preliminary and informal, and not yet in an official way. I said that I was going to get an instruction from the Department in due course, on the basis of which I would address a note to the Mexican Government indicating that no oil loan such as that requested by the Mexican Government was possible. I felt, however, that as a matter of courtesy, and because of the frankness and collaboration which characterized our intercourse and the relationships between our two countries, it was my duty to give him this preliminary informal information.

The Minister showed a certain amount of surprise over the information which I communicated but did not express it in words. He said that naturally the information which I gave him was most important and most interesting. He did not express by words any regret that an oil loan as requested was not forthcoming or possible. His major comment was that now we would have to see what could be done to meet the situation and that we carry on our conversations along the lines that we had been carrying them on before the question of a loan came up.

I told the Minister that with his permission I would be very glad to discuss the matter further with him in a frank and informal and off-the-record manner, and he said that he would be very glad to do so and thought it would be useful.

I then went on to say to the Minister that I had from the outset felt that a loan for the ordinary oil development by my Government to the Mexican Government, or any other government, was impossible. I said that I had always been confident that such a loan fell without the province of the Export Import Bank, and even if it could be construed to fall within the prerogatives of the Export Import Bank, the bank would not make such a loan which would run eventually into hundreds of millions of dollars and was so highly risky in character, without seeking the approval of Congress. I said that in my opinion if approval were sought from the Congress for a loan by our Government to the Mexican Government or to any other government for oil exploration and development such as they contemplated, that Congress would overwhelmingly disapprove any such proposed legislation. I said that I had been of this opinion from the outset and that I was therefore not surprised to find that a loan of this kind by our Government was not possible. I made it clear that it was not a question of Mexico, but of any loan of such a character to any country.

I then went on to say that in this off-the-record way I thought I should say that even if a loan of such a character were possible by my Government it would be the very worst service which we could render to Mexico to make such a loan. I said that I recognized that

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the Mexican Government would maintain its oil monopoly. I said that I did not believe there would be any change so far as the oil monopoly was concerned for many years in Mexico. Petroleos Mexicanos, instead of improving in its operations and administrative practices, was deteriorating. It would not have the administrative or technical staff to carry through the great operation with which it was charged. No exploration and development had taken place since expropriation on anything like an adequate scale and could never take place under Petroleos Mexicanos acting on its own, for this involved extraordinary expenditures of funds, which Petroleos Mexicanos did not have, and which the Mexican Government was not in a position to supply to Petroleos Mexicanos. I said that adequately managed and operated, Petroleos Mexicanos should show a good profit, but it was not doing this, and whatever profit there was was absorbed by the increased wages which the petroleum workers demanded. I said that so far as the Petroleos Mexicanos ever being able to do adequate exploration and development to meet even the needs of Mexico was concerned, everyone recognized that this was impossible.

I said that the Minister knew very well how thoroughly I had studied the budgetary and financial business of Mexico and how sympathetically I considered all of her problems. I said that even someone who had gone into the matter less thoroughly than I realized that the Mexican Government could, therefore, in the next decade and perhaps two decades, find the funds to advance to Petroleos Mexicanos to explore and develop new oil resources. I said that my Government and I were sure that no other government would make a loan to Mexico for this purpose as it was too speculative a loan, and I said that the Mexican Government had so much need for funds which it might have to borrow for roads, electrification, sanitation, schools, and other social measures; that a loan, internal or external, for oil development was impracticable. I said to the Minister that this was the real situation which had to be faced and that therefore there was only one solution, and that was for the Mexican Government to make contracts through Petroleos Mexicanos with American or other foreign companies to explore and exploit particular areas which might be set aside under the contract and under which contract the Mexican Government would receive its full and equitable share of the profits, after amortization of the charges incurred by the companies has been taken care of. I said that in previous conversations we had so fully discussed the special character of the oil business, and that it was a business which had to be carried on by big companies which had huge reserves at their disposal. not

The Minister at this point said that as I well knew, he had always been of the opinion that this was the sound way for Mexico to proceed. He asked me whether I did not think the question of an oil

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bank, as he had discussed it with me, was feasible. I said that it was not feasible in my opinion because an oil bank had to have capital and that capital had to come from governments, and governments were not going to be in a position to give that capital. I said it was an idea which I thought should be forgotten, for it was not, in my opinion, worth exploring. I said that oil companies, whether they were American or British, etc., did not carry on exploration and development on money which they borrowed from the banks. I said that perhaps some of the big companies with sufficient resources would be able to borrow money from banks for this purpose, but I said that they did not even try. I said that all the oil exploration and development which had been carried on outside of Russia had been carried on by these companies using their own reserves. I said that all the oil companies had to have very considerable reserves, and that they maintained such reserves for the very specific purpose of doing this highly speculative but necessary exploring and development.

I said to the Minister that I wished to again revert to what I had said in previous conversations that there was no use talking with small companies in the oil business because they did not have the reserves and they would have to look for financial assistance from governments and banks, which couldn't be got. I said that the large oil companies were now prepared to go into such contracts or an equitable character, as the recent arrangements in Venezuela demonstrated. I said that the oil companies were entirely prepared to recognize the principle that in Mexico the subsoil was the property of the Government. I said the companies were prepared to come in, knowing that they were fully subject to Mexican law and would have to operate clearly within the law. I said the companies were prepared to take the risks involved in exploration and development under proper contracts which would provide for equitable distribution of eventual profits. I said that the Mexican Government had everything to gain and nothing to lose through such arrangements because it could not lose, for the companies would have to take all the risks, and they were prepared to do this. They were prepared to share the eventual profits on an equitable basis.

I again recalled to mind the financial and budgetary situation which Mexico has to face in the next years as the result of decreased purchases by us of strategic materials, etc. I said that the President of Mexico had recently asked me to take up with my Government the question of a loan to be used for sound development purposes, such as road building, electrification, etc. I said that undoubtedly such loans would be necessary, and my Government had indicated a sympathetic attitude thereto. I said, however, that if Mexico had started to exploit her oil resources in an adequate way a few years back she would already be getting sufficient revenue to more than provide for all the needs of the Government on a reasonable basis. I said that the Venezuelan Government had more money than it knew

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what to do with as result of the arrangements with the oil companies. I said that the solution of Mexico's budgetary difficulties for the next few decades lay in the exploitation of her oil resources. I said that now unfortunately even if arrangements were made with the companies today on an equitable basis it would take two years before the Government would begin to get returns from this new development. In the meantime some ~~kind~~ ^{kind} of another character might be necessary to keep the economy of the country going.

I said that if oil exploration and development had been started three years ago the Mexican Government would have more money at its disposal today than it would need for even the most advanced program of development of other resources.

The Minister admitted the justice of what I said, and said that I knew he was in agreement with what I had said. The Minister went on to say that he felt sure that I knew that the President felt very much the same way. The Minister frankly admitted the deficiencies of Petroleos Mexicanos and indicated that on its own he saw no hope of its adequately developing the oil resources of the country. He recognized the need of the revenues from oil as the proper source to meet certain government expenditures until new sources of revenue were developed through the increasing strength of the economy of the country.

I went on to say to the Minister that this situation was getting much more serious so far as Mexico was concerned because already she was not an exporter of oil but needed to buy some oil. I said that our own resources were dwindling and our needs were increasing, and I could see the possibility that before the war ended in Europe and in the Far East that Mexico might not be able to get the oil to supplement her own production, and which she would need. I saw the Mexican economy possibly becoming greatly handicapped.

I said that with increasing development of agriculture and industry and traffic, the present fields were just unable to meet Mexican needs, and Petroleos Mexicanos, instead of being able to do anything about it, was getting into worse shape continually. I saw a very serious situation developing for Mexico because the countries which had oil were going to use it for their imperative purposes before they let others have it. I said that I was not raising a specter but that what I said was increasingly a reality which the Mexican Government and economy might have to face.

The Minister said that he understood this situation.

I went on to say that the instruction which I would receive from the Department, and which would

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state that a loan was not possible, would authorize me to continue my conversations on oil along the lines we had been talking during the last two years. The Minister said that it was necessary to carry on and that he was prepared to do so. He said that the unfortunate difficulty was that I knew the attitude of General Cárdenas and of certain elements in the country and that this question of oil policy had been a fetish with some people. He said that unfortunately there were some in Mexico who were willing to retard the development of the country rather than to take steps with respect to oil policy which they knew to be necessary. The Minister said that I knew how real this problem was in Mexico.

I said to the Minister that I knew how real the problem was but that I felt that the President of Mexico and the present government had an extraordinary opportunity to take a constructive step. I said that the country realized that it would have budgetary difficulties. I said the country demanded that roads be built, new schools opened, irrigation projects carried through, etc. I said that it was easy to convince the people that these things could not be done out of the revenues which the government could command. I said that recently the President had made a statement that a foreign loan might be needed in order to carry on certain needed social programs. I said that the idea of a loan to the Mexican people was not pleasing, even if they recognized it was necessary. I said that in my opinion the President and the Government of Mexico had an extraordinary opportunity to take advantage of the present situation and convince the people that oil exploration must be carried forward in order to provide for the necessities of the country and for adequate revenues to carry on social programs. I said that if this matter were adequately presented to the public, the Mexican Government would find ample support for a program of oil exploration and development along the lines of equitable contracts with American and foreign firms competent to carry through and who were willing to take the risks without cost to the Mexican Government and people. I said that it could easily be shown that the policy of those who were opposing a reasonable oil policy was a policy of keeping down the standard of living in Mexico and stopping development of agricultural and industrial resources. I said that everyone knew that the management of Petroleos Mexicanos was incompetent and unable to carry through the task. The Government therefore had a wonderful opportunity which it did not take very much courage to seize. I said that General Cárdenas had always presented himself as the apostle of social reform and uplift and as the promoter of programs for the improvement of the standard of living. I said that the fact could easily be shown that the opposition of General Cárdenas to a program of proper development of Mexico's oil resources was a complete negation of all the principles

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which he had professed to stand for. I said that if the matter were properly presented to the Mexican public, General Cárdenas and those who were opposing a reasonable oil policy could not even protest because they would be put into an impossible position. It was just a question of a courageous, clear, forthright program of informing the Mexican people, who were far more interested in their standard of living than they were in the personal ideas or political position of any individual. I emphasized again that I thought the President of Mexico and the present Government had a most extraordinary opportunity to strengthen the position of the Government, and in a large measure to shape the whole future of Mexico and her development and her position among the American countries and in the world picture.

The Minister said that he was intensely interested in all that I had said which showed such a profound knowledge of the Mexican situation and that he would not fail to inform the President of the substance of our conversation. He indicated that now that a loan was not possible we would have to continue our conversations to find a way through which these oil resources could be developed. I told him that I was entirely at his disposition but that I wished to wait a short period until I received the formal instruction from the Department indicating that a loan was not possible and authorizing me to proceed in my conversations on oil policy on the basis that I had been conducting them during the last several years.

G. S. M.

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