

PUBLIC POLICY PERSPECTIVES are issued periodically, in English or in Spanish, as a public service with the aim of inviting fresh discussion of matters of politics, law, policy, regulation and corporate governance.

OUTLOOK FOR GASOLINE PRICING IN MEXICO RETAILER OPPORTUNITY VS REGULATORY OVERSIGHT

IN AN OFF-MIKE CONVERSATION at the OPIS conference that was held in Houston April 25-26, 2017, one of the speakers from Mexico City observed that he normally uses **Uber** taxis in preference to regular commercial ones. “Even though they cost more than regular taxis, I use them because of the additional safety (I have the license plate number of the vehicle), comfort and the benefit of not having to use cash.”

The comment was part of a larger conversation about the pricing of gasoline in Mexico, which, at present, is under a maximum pricing regime managed by the Energy Regulatory Commission (CRE). “In rural Mexico, a town or village may have just one gasoline station, and some 30% of all municipalities lack even one. A major increase in gasoline prices in a town with just one or two gasoline stations could be seen as an abuse of monopolistic power.”

In this report, we shall first listen in on a conversation that imaginably could take place about a price increase in an upscale market in which there were just one or two gasoline stations in a neighborhood. We shall then consider the components of gasoline pricing from the perspective of the retailer, focusing mainly on the soft, or qualitative, ones for which there are no price benchmarks such as those provided by OPIS, PLATTS and LUNDBERG SURVEY.

This update reflects presentations and discussions held on December 6 at the workshop presented by CRE at the Law Center of the University of Houston. The report asks about the seriousness of the government and regulators to allow for market forces to determine fuel prices.

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SUMMARY

IT'S WORTH REPEATING that in Spanish *reformular* does not carry the English sense of “to reform”; it means “to edit or amend,” as in constitutional amendments. Authorities praise Mexico’s “Energy Reform,” but a *reforma* in Spanish may or may not be a *reform* in English.

To “edit or amend” a document or policy is to leave most of the original unchanged. Such is the case with Mexico’s energy reform: where, *before* the reform, there was an official disavowal of market forces as a framework for the allocation of capital, *after* the reform there is an official embrace of market forces—only the same distrust remains.

The easiest place to see this continuing distrust is in relation to the pricing of motor fuel. Where, *before*, there was a policy of *precio único* (a single price for each grade of gasoline and diesel); *afterwards*, by rules issued by the **Energy Regulatory Commission (CRE)**, all service stations are required to inform the regulator of any change in pricing one hour before the change is to be made. The CRE has made it clear that it will disallow any price movement that it regards as “disproportionate,” alluding to a price increase that would exceed logistical justification.

Expressed in the language of economics, the regulator will disallow price changes intended to test *the price elasticity of demand*. Will customers pay more for the convenience of refueling close to home or at certain times of the day? Good questions.

At the informative workshop that CRE presented in Texas in Austin, Houston and Dallas, the audience was told that some 2,000 **Pemex** service stations (nearly 20% of total stations) have dropped the Pemex brand. On December 6, the day the workshop was held at the University of Houston’s Law Center, **ExxonMobil** sent a rail shipment of its gasoline from Texas to a distribution network in central Mexico. Hundreds of permits have been issued for the importing gasoline and diesel, and by year-end 2017, instead of one brand (Pemex) there are 30.

MEXICO COMBUSTIBLES
Exxon Mobil abre en México gasolinera con combustible importado de EE.UU.
10/11/2017 17:00:00

Such developments tell us that something is changing in Mexico’s gasoline market; at the same time, much is staying the same: of the hundreds of import permits, only a dozen or so have been actually used, none of them for significant volumes that would compare with the amount that is handled by **PMI Comercio Internacional, S.A. de C.V.**, Pemex’s trading affiliate. Statistics on the importation of motor fuel, by mode of transportation and point of delivery are still treated as Pemex’s confidential information. Pemex’s ability to lower prices that would undercut non-Pemex suppliers serves as a deterrent to investment in storage infrastructure that would make deliveries of at least 300,000 barrels/day an attractive commercial opportunity.

In January of this year, there was a mini-social uprising when the government raised gasoline and diesel prices by 40% (the so-called *gasolinazo*). By December 1, fuel pricing in all the five price zones in the country had been deregulated. Authorities were relieved that prices at the pump would move only slightly, by *centavos* but not by *pesos*.

Where, before, there was a *precio único*, today there is a *banda única* (a single band or range) in which prices are allowed to move by CRE’s helicopter regulations. So long as Pemex’s Pricing Committee has members from the ministries of Finance and Energy, so long as PMI’s near-monopoly on the importation of motor fuel is not challenged by law or regulation, so long as the government embraces centralized economic planning for the energy sector, and so long as the regulator intrudes into the pricing decisions of distributors (effectively ruling on what is “competitive”), the fundamentals of the *ancien régime* will remain in place.

Outlook for Gasoline Pricing in Mexico

Retailer opportunity vs regulatory oversight

INTRODUCTION

WE MAY EXPLORE, IN A PLAYFUL WAY, some of the themes just mentioned in the summary by imagining a conversation at a service station in Mexico where the owner had decided to test the price elasticity of supply (and in defiance of CRE's warnings about disproportionate price increases).

What if gas prices were to double in Lomas?

We may consider the gasoline market of Lomas de Chapultepec, a wealthy residential enclave of walled mansions that is located on the west side of Mexico City through which an extension of the fabled Reforma Boulevard passes. About half-way up the hill that leads to the ultra-modern district of Santa Fe there is a gasoline station.

Let's listen into the conversation at the pump on the day when gasoline prices were doubled. fuel:

Motorist: What do you mean charging MX\$30/liter [US\$5.97/gal]? They don't even charge that much for gasoline in France [\$5.79/gal].

Attendant: Sir/Ms, *Buenos días*. These are the prices that management has determined to be fair in this market.

Motorist: But they're almost double what you can buy gasoline for down the hill in other neighborhoods.

Attendant: Yes, but notice that there are no lines, offering you greater convenience. You are of course free to buy your gasoline at other service stations.

Motorist: Yes, but it would take me 20 minutes out of my way. I'm headed up the hill to Santa Fe for a meeting with **BP**. Have you thought about having a fast lane with higher prices and a slow lane with regular prices?

Attendant: Yes, but the authorities, that is, the Energy Regulatory Commission [CRE], for some reason won't permit it. They want prices only as a function of logistic costs, ignoring the economics of the value of the land or the marginal convenience value that would be reflected in prices that customers like you would be willing to pay.

Motorist: How do they justify that? Clearly, the value of your land Reforma Boulevard is much more valuable than the same number of square meters in Vallejo or Tlalpan.

Annex A

Federal Economic Competition Act of 2014

CRE is an economic actor subject to the law

Lexical entry

Translation

Article/ section

LAWS

- | | | | |
|---|--------------------------|----------------|---|
| 1 | Agente Económico: | Economic agent | 3 |
|---|--------------------------|----------------|---|

Toda persona física o moral, con o sin fines de lucro, dependencias y entidades de la administración pública federal, estatal o municipal, asociaciones, cámaras empresariales, agrupaciones de profesionistas, fideicomisos, o cualquier otra forma de participación en la actividad económica;

Any natural or legal person, whether or not for-profit, dependencies and entities of the federal, state or municipal public administration, associations, business chambers, professional associations, trusts, or any other form of participation in economic activity;

- | | | | |
|---|--|----------------------|---|
| 2 | Barreras a la Competencia y la Libre Concurrencia | Free market barriers | 3 |
|---|--|----------------------|---|

Cualquier característica estructural del mercado, hecho o acto de los Agentes Económicos que tenga por objeto o efecto impedir el acceso de competidores o limitar su capacidad para competir en los mercados; que impidan o distorsionen el proceso de competencia y libre concurrencia, así como las disposiciones jurídicas emitidas por cualquier orden de gobierno que indebidamente impidan o distorsionen el proceso de competencia y libre concurrencia.

Any structural characteristic of the market, fact or act of the Economic Agents whose object or effect is to prevent the access of competitors or limit their ability to compete in the markets; That impede or distort the process of competition and free association, as well as the legal provisions issued by any public agency that unduly impede or distort the process of competition and free association.



Reports on Mexico's motor fuel markets

Table 1
Comparing the prices of gasoline grades in Mexico and U.S.
U.S. gas cheaper with bigger spread between grades

		MEX avg. of max. price (March 3)	Houston price (March 30)*	
		Mex\$/l		% var
Octane {	87	\$16.01	\$10.68	-33.3%
	93	\$17.79	\$13.84	-22.2%
	% var	11.1%	29.6%	
<i>Data:</i>				
	<i>x-rate</i>	\$18.72	\$2.16	<i>87 Octane</i>
	<i>liter/gal</i>	3.7854	\$2.80	<i>91 Octane</i>
*Shell station near Katy Fry & Campbell Rd.				
Data: MEI 842				

Year	Topic	File #	Pages	Chart
2017				
Mar 31, 17	Comparing the price spread of Mexico's gasoline grades	843	2	1
<p>This report compares the national average of maximum prices in Mexico for regular and high-test gasoline with the prices of comparable gasoline grades in the U.S. Table 1 shows that prices in the U.S. are lower and there is a much bigger spread between regular and premium gasoline. One conclusion is that the price of high-test gasoline in Mexico is being subsidized. A second conclusion is that in areas where price deregulation takes place, the price of Pemex's premium-grade gasoline is likely to increase by at least 25%.</p>				
Mar 27, 17	Motor Fuel Pricing in Mexico	842	13	9
<p>This report provides a statistical examination on the motor fuel price series that is published by the Energy Regulatory Commission (CRE) as a transitional regime that would eventually be phased out with the deregulation of prices, starting with Baja California and Sonora. We note that there is popular and political resistance to the government's fuel pricing program. Of greater concern is the lack of preparation for a competitive market. At present, Pemex is the only supplier of motor fuel in Mexico. The deregulation of motor fuel prices in Baja California and Sonora will provide a test of the feasibility of successive price deregulation for gasoline and diesel.</p>				

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Reports on Mexico's motor fuel markets

Year	Topic	File #	Pages	Chart
Feb 28, 17	Bilingual Glossary of Fuel Quality Standards in Mexico <p>In anticipation of investor interest in Mexico as an export market for gasoline, diesel and jet fuel, and in the market segments of storage and transportation, on August 29, 2016, CRE issued regulations for compliance with fuel quality standards (NOM-016-CRE-2016). This glossary provides translations in English of the terms and definitions associated with the standards and the compliance framework. Tables 1, 3 and 4 sort terms in their alphabetical order in Spanish, while Table 2 sorts terms according to their English translation.</p>	836	22	4
Jan 16, 17	Gasolinazo 2017 <p>This report examines the popular backlash against the government's price increases for motor fuel that went into effect January 1, 2017. The government invoked two independent arguments: 1) gasoline prices should be in alignment with international indexes and 2) not increasing gasoline prices would put Mexico's economic stability at risk. Leaders of opposition parties rejected the first argument and blamed any lack of government revenue on incompetent economic management. Absent a full disclosure of the government's financial picture, the wisdom and timeliness of the prices increases cannot be determined. Officials chose to ignore the geopolitical moment of the imminent installation of a U.S. administration whose policies may be hostile to Mexico.</p>	834	18	2
<hr/>				
2015				
Mar 25, 15	Turmoil in Mexico's Gasoline Market: Lawlessness Jeopardizes Downstream Deregulation <p>The turmoil in Mexico's gasoline market puts in jeopardy the calendar of the government's strategy to deregulate the gasoline market in 2018. In this report, we try to squeeze insights out of institutional data from Pemex about the incidents of product theft, and we examined press and other reports to see how specific industries were being affected by the activities of a given drug cartel. The situation in Nigeria should be a warning to government authorities that the lack of asset and product security onshore could lead oil companies to restricting their principal investments offshore.</p>	777	11	7
<hr/>				
2000				
Jun 08, 00	Mexican gasoline price trends and issues, 1997-99. <p>Analysis of recent trends in gasoline prices in Mexico, noting movements relative to producer price index.</p>	424	12	5



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