An Economic Perspective on Mexico's Nascent Deregulation of Retail Petroleum Markets

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Executive summary

Motivation

Economists have long studied the impact of government regulation on economic outcomes. Over the last several decades the trend has been toward deregulation and a substantial literature in economics has developed aimed at understanding these market changes. Many industries have been analyzed including airlines, telecommunications, trucking, natural gas, and electricity. These studies have provided important lessons about regulation, while also shedding light on broader issues in economics including price competition, productivity, market entry, and vertical integration.

We use this rich existing economic literature as a lens through which to view Mexico's nascent deregulation of retail petroleum markets. For decades all 11,000 gasoline stations in Mexico have carried the brand of the state-owned petroleum company Pemex and sold Pemex gasoline at federally regulated retail prices. This industry structure is now changing. Since April 2016, independent companies can now import, transport, store, distribute, and sell gasoline and diesel. The deregulation is part of Mexico's broader energy reforms aimed at increasing private investment. For Mexican consumers, no other piece of the energy reforms is as visible as what is beginning to happen with gasoline stations.

Research performed

We revisit many of the themes in the existing literature including price competition, cost-minimization, market power, product differentiation, entry and exit, and vertical integration, and discuss what we can expect and not expect based on historical experience and academic literature. Although in many ways the reforms are unprecedented, we argue that past experiences in other markets give important clues about what to expect, as well as about potential pitfalls.

The market we study has been mostly unexamined in previous research, so we also provide novel descriptive information about what the market looks like on the eve of deregulation. We describe the former system by which retail gasoline prices were set and discuss how this is changing under deregulation. We also present descriptive information on the retail gasoline sector in Mexico and contrast these results with relevant statistics from the United States.

In addition, a novel feature of our analysis is that we performed original data collection, designing and conducting a survey of all gasoline stations in Mexico City. The results provide

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insight into the service quality at gasoline stations, for example, documenting the availability of different products and services. This information provides baseline information about starting conditions as well as some guidance on what we think are important metrics for measuring the success or failure of the transformation moving forward.

Main conclusions and policy implications

Market competition has the potential to unleash not only productivity improvements but also to spur innovation and to reduce prices. At the same time, economists also continue to be acutely concerned about market power, and the idea that excessive concentration in a market can lead to prices above their efficient level and large transfers from consumers to producers.

Thus it is with great excitement but also real trepidation that we await the continued evolution of Mexico's retail petroleum market. Mexico's reforms are different from other deregulation processes, given the degree of entrenchment by the incumbent firm and the likely continued dominance of Pemex in upstream markets. Nonetheless, there are many similarities, which we have attempted to highlight in this paper.

However, this paper is a prospective study, and we emphasize that there continues to be a great deal of uncertainty about how this market will unfold. From the government side, there will be more course corrections and perhaps even temporary reversals. From the industry side, there will be periods of growth and optimism, but also periods of challenge and retrenchment. Whichever direction the market goes, we expect the transformation to be of considerable interest to economists and policy analysts interested in market design and optimal regulation.

We urge patience on all sides. Deregulation takes time. With U.S. airline deregulation, for example, even twenty years after deregulation started, the industry continued to become more efficient. Thus it will take time for firms to find new ways to compete, to differentiate, and to increase productivity. We should not try to judge the success of deregulation based on the performance over the first few years. Nor should policymakers be tempted to “re-regulate” at the first sign of trouble. Previous experience shows that benefits continue to accrue over many decades, so deregulation is best viewed through a long time horizon, and it is critical that the market be given an opportunity to work.