MEXICO: INVENTORY OF ESTIMATED BUDGETARY SUPPORT AND TAX EXPENDITURES FOR FOSSIL-FUELS

Energy resources and market structure

Mexico has substantial resources of oil and natural gas. It is the world's seventh-leading producer of oil, though production has fallen sharply in the last five years or so as a result of declining output at the country's main producing field, Cantarell. Over one-third of Mexico's oil production is exported. Natural gas production has been rising rapidly, but has not kept pace with demand, such that net imports — mainly piped from the United States, but now supplemented by increasing volumes of LNG — have grown from less than a tenth of supply in 2000 to more than one-fifth in 2010. Approximately one-fourth of the country's total primary energy supply is imported. Mexico's energy mix is dominated by oil and gas: oil accounts for 55% of total primary energy supply and natural gas 29%; most of the rest comes from a mixture of coal (half domestically produced and half imported), combustible renewable and waste, and geothermal energy, with a single nuclear plant contributing 1%. The share of oil has continued to fall steadily in recent years, while that of gas has grown briskly. National coal production peaked at 13.8 million tonnes in 2007, and has declined since then. Roughly one-third of the country's total production of energy is exported.

The energy sector is almost entirely run by state-owned companies. The national oil and gas company, Pemex (*Petroleos Mexicanos)*, enjoys a monopoly on hydrocarbons production, oil refining and the marketing of oil products in the country. Pemex is the largest company in Mexico and one of the largest oil companies in the world. It has four operating subsidiaries: exploration and production, gas and basic petrochemicals, petrochemicals, and refining. In 2008, Mexico enacted new legislation that sought to reform the country's oil sector, with the aim of curbing the slide in crude-oil production. The measures included several administrative and institutional changes, including the establishment of a new hydrocarbons agency to regulate the sector. The reforms fell short of opening up exploration and production to competitors, but allow Pemex to create incentive-based service contracts with private companies. Pemex was also granted greater autonomy, including the ability to establish more flexible mechanisms for procurement and investment, and a corporate governance system.

Pemex is also the dominant, but not the sole, company active in natural gas distribution and retailing. The Mexican government opened the downstream gas sector to private operators in 1995, though no single company may participate in more than one industry function (transportation, storage, or distribution). It also created the Energy Regulatory Commission (CRE) to monitor and regulate the sector. Nonetheless, Pemex still operates all the country's high-pressure gas pipelines and all 12 gas-processing plants, as well as most of the country's gas-distribution network. The two LNG import terminals currently in operation in Mexico are owned by foreign companies: Altamira, which started up in 2006, is a joint venture of Royal Dutch Shell, Total and Mitsui, while the Costa Azul terminal, which began receiving LNG in 2008, is operated by Sempra. A third plant is being built at Manzanillo by a consortium of Mitsui, KOGAS, and Samsung.

The structure of the coal-mining industry in Mexico has undergone tremendous change over the last 50 years. The 1961 mining code placed the control of capital in Mexican hands (a process known as the "*Mexicanización*" of the industry). A reform of the code in 1975 opened up foreign investment to a maximum 34% of the share of total capital in coal mines, and the 1992 Mexican Mining Law allowed 100% control of coal-mining properties not only by private Mexican interests, but also by foreign mining companies, subject to a standard concession-based process. Today, the major players in the industry are a mix of Mexican and foreign companies, some subsidiaries of diversified mining conglomerates.

State-owned *Comision Federal de Electricidad* (CFE) is the dominant player in power generation, controlling about two-thirds of installed generating capacity. CFE also holds a monopoly on electricity transmission and distribution. In 2009, CFE absorbed the operations of *Luz y Fuerza del Centro* (LFC), a state-owned company that managed distribution of electricity in Mexico City. The *Comision Reguladora de Energia* (CRE) has principle regulatory oversight of the electricity sector, but does not have direct jurisdiction over CFE. Changes to Mexican law in 1992 opened the generation sector to private participation. Any company seeking to establish private electricity generating capacity, or begin importing or exporting electric power, must obtain a permit from CRE. Most of the independent power producers operate combined-cycle gas turbines fuelled with natural gas.

Prices, taxes and support mechanisms

Almost all energy prices are controlled in Mexico. The current legal framework, which dates back to 2000, allows the government to set retail prices of gasoline, diesel and LPG. Because of a sustained rise in the international prices for oil and its derivatives, pre-tax prices have been set well below the cost of imports in recent years, generally lagging any rise in import prices, with the government paying Pemex (the monopoly importer) the difference (except for LPG). Excise taxes are levied on transport fuels. VAT is levied on all fuels and energy services to non-commercial consumers.

All electricity tariffs are approved by the Ministry of Finance and Public Credit (SHCP); tariff proposals are prepared by an interagency group composed of the SHCP, CFE, CRE, and the Ministry of Energy (SENER). Average electricity tariffs in Mexico for agriculture and households have generally been held well below average cost, resulting in large subsidies, though – with the exception of the informal agricultural sector – they have trended upwards over the past decade.

The bulk of support to the consumption of fossil fuels in Mexico appears to be provided through tax provisions such as the Excise Tax on Products and Services on Gasoline and Diesel (*Impuesto Especial sobre Producción y Servicios por Enajenación de Gasolinas y Diesel* – IEPS). The IEPS uses a floating rate that varies according to a formula, which is in turn based on international benchmark prices for gasoline and diesel. When this international price is high, the rate of IEPS becomes negative so that domestic prices fall below the opportunity cost of gasoline and diesel. Conversely, a lower international price triggers an increase in the rate of IEPS, which increases tax revenues. In addition, there are certain fuel-tax credits available for the agriculture and fisheries sectors, for commercial vessels, for passenger and cargo transportation, and for certain uses of diesel for other purposes than in a vehicle. However, these tax credits apply only when the rate of IEPS is positive, with most of them benefitting diesel fuel.

Data documentation

General notes

The fiscal year in Mexico coincides with the calendar year.

Consumer Support Estimate

Diesel Tax Credit for Passenger and Cargo Transportation (data for 2003-)

This measure provides a tax credit applicable to purchases of diesel fuel to support the private and public transportation of passengers or cargo through roads and highways. As with similar measures in Mexico, this provision only applies when the rate of IEPS is positive (see “Prices, taxes and support mechanisms” above).

A similar measure applied to purchases of both Magna and Premium types of gasoline, but not to unmarked gasoline, which has been the sole type of gasoline used in Mexico. As a consequence, this measure for gasoline did not benefit any users; it was eliminated in March 2012.

Sources: Secretaría de Hacienda y Crédito Público (various years).

Tag: MEX_te_02

Tax Credit for Marine Diesel (data for 2002-)

This measure provides a tax credit to final consumers of "marine" diesel fuel. The credit applies mostly to commercial shipping and related activities. As with similar measures in Mexico, this provision only applies when the rate of IEPS is positive (see "Prices, taxes and support mechanisms" above).

Sources: Secretaría de Hacienda y Crédito Público (various years).

Tag: MEX_te_03

Tax Credit for Purchased Diesel for Machinery (data for 2003-)

This tax credit targets the end use of diesel fuel in general machinery, with the exception of vehicles. Eligible uses include most commercial activities (with the notable exception of mining) and certain marine vehicles. As with similar measures in Mexico, this provision only applies when the rate of IEPS is positive (see "Prices, taxes and support mechanisms" above).

Sources: Secretaría de Hacienda y Crédito Público (various years).

Tag: MEX_te_04

Fuel-Tax Credit for Agriculture and Fisheries (data for 2003-)

This measure provides the agriculture, forestry, and fisheries sectors with a fuel-tax credit on their purchases of diesel fuel for final use in general machinery, with the exception of vehicles, regardless of the prevailing rate of IEPS.

Sources: Secretaría de Hacienda y Crédito Público (various years).

Tag: MEX_te_05

Negative Excise Tax on Products and Services for Gasoline and Diesel (data for 2007-)

This measure provides for a price-setting mechanism that considers differences in the domestic price for petroleum products and an international reference price (i.e. the benchmark price). While the prices for gasoline and diesel vary almost daily in the international market, retail prices in Mexico are set by the federal government on a monthly basis.

When the benchmark price is high, and greater than the domestic price, the rate for the country's excise tax becomes negative. Pemex—the national oil company—then obtains a compensatory tax credit equivalent to the price difference, which the company can credit against other taxes such as its own value-added tax or the "Ordinary Duty on Hydrocarbons Production" (*Derecho Ordinario sobre Hidrocarburos*, a production tax on hydrocarbons).

Sources: Secretaría de Hacienda y Crédito Público (various years).

Tag: MEX_te_06

Implicit Subsidy on LP Gas (data for 2003-)

Since 2003, the domestic price of LPG in Mexico has been controlled by the government and fixed below its opportunity cost (i.e. international reference price, plus transport and internment costs). The resulting difference between this opportunity cost and the prevailing domestic price is absorbed by the balance sheet of Pemex, the national oil company.

Sources: Pemex, *Fourth Quarter Financial Report* (various years).

Tag: MEX_te_07

Sources

Policies or transfers

Secretaría de Hacienda y Crédito Público (various years) *Presupuesto de Gastos Fiscales*, Government of Mexico, Available at: *www.shcp.gob.mx/INGRESOS/Paginas/presupuestoGastos.aspx*.

Pemex (various years), *Reporte de resultados de Petróleos Mexicanos, Organismos Subsidiarios y Compañías Subsidiarias*, Petroleos Mexicanos, Available at: *www.ri.pemex.com/index.cfm?action=content&sectionid=14&catid=12146*.