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Mexico to Reduce Price of Natural Gas for Consumers, Businesses

by LADB Staff

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President Vicente Fox's administration has implemented a temporary subsidy program to help reduce the cost of natural gas for Mexican consumers. The 18-month program, which will cost about 500 million pesos (US$45.4 million), is expected to lower the costs of gas by 28% for as many as 1.14 million families. The subsidy will be applied to the first 35 cubic meters of gas consumed in each home monthly. "This is part of an effort by the federal government to make fuel prices less volatile for Mexican families," said Fox's top economic adviser Eduardo Sojo.

At the request of the private sector, the Fox government has also agreed to develop a plan to subsidize the cost of gas for businesses. "When the cost of gas doubles, this inhibits production and reduces our competitiveness at the global level," said Leon Halkin Bider, president of Confederacion de Camaras Industriales (CONCAMIN). Furthermore, said Halkin, the high cost of gas has already forced many Mexican businesses to go bankrupt.

Global market, PEMEX pricing structure boost costs

The consumer subsidy intends to counter the effects of a surge in the price of natural gas on the world market, which has risen by 16% since Jan. 1, administration officials said. Some experts and industry officials also blame the high domestic prices on the pricing structure used by PEMEX. The state-run oil company uses quotes in the South Texas market as a guideline even though only about one-fifth of the gas sold in Mexico is imported from the US.

The South Texas price has recently averaged between US$6.00 to US$6.50 per million per million British Thermal Units (BTUs), and at times has risen to as high as US$7.00 per million BTU, said Eduardo Andrade Iturribaria, president of the Asociacion Mexicana de Energia Electrica (AMEE). In contrast, the domestic cost of gas in Mexico is only US$3.50 per million BTU, including production costs and other factors. If PEMEX averages the price of imports with this domestic cost, then the domestic price should only be about US$4.50 per million BTU, said private energy consultant Jose Luis Apodaca Villarreal.

Apodaca said the government had been keeping quiet about the price structure for the domestic gas market because it has been making a profit with the price differential. "Gas prices were set at the same level as the import price because this gave the Mexican Treasury another option to obtain revenues," said Apodaca, who once served as a regional official with the state-run power company, the Comision Federal de Electricidad (CFE). Those revenues will decline with the consumer and business subsidies that the government has enacted this spring. "The only thing that PEMEX is doing here is reducing its earnings," said Claudio Rodriguez Martinez, an official with the private gas company MaxiGas.
PEMEX urged to abandon South Texas market as guide

Economists like Robert Brito of Rice University in Houston are urging PEMEX to discontinue using the South Texas price to determine domestic prices in Mexico. Brito, who originally recommended that Mexico use the South Texas market as a guide, has now reversed that recommendation. Conditions have changed sufficiently to make the South Texas reference price unreliable, he said. Business leaders are also blaming private providers like Gas Natural de Mexico (GNM) for taking advantage of price differentials to reap huge profits from their operations in Mexico. This is especially the case in cities like Monterrey, where a larger share of the population relies on natural gas than on liquefied petroleum gas (LPG) for domestic energy needs.

The Camara de Industria de la Transformacion (CAINTRA) de Nuevo Leon and other business groups in Monterrey are now proposing that businesses set up cooperatives where they can purchase natural gas directly from PEMEX instead of having to go through GNM. GNM is one of several private companies that has supplied gas to the public since former President Ernesto Zedillo opened the sector to private investment in 1996 (see SourceMex, 1996-04-24, 1996-08-28 and 1999-01-20). Some industry officials say, however, that other market factors will continue to keep prices high in Mexico over the long run.

Carlos Atallah, director of ChevronTexaco de Mexico, said the lack of infrastructure to extract and produce natural gas in Mexico will continue to limit domestic supplies, which will not be able to keep up with demand. "Supply has increased because of investments made after the North American Free Trade Agreement (NAFTA) went into effect, but they are not adequate to meet future demand," said Atallah.

The Fox administration has attempted to ensure an adequate supply of natural gas over the long term through its multiple-services contracts (Contratos de Servicios Multiples, CSMs), by which private companies or conglomerates are given concessions to explore and extract gas in the Burgos Basin in northeastern Mexico (see SourceMex, 2002-06-26 and 2003-03-19). The program has met with mixed success, initially attracting strong interest but later encountering scant participation (see SourceMex, 2003-10-29, 2004-01-28 and 2005-03-16).

Fox looks to South America

The government is also seeking to diversify its sources of natural gas, looking particularly at South America. During a trip to Bolivia in early May, Fox and Bolivian President Carlos Mesa laid the groundwork for an agreement for Mexico to import gas from the South American country once legislation is in place to allow Bolivia to export natural gas (see NotiSur, 2004-07-30). The Mexican president said the move would allow Mexico to greatly reduce its imports from South Texas.

Fox's trip to South America also included a stop in Lima, where he discussed the possibility of importing Peruvian natural gas. The Peruvian gas would be used primarily to supplement the needs of the state-run power company, the CFE.
Government seeks to keep inflation in check

Some economists also see the subsidy for natural gas as a strategic move by the Fox administration to keep consumer prices in check this year. "It's part of an effort to help prevent inflation from rising," said Salvador Moreno, an economist at the office of ING Groep NV in Mexico City. "But because most households in Mexico use liquefied gas, the impact from these subsidies will be very small."

Government officials like Carlos Arce Macias of the consumer protection agency (Procuraduria Federal de Proteccion al Consumidor, PROFECO) acknowledged that the subsidy will have little impact on inflation because electricity and other utilities remain costly. "[The gas subsidy] is not the ideal instrument to alleviate pressure on other energy services," said Arce.

The government has managed to keep the price of LPG in check by setting a price ceiling. Even so, prices for this type of fuel have risen by 2.1% since January. The LPG price ceiling continues to create tensions with private providers. At its meeting in Cancun in early May, the Asociacion Mexicana de Distribuidores de Gas Licuado y Empresas Conexas (ASOCIMEX) reiterated its demand that the government eliminate the ceiling because it restricts profit margins and prevents companies from recovering some costs of production and marketing.

Authorities are not expected to accede to ASOCIMEX's demand any time in the near future. Deputy energy secretary Hector Moreira Rodriguez, speaking to participants at the ASOCIMEX meeting, said the government cannot liberate the market for two reasons: the existence of LPG distribution monopolies in some parts of the country, and the continuation of high energy prices at the global level. "We don't want to do anything that will significantly affect the price for consumers," said Moreira.

High energy prices, including natural gas, were cited as one reason for increases in the consumer price index (indice nacional de precios al consumidor, INPC) of 0.45% in March and 0.36% in April. High costs for agricultural products, particularly tomatoes, also contributed to the spike in the INPC during those two months. The Banco de Mexico (central bank) has been able to keep inflation in check by raising interest rates 12 times since February 2004, which has slowed down economic growth, said economists. "The economy is slowing and companies are starting to incorporate lower inflation expectations into prices after the central bank tightened so much," said Mario Correa, an economist with Bank of Nova Scotia in Mexico City. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on May 11, reported at 10.99 pesos per US$1.00] (Sources: La Crisis, 05/02/05; Spanish news service EFE, 05/04/05; La Jornada, 04/04/05, 04/11/05, 04/13/05, 04/15/05, 04/22/05, 05/03/05, 05/06/05; El Financiero, 04/07/05, 04/25/05, 05/06/05; La Cronica de Hoy, 04/01/05, 04/07/05, 04/08/05, 04/11/05, 04/14/05, 04/21/05, 05/03/05, 05/09/05, 05/10/05; El Universal, 04/08/05, 04/11/05, 05/04/05, 05/10/05; The Herald-Mexico, 04/08/05 04/21/05, 04/22/05, 05/10/05)