FOSSIL FUEL SUPPORT COUNTRY NOTE

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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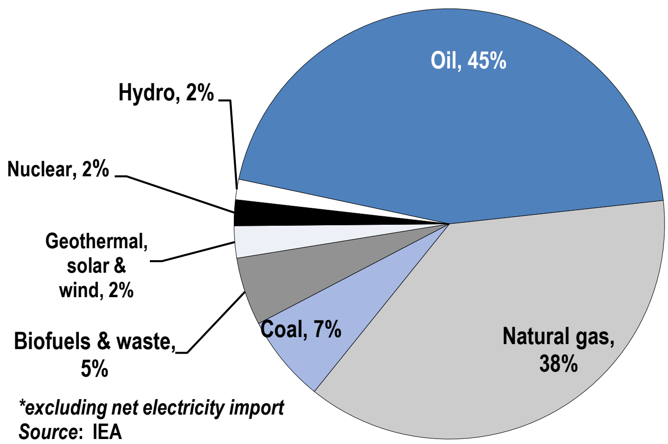
Mexico

The OECD Inventory of Support Measures for Fossil Fuels identifies, documents and estimates direct budgetary support and tax expenditures supporting the production or consumption of fossil fuels in OECD countries, eight partner economies (Argentina, Brazil, the People's Republic of China, Colombia, India, Indonesia, the Russian Federation, and South Africa) and EU Eastern Partnership (EaP) countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine).

Energy resources and market structure

Mexico has substantial resources of oil and natural gas. In 2019, it was the world's fourteenth-leading net exporter of oil, though production has fallen sharply over the last decade as a result of declining output at the country's main producing field, Cantarell in the Gulf of Mexico. Natural gas production started a general trend of decline in 2011, driving up imports. After experiencing a sharp decline, national coal production picked up anew in 2010, only to go down again after a peak in 2011. It stood at 6.8 million tonnes of oil equivalent in 2018. Previously Mexico was a net energy exporter, with more than a quarter of the country's total production of energy being exported mostly to the United States. However, with the increasing proportion of imports, the country has turned into a net energy importer as of 2015.

Total Primary Energy Supply* in 2018



*excluding net electricity import
Source: IEA

In December 2013, Mexico's Federal Government enacted constitutional reforms to restructure the country's entire energy sector. Prior to these reforms, Pemex (*Petroleos Mexicanos*), the national oil and gas company, enjoyed a monopoly on hydrocarbon production, natural gas processing, oil refining, and the marketing of oil products. Under the new regime; Pemex has to compete with other firms on new hydrocarbon projects. It is still, however, the largest company in Mexico, and one of the largest oil companies in the world. The 2013 energy reform also saw increased transparency within the sector in the establishment of the *Fondo Mexicano del Petroleo* (FMP) which now independently manages the country's oil and gas income and redistributes it to the federal budget, oil producing regions and clean energy research and development, among others.

The structure of the coal-mining industry in Mexico has undergone tremendous change over the past 50 years. The 1961 mining code, which placed control of capital in the coal-mining industry exclusively in Mexican hands, was followed in 1992 by the Mexican Mining Law allowing control of coal-mining assets by both domestic and overseas mining companies, the latter as long as they are legally constituted in conformity to Mexican laws. Major players in the industry today comprise a mix of Mexican and foreign invested companies, along with subsidiaries of diversified mining conglomerates.

Changes brought by the 2013 energy reform unbundled the *Comisión Federal de Electricidad* (CFE) and subsequently allowed private parties to fully participate in the generation, transmission, and distribution of electricity even if the latter two are still heavily dominated by the state. The creation of Mexico's first investment energy trust, FIBRA E, was one important instrument to increase private sector investment in transmission infrastructure by offering tax breaks to investors. CFE stock certificates were issued in July 2018 representing the first Initial Public Offering (IPO) of a CFE subsidiary, raising almost MXN 22 billion, or over 12% of the total transmission investment needs over 15 years.

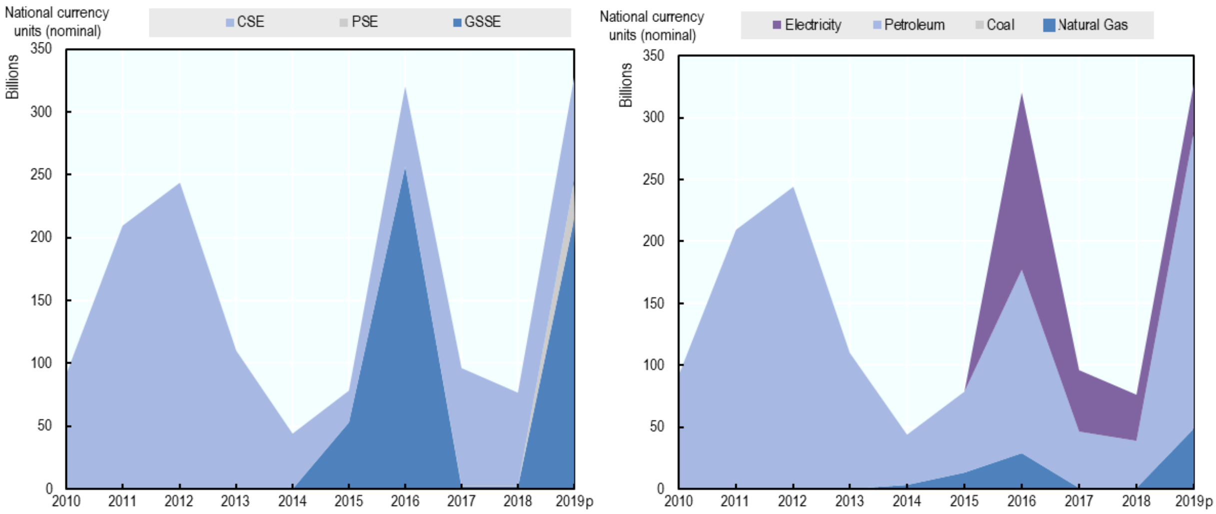
Energy prices and taxes

Fuel prices in Mexico are determined by market forces. In particular, prices for gasoline and diesel are set by the market since December 2017 and without a maximum price limitation. LPG has had full market prices since January

2017. At the same time, the Federal Government sets excise taxes on the sale of gasoline and diesel (*Impuesto Especial sobre Producción y Servicios por Enajenación de Gasolinas y Diesel* or IEPS).

All electricity tariffs were approved by the *Secretaría de Hacienda y Crédito Público* (SHCP) until the Energy Reform switched this responsibility to the Energy Regulatory Commission (CRE) for all cases, except household consumption and agricultural use. As a result of a policy of subsidies for these two sectors, average electricity tariffs for agricultural users and households have been held well below average costs. However in 2016, there were also cross-subsidies from the top 1% household consumers, which face a rate above costs for all their consumption units.

Total support by for fossil fuels in Mexico by support indicator (left) and fuel type (right)



Note: CSE=Consumer Support Estimate; PSE=Producer Support Estimate; GSSE=General Services Support Estimate

There are also fuel-tax stimulus (fiscal expenditure) available for the agriculture and fisheries sectors, and excise tax credits against the income tax for general machinery, commercial vessels, to support the private and public transportation of passengers or freight, as well as tourism, and for diesel used in the industry for purposes other than fuelling vehicles.

In 2012, as part of its General Climate Change Law, Mexico implemented a carbon tax as a fiscal instrument to reduce its carbon emissions and to put a price on the negative environmental externalities of fossil fuels**.** It was legislated as a component of the IEPS in 2013 and came into full force in 2014. Similar to other jurisdictions with a carbon tax, the tax is applied to fossil fuels based on their carbon emission content with a standard rate in 2020 of MXN 50.32/tonne of CO_2 equivalent (tCO_2e). However, there are certain exemptions to the application of this tax. Among these are natural gas, which receives a carbon tax price of zero as well as fuels used in production processes other than for combustion, and all aviation kerosene and aviation fuels..

Recent developments and trends in support

In late 2014, Mexico eliminated the direct support it provided for the consumption of gasoline and diesel fuel through the IEPS, the country's floating excise tax. Previously, variable rates of IEPS were set by the government on the basis of international prices for the country's two grades of gasoline, Regular and Premium (low-octane and high-octane gasoline, respectively), and diesel fuel. When international reference prices for these fuels were above (below) the national set prices, IEPS rates would turn negative (positive), thereby generating a tax expenditure (tax revenue). As part of the reform, the Federal Government steadily increased retail prices on a monthly basis in order to reduce the support conferred to consumers. Together with the lower international oil and fuel prices, these efforts contributed to reduce total consumer support in Mexico, from MXN 223 billion (USD 17 billion) in 2012 to MXN 34 billion (USD 2.6 billion) in 2014. Due to changes to both fiscal and tax regulatory frameworks since late 2014, the rates of IEPS have been positive, generating revenues of around 0.8 % of GDP in 2018. Since 2016, the tax rate is fixed. Also, a fiscal stimulus started to mitigate the variations in international references and the exchange rate, so as to reduce its impact on domestic prices. Since January 1st 2019, the fiscal stimulus mechanism changed, in order to comply with the objective of keeping prices from increasing in real terms, and to mitigate their volatility; when the international price is lower than the internal price target, the stimulus for fuels is zero, as happened in late 2019 and early 2020.

The new mechanism, coupled with lower international prices, resulted in government revenues of MXN 187.7 billion in 2018, and MXN 268.9 billion in 2019.

Examples of measures	
Tax Credit for Purchased Diesel for Machinery (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 exception of railways and limited for mining companies with 50 million pesos of revenues) and marine vehicles. In 2020 the Mexican Federation Revenue Law limited this credit to companies with less than 60 million pesos of revenues.. Before the Excise Tax Reform this provision only applied when the rate of Impuesto Especial sobre Producción y Servicios (IEPS) was positive. IEPS has since been defined exclusively as a (positive) tax, making this measure to take effect annually.
Fuel Tax Credit for Agriculture and Forestry (2003-)	This measure provides the agriculture, forestry, and fisheries sectors with the possibility of crediting fuel-tax towards income tax, whenever used in general machinery, with the exception of vehicles, regardless of the prevailing IEPS rates. In 2020 the Mexican Federation Revenue Law limited this credit to companies with less than 60 million pesos of revenues.