

The Price of Finished Petroleum Products Rises faster than it Falls

By

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When it comes to Jamaica's energy options, the narrative is changing! In December 2014, Nestle Jamaica Limited announced that it would cease local production in January 2015, due to unfavourable energy costs; reducing the price of energy has been an unwavering demand of both residential and commercial consumers alike. There is a noticeable shift, however, in the nature of the discussion surrounding the way out of Jamaica's energy crisis as short-term policy proposals have now been introduced into the hitherto bag of long-term prescriptions.

Long-term Prescription

The price of crude oil on the world market is largely under the influence of a powerful group of sovereign oil-producing nations formally known as the Organisation of Petroleum Exporting Countries (OPEC). Given the position held by OPEC, it was reasonable for the public to presume that the price of imported petroleum in Jamaica is ostensibly outside of the influence of domestic suppliers since domestic demand for petroleum products is satisfied entirely through importation.

Accordingly, previous prescriptions aimed at alleviating the high cost of energy in Jamaica were confined to long-term proposals such as calls for the government to diversify its energy base to reducing its dependency on fossil-based fuels thereby avoid the relatively high price of finished petroleum products. Other proposals called for a restructuring of the electricity sector to ensure that our energy needs are satisfied more efficiently from fossil-based fuels.

Game Changing Trends in the Global Price of Oil

Recent trends in the price of crude oil have 'fueled', for want of a better word, a change in the tone of this important conversation. The presumption that the price of finished petroleum products is outside the control of domestic suppliers appears to be no longer tenable among key stakeholders in the business community--the narrative has changed. Pointing to alleged "discrepancies" between movements in the ex-refinery price of finished petroleum products from Petrojam and the price of crude oil on the world market, the Private Sector Organisation of Jamaica (PSOJ) has implicated Petrojam's pricing strategy as a significant contributor to the high price of finished petroleum products in Jamaica. In particular, the PSOJ argues that the percentage reduction in the ex-refinery price during the latter half of 2014 was not commensurate with the percentage reduction in the price of crude oil on the world market over the same period. In December 2014, the PSOJ called for a more transparent pricing mechanism—one which allow for a greater pass through of cost reductions when the global price of oil declines. In what follows, we argue that greater competition offers the best environment to encourage such transparent prices.

Competition as a Short Term Solution

Using the jargon of competition law, the PSOJ is arguing that in the absence of proper competitive constraints, Petrojam has been exercising significant market power in the upstream (wholesale) market to the detriment of its customers in the downstream (retail) market. While not commenting on the main conclusion stated by PSOJ, the main purpose of this note is to document the influence of competitive constraints on the transmission of cost movements in the ex-refinery price on the retail price. In particular, we compare movement in the ex-refinery price on the movement of pump prices in three areas in Kingston: Norman Manley International Airport (NMIA), Heroes Circle and Liguanea. In the

Heroes Circle area, we track the prices of four dealers operating in close proximity with each other. At the Liguanea location, we track the price of six dealers operating close to each other. At the NMIA, we track the price of the sole dealer location, with its nearest rival located approximately 8 kilometers away at the Harbour View Round About. These areas were selected for comparison due to the difference in localized competitive dynamics observed to be operating therein. All other things constant, greater competitive constraints should be reflected by lower average prices and smaller price differentials among competing dealers. The competitive dynamics are reflected below.

Table 1 Prices during Jan-Oct 2014 for E10-87 petroleum

	Heroes Circle	Liguanea	Airport
Number of dealer locations	4	6	1
Average Price (\$/litre)	127.06	135.66	133.55
Average Price Differential (\$/litre)	0.64	1.35	---

Data Source: Consumer Affairs Commission.

Comparison of Pump Prices

Using monthly data on pump price for 87 Octane fuel gathered January-October 2014 by the Consumer Affairs Commission, we observe at least three trends which are consistent with the common perception that dealers in the Heroes Circle region face greater competitive constraints than dealers in the other areas.

Firstly, we observe that the average price in the Heroes Circle area is consistently below the average price within the other two areas. In particular, the fuel in the Heroes Circle region was, on average, \$6.49 per litre more affordable than the fuel sold at the Airport, and \$8.60 per litre more affordable than the fuel sold in the Liguanea area. Secondly we observe that the fuel sold at dealers located in the Heroes Circle Area was more affordable than identically branded locations in the other two areas. Specifically, the Petcom-branded location at Heroes Circle was, on average, \$6.60 per litre more affordable than the fuel sold at the Petcom-branded location at the Airport. Similarly, the Total-branded location at the Heroes Circle was, on average, \$8.22 per litre more affordable than the fuel sold at the Total-branded location in the Liguanea area. Finally, the difference between the most affordable and the least affordable dealers ('price differential') was, on average, 64 cents per litre in the Heroes Circle while it was as much at \$1.35 per litre in the Liguanea area.

Pace of Gasoline Price Pass-Through

The central focus of the recent discussions is the pace at which changes in the global oil price is reflected domestically at the point of consumption by motorists, electricity producers, manufacturers etc. The data show that there was a general upward trend in the ex-refinery price of 87 Octane during the period January-June 2014. During this period, the ex-refinery price increased by \$12.08 per litre. It is also observed that during this period, dealers in the Heroes Circle area increased the pump price within seven days ('immediately') by \$0.80 per litre, on average, for every dollar increase in the ex-refinery price. By way of comparison, the dealers located in the Liguanea area and Airport areas increased pump price immediately by \$1.04 cents per litre and \$0.82 per litre respectively, for every dollar increase in the ex-refinery price.

The data also confirm that prices tend to increase at a faster pace than they tend to fall. In particular, during July-October 2014, the ex-refinery price of 87 Octane fuel decreased by \$12.99 per litre. During this period, dealers located in the Heroes Circle region reduced pump prices by \$0.70 per litre for every dollar reduction in the ex-refinery price, whilst dealers in the Liguanea and Airport Areas reduced pump prices by \$0.71 per litre and \$0.68 per litre respectively. These results are summarized in the table below.

Table 2 Showing that Competition offers “More transparent” retail pricing.

Ex-Refinery Price...	Heroes Circle	Liguanea	Airport
...increased by \$1.00	Pump price increased by \$0.80	Pump price increased by \$1.04	Pump price increased by \$0.82
...reduced by \$1.00	Pump price reduced by \$0.70	Pump price reduced by \$0.71	Pump price reduced by \$0.68

Conclusion

This study highlights four important points. Firstly, it is more appropriate to use dollar-valued, rather than percentage, changes to measure the extent to which reduction in global oil prices are passed through to domestic consumers. Secondly, only a fraction of movements in ex-refinery price is reflected immediately in the pump price. Thirdly, dealers pass through increases in the ex-refinery price at a faster pace than they pass through reductions in the ex-refinery price. Finally, customers of dealers facing more restrictive competitive constraints secure more benefits from movements in the ex-refinery price, relative customers of dealers facing less restrictive competitive constraints; this, as the disparity in the pace at which price increases and reductions are reflected in the pump price is less pronounced in the more competitive area.

Based on the results of this study, the PSOJ’s call for “more transparent” can be answered by promoting greater levels of competition at wholesale and retail segments of the distributive trade.