

FUEL MARKET CONTESTABILITY: AN ANALISYS OF BRAZILIAN MARKET

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1. Overview

A contestable market is that one in which the potential competition equals the market price to the cost of the marginal supply. In principle, the existence of an organized and liquid international market for oil and its products would open space to “hit and run” strategies in domestic fuels markets: some agents would import fuels to sell in domestic market whenever there is a profitable opportunity of doing so. According to the Theory Contestable Markets, potential competition would restrain the market power of domestic oil companies and domestic fuel prices would tend to follow the fluctuations of international spot prices.

The objective of this article is to analyze the level of contestability of fuel markets in Brazil. The fuel market in Brazil was fully liberalized in January 2002. However, in terms of its industrial structure, Petrobras, the state controlled oil company, is still the dominant player controlling more than 95% of refining capacity as well as transport infrastructure. Therefore, the objective of this paper is to verify to what extent the potential competition is influencing the market power of Petrobras.

2. Methods

In order to verify the existence and the level of the potential competition in the Brazilian fuel market, it will be analyzed how fuel importer's, excluding Petrobras, have been influenced by the price differentials between domestic prices and international spot prices. In principle, if the potential competition is significant there should be a positive correlation between fuel imports by Petrobras' competitors and fuel price differentials. The study will be focused on the behavior of gasoline and diesel markets, from January 2002 and December 2005.

The data on fuel imports available refers to the monthly imports authorizations by volume awarded by the National Petroleum Agency, the office in charge of the regulation of oil and gas industry in the country. Concerning the data on

prices, it will be used the monthly average of the producer price in Brazil and the monthly average of spot prices in US Gulf Coast.

The study is divided in the following sections: i) Introduction; ii) an overview of Brazilian fuel market; iii) evolution of domestic fuel prices *vis a vis* the international spot prices; iv) The imports and fuel price differentials, v) conclusions.

3. Results

There can be three possible alternative results from the analysis. The first one would be that in fact there is a positive correlation between the import authorization volume and fuel prices differentials. This would be an indicative of the contestability of fuel market in Brazil. The second and most probable one is that there is not a correlation between these two items. This would be a result from the great barriers to entry in Brazilian market, due to the market presence of Petrobras. In this sense, liberalization would be interpreted as a necessary, but not a sufficient condition to exert competitive pressure on domestic agents and so to bring domestic price to international levels. In fact, the fuels prices in Brazil have not been near following international ones

4. Conclusions

In a context of increasing instability in world oil industry, several countries implemented institutional reforms aiming to deregulate local oil products markets and promote the competition. These measures included in different degrees: privatisation of state oil companies, fuels price liberalization and opening to new investments and international transactions. Although, the local industry structure has remained vertical integrated and with high degree of concentration in most of the countries, this was not seen as a problem since the arbitrage between local and international markets would bring local oil products prices close to international spot prices. Based on the theory of contestable markets, this possibility, would restrain market power of local firms. However, at least in the particular case of Brazil, this study can show that market concentration is still a matter concerning fuel prices.