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By Valentino Sy

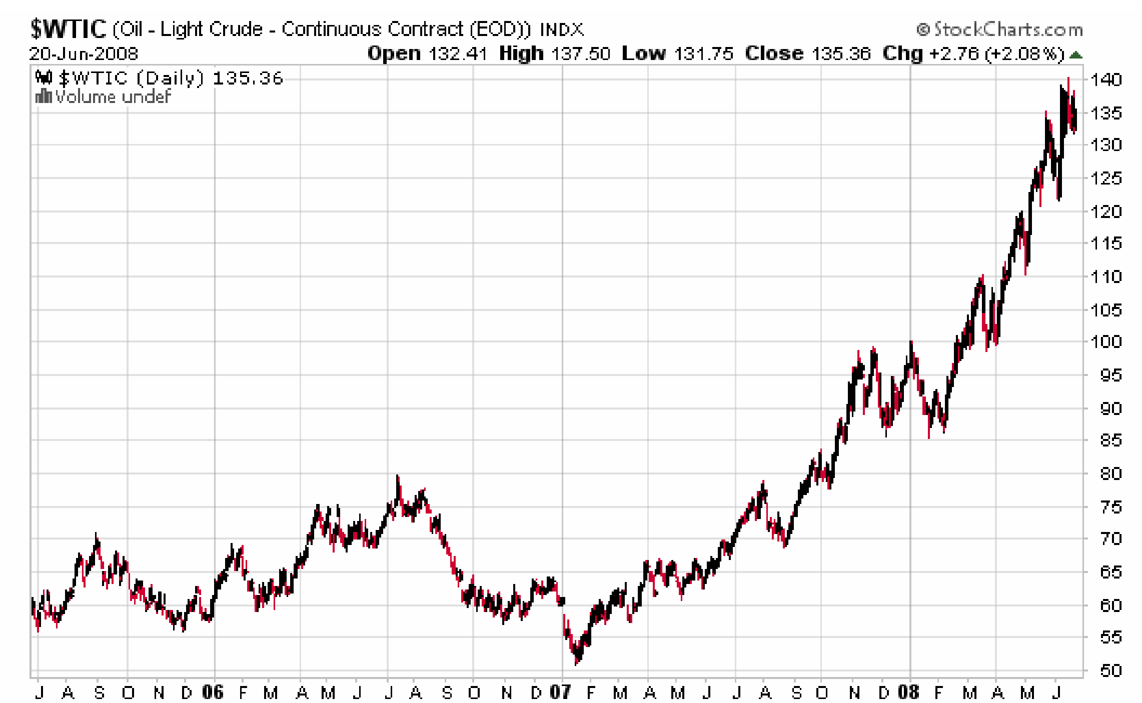
Be careful with fuel subsidies

The large and sustained increase in the price of oil has led to popular support for policies that minimize fuel prices by subsidies or reduced taxes. But lessons from other countries show that price-minimization policies are likely to harm consumers and the economy overall by encouraging inefficient use of fuel, smuggling & hoarding, increasing public debt and squeezing other government spending. In the long-run, these price distortions prolong the global supply-demand imbalance and keep oil prices higher for longer.

Lessons from other Asian countries

Subsidizing fuels entails high costs and compounds fiscal difficulties. The government of Thailand, for example, introduced price ceilings in January 2004, estimating that it would last no more than 2 months and that fiscal cost would be at most $128 million. By the time subsidies were removed – in October 2004 for gasoline and in July 2005 for diesel – the bill had reached $2.2 billion. In Indonesia, the cost for the government in 2005 alone amounted close to US$10 billion.

Since 2005, oil prices have more than doubled and it is very obvious that large fuel subsidies are unsustainable.



Recently, Malaysia slashed hefty fuel subsidies that would have cost $17.5 billion this year causing a 41 percent jump in fuel prices. Indonesia likewise hiked fuel prices by 29 percent last month, saving the government about $3.7 billion. Meanwhile, India and Taiwan increased fuel prices by 10 percent and 16 percent, respectively.

China, which has ample funds to maintain subsidies, announced last week that fuel prices will increase by 17 to 18 percent. The move is said to be a political one as much as policy-dictated.

Unintended consequences

Studies have also shown that most oil subsidies benefit less the people that they were intended for: the poor. Cheap fuel benefits most those who drive the biggest and most inefficient cars, namely the rich. Even targeted subsidies can end up with the wrong hands. Many countries subsidize kerosene, since the poor often cook with it, but so do lots of well-to-do restaurateurs.

In addition, since petroleum products are easy to store and transport, petroleum subsidies also encourage smuggling (to neighboring countries for resale at higher prices) as governments of Iran, Iraq, Venezuela, Nigeria, Kazakhtsan, Indonesia, Malaysia, and Vietnam can attest.

To make matters worst, artificially low prices encourage waste & traffic congestion and provide disincentives to fuel efficient vehicles.

Philippines mulling susbidies

As a net oil-importing country, the Philippines had to bear the full brunt of surging oil prices. So far, the Philippine government has provided subsidies to the poor by providing P500 a month plus P300 for every child sent to school for 300,000 families in the 20 poorest provinces, P500 in one-time allocation to each household using less than 100 kwh of electricity a month and NFA rice sold at P18.50 per kilo.

As expected, public land transport groups are crying out for more assistance. Some groups are asking for a P2 per liter subsidy on fuel purchases by jeepneys, buses and taxis. Meanwhile, other transport groups are calling for the removal of the 12 percent VAT on petroleum products.

The government is said to be contemplating the P2 per liter subsidy and is looking at spending P3 billion per quarter to provide assistance to the transport sector and prevent another round of fare increase.

Short-term gain, long-term pain

While other Asian countries are slowly phasing out fuel subsidies, the Philippines is considering to introduce them. We have to be very careful, however, about giving them away. The taxpayers, of course, will eventually foot all these bills.

Meanwhile, growing public debt puts upward pressure on interest rates which raises the cost of doing business and reduces the capital available to more productive borrowers. In addition, fiscal underperformance will likely depress the Philippine peso, making imported fuel more expensive, and feeding the inflation the subsidies are supposed to curb. In the long run, these could cause more damage than high oil prices.

True, subsidizing fuel prices help the poor, but at a large cost to society and to government. As our Asian neighbors can attest, it doesn't work.

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