

by Datuk Mustapa Mohamed



A Sticky Situation

Sound economic management has enabled the Malaysian Government to subsidise rising oil prices. But how long can it bear this burden?

BEGINNING Nov 13, the National Economic Action Council (NEAC) began distributing 50,000 copies of its booklet *Harga Minyak: Peranan Kerajaan dan Rakyat* (Oil Price: The Role of the Government and Citizens) to the public. The idea is to provide a simple but clear explanation on the recent Government decision to raise the price of petrol and diesel on Oct 1.

The importance and urgency of providing the public with such understanding was not lost on the Cabinet, which discussed the matter at length the past few weeks. It was prompted by the steady rise of the global oil price to record levels, and the need to curb profiteering by unscrupulous traders.

Though the price increase is minimal, we must not take things for granted. Indonesia is a case in point. The diesel price increase and the hike in electricity tariff, in the midst of rising inflation and at a time when its economy was in chaos, were among the main factors that led angry and agitated Indonesians to bring down the Suharto Government in 1998.

Besides the publication of this booklet, I have chosen television as one of the mediums to disseminate information on

this issue. On several occasions, I have appeared on talk shows on TV1 and TV3, such as *60 Minit Bersama Menteri*, *Selamat Pagi Malaysia* and *Malaysia Hari Ini*. Here, I would like to touch on some of the major themes in this nine-page booklet, the second to be produced by NEAC in two years. Last year, it published a booklet to explain Malaysia's stand and rebut Singapore's allegations with regards to the water agreement between the two countries.

The main point is that an increase in the local price of petrol and diesel is inevitable. Malaysia is an open economy, as such prices here are impacted by the increase in the price of crude oil in the global market, which has been steadily rising in the past decade, and especially so in the last few months.

The West Texas Intermediate (WTI), for example, was US\$ 19 per barrel in 1993. In 2003, the price rose to US\$ 31. At one point in October 2004, it went up to a record level of US\$ 55 and many were predicting it might even hit US\$ 60. Although the price of oil has eased since then, the future remains uncertain.

Analysts point to many reasons for the huge spike in prices, more than 60% over the past year. In every troubled corner of the oil-producing world the list of shocks has

grown; from terrorist attacks in Saudi Arabia to hurricanes in the Gulf of Mexico, the Yukos commotion in Russia and unpredictable demagoguery in Venezuela. Shipping lanes in Asia are plagued by pirates and threatened by terrorists. There's growing unrest in Nigeria and along the African coast, as well as chaos in Iraq.

All this is happening while demand from China surged 30% last year and nearly 40% in the first half of 2004 alone, beyond anyone's expectations. Its booming economy and burgeoning appetite for cars and other modern conveniences have caused energy demand to soar. The country accounted for about one-third of the increase in world oil consumption this year, more than any other single nation. This is happening in India, too.

A cold winter is coming on, upping demand for heating oil. And oil is in such short supply today. Currently, producers are pumping just 300,000 barrels more than the 82 million barrels being consumed worldwide every day.

Nevertheless, the price rise of petroleum products in Malaysia has been much lower than the rise in the global crude oil price. Between 1993 and October 2004, the global oil price had risen 253.7%. In comparison, the price of petroleum products in Malaysia has risen only 25.7% for RON 97 (RON or Research Octane Number indicates the oil power, the higher the number, the more powerful the fuel), 26.6% for RON 92 and 27.7% for diesel, due to heavy Government subsidies.

According to the World Bank Database on Transport, oil prices in Malaysia rose only 6.7% between December 2002 and June 2004. In comparison, oil prices in the United States have gone up 54.8%, 13.4% in Germany, 15.3% in France, 51.7% in Japan, 22.3% in China and 90% in India.

Although prices were raised twice this year (two sen in May and five sen in October 2004), the prices of petroleum and diesel in Malaysia are still the lowest in Asean. For a litre of unleaded gasoline (ULG), for example, Singaporeans pay RM3.43, Thais RM2.07 and Filipinos RM1.83. Malaysians pay only RM1.42.

Only Indonesia has lower prices, as the

Indonesian government has allocated RM26.6 billion in oil subsidy for 2004, markedly higher than the initial estimate of RM6.04 billion. Some economists suggest the gradual elimination of oil subsidies should be one of the top priorities of President Susilo Bambang Yudhoyono.

Likewise, if the Malaysian Government had not subsidised oil prices, the actual price would have been much higher. Petrol would have been RM2.35 a litre and diesel RM2.23 a litre in peninsular Malaysia in October 2004; RM2.36 and RM2.22 a litre, respectively, in Sabah and RM2.33 and RM2.21 a litre, respectively, in Sarawak. Currently, petrol costs RM1.42 a litre and diesel 83 sen a litre in peninsular Malaysia; RM1.40 and 83 sen, respectively, in Sabah; and RM1.41 and 83 sen, respectively, in Sarawak.

This subsidy has been growing over the past year, due to the higher crude oil prices in the global market. The subsidy in 2003 amounted to RM1 billion, and is expected to go up four times to RM4.2 billion this year. In 2001, subsidies amounted to RM2.9 billion, while in 2002 it was RM1.7 billion.

From the government's perspective, subsidising is only one part of the story. Its financial burden goes beyond that. By not collecting tax on the sale of petrol and diesel, the government forego revenue amounting to RM5.1 billion in 2001, RM3.3 billion in 2002, RM4.8 billion in 2003 and an estimated RM7.3 billion this year.

This means that the total amount of financial burden borne by the government was RM8 billion in 2001, RM5 billion in 2002 and RM5.8 billion in 2003. If oil prices were maintained, then the amount lost through direct subsidy and loss of revenue for 2004 would total a staggering RM11.5 billion.

On this issue, the government is faced with a real dilemma: If the global price of crude oil continues to rise, say to US\$ 60 per barrel, should the government continue or stop the subsidies? If the government stops subsidising, it means consumers will have to pay more for their petrol and diesel consumption. The *rakyat*, especially the poor, might not be happy. But by continuing with the subsidies, the government will be depleted of much needed funds to finance public projects, such as rural and urban development as well as the provision of

infrastructure, education and health facilities.

The fact is that development funds have to come from somewhere. Take 2003 and 2004, for example. The combined bill in the form of direct subsidies and tax revenue foregone for the two years was a staggering RM17.3 billion. That's an awful lot of money that could be put to better use: building many new hospitals and schools, providing more scholarships, building better quarters for policemen, soldiers and civil servants, safer roads, cleaner water, etc.

In addition, if the price difference between Malaysia and its neighbours was too high, then smuggling will occur. Assuming smuggling was at a rate of 5%, Malaysians would have subsidised RM200 million to consumers in neighbouring countries. Malaysian consumers have a big role to play. They should report profiteering activities by unscrupulous traders. Research shows that

billion, the government will use RM4.2 billion to subsidise petrol and diesel prices. This directly benefits consumers. The rest is used to fund government expenses, including emoluments and development projects.

The government has established a Cabinet Committee, chaired by the Prime Minister himself, to study the impact of oil prices on the national economy. Among its main objectives are to promote the use of natural gas for government vehicles and those in the public transportation network, encourage the use of renewable energy such as solar energy and biomass, palm oil as bio-fuel as well as the 'low-energy office' (LEO) concept.

So, this is the bottomline. The sharp rise in oil prices, if sustained, may shave off some decimal points from the global growth forecast. Despite the recent decline, oil prices are still at historic highs. Although Malaysia will benefit from being a net oil exporter, a

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oil constitutes less than 1% of the production cost of goods and products. Consumers should also learn to conserve energy. Our citizens – individuals, the public and private sectors – should use petrol and energy more effectively and prudently.

What about Petronas? If indeed it is making billions in profits annually, why can't it absorb some of the financial burden, some may ask. Others argue that Petronas, being an 'Asian Fortune 500' company, should give bigger dividends so that the government can continue to subsidise petrol prices.

The real fact is that it has – and a lot. Petronas now does business in 35 countries, deriving about 35% of its revenue from its worldwide operations. As a company, Petronas pays corporate and income tax to the government. It also pays annual dividends and duties for the crude oil it exports. On top of that, Petronas also pays royalties to both the Federal and state governments.

The company's contribution to national coffers amounted to RM25.3 billion for the period 2003/2004. The amount has been rising, from RM15.5 billion in 2001/2002 and RM18.6 billion in 2002/2003. Of the RM25.3

slightly slower growth in the world economy will dampen the growth of our non-oil exports and gross domestic product (GDP). It is estimated that a sustained increase of US\$ 10 in oil prices will result in a slower growth in GDP by 0.4 percentage points. However, indications are that WTI crude oil prices would settle at around US\$ 34 at end 2004.

The government is able to subsidise rising fuel prices because of our good economic fundamentals and healthy foreign exchange reserves. But subsidies do put pressure on the national budget. We cannot continue to nibble at our strong economic position or trade-off our long-term economic stability. As such, the government will continue to subsidise oil prices and bear the burden of foregone revenue, but only at a reasonable rate. If indeed the crude oil price rises to US\$ 60 or higher per barrel, then the government will have to fork out a hefty RM9.9 billion in petroleum subsidies. At that point, the government may have to revise oil prices again. **mb**

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