



Managing the Economy

National oil corporation Petronas has announced record profits this time around. Perhaps, part of it should go to subsidising oil prices at the pump, considering that inflation has risen substantially after the 30-sen oil price hike?

THE national oil corporation Petronas must be congratulated for turning in record profits of RM70.18 billion for the year ended March 31, 2006.

No doubt, the 20.9% increase in profits was largely attributed to the record oil price more than any brilliant productivity increase or cost-cutting efforts on the part of the oil company. To the layman, it is simply a direct correlation between higher oil prices and higher profits.

So, the debate continues – should part of the bumper profits be used to subsidise oil prices at the pumps? After all, even with the subsidy, there will still be excess revenue that can be channelled towards development projects.

The question really is choosing between maintaining subsidies and facing the effects of higher fuel prices. Or rather, which is the lesser of the two evils?

When RM4.4 billion in subsidies were removed at end February, petrol prices shot up by 30 sen – one of the largest single increases ever. The result was that inflation spiralled to 4.8% in March and 4.6% in April. Before the fuel increase, the inflation rate for February was just 3.2%.

The May inflation rate was 3.9% but analysts say it is most likely to rise above 4% again in June, given that electricity tariffs rose by 12% from June 1.

And to counter this rising inflation, Bank Negara Malaysia had to raise interest rates. Incidentally, the current cause of inflation is widely thought to be cost-push (due to rising prices caused by the petrol hike) rather than demand-pull (where too much money chases too few goods). So, raising interest rates may not necessarily control inflation.

On the other hand, higher interest rates can have profound effects. As the cost of borrowing increases, lending by banks declines and the economy slows down.

Put in another way, would it have been prudent to continue subsidies just to maintain economic stability?

Let's look at what Petronas President and Chief Executive Tan Sri Hassan Marican had to say on the fuel subsidies: 'When the price of oil goes up, the government gets less duties, so before you get into the subsidy environment, there is already a reduction in revenue to the government. When the price goes down, the duty goes up. As prices go up and up, duty becomes subsidy. So from a positive revenue flow to the government, it is now a negative outflow for the government to maintain a certain price level at the pump.'

Well, not many may fully understand Hassan's reasoning. But what matters to the layman is the negative effects of the 30-sen rise and the extra revenue Petronas is gaining.

Rising inflation also erodes savings. Your real returns in a Fixed Deposit (FD) account earning around 3.3% per annum is negated by an inflation rate above that.

Which perhaps explains why Permodalan Nasional Bhd (PNB)'s RM1 billion unit trust offer a few weeks ago was snapped up in just 1½ hours!

People are banking that PNB would give returns of above 7% on their investments.

Bank Negara has hinted that the current negative return on savings might not be sustainable. So, either the FD rates must go up or the Base Lending Rate (BLR) must decline.

To be sure, fuel subsidies may not be sustainable in the longer term. They even lead to smuggling activities. They also encourage to a subsidy mentality among people.

But surely a more gradual removal of the subsidy in stages as in the past would have been more prudent? Why the need for shock treatment? If the price hike had been 10 sen, would inflation have spiralled to nearly 5%?

In the larger interest of the economy, isn't maintaining stable economic growth of paramount importance, for now at least? **mb**

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