No turning back from targeted fuel subsidy

MY Say

BY AZAM ARIS

In this column on July 25, 2022, I said that a targeted fuel subsidy, instead of a blanket benefit for all, including those who do not need it, was the way to go. At the same time, I asked whether there was political will to do so.

Over many years, the same questions have been asked by journalists, analysts, economists and planners, but there was no political will then as it is never a popular move for the government to remove subsidies. It is the case that once given, a subsidy is difficult to pull back, especially during times when the prices of goods are increasing — and in the current environment, with water and electricity tariff hikes as well — while wages remain somewhat stagnant.

In another article, which I wrote way back in May 2, 2005, ("End the fuel subsidy", Issue 547), I said: "If there is a need to continue fuel subsidies, these should not be blanket subsidies because the rich will also benefit, as in the case of petrol. Fuel subsidies must be targeted at specific sectors ..." which include the poor, farmers, fishermen and public transport.

One reason why it was not implemented — apart from being unpopular — is that past governments dwelt too much on the mechanism of how to implement it, and whether to float the price to reach market parity where everyone pays the same pump price. And if this was the case, would cash vouchers be given to the needy and qualified? Or would there be a tiered pricing mechanism at the pump, where subsidy eligibility would also depend on the car model and engine capacity?

While trying to find the right mechanism, which requires time and a thorough study, over the years the issue of a targeted subsidy died down, generally when the price of crude oil dropped below US$40 or so and remained low for an extended period. This meant that fuel subsidies were affordable and sustainable for the government of the day, allowing it to postpone the unpopular move.

But whenever the price of crude oil increases due to tight supply, stronger demand led by high economic growth — for example, in China — or when geopolitical issues mainly in the Middle East crop up and disrupt supply; and the price remains high for an extended period (normally between US$70 and US$80 a barrel, like the current price range), the fuel subsidy can become substantial if the government continues to maintain an artificially low pump price.

Today, for example, RON95 is priced at RM2.05 a litre at the pump. As at September last year, the government's subsidy on RON95 was estimated to be RM1.15 per litre. At this subsidised rate of RM2.05, the pump price of RON95 in Malaysia was among the lowest in the world.

It was even lower than in Saudi Arabia — one of the world's largest producers and exporters — which has the equivalent pump price of RM2.91 a litre. As at September last year, in ringgit terms, comparatively in Singapore, it cost RM9.73 per litre, in Cambodia RM5.97, in Thailand RM6.25 and in Laos RM6.28. Unlike Malaysia, many governments globally also impose duties on the sales of petrol and diesel (as a source of government revenue).

The subsidy bill will spiral if the price of crude oil increases, which will impact the cost of refined products like petrol and diesel, more so if they breach US$100 per barrel. Last year, the benchmark price of Brent crude oil averaged US$82 a barrel. This year, Brent — according to the US Energy Information Administration — could average US$82 too and is forecast to remain relatively high at US$79 in 2025. A Bloomberg consensus report puts Brent at US$77 and US$72 a barrel in 2026 and 2027 respectively.

At these levels, it means fuel subsidies will remain high for the next few years and based on the government's financials, which are currently in deficit, a blanket subsidy is neither affordable nor sustainable. It was reported that the total subsidy was RM80 billion in 2023. The bulk of these subsidies, of more than 60%, goes mostly to fuel, which is primarily RON95 petrol and diesel and, to a lesser extent, electricity and cooking gas.

Bank Negara Malaysia reported that in 2022, blanket fuel and electricity subsidies totalled RM60.6 billion. At this level, the government spent six times more on fuel subsidies than education, 12 times more than on social and community services, and 14 times more than on health.

This sort of unproductive spending must end and the current government seems to be committed to taking a holistic approach towards implementing a targeted subsidy and tackling the issue once and for all, so that it will not get caught in a vicious cycle of incurring high subsidies if the price of crude oil remains high and breaches the dreaded US$100 a barrel level.

Yes, the world is in transitioning towards cleaner fuel and renewables, and moving away from depending too much on fossil fuels, but it will still take many more years for it to reach a balanced energy mix in consumption. In the meantime, the world still needs a lot of fossil fuels and if targeted subsidies are not implemented now, it will continue to be costly for the nation.

It is a tough decision, but it must be done and the present government is brave enough to implement targeted subsidies and move away from blanket coverage. The government has said that the current system is unsustainable and unfair as the top 20% of income earners receive 53% of the subsidies.

With Padu, the government's central database hub, it is hoped that targeted subsidies will be supported by the right income data, and those not eligible — the rich and foreign workers — will finally be excluded from government assistance. The key to the effectiveness of Padu is to get as many individuals and households as possible to update their personal and income data by March 31.

Targeted here can also mean that the pump price is gradually increased over time to reach market parity. If this is done, foreign workers and the rich will no longer get the subsidy at the pump via the blanket system. The higher market price will also help to curb smuggling and leakages caused by the ineffectiveness of banning petrol and diesel sales to foreign-registered vehicles at petrol stations.

While the mechanism for the targeted subsidy has not been announced, Economy Minister Rafizi Ramli said in November last year that with the information from Padu, the implementation of targeted subsidies for petrol and diesel will be done using three methods. The first is a subsidy provision based on an individual's net income through a social protection scheme; the second will involve household net income, through a combination of social protection and social assistance; and the third, based on both individual and household net income, where a subsidy card will be used.

Whatever the method, it will be good for the government, once the targeted subsidy is implemented, let's say after year, to show how much is being saved and where the money is going to. E

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