

Managing the Oil Crisis

Speech delivered during the Development RoundTable Series Forum on Oil and Electric Power held at the Sulo Hotel on 17 June 2008

Our dependency on oil has never been more excruciating than it is today. The price of fuel has reached unheard of heights. The price of crude went above \$139 a barrel over a week ago, before easing. At the pump, the price of unleaded gasoline has gone beyond P56 and diesel above P49. We are now consuming over 120 million barrels a year, and 90 per cent of that is sourced outside the country.

What is causing this unprecedented rise in global oil prices? The key factor seems to be that the demand for oil is rising much faster than its supply, and this is due fundamentally to the fact that the few old oilfields on which the world relies for most of its oil are being depleted and no new fields have been discovered that can match their production and reserves. Peak oil, which was viewed just a few years ago as a outlandish theory, is now being treated as fact. The second factor pushing up prices is the rush to buy oil futures contracts, a development that is partly determined by the fear that available oil will increasingly become scarce, partly by the desire of investors to park their wealth in oil instead of the declining dollar.

We ought not to be completely helpless, however. What is so shocking about the current state of affairs is that our capacity to influence developments in oil has deteriorated from 25 years ago. Then we had a proactive energy strategy, we had a government energy complex working to diversify our energy sources, and we had mechanisms to influence the domestic price of oil. Today, in the era of oil deregulation, we are 100 per cent at the mercy of Chevron-Caltex, Shell, and Aramco, which controls Petron. The OPEC countries that dominate the production of crude are often cast as the villains of the piece, yet the last few years have been years of record profits for the oil majors. In just the first three months of this year the five largest US oil companies made a record \$36 billion in profits, prompting the Democrats in Congress to push a bill to impose a 25 per cent tax on “unreasonable profits.”

In the Philippines, the subsidiaries of the majors have been doing very well. In 2007, Shell's net profit rose 54 per cent over 2006, from P4.12 billion to P6.36 billion. Petron's net profits rose 6.3 per cent, from P6.02 billion to P6.4 billion. Mind you, these are reported, not necessarily real profits, which are most likely higher, what with transfer pricing and all that. The majors act as a cartel and pretty much set whatever price they agree on, with no government intervention and little government monitoring.. All our officials can do is to exercise what economists call “moral suasion,” but we still have to find an oil company that will allowed itself to be swayed by morality.

In the US, it takes 4 to 6 weeks before a rise in the price of crude is reflected in the pump price. Here in the Philippines, with the rapid succession of pump price rises, the truth is we no longer know how prices are being determined. We don't know if prices are being determined in response to actual past rises in crude prices or in anticipation of future price rises. Non-transparency is the rule in the oil industry.

Marcos was guilty of many crimes, but, as they say, we must give the devil his due. His regime did have a proactive energy strategy and an effective energy bureaucracy. The fact that it blundered big-time in the case of the Bataan nuclear plant should not blind us to the positive aspects of the regime's approach to energy. Instead of building on these positive aspects, the succeeding regimes, in the name of the free market, committed three major blunders: Cory dismantled the state energy complex, she deregulated oil, and Ramos sold a controlling bloc of Petron shares to foreign interests. In this regard, Petron was not just a very profitable enterprise, the crown jewel of the state corporate sector. Being involved in nearly all phases of the oil business, Petron knew what a reasonable price and what reasonable profits were. Controlling 40 per cent of the market, Petron set its price and the oil majors tended to follow. Today what power government has was summed up by Energy Secretary Angelo Reyes: “It has to be the market that dictates the price. [But] we can't be helpless and not act when there's unreasonable pricing. That's our job, monitoring prices and dialoguing with them,” meaning the oil majors. I guess this is what is called moral suasion.

So given this self-inflicted, grim scenario, what should we do? Whatever it is, we can't let it be a piecemeal and largely reactive response, like passing out a one-time P500 to poor families. It must be comprehensive, with short-term and long-term components.

Let me share some suggestions with you, and here I take no credit for originality, having lifted these recommendations from different people. Also, let me say here that these suggestions do not constitute official FDC recommendations but are my own thoughts on the matter..

First the short term. There are several important proposals that are worth considering. One popular one is that the value added tax be abolished on fuel. This would certainly result in significantly lower prices and thus benefit the consumer, but only if pricing is being done in a transparent manner. The problem is that with a cartel that is extremely non-transparent in fixing prices, we have no way of checking if the removal of VAT is being reflected in the pump price.

Thus the removal of VAT should be accompanied by a measure of reregulation. The oil companies must obtain government's permission to raise prices. To determine whether the proposed price increase is fair and reasonable, the government must have access to the oil companies' costing data.. The objective is not to control prices but to correct the current situation of windfall profits and make the oil majors share the burden of the rise in the price of crude with the consumer rather than passing this all to the latter.

There are other short-term measures, among them the designation of service stations where public transport vehicles can purchase oil at subsidized prices, with the subsidy being financed by money rechanneled from debt servicing. There are said to be over 1000 designated stations at present. They should be increased.

Among the more strategic moves we can undertake is to undo one of our biggest mistakes. The government, which currently owns 40 per cent of Petron, must regain controlling interest and management control of that firm. This will mean a quantum leap forward in bringing price rises under control since it will mean state influence on some 35-40 per cent of the market. Petron can again be the price leader. There are fears that this will invite retaliation from Saudi Arabia, but I think these are overblown. The Saudis will talk if the price is right, and repurchasing Petron can be financed from rechanneled debt service payments. A re-Filipinized Petron will, in fact, be able to diversify our oil sourcing and make preferential deals with governments such as that of Venezuela, which is now selling oil to certain counties at 40 per cent off the world market price.

Another strategic move is to begin to radically shift from oil to electric power in transportation. Here priority must be placed on enlarging the electricity- run train and bus transportation system, with the necessary investments coming from resources that would otherwise go to debt service payments. This expansion could be coordinated with the popularization of the use of bicycles for relatively short distances from stations to residence or the office. Where the shift from oil to power is not yet feasible, we must move to convert a significant part of the bus and jeepney fleet from gasoline and diesel to cheaper CNG and LPG. Incentives should also be put in place to convert private vehicles into CNG and LPG.

Finally, we should reconstitute the Department of Energy, one with real power in comparison to the monitoring agency now headed by Angelo Reyes. A re-Filipinized Petron, the parts of the old PNOC still under state control, and Napocor would form the core of this new reconstituted agency that would be tasked with comprehensive planning to bring down energy prices, diversify our energy sources, and link manage our energy consumption to mitigate climate change.

I thank you.