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**“MANAGING IN A VOLATILE ECONOMIC ENVIRONMENT:  
ADDRESSING THE CHALLENGES BEFORE US”**

**“Energy Challenges and Policy Prescriptions”**

***What to do about the petroleum fuel subsidy in Trinidad and Tobago? - A sustainable reform of the fuel subsidy***

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A photograph of an offshore oil rig in the foreground on the left, with a large oil tanker ship in the middle ground on the right. The background shows a hazy coastline with mountains under a clear sky. The text 'Presentation Outline' is overlaid in large red font on the right side of the image.

# Presentation Outline

- ❖ Introduction
- ❖ Economic and Political arguments for subsidies
- ❖ Fuel Subsidy in Trinidad and Tobago
- ❖ How have we gotten to this point
- ❖ Comparison of Fuel prices in the Americas
- ❖ Options open to the State
- ❖ Petroleum Prices- Poverty Linkages
- ❖ Possible impact of subsidy removal/reform on the Economy, Society and the Environment
- ❖ Subsidies in a Sustainable Development context
- ❖ Recommendations & Conclusion
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An offshore oil rig is visible on the left side of the image, with a large oil tanker ship in the distance. The background shows a blue sea and hazy mountains under a clear sky.

# Introduction

- ❑ The Petroleum subsidy and levy were introduced in the 1970s to protect consumers from the sharp increase in petroleum prices and ensure that they enjoyed the fruits of the national patrimony through low and stable prices
- ❑ The entire cost of the subsidy was initially borne by oil-producing companies
- ❑ In 1992 the Petroleum Production Levy and Subsidy Act was amended to restrict the amount of levy to be paid by any producing company to not more than 3 per cent of the company's gross income
- ❑ The Act was further amended in 2003 by increasing the company's limit to 4 per cent of their gross income and exempting from the levy altogether, companies which produced less than 3,500 barrels of crude per day
- ❑ Any share of the subsidy in excess of the 4 per cent cap is currently borne by the government
- ❑ This has implications for the size of the government's contribution to the overall subsidy, especially in times of rising petroleum prices. (Cotton & Cassie, 2009)



# Introduction

- ❑ The petroleum fuel subsidy which is financed partly by energy companies operating in the domestic energy sector, and mostly by the State, has grown in size annually since 2004
- ❑ Crossed the \$4 billion mark in 2008
- ❑ High and rising international crude oil prices. ➡ an increased burden on Government's expenditure envelope w.r.t. the Fuel Subsidy
- ❑ As a result of dwindling oil production at Petrotrin, less crude is being sold
- ❑ Depressed price for natural gas on the international market
  - New gas reserves in the Middle East
  - Growing importance of shale gas in the United States of America ➡ Energy revenues to the State have been declining



# Introduction

- ❑ The Minister of Finance indicated that Government must now take a hard look at the structure of the fuel subsidy
- ❑ This paper analyses various alternatives open to the State to restructure the subsidy in a manner that is both economically and socially sustainable
- ❑ Reforming it or terminating it should be done in a manner that does not unduly put pressure on the vulnerable in the society
- ❑ This paper proposes the linking of subsidy reduction to poverty reduction in a manner that ensures the sustainability of any subsidy reduction strategy which the Government chooses

An offshore oil rig is visible in the background of the slide, situated in the ocean under a clear sky. The rig is a complex structure of steel and concrete, with various platforms and pipes.

# Economic and Political arguments for subsidies

## What are subsidies?

- ❑ Payments of cash in some form or fashion while others relate to the opportunity cost in terms of firms not internalizing the full economic cost of their operations
- ❑ “[T]he result of a government action, that confers an advantage on consumers or producers, in order to supplement their income or reduce their costs”, (OECD, 2005)
- ❑ A financial contribution by a government or any public body within the territory of a Member which confers a benefit (WTO)

An offshore oil rig is visible in the background of the slide, situated in the ocean under a clear sky. The rig is a complex structure of steel and concrete, with various platforms and pipes. The text 'Economic and Political arguments for subsidies' is overlaid in large, bold, red font on the right side of the image.

# Economic and Political arguments for subsidies

Subsidies are usually used to correct or support some economic activity targeted towards a particular group or groups within an economy. Well-designed subsidies are able to target the particular economic activity they were designed for without having too many negative spill-over effects or unintended consequences

Arguments in support of energy subsidies:

- Employment creation
- Support of social safety nets
- Energy security
- Developing alternative sources of supply, to supporting economic development

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# Economic and Political arguments for subsidies

The trade-offs from large energy subsidies:

- ❑ Competition for limited resources
- ❑ Increasing rent seeking behavior and commercial malpractice (e.g. diesel fuel bunkering)
- ❑ Promoting noneconomic energy consumption
- ❑ Discouraging both supply side and demand side efficiency improvements
- ❑ Creating an uncompetitive economic environment for alternative sources of energy such as renewables





- ❑ The Petroleum Production Levy and Subsidy Act of 1974 and all its amendments up to 2009 lay the foundation for what is popularly referred to today as the fuel subsidy
- ❑ The Act identifies that persons who are carrying out business of a petroleum marketing nature are to be the recipients of the subsidy payments
  - United Independent Petroleum Marketing Company Ltd. (UNIPET)
  - National Petroleum Marketing Company Ltd. (NP)
- ❑ These marketing companies are paid a subsidy whenever the reference price is above the controlled consumer price for petroleum fuels
- ❑ **The Reference Price** = Ex-Refinery Price + handling charges + excise duties oil + wholesaler's margin
- ❑ **The Retail Price (fixed)** = set by the Ministry of Energy and Energy Affairs



- ❑ Subsidy computed monthly with respect to sales of:
  - Unleaded premium gasoline (95 Ron)
  - Unleaded super gasoline (92 Ron)
  - Regular (Ron 83)
  - Kerosene
  - Auto and Marine diesel
  - Liquefied petroleum gas
  
- ❑ Where reference price is lower than fixed retail price Government receives a surplus on the sale of petroleum fuels
  - This surplus has invariably come from the sale of unleaded premium gasoline
  
- ❑ Diesel has historically gotten the largest share of the subsidy



# How have we gotten to this point?

## Transfers and Subsidies

	2005/2006	2006/2007	2007/2008	2008/2009	2009/2010
Total Current Expenditure (TT\$Mn.) <sup>^</sup>	32219.5	<b>31134.7</b>	<b>43738.8</b>	<b>36683.4</b>	<b>37595.3</b>
Transfers & Subsidies (TT\$Mn.) <sup>*</sup>	14830.4	16,781	20,114	21,174	21,134
Fuel Subsidy <sup>**</sup>	1692.5	1,823	4,001	1,356	2,681
Transfers & Subsidies/Total Current Expenditure (%)	46%	54%	46%	58%	56%
Fuel Subsidy/Total Current Expenditure (%)	5%	6%	9%	4%	7%
Transfers & Subsidies/GDP (%)	13%	12%	12%	17%	16%
Fuel Subsidy/GDP (%)	1%	1%	2%	1%	2%

<sup>^</sup> Source: Ministry of Finance

<sup>\*</sup>Source: Central Bank of Trinidad and Tobago, Adjusted for transfers to the Infrastructure Development Fund, Government Assisted Tertiary Education Fund and CARICOM Petroleum Fund

<sup>\*\*</sup> Source: Ministry of Energy and Energy Affairs







# Comparison of fuel prices in the Americas

■ Red Benchmark

Line: Retail price of gasoline and diesel of Spain. In November 2008, fuel prices in Spain were the lowest in EU-15 (without new accession countries).

November 2008

■ Green Benchmark

Line: Retail price of gasoline and diesel in the United States. Cost-Covering retail prices incl. industry margin, VAT and incl. approx. US 10 cents for 2 Road Funds (Federal and State). This fuel price being without other specific fuel taxes may be considered as the International Minimum Benchmark for a non-subsidised Road Transport Policy.

Source: GTZ-  
International  
Fuel Prices  
2009

A photograph of an offshore oil rig in the foreground, with a large ship in the middle ground and mountains in the background under a clear sky. The text "Options open to the State" is overlaid in red on the right side of the image.

# Options open to the State

Need to realize that subsidy reform is essentially about change management (Comley, 2005)

- Policy objectives must be defined clearly and rigorously
- Distribution of costs and benefits must be transparently identified
- The government must engage broadly with stakeholders
- The government must set ambitious end points but cautious timetables for reform
- Fiscal transfers are often required to facilitate the transition process



A photograph of an offshore oil rig in the foreground, with a large oil tanker ship in the middle ground, and mountains in the background under a clear sky. The text 'Options open to the State' is overlaid in red on the right side of the image.

# Options open to the State

- Capping the Subsidy- Government has the option of placing an upper limit on the fuel subsidy in an attempt to limit its liability for support of the subsidy
- Increasing the petroleum levy to energy companies
- Termination of subsidy
- Gradual reductions tied to targets for the reduction in poverty linked with a greater drive to encourage the use of CNG



# Options open to the State

## Alternative subsidy reform strategies- Types of Transition support

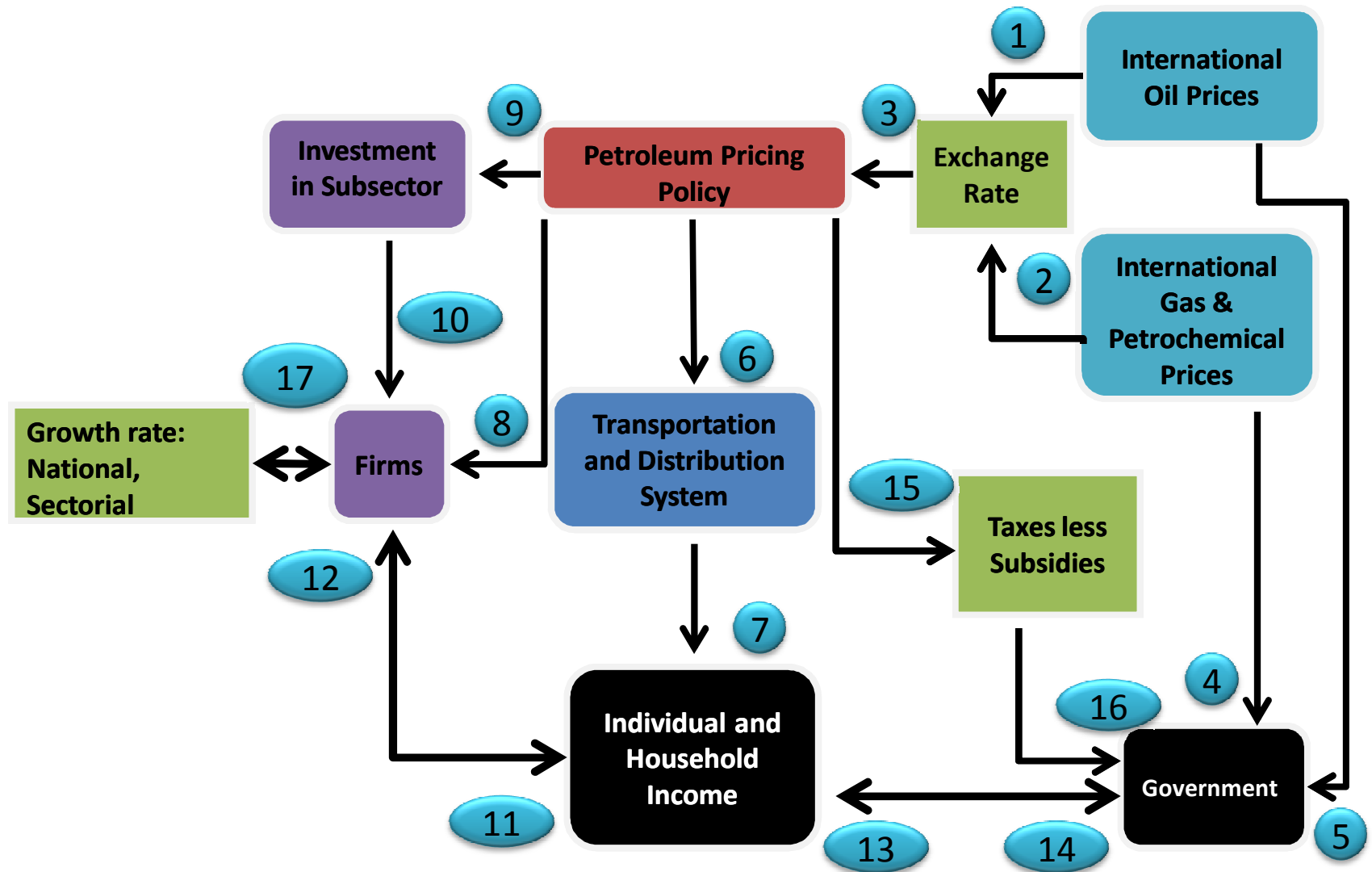
Source: Easing Subsidy Reform for Producers, Consumers and Communities, OECD Subsidy Reform and Sustainable Development: Political Economy Aspects

A photograph of an offshore oil rig in the foreground, with a large cargo ship in the middle ground and mountains in the background under a clear sky. The text "Options open to the State" is overlaid in red on the right side of the image.

# Options open to the State

- ❑ No matter which alternative is chosen the State needs to decide whether or not it will have to compensate anyone as a result of loss of income/benefit because of subsidy reform/removal
  - ❑ Money saved from the removal of a fuel subsidy may have to be spent lower down the chain on protecting consumer spending power via the social safety net
  - ❑ Need to weigh the cost and benefits carefully before action is taken
- ❑ The Duration of implementation has to also be considered

# Petroleum Prices - Poverty Linkages



Source: Adapted from Manson Nwafor et al., Does Poverty Removal Hurt the Poor?

An offshore oil rig is visible in the background of the slide, situated in the ocean. The rig is a complex structure of metal platforms and pipes, supported by a large steel jacket. The sky is clear and blue, and the water is a deep blue. The title text is overlaid on the right side of the image.


# Petroleum Prices- Poverty Linkages

- ❑ The last Survey of Living Conditions estimated the poverty rate of Trinidad and Tobago at 16.7 percent as at 2005
- ❑ We can safely infer that this rate has risen due in part to:
  - the high levels of homicides locally, with many of those killed being the main breadwinner for their households; and
  - the high levels of inflation, especially food inflation that obtained over the recent past

A photograph of an offshore oil rig in the ocean, with a large ship visible in the distance under a clear sky. The rig is a complex structure of steel and concrete, supported by several legs. The ship is a large, dark vessel, possibly a supply ship or a tanker, positioned in the middle ground. The background shows a hazy horizon with some landmasses or mountains.

# Possible Impact the on Economy

- ❑ Capping the subsidy would result in the release of government revenues which can focus on other areas of expenditure. If these funds are used to increase investments in infrastructural type projects this can lead to stimulation of economic activity domestically
- ❑ Increasing the petroleum levy on energy companies can have a similar effect as Government would have shoulder less of the burden relating to the fuel subsidy
- ❑ A once and for all termination of the subsidy would completely free the Government's hands of the cost of subsidizing petroleum fuel. This can lead to transfers of funds to other productive areas of the economy

A photograph of an offshore oil rig in the foreground, with a large oil tanker ship in the middle ground, and mountains in the background under a clear sky. The text 'Possible Impact on Society' is overlaid in red on the right side of the image.

# Possible Impact on Society

- ❑ The main fall-out from a once and for all stop to the petroleum fuel subsidy can be negative social redistributive impact on the poor in terms of rising prices for transportation and food items
- ❑ Headline inflation as measured by the 12-month change in the Index of Retail Prices has slowed to 0.6 percent in August 2011 y.o.y. This is down from 1.4 percent in the previous month
- ❑ Generally in a low inflation environment there is ample justification for reducing or removing subsidies that are geared to fight inflation
- ❑ Given that in the recent past wages and salaries have not been keeping up with the rate of inflation, real incomes have been on the decline and thus even though inflation has been low recently, purchasing power among the poor and middle class have not been restored

An offshore oil rig is visible in the background of the slide, situated in the ocean. The rig is a complex structure with multiple levels and a central tower, supported by a steel lattice. The sky is clear and blue, and the water is a deep blue. The title text is overlaid on the right side of the image.

# Possible Impact on the Environment

- ❑ The Carbon Dioxide Information Analysis Centre (CDIAC) has ranked Trinidad and Tobago 2<sup>nd</sup> in the world behind Qatar for CO<sub>2</sub> emissions per capita. This is out of a total of 215 countries surveyed in 2008
- ❑ In absolute terms Trinidad and Tobago does not appear in the top 20 of CDIAC's 2008 CO<sub>2</sub> emissions estimates. The top three in order of appearance are China, the USA and India
- ❑ Removal of the fuel subsidy would lead to:
  - An increase in the price of fuel at the pump, since there would be no more comparison between an administered price and a reference price.
  - Increase in the price at the pump would lead to a short run fall in the quantity demanded for petroleum fuel, and a long run reduction in demand as some substitution takes place between petrol/diesel vehicles and possible CNG powered vehicles.
  - This would lead to less carbon emissions from motor vehicles



# Subsidies in a Sustainable Development context

SUBSIDY



## Dynamic Economic impacts

### Macroeconomic Effects

- Efficiency and productivity impacts
- Fiscal, balance of payments and inflationary impacts

### Microeconomic Effects

- Impacts of price changes on firms or consumer behaviour



## Social and environmental impacts

### Impacts on people

- Immediate
- Changing over time



### Impacts on environment

- Immediate
- Changing over time

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# Subsidies in a Sustainable Development context

- ❑ “Sustainability development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” – Brundtland Commission, United Nations, 1987
- ❑ The sustainable development framework takes into account the impact of subsidy reform on the society, the economy and the environment simultaneously
- ❑ The option that would best meet this criteria is the gradual reductions in the subsidy tied to targets for the reduction in poverty linked with a greater drive to encourage the use of CNG
- ❑ The main impediment to subsidy reform is the political will to carry out such reforms
- ❑ It is normally seen as politically expedient to continue supporting such programmes & political suicide to completely remove them



# Recommendations & Conclusion

- ❑ The most sustainable approach to reform of the petroleum fuel subsidy is one where reductions are tied to targets for poverty reduction
- ❑ There is a need to complete an updated Survey of Living Conditions to estimate what the current rate of poverty is in Trinidad and Tobago
- ❑ The State can then target an  $X\%$  reduction of the petroleum subsidy and link it to a reduction in poverty by  $Y$  percentage points
- ❑ The condition being that if the State cannot reduce the level of poverty by  $Y$  percentage points per period of time, then it should not reduce the petroleum fuel subsidy by  $X\%$  over this period of time



# Recommendations & Conclusion

- ❑ Capping the fuel subsidy can be a short term measure to ease some of the fiscal burden of the State
- ❑ An aggressive implementation of CNG fuel is one of the best ways to ensure a sustainable reduction of the fuel subsidy
- ❑ The full brunt of the law should be felt by persons engaged in fuel bunkering



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9. US Energy Information Administration



**FIN**

**THE END**

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