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Consumers' welfare through deregulation, not politicized pricing

(A position paper on new moves to re-regulate the oil industry)

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Introduction

The Consumer and Oil Price Watch (COPW) issued a full-page newspaper ad the other day in one (possibly two or more) national newspaper. The COPW opened with this declaration:

"Regulate the Oil Industry.
It will endure transparency, fair pricing, and will safeguard consumers' welfare.
The Oil Industry was regulated in the 1980s. Regulation worked.
Oil prices were stabilized. So were government finances.
We must bring back regulation now."

COPW's 7 reasons why the oil industry should be re-regulated

After making the above headline declaration, COPW

1. The COPW Chairman (Mr. Raul Concepcion) walked out of the Congressional Committee hearing this week when Department of Energy (DOE) Secretary Angelo Reyes declared that "anybody who says he can determine the current price of oil is lying – to attract public attention."

2. The DOE and the DOJ are required by law to form a task force to monitor oil inventories and costs of the oil companies and to inform the public weekly. They did not do this for the past 11 years.

3. Regulation will mean more reasonable prices of oil.

4. There will be a better basis for determining oil prices. Oil pricing is not based on the actual acquisition price but on the Means of Platts Singapore (MOPS).

5. Oil pricing will be based on the return on capital in the case of Petron.

6. If refiners Shell and Petron had bought crude oil at $33.98 per barrel in February 2009 for March delivery, the price reduction would have been P8 per liter in March.
If refiners Shell and Petron had bought crude oil at $37.52 per barrel in March 2009 for delivery in April, the price reduction would have been P8 per liter in April.

7. The Oil Refiners have refused to buy forward oil contracts. They purchase their crude at higher prices.

Simplistic arguments and why

The above arguments do not reflect that they were well thought of. They tend to be simplistic, short-sighted and emotional. Here are the reasons why.

<u>a. Price regulation means politicized pricing</u>. Politicians and government bureaucrats, not the sellers and consumers in the supply-demand dynamics, will determine what is the "appropriate" price of the regulated commodity. When demand would increase significantly, say people suddenly have extra income, or they over-spend their savings for a big fiesta or festival, etc., prices will rise when suppliers did not anticipate such big increase in demand. But under a politicized pricing regime, prices should remain where they are unless the price regulators and bureaucrats will say, "Yes, you may raise your prices, but only at this level; in addition,…"

<u>b. Renewed oil price control scheme will attract the most corrupt politicians and bureaucrats</u>. The corrupt will be so thrilled to have the power to say "Yes" or "No" to all applications for price adjustment by ALL corporations and players. All they have to do is to delay by one day, one week, one month, any upward price adjustments regardless of the reason, in order to force those companies to give them bribes so that price adjustments will be acted upon quickly.

<u>c. In a deregulated environment, consumers are not helpless; they are empowered.</u> So long as there are other competing firms that can supply them their needs, consumers can always boycott and disregard all companies that charge them very high prices. In the case of the oil industry, if consumers think that Shell and Petron are sucking them big time, then motorists can always go to a Caltex or Total or Seaoil or Uni-oil or Flying V or many other new and upcoming oil retailers. This fear of being boycotted by consumers is the single biggest factor why companies will price their products to the most reasonable level possible. Over-pricing will happen only in a remote island and there is only one supplier, say there is only one gasoline station there.

<u>d. Price control and industry re-regulation will drive away new and upcoming competitors</u>. The main reason why they come in is because they sense there is profit to be made while doing public service in a deregulated environment. With politicized pricing, companies will spend their money bribing politicians and bureaucrats, or funding political parties with politicians who can be swayed to their corporate interests at the expense of the public. Whereas in a deregulated and depoliticized environment, companies will spend their money improving their services, making their shops and stores cleaner and more enjoyable for consumers and motorists, and pricing their products to a certain low level that will undercut the nearby competitors, and consumers will again benefit.

<u>e. To reduce oil prices, government should consider drastically cutting or abolishing certain taxes on oil</u>. In particular, the import tax and excise tax. These two plus import documentary stamp tax, local government tax, value added tax (VAT), and any other fees should be contributing up to 25 percent (or higher) of the retail price of gasoline products. The COPW and other activist groups and individuals that demand more government intervention in oil pricing hardly ever mention reducing the taxes on oil products.

There was one proposal to exempt petroleum products from the 12 percent VAT. While this may sound laudable, it is not advisable because once it is granted, all other sectors will soon be calling that their products should also be exempted from VAT. And it will be doubly hypocritical for the government to grant tax exemption to one product but not grant same exemption to most or all other products.

The excise tax on gasoline is based on a wrong premise, that gasoline is a “public bad” like alcohol and tobacco products and mining activities. Gasoline is an essential input for the production of various goods and services. From fishing boats to tricycles to cars to airplanes that transport huge volume of people and their commodities, they all require gasoline. By slapping an excise tax on gasoline products, the government is raising the cost of production of the various sectors of the economy. It makes the government a major contributor to inflation, even if the government declares that it wants to "fight" inflation.

<u>f. Motorists and consumers adjust to fluctuating oil prices</u>. About a year ago, unleaded gasoline and diesel reached nearly P70 and P60 per liter respectively, versus the current average prices of P40 and P30 per liter, respectively. When oil prices become too high, many motorists began conserving, planned and organized car pooling. Gas-guzzling huge cars were also less visible on the roads. When oil prices went down, people resumed driving more often and discontinued car pooling, the big cars which have low kilometer per liter usage are seen more often on the roads.

Making oil prices artificially low through government price control and regulation will result in increase demand for oil by motorists while supply will not be able to catch up as small oil retailers will be forced to discontinue expansion, if not close shop if they will not be allowed to charge to the motorists their losses and required returns to survive. A worse case scenario is oil rationing as some gasoline stations will limit their sale of oil in order to minimize their losses.

<u>g. From "Big 3" back to "Only 3"?</u> When the local oil industry was heavily regulated, there were "Only 3" players – Shell, Petron and Caltex. After the industry deregulation more than a decade ago, lots of new players came in. Like Total, PTT, Uni-oil, Seaoil, Flying V, and a few hundreds more. There were 601 new players (from bulk purchases to retailers to LPG sellers, etc.) that came in by end-of December alone.

Of course the share of the "big 3" remains high up to these days. This is because they have been a near oligopoly for many decades. It will take two or three decades more for the share of the new players to significantly increase and probably be at par with the current "big 3".

Competition is kicking in. It does not always result in lower prices but rather reasonable and competitive prices. There are certain costs of production that cannot be abolished and which contribute to high oil prices – like multiple oil taxes and various regulatory fees.

The important point is that all those talks and plans to go back to a highly politicized and over-regulated oil industry must be squashed because only a very few big players and a few big politicians and bureaucrats will benefit.