Issue #5 July 2008

Emerging Markets Weekly

Kris Sookdeo, Client Relations Officer kris.sookdeo@mycmmb.com

The Fuel Subsidy: A real crowd pleaser

Who in their right mind would want to pay more for something?

Everyone in Trinidad and Tobago depends on or is impacted by motorized transport. People and goods make their way over land, sea and air every day and we pay for it directly at the pumps and taxi fares and indirectly through freight charges factored into everyday prices for goods.

There are benefits to subsidizing fuel to make it more affordable. Obviously, it becomes cheaper for people to travel. People then have more money at their disposal and should experience a higher standard of living. Another reason is that fuel subsidies (principally on diesel) help keep the inflation demon away by suppressing the cost of goods, all of which depend at some stage on transport to get to the consumer (even more so when it comes to shipping goods to Tobago, where higher prices reflect the increased transport costs).

At the end of the day, citizens go home with a little extra change in their pockets and a smile on their faces, and a happy workforce/populace is great news for any economy/democratically elected government.

The Price of Cheap Fuel

What is the disadvantage of subsidizing fuel? Here's a hint: it has nine zeroes and increased three times since 2007. It is our whopping TT$6 billion fuel subsidy bill. Granted this is a projected figure (by the Minister of Finance no less) for 2008, but the price of oil is going up, which means the subsidy bill can only increase.

Our local oil refinery supplies all of our gasoline and diesel needs, both of these being products of oil distillation. It is a common perception that, as Trinidad exports oil and with the current price of US$134 per barrel of light sweet crude, the country stands to benefit tremendously from the windfall and as such we could easily absorb the subsidy bill. The truth is we don't export much oil. Currently Petrotrin has the capacity to refine about 150,000 barrels of oil per day but our local oilfields can only supply 60,000 to 90,000 barrels. As such, to the surprise of many, we actually import oil to make up that difference. It is because we have to import oil that we then become subject to international oil prices and while we may not be importing premium light crude at US$134 per barrel (we import cheaper heavy crude oil) all oil prices, regardless of grade, are going up. The government fuel subsidy is pegged at US$32 per barrel. Anything in excess of that is, therefore, subsidized by the government (Source: Trinidad Guardian).

Table 1

	Price with subsidy	**Price without subsidy**
Super Gasoline	3.00	5.57
Premium Gasoline	2.70	5.14
Diesel	1.50	5.30

It is argued that the funds spent on subsidizing fuel could be spent elsewhere, like on health, agriculture or local government. And while Trinidad and Tobago is sufficiently rich to cater for all these needs (the problem here has always been one of management), being rich is no excuse to spend funds wildly as that day will come when oil disappears completely and natural gas is no more. “Save for a rainy day” some voices urge.

Other than the financial burden there are perhaps more serious side effects. The folly lies in believing the subsidizing fuel is good because ordinary citizens don’t have to pay much for it. But the fact is we do pay for it. Payment comes in the form of our taxes, our time and peace of mind lost in traffic, the pollution of our environment, global warming, increased vehicular accidents (which in turn means loss of life and increased insurance premiums), parking congestion and, eventually, increased spending on transportation infrastructure (which again comes from taxpayers).

Looking at Table 1 however, it should be clear that we cannot simply drop the subsidy. The shock would be too great for many sectors of the economy to bear. Consider the following:

The Taxi Driver

Consider a typical taxi driver who plies the Port of Spain to San Fernando route (a fare of $13.00 at the time of writing). The vehicle is registered for 4 passengers and the majority of cars coming on the road are diesel powered. A driver can therefore in one return trip carry 8 persons (4 persons to San Fernando and then 4 back) and may make 4 trips per day usually 5 days per week

Table 2

(+)Revenue	**per month ($)**
Fares ($13 x 4 passengers x 2 x 4 trips per day x 5 days x 4 weeks)	8,432.00
(-)Business Costs	
Fuel if Diesel (60 liters per day x $1.50 x 6 days x 4 weeks)	2,160.00
Maintenance	600.00
(-)Household Costs	3,000.00
Surplus Income	2,672.00

Now consider if the diesel subsidy was removed:

Table 3

(+)Revenue	**per month ($)**
Fares ($13 x 4 passengers x 2 x 4 trips per day x 5 days x 4 weeks)	8,432.00
(-)Business Costs	
Fuel if Diesel (60 liters per day x $5.30 x 6 days x 4 weeks)	7,632.00
Maintenance	600.00
(-)Household Costs	3,000.00
Income deficit	-2,800.00

Clearly not a good idea. At this point I will remind you that there are two facets of the fuel subsidy: gasoline and diesel. Private transport is largely fueled by gasoline. Public transport as well as the haulage of consumer and industrial goods is fueled by diesel.

It is not unreasonable to assume that the largest consumers of gasoline are the middle to upper class vehicle owners. The individuals in lower income brackets depend more on public transport (i.e. diesel) and any inflationary increase in the price of consumer items (through the removal of a diesel subsidy) is going to affect this group first. Any measure taken must consider the lower income group, as they are the most vulnerable to the price of diesel. Conversely the middle to high income individuals will find it easier to weather the effects of un-subsidized gasoline.

A Better Way Forward?

One possible solution therefore appears and I would submit that if the public transportation network could be sufficiently improved so as to be able to effectively handle the increased commuter traffic, that the subsidy on gasoline should be eventually removed whilst a subsidy on diesel be left in place.

If the intention of the fuel subsidies is to bring affordable transportation to the public then there are more economic and more sustainable ways of doing so. One effect of subsidizing gasoline prices is that it has become wholly possible for the individuals to leave their homes, sitting by themselves, one person in a vehicle meant to seat five. Yet this is the message that the subsidy sends to the market - that this grossly inefficient mode of transport is desirable. Instead of subsidizing fuel, why not take that six billion and pump it into public transportation itself? Imagine a real mass transit system, regardless of whether by bus, monorail or water taxi, where fares are so low that everyone could afford it, so reliable that nobody is inconvenienced by the lack of personal transport. Certainly this is a better alternative to the simplistic approach taken by government of throwing money (indirectly) at the consumers while the true economic and social picture becomes distorted by the subsidy’s misleading market signals.

Who in their right mind would want to pay more for something? Not Trinbagonians. Regardless of whether or not subsidies are good for our society, if we are ever going to achieve first world status, eventually we are going to have to respond to these and other challenges in a mature manner. And perhaps if we examine the issues we just may find that the cost is worth paying.

FINANCIAL & ECONOMIC INDICATORS

As at 30 July, 2008

Exchange Rate/US$	Closing Value	Previous Week
Yen	108.13	107.33
Euro	1.56	1.57
Jamaica	72.23	72.30
Guyana	203.70	204.90

Commodity Prices	Closing Value	Previous Week
Crude oil (US$/bbl)	126.77	125.49
Natural Gas (US$/mmbtu)	9.00	9.69
Gold (US$/Troy Ounce)	906.10	928.05

Eurobond Indices (Return % YTD, as of 30-July-08)	
Lehman Brothers Global Aggregate Index	3.31
JP Morgan EMBI+ (percentage change)	11.20
CMMB Eurobond Index	n/d

Policy Interest Rates (%)	Closing Value	Previous Week
United States	1.75	2.06
Euro Zone	4.25	4.25
Japan	0.52	0.51
Brazil	13.00	13.00
Trinidad	8.50	8.25
Jamaica	13.50	13.50
Barbados	4.50	4.50

Market Interest Rates (%)	Closing Value	Previous Week
US 90-day T-Bill	1.66	1.62
US 10-Yr Treasury	4.05	4.00
3-month UK Libor	5.78	5.80
Japan 90-day T-Bill	0.53	0.53
Brazil 90-day T-Bill	13.20	13.48
TT 90-day T-Bill	7.17	7.17
Jamaica 90-day T-Bill	14.46	14.46
Barbados 90-day T-Bill	4.02	4.02

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com