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## The Petroleum Sector Should be Fully Deregulated and Depoliticized in the National Interest

by

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### Summary

For more than a decade, a process to deregulate the domestic petroleum sector remains uncompleted. This is because successive Governments have not been able to muster the necessary political courage to implement it fully. At best, the policy has been implemented on a piecemeal basis. In the process, Tema Oil Refinery (TOR), Ghana National Petroleum Corporation (GNPC), and the National Petroleum Authority (NPA) have maintained their dominance over importation and retail price setting. On the whole, ex-pump prices have not been allowed to fully reflect industry costs. This implies that Governments have been subsidizing petroleum products, ostensibly intended to cushion consumers and the economy against price shocks.

The question, however, is whether continued regulation and subsidization of the petroleum sector can be justified on economic or even social grounds. This paper argues that the petroleum subsidy that is provided universally can only be defended on political grounds but not on economic or social grounds as the costs outweigh the benefits. The paper suggests that full deregulation of the petroleum sector and depoliticization of the pricing scheme will serve the national interest better.

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## The Case Against Regulation And Provision Of Universal Subsidies

The regulation of the petroleum sector and provision of universal subsidies have serious costs and shortcomings. Perhaps the most important costs of subsidization are the foregone development and social projects. A subsidy deprives the Government of resources that could otherwise have been spent on productive projects and programs, such as investment in physical and human capital, and on alleviating poverty through expansion of social services.

Various studies, including one carried out by the IMF at the instance of the Ghanaian authorities, have shown that a universal oil subsidy benefits the rich more than the poor. This is because the subsidy supports the luxurious life-styles of the rich, while providing only limited relief to the poor. In that sense, it is not even socially defensible. A subsidy generally supports high oil consumption and encourages inefficiency in its use. Alternatively, a subsidy reduces the incentive to economize in the use of petroleum products. This costs the nation more money in terms of having to import higher volumes of oil.

A subsidy provides an incentive for smuggling petroleum products to neighboring countries especially if it leads to significant price differentials. This costs the country in terms of lost oil and lost revenue. The management of a subsidy entails a bureaucracy with administrative costs. The fixed-pricing and subsidy system has to be overseen by various bodies established at a cost to the state.

The dominance of TOR, GNPC, and NPA in the oil sector deprives consumers of the necessary competition expected in a more deregulated and freer market. Because TOR has been prevented from recovering its costs fully—and has not been fully reimbursed for its losses—it has had to borrow large amounts of

money from the banking system. These debts have put enormous stress on the banking system and threatened its stability. Recognized as government liability, the debts were from time to time converted into other forms and became part of the public debt.

To get some sense of the size of the oil subsidy, we refer to figures from the 2012 budget. It was reported that Government had had to subsidize ex-pump petrol prices to the tune of GH¢267 million in the year through September<sup>1</sup>. By end December, it was estimated that the total cost of the subsidy would reach GH¢364 million. The budget argued that the subsidy was a price worth paying to achieve macroeconomic stability. We beg to differ, however, from the reason proffered for the subsidy. As we have noted above, the biggest (opportunity) cost of the subsidy is the foregone spending on priority development and social projects, which could have spurred economic growth and job creation. This would have yielded a greater long-term benefit than the presumed short-term stability gain.

### What Full Deregulation Will Entail

A fully-deregulated petroleum sector should achieve two main objectives. First, deregulation should break TOR's and GNPC's market dominance. In particular, the Oil Marketing Companies (OMCs) should be allowed to participate fully in importation and financing of crude and products in addition to their usual distribution functions.

Second, deregulation should end politicized pricing of petroleum products. Retail prices should be allowed to reflect full cost, thereby eliminating any budget subsidies.

A short transition period would be required to usher in full-fledged deregulation. During the period, the participation of OMCs should increase. Meanwhile, pricing may in the interim be based on an automatic formula overseen by the National Petroleum Authority (NPA). Price adjustments should be made more frequent, say monthly. They should also be

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<sup>1</sup>The wording seems to suggest that the Government saw it as an obligation to provide the subsidy. But did it really have to be Government obligation? We believe the subsidy is more of Governments' political choice than an economic or social necessity.

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transparent, with the public informed about what parameters had caused any price increase. The pricing formula should account for importation and refining costs, government taxes/duties/levies and distribution/marketing margins.

Eventually, the OMCs should be allowed to fully assume responsibility for retail prices. A public body will still be needed even in a deregulated system to exercise oversight responsibility over the OMCs. The body will set general guidelines for and regulate—but not control—OMCs' prices. The guidelines should ensure recovery of importation and refining costs as well acceptable distribution/marketing margins.

We have to recognize here that even with the subsidy, fuel prices in Ghana are still relatively high and will likely go up further without the subsidy. But the high price is also partly due to the wide-ranging duties and levies included in the pricing formula<sup>2</sup>. The duties/levies support development and social projects and most of them have been in place for a long time. It is recognized that oil is a uniquely important source of fiscal revenues in most countries. Yet still, the duties/levies could be reexamined with the view to reducing their scope and levels in order to bring down the unusually high fuel prices<sup>3</sup>.

We had to pose the question here as to what would happen in a deregulated system if there was a major shock on the world oil market that sent prices sky-rocketing. We think that in such an extreme situation, the key stakeholders, i.e. Government, the OMCs, the Regulatory Body, and civil society, could come together and find a mutually acceptable solution. This could involve reducing or setting aside some of the duties/levies, government providing limited subsidy; and introducing some conservation

measures.

## **The Case For And The Benefits Of Deregulation**

The benefits of deregulation of the petroleum sector are actually the flipside of the costs of regulation and subsidization elaborated above. More importantly, deregulation and removal of subsidies will free resources for Government to spend on productive ventures and social sectors. Large deficits in infrastructure, education, health, power supply, water supply, sanitation, etc. are begging for attention at a time when huge resources are tied to oil subsidization, where economic and social benefits pale in importance in comparison to the costs.

Allowing full pass-through of market prices will encourage economy and efficiency in the use of petroleum products, as consumers adjust to higher prices. This will save the country money in terms of reducing oil consumption and imports.

Removing the subsidy will reduce the incentive for smuggling as price gaps with neighboring countries are closed. This will save the country foreign exchange and also allow government to realize the full complement of duties. Even more fundamentally, deregulation will depoliticize petroleum pricing and eliminate the speculations, rent-seeking, and other practices usually associated with anticipated Government-announced price increases. Further, people will stop blaming government for price increases.

Market pricing of petroleum products should allow the benefits of cost reductions, including through oil price falls, to be passed on to consumers. From consumers' point of view, a major injustice in the regulated system has been asymmetrical pricing, whereby retail prices are

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<sup>2</sup>These include: excise duty, road fund levy, energy fund levy; exploration levy, TOR debt recovery levy, etc.

<sup>3</sup>For instance, as we have argued in other submissions, the inclusion of the TOR Debt Recovery Levy (TDRL) in the petroleum price formula is misplaced. We have suggested that the best way to deal with the TOR debt was for Government to take it over, securitize it, and liquidate it through the budgetary allocations' including from oil revenues . We, therefore, welcome the conversion of part of the debt into bonds. It is equally difficult to justify the exploration levy, why the road fund and energy fund levies could be levied in other forms.

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usually increased in response to higher world prices but never decreased when world prices fall. Competitive price differentiation is likely to result from the different costs and distribution/marketing margins that would be set by the OMCs and benefit the customer.

### **Targeting Subsidies To The Needy**

A major reason offered for petroleum subsidy is the protection it provides to the consumer. But as we have been arguing in this paper the universal subsidy is difficult to justify even on social grounds, since it has been found to benefit the rich more than the poor.

Those who need subsidies are the poor, not the rich. So it is best to remove the subsidy and let everybody pay for the unsubsidized price. The poor just like the rich will suffer from the cascading effects of oil price increase. Then the Government steps in to provide social interventions targeted to the poor from the funds saved from eliminating universal subsidies.

Several key sectors can be subsidized for the direct benefit of the poor, some of which are currently being catered for in one form or another and to varying degrees.

Public education, especially at the basic level, is such a sector, where interventions to subsidize feeding, uniforms, and books would provide direct help to the poor. The public health system could also be somewhat subsidized for the benefit of the poor. Even health insurance premiums for the poor could be subsidized.

Public transportation is an important sector where subsidies would directly benefit the poor. Expanding and subsidizing railway and public bus transportation patronized largely by the poor will be a step in the right direction. Subsidizing commodities used largely by the poor will be an appropriate policy. Continued subsidization of kerosene and pre-mix fuel is, therefore, justified.

The tax system could be used to alleviate hardship on the poor. This could be done through discriminatory taxation in favor of goods used largely by the poor as against luxuries consumed by the rich. Further, income tax thresholds could be set at levels that favor the poor.

The above list of interventions targeted to the poor is neither exclusive nor exhaustive and could be added to.

### **Conclusion**

This paper makes both an economic and social case for full deregulation and depoliticization of the petroleum sector in Ghana. A universal subsidy benefits the rich more than the poor and cannot be justified on even social grounds. A subsidy is best targeted to specific, more disadvantaged, groups through appropriate social interventions, some of which have been enumerated.

Efficiency considerations call for removal of universal subsidies. Even at the time that Ghana has become an oil producer, it would be imprudent to subsidize fuel for everybody. The economy will benefit and the poor will be better off if the subsidy funds are used for productive investments and for social interventions targeted to the poor.

The tide of deregulation and de-subsidization of the petroleum sector is moving fast. After waiting too long, Nigeria is paying a heavy price for removing a large subsidy. For Ghana, the price gap is not so big, so de-subsidization will not be as painful. The time to act, therefore, is now, rather than later. This is a necessary change that should not be sacrificed on the altar of political elections. We should add that, taking a leaf from the Nigerians, de-subsidization will be easier to sell to the public if accompanied by measures to conserve fuel, including by public officials who enjoy free fuel, in addition to other austerity financial measures.

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