ASIA'S ADDICTION TO FOSSIL FUEL SUBSIDIES CONTINUES UNABATED

At the 2009 G20 Pittsburgh Summit, leaders recognized the problem of fuel subsidies and made a commitment "to rationalize and phase out inefficient fossil fuel subsidies" (G20 2009). But Asian economies have gone the other way, and are pushing economic growth at a breakneck pace underpinned by fuel subsidies not only to consumers, but also to oil companies, mostly through production incentives. These subsidies have created an expectation that gas and oil are cheap and plentiful fuels available on demand. Yet without oil, the world would grind to a halt and chaos and social upheaval would probably ensue. Alternative and renewable energy resources are simply not yet available on a large commercial scale, leaving many people without recourse.

Chaos and social upheaval can happen if fuel subsidies are cut radically and fuel prices skyrocket.

Nigeria is Africa's biggest oil producer but most of the two million barrels it produces daily are exported in an unrefined state, forcing Nigerians to repurchase their fuel after refinement. In January 2012, the Nigerian government ended the fuel subsidy for gasoline, which caused prices to more than double. This was a price shock most in low-wage Nigeria could not bear and resulted in chaos and riots, forcing the government to back down (Kareem 2012). Yes, the rich and the emerging middle class will benefit unfairly as well as smugglers, but Nigeria is overall an impoverished country .

With roads in Chennai to Jakarta clogged with SUVs and new Honda CRVs, it would only seem logical to increase fuel prices to dampen the demand for gasoline. Yet the owners of such vehicles are not the same people who would be in the streets protesting if subsidies were cut. It would be the most impoverished—the vendors, students, cleaners, and factory workers—who will as they would bear the brunt from price hikes. These people constitute the majority of developing Asia's population, but their wages will not magically increase 100% overnight. In fact, their real wages may drop as higher fuel costs are passed through the system on to them in higher input prices.

Ideally, a well-functioning, targeted cash transfer system would insulate the most impoverished from oil and gas price hikes, but in many developing countries, such a system is hard to establish because of administrative capacity limit. Indonesia for example had a bad experience with such a system about five year ago.

Fuel subsidies are a trillion-dollar industry, and while much of that money goes to fuel subsidies for people, most ends up in corporate coffers. These corporate profits alone are larger than the GDP of many poor countries. Many governments and think tanks have it upside down—the World Bank, the International Monetary Fund, and others are seemingly hell-bent on reducing consumer subsidies for people, but not for companies. Fuel subsidies are a hot-button issue because corporate welfare in a time of national budget shortfalls also stymies innovation and development in green technology and renewable energy.

Oil companies use a profitable mechanism in developing countries called the production sharing contract (PSC). PSCs reimburse oil companies and their contractors, both foreign and domestic, on capital outlays to protect against risk (Machmud 2000). In other words, company profits are ensured because risk protection is guaranteed. PSCs are a colonial-era contractual mechanism banned in developed countries as an abuse of bargaining power against unsophisticated government officials.

There was once a time for PSCs, when banks would not lend to new governments such as those in Ecuador or Malaysia because of perceived capital risks. But times have changed. Since emerging economies now have more democratic governance and mobile capital scours the globe looking for investment opportunity, PSCs have outlived their original purpose and are considered as producer subsidies (Koplow et al 2010). Yet they are actively courted in the developing world by IOCs.

Sometimes, aggregated PSCs are equal to the entire projected yearly fuel consumer subsidy budget for a country such as Nigeria or Indonesia because of inflated oil demand. For example, just two out of the many expansive PSC projects in Indonesia are guaranteed $31 billion in reimbursements, while the country’s entire 2012 consumer fuel subsidy budget was $30 billion. Of course these are reimbursements on a project timeline, so that any net present value of the projects today will appear small, but over a time, can correspondingly balloon with interest added and ever present “cost overruns.” There are hundreds of PSCs in oil and gas projects in developing Asia. These cost recovery mechanisms have done little to raise living standards, but have insulated foreign investors on project risks by transferring that risk, and costs of that risk, to local citizens—without the citizens’ objections, or knowledge.

Chinese oil companies, such as Petrochina and CNOOC, now with enormous economic clout and a thirst for fossil fuels to match, also want in on oil and gas reserves with the promise of being delivered from any project risks under a PSC (Petrominer 2010).

For citizens of some developing countries, consumer fuel subsidies are the only tangible *claim to ownership rights* of the vast fossil fuel empires that lie beneath their feet. Without subsidies, and with decrepit infrastructure and poor educational and health facilities in these countries, living standards will deteriorate, not improve. PSCs or corporate energy subsidies that spirit wealth out of countries do not honor any development mandate. While consumer fuel subsidies may be offensive to many in terms of misguided policy that benefit the rich, the middle class, traffic gridlock, and CO_2 emissions, they do in part honor the ownership principle.[1] Countries using producer subsidies will not become more energy independent, but will instead foster consumer dependency. Cut producer subsidies first to avoid the fossil fuel cravings that have amplified demand.

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