

# Reviving the Oil Price Stabilization Fund: Risks and Alternatives

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Philippine Institute for Development Studies

*Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas*

# Discussion Flow

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1. The origin and demise of the Oil Price Stabilization Fund (OPSF)
2. Risks of reviving the OPSF
3. Few remaining countries with fuel price stabilization funds
4. Premise in and promises of deregulation
5. Possible policy responses
6. Other ways forward
7. Final remarks

# 1. The origin and demise of the OPSF

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- **Before 1971:** free market in the downstream oil industry; freedom of entry and exit by firms; price was not regulated by the government
- **1971:** start of heavy regulation; RA 6173 established the Oil Industry Commission to regulate the domestic prices, among other powers; the law also created a **Special Fund** (later became known as the Oil Industry Special Fund), which had broad uses but was also used in profit regulation and price stabilization
- **1979:** the Consumer Price Equalization Fund was carved out of the Oil Industry Special Fund
- **1983:** the Consumer Price Equalization Fund had eroded and was abolished
- **1984:** PD 1956 imposed ad valorem taxes and revised specific taxes on oil products to help the cash-strapped and heavily indebted government; at the same time, the decree abolished the Oil Industry Special Fund, created the **Oil Price Stabilization Fund (OPSF)**, and declared the OPSF as the mechanism for stabilizing the prices of petroleum products.

# 1. The origin and demise of the OPSF

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## **OPSF design**

- the contributions to the OPSF were the increase in ad valorem taxes and customs duties on petroleum products and the increase in tax collection due the lifting of tax exemptions on government corporations, plus any additional tax imposed on petroleum products (PD 1956)
- the claims against the OPSF were the reimbursements to oil companies for import cost increases due to exchange rate adjustments and world price movements (PD 1956 & LOI 1431)
- price smoothing was set every two months (LOI 1441)

## **Changes in the design**

- 1985 - oil companies' cost savings due to market forces and ad valorem tax changes were contributed to the OPSF (LOI 1460)
- 1987 - the contributions to the OPSF were expanded by including the positive cost differentials between the costs fixed by the regulator and the actual import costs by the oil companies; the utilization of the OPSF was expanded by including as reimbursables the under-recoveries of oil companies during the regulatory reset periods (EO 137)

# 1. The origin and demise of the OPSF

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- occurrence of deficits or mismatches between payments to the OPSF and claims against it, requiring that the general public subsidize petroleum consumers through the national budget
- the Philippine oil industry needed investments and services greater than those being provided by the "Big Three" oil companies (Petron, Shell, and Caltex)
- **1996:** RA 8180 was enacted to deregulate the downstream oil industry; however, the Supreme Court ruled in 1997 that RA 8180 was unconstitutional due to anti-competition provisions (four percent tariff differential between imported crude oil and refined petroleum products, minimum inventory requirement for oil companies, definition of predatory pricing)
- **1998:** RA 8479 addressed the constitutionality issues, fully deregulated the downstream oil industry, and **abolished the OPSF**
- temptation to reverse the deregulation policy was tested in: 2008 - when speculative bubble was building up; 2011 - when supply shortages occurred due to the Arab Spring movements; 2017 to 2018 - due to the high demand growth (prior to the oil crash); October 2021 - due to the sudden jump in global demand when COVID-19-induced mobility restrictions were relaxed
- recently due to the Russia-Ukraine war, the revival of the OPSF was raised; this is tantamount to policy reversal

## 2. Risks of reviving the OPSF

### Risks in historical perspective

**Risk of mismatches between sources of and claims against the price stabilization fund**

Instead of being self-financing, the OPSF had to receive transfers from the national budget; in 1990, RA 6592 appropriated PHP5 billion (equivalent to PHP25.59 billion at present) to help fund the price mismatches





## 2. Risks of reviving the OPSF

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### **Temptation to use the OPSF for other purposes**

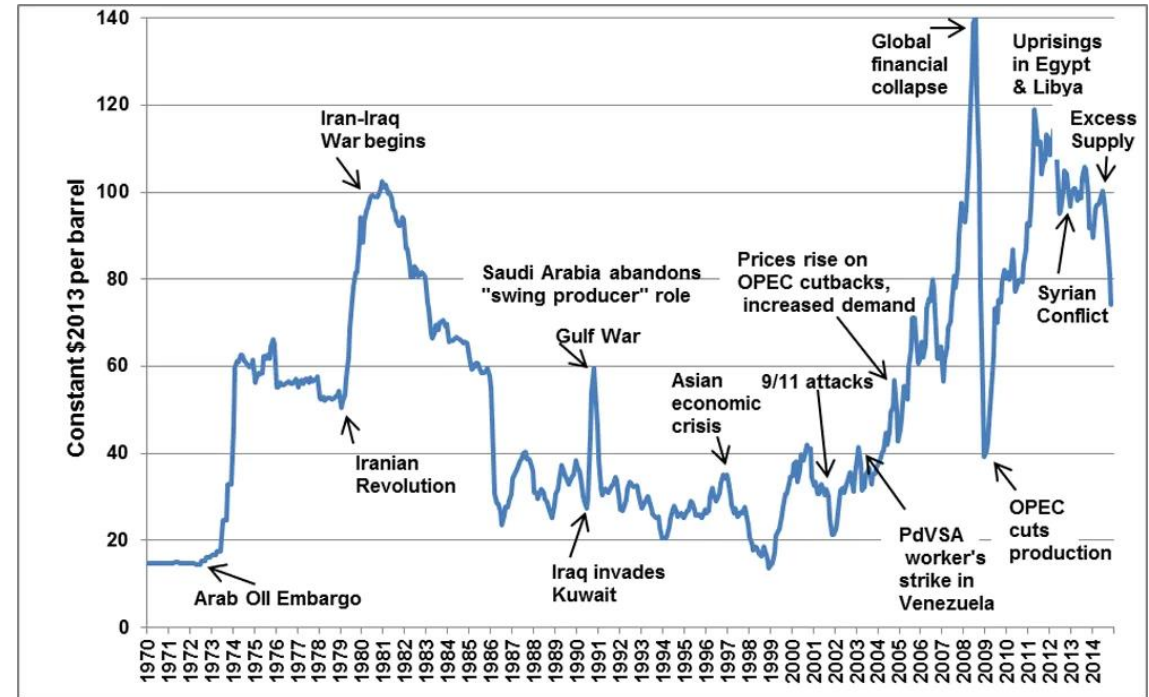
There was lack of discipline in sticking to the price stabilization purpose of the OPSF; e.g., in 1992, legislators allowed the use of the OPSF for the payment of capital stock subscription to the National Power Corporation through RA 7639.

## 2. Risks of reviving the OPSF

### Wavering political will to implement needed price increases

Especially when the magnitude was large, which was in turn due to high world oil prices

e.g., In 1994, the government backpedaled on price increases it planned to implement.<sup>1</sup> This contributed to the erosion of the OPSF.



<sup>1</sup>International Monetary Fund. 1995. Philippines: Recent Economic Developments, 01 December 1995. <https://www.elibrary.imf.org/view/journals/002/1995/113/article-A001-en.xml> (accessed on April 2, 2022).



## 2. Risks of reviving the OPSF

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### **Cost of lengthy legal challenges to OPSF credits and payments**

The OPSF's financial position was complicated by lengthy settlements of OPSF credits and payments, such as the government's 1991 claim on Shell's underpayment of contributions. After back-and-forth claims and counterclaims between the government and Shell, the Supreme Court favored Shell with a final ruling in 2008.

## 2. Risks of reviving the OPSF

### Unintended effects of price distortions

e.g., incentivizing use of carbon-intensive diesel during the OPSF days

The government set the regulated price for premium gasoline higher than the computed price in order to keep the diesel price low; a cross-subsidization. But this encouraged consumers to shift to diesel which emits more carbon.<sup>2 3</sup>



<sup>2</sup>Caparas, M. 2000. Oil Deregulation. Economic Issue of the Day, Number 2, February 2000. Philippine Institute for Development Studies. <https://dirp3.pids.gov.ph/ris/eid/pidseid0002.pdf> (accessed on April 2, 2022).

<sup>3</sup>Mendoza, M. 2014. Lessons Learned: Fossil Fuel Subsidies and Energy Sector Reform in the Philippines: GSI Report. <https://www.iisd.org/system/files/publications/lessons-learned-ffs-energy-sector-reform-philippines.pdf> (accessed on April 2, 2022).

### 3. Few remaining countries with fuel price stabilization funds

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#### 1. Thailand

Thailand established its oil fund in 1979. Now known as the Oil Fuel Fund, it has been used to stabilize domestic prices for oil but at the expense of having a deficit. As of March 2022, the Fund is incurring loans of THB20 million to support the spikes in subsidies due to the Russia-Ukraine war.



### 3. Few remaining countries with fuel price stabilization funds

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#### 2. Vietnam



In 2009, the Vietnamese government passed Decree No. 84/2009/ND-CP, setting aside price valorization funds. While initially successful, the funds have not been able to prevent price increases for oil in the country. In 2021, it registered a negative balance of VND600 billion.

### 3. Few remaining countries with fuel price stabilization funds

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#### 3. Malawi

Malawi established its price stabilization fund in 2004 through the Liquid Fuels and Gas (Production and Supply Act), but it was reported to be impotent in stabilizing oil prices and preventing oil supply shortages.<sup>4</sup> The government was also criticized for using the fund to purchase maize in 2016.<sup>5</sup>

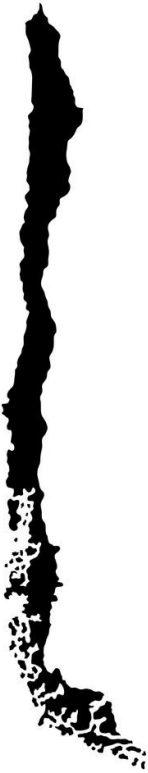


<sup>4</sup>Mianjira, Duncan. 2022. "Malawi: Mera Set to Adjust Pump Fuel Prices - As Cama Demands Review Review of Many Levies On Fuel Prices." Nyasa Times, January 27. <https://allafrica.com/stories/202201270557.html> (accessed on March 18, 2022).

<sup>5</sup>Nkawihe, Maurice. 2016. "Consumer activist Kapito rues Malawi fuel prices increase." Nyasa Times, June 11. <https://www.nyasatimes.com/consumer-activist-kapito-rues-malawi-fuel-prices-increase/> (accessed on March 18, 2022).

### 3. Few remaining countries with fuel price stabilization funds

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#### 4. Chile

In Chile, price stabilization funds started in 1991 but most of these had already been abolished, leaving only what was dedicated for household consumed kerosene. The funds helped mitigate drastic price increases, but it necessitated the transfer of money from other funds, such as when USD 7 billion of copper funds were transferred to the oil fund in 2008.<sup>6</sup>

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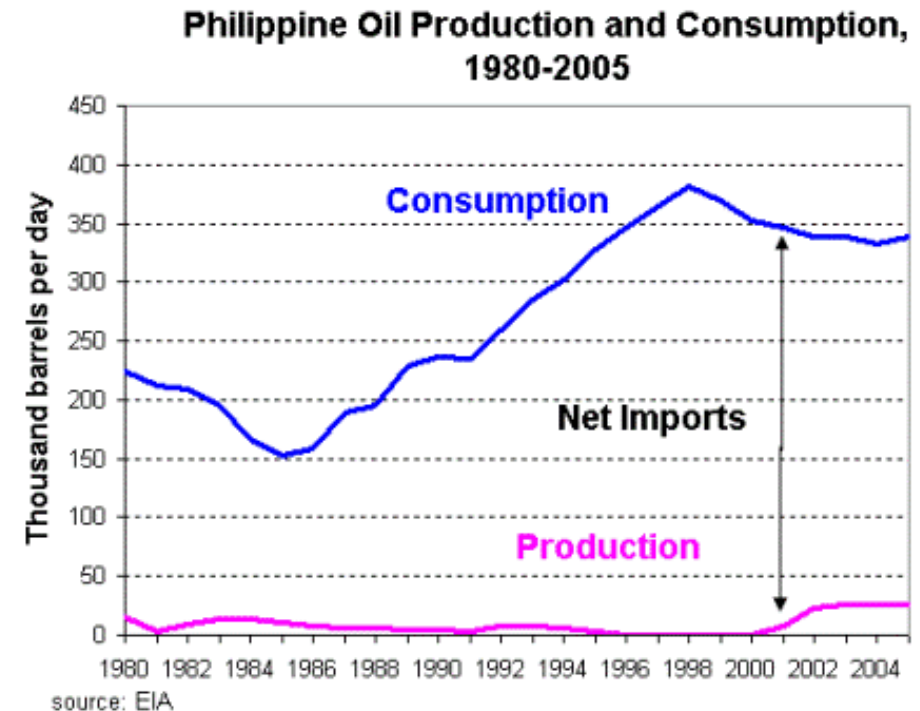
<sup>6</sup>Kojima, M. 2016. "Fossil Fuel Subsidy and Pricing Policies: Recent Developing Country Experience." Policy Research Working Paper. World Bank. <https://openknowledge.worldbank.org/handle/10986/23631> (accessed March 16, 2022).



## 4. Premise in and promises of deregulation

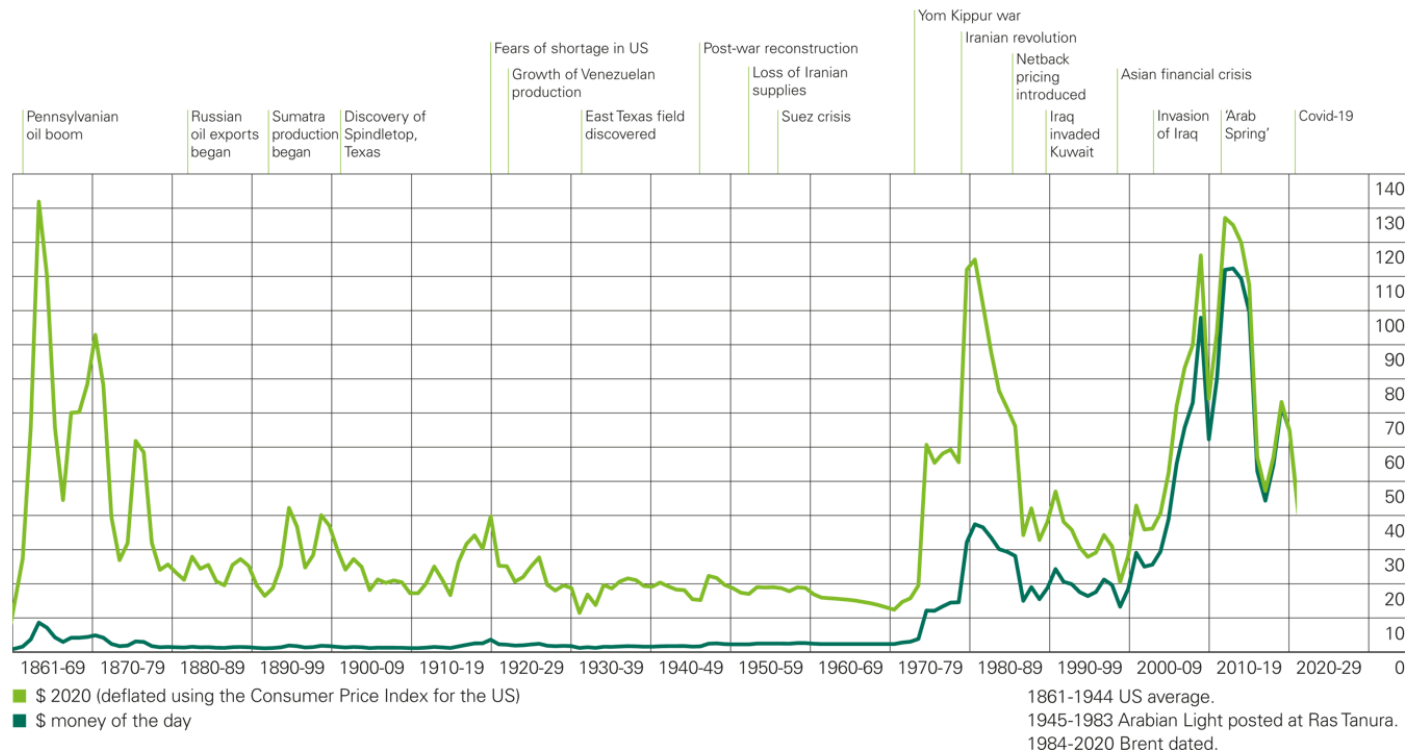
Price regulation is not effective because external events that led to price spikes and crashes are usually major world events. Maintaining prices for a small importing country like the Philippines is difficult and costly.

There are less distortionary and more effective instruments for mitigating the adverse consequences of high world prices.



# 4. Premise in and promises of deregulation

Figure 1. Nominal and real prices of crude oil (US\$ per barrel) amid significant world events, 1861-2020<sup>7</sup>



Statistical Review of World Energy 2021  
© BP p.l.c. 2021

<sup>7</sup>BP p.l.c. 2021. Statistical Review of World Energy 2021. <https://www.bp.com/content/dam/bp/business-sites/en/global/corporate/pdfs/energy-economics/statistical-review/bp-stats-review-2021-full-report.pdf> (accessed on March 18, 2022).

## 4. Premise in and promises of deregulation

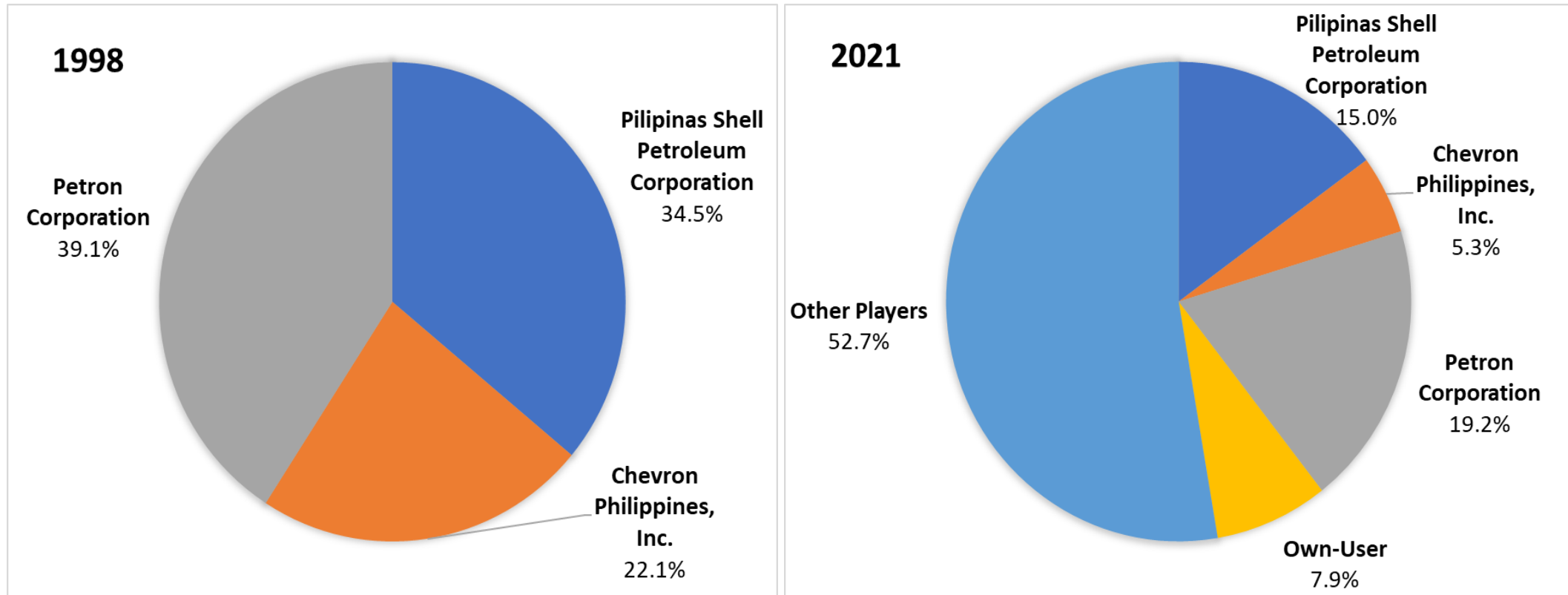
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The deregulation law did not promise to lower prices or stop price increases, rather it set as a policy goal “a truly competitive market under a regime of fair prices” (Section 2, RA 8479).

- ✓ Since the 1998 deregulation, greater competition in the market has been achieved, improving quality of petroleum products and expanding oil industry coverage to serve underserved areas
- ✓ 400 firms are participating in the industry with a cumulative investment of PHP 209.50 billion as of December 2021
- ✓ On fair pricing, three independent reviews (2005, 2008, and 2012) found that profit margins of firms were reasonable.

## 4. Premise in and promises of deregulation

Figure 2. Philippine petroleum product market shares, 1998 vs. 2021<sup>8</sup>

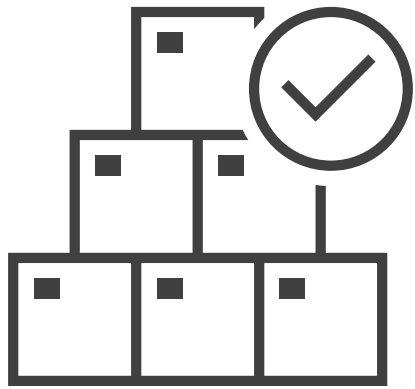


<sup>8</sup>Department of Energy-Oil Industry Management Bureau. 2022. Annex A - Total Country Petroleum Product Market Share (data file). Taguig City, Philippines: Department of Energy Central Office (accessed on April 5, 2022).

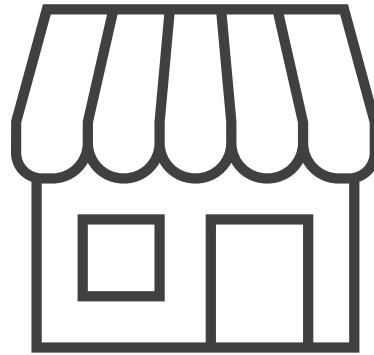
## 5. Possible policy responses

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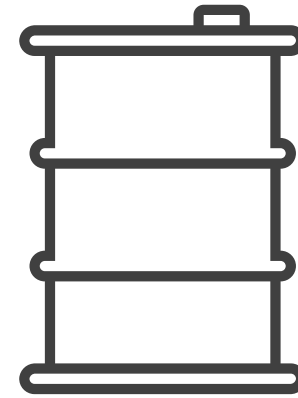
A highly recommended strategy: **Lock in reforms** by making commitments to stay the course through legislative amendments and supplemental issuances that cement and improve, rather than reverse, the reforms



**Minimum  
inventory  
requirement**



**Retail price  
unbundling**



**Strategic oil  
reserves**

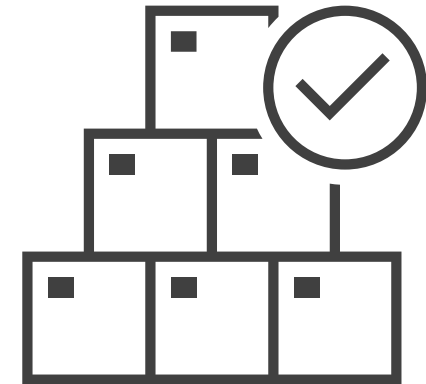
# 5. Possible policy responses

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## Minimum inventory requirement

This was struck down as unconstitutional by the Supreme Court in 1997, but note that the current environment is markedly different from what the Supreme Court appreciated in 1997.

Currently, the Department of Energy , through Department Circulars, requires 30 days of supply for refiners, 7 days for LPG supplies, and 15 days for all other oil companies and bulk suppliers. Continuing this will guarantee continuous domestic supply, discourage fly-by-night operators, and will not be considered as providing unfair advantage to existing players, as the industry now enjoys greater competition than before.





## 5. Possible policy responses

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### **Retail price unbundling**



Currently proposed in HB 10823, retail price unbundling aims to separate petroleum prices based on its components such as landed costs, port charges, refining costs, storage costs, handling costs, marketing costs, and transshipment costs. This will promote transparency and fair pricing, helping spot anti-competitive practices such as predatory pricing, or even smuggling.

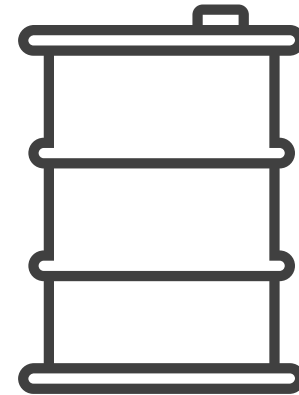
Retail price unbundling, however, is currently being opposed by industry players.

# 5. Possible policy responses

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## Strategic oil reserves

Government participation in holding oil reserves may help generate industry consensus on compliance, as long as it is clear that the government-owned oil stocks are strictly for contingencies and not meant to compete with the private sector. After all, during oil supply disruptions, it is in everybody's interest to avoid economic losses and ensure a critical level of supply through an aggregate strategic reserve composed of government stockpile and industry-held stockpile.

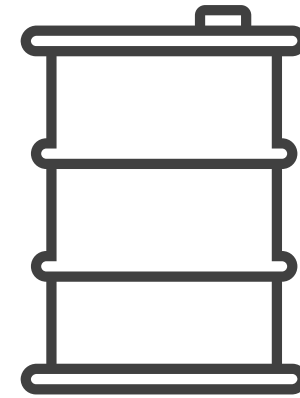


# 5. Possible policy responses

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## Strategic oil reserves

The proposed strategic oil reserve for the Philippines is not yet articulated in the National Energy Plan (prepared in 2002)<sup>9</sup> but it is proposed to be stockpiled by the Philippine National Oil Company (PNOC).<sup>10</sup>



<sup>9</sup>The National Energy Plan, a document which includes the National Oil Contingency Plan, is being updated, according to the DOE (In discussion with the DOE-OIMB on March 29, 2022).

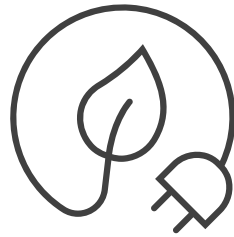
<sup>10</sup>As of April 2022, the PNOC was preparing to hire an advisor for the needed feasibility study (In discussion with the PNOC on April 19, 2022).

## 6. Other ways forward

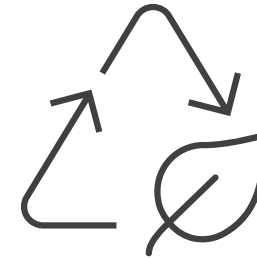
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**Targeted  
subsidy  
program**



**Energy  
efficiency  
programs**



**Diversification of  
energy supply  
sources**

## 6. Other ways forward

### Targeted subsidy in lieu of fuel excise tax suspension

The fuel excise tax suspension would result in fiscal revenue loss of PHP105.9 billion in 2022, affecting the delivery of social services. Those who can very well afford fuel price increases will stand to benefit more from fuel price declines when fuel excise taxes are suspended (Table 1).

Table 1. Annual family mean income and fuel expenditure by income decile, 2018<sup>11</sup>

| Income Decile                         | Income            |                             | Fuel Expenditure            |                                      |                             |
|---------------------------------------|-------------------|-----------------------------|-----------------------------|--------------------------------------|-----------------------------|
|                                       | Mean Income (PHP) | Percentage Distribution (%) | Mean Fuel Expenditure (PHP) | Total Fuel Expenditure (million PHP) | Percentage Distribution (%) |
| 1 <sup>st</sup> Decile (Poorest 10%)  | 73,186.7          | 2.34                        | 1,144.32                    | 2,727.96                             | 1.39                        |
| 2 <sup>nd</sup>                       | 113,005.1         | 3.59                        | 2,127.91                    | 5,252.09                             | 2.67                        |
| 3 <sup>rd</sup>                       | 141,375.8         | 4.48                        | 3,034.34                    | 7,636.64                             | 3.88                        |
| 4 <sup>th</sup>                       | 170,617.8         | 5.41                        | 4,040.73                    | 10,087.19                            | 5.13                        |
| 5 <sup>th</sup>                       | 203,258.3         | 6.45                        | 5,159.76                    | 13,107.46                            | 6.66                        |
| 6 <sup>th</sup>                       | 243,225.0         | 7.71                        | 6,327.45                    | 15,786.33                            | 8.02                        |
| 7 <sup>th</sup>                       | 295,752.4         | 9.38                        | 7,750.85                    | 18,988.27                            | 9.65                        |
| 8 <sup>th</sup>                       | 373,828.1         | 11.85                       | 9,716.05                    | 23,599.41                            | 11.99                       |
| 9 <sup>th</sup>                       | 503,287.2         | 15.99                       | 12,960.26                   | 32,014.95                            | 16.27                       |
| 10 <sup>th</sup> Decile (Richest 10%) | 1,015,968.8       | 32.81                       | 26,136.14                   | 67,559.44                            | 34.34                       |

Note: Income deciles are based on the 2018 Family Income and Expenditure Survey (FIES)'s grouping of total family incomes into ten categories, ranked from lowest to highest. Fuel expenditures are based on liquid petroleum gas, kerosene, diesel, and gasoline consumption.

<sup>11</sup>Philippine Statistics Authority. 2020. *2018 Family Income and Expenditure Survey*. Quezon City, Philippines: Philippine Statistics Authority.

## 6. Other ways forward

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### **Targeted subsidy in lieu of fuel excise tax suspension**

As an alternative to the suspension of fuel excise taxes, targeting those most affected by fuel price increases through subsidies is the better option, but there need to be improvements in the timing, coordination and efficiency in distribution as well as the generousness of the amounts, given the issues in the fuel subsidy program for the public transport sector and agriculture sector.



## 6. Other ways forward

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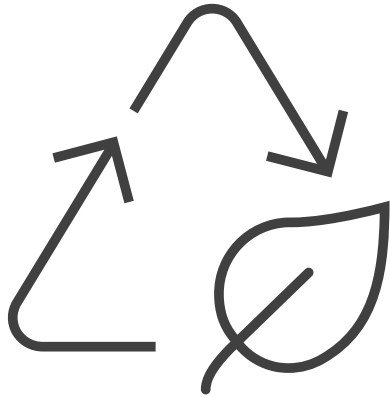
### **Demand management through energy conservation and efficiency**

The Energy Efficiency and Conservation Act of 2019 lays down the framework for energy efficiency programs, which can help mitigate the impacts of oil price peaks. As private sector compliance becomes extra challenging during the pandemic, the government should help firms financially facilitate the transition toward energy efficient options.



## 6. Other ways forward

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### **Supply side responses through diversification of energy supply resources**

We need to improve the enforcement of existing renewable energy-related laws.

The Philippine Energy Plan 2020-2040 has declarations on indigenous oil and gas exploration and development, but earnestness in plans must be matched by resoluteness in actions.

## 7. Final remarks on behalf of the poor

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**Reviving the OPSF will be anti-poor** in at least **three** respects:

- 1. First**, given that it is usually the rich who consume a higher volume of petroleum, **the subsidy from the OPSF will disproportionately benefit the rich** more than the poor;
- 2. Second**, **reviving the OPSF** will likely result in the national government **having to bail out the special fund using the general fund, displacing funding for anti-poverty programs** in the process; and
- 3. Third**, as there are **many players** now in the downstream oil industry, **administering the OPSF will be very costly**, and the huge cost will be disproportionately borne by the poor.

**Programs on targeted assistance to the poor is preferable to the OPSF.**



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policy research*

# Thank you!

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