

Measures to Stabilize Domestic Retail Petrol Prices

The objective of the scheme is to maintain oil price stability within the country, minimize the economic and social impact, and lessen the burden on households from higher world oil prices. The scheme is to be maintained for only a short duration of around 4 months starting from 8 February 2003, and involves price ceilings of 16.99 baht per litre on Benzene 95, 15.99 baht on Benzene 91, and 14.79 baht on diesel.

The scheme is financed by credit from the Government Savings Bank and other financial institutions amounting to around 8 billion baht by overdrawing accounts using government guarantees. In this regard, the government will issue a royal decree establishing the energy fund management institute as an independent institution that can borrow. These borrowings will be recorded in an oil subsidy fund account separate from the oil fund account.

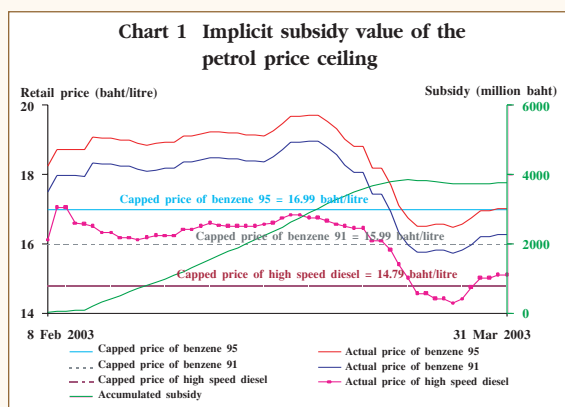
The subsidy will be disbursed as the difference between oil fund receivables and the subsidy for the corresponding type and quantity of fuel. The net amount that producers and importers have to pay/receive will be processed in conjunction with tax payments and the Comptroller General will transfer funds from the oil subsidy fund to the oil fund in the amount that was paid out. Once world oil prices fall by enough to push the domestic unrestricted retail price (that would obtain absent the price control) below the restricted price, the process will be reversed with funds being transferred into the oil fund to repay borrowings from financial institutions until these have been fully repaid.

Should the market clearing price fall below the maintained level, funds accruable into the oil fund will be divided into two tiers, namely: 1) half of the first 1 baht reduction will accrue to the oil fund (for instance, if world prices declined by 30 satang a litre, domestic prices would fall by only 15 satang and the other 15 satang will accrue to the oil fund); and 2) for price reductions beyond the first 1 baht, two thirds will accrue to the oil fund.

Assessment of oil price developments will be conducted weekly. Should the spot price in the Singapore market fall by less than 30 satang per litre in any given week, domestic prices will be maintained and the savings will accrue to the oil fund. The reduction would, however, be carried over into the following week and

should the total price decline reach 30 satang, domestic prices will be reduced by 15 or 10 satang per litre depending on the situation.

As of 31 March 2003, the government had used up 3,775 million baht in stabilizing domestic oil prices over a 52-day period starting from 8 February. This amount reflected production up to 19 March (which has to be reported by 29 March) and funds began accruing into the oil fund subsequently as world oil prices fell.



Source: Energy Policy and Planning Office

Impact of the scheme:

In terms of the **economic and social** impact, the stabilization of domestic oil prices would help to contain upward price pressures on other goods and services and minimize the burden on households from higher oil prices. Preventing oil prices from rising, however, may discourage households from economizing on energy usage and lead to a larger loss of foreign exchange than otherwise (the government has therefore promoted energy conservation measures along with the scheme). Moreover, goods and services prices that do not fully reflect costs may lead to distortions in demand and once world oil prices start falling, the decrease will not be fully passed onto local oil prices and domestic costs of production would remain high for a period of time.

In assessing the financial condition of the oil fund to determine when the oil subsidy account will return to balance, the key factor taken into consideration was the outlook for world oil markets. On the assumption of a baht/US dollar exchange rate of 43 throughout the forecast horizon, there were two main scenarios, namely: 1) the impact of the war on world oil prices was small with the Dubai crude oil price averaging 25 US dollars per barrel in 2003 Q2 and falling to 23 US dollar per barrel in the latter half of the year, and 2) faster reduction in prices with the Dubai crude oil price averaging 23 US dollars per barrel in 2003 Q2 and falling to 21 US dollar per barrel in the latter half of the year.

Estimated financial impact on the oil fund of the oil price subsidy

2003	Case 1						Case 2					
	Dubai crude oil price (usd/barrel)	Domestic retail price			Financial impact		Dubai crude oil price (usd/barrel)	Domestic retail price			Financial impact	
		Benzene 95 (baht/litre)	Benzene 91 (baht/litre)	Diesel (baht/litre)	Net (million baht)	Accumulated (million baht)		Benzene 95 (baht/litre)	Benzene 91 (baht/litre)	Diesel (baht/litre)	Net (million baht)	Accumulated (million baht)
Jan	28.02	16.80	15.80	14.65		0	28.02	16.80	15.80	14.65		0
Feb	30.02	17.07	16.07	14.87	-1,775	-1,775	30.02	17.07	16.07	14.87	-1,775	-1,775
Mar	27.38	16.99	15.99	14.79	-2,000	-3,775	27.38	16.99	15.99	14.79	-2,000	-3,775
Apr ^{1/}	24.00	16.86	15.86	14.66	1,900	-1,875	24.00	16.86	15.86	14.66	1,900	-1,875
May ^{1/}	25.00	16.55	15.55	14.12	1,386	-489	23.00	16.35	15.35	13.95	2,005	130
Jun ^{1/}	25.00	16.52	15.52	14.15	1,257	769	23.00	15.25	14.46	12.67		
Jul ^{1/}	23.00	15.28	14.47	13.02			21.00	14.63	13.85	12.25		
Aug ^{1/}	23.00	15.23	14.40	12.86			21.00	14.56	13.77	12.09		
Sep ^{1/}	23.00	15.19	14.36	12.82			21.00	14.52	13.71	12.06		
Oct ^{1/}	23.00	15.17	14.33	12.82			21.00	14.49	13.68	12.07		
Nov ^{1/}	23.00	15.16	14.31	12.83			21.00	14.47	13.65	12.08		
Dec ^{1/}	23.00	15.15	14.30	12.84			21.00	14.46	13.64	12.09		

^{1/}Estimated

Source: Bank of Thailand

In the first case, the oil subsidy account would return to balance in June 2003 and would be consistent with domestic retail prices that are 0.45-0.65 baht lower than the controlled level, but approximately 0.45-0.80 baht higher than the unrestricted market-clearing level. In the second case, balance in the oil subsidy account would be achieved as early as May 2003 with domestic retail prices being 0.65-0.85 baht lower than the controlled level, but 0.80-1.20 baht higher than the level that would obtain if markets were to clear. While the assumption on crude oil prices in this second scenario was lower than that used to generate the MPC's forecast (as outlined in chapter 4), the fact that retail prices would remain higher than the market-clearing level would continue to have an impact on inflation and growth in 2003 Q2. Importantly, the burden on the government and the impact on public debt under both scenarios are negligible.