

PLUMMETING OIL PRICES: DOES IT MATTER FOR TAX SUBSIDIES REFORM IN ASIA-PACIFIC COUNTRIES?¹

Nam Foo, Curtin University, Phone +61403662915, E-mail: nam.foo@curtin.edu.au

Overview

The importance of energy as a primary driver of economic growth and industrial development is historically clearly evident. Energy trends show how the world's energy consumption patterns have evolved over the years. It shows there is uncertainty in the energy industry, with the highly volatile current trends as a result of fluctuations in the international crude oil market. The trend of such changing crude oil prices continues to affect the economic growth prospects particularly of the nations in the Asia-Pacific region. The decline in crude oil prices indeed can affect a country's economy, especially having macroeconomic, financial and policy implications. However, plummeting crude oil prices present another window of opportunity for oil exporting countries in the region to move toward more effectiveness and fairness in energy pricing. The objective of this paper is to discuss policy issues relating to the effects of fuel subsidisation in the Asia-Pacific region as a result of a sharp decline in the crude oil price.

The paper is organised as follows: After the introduction the second section gives a brief overview of the impact of falling crude oil prices that relate to the debate of fuel subsidisation in Asian economies. The third section addresses the model applied in the energy subsidisation by Asia-Pacific governments, which incorporates of household consumption. The model examines the impact of a fuel subsidy, how household consumption can be affected as a result of the removal energy subsidisation and why the government choose to have them even though this policy can diminish the nation's economic growth. In section four the researcher discusses the empirical outcomes and in the final section policy implications are derived.

Methods

The vector autoregression (VAR) model is applied in this study.

Results

In the first section, the researcher uses a three variables vector autoregression (VAR) model that includes gross domestic saving, gross domestic income and trade balance applies in this study.

In the second section the results of this analysis show that there is a positive correlation between energy subsidisation and these three variables.

In the third section, the researcher finds that the study is consistent with the literature in which increasing fuel subsidy benefits high-income earners.

Conclusions

Fuel subsidies are an important policy issue for many emerging economies in the Asia-Pacific region. In particular, for net oil exporting countries, fuel subsidies comprise a significant proportion of government fiscal budgets. These subsidies are difficult to remove once in place. In this study, the researcher concludes that fuel subsidies can indeed affect a nation's economic growth, distorting the entire social welfare and long-run macroeconomic variable. However, abolishing subsidisation scheme is tough because resource and energy companies are among the major sponsors of business and government activities in these countries.

¹ The first version of this paper has been published in the forthcoming issue of the Energy Forum newsletter under the title of "Falling crude oil prices: The impact on the economy of the Asia-Pacific region."

References

- CARPENTER, C. & KHAN, S. 2015. *U.A.E. Removes Fuel Subsidy as Oil Drop Hurts Arab Economies* [Online]. Bloomberg Business. Available: <http://www.bloomberg.com/news/articles/2015-07-22/u-a-e-to-link-gasoline-price-to-global-markets-effect-aug-1> [Accessed 23 August 2015].
- COTTARELLI, C., SAYEH, A. M. & AHMED, M. 2013. ENERGY SUBSIDY REFORM: LESSONS AND IMPLICATIONS. *In*: IMF (ed.). Washington.
- FOO, N. 2015 Falling crude oil prices: the impact on the economy of the Asia-Pacific region. *Energy Forum newsletter*, Forthcoming, IAEE.
- MORRIS, A. & WESSEL, D. 2015. *How large are global energy subsidies?* [Online]. Massachusetts: Brooking Institution. Available: <http://www.brookings.edu/~media/events/2015/05/18-global-energy-subsidies/global-energy-subsidies-presentation.pdf> [Accessed 23 August 2015].
- MOURMOURAS, A. 2015. Malaysia: Selected issues. *In*: IMF (ed.). Washington: Asia and Pacific Department.