Research Brief on Energy

Office of Senator Win Gatchalian

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Version 1

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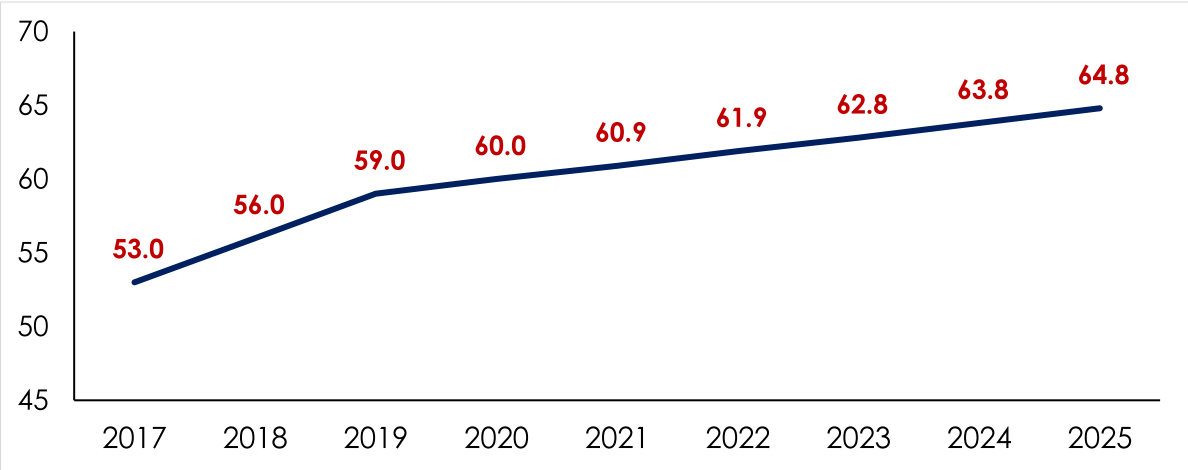
Monitoring Fuel Price Increases

Fuel Situation and Forecasts Overview

- According to the World Bank, the price of crude oil is expected to increase until 2025. The compounded annual growth rate (CAGR) of the most recent World Bank price projections is approximately 2.5%. Given that the Philippines imports most of its oil, local diesel and gasoline prices are expected to follow prevailing international trends. Figure 1 provides an illustration of the latest World Bank price projections.
- Analysts, however, caution that crude oil is expected to display more volatility in the coming years given (1) recent moves by the Organization of Petroleum Exporting Countries (OPEC) to increase the global oil price (e.g. capping supply), (2) continued instability in Venezuela, (3) possible economic sanctions on Iran, and (3) possible supply expansions in the United States.
- It is thus important to emphasize that the price projections below are likely to be inaccurate.

Figure 1: World Bank Crude Oil Projections ($/bbl)



- Figures 2 and 3 provide a visual overview of the projected prices of selected fuel products and the tax burden brought about by the TRAIN over the next several years.
- The numbers in Figure 2 suggest that without the TRAIN the price of diesel is expected to increase by approximately 1 peso per annum. The adjustments brought about by the TRAIN are expected to push the price of diesel to 50 pesos per liter at around 2025.
- The numbers in Figure 3 suggest that without the TRAIN the price of gasoline is expected to increase by 1.2 to 1.3 pesos per year. The adjustments brought about by the TRAIN are expected to push the price of gasoline to 60 pesos per liter at around 2020.

Figure 2: Diesel Price Projections (₱/liter)

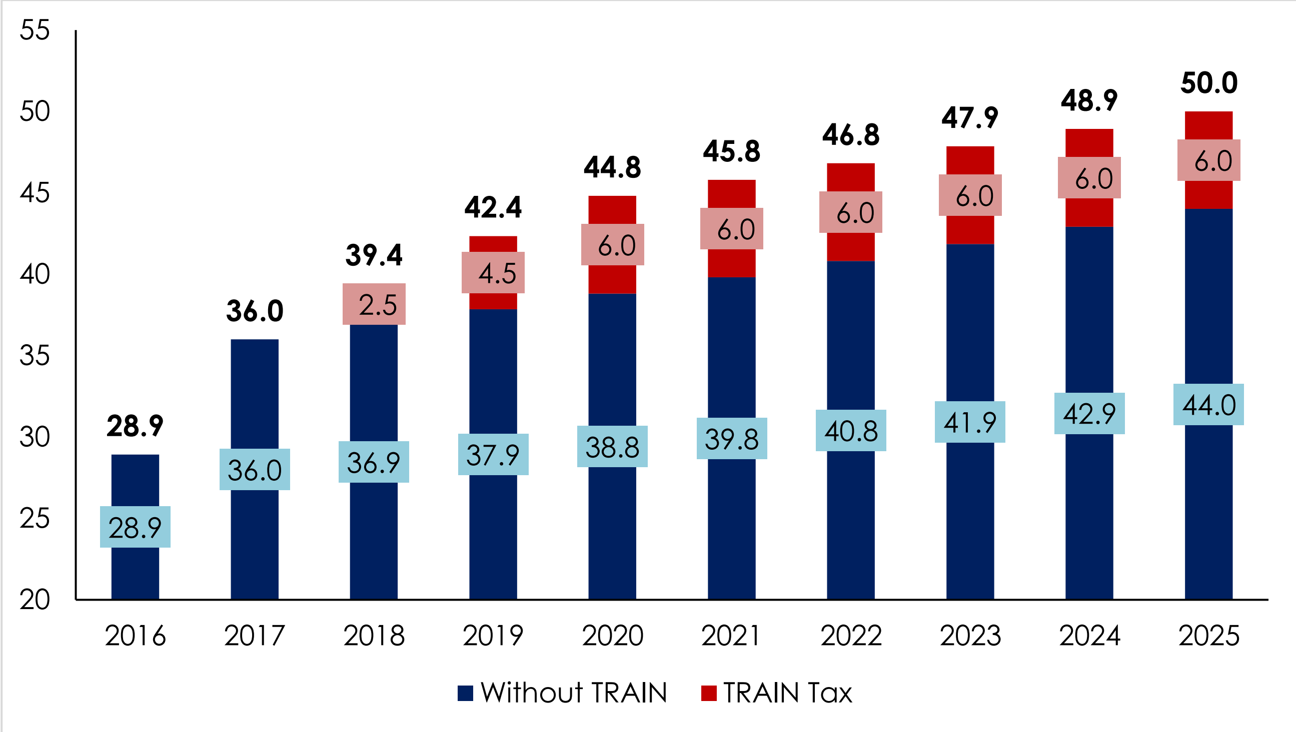


Figure 3: Gasoline Price Projections (₱/liter)

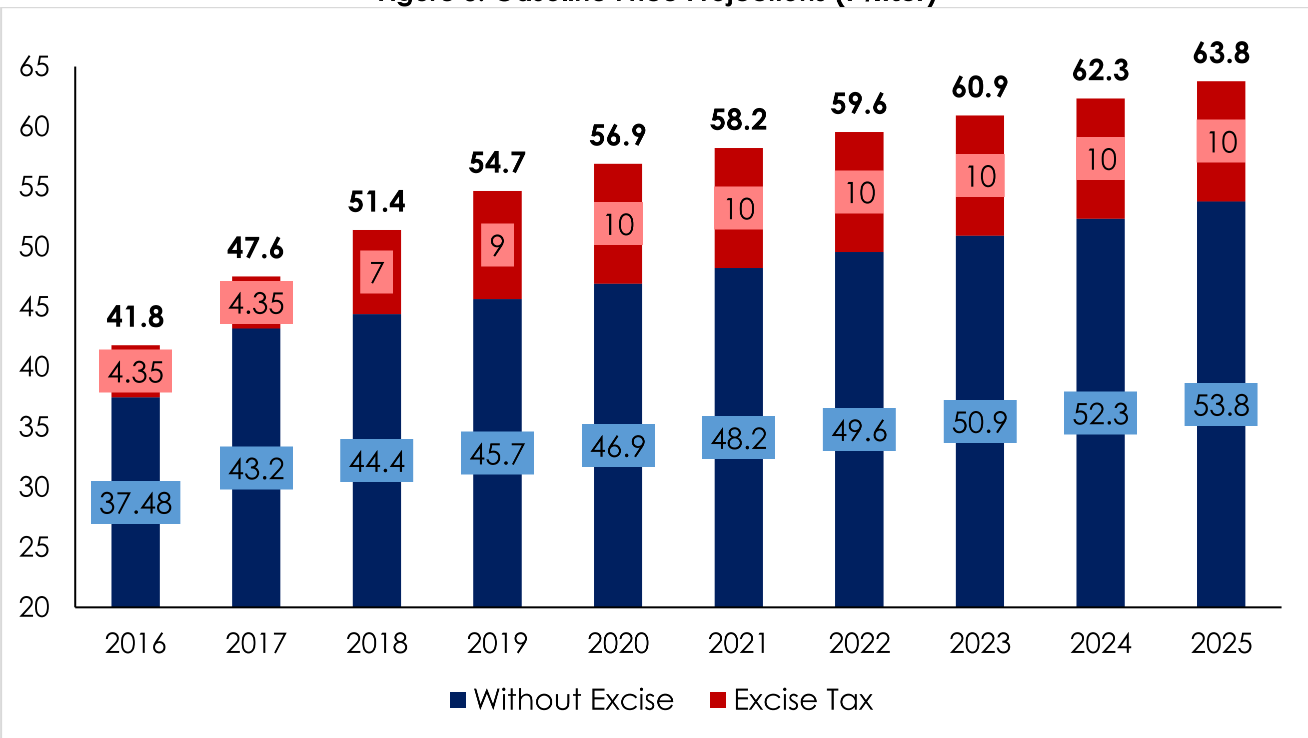


Figure 4. Kerosene Price Projections (₱/liter)

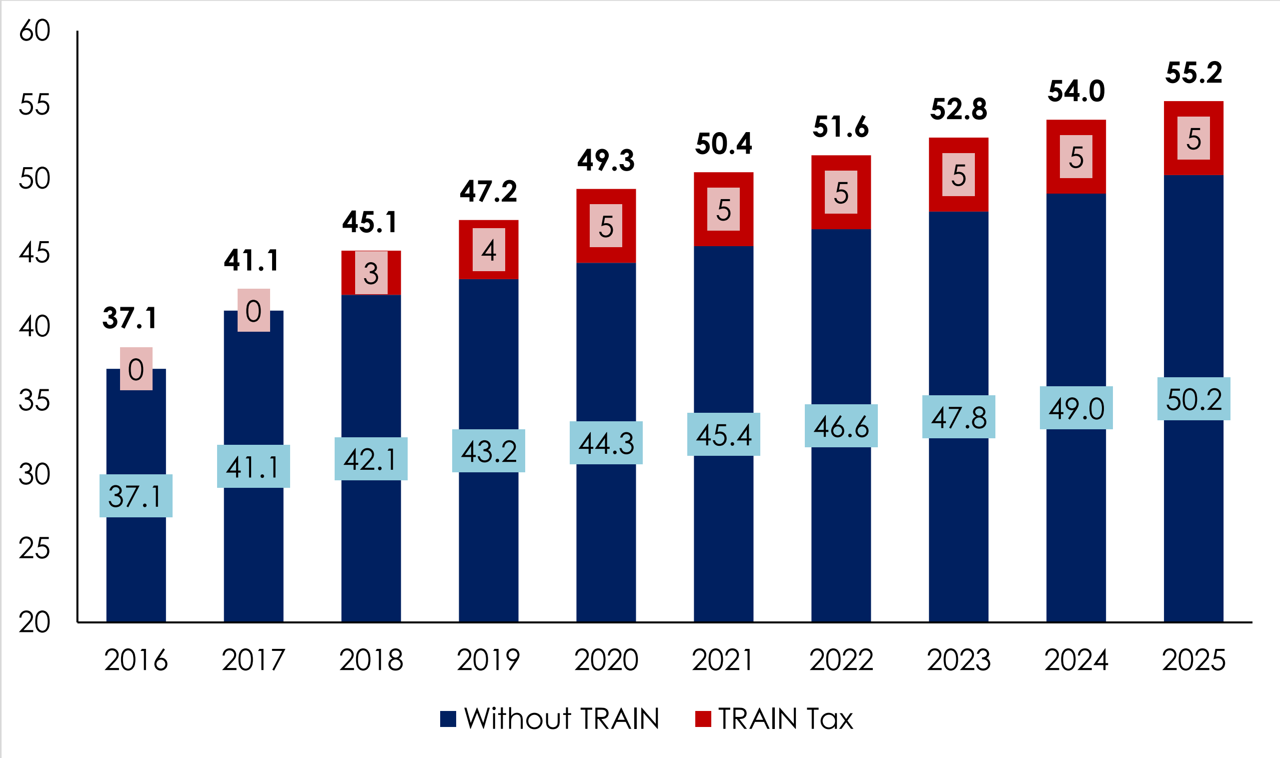
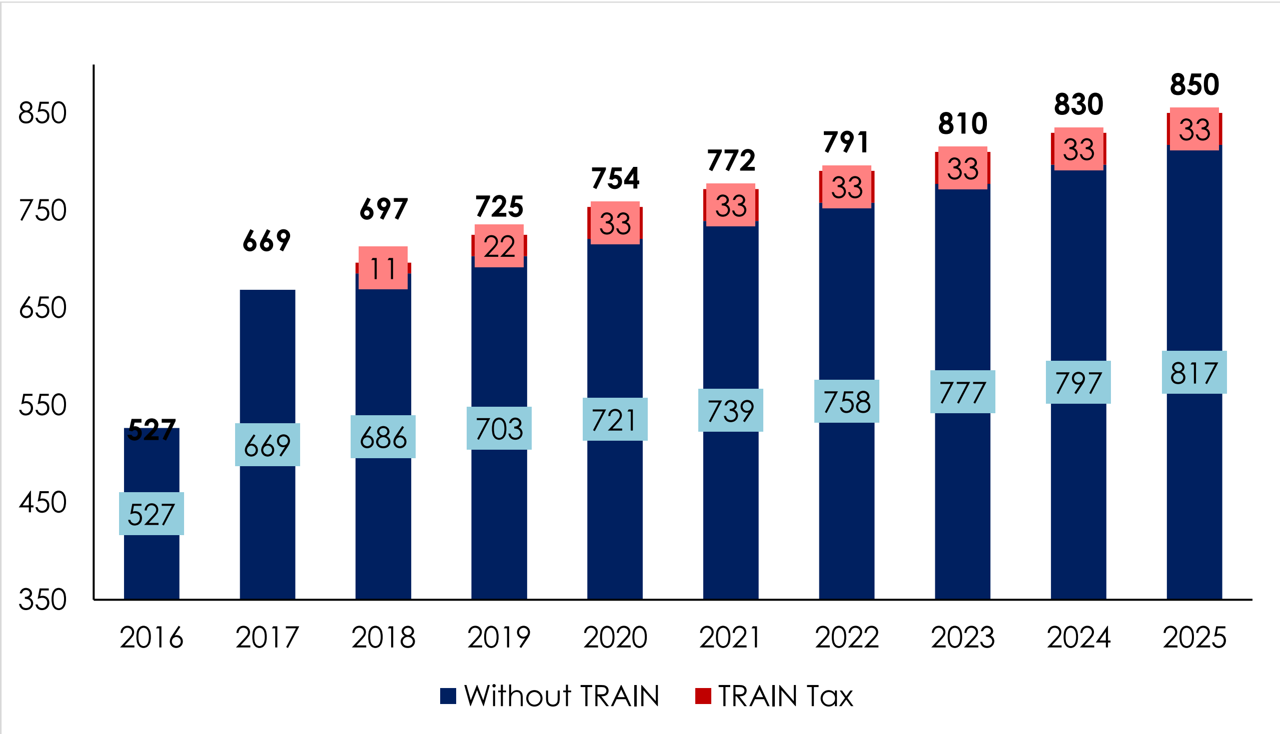


Figure 5. LPG Price Projections, Pre- TRAIN and Post-TRAIN (₱/11 kg Tank)



Point of Taxation

- The first consideration in determining the price lock-in period is determining the salient points of taxation insofar as the fuel excise tax is concerned.
- According to Senate Tax Study and Research Office (STSRO), the salient points of taxation insofar as fuels are concerned are as follows:
    - For imported fuels the tax is collected by the Bureau of Customs (BOC) upon arrival. The taxes are remitted directly to the treasury by the BOC.
    - For domestically refined fuels the tax is collected by the Bureau of Internal Revenue (BIR) upon production of the fuels.
- Figures 1 and 2 provide a visual overview of the aforementioned discussion. The figure emphasizes the point that the tax is applied on imported fuels at the moment they are brought into the country. Similarly, the tax for domestically refined fuels is applied at the moment they are shipped out of local refineries. These observations define the window wherein fuels should be sold at 2017 tax rates.

Figure 1: Diagram of the Points of Taxation for Imported Fuel Products Affected by the TRAIN

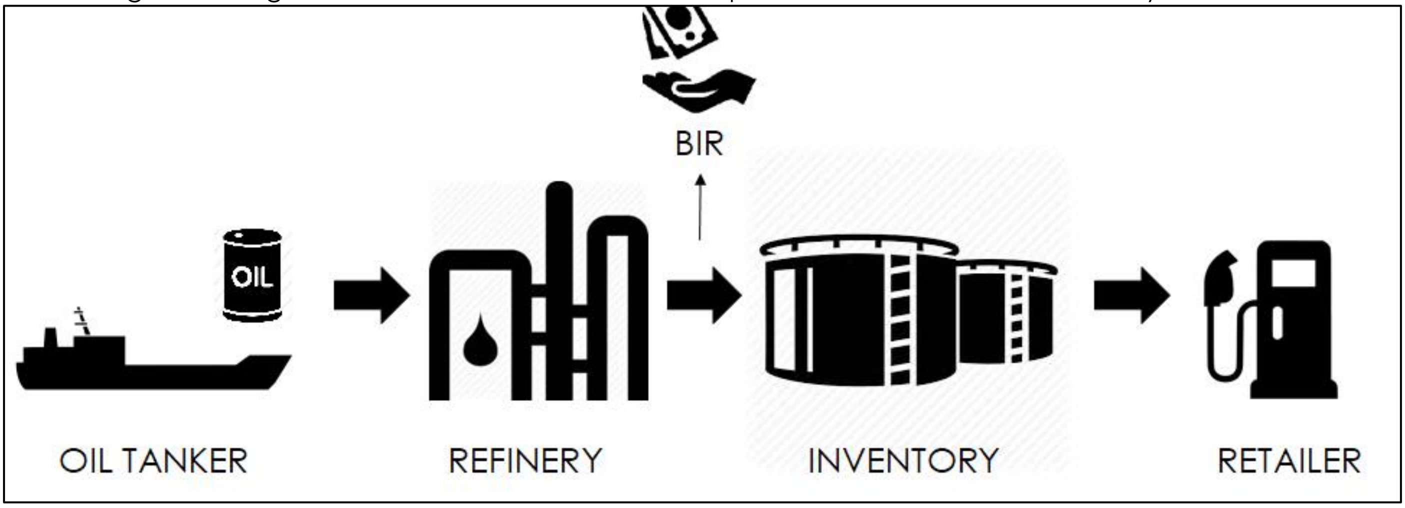
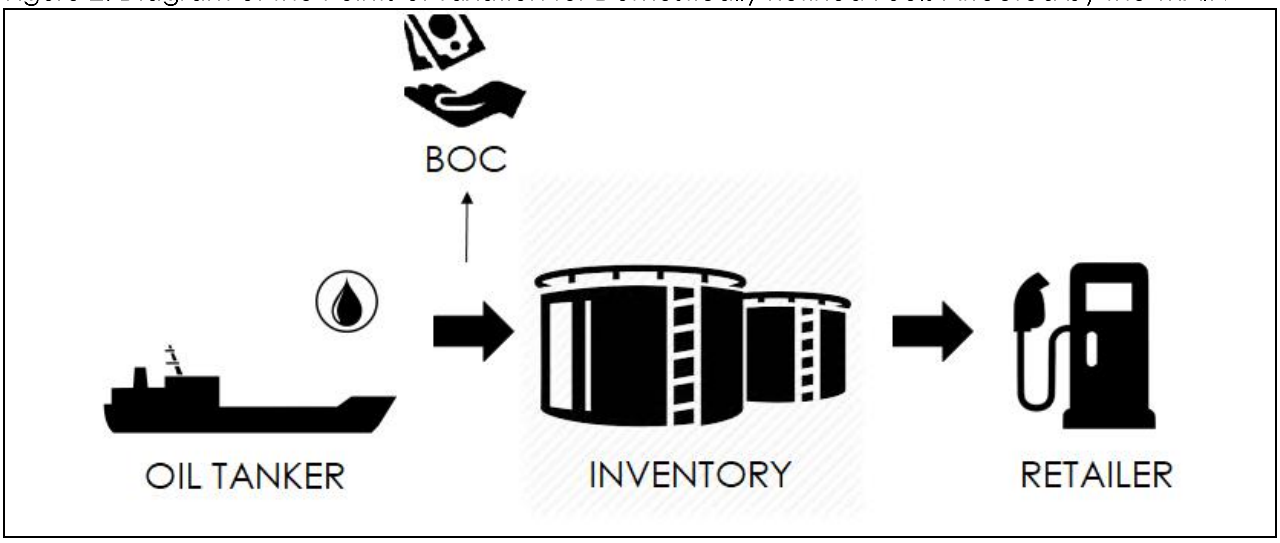


Figure 2: Diagram of the Points of Taxation for Domestically Refined Fuels Affected by the TRAIN



- The preceding discussion leads to the following inferences:
    - Imported fuel that has not been processed by the BOC as of January 1, 2018 will be subject to the new tax rates under the TRAIN.
    - Fuel produced by local refineries on or after January 1, 2018 will be subject to the new tax rates under the TRAIN.
    - Crude oil imported below December 31, 2017 and crude oil imported after December 31, 2017 will be viewed as identical inputs insofar as the BIR is concerned. What matters is the time that the crude oil is refined into actual usable fuel. Crude oil processed below January 1, 2018 should be

levied the old tax rates. Crude oil processed after December 31, 2017 should be levied the new tax rates.

Minimum Inventory Requirement

- The second consideration in determining the price lock-in period is the set of rules governing the inventories of fuel importers, suppliers, and refineries. Additionally, it is important to consider the size of the inventories of fuel players as well as the types of inventories that they actually possess.
- According to the Department of Energy (DOE), the Minimum Inventory Requirements (MIR) are as follows:
  - 30 days of in-country stock for oil refiners
  - 15 days of stock for bulk marketers
  - 7 days of stock for LPG players
- In June 2017, the DOE indicated that actual crude and petroleum product inventories corresponded to approximately 56-days of supply. The 56 days correspond to 37 days of in-country crude oil and fuel products and 19 days of in-transit crude oil and fuel products.
- If, for example, similar levels of inventory were available on December 31, 2017, then the following inferences can be made:
  - The 19 days of in-transit crude oil and fuel products have not been taxed and will thus be subject to the new fuel excise taxes under the TRAIN. This reduces the inventory to 37 days.
  - The 37-day inventory is comprised of fuel products and crude oil. This means that the inventory of taxed fuel products is less than 37 days. This is because the crude oil will be taxed after refining.
  - Given the aforementioned MIR, bulk marketers are supposed to possess an inventory for at least 15 days. This suggests that the inventory of taxed fuel products is at least 15 days and less than 37 – likely less than 30 given the crude oil stocks of refineries.
  - The stock of taxed fuel products could thus be viewed to likely last for two to four weeks from the start of the current year. This implies that inventories are either drawing down or exhausted at this point in time.
- The inventories of bulk marketers are expected to vary and would likely not be pegged to 15 days. Bulk marketers looking to profit in the wake of the imposition of the TRAIN could have increased their inventories at the end of 2017. If, for example, the DOE lifts the tacit price ceiling on fuel prices next week (three weeks after the start of 2018) and a bulk marketer accumulated an inventory equivalent to its supply requirement for a month, then the bulk marketer could expand its profit margin on the fourth week.
- The onus of preventing TRAIN-related profiteering falls on the DOE - given that it has the capacity to monitor the inventories of refineries and bulk marketers.

Recommended Points of Discussion