Oil money fuels Malaysia's economy

IT is black, but it is also gold. Petroleum, or crude oil, is one of nature's most precious gifts to mankind. Those who strike oil will strike it rich. The commodity is so useful that the world is predominantly powered by it.

Malaysia has been blessed with an abundance of natural resources, all of which have contributed to the country's development in their own ways.

But it is oil and gas that have, over the years, superseded other resources in becoming the major fuel of economic growth.

A key component of Malaysia's economy, the oil and gas sector accounts for 30% of the country's manufacturing income and about 8% of the annual gross domestic product.

Last year, total oil production in the country stood at an estimated 720,000 barrels per day, of which around 550,000 barrels per day were refined for local consumption.

Total production of natural gas last year was around 2.3 trillion cu ft, of which 50% were consumed locally.

And as a net exporter of oil and gas, it is no doubt that Malaysia will benefit from the rising oil prices.

The higher prices will raise the national income, as well as the Government's revenue.

Crude dependency

The oil and gas sector has been an important contributor to the Government's coffers since the 1970s. This is evident in the amount of money it has received from Petronas through the years.

According to the national oil company, it has paid the Government a total of RM403.3bil between 1974 and 2008.

Last year alone, Petronas' payment was RM67.6bil, or 63.1% of its profit for the year.

That amount represented 44% of the Government's revenues for 2008.

The trend of the Government becoming increasingly dependent on oil revenues can be traced back to the early 2000s, when there was an emergence of a strong and sustained rally of crude oil prices, mainly as a result of the geopolitical tension in the Middle East.

However, economists have pointed out that the growing proportion of oil revenues is worrying.

They believe that high dependency on oil revenues to finance fiscal spending is not a viable long-term option, as it increases the vulnerability of the Government budget, and hence the country's economy, to fluctuations in the commodity's prices.

So, fiscal adjustment is needed for the Government to ensure long-term stability of its finances.

There is a need for the Government to seek other sources of revenue through diversification and to focus on increasing its non-resource-based revenues, such as taxes.

Among the potential initiatives are tax reforms and reinvestment of oil money in revenue-generating assets.

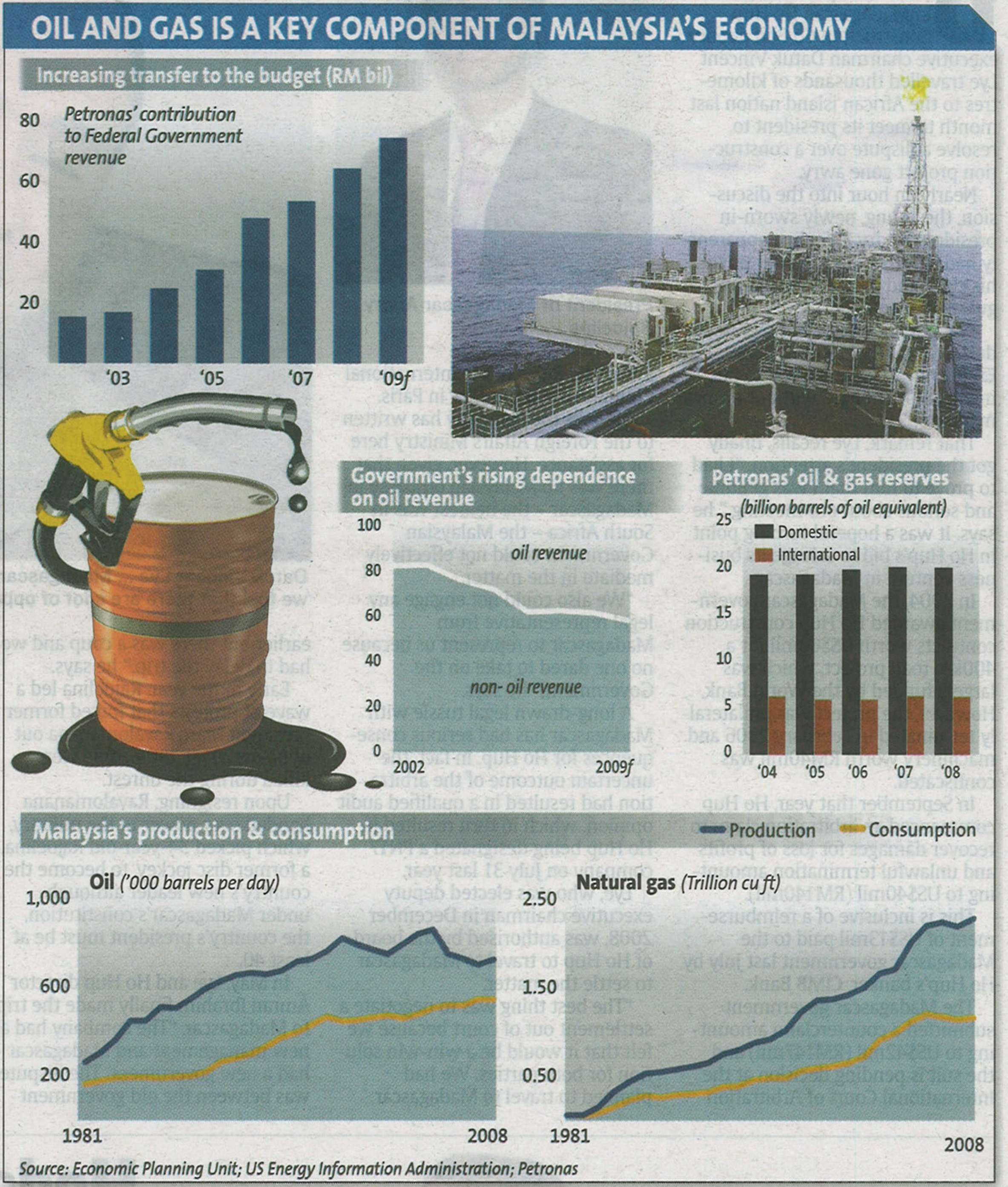
Previously, the Government had considered implementing goods and services tax (GST) by 2007, but the plan has since been shelved.

Another issue that the Government has to contend with is the subsidies for fuel and gas. In Malaysia, both oil and gas are subsidised, hence their retail prices are lower than market prices.

While high oil prices are a boon to its kitty, it also means that the Government will have to fork out more to subsidise the public's consumption of fuel.

»An environment where fuel prices are kept artificially low will do more damage than good in the long term«

ENERGY ANALYST DR POLA SINGH



Source: Economic Planning Unit; US Energy Information Administration; Petronas

The Domestic Trade, Cooperative and Consumerism Ministry has said the Government did not have to pay fuel subsidies as long as crude oil prices were below US$65 per barrel.

But now that the commodity has exceeded that level, it appears that the Government will have to pay subsidies again.

According to the Economic Planning Unit (EPU), the total amount of subsidies borne by the Government between 1997 and 2008 was roughly RM78bil.

The total subsidies last year came to about RM20bil, compared with RM16bil in 2007.

Former deputy director of the Energy Section of the EPU, Dr Pola Singh, who is now an independent energy analyst, says Malaysia is a laggard in removing subsidies.

"An environment where fuel prices are kept artificially low will do more damage than good in the long term," he explains.

He added that it is necessary for the Government to reduce the level of subsidies gradually for retail prices to reflect market prices and to wean Malaysians off their addiction to cheap fuels even though this will not be a popular move.

"We are generally wasteful when prices are low," Pola argues.

He cites the example of petrol stations experiencing a significant decline in the demand for fuel when pump prices went up to RM2.70 per litre in July last year.

But following the lowering of pump prices to the current rate of RM1.80 per litre, Malaysian consumers have reverted to their old ways, and their consumption pattern is now back to normal.

Depleting resources

Meanwhile, there is no quick fix to the world's dependence on oil. As the global economy continues to expand (despite the current hiccups, which it has been suffering over the past one year), demand for oil and natural gas as sources of energy continues to grow.

Reserves are fast depleting, as oil and gas, being non-renewable commodities, are continually being extracted to feed global consumption.

The combination of growing demand and depleting reserves may turn many net oil exporters into oil importers.

In the case of Malaysia, if domestic demand continues to grow at 4% annually and the country's oil and gas production remains at a flattish 2.7% per year, there is a possibility of the country becoming a net importer within the next 10 years.

Held by Petronas, Malaysia's total domestic reserves of oil and gas as at Jan 1, 2008, stood at 20.13 billion barrels of oil equivalent, while its total international reserves of oil and gas was at 6.24 billion barrels of oil equivalent.

In 2008, Petronas' reserve replacement ratio stood at 0.9 times, down from 1.4 times and 1.8 times in 2007 and 2006, respectively.

The ratio is a measurement of new reserves discovered to volume of production. It is an indication of the company's track record in maintaining a stable reserve of oil and gas.

There are various efforts to find new reserves. It is reported that Petronas spends about RM40bil per year on exploration and development activities, and it has indeed been successful in making discoveries, particularly in the deepwaters of Sabah and Sarawak over the years.

In addition, Petronas has overseas ventures in more than 30 countries now.

This could boost its reserve replacement ratio and provide opportunities for local oil and gas services providers to penetrate international markets via the national oil company, which usually prefers to award contracts to Malaysian companies.

However, the thinking that as long as we continue to invest, we will keep finding new oil reserves and that we may not run out of oil will give rise to a lack of a sense of urgency to devise new strategies for a fallback plan, says Pola.

There are no short cuts to counter the depleting fossil fuel resources, he says, but policymakers and corporations can accelerate initiatives to improve energy conservation and develop renewable energy to reduce consumption of oil and gas.

On the role of consumers, Pola says they can practise voluntary restraint and conservation to reduce pressure on oil demand. – **By CECILIA KOK**