

The “Real” Cost of Energy in Malaysia

Input for: Industry Speaks - Does Cheap Oil Weaken the Case for Energy Efficiency? 21st Aug 2015

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When we discuss the price of oil we assume that oil is priced efficiently, where all costs (both private and social) are included. However, according to numerous studies by the International Monetary Fund (IMF), this is far from the case.

In a Malaysian context, the IMF estimates that one litre of petrol should be taxed by RM2.20 in order to compensate for its negative externalities. (*Getting Energy Prices Right*, Parry et al. 2014) This implies that if petrol was free, and assuming demand remained constant, it should still cost RM2.20/litre to pay for the underlying cost to society. The cost of by-products and harm from using fossil fuels will remain no matter what the current market price is. Here is the problem in our conventional pricing methods: *unpriced negative externalities*.



50 litres = RM100

RON95 RM2.05/litre (Aug 2015)
Cost of filling up your car today

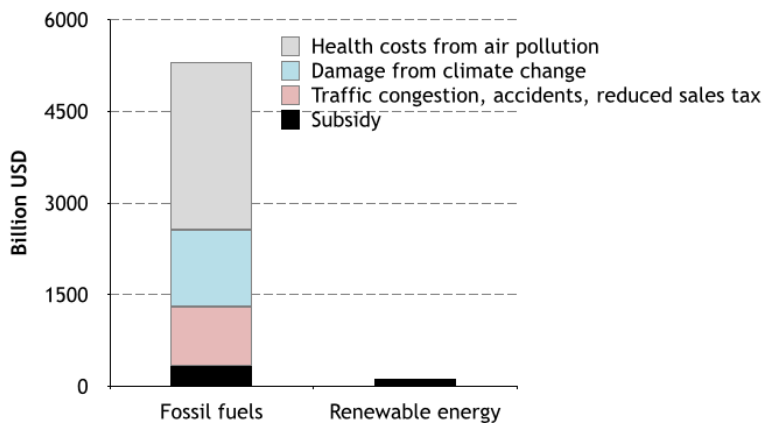
50 litres = RM220 (120% increase)

RON95 est. RM4.40/litre
Real cost of filling up your car
Current price + removal of subsidies + tax to correct for externalities

From the IMF paper *How Large are Global Energy Subsidies?* (Coady, Parry et al. 2015), the report shows that energy from fossil fuels is severely underpriced, and the cost of subsidies are substantially undervalued. The global estimated cost of externalities from fossil fuel use, as a result of subsidies, is shown below in figure 1.

Additional costs of fossil fuel use include:

- Damage to the environment
- Deaths and damage to human health as a result of pollution
- Adverse side effects of excess vehicle use: congestion, accidents etc.
- Fiscal costs: forgone tax revenue, crowding out of more productive spending



↑ USD5.3 trillion per year - or 6.5% of the global GDP!

USD333 billion globally in fossil fuel subsidies annually translates to USD5.3 trillion in total cost, after factoring in externalities.

Figure 1, Source: Coady, Parry et al. May 2015

For Malaysia, according to the IMF paper *Energy Subsidy Reform: Lessons and Implications* (2013), petroleum product subsidies in Malaysia are estimated to cost **1.24% of GDP**. After the cost of externalities are included, this cost of subsidies rises to **5.12% of GDP**.

The message is clear, the use of fossil fuels as an energy source is not “cheap.” The pricing of oil is not efficient and sends the wrong signals to the market. Oil is inherently expensive, due to the cost of long term consequences, which are not reflected in the current price. There is no such thing as cheap oil, it is expensive not to go green.

References:

Benedict J. Clements; David Coady; Stefania Fabrizio; Sanjeev Gupta; Trevor Serge Coleridge Alleyne; Carlo A. Sdravovich, “Energy Subsidy Reform: Lessons and Implications.” (2013).
David Coady; Ian W.H. Parry; Louis Sears; Baoping Shang, “How Large are Global Energy Subsidies?” (2015).
Ian W.H. Parry; Dirk Heine; Eliza Lis; Shanjun Li, “Getting Energy Prices Right: From Principles to Practice,” (2014).