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LIQUIDATION OF THE TOR* DEBT: WHY SECURITIZATION IS A BETTER OPTION THAN RECOVERY THROUGH PETROLEUM PRICES

by

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Summary

This Legislative Alert argues that the current system of levying taxes through fuel prices to pay the Tema Oil Refinery Debt is seriously flawed. Not only is the process cumbersome and inefficient, but it also puts an unnecessary burden on consumers. The paper suggests that a tidier, more pragmatic, and more effective way of liquidating the debt would be for Government to take over the debt, securitize it, use the proceeds to pay the creditors and redeem the securities over a period of time.

*Tema Oil Refinery

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Over the years, The Tema Oil Refinery has accumulated large debts as it borrowed to cover its budget deficits. The budget deficits arose because TOR was not allowed by successive Governments to set ex-refinery prices of petroleum products to reflect it's full costs. Figures obtained from the National Petroleum Authority (NPA) indicate that TOR's debt stood at about GH¢ 2.1 billion as at end-2010. Most of the debt is held by the predominantly state-owned Ghana Commercial Bank (GCB), which provided credit to TOR. The debt has consistently put not only the balance sheet of GCB, the largest bank in the country, at considerable risk, but has also threatened the financial stability of the entire banking system.

It has often been reported in the media or heard from official pronouncements that Governments have been "subsidizing" petroleum products. This assertion is however misleading. Technically, such "subsidies" should appear as a line item in the budget payable to TOR to meet its unrecovered costs. The fact that TOR accumulated such large debts over the years suggests that it was either not being compensated at all or was being only partially compensated. The entities that provided funds to TOR to cover its budget deficits were really the ones that paid the "subsidies" enjoyed by consumers through lower-than-cost prices. If Governments want to provide fuel "subsidies" to consumers in a true sense of the word, they should compensate TOR for its losses and not leave it to seek funding from creditors.

In any case, it needs to be pointed out that studies, including one by the International Monetary Fund (IMF) on Ghana, have found that provision of "universal petroleum subsidies" benefit the rich rather than the poor. It is, therefore, not a good social safety net.[1] Stanley Fischer, former Deputy Managing Director of the IMF, once noted in an IMF Board discussion on provision of oil subsidies by oil producers, that the best way to help the poor was not to give them free oil but rather to provide them with targeted social safety nets. This is a very sound proposition.

As Ghana becomes an oil producer, the mistake of selling petroleum products below "genuine costs" should not be made. Oil-producing countries that for long periods subsidized oil for their populations paid heavily in terms of consumption inefficiencies and foregone critical development and social projects. When the countries realized their mistake and decided to eliminate these subsidies, they were met with widespread protests and social unrest. The prudent thing to do is to sell petroleum products—even when you are a producer—at full cost and find other interventions to mitigate the effects on more vulnerable groups. Meanwhile, the key components of TOR's "costs" are crude oil price, the cedi-dollar exchange rate, refining costs and other operational costs. These cost components determine the ex-refinery price, which contributes about 65 percent of the ex-pump price. The remaining 35 percent is made up of a range of taxes and levies. If the ex-refinery price is kept below what these cost-components call for, then TOR will not be able to fully cover its costs and would have to be reimbursed by Government or it would have to

[1] It has to be noted that the burden of the so-called fuel subsidies have to be borne by somebody. If levied as part of the fuel price, fuel users bear the burden. On the other hand, if it is paid through the budget, taxpayers eventually bear the burden. Truly, there is no free lunch!

borrow to finance the difference. While the first two cost components are beyond TOR's control, the last two depend on its operational efficiency. It is important that such efficiency meets industry standards so that TOR's operational inefficiencies are not undeservedly factored into the ex-refinery price to the detriment of consumers. The NPA has a responsibility to ensure this.

As a means of recovering the TOR debt over time, a TOR Debt Recovery Levy (TDRL) was introduced into the petroleum pricing formula. As of May 2008—the latest information available—the TDRL constituted 4.2 percent of the ex-pump price,[2] with other taxes and levies accounting for 30.5 percent. However, incorporating the TDRL in a petroleum formula is seriously flawed. The TDRL adds to the cumbersomeness and complexity of a formula already overloaded with numerous taxes and levies.

The best way to liquidate the existing stock of TOR debt is not to levy it through the petroleum price, but for Government to take it over as part of the public debt and securitize it, with its guarantee. The securities will be in the likeness of the TOR Bonds that were issued several years back, and guaranteed by the Bank of Ghana (BoG)/Government, to raise funds to defray part of the debt owed by TOR to its creditors.[3] The modalities for the proposed TOR Debt Securities (TDSs) could be worked out. However, unlike the TOR Bonds that carried a fixed coupon rate, it is proposed that to enhance the attractiveness of the TDSs, they should be indexed to inflation or linked to Treasury bill rates. Subscription to the TDSs should be open to banks, corporations, and the general public.

A framework should be developed to make the securities tradable in the secondary market or rediscountable at BoG, such that holders need not hold them to maturity if they do not so wish. This would increase their attractiveness.

The TDSs could have a maturity period of ten years. The interest costs on the TDSs should be borne by the budget. This would of course put some burden on the budget, but this is a necessary and manageable burden. In ten years, the maturing bills will be paid by Government. Although GH¢ 2.1 billion today may look high, in ten years the economy and taxes would have expanded to the extent that it would be much easier to pay the maturing TDSs from the budget. Part of the oil revenue could even be set aside to help in liquidation of the debt. Therefore, potential risks of the TDSs to the budget will be tolerable.

The TDRL should then be expunged from the petroleum pricing formula, where it does not belong. Taking the TDRL out of the formula should be part of a process to make the formula less cumbersome, less bureaucratic, and less bothersome to consumers. Removing the TDRL, would reduce ex-pump prices significantly.

Meanwhile, it is important to prevent further debt accumulation, given the huge risks not

[2]In the 2011 budget, the TDRL was increased four-fold. The current contribution of the TDRL to the ex pump price would therefore be much higher.

[3]Some of the Bonds were issued to GCB to help improve its balance sheet as they had a better market value than the low-quality TOR debt.

only to TOR but also to the banking system and the entire fiscal system. The way to do this is to apply the automatic pricing mechanism (APM) on a regular basis.[4]

It is worth emphasizing that the TOR Debt Recovery Levy in the petroleum pricing formula makes the formula cumbersome and puts an unnecessary burden on consumers. It would be best for Government to take over the TOR debt, securitize it, use the proceeds to pay TOR's creditors, and redeem the securities over a period. This will be a tidier, more pragmatic and more effective way of addressing the TOR debt problem.[5]

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[4] The implementation of the APM will be treated in greater detail in a follow-up Legislative Alert. A case for progressive deregulation of the oil market and "depoliticization" of the pricing mechanism will be made.

[5] Alternatively, securities of 1, 2, 3 --- up to 10 years maturities could be issued and redeemed as they mature if the budget can bear that.