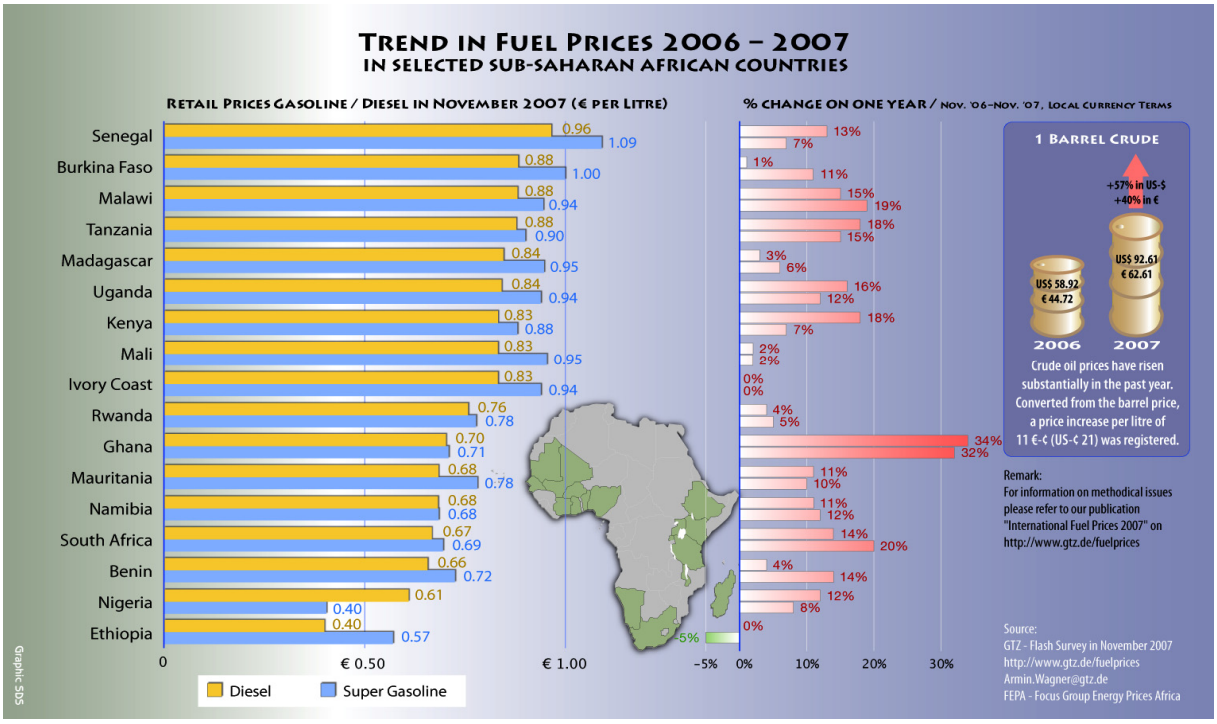
Discussion Paper - Flash Survey of Fuel Prices in November 2007

The world market prices for crude oil rocketed last year (November 2006 to November 2007) – rising by about 40% in euros, and by around 57% in dollars. How did selected partner countries respond?

In November 2007, GTZ conducted a short study of current fuel prices in **17 capital cities in sub-Saharan Africa**. In addition to price rises, mechanisms and policy approaches were highlighted.



In the course of the year, the individual states **responded to the rising crude oil prices with very different policies.** In addition to the absolute rise in prices in local currency, the issue of the development of **gross margins,** i.e. the sum over and above the costs of crude oil (generally production and distribution costs, taxes and other charges and profit margins) is relevant.

In states in which **prices have not risen and/or the gross margin has shrunk significantly (such as Ethiopia, Rwanda and Nigeria)** the central issue is the sustainability of these policies given the need to finance central state activities, to finance the energy and transport sectors and to bring prices into line in the long term with the higher fossil fuel prices we will see, as well as investigating ways of promoting alternative and renewable energies. No price increases or lower than average price increaes mean **lost taxes/ charges, lower profit margins/ fewer reinvestment funds for oil businesses or direct subsidies** from the state budget. Constant (and comparatively low) energy prices signal no shortages and fail to provide an incentive to change or adapt consumption patterns. As crude oil prices rise, more and more states have begun to subsidise fuels, including Ethiopia. **Price adjustment mechanisms fail in these states against the background of extreme price shocks** and threaten to cause adjustment difficulties in the long term. Long-term supply contracts with favourable terms for the purchaser combined with higher oil prices in the long term only defer the problem.

- **Ethiopia:** At EUR 0.40 diesel is only half the price it is in Burkina Faso (EUR 0.88) and is cheaper than in the USA, where taxes are low (EUR 0.62). In 2006, according to press reports, the Ethiopian government subsidised fuel to the tune of USD 40 million between May and July alone.

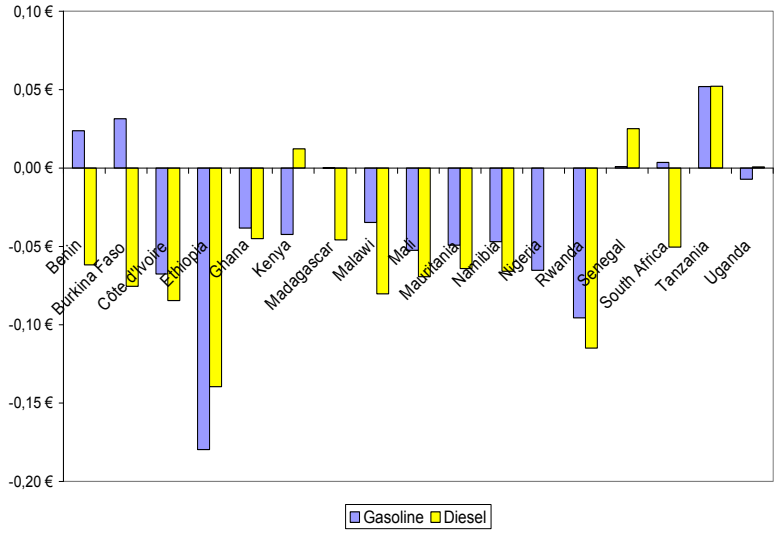
- **Rwanda**: Price rises of less than 5% (to EUR 0.76 for petrol and EUR 0.78 for diesel) put prices below the level in Uganda (EUR 0.94 for petrol and EUR 0.84 for diesel), although fuel

from Kenya was imported via Uganda. The gross margins for both diesel and petrol have dropped substantially.

- The situation in **Nigeria,** which is of course an oil producer, remains critical, with petrol prices of 70 naira (EUR 0.40). Resistance within the country is making it impossible to raise prices and thus makes supplies more secure, broaden the state's revenue basis and stimulate energy efficiency. The smuggling of cheap petrol into neighbouring states is further eroding the revenue basis of these states.

- In countries with high prices and currencies pegged to the euro (such as the **Côte d'Ivoire**), the relative changes in the gross margins are less marked and can in some cases be offset in the course of the year.

In these states we must investigate to what extent Road Funds (instruments used to finance highway maintenance) are being adequately supported, i.e. whether or not the percentage agreed is in fact being put at the disposal of the Road Funds.



Change in margins (rough estimates based on trend in crude oil price and retail prices; November 2006 on November 2007). Gross margin represent the sum over and above the costs of crude oil (generally production and distribution costs, taxes and other charges and profit margins).

In states with **moderate price rises and/or a slight drop in the gross margins,** the further development of (existing) price adjustment mechanisms should be observed along with the continued use of these mechanisms parallel to short- and medium-term measures.

- **Diesel prices** have generally risen less or have stagnated – distribution policy issues play a part here, since diesel is used in particular for commercial vehicles and for pumps in agriculture (and of course to generate electricity).
- In the **West African context** we should also investigate which mechanisms can be used to stop smuggling and hence stop eroding tax revenues, given the widening gap between the price of fuel in Nigeria and in neighbouring countries.
- In some states with deregulated markets, such as Kenya, the option of reintroducing state price controls is being discussed.

Radical price rises and/or rises in the gross margins in some cases can have **social and economic impacts**. The focus is on **cushioning the shock in the short term** for sectors at risk (e.g. agriculture and transport) and the affected sections of the population. Apart from this, measures should be identified for further adjustments to higher prices, as these are not set to come down again in the long term.

- **Ghana** can be seen as a positive example in the overall context. The government in Ghana has discontinued its policy of subsidising fuel prices and now passes on world market prices to consumers. The market situation is regulated and supervised by the National Petroleum Authority (NPA), which sets maximum prices which reflect the price of crude oil, plus refinery costs and distribution costs as well as the taxes payable.

- **Tanzania** has been able to keep gross margins steady.

- In **South Africa** the fuel price is fixed monthly on a set date on the basis of developments on the crude oil market and other factors. Details can be found at http://www.dme.gov.za/energy/liquid_petrol.stm.

Outlook

It is becoming clear that the high rate of price rises is essential, and indeed that increases are not sufficient in many cases to keep the gross margin for fuels (i.e. production and distribution costs, taxes and other charges, profit margins) constant. We believe that the following basic prerequisites must be met in the interests of sustainable energy and transport policy, even when crude oil prices are high:

- Abolition of fuel subsidies which distort demand by sending out the wrong price signals, and obstruct the transition to sustainable transport patterns and the introduction of alternative fuels
- Introduction and needs-driven adjustment of taxes and other charges to finance highway maintenance (i.e. the ongoing funding of Road Funds or other instruments)
- Ongoing adjustment / increasing of taxes, which are a major factor in managing demand for energy and transport, promotion of energy-efficient power stations and vehicles and promotion of energy-efficient settlement and production structures.

The sustainable design of the transport sector with the targeted promotion of efficient settlement and production structures, the promotion of public and non-motorised means of transport and the promotion of energy-efficient vehicles and means of transport (also rail transport and shipping for long-distance transport) are thus set to become very important. The pertinent regulatory, planning and economic instruments are available.

Rising prices and concomitant adjustment problems are an international challenge, for instance in:

- Cambodia: Annual energy price subsidies of about USD 120 million
- China: State price regulation leads to bottlenecks in supplies, since the fuel producing and distributing businesses do not bear the losses that can be expected
- Iran: Rationing of fuel and the sale of additional quantities at higher prices
- Jordan: Fuel subsidies in 2007 totalled about USD 350 million
- Burma: Price rises led to unrest at the beginning of 2007

Background

Since 1998, GTZ has helped influence the debate on the taxation of fuels in developing countries by providing comprehensive data on behalf of BMZ. Decision-makers in partner countries have been provided with the essential information on pricing in the regional context and on the potentials offered by taxing fuels. In *International Fuel Prices 2007,* GTZ pinpoints trends and publishes comparative data going back to 2001. (cf. www.gtz.de/fuelprices)

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