Contact: Mwaka Nyimbili
Centre for Trade Policy and Development
Phone: +260 211 264409|+260975876038
Fax: +260 211266234
Plot 3823, Manda Hill Road, Olympia Park
www.ctpd.org.zm

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DYNAMICS OF ZAMBIA'S PETROLEUM PRICES – ARE MONTHLY REVIEWS A PROBLEM?

Post the August 2021 elections, government embarked on sectoral economic reforms aimed at rebuilding the economy. Key reforms in the energy sector involved the removal of some fuel subsidies, placing of INDENI refinery on care and maintenance and much more recently, the introduction of monthly reviews for setting pump prices of fuel whose pros and cons have been up for debate, especially when the resulting adjustment is upwards. The overarching question is, are these monthly reviews inherently problematic? In our view, monthly reviews are neither the problem nor the solution but are necessary to get us close to an efficient energy market. Although Zambia has relied on anchored expectations to model gas prices in the past, nothing empirically stops us from trying out unmoored expectations – something which the monthly reviews get us close to. It may take some time for us to get used to this and yet, that's the efficient thing to do.

A market is economically efficient if it fully internalizes new innovations which affect supply and/or demand. In fact, the 'first-best' choice is given by a free market - without intervention. However, owing to the significance of energy prices for inflation outcomes and the political dynamics surrounding the sector, implementing a free-market equilibrium in the energy sector is evidently far-fetched. Sometimes, politically sensible decisions dictate market intervention to keep prices artificially low which, unfortunately but often, is at odds with basic economic efficiency principles.

As often in economics, we have a 'second-best' choice to fall back on. In this case, this is where government intervenes to set the price but does so at a frequency that is underpinned by the frequency of shocks in the market. For a petroleum importing economy like Zambia, energy prices are expected to be pro-cyclical to exchange rate volatility overtime. The frequency of these exchange rate cycles (which depend mainly on the strength of the Kwacha) can be as high as daily. This alone, requires a high frequency of price reviews for the energy market to efficiently internalize new information from the FOREX market.

On the flipside, the downside implication of monthly reviews has to do with increasing uncertainty not only in the energy market but in other markets which rely on energy as an input into production. This is bad for business and may negatively impact on production plans. However, one of the biggest challenges facing Zambia's energy sector which also further necessitates high frequency price reviews is inadequate storage infrastructure. Most of our provincial depots are exclusively utilized as operational depots leaving us with no room to

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procure adequate strategic petroleum reserves. This makes us vulnerable to all shocks whether aggregate or idiosyncratic to the energy sector even when such shocks could be temporal. This also applies at individual level, consumers without the ability to buy in bulk will likely be more vulnerable even to temporary shocks.

Another key intervention revolves around enhancing efficiency in procurement processes. Over the past, about 40% of petroleum products consumed in Zambia were produced by INDENI Petroleum Refinery Limited, with the remaining 60% imported by road. The recent placing of INDENI on care and maintenance meant that nearly all petroleum procurements are now moving by road which is not only the most expensive means of transporting petroleum products, but also significantly reduces the lifespan of our roads.

In our view, these are the real factors that we should focus on to keep petroleum prices in check. We should prioritize capital investment towards infrastructure to ensure that; much of our petroleum imports are transported through TAZAMA and feedstock is efficiently refined at INDENI, and we have enough storage capacity for strategic reserves. Efforts to strengthen and stabilize the Kwacha should also take prominence. These factors matter more for stability of energy prices than the frequency of price reviews.

Issued by:

Wakumelo Mataa (Mr)

Centre for Trade Policy and Development

Public Finance Management Researcher

Editor’s Note

The Centre for Trade Policy and Development (CTPD) is a not- for –profit, membership based trade policy and development think tank. The organization was established in 1999 and existed as the civil society trade network (CSTNZ), until 2009 when it was rebranded as the Centre for Trade Policy and Development (CTPD).

The mandate of CTPD is to influence pro-poor trade and investment reforms at national, regional and multilateral levels as well as facilitate the participation of various stakeholders including member organizations in ensuring that trade is used as a tool for poverty eradication.

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Address: office Plot 3823, Manda Hill Road, Olympia Park ,

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