

Will the Deregulation of the Petroleum Sector Result in Competition?

The Government of Ghana has implemented the price deregulation of petroleum products since June 16, 2015, with the Oil Marketing Companies (OMCs) determining prices rather than the National Petroleum Authority (NPA). This is anticipated to result in effective competition in the petroleum sector, increasing consumer welfare by offering consumers lower prices of petroleum products. However, in the absence of functional competition policy and law in Ghana, it raises concerns over anticompetitive practices, such as collusion and cartelisation. In order to promote healthy competition, the Ghana Chamber of Bulk Oil Distributors (CBOD) introduced a new petroleum pricing formula, providing information on price trends to consumers. This calls for consumers to strengthen their knowledge on the prices of petroleum products and make educated and quality decisions in order to maximise their welfare.

Introduction

The much-anticipated price deregulation of petroleum products has been implemented on June 16, 2015. This marks a great step towards the full deregulation of the downstream petroleum sector and also makes a major breakthrough in the petroleum deregulation policy. The NPA will cede its power in the pricing of petroleum products, allowing the Bulk Oil Distribution Companies (BDCs) and the OMCs to price their own products. Moreover, the deregulation is anticipated to eliminate the government's subsidies and depoliticise the sector. As a result, the deregulation is expected to promote competition, offering lower prices of petroleum products to consumers in Ghana as well as improving efficiency of the petroleum industry.

Current State

The Government of Ghana regulated the prices of petroleum products until 2001. Its failure to adjust prices in response to the unforeseen hike in the world crude oil price led to debt accumulation by the Tema Oil Refinery (TOR). The Automatic Petroleum Product Pricing Formula (APPPF), a much more market-efficient approach

to pricing, was therefore adopted in June 2001, with the NPA in charge of determining the prices in line with formula. The formula compared Ghana's ex-refinery prices for ten petroleum products in cedi terms during the preceding 30 days to corresponding prices for those products in northwest Europe (plus shipping and port charges), and computed the total value difference between the two (using product consumption volumes for the current month in Ghana). The idea is to ensure full pass-through to the consumer of increases in world petroleum prices and depreciation in the cedi.

The formula has been very controversial due to its asymmetrical direction of pricing. The prices of petroleum products usually increased in response to higher world prices but rarely decreased in response to lower world prices. In the wake of the oil price crush in the international market, which hit new six-year lows below US\$46 per barrel, consumers in Ghana expected drastic reduction in the price of petroleum products. The NPA, however, announced a 10 percent reduction, reflecting inconsistent application of the formula. Its decision was made to use over-recoveries during lower world prices to defray debts from under-recoveries. As a result, the NPA was able to pay the debt owed to the BDCs. In spite of debt

reduction, such political interference generated consumer distrust in the APPPF. Moreover, transparency of the pricing formula is questioned.

In addition to the pricing formula, the government has been subsidising the petroleum sector. The size of the subsidies has been on the rise, threatening fiscal sustainability and increasing budget deficit in Ghana. In 2013, the government would have spent GHC2.4 billion on subsidies, accounting for 3.2 percent of gross domestic product (GDP). This figure is more than half of the government's budget for education sector.¹ Heavy subsidies on the petroleum sector drain available resources for productive projects and programmes that could otherwise have improved socio-economic conditions in the country. More importantly, the provision of subsidies further accelerates the growth of budget deficit and national debt. In 2012, the level of budget deficit recorded 12.1 percent of GDP, twice as much as its target level for the year.

Although the poor are intended beneficiaries of fuel subsidies, the effect of subsidies is regressive – the richest quintiles benefit the most from the subsidies. According to United Nations Children's Fund (UNICEF) policy paper,² the richest households receive GHC7.32 per year for the petrol subsidy, compared to just GHC0.17 for the poorest quintile. Despite Kerosene's notion as the petroleum fuel for the poor, it shows a similar pattern. The richest quintile receives GHC3.40 per year for the kerosene subsidy, compared to the poorest quintile's GHC2.05. The study concludes

that subsidies in the petroleum sector are highly regressive. Almost 78 percent of subsidies benefit the wealthiest households, whereas less than three percent the poorest households.

In addition, the subsidies create an incentive for smuggling petroleum products to low-subsidy neighbouring countries, encouraging rent-seeking behaviour. The prices for the petroleum products in its neighbouring countries are significantly higher than the subsidised prices in Ghana, thereby increasing the incidence of smuggling petroleum products across borders.

Benefits of Deregulation

The deregulation of the downstream petroleum sector includes price liberalisation, which will depoliticise the sector by allowing BDCs and OMCs to determine petroleum pricing. It takes away the sole right of the NPA to determine the pricing of petroleum products. Unlike the APPPF's asymmetrical pricing, OMCs will adopt competitive price differentiation, thereby allowing consumers to benefit from the fall in world fuel prices. Moreover, the government will save its administration and management costs, as the role of the NPA will be limited to overseeing the quality of petroleum products rather than regulating the pricing system.

The price deregulation policy took effect on June 16, 2015 with several OMCs announcing their own prices of petroleum products. Total and Shell



both increased prices of most petroleum products by four percent soon after the announcement. Goil, on the other hand, did not adjust its prices. It rather stated that “Goil is happy to announce to all its cherished customers that the price of all petroleum products at its stations remain the same across the country.”

The price deregulation will promote competition among OMCs to make prices of petroleum products cheaper for consumers. Despite upward adjustment in prices of petroleum products of Total and Shell, Goil did not increase its prices, attracting more consumers by offering lower prices. Goil’s strategy also aims to increase market share in the sector and to build brand loyalty for consumers in a bid to remain competitive. In addition, OMCs will improve their efficiency and competitiveness to lower cost of production as well as quality to compete with one another in the petroleum sector.

The petroleum prices have increased twice since the NPA became no longer in charge of pricing petroleum products. Besides the four percent increase in June, the prices were increased by 15 percent in early July. However, OMCs reduced prices by 15 percent in the third week of July and some of them further reduced their prices by two percent the following week in the wake of appreciation of the cedi against the US\$.

Figure 1 shows percentage changes in price of petroleum products since the price deregulation of the downstream petroleum sector:

Senyo Hosi, the Chamber’s Chief Executive Officer, also presented a positive outlook in petroleum sector that the prices will decrease further “so long as the cedi rises and the world market price of refined products reduces.”³ The recent movement of prices of petroleum products is likely to resolve major injustice in the old pricing scheme, as it supports symmetrical pricing which reflects the value of the cedi and world market price.

Importantly, the deregulation of the petroleum sector will eliminate subsidies. This will not only reduce the debt burden in the government but also improve the efficiency in allocation of resources. The government will no longer provide subsidies to the petroleum sector which account for 3.2 percent of GDP but rather reallocate the resources to social welfare projects and programmes, such as education and healthcare to achieve sustainable economic development.⁴

The drawdown on expensive subsidy policy will discourage rent-seeking behaviour and reduce illegal export of petroleum products to Ghana’s neighbouring countries. The end of subsidisation will reduce the price differentials between high-subsidy Ghana and low-subsidy neighbouring countries, lowering the rents from illegal trade. This creates a disincentive for smuggling, and therefore reduces a significant loss of tax revenue to the government.

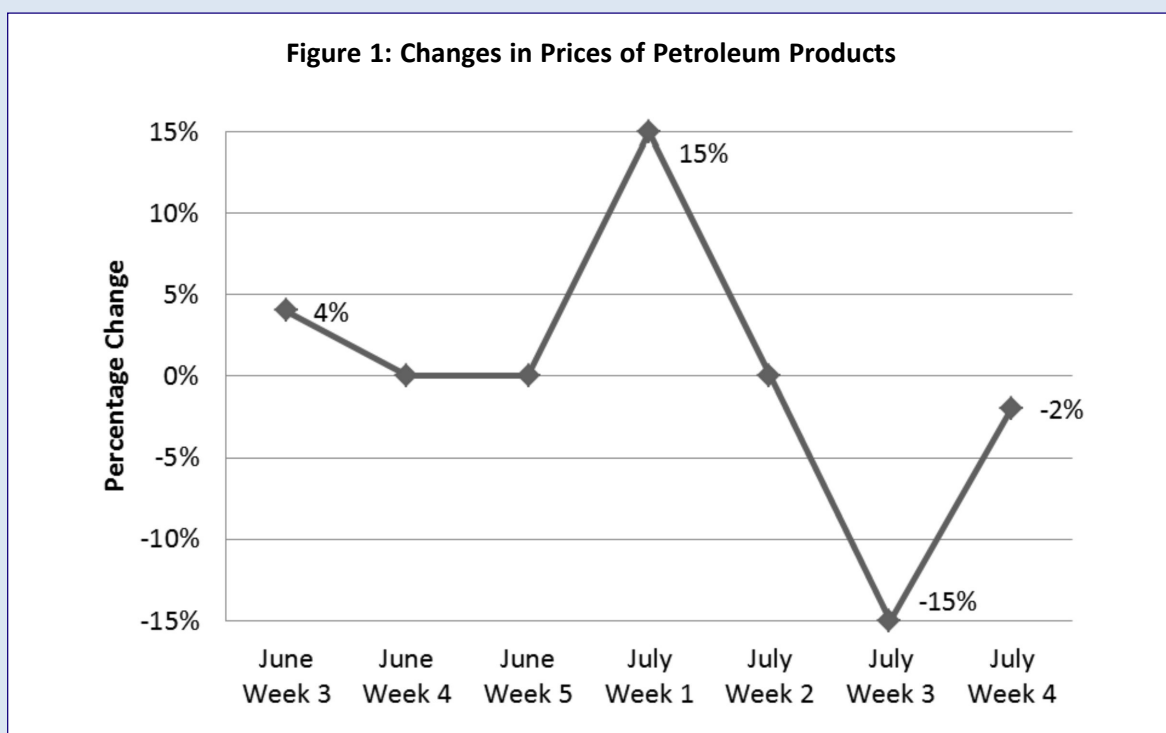


Table 1 summarises the benefits of the deregulation enjoyed by government, OMCs, and consumers:

Table 1: Benefits of Deregulation		
Government	OMCs	Consumers
Saving in administration and management costs of the APPPF	Ability to determine prices of petroleum products	Symmetrical pricing which effectively reflects the value of the cedi and world market price
Improvement in budget deficit	Improvement in efficiency to reduce cost of production in order to remain competitive	Lower prices of petroleum products without affecting the quality
Effective investment in social welfare programmes	Opportunity to increase market share in the petroleum sector	Improvement in socio-economic conditions due to the government's social welfare programmes
Gain of tax revenue loss previously from illegal export of petroleum products		Increase in choices and options

Potential Pitfalls in the Deregulation

Despite the benefits, there is growing concern over the deregulation of the petroleum sector in Ghana, mainly on ineffective competition and negative impact on poverty.

The downstream petroleum sector in Ghana is dominated by three major OMCs, namely Total, Shell, and Goil. Soon after the NPA has transferred its responsibility of pricing petroleum products to OMCs, Total and Shell both increased their prices by four percent, whereas Goil maintained its prices. Moreover, these three dominant OMCs have only lowered 15 percent reduction in the prices in the third week of July, despite 25 percent reduction in oil prices, showing their reluctance to pass benefits on to consumers.⁵ Although it is premature to accuse any OMCs of engaging in collusive behaviour, it is important to note the consequences of this anticompetitive practice.

With the full decision-making power over pricing petroleum products, OMCs in the petroleum sector may form collusion to gain illegal mutual benefits. Motivated by joint-profit maximisation or encouraged to reduce price and revenue instability in the sector, competitors collude on price. Such collusive tendencies eliminate competition, defeating the purpose of the deregulation of the petroleum which aims to promote effective competition among industry

players. Consequently, OMCs do not have incentive to improve their efficiency or to lower cost of production. Lack of competition will raise their profits at the expense of higher prices of the petroleum products to consumers.

In the absence of functional competition policy and law in Ghana, unfortunately, the government does not have legal measures to punish and regulate anticompetitive practices. Although the NPA Act 691 of 2005 has some provisions on fair trade and competition, it is uncertain whether the authority has the institutional capacity to investigate anticompetitive practices and proffer stiff punishments to the violators. The frequent discussions among BDCs and OMCs on price increases and decreases perhaps could be tantamount to the anticompetitive agreement of price-fixing. Therefore, whether the deregulation of the downstream petroleum sector could promote and maintain effective and health competition is highly questionable.

Moreover, the removal of subsidies may result in social and economic repercussions on poor Ghanaians. The UNICEF report suggests that subsidy policy in Ghana primarily benefits the richest households despite its target on the poor. This, however, cannot be translated into the statement that poor households do not benefit from the fuel subsidies.



On the condition that the value of the cedi and world market price remain constant, the complete elimination of the subsidies increases the prices of petroleum products, imposing both direct and indirect effects on household welfare. The direct effect includes higher spending on petroleum products for daily activities such as cooking and transportation. On the other hand, the indirect effect includes increase in spending due to higher costs of goods and services which use petroleum products as inputs.

According to the UNICEF report, such impact on household welfare affects the poorest quintile the most. These households will experience a 2.1 percent decline in their total consumption, whereas the other segments of society see between 1.56 percent and 1.86 percent decline. Moreover, poverty rate in Ghana will rise by 1.5 percent. This means that 395,180 people will fall into poverty trap as a result of the removal of subsidies.

Effective Regulatory Regime, Role of Consumers and Alternative to Subsidies

In order to prevent ineffective competition in the petroleum sector, the NPA must not assume that self-regulation by the BDCs and OMCs would be optimal especially on issues relating to pricing. The Ghana CBOD recently launched a new petroleum pricing formula⁶ to regulate price-fixing practices on July 15, 2015. The formula

ought to be interrogated based on international best practices and each variable in it should be made known public to help consumers understand price trends and how petroleum prices work.

The role of consumers is critical to the price deregulation of the downstream petroleum sector. With the information they gain from the new petroleum pricing formula and the detailed components of the formula, consumers need to make educated decisions and demand more from OMCs. Their active involvement will push OMCs to negotiate better with BDCs for lower prices and pass those on to the consumers directly, thereby protecting the interests of the consumers.

In addition, the NPA could oversee the prices set by OMCs and regulate anticompetitive price fixing behaviour. In the meanwhile, the government should start drafting antitrust law by studying its application in the world in a bid to prevent and manage anticompetitive practices that defy effective and healthy competition, protecting the interests of consumers and promoting efficiency and innovation within the sector.

Moreover, in response to possible repercussions on the poor Ghanaian, the government could use a proportion of its budgetary savings generated from eliminating subsidies to finance social welfare programmes, such as cash transfer programme – Livelihood Empowerment against Poverty (LEAP) to mitigate the impact of the removal of subsidies.



The government also will end its subsidy policy as a result of the deregulation, significantly improving its budget deficit. In addition, it will discourage rent-seeking behaviour and reduce the incidence of illegal export of petroleum products to its neighbouring countries. The budgetary savings and tax revenue gained from ending subsidy and reducing smuggling could be used for productive investments and projects that promote socio-economic development in the country, further benefiting consumers.

Conclusion

Followed by the government's announcement to transfer NPA's responsibility of pricing petroleum products to OMCs, major OMCs adjusted their prices, taking the value of the cedi and world market price into account. The introduction of the new pricing formula brings symmetrical pricing of petroleum products, allowing consumers to benefit from appreciation of the cedi or the fall in world market price. Moreover, the price deregulation of the downstream petroleum sector promotes competition, providing lower prices to consumers without affecting the quality.

To fully address the benefits of the deregulation of the petroleum sector, the government, however, must have an effective regulatory regime to prevent anticompetitive practices which defeat healthy competition. This calls for the passage of competition policy and law as well as the subsequent establishment of the Competition Authority. Consumers must use information on price trends and how pricing of petroleum products work to protect their interests by demanding OMCs to pass lower prices on to them directly.

Endnotes

- 1 Please refer UNICEF Ghana for its Working Paper 2014-02: Estimating the impact on poverty of Ghana's fuel subsidy reform and a mitigating response
- 2 *Ibid*
- 3 The detailed interview with Senyo Hosi is available at: <http://citifmonline.com/2015/07/13/fuel-prices-to-go-down-15-this-week/>
- 4 The African Development Bank Group's article on *Fuel subsidies in Africa* is available at: <http://www.afdb.org/en/blogs/afdb-championing-inclusive-growth-across-africa/post/fuel-subsidies-in-africa-8812/>
- 5 The article on OMCs' reluctance to reduce prices further is available at: <http://citifmonline.com/2015/07/17/bdcs-to-omcs-dramatically-reduce-prices-of-fuel-to-reflect-change/>
- 6 The CBOD Price Indicators include the Ex-Refinery Price Indicator (XPi), Oil Transfers Index (OTi) and Fuel Forex Rate (FuFeX30), which will be duly complied with by the OMCs. The detailed information on the new pricing formula is available at: <http://graphic.com.gh/news/general-news/46277-formula-to-regulate-petroleum-pricing-launched.html>

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