EXECUTIVE BOARD MEETING

SM/15/109
Correction 2

June 10, 2015

To: Members of the Executive Board

From: The Secretary

Subject: **Zambia—Selected Issues**

Board Action:	The attached correction to SM/15/109 (5/7/15) has been provided by the staff:
Typographical Errors	**Page 24**
Questions:	Mr. Tsikata, AFR (ext. 39601) Mr. Jang, AFR (ext. 34169) Mr. Rosales, AFR (ext. 38688)

PRICING OF PETROLEUM PRODUCTS IN ZAMBIA[1]

A. Introduction

1. **Zambia imports all of its petroleum products.** The bulk of fuel imports have traditionally been piped from the port of Dar-es-Salaam to the Indeni refinery in Ndola using the 1,710 km Tazama pipeline. These imports are in the form of spiked petroleum feedstock,[2] which is refined at Indeni to obtain the final market mix. Due to capacity constraints of the pipeline and refinery, refined products are also imported directly by road, with such imports now accounting for about half of the total.[3] All procurement is handled by government and both the ~~Tazara~~ Tazama pipeline and the Indeni refinery are fully government-owned.

2. **Using the cost plus pricing (CPP) model employed by the Energy Regulation Board (ERB), this paper evaluates the extent to which retail fuel prices in Zambia have reflected the full cost.** The analysis is based on data covering the volume and price of 35 cargos of petroleum feedstock delivered between January 2010 and March 2015.

B. Pricing Mechanism

3. **The CPP model has been in effect since January 2008 and operates on the principle that the final local currency price of petroleum products should cover all costs in the supply chain plus a fair profit margin.** The model involves two stages in the price buildup—wholesale and retail—each covering different costs incurred in the supply chain (Tables 1 and 2). As the margins at the different stages of the price buildup are largely fixed, changes in the overall cost are mainly determined by two variables: the international oil price and the exchange rate of the Zambian kwacha.

4. **The CPP model is applied to each shipment of petroleum feedstock going to the Indeni refinery with a view to determining the cost-reflective final sale price**. Direct imports of finished products have not been reflected in the model, a potentially important source of error in establishing the overall cost-reflective price given the growing role of such imports. The ERB employs a trigger band of 2.5 percent for price reviews. This means that, in principle, the retail fuel price should be adjusted whenever the computed change is beyond the trigger band.

[1] Prepared by Grivas Chiyaba and Tobias Rasmussen.

[2] A blend of crude oil, condensate, naphtha, and gasoil (diesel).

[3] The Tazama pipeline and Indeni refinery date back to the late 1960s and early 1970s and are near the end of their lifespans.