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Irrational Regulation of Fuel

Solidarity Research Institute

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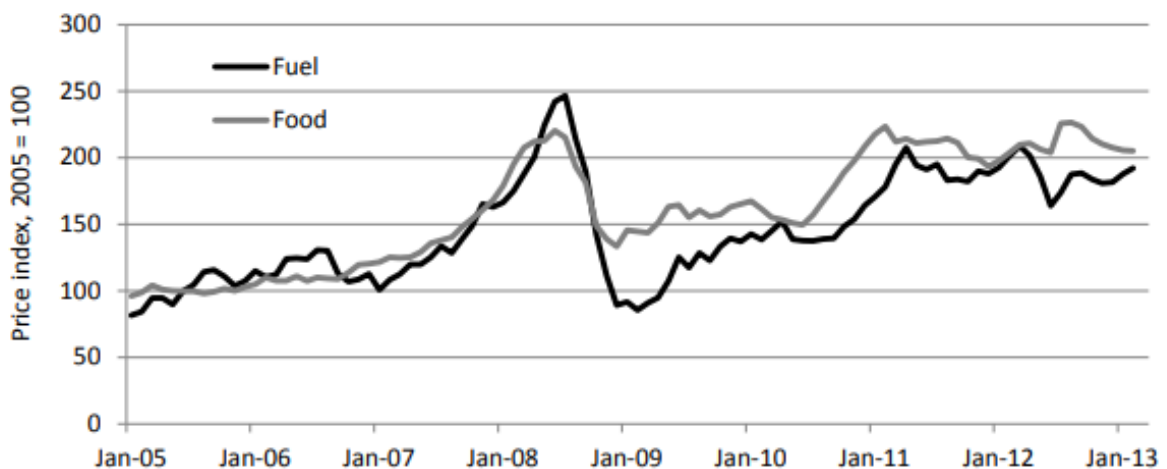
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1. Introduction

Almost all people are dependent on fuel, with our members, as they are generally in employment, being especially dependent for all their transport needs, such as getting to and from work. Everyone is indirectly impacted by the fuel price, as all goods that need to be transported rely on lower fuel prices to keep transport costs down. For this reason, although fuel is a relatively small part of the CPI basket, it impacts almost every other item.

This is clearly illustrated by research done by the World Bank, and portrayed in the following graph:

Figure 1: Monthly indices for fuel and food prices since 2005 in low- and middle-income countries



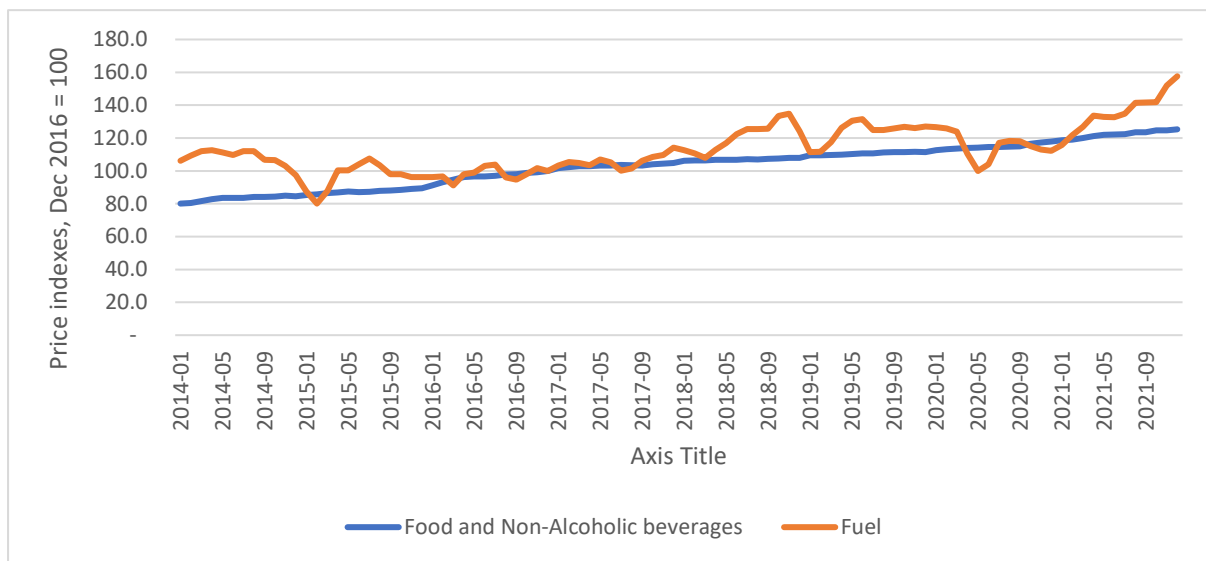
Sources: World Bank 2013.

The following graph indicates fuel price indexes compared to food price indexes in South Africa. As in the previous graph, there is a clear correlation between fuel



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prices, which serve as a leading indicator for food prices in subsequent months. As an example, fuel prices started to rise excessively in 2021, after which food price inflation also increased rapidly. Year on year CPI inflation for fuel currently stands at 40.5% for December 2021, the most recent publication.



Source: StatsSA

Currently, the wholesale price at which fuel is imported makes up just over half of the petrol price. The rest is made up of taxes, transport costs and profit for the relevant stakeholders. About 20% accounts for costs and profits on the wholesale, transport, and retail levels. Larger retailers may be willing to accept much less profit than the current R2.28.8 that the state forces them to take. Where wholesalers sell on the retail level, it may be even less. The same applies to wholesale margins and transport costs, currently 45.5c and 64.9c.



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The average South African would benefit greatly from competition in the fuel market. In order to prove this, as well as the irrationality of continuing regulation in any form, a comparison is made between petrol and diesel, other research on the topic is discussed and comparisons to other countries are made in this report.

It has been noted by many South Africans, even in parliament,¹ that fuel prices in neighbouring countries are lower than in South Africa, despite these countries importing fuel from South Africa. This also proves the inefficacy of South Africa's regulatory and tax regimes.

2. The State of South Africa's Economy

The South African economy has been terribly impacted by the ongoing Covid-19 pandemic. Due to disappointing economic growth, South Africa has also not yet recovered from the losses incurred by the pandemic. This is reflected in excessively high levels of poverty and unemployment, for which the general public bears the brunt.

Between 2011Q2 and 2021Q2, South Africa was only able to attain a miserly 0.3% average quarterly growth rate. Between 2016Q2 and 2021Q2, this went down further to an utterly pathetic 0.2%.² This means that South Africa's growth rate is not only extremely slow, but it is also slowing further.

¹ <https://pmg.org.za/committee-meeting/16154/>

² Measured in terms of market prices in series data at 2015 constant prices, quarter-to-quarter, and seasonally adjusted. Data taken from Statistics South Africa.



Unemployment rates in South Africa has become even higher, and currently stands at an all-time high of 34.4% in 2021Q2. This follows an 8.8% increase in unemployment from the same quarter in 2011, when unemployment stood at an already alarming 25.6%. If the expanded definition of unemployment is used, the unemployment rate currently stands at 44.4%.

Consumer Price Inflation for December 2021, the most recent rate at the time of writing, stands at 5.9%. The largest year-on-year price increase for any item included in the CPI basket is fuel price inflation, which stands at 40.5%.

3. History of Price Controls in South Africa

Although price controls in South Africa are mainly a thing of the past, these controls in themselves are nothing new. Neither are warnings about their inefficacy and their tendency to actually worsen the problems that they are meant to address. During the pandemic, price controls were suggested once again, specifically for items related to combating the disease. This was not implemented, however, for good reason.

Prof. Willem Boshoff from the Centre for Competition Law and Economics writes of such controls that they simply do not work. He cites Adam Smith, the father of modern economics, who pointed out that “price controls are likely to maintain demand at levels which supply cannot meet...”



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Put differently, prices regulate demand and supply, resulting in smaller shortages.”³ Smith came to this conclusion almost 300 years ago, and is yet to be proven wrong. Prof. Boshoff comes to the conclusion that “longer term constraints on price increases will not help consumers or alleviate shortages.” If they do not help consumers, we must ask ourselves why any price controls are ever put in place.

The 1998 White Paper on Energy Policy⁴ states that “Government policy is to remove distortions and encourage energy prices to be as cost-reflective as possible.” The same policy paper states that “Price control will be removed... Import and export control will be phased out although quality standards will be compulsory.”

Section 7.4.9 reads as follows:

Price control is based on import parity pricing (in-bond landed cost) at the refinery gate, with control over the profitability of the wholesale and retail sectors of the industry through the respective wholesale and retail margins. Price control, especially retail price maintenance in respect of petrol, and import control together form the cornerstone of the regulatory dispensation of the liquid fuels industry.

³ <http://www.sun.ac.za/english/Lists/news/DispForm.aspx?ID=7322>

⁴ http://www.energy.gov.za/files/policies/whitepaper_energypolicy_1998.pdf



The government believes that competitive market forces should determine prices.

However, as long as price control is applied the import parity pricing approach will be retained, with suitable improvements if necessary.

Government intends to move away from price control with the achievement of suitable transitional milestones and arrangements. Control of industry margins, at wholesale and retail level will be removed and thereafter will be determined on a competitive and commercial basis.

23 years later, however, stringent price controls are still in place, and the price of liquid fuels, specifically petrol, are at record highs.

The same holds true for the 1998 promise concerning regulated transport costs: "When price control in the liquid fuels industry is removed it will no longer be necessary to continue with the current practice of making reference to a transport cost in the price build-up for certain products. Government will promote competition in the transport of liquid fuels."

In a Master's dissertation by Tawney Lott⁵, it is also noted that the continued regulation of fuel prices causes Sasol to generate excessive profits, or economic

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https://open.uct.ac.za/bitstream/handle/11427/27233/thesis_ebe_2017_lott_tawney%20%281%29.pdf?sequence=1



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rent. This is especially true when international oil prices are at high levels. “The fact that Sasol continues to accept import parity pricing is in line with historical institutional thinking on the difficulties involved in achieving institutional change, particularly when actors have a vested interest in maintaining the status quo,” Lott writes.

The same study also notes that:

Conversely, Marquard (2006: 319) notes that the business caucus was in favour of deregulation. Indeed, ‘...there was an antipathy from the broader business community towards Sasol and the oil companies who were believed to be benefiting unduly from the state’ (Crompton, 1998: 8). While business press targeted criticism at the regulatory system due to the belief that the liquid fuels industry had received extensive support from the state, the synthetic fuels producers were at the centre of this criticism.

The other oil companies capitalised on this opportunity to separate themselves from the synthetic fuels industry and the negative perceptions associated with it. Subsequently, Engen managed to broker an agreement with industry for a process of phased deregulation. Marquard (2006: 320) notes that the objective of the OOCs in this regard was to undermine the dominant position enjoyed by Sasol as a result of the regulatory framework. Indeed, deregulation aligned the OOCs with the business caucus against Sasol and was a safer option as



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there were 'more known parameters' involved in deregulation (Marquard, 2006: 320). As previously mentioned, this division between the synthetic fuel producers and the other oil companies became more prominent as the debate over deregulation continued.

It is therefore evident that continued regulation would further disproportionately benefit the synthetic fuels industry at the cost of traditional liquid fuels, at the cost of the consumer. In effect, government is mandating inflated profits for synthetic fuel manufacturers.

A report by treasury⁶ states that administered prices are instituted for the following reason:

In economic theory, efficient prices are defined as prices that approach marginal cost, which is the level achieved under - perfectly - competitive conditions. Economic regulation is generally introduced when market failures prevent effective competition and is aimed at mimicking the competitive conditions to steer prices towards efficient levels.

The rest of the report makes it clear that this simply is not attained by regulating prices. The report states "[t]hat the current approach to administered pricing is failing to deliver efficient cost-reflective prices - consistent with promoting the Government's social objectives - is widely acknowledged."⁷

⁶ <http://www.treasury.gov.za/publications/other/epir/Summary%20of%20sector%20reports.pdf>

⁷ <http://www.treasury.gov.za/publications/other/epir/Summary%20of%20sector%20reports.pdf>



The report continues elsewhere: “It is easy for ministries to conclude that by intervening in the price-setting/control process they can promote the achievement of key social objectives without incurring any corresponding cost penalty and that this approach therefore offers a virtually cost-free route to pursuing these objectives. This is rarely, if ever, the case.”

Treasury itself thus acknowledges that price controls attain the opposite of what they are meant to attain.

4. Regulation and Deregulation: Petrol and Diesel

Currently, the wholesale import prices between petrol and diesel differ by about 20c, with petrol being slightly more expensive at a cost of R9.03. At the retail level, however, the prices differ quite a lot. In the Pretoria/Centurion area, prices for 50ppm diesel differ from R16.52 to R19.25, whereas 95 Octane petrol is fixed at R19.64.⁸ The disparity in retail diesel prices, when compared to petrol prices is due to competition in the diesel retail market. Consumers’ ability to “shop around” would also be to their benefit if the same price freedom is allowed for petrol. This is acknowledged by the Automobile Association.⁹

⁸ <https://www.appsheets.com/start/835fba25-e650-4739-8068-ce271ff72ce3#appName=PitStops-417487-2&group=%5B%5D&page=fastTable&sort=%5B%7B%22Column%22%3A%22Date%22%2C%22Order%22%3A%22Descending%22%7D%2C%7B%22Column%22%3A%2210ppm%22%2C%22Order%22%3A%22Ascending%22%7D%2C%7B%22Column%22%3A%2250ppm%22%2C%22Order%22%3A%22Ascending%22%7D%5D&table=Diesel&view=Diesel>

⁹ <https://aa.co.za/fuel-price-deregulation-complex-2/>



In a 2007 article by Sartorius, Eitzen and Hart¹⁰, it is found that the quest for affordable or cheaper diesel is more important to customers than loyalty to their favourite fuel station. Even back then, the expectation was that all fuel would be deregulated, and it was recommended that fuel retailers focus on making money on other items besides fuel. One of the hurdles to deregulation that they identified was the completion of the pipeline between Durban and Gauteng. This pipeline has long since been completed, but besides diesel at the retail level, the entire industry is still regulated.

One reason for regulation to remain in place, according to a United Nations University report¹¹, is to maintain prices above market prices, in order to retain foreign investment from multinational fuel companies. This would imply admitting to a conspiracy between companies and the government, against the people of South Africa. No government that is in favour of its citizens could approve of such a price conspiracy.

The report notes that investment has not slowed down in history and that there has been no shortage in buyers for fuel-industry assets in South Africa. "For these reasons, together with the pressing need for lower-cost intermediate inputs such as liquid fuels in the aftermath of the COVID pandemic, deregulation has never been more propitious in the last 30 years than it is in 2020," the report notes.

¹⁰ Sartorius, K. Eitzen, C. Hart, J. *An examination of the variables influencing the Fuel Retail Industry*, Acta Commercii, 218-235, 2007

¹¹ Petrol price Regulation in South Africa



The same holds true for 2021, or any subsequent year.

Said report also notes the following:

There are worrying signs that a practice of regulation by consent has emerged. The reasons for this probably lie in the institutional design of the regulator. The regulator is a politician, the minister of energy, who is both policy-maker and regulator, an undesirable combination by modern standards. The international literature suggests that politicians are susceptible to political pressures that independent regulators are sheltered from.

The South African Petroleum Industry Association also expects imminent deregulation, as their overview page on the fuel price states that:

The DME was also of the view that this review would assist in preparing the sector for eventual deregulation.

The review proposed the use of regulatory accounts to set appropriate margins for retail petrol. From 2004 until 2011, when the regulatory accounting system (RAS) transitional phase commenced, no regulatory system was in place to determine retail petrol wholesale, secondary storage and secondary distribution margins.

For the review, the following principles were accepted as important for the viability of the industry:

- The industry needs a predictable regulatory system to encourage



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investment by existing and new entrants.

- The margin needs to sufficiently reward investment across the value chain.
- Investment returns need to be sustainable.

The above principles must be balanced with the principle of efficient prices for consumers and, through RAS, prices are based on a transparent and defensible methodology.¹²

It is therefore especially worrying that the department of mineral resources and energy recently decided to be less transparent about fuel prices, and that regulation would continue.

5. Fuel Price Regulation in Other Countries

Regulated fuel prices have fallen out of favour internationally, although some countries still set a maximum price. It is noteworthy that most of the countries that still have regulated fuel prices are mostly underdeveloped countries. The same mostly holds true for countries with price ceilings.¹³

¹² <https://www.sapia.org.za/Overview/Fuel-Price>

¹³ <https://www.globalpetrolprices.com/articles/42/>



A simple comparison to Namibia,¹⁴ where consumers pay about R15.56 per liter as opposed to R19.61 (January 2022) here, illustrates the failure of South Africa's price controls and tax regime. Namibia is a fair comparison, as their currency is linked to the Rand, and they receive fuel from South Africa.

A recent example of a country that deregulated fuel prices is India. In the short term, it led to reductions in prices.¹⁵ Even though basic fuel prices continued to drop, this was undone by opportunistic government officials, who introduced new fuel taxes.¹⁶ South Africa's government would need to undertake to not also fall into this trap of undoing a potential engine of economic growth, being low fuel prices.

When New Zealand deregulated their fuel industry in the 1980's, an immediate drop in fuel prices was noted. The real effect of the deregulation, however, only came about in 1998, when a new wholesaler entered the market. This once again led to decreases in prices.¹⁷ Unlike New Zealand's fuel industry, South Africa already has a varied supply, with imports competing with locally manufactured synthetic fuels, such as that produced by Sasol. One could therefore expect to see a much larger immediate drop in prices, which could also be expected to be sustainably lower, especially in urban areas.

¹⁴ https://www.namcor.com.na/wp-content/uploads/2022/01/04c_Fuel-Media-Release_January-2022.pdf

¹⁵ <https://www.gatewayhouse.in/impact-deregulation-of-gas-prices-in-india/>

¹⁶ <https://www.outlookindia.com/website/story/opinion-immorality-of-policymakers-behind-rising-petrol-prices/374571>

¹⁷ https://nzier.org.nz/static/media/filer_public/6d/43/6d4323f0-21e3-4421-9e5f-8de7ab66d59f/nztcwp12.pdf



From all available data, South Africa seems to be mandating excessive fuel prices, at the cost of consumers. Especially in light of the pandemic, countries who are instituting price controls, are rather doing so for the sake of keeping prices at lower levels. France even considered issuing petrol vouchers to lower income households, on top of tax cuts.¹⁸ India also recently announced a reduction in fuel taxes, in order to stimulate their ailing economy.¹⁹

6. Conclusion

It is our firm conviction that the continuation of the regulations in terms of Section 2 (c) of the Petroleum Products Act amounts to irrational and inequitable actions and/or decisions on the part of the minister.

Given the concessions by treasury that the policy of price controls with regard to fuel have failed to achieve their desired goals, the case in favour of a legal challenge in respect of their rationality and legality is further bolstered. It should, moreover, be noted that the most powerful engine for the alleviation of unemployment, which has also seen a rise towards record highs of late, remains economic growth.

¹⁸ <https://www.france24.com/en/europe/20211018-france-eyes-petrol-vouchers-for-low-income-households-to-ease-spike-in-energy-prices>

¹⁹ <https://www.bbc.com/news/business-59129472>



The most direct means of amelioration of poverty and inequality also lies in the reduction of costs which disproportionately affect the poor - and most notoriously - affect the prices of food products within our country. The effect of the maintenance of rigid price controls have been regressive in the South African context and must be addressed in that light.

These negative effects have also been noted by independent researchers, as well as governmental inquiries. The positive effects of deregulation can already be seen in the local diesel market, as well as in local liquid fuel markets across the world.

With most of the world embracing a move towards a freer market, also concerning the price of fuel, in the interest of its citizens, and treasury as well as the department of mineral resources and energy themselves realising it in their own reports, we firmly demand that all liquid fuels should be completely deregulated on the wholesale, transport, and retail levels.



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