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Burundi

Report on the Study on the Pricing Policy and Petroleum Sector Taxation

Preliminary Draft

Analysis of the Conditions Necessary to Improve the Supply of Petroleum Products

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I. Executive Summary

Reform of the Petroleum Pricing Structure and Procedures in Burundi

The extreme price volatility observed in 2008 in the international oil market and the difficulties experienced by the Government of Burundi in passing on increases or reductions in real time in pump prices have continued to cause serious oil supply problems in Burundi. In May 2008, the Ministry responsible for the sector had solicited the World Bank's assistance to help the Government find an economically viable solution to address the country's supply problems and stabilize petroleum product prices, following the recent sharp increase in world prices. The current petroleum product pricing structure had already been revised upward twice by the Government between December 2007 and May 2008. While underscoring the persistent difficulties in this sector, the authorities sought expert technical assistance in this area in order to conduct a study on all aspects of the petroleum sector, the findings of which would allow the Government to adopt appropriate policy measures with a view to stabilizing petroleum product prices and thus helping control the ensuing inflation.

This report provides a comprehensive analysis of Burundi's oil market by examining, *inter alia*, the response of local market forces to the exceptional events of 2008 and, specifically, during the second half. It first reviews the prevailing situation by analyzing the country's system for supplying, storing, and releasing products to the market, which is followed by a detailed assessment of the current pricing process, from their purchase on the international market by importers to their sale on the domestic market. This analysis helped to better identify the strengths and weaknesses of this market and proposes the introduction, in the market, of a number of corrective measures, including an automatic retail price adjustment mechanism, so that they will now be predictable and tolerable for the local market and the economic actors operating therein.

Three consecutive World Bank petroleum sector missions visited Bujumbura from July 20–25, 2008, September 15–19, 2008, and December 7–12, 2008. Ongoing contact was maintained during the periods between each mission with the relevant officials from the Government and the industry operating in the country, in order to work together to achieve the Government's objective. The Government had desired the collaboration and coordination of the World Bank with the Standing Committee on Petroleum Products [*Commission Permanente chargée des produits pétroliers*], which it established in 2008 to help it manage the sector's day-to-day problems, especially those pertaining to prices. Collaboration between the Committee and the World Bank team facilitated the assessment of the inherent causes of the problems encountered and improved identification of the reasons for the tensions that have plagued the market for several months, with a view to working together to find solutions that will ensure a smooth, feasible, and sustainable exit from the crisis.

This task also coincided with the most unstable period in the history of the petroleum industry, with prices doubling between July 2007 and July 2008, peaking at US$147/barrel, then suddenly plummeting during the last few months of the year (US$113/barrel in August, US$100/barrel in September, and US$72/barrel in November), hitting their lowest level since 2005 (US$36/barrel on December 18, 2008), despite OPEC's decision to cut production for a second time. This crisis was preceded by a global economic and financial crisis that weakened the economic and social fabric of all countries, including developed countries. This crisis, as well as the extreme volatility of oil prices, will undoubtedly persist in 2009. These powerful exogenous constraints call for an urgent revision of the current pricing structure and its immediate implementation, while oil prices are still low. This will help better protect the budgetary balance from the negative fiscal impact that any delay would have on State revenues and on consumers. It is imperative that these changes reflect in real time the variations in international prices on the local market. This new structure should be sustained by support measures in the medium and long term, in order to absorb the erratic variations caused by this volatility, and consolidate, stabilize, and better manage supplies to Burundi's market, as well as protect the most vulnerable segments of the population, irrespective of price variations.

The new legal and regulatory framework that will support the reforms that the Government has undertaken and wishes to continue should also adapt to this market volatility, which will eventually resume its upward trend. It is therefore strongly recommended that the Government explain to the public the rationale behind the reforms undertaken before implementation of the automatic price adjustment mechanism while prices are still low. This will facilitate its acceptance by consumers, set the customs and tax revenue levels in a sustainable manner as well as the profit margins for importers and distributors, thus ending the contentious relationship between private operators and the Government.

The immediate benefit of such an approach will also be to send a clear signal to investors that the Burundi market, as is the case with the markets of neighboring countries, is transparent and unmistakably oriented toward economic growth sustained by foreign direct investments (FDIs), with clearly articulated protection of consumer and State revenues, and is especially open and favorable to those investing in the country over the long term.

The proposed reforms should also facilitate the country's accession to the East African Economic Community (EAC), where the markets through which all products imported into Burundi pass are already deregulated, and where competition is developing. This accession to an integrated regional economic system will boost competition in the subregion and undoubtedly benefit Burundi, which is at a disadvantage owing to its geographic location and its landlocked status, and to the small size of its oil market, thus making it totally dependent on imports. These reforms also enhance the security of the country's energy supplies in the medium and long term.

The analysis of the market and the logistical constraints characterizing it advocates the development of the current pricing structure using a “roadmap” that has been proposed to emerge from this crisis. It is subject to review by the main actors in the Government, especially the Ministry of Commerce and the Ministry of Finance, as well as the Office of the Second Vice-President.

- The current pricing formula is too complex and does not encourage importers or distributors to reduce their costs and engage in healthy competition, based on the quality of services they provide. Added to this is the fact that certain costs quoted in percentages (and not in absolute figures) do not encourage operators to make a greater effort in this regard. The reform and simplification of this formula will therefore be a useful component that should be promptly taken into account by policy makers.

- There is no direct and regularly verified correlation between the Platts quotations and FOT prices, which should evolve at the same time, with only shipping differentials and their related costs as the fixed components. This key component of the basic price must be verifiable at all times in the interest of transparency.

- The current formula also requires a compilation of the taxes and markups, also quoted in percentages instead of absolute figures, which have a distortionary, exponential multiplier effect on retail prices when international prices rise. They eat into and reduce State tax revenues and profit margins when prices fall, and perpetuate demands from importers and distributors, unnecessarily causing further harm to their relationship with the Government. This problem can and must be easily and swiftly resolved by replacing them with the taxes and markups proposed in the new formula.

- The formula should be simplified by adopting measures to consolidate its various components, which are not subject to ongoing variations, such as financial costs or insurance. The implementation and monitoring of this formula by all relevant parties (Government, importers, and consumers) would be easier. A simplified formula would help stabilize the market and enhance the predictability of fiscal revenues such as taxes, fees, customs duties, and other charges.

- The same rationale applies to the markups for importers, wholesalers, and retailers, whose activity must reflect the quality of the services remunerated and the efforts made, which will increase according to the volume of FBu/liter sales.

- The formula should have a reasonable range of +/- 5 percent of the variations in the FOT reference price, that is, the one that reflects all of the trade parameters in which neither the importers nor the Government have the

authority to intervene, in perfect correlation with petroleum product prices in the subregion.

- This highly technical pricing formula must be depoliticized; in other words, it must be administered automatically without any direct intervention from the authorities. However, all of its parameters must be subject to ongoing monitoring and verification by specialists from the Ministry of Finance and the Ministry of Commerce, who have been brought together into the joint operational unit and will be trained for these purposes. They should have access to all commercial and financial information used by importers to purchase, stock, and deliver their products to the end consumer.

- The formula must also equitably reflect the true purchase and marketing costs of imported products, which are the responsibility of the operators and which they must be able to pass on to the consumer without engaging in perpetual negotiations. The duly informed joint Finance/Commerce unit should thus be able to conduct the necessary negotiations with the operators, in an environment free of any tension.

- In order to achieve positive results quickly, this permanent unit that was established to monitor and control petroleum product prices must be promptly put in place. Its personnel will have to be trained in the details of international petroleum transactions, have continued access to information (Platts), and engage in regular consultation with their counterparts in the Customs and Tax Directorates in the transit countries in the subregion (Kenya, Tanzania, Uganda, and Rwanda).

- It is for these reasons that the World Bank had proposed a mission, under the PAGE project, for a meeting between a number of Committee members and their Tanzanian and Rwandan counterparts. This mission was expected to facilitate upgrading of their skills to a level comparable with that of the private operators, who are also members of the Committee. As this very useful initiative remains relevant, it can be expanded to include the unit proposed in this report and implemented as soon as possible by the Government, which will acquire an operational and reliable tool for market verification and control.

- Lastly, simplifying the current formula and ensuring that its upgrade is automatic for any variation of around five percent in the FOT price is a matter of urgency. Prices that are still low will facilitate this process at a lower cost to the State and the consumers, while mobilizing the support of the operators who desire increased visibility and stability in the market. This action should be preceded and accompanied by an awareness-building and information campaign for the public and civil society, who will endorse and support this initiative, as was the case in the neighboring countries.

II. Introduction

This report is as comprehensive an analysis as possible of the prevailing situation in Burundi's petroleum product market, in particular its response to the erratic international market forces and the events that made 2008 a special year, and especially during the second half. The report provides a critical assessment of the country's system for supplying, storing, and releasing these products to the market, and an in-depth analysis of the petroleum product pricing system, from their purchase on the international market by importers to their sale on the domestic market. To this end, it identifies the areas where simple yet effective improvements could be made to ensure greater operational efficiency, increased stability in the market, and improved security of supplies. This should protect the country against recurring disruptions in supplies and shortages, which have an extremely damaging effect on the economy and the consumers who always pay the price, the operators who miss out on trade opportunities, and especially the State, which loses tax and quasi-tax revenue, thereby unnecessarily burdening its budget.

In May 2008, the Ministry responsible for the sector had solicited technical assistance from the World Bank to help the Government find an economically viable solution for the country's supply problems, underscoring the fact that Burundi was facing difficulties with respect to the supply and price stabilization of petroleum products because of the sharp rise in world prices for these products. The petroleum product pricing structure had already been revised upward twice since December 2007. These frequent changes in fuel prices have had an impact on the prices of all other basic products…and are the root cause of inflation that is very hard to control. The Government was therefore requesting expert technical assistance in this area in order to conduct a study on all aspects of the petroleum sector in Burundi. The findings of this study would then allow the Government to adopt appropriate policy measures to stabilize petroleum product prices and thus help control inflation.

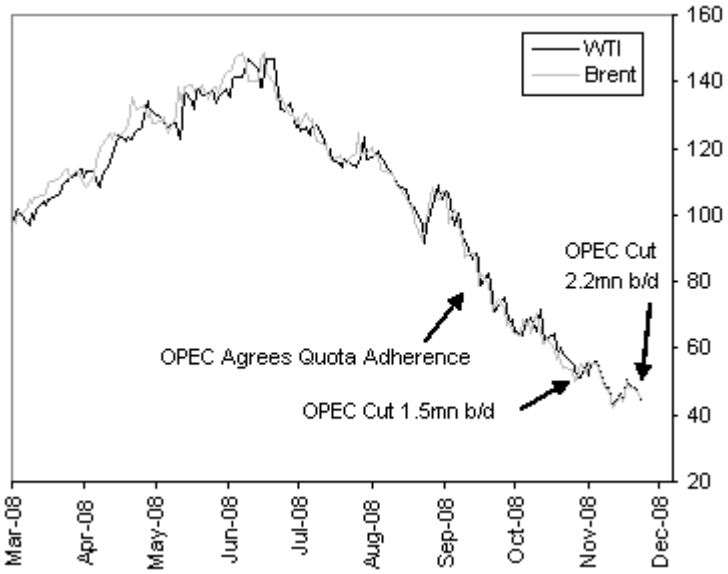
Following this request by the Government, three consecutive World Bank petroleum sector missions led by Mourad Belguedj, energy specialist, and composed of Jean-Pascal Ngessa Nganou, economist responsible for Burundi, and Eric Mabushi, resident economist, visited Bujumbura from July 20–25, September 15–19, and December 7–12, 2008. These missions were also strengthened by maintaining ongoing contact with the relevant officials in the Government and with the industry operating in the country through the Standing Committee on Petroleum Products. This approach, as desired by the Government, facilitated consideration of all the viewpoints and aspects inherent in the problems encountered and the identification of the causes of the situation affecting the country over the past several months, with a view to working together to find solutions for a feasible and sustainable exit from the crisis.

III. Special Circumstances of the Global 2008 Crisis

The importance of this work that coincided with the most unstable period in the history of the petroleum industry, which was triggered by an acute, global financial and economic crisis to which even the most developed countries are vulnerable, bears noting. This crisis had a ripple effect on all economic sectors and especially on petroleum prices, which doubled between July 2007 and July 2008, and then plummeted during the last three months of the year to their lowest level since 2005. Between the first mission in July and the mission in December 2008, petroleum prices peaked at US$147/barrel on July 17, then plunged during the last five months of the year (US$113/barrel in August, US$100/barrel in September, and US$72/barrel in November), finally hitting their lowest level since 2005 (US$36/barrel on December 18, 2008) despite OPEC's decision that same day to reduce production for a second time (see graph on page 7). Owing to this extreme volatility that will undoubtedly continue in 2009, it is important to quickly identify the ways and means of stabilizing the market and implement therein a simplified, more flexible and adapted pricing structure that responds in real time to international market fluctuations over which no State has direct or indirect control. It should also be pointed out that a series of measures proposed in the conclusion of this study will help mitigate, to some extent, the aforementioned erratic variations and help better project and manage the security supply of Burundi's market, whether prices rise or fall. The volatility of the prices between March and December 2008 is well illustrated in the following graph.

Average price variation in 2008

Closing Price of WTI and Brent Crude Oil February 2009 Contract, US$/bbl



Source: Bloomberg

IV. Duration and Format of the Work

The requested work required several on-site missions, half a dozen videoconferences, which were tailored according to the importance and difficulty of the mission, the availability of persons for meetings, and the visits to be carried out at the relevant sites. The objective of the mission was to review, together with the representatives from the public and private sectors and civil society, the prevailing situation in the petroleum sector and the dysfunctions affecting its performance, from the supply of products from the international market to their release on the Burundi market. This report will be sent to the authorities and developed into a final report, once comments and suggestions from the Government have been received. It should finally be submitted to and discussed by the Council of Ministers with a view to its adoption for the implementation of the automatic pricing structure in 2009.

The mission was pleased with the excellent spirit of collaboration displayed by all its interlocutors in Burundi, the quality of the welcome it received everywhere, and the availability and commitment of all parties to the search for sustainable solutions. It was especially pleased with the availability of high-level authorities with whom it had meetings, including the Second Vice-President of Burundi, the Minister of Finance, the Minister of Commerce, and the Minister of Mines. The mission would also like to thank the members of the Standing Committee on Petroleum Products for their availability and for their individual

contributions to a better understanding of the problems and the search for practical and viable solutions to current market constraints.

V. Organization of the Work

The mission met with the main relevant departments of the State, the Ministers of Energy and Finance, the Directorate of Customs, and the Directorate of Taxes, to review together current adjustment mechanisms and their impact on the stability of prices, as well as the effective reflection in real time of their increases or reductions in the domestic market. These consultations helped identify the specific external and internal constraints of Burundi's market and improve the targeting of appropriate measures to ensure its stability. These measures should have an effect on the supplies, costs, and markups for operators, as well as on tax flows that the State is expected to collect from this activity.

The mission also visited the reception, storage, and product transfer facilities of the Petroleum Product Storage Company [*Société d'entreposage des Produits Pétroliers*] (but not those belonging to Gitega), and looked at the ways and means used by the relevant authorities to oversee the quality of the products that are imported and distributed and combat fraud and the adulteration of products provided to consumers. It also ensured that dialogue was established with the private operators, whose involvement in the transparency of the sector's operations is a *sine qua non* for the success of any reform. The preliminary report, which covers the work achieved in great detail, will propose appropriate recommendations for the establishment of an automatic price adjustment structure, thereby helping improve, in a sustainable manner, the stability of the market, the country's supply security, and the quality of the products, with maximum transparency for all market supply stages. The legal and regulatory framework to support these efforts will also be revised and tailored to suit the new environment.

VI. The Work of the Mission

The mission's work covered a number of key areas pertaining to taxation, regulatory aspects, and the pricing structure. The mission also met with officials from SEP of Bujumbura. It visited the facilities at SEP's storage center and reviewed, along with senior officials, the logistical, technical, and maintenance problems, as well as the possibilities for improving storage capacities, and their safety and availability. The good operational performance observed at this center is especially significant because the economic recovery desired in Burundi will lead to increased demand for petroleum products in the country's interior. The upgrading of Gitega's storage capacity, which was also mentioned, should play a key role in this recovery effort. Operational maintenance and safety problems that can affect the performance of this storage center were also discussed. Lastly, the mission held discussions with representatives from the Burundi

Association of Petroleum Companies [*Association des Sociétés Pétrolières du Burundi* ASPB] to assess the country's current storage capacity and jointly examine the ways and means to put all available facilities back into service. The discussions also focused on the technical and commercial aspects, as well as the role and cost of storage under the current pricing structure.

With respect to tax issues, the mission met, on several occasions, with the National Directorate of Taxes and the National Directorate of Customs in order to discuss petroleum taxation. To this end, it requested that the range of all tax revenues from the petroleum sector for fiscal year 2007 and the first half of 2008 be submitted to it as quickly as possible, in order to facilitate an assessment of its effective contribution to the State budget. This will help ensure that the tax gold mine that the sector represents makes its full contribution to the State budget, and that it is in line with the same level of taxation in the subregion.

With regard to the issue of the current pricing structure, which was also discussed at length with the relevant administrations, the mission noted that it did not appropriately reflect each of the different stages of the supply chain. This is manifested in the prices at the pump, which are among the highest in Africa, while giving rise to uncertainties in the local market often characterized by severe shortages, thus prompting the urgent need to address this matter. Consequently, the mission underscored the necessity to:

(a) Intensify efforts to reduce operating expenses, from the purchase of products to their release to the market. Prices at the pump must be adapted to the economic and social situation in the country, while reflecting the constraints of the international market that dictates the purchase and transportation prices of refined products until delivery to their final destination. For example, the FOB/Mediterranean or Arab Gulf references, which were used by the countries in the subregion, as well as the other components of freight calculation, associated costs, and markups that significantly affect this structure, were reviewed and discussed at length with a view to their adaptation to the market situation and the purchasing power of the Burundi consumers;

(b) Upgrade the pricing structure in order to enable importers to cover the marketing costs of products and provide a reasonable markup for distributors and retailers. Taxes and markups should, as is the case elsewhere, be quoted in absolute values and no longer as a percentage of the purchase price, which would eliminate the distortions that affect the viability of the pricing structure in the case of sudden increases or reductions; and

(c) Revise the adjustment frequency of the pricing structure in order to allow for real time reflection of international prices in the local market. It must also allow the Government to better anticipate the level of revenue from the significant tax and quasi-tax gold mine represented by petroleum activity in the mobilization of budget resources. Moreover, possible subsidies for the most

fragile segments of the population should be better targeted and covered in the State budget.

(d) With respect to the legal and regulatory aspects, the mission held in-depth discussions with the various officials it met on the recent decree on the legal and regulatory framework. The aim was first to assess the objectives and expected results of this provision and then determine the implications of its implementation for the various economic actors, and consider an assessment of its impact on the market, including to avoid any disruptions in the supply of petroleum products to the country.

(e) All aspects relating to commissioning standards and verification of compliance with the established rules pertaining to the safety of the Bujumbura and Gitega storage centers, the various service stations, and the distribution points in Bujumbura and in the country's interior must be promptly upgraded. This will help bring all operators in line with the standards in force in the area of health, safety, and the environment, beginning with the placement of a registered trademark name at the front of each station, to display clearly the prices offered at these stations, and ensure compliance of the premises with the safety rules specific to this activity as stipulated in the regulations in force.

VII. Methodology Adopted

The methodology adopted to conduct this mission together with the representatives of the public and private sectors and civil society eventually required three on-site missions and half a dozen videoconferences with the Standing Committee from the World Bank's headquarters. This work was tailored according to the importance and difficulty of each mission, and the availability of persons for meetings and of the documentation required, as well as the visits to be carried out at the sites in question. This report will be developed into a final report following its review by the authorities, with a view to implementation of the automatic price adjustment structure in 2009.

VIII. Analysis of the Burundi Market. Geographic and Logistical Constraints Specific to the Country

Owing to its geographic location, making it one of the world's most landlocked countries at more than 1,000, indeed, 1,200 kilometers from the nearest shipping ports, Burundi is at the tail end of traditional supply networks, namely shipping routes and ports of import. The only entry points for petroleum products into the country are Tanzania and Kenya, or through Uganda via Lake Victoria as well. As a result, retail prices will always and necessarily reflect high marketing costs, related to a long and costly supply chain and complex, cumulative logistical constraints that are often difficult to manage.

Periods of high price volatility on the international market also lead to a greater difference between very high or very low international prices and those that are applied at the same time on the Burundi domestic market. This is attributable to the time required (approximately 45 days from procurement) to transport the petroleum products, from their loading port (in the Mediterranean or the Arab Gulf), through transit countries, to their release on the Burundi market. This difference was particularly stark in August 2008 and in November 2008.

Petroleum taxation is one of the tools for addressing these constraints, and should generally be a market stabilization tool and source of regular and reliable revenue for the State budget. On the surface, it appears that no revenue is derived from this source of taxation in this case, as is the norm in importing countries, in terms of level and adaptability. In fact, it is often used as a "social buffer" by the Government, which must do without a portion of it during periods of sharp price increases, in order to avoid passing the same level of increases on to the consumers and the ensuing inevitable social instability, as was the case in several countries during the summer of 2008. In comparison to other countries in the subregion (Uganda, Rwanda, and Kenya), the contribution of petroleum taxation is not yet within the capacity of the Burundi market and even less so when it is compared to that of countries such as Rwanda and Tanzania, which reformed their petroleum sector long before the recent crisis.

This is why the World Bank, in light of discussions with the Directorate of Taxes and the Standing Committee on Petroleum Products, recommended that a small delegation visit two or three of these neighboring countries to learn about their progress in this area (World Bank would cover delegation costs while private operators would cover their own expenses). This information mission was expected to facilitate a comparison, along with their counterparts in neighboring countries, of the existing operating conditions for their pricing structure, import systems, and pricing adjustments, customs and tax revenue levels, and markups for wholesalers and retailers. Even if it were to be conducted later, this mission would present a unique training opportunity for the Committee members, as well as an opportunity to establish lasting professional links with the other governments and operators in the subregion, which would be extremely

useful during the preparation of Burundi's imminent entry into the EAC. It would also help strengthen the role of taxation in mitigating costs incurred owing to the country's landlocked status.

IX. Institutional and Regulatory Framework and Pricing Policy

It bears noting that, in accordance with the provisions of Decree No. 100/110 of June 25, 2008 regulating the importation and marketing of petroleum products, their prices are administered in Burundi while they are deregulated in most of the neighboring countries. The Government must therefore replace market forces in a bid to mitigate the impact of price variations by managing them directly. This creates tension between the authorities who are eager to control inflation (and who ensure that prices are not excessive for the consumers) and private operators who procure supplies from the international market and want to see retail prices reflect, in real time, their purchase, transportation, storage, and delivery costs. The current pricing structure, despite all efforts by the authorities to engage in negotiations for each major change in international market prices in order to reach a viable solution for all parties involved, has failed to meet reciprocal expectations.

An appropriate upgrading of the pricing structure is required to reflect current and future market realities. This is how clear signals will be sent to consumers to manage their consumption based on costs at the pump (or demand management), and how importers will be better able to project their market needs (supply management), purchase their products with the assurance of reasonable returns on their investments, meet local demand, and increase their market shares there through appropriate and sustainable development investments. The State would be able to better project its customs and tax revenues and include them with greater certainty in its budget, while thus protecting the most vulnerable segments of the population, through targeted, albeit time-bound, subsidies.

The Government would also be able to manage the current and future crises by introducing a simplified, equitable pricing structure that constantly reflects variations in the international market, while protecting the economy against runaway inflation. The support measures that should follow its application in 2009 are also expected to guarantee, in a sustainable manner, the country's supplies through their use by the entire profession, and ensure the stability of retail prices and increased predictability of tax revenues that the Government is expecting to collect from this sector. This will also promote greater transparency with regard to import and markup expenses, as well as storage and delivery costs for importers and distributors.

Various meetings that the mission held with senior officials and members of the Standing Committee on Petroleum Products, as well as visits to the SEP storage center in Bujumbura and the Directorates of Customs and Taxes at the

Ministry of Finance, revealed that although the sector's institutional and legal framework is essentially in place, its strict application nevertheless requires efforts to address its shortcomings, which exacerbate the tensions regularly observed in the market. Its adaptation and monitoring will help improve the ability to address any major crisis and guarantee the country's supplies on better terms and at an affordable price, and will seek to:

(i) increase the security of supplies and control their costs;

(ii) promote competition and transparency in the fuel market in order to increase its availability;

(ii) ensure the collection of levies, and taxes and quasi-taxes at all levels of the fuel distribution and delivery chain;

(iv) improve the quality of fuels and related services, especially with respect to health, safety, and the environment;

(v) introduce a functional and stabilized petroleum product pricing policy that is adapted to the volatility in the market and inform consumers of this policy; and

(vi) introduce an automatic price adjustment mechanism with the support measures necessary to protect the most vulnerable segments of the population. The regulatory framework applied to all economic actors, which is closely monitored by the Government, will establish a solid foundation to stabilize this vital sector of the economy.

X. Analysis of Burundi's Economic Policy with Respect to Supply

The objective and main phases of this study on the Burundi market entailed the analysis of the status quo by reviewing the prevailing situation and conducting an objective analysis of the causes for the destructuring of this market, through direct and constructive dialogue with all parties. The work carried out first entailed obtaining information from the authorities and stakeholders in the supply chain on the actual conditions in which this market operates, in order to better identify the measures that can generate a prompt, significant improvement in the market in the short term. This analysis focused on the areas of contention such as supplies, with a view to improving them by targeting the problems of transparency and competition at each of the operations' crucial stages, from bids for the importation of petroleum products to their delivery for storage and distribution to the end user. The analysis ensured that all operators were fairly and equitably treated under the law, especially with respect to fulfilling their customs and tax and quasi-tax obligations, contributing to the various funds,

and gaining access to basic infrastructure such as storage centers, which must be open to all approved operators, in accordance with clear terms of entry that have been published, posted, and are identical for all parties concerned.

The analysis also ensured that there was greater transparency in the activities of this sector for operators and consumers, with support provided by a direct communication policy targeting the general public. This action must reflect realism, professionalism and continuity in order to ensure that all parties understand the constraints pertaining to the geography of Burundi and the real costs of securing fuel for the country, owing to its distance from traditional supply sources and networks. It must also anticipate events and address them in a preventive, or even predictive manner, instead of in a reactive fashion, which was often the case in the past, especially in light of the recent and unusual volatility of the international market. A tripartite discussion (authorities, operators, and civil society) taking place in the context of a permanent consultation forum is strongly recommended in order to mainstream and depoliticize the adjustments that will be necessary in the future, by involving the media and members of Parliament.

XI. Economic Assessment Relating to the Structure of the Burundi Market

Petroleum products are the main source of commercial energy in Burundi, which imports all of these products to meet its industrial and domestic needs. Owing to the rapid increase in international market prices in 2007 and 2008 and to the accompanying volatility, petroleum product imports absorbed a significant share of the country's foreign exchange earnings and had a negative effect on the economy in general, and on consumers, especially the poorest. The analysis of the current situation, which was at its most dire when prices peaked between July and August 2008 and then tumbled rapidly between October and December to their May 2005 level, revealed one of the structural weaknesses in the current pricing formula, namely its rigidity and lack of flexibility and adaptability to the events of the last few months.

In the current regulatory framework, instead of being passed on within a reasonable time frame to consumers, price increases or reductions prompt long and difficult negotiations between the economic operators and the State. These negotiations result in shortages linked to speculation or protectionism, which does a disservice not only to the operators, but to the consumers and the Government as well.

Within this same framework, operators inform authorities of the component costs at each stage of the process for the importation and release to the market of petroleum products. The latter are verified by the Government, which then establishes an average for each product, which subsequently leads to a ministerial order that sets the prices for an indefinite period. This approach, however, leaves the various actors dissatisfied with each solution and

institutionalizes a market management procedure that is often political in nature. This is not the case with all the other essential products and they are not subject to such levels of tension, especially with such frequency.

In 2008, the State established a tripartite committee, which brought together the Government, the operators, and the consumers, and was responsible for determining the price level that would most accurately reflect market realities. The lack of an agreement between the State and the operators on a price deemed fair to all parties is often the norm. The price that the State and consumers wish to see at the pump would obviously be low and would maintain inflation at tolerable levels in an economy still reeling from the war. The price desired by importers and distributors would be one that reflected all their expenses and charges, as well as a reasonable markup to compensate them for their investments and the risks incurred. Owing to the lack of a formula to which both parties would have agreed beforehand, the contentious situation that has prevailed for several months and done a disservice to all parties will simply persist.

Moreover, the distribution market for petroleum products is a captive market and provides significant growth opportunities for the services sector. It is nonetheless dominated by a number of major stakeholders, because it fails to attract enough medium-sized operators that, owing to their size and quantity, would make it more competitive, increase its stability, and constitute an important growth factor for this market. The pricing policy that the Government wishes to reform should therefore establish a solid commercial base with potential for growth and stability that would be beneficial to all. The report proposes that the Government define an equitable pricing policy that reflects international market variations in real time, while protecting consumers. The report also proposes modifications to the current formula and its transformation into a pricing structure that automatically adapts to short- and medium-term market variations. Lastly, it proposes an adequate adaptation of the legal and regulatory framework to high price levels and the attendant volatility in order to ensure the stability of the domestic market and greater predictability of its behavior, including customs and tax revenue from this important economic activity.

XII. Reform of the Current Pricing Policy and the Need for a Market Observatory

Burundi's current pricing policy, which entails the direct administration of prices by the Government, is not in contravention of the rules of international trade. This direct management is acceptable, provided it meets market conditions from the standpoint of time and rigor, especially through full compliance with the conditions necessary for a regular and predictable adjustment of retail prices. In the recent past and owing to the unusual volatility of the international market, it has been characterized by an approach that is far more "reactive" than

“predictive.” Indeed, prices were revised upward only when price differences between the local market and international markets had become too significant, thus preventing operators from replenishing their stocks at a sales price that differed greatly from its replacement cost. It would definitely have been possible to anticipate these variations, in view of the delay caused by the distance (which is useful in this case) that separates Burundi from the markets where all fuel transactions are conducted. This approach was reflected by two to three price adjustments per year only while market variations could justify more frequent adjustments, which were nevertheless lower and less difficult to be absorbed for the economy and the consumer, regardless of whether there was an increase or decrease.

Moreover, everyone, including the least informed consumers, knows that few governments have any influence over world oil market forces, and truth in pricing is universally accepted around the world, including in the poorest countries. However, one of the fundamental weaknesses of the current direct management system is the lack of access to firsthand market information, which would allow it to obtain, at the same time as the operators, the parameters establishing their cost price, rather than obtaining it from them and having doubts about their accuracy, given the inability to verify them using a different method. This weakness is exacerbated by the lack of information provided to the public in need of reassurance and to whom the Government and operators must speak in one voice.

The other inherent weakness of the current system pertains to the frequent price changes on the domestic market, which, by all appearances, are not consistent with any economic or commercial approach but are based on the Government’s assessment of the domestic market situation and the potential risk of shortages and social tensions. This approach should take into account time periods that are necessary and appropriate for the frequency of each price adjustment, mirroring the true behavior of the market and the stock turnover rate.

Under the recommended approach, domestic prices would vary as often as deemed necessary, closely mirroring fluctuations in the international market. This approach must, in particular, respect the well-known delivery time periods for petroleum products to Bujumbura, which will still be approximately 45 days and reflect the true time difference in the local market relative to the variations in the international market. This would restore confidence in the local market and consumers who would be informed of imminent price variations and would help significantly reduce the extent of each price adjustment, thus rendering futile any attempt at speculation by operators for whom the propensity to stock products in order to sell them at higher prices would be greatly diminished.

XIII. Participatory Approach of Direct Management

The Government has definitely done the right thing by establishing a Standing Committee on Petroleum Products, comprised of Government representatives, private importers, and consumer and civil society representatives as full members. This Standing Committee has met at least once per month since it was first established in 2008 and helps evaluate, by consensus, the average price for each imported product to be recommended to the authorities. If market conditions so dictate, this subsequently results in a recommendation to the supervisory Minister who issues a Ministerial Order for a consumer price adjustment for the entire country, generally at the beginning of the month.

These recommendations are made especially when there are large variations in prices on the international oil market, but they are devoid of a frame of reference such as “Cap and Floor” levels, like, for example, that of a given percentage of price variations in relation to a base price, which would be the triggers.

This approach, though consensual and participatory, has nevertheless shown its limitations during periods of high price volatility and the need to pass these prices on to consumers. International prices remain sensitive to transaction and service-related charges such as maritime transport (large fuel consumer), insurance costs, bank charges, and other financial charges, as well as road and rail transport, in order to respond appropriately to market signals.

It has also at times been a source of contention between the Government on one hand, which is not only concerned about the accuracy of prices, but also about controlling inflation and maintaining social peace, and importers/distributors on the other hand, who incur surcharges that are not always recognized by the Government, which results in a breakdown in relations between them, even on the Standing Committee. This results in the intervention by the supervisory Minister or the President of the Republic, or as a last resort, the hoarding of the products in stock, thus completely invalidating the steps taken toward establishing the Committee and its quasi-public service obligations of fuel importation and distribution. This approach has also served to strongly “politicize” an activity that is first and foremost commercial, and which does not trigger similar reactions for other high consumption products, except when they are subject to unreasonable speculation.

XIV. Logistical and Other Constraints

Logistical and other constraints arising from the geographical location of the country, which is one of the most landlocked in the world, result in a long and therefore costly supply chain, placing the entry points for the country’s borders,

Bujumbura and Gitega, at more than 1,000 kilometers away from the closest maritime entrances, which are the ports of Mombasa in Kenya and Dar Es Salam in Tanzania. Products are transported to Eldoret or Kisumu, then to Kigali and Bujumbura, or even from Dar Es Salam to Gitega. Products are generally transported by road in 30–40 m3 tank trucks, which are the most expensive carriers after the railway (which is not always in operation in Tanzania), or by the pipeline of the Kenya Pipeline Company (KPC), which slowly transports products to Eldoret and then to Kisumu. Burundi therefore finds itself at the end of the traditional supply networks, which are the shipping lanes and ports of import of Tanzania and Kenya, or even through Uganda by Lake Victoria.

As a result, consumer prices must reflect the high purchase and marketing costs arising from a long and costly supply chain and the combined logistical constraints that are often difficult to manage. Petroleum product storage companies like SEP should play the role of physical regulator for fuels, ensuring their constant availability, the sustainability of adequate commercial stocks and security, in order to regulate and stabilize the market, and therefore, prices. Unfortunately they have not been able to fully carry out this task for several reasons, in particular because of the unavailability of adequate operational capacity for storage and transfer. The country's fuel supply is therefore suffering from acute shortages, especially with regard to intermediate infrastructure at security storage centers, which is lacking, not only because of the insufficient capacity of the existing centers, but also because of lax management and regulations that are more suited to the length of the supply chain. These inadequacies also lead to frequent and successive shortages and regular sharp price increases, which slow down the economic recovery underway and damage the country's image as a safe destination for foreign investments.

XV. Legal and Regulatory Framework for Supply Security

Existing Legal Framework. The provisions of Decree No. 100/110 of June 25, 2008 stipulate that the obligatory fuel reserve levels to be maintained for commercial and security stocks are two months of consumption for each type of fuel. The applicable International Energy Agency (IEA) standards stipulate that there should be a minimum of between 90 to 130 days of consumption available at all times (all products combined). This applies especially to industrialized countries, large consumers of energy, which are found at the most extreme latitudes where the calendar effect (especially winter), with its unpredictable needs for domestic and commercial heating, has a major impact on the demand for peak shaving, and hence, on prices. But this reflects above all the difficulties facing domestic demand at all times, and this period corresponds to the lead time needed for purchasing products on the international market and delivering them to the nearest port of discharge, in order to avoid any shortages on the domestic market.

In the case of Burundi, the external constraints are essentially the same as those of Kenya or Tanzania, but there are additional constraints relating to port congestion at Mombassa and more so at Dar Es Salam. There, the ship unloading time often exceeds seven days and the waiting time for loading trucks at the depots in Dar Es Salam is often just as long—between two to eight days at the depots of Kisumu and Eldoret in Kenya, at the end of the KPC pipeline. A minimum of 15 to 20 days must therefore be added for transporting products to the SEP depots in Bujumbura and releasing them to the market in the capital and the interior of the country, which is even more landlocked. This time component is very important and must be taken into consideration in the proposed new pricing structure equation.

In addition, the lack of substantial security stocks that would allow for an appropriate response to the above situation creates constant uncertainty and a lack of visibility for the authorities regarding a steady and guaranteed supply for the market for which they are responsible. This insecurity results in real shortages, or even contrived ones on the local market, which causes unexpected consumer price increases, thus generating chronic fears among consumers about market security and stability. These difficulties often translate into a depletion of fuel stocks, the most visible signs of which are the price increases resulting from speculation by suppliers and/or retailers trying to cover their real supply expenses, or perhaps just trying to profit from a purely commercial opportunity.

The authorities recognize the problems associated with fuel importation costs, the intrinsic costs in the logistics chain specific to them, and the maintenance of a comfortable level of security stocks, and have agreed to address this problem in an equitable, structured, and definitive manner. The Standing Committee should also act as the Government's advisor on storage and availability of products, as it does for the evaluation, determination, and setting of fuel prices based on the costs recorded, from their purchase to their release to the market. However this Committee has shown its limitations since, to date, it has not dealt with the issue of storage, which is the main supply market regulation tool. It has also undergone various changes and a number of its members have been replaced, after less than one year of existence during the most difficult and most uncertain period in the history of petroleum. It is therefore expected that this participatory and consultative formula, which has nonetheless proven its worth, will be given special attention by the Government and the possibility of its reform cannot be excluded. In light of the clear interest and role played by the Ministry of Finance and the Ministry of Commerce in the hydrocarbons sector, an interministerial operational unit, comprised of several experts from two ministerial departments, would probably be a (better) additional essential regulatory tool, with the Standing Committee being retained as a forum for consultation and coordination between the public services, operators, and civil society.

XVI. Methodology Used to Analyze the Problems Identified in the Current Pricing Structure

The task undertaken, beginning with the Bank mission in July 2008, entailed the involvement, with the consent of the authorities, of the Standing Committee on Petroleum Products throughout the entire market research and current pricing structure review period. This participatory approach allowed for the sharing of commercial information among all parties and the use of the Committee as a platform for reciprocal information sharing among and training of all its members. This helped ensure the continuation of the effort at direct, citizen participation by the sector's stakeholders, and thus improve their introduction to details on the downstream petroleum industry.

This should also be the case for the aforementioned interministerial unit, which will be responsible for monitoring and coordinating the sector's activities in the future, and which will be addressed below. This effort to provide information and on-the-job training for government officials and economic actors who do not necessarily have the same level of understanding or expertise in the specialized area of hydrocarbon economy has yielded good results after just a few weeks of work. It was necessary to proceed in that manner to eliminate the mutual distrust that existed among the parties, private operators, and the Government, because some had technical market information that they use on a daily basis for their commercial activities, while others did not possess this information, either for lack of trying to obtain or an inability to gain access to it.

It is nevertheless still difficult to accept that the Government should ask the operators that it is supposed to regulate, coordinate, and oversee to provide it with the information that it will use to execute its sovereign duty of setting petroleum products prices. This approach obliges it to adopt legislation arbitrarily from various sources of information that may not be accurate and undermine to some extent its macroeconomic management capacity and credibility. This shortcoming must be addressed through direct access to this information and its availability to the interministerial monitoring unit that is proposed in this report.

At this stage, the urgent need to establish this joint government entity, comprised of high-level officials from the Ministry of Commerce and the Ministry of Finance, especially from the Tax and Customs Directorates, must be emphasized. It should be put into operation quickly to ensure the rigorous monitoring and control of this market by direct and unrestricted access to the information used in the current and future pricing structures, as well as to ensure the compliance of all operators with the provisions of the law, and more particularly, with those of Decree No. 100/110 of June 25, 2008.

The mission also proposed to the Standing Committee that it use the Platts data and other parameters used by operators (including the G.L.I.C. oil

company, which subscribes to it), and which are sent to the Government during price adjustment negotiations. This approach has allowed for the Committee members to be introduced to a database that is accessible and easily verifiable by all, including by crosschecking with similar information and documents available at the World Bank's Oil and Gas Policy Division (COCPO). This has been done regularly since the launch of the first mission, for quotations for imported fuels as well as for the costs of shipping, insurance, bank charges, and other fees. Port fees and other related charges for transfers to Burundi could not be accurately verified, but should be verified by the Committee's Mission of Experts, which is expected to visit Tanzania and Rwanda. Importers have also been asked to compile a number of standard documents, covering "end-to-end" imports to the release to the market, so that the related fees and charges may be verified before the implementation of the new pricing structure in 2009. At this juncture, particular mention must be made of the availability and effective contribution of the Committee and of most of its members who participated in all aspects of the Committee's work, be it during the visits of the three consecutive missions conducted in Burundi or during the six videoconferences held between the Bank's headquarters in Washington and Bujumbura, for which we are grateful. (See details in the annex.)

XVII. Structure of the Burundi Domestic Market

Furthermore, and as is often the case for many landlocked countries in the subregion, the Burundi domestic market is dominated by a few importers and distributors who have a virtual monopoly of the market. As a result, five of the twenty product importing companies also control the largest number of stations (66). The five importers/distributors dominate the market and also have the largest number of points of sale. They are, in order of size: Engen (14), Interpetrol (9), Dalbit Petroleum Burundi (9), Petrobu (6), and G.L.I.C. (5).

This phenomenon is exacerbated by the fact that a large importer and major distributor is also the exclusive manager of the Gitega Storage Center, which makes it a monopoly that is vertically integrated across the entire supply chain. This restricts free competition for the importation and distribution of petroleum products, and limits the prospects for market expansion. It might even be followed by a reduction in product quality because of the dangerous practice of adulteration by consumers or unscrupulous resellers who mix the products of various price groups in order to resell them at a higher price, including at the borders with neighboring countries.

Despite the existence of a basic regulatory framework, the necessary adjustments should be made and ongoing quality control conducted for products put on sale in order to optimize the framework's application on the ground and its adaptation to international market conditions, which the country must face. This

will discourage some operators from hoarding products, in order to drive up prices for their benefit.

This lack of competition, transparency, and quality control or professionalism discourages investors and depreciates the qualitative value of this market, which should nevertheless be easy to regulate using the simple measures that will be proposed in this report. The ASPB, the professional association that is responsible for bringing these companies together in order to defend the profession and normalize relations with the Government, is expected to be a stabilizing factor for the market and should benefit both the profession and consumers. Although already in operation, it rarely or never intervenes in the activities of the production stream, and should therefore be encouraged in this regard.

Based on information received from different sources, including information provided by the authorities and the operators concerned, a number of preliminary conclusions may already be drawn from the analysis conducted herein, namely that:

1. Changes in the prices of liquid fuels, the comparison with import parities, the erratic change in duties and fees, as well as distribution markups for wholesalers and retailers, are characterized by unpredictability and lack of planning, which can only be exacerbated by the extreme volatility of the international oil market in recent months, and which will certainly continue for some time;
2. The duties and fees applicable to fuels also show that there is leeway for their stabilization, and even reductions, especially with regard to the most vulnerable sectors of the population, while stabilizing the revenues of the State;
3. The current market could be better structured with a view to improving the ways and means of importing and marketing products, the level of participation by companies currently operating in the domestic market, their degree of vertical integration, the monopolization of supply and other barriers to entry into the market as well as the legal and regulatory aspects that could affect free competition, especially with regard to the combination of various commercial;
4. The fact that importers are also distributors exacerbates the problems in the event of a crisis and leaves few options and little flexibility for the authorities to handle domestic demand at reasonable prices. This combination of activities must be reexamined in detail;
5. The fact that an importer controls a storage center and is also a distributor creates a vertical integration of the activity, which eliminates any healthy competition, sets a precedent that is contrary to the law, and compromises the market balance even further; and
6. The updating of the term of the contracts for oil companies, the various storage centers, and the distribution centers, as well as the intrinsic

commercial constraints of this activity, should also be examined with greater transparency.

XVIII. Shortcomings of the Current Formula

The analysis of the market and the related logistical constraints leads to an analysis of the current pricing structure and shows that:

- The current pricing formula is too complex and does not encourage importers or distributors to reduce their costs and engage in healthy competition, based on the quality of services they provide, in view of certain costs quoted in percentages and not in absolute figures, which does not encourage them to make a greater effort in this regard. The simplification of this formula will therefore be a useful component that should be taken into account.

- There is no direct and regularly verified correlation between the Platts quotations and FOT prices, which should evolve at the same time, with only shipping differentials and their related costs as the fixed components.

- The current formula also requires a compilation of the taxes and markups, also quoted in percentages instead of absolute figures, which unnecessarily increase retail prices when international prices rise. They reduce State tax revenues and profit margins when prices fall, and perpetuate demands from importers and distributors, needlessly causing further harm to their relationship with the Government.

- It should be simplified by adopting simple measures to consolidate the various components, which are not subject to ongoing variations.

- It would also help stabilize the market and enhance the predictability of fiscal revenues such as taxes, fees, customs duties, and other charges, by setting them in absolute figures and not in percentages. Customs duties should therefore be calculated in absolute figures and not as a percentage of the product price, which increases them when prices rise and decreases them significantly when prices fall.

- This also applies to the markups for importers, wholesalers and retailers, whose activity should reflect a service that is remunerated according to the quality of the services provided, increased based on volume of sales in FBu/liter and not as a percentage of the petroleum price, which becomes cumulative and puts everyone at a disadvantage, because of the illogical and commercially untenable distortions.

- The formula should have a reasonable range of +/- 5 percent of the variations in the FOT reference price, that is, the one that reflects all of the parameters that neither the importers nor the Government have the authority to modify, and which also reflects petroleum product costs in the subregion.

- This highly technical pricing formula must be depoliticized; in other words, it must be administered automatically without any direct intervention from the authorities. However, all of its parameters must be subject to ongoing monitoring and verification by specialists from the Ministry of Finance and the Ministry of Commerce, who have been brought together into the joint operational unit and have access to all information used by importers to purchase and deliver their products to the end user.

- The formula must also equitably reflect the true purchase and marketing costs of imported products, which are the responsibility of the operators and which they must be able to pass on to the consumer without engaging in perpetual negotiations. The duly informed joint Finance/Commerce unit should thus be able to conduct the necessary negotiations with the operators, in an environment free of any tension.

- In order to achieve positive results quickly, this permanent unit that was established to monitor and control petroleum product prices must be promptly put in place. Its personnel will have to be trained in the details of international petroleum transactions, have continued access to information (Platts) and work in coordination with their counterparts in the Customs and Tax Directorates in the transit countries in the subregion (Kenya, Tanzania, Uganda, and Rwanda).

- It is for these reasons that the World Bank had proposed a mission to be covered under the PAGE project for a meeting between a number of Committee members and their Tanzanian and Rwandan counterparts, with a view to upgrading their skills to a level comparable with that of the private operators who are also members of the Committee. This very useful initiative remains relevant and can be expanded to include the unit proposed herein and implemented as soon as possible by the Government, which will acquire an operational and reliable tool for market verification and control.

XIX: Current Pricing Structure and Road Map for its Modification

The current pricing formula, as it appears in the Ministerial Orders, is comprised of 23 elements (in fact, 28 in total). It is available in the annex and is structured as follows:

A. The base reference is the FOT price (charged on freight cars and tank trucks) quoted in US$/liter, itself based on average Platts reference prices for Mediterranean gasoline and Arab Gulf diesel oil, jet A1, and kerosene or lamp oil. It is then evaluated at the exit of the Dar Es Salam, Eldoret, and Mpulungu depots. Importers communicate their delivered price at Bujumbura to the Ministry of Commerce, which determines the most competitive price in order to arrive at the Bujumbura reference point. This price is then converted into FBu at the exchange rate of the Central Bank of Burundi. It would be useful to provide an explanation of the components of the CIF price (cost, insurance, and freight), because they represent an important share of the price of the products delivered. *It is proposed that the quotations for the month preceding the application month (M-1) be used to make automatic changes in the prices before the fifth of the following month.*

B. Ground transportation costs through Kenya or Tanzania, losses from evaporation up to Bujumbura, insurance fees, and bank charges are then added to give the price provided at the entrance of the SEP depot in Bujumbura. The charges for transfer to the SEP depot as well as the customs charges are then added in order to arrive at the cost price. *The basis for setting transportation rates for all products is not clearly defined. It would be useful to set it definitively at US$0.18/liter, which is the current rate in EAC countries, in order to conclude the unending negotiations on this point that nevertheless seems to be agreed upon by all.*

C. *The exchange rate used for the US$/FBu conversion should be the selling rate used by the Central Bank plus the average of the foreign exchange commissions used by the commercial banks.*

D. Evaporation and other losses (or transport leakage) during transfers to SEP, as well as duties and transaction fees are added to the cost price. This includes a set of payments to various funds and other charges to arrive at the total cost that all importers will have to pay before receiving their products. These costs are invoiced by SEP but disputed during negotiations with the operators. *It would be useful to establish an insurance rate of 0.4 percent, which is in keeping with the reality in the market, as well as bank charges amounting to two percent (instead of the current 2.5 percent) and which can be verified upon presentation of the relevant invoices. The tariffs applied by SEP should refer to the Order of the Ministry of Finance that establishes them and it is these tariffs that*

should appear in the pricing structure, with all the others in "Storage and Handling Fees" placed under this single heading.

E. It must be pointed out here that similar information regarding imports through the Gitega depot, which resumed operations in 2008, was not available and was not taken into account in this study. This will certainly lead to distortions in the analysis conducted here because this depot is in operation and should contribute to the general market balance and, above all, to the security of supplies, that is, the composition of reserve stocks and strategic stocks. It also bears noting that the products imported to the Gitega center are subsequently transferred to the SEP center with a view to their release to the market, which creates a double warehousing situation coupled with the fees and related losses from leakage, for which there is no explanation in the established commercial rules for market supply. *This point needs clarification, because a number of importers seem to use it exclusively, which is contrary to the spirit and letter of the law, especially with respect to free competition, and freedom of access and entry to national storage facilities.*

F. Once the products have left the SEP depot, customs duties and the wholesalers' markup (for importers) will be added, followed by the retailers' markup, giving the total price for release to the market.

G. As has been emphasized, the various customs duties and fees used in the structure are established in percentages and not in absolute figures. This has a perverse effect on the pump price, which is reflected in cascading increases when prices rise, while absolute figures would only reflect a service cost, a clear signal to consumers in terms of fiscal discipline and prudent management of resources. *It is important that the customs duties and fees be set using FBu/liter, in order to better predict the contribution of these tax revenues to the State budget, which then would no longer be affected by upward or downward fluctuations in the international price, especially during periods of high volatility.*

H. The same applies for importers, distributors, and resellers' mark-ups, also quoted in percentages and not in absolute figures. *These markups are supposed to reflect the quality of service provided at each stage of the supply chain and should also be set in absolute figures.*

I. The perverse and cumulative effect of this approach for customs duties (and profit margins) is easy to explain, especially during the period under consideration. When the price hit US$150/barrel, and assuming that the taxes and duties were 30 percent, the after-tax price would have been US$195/barrel and would have pointlessly inflated the State's budget, to the detriment of the consumer. In a bid to avoid overburdening the consumer, the State therefore resorted to "trimming" its tax revenues by

subsidizing a number of products. When the price again fell to US$50/barrel, the after-tax price dropped to almost US$65/barrel, which decreased tax revenues by two-thirds of the amount expected from the sector and deprived the Government of revenues that it could have tapped into. An absolute figure, however, would provide greater visibility and stability for the sector's tax revenues and would be in accordance with budget estimates, which would not be impacted by past or future market volatility. On December 19, oil fell to US$34/barrel, that is, below a quarter of its value in July, which gives an idea of the sharp reductions in tax revenues that are tied to the oil price, which would have been quoted in percentages instead of absolute figures in an automatic price adjustment structure.

J. The same rationale is applied to importers' markups for which the fees are in no way related to the market value of the product that has been imported and distributed, rather to the regularity and security of supplies, the security of persons and goods, and the nature of their activity, which reflect a quality of service that is independent of the value of the product sold. This approach also prevents unending negotiations between operators and the Government about import and distribution markups, which give rise to a certain degree of uncertainty about the stability of this market, thus discouraging current and future investors.

K. When the two effects of the percentage increase in taxes and markups are combined, it is the consumer price that increases (or plummets) as in the two cases seen this year. This has an inflationary effect on all users, especially on the transportation of persons and goods, which was witnessed around the world during the last simultaneous surge in oil and basic food prices.

L. The parallel nature of methods and time periods with regard to upward and downward price adjustments must also be taken into account. Price variations on the international market at any given moment will be reflected in the cargo imported approximately 45 days later for the Burundi consumer, because this period corresponds to the time needed to transport cargo to the final point of consumption. *These irreducible times must be observed as prices go up and down, because they are a very stabilizing component of the market, both for operators and consumers. An automatic monthly price adjustment formula will help achieve this goal, by "smoothing out" the excessive monthly variations, using the past bimonthly or even quarterly period as a reference. This will stabilize the market and help restore confidence among the parties and above all among the consumers who will see in this the signals in the international market, both in terms of frequency and scope of their variations in the domestic market.*

M. Public Communication Policy. A proactive and predictive two-way policy for future measures, properly and regularly communicated to the public, will bolster this confidence and help prevent the risks of shortage. An effort to educate and fully inform consumers on a regular basis will help bring the relief that is needed for the proper operation of the market.

It is therefore recommended that a review be conducted of this particular aspect of the pricing structure to give it greater flexibility and visibility with respect to the State, the consumers, and the operators. This is what the automatic price adjustment formula proposes to achieve in 2009.

XX. Recommendation for Improving the Legal and Regulatory Framework

In order to avoid any recurrence of the shortages that hit the country, the existing legal and regulatory framework must be adapted to the overhaul of the sector, in order to ensure its stability and the transparency of operations, and fulfill the necessary conditions for its development.

Approval: In accordance with Decree 2008, petroleum product imports are highly regulated and 15 of the 20 companies operating in Burundi are declared to be importers although in fact this activity is monopolized by three or four operators who meet all the eligibility criteria stipulated in the law. The authorization or approval clearly outlines the 10 minimum conditions that must be met in order to qualify to carry out this activity. *In light of the shortages that affected the country in 2008, it is obvious that the approved companies do not meet ALL the necessary conditions and this situation must be rectified by the relevant authorities in terms of operating licenses, and the observation of health, safety, and environmental regulations.*

Security Stock: A minimum security stock of two months for each type of product imported should be available at all times in order to address any tension in the market and avoid any disruption in supply and shortages for the consumer. The above analysis clearly refers to the IEA standards that recommend between 60 to 120 days' supply of all stocks combined for non-landlocked countries. With regard to Burundi, most importers cannot fulfill the minimum requirements because they do not satisfy all of the quantitative and qualitative criteria stipulated in the previous section. *The authorities estimate national consumption at approximately three million liters per month, which would warrant permanent security stocks of six to 12 million liters to avoid any disruption or tension in the market. The corresponding capacity should therefore be available, accessible, and compulsory for all operators, prorated to their volume during the previous year*.

Storage: Storage, the primary interface between imports upstream and marketing downstream, is the most important function and therefore represents

the essential link to the country's security of supply, the stability of the domestic market, and its self-regulation. It allows for a better understanding, in real time, of the present and future balance between domestic supply and demand. It will allow for accurate predictions of the impact of any tension in the international market, in order to release the volumes of products needed to maintain stability in the market and, if warranted, take the necessary precautionary measures, in the event of an actual crisis. This function is even more vital for a landlocked country like Burundi, because added to the international tension are constraints imposed by distance and the uncertainties related to the phases of unloading at import points, and ground transportation to the country's border, which can only be mitigated by a sizeable volume of commercial and strategic reserves. *Therefore, the storage function must satisfy the criteria set forth in the law, which stipulates, among other things, the opening of the storage facility to ANY approved importer, in accordance with the terms of entry and rules governing transparent and fair pricing for all distributors. SEP, in theory, has a storage capacity of 15 million liters, that is, five months of consumption. In addition, the Gitega depot, whose operational capacity will be established once it has been upgraded, could play a regulatory role, if it were to be opened to other operators apart from Interpetrol, which seems to have exclusive access to it. It is our understanding that a storage center is under construction near the port of Bujumbura, but the information available does not allow for a determination of its capacity. It is expected that its capacity will be greater than that of SEP, thus warranting the harmonization of the regulations and procedures governing access and storage for all importers and all distributors.*

Marketing. Owing to its direct interface with the consumer, this function is also very important and satisfies the criteria pertaining to selection and professionalism, which are highly stringent and verifiable on the ground at any time. This function, whose independence of the other links in the supply chain cannot, in principle, be combined with those of the importer, has clearly shown the limits of its influence upstream, especially during the recent tensions in the Burundi domestic market. *Quality and safety standards in this area merit special attention from the authorities, and the renewal or establishment of an annual license should be speedily implemented by the authorities, at all points of sale clearly identified in the name of the holder of the business operating license or that of the legal entity concerned, beginning in early 2009.*

Combination of activities. This state of affairs is incompatible with the nature and inherent risks of the profession, which requires different skills depending on the type of activity. Several studies have shown that the most serious accidents occur during transportation and distribution, which have the highest number of victims because of the presence of members of the public in the areas where these activities are conducted. *The three functions need to be clearly separated, as very few companies can manage end-to-end activities on a permanent basis. This aspect warrants more in-depth analysis in order to make it*

compliant with the "best practices" in this area, which are in force in the countries of the subregion.

In Burundi there are about twenty duly registered companies that can import petroleum products. Most of them are authorized to import products and/or distribute them. One of them also manages a storage center. *This combination of activities creates vertically integrated de facto monopolies, and weakens the Government's capacity to encourage competition that generates quality service, cost control, and even cost reduction, and provides incentives for investment in production, which improves the country's long-term energy security, without mobilizing public funds*. SEP only provides storage, which is in accordance with the law and is still open to all operators.

XXI. Conclusions and Recommendations

The reform of the pricing structure and procedures in the domestic petroleum sector. The recent extreme price volatility on the international market and the challenges for the Government to pass on these increases or reductions in real time, so that they are reflected in pump prices, by a predictable automatic adjustment that is communicated to the consumer, has continued to cause serious oil supply problems in Burundi.

The aim of the reform undertaken by the World Bank with the country's authorities is to secure and improve the country's oil supply and increase the revenues that the State can obtain from the sector, through greater transparency, equity, and efficiency in its management. The mission recommends that priority be given to the new pricing structure, which would help simplify and operationalize automatic monthly price adjustments that will reflect the variations in the international market in real time. Several efforts were made with the assistance of the World Bank to successfully implement this new structure. Several videoconferences were held in October 2008 with the national committee, which is monitoring the implementation of this reform and conducting the first simulations for the proposed revised pricing structure.

The period November–December 2008 was marked by an artificial shortage of fuel, caused by importers who apparently felt aggrieved by the price reduction announced by the Government on November 6, 2008, which did not reflect their cost price. International prices did in fact fall again in November to a third of their average value for July, the period during which operators had purchased their cargo at the highest price. Demotivated by this measure that did not take into account the period for the delivery, distribution, and sale of their stocks at a price that reflected their real cost price, they refused to make deliveries to the independent distributors, including their own stations.

Upon arrival, the mission of December 10, 2008 discreetly addressed a number of members of this group to propose an immediate and effective

resumption of deliveries. It emphasized primarily that the importation and distribution of petroleum products constituted a public service and that the disagreements with the Government should not be settled at the consumer's expense, but through the recourse established by law, for all corporate citizens. Deliveries resumed immediately.

It also met with the Standing Committee to discuss measures to be adopted for the pending establishment with the authorities of the automatic monthly price adjustment formula, which should put an end to such situations. Simulations will be necessary in order to benefit from this period where prices are still relatively low, to definitively set all the parameters of the new structure and integrate them into the aforementioned monthly adjustment system. This will also put an end to the incessant and unproductive negotiations, sources of ongoing tensions between operators and the State, and all the real or reactive shortages that were noted in 2008.

The formula proposed entailed making improvements while simplifying what already exists, by making a number of modifications that would help:

- Collapse several line items into one, such as unloading fees at storage centers, storage, transfer, and leakage fees, which should all be included under the heading "SEP Fees" and should also apply to the Gitega center, in accordance with the ministerial order establishing and regulating storage; and

- Set customs duties at their current level in FBu/liter and present them in the Budget Law. If there were a significant increase or decrease in petroleum prices during 2009, which cannot be ruled out, they would be subsequently modified. The State would be better able to forecast its customs revenues for budget projections and importers would no longer be able to speculate when clearing their cargo through customs. This would also help combat tax fraud.

- Remove the service charge for non-use and ensure that:

  The warehouse leakage charge that is applied to all importers is revised downward (from 0.5 percent to 0.25 percent), which is the applicable standard for the industry;

  The transaction fee of 17 percent is confirmed by the Budget Law of 2009 and replaced by the VAT at the same tariff, when Burundi rejoins the EAC, which is already the case for the other member countries;

  The contribution to the National Road Fund is increased from 60 to 80 FBu, and is included under the line item Customs Duties and Fees, along with the Strategic Stocks Fund and Administrative Charges, and applied to all operators;

Government Stock Fees that seem minor should be placed under the new line item entitled “storage and handling fees” and applied to the two existing storage centers and to any center at the planning stage or under construction;

Local transportation is revised upward in order to reflect the real fuel prices for the delivery of products to the interior of the country;

The wholesalers’ markup is revised upward to 80 FBu/liter;

The retailers’ markup is set at 48 FBu/liter;

Pump prices for the three products, namely, gasoline, MSP, and diesel oil are kept at the level established by the order of November 6 and the increases, reductions, and changes recommended above, adjusted accordingly, in the structure;

If the average bimonthly FOT price (or quarterly depending on the preference of the authorities) fluctuates between +/- five percent, the pump price should be adjusted accordingly, after adding all the fixed and variable costs as stated above; and

Simulations are done first in order to definitively select the calculation basis that will be used, and once the choice has been made, it should be applied for the year 2009, as soon as it has been discussed and endorsed by the Council of Ministers.

This report summarizes the strengths and weaknesses of the existing institutional, legal, and regulatory framework and proposes solutions and recommendations that are compatible with the current situation on the international market. It was sent to the authorities at end-December 2008 for review and follow-up.

XXII. Annexes

Structure for super gasoline, diesel oil, and petroleum (November 6, 2008)

Proposed Structure

ESTIMATED DEMANDED COST FOR PETROLEUM PRODUCTS – OCTOBER 2008

Platt's Average:	OCTOBER + NOVEMBER				
		CONVERSION FACTORS	0.736	0.859	0.786
			MSP	GO	IK
	DESCRIPTION	UNIT	PRICE	PRICE	PRICE
	Average Platt's FOB	USD/MT	526.09	535.11	627.04
Plus	Freight and Premiun	USD/MT	22.52	60.52	36.94
Plus	Insurance (0.1 % C& F)	USD/MT	0.55	0.60	0.66
Sub- Total	**COST CIF DAR (A+B+C)**	**USD/MT**	**549.16**	**596.23**	**664.64**
	LOCAL COSTS PAYABLE TO OTHER AUTHORITIES				
	Wharfage 1.06 % of CIF + 20 % VAT	USD/MT	6.99	7.58	8.45
	Destination inspection 1.2 % of FOB	USD/MT	6.59	7.15	7.98
	SUMATRA USD 0.25 per MT	USD/MT	0.25	1.25	2.25
	TBS 0.20 % O of C&F	USD/MT	1.10	1.19	1.33
	TBS Application and Testing Fees*	USD/MT	0.37	0.37	0.37
	TIPER fees USD 0.15 per MT	USD/MT	0.15	0.15	0.15
	Transit loss (0.5 % GO, IK & 1 % MSP) CIF	USD/MT	5.49	5.96	6.65
	Demurrage (Estimate)	USD/MT	5.00	6.00	7.00
	Finance Cost (1.5 % CIF)	USD/MT	8.24	8.94	9.97
Sub- Total	**LOCAL COSTS**	**USD/MT**	**34.17**	**38.61**	**44.15**
Sub- Total	**Est. Landed Cost - Dar Es Salaam (CIF + LC)**	**USD/MT**	**583.33**	**634.83**	**708.79**
Sub- Total	**Est. Landed Cost - Dar Es Salaam / M3**		**429.33**	**545.32**	**557.11**
	KPC Charges + Losses		45.00	45.00	45.00
	Gross Margin		40.00	40.00	40.00
	Sale price		514.33	630.32	642.11
	Transport Eldoret / Kisumu to Buja/Gitega		160.00	170.00	170.00
	Landed Cost CIF Bujumbura		674.33	800.32	812.11
			Gasoline	Ago	Kerosene

Customs Duties

CUSTOMS DUTIES AND ASSIMILATED TAXES 2006–2008

		GASOLINE		DIESEL OIL		PETROLEUM	
STRUCTURE	**DATE**	CD	**PUMP PRICE**	CD	**PUMP PRICE**	CD	**PUMP PRICE**
Ministerial Order No. 750/442	May 12,2005	287.48	1100.00	322.90	1150.00	287.69	1100.00
Ministerial Order No. 750/0007	January 4,2006	381.48	1200.00	413.70	1250.00	381.69	1250.00
Ministerial Order No. 750/428	May 12,2005	195.24	1200.00	234.05	1250.00	385.88	1250.00
Ministerial Order No. 750/547	June 1,2006	374.55	1300.00	394.55	1320.00	377.30	1320.00
Ministerial Order No. 750/1142	November 24,2006	394.01	1250.00	394.01	1250.00	413.40	1250.00
Ministerial Order No. 750/358	April 11,2007	400.08	1250.00	400.08	1250.00	351.74	1200.00
Ministerial Order No. 750/420	April 29,2007	401.40	1300.00	401.40	1300.00	316.33	1300.00
Ministerial Order No. 750/599	June 15,2007	335.18	1400.00	365.47	1400.00	285.47	1300.00
Ministerial Order No. 750/708	July 9,2007	335.18	1400.00	365.27	1400.00	286.47	1300.00
Ministerial Order No. 750/10141	December 11,2007	404.80	1600.00	401.31	1600.00	347.23	1580.00
Ministerial Order No. 750/362	April 2,2008	507.50	1860.00	420.00	1820.00	383.90	1730.00
Ministerial Order No. 750/722	July 10,2008	599.70	2030.00	125.97	1950.00	160.13	1920.00
Ministerial Order No. 750/876	August 25,2008	603.39	1990.00	172.30	1770.00	170.34	1740.00
Ministerial Order No. 750/1055	October 10,2008	602.50	1930.00	165.55	1640.00	169.18	1600.00
Ministerial Order No. 750/1165	November 6,2008	606.04	1700.00	297.33	1500.00	191.03	1400.00

By way of example, a simulation of these changes for the three products is attached hereto. In order to “smooth out” the largest variations over a month, this exercise will be repeated when all the Platts quotations for December 2008 are available at the beginning of January, in order to make a suitable recommendation to the Government in early 2009.

1. Pricing structure based on average Platts quotations for November 2008.

STRUCTURE 08-12-11 BM - GOV.xls

2. Average Platts quotations for November 2008.

Platts Moving Average for the Month of November 2008.xls

3. <u>Details of the methodology used to analyze the pricing structure (pg. 23)</u>

This is why 10 meetings have been held since the evaluation mission of July 2008, whether directly at the Bank’s offices in Bujumbura or indirectly by videoconference with the Bank specialist and his colleagues in Washington. This “training” should be supplemented by a four-day working visit (financed by the World Bank’s PAGE Project) to their counterparts in Tanzania and Rwanda, to get on-site progress updates on these two countries, which have totally deregulated their domestic petroleum markets and which are either supplied by the same import chain or are as landlocked as Burundi.

It must also be pointed out that during the videoconference meeting on October 31, 2008, it was decided that the Director-General of SEP should be invited to shed some light on the differences between the storage charges and the transfer fees paid by importers to SEP and the extent to which they are recognized by the State within the pricing structure. Two representatives from the Gitega Petroleum Facility, which is an entry point for cargo arriving from Tanzania, and who participated in this meeting, legally represented Interpetrol, which is registered as an importing company and a distributor. It must be pointed out that the combination of three functions, namely importing, storage, and distribution, is incompatible with the spirit and letter of the law, as stipulated in

Decree No. 100/110 of June 25, 2008. A review should therefore be conducted on the need to treat the storage link in the supply chain as a central and vital element for the security of supplies. This function must therefore be separated from those pertaining to importation upstream and distribution downstream, which creates conflict of interest situations and a *de facto* monopoly, both of which are contrary to the law.

This participatory effort on the part of the Committee has helped minimize to some extent the distrust that existed between the economic operators and the Government. It felt, wrongly or rightly, that the importers and distributors "inflated" their figures somewhat, and without access to economic information that the latter had for their activities, it would have maintained a margin of safety for the figures presented to it. The operators also felt, wrongly or rightly, aggrieved by the Government's reservations about the veracity of the figures and costs they presented, and complained constantly in writing to the Government to denounce its approach and its refusal to take into account their real costs, which according to them reflected the reality in the market that they had to face. This in fact helped perpetuate a virtually permanent conflictive relationship between the State and the operators, which only began to improve somewhat with the participation of all actors in the work of the Committee, where information and working documents were made available to all, therefore becoming easily verifiable and acceptable.

This was especially the case for the cost price of products on the international reference market, published by the Platts Oilgram publication, a reputable organization, and the related freight charges. These "quotations" that provide a daily reflection of typical transactions on all the world's markets were traditionally provided by importers to the other members of the Committee who did not have access to them. Importers who are subscribers use them to place their orders on the international market, but it is still difficult for non-subscribers to gain access to them. Being by definition external to the product delivery system within the country, they have in the past fuelled this justifiable distrust on the part of the Government, which could not verify their content and fairness, because these figures changed on a daily basis, especially during periods of high volatility. This led to unending negotiations on these parameters which are easily verifiable, and this is what has been done by the Bank through these targeted verifications that were shared with the members of the Committee in the learning and participatory process that has characterized all the meetings.

While this effort paid off during the months of price increases on the international market without there being any shortage, this stability collapsed with the price adjustment of November 6, 2008, which led to the crisis that lasted until December 10, 2008.

STRUCTURE FOR SUPER GASOLINE, DIESEL OIL, AND PETROLEUM IMPORTED THROUGH EL DORET AND DAR-ES-SALAAM TO THE GITEGA DEPOT

Components of the structure	Super gasoline	Diesel oil	Petroleum
FOT (US$/l)	0.80011	0.91111	0.88081
Transport (US$/L)	0.160	0.170	0.170
C&F (US$/L)	0.96011	1.08111	1.05081
Exchange rate (FBu/US$)	1,206.2520	1,206.2520	1,206.2520
Cost and transport (in FBu)	1,158.13	1,304.09	1,267.54
Insurance	5.79	6.52	6.34
CIF Bujumbura	1,163.93	1,310.61	1,273.88
Unloading SEP	2.00	2.00	2.00
SEP fees	8.00	8.00	8.00
Transport leakage	3.47	3.91	3.80
Bank charges	22.28	25.09	24.39
Customs duties	238.82	35.67	159.00
Cost price	1,438.50	1,385.28	1,471.07
Warehouse leakage	7.19	6.93	7.36
Transaction fee	270.88	0.30	1.13
National Road Fund	60.00	60.00	-
Strategic Stock Fund	32.88	39.58	9.05
Government Stock Fee	0.21	0.21	0.21
Wholesale markup	71.67	70.10	66.00
Wholesale price	1,881.33	1,562.40	1,554.81
Transport Gitega-Bujumbura	-	30.00	-
Retail markup	48.67	47.60	45.19
Pump price	1,930.00	1,640.00	1,600.00

Done at Bujumbura, October 10, 2008

MINISTRY OF COMMERCE, INDUSTRY
AND TOURISM
/s/
Euphrasie Bigirimana

[STAMP]

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