

Fuel Price Reform in Bolivia

The failure to increase prices for fossil fuels in Bolivia is an important case study of reform strategies for countries with low prices and ad-hoc pricing measures.

Everything that could go wrong, went wrong in the implementation of the price hike in Bolivia in December 2010. This is a classic example for the extreme consequences of ad hoc price setting mechanisms.

Chronology:

- 26 December 2010: Price increase announced by Vice President (Decree 748):
 - Gasoline: From 3.74 Bolivianos (0.53 USD) to 6.47 Bolivianos (0.92 USD): +73%
 - Super gasoline: From 4.79 Bolivianos (0.68 USD) to 7.51 Bolivianos (1.07 USD): +57%.
 - Diesel: From 3.72 Bolivianos (0.53 USD) to 6.80 Bolivianos (0.97 USD): +83%.
 - General announcement of wage increase for state employees and no price increases for electricity, gas and water
- 27, 28 December 2010: Strikes by teachers and bus drivers, also some riots
- 29 December 2010: President Morales announces 20% wage increase for state employees and increase of minimum wages
- 30 December 2010: Country-wide strike action with disturbances
- 31 December 2010: Bolivian President Morales cancels all planned price increases and accompanying measures

Background:

- Bolivia is a net importer of fuels - these imported fuels are sold at subsidized rates in Bolivia
- Fuel prices are regulated by government and were increased only marginally in the recent years (with ad-hoc pricing)
- Significant price differential with neighboring countries (see chart 1 in Annex) results in smuggling
- Oil producers in the country are paid a relatively low income of U.S. \$ 27 per barrel, leading to lower investment and little interest in new development (an increase to 59 dollars a barrel is envisaged). This increase needs to be refinanced.

Initial assessment:

- The increase of prices is an appropriate and necessary step to curb smuggling and to promote investment in the oil industry
- Low, subsidized prices of fossil fuels are an inefficient instrument for poverty reduction because high income increases the consumption of resources. Low prices encourage waste and impede acceptance of alternative energy sources.
- Price increase was inadequately planned, prepared and implemented
- Price increase was poorly communicated and not announced in advance
- Price increase was implemented without the necessary adjustment of the pricing mechanism (regulation) as well as without improved transparency (only one-dimensional step)
- Principles of good governance in relation to price regulation of fossil fuels were ignored, including: *(see table overleaf)*

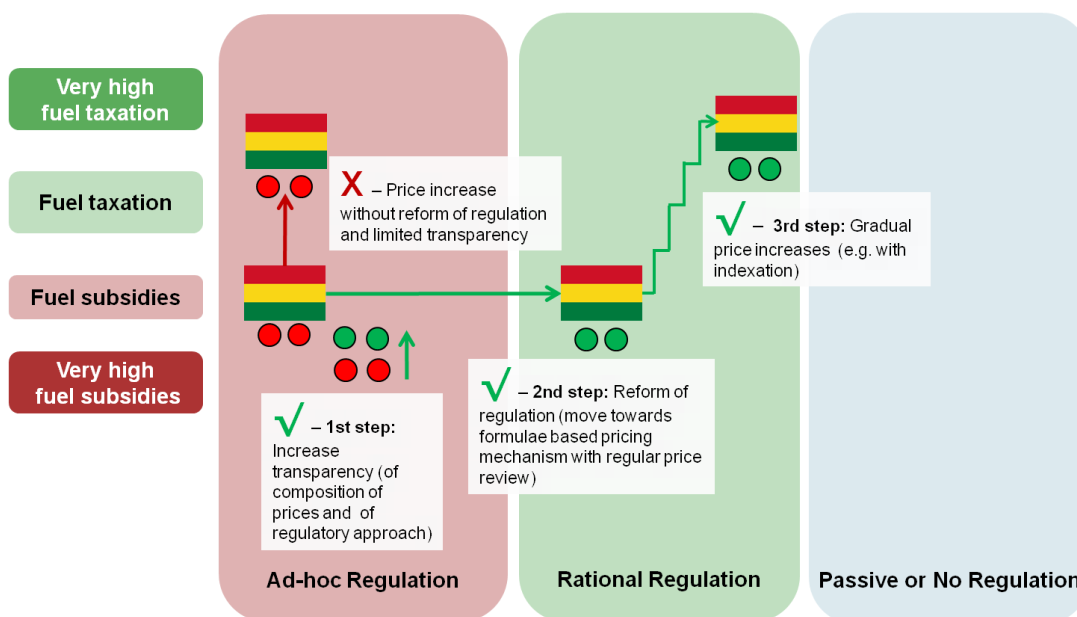
Challenge in Bolivia	Illustration	Positive examples
Amount of price adjustment	Avoid price jumps over 10% per adjustment	
Regulation is not adequate	Bolivia applies ad-hoc price setting, ie prices are set in irregular, rather long intervals. Price increases are therefore hard to sell to the public and difficult to implement / to absorb for companies (eg transport companies). Countries with imperfect markets can take advantage of periodic price adjustments (monthly, weekly) to allow the population to adapt to price changes and to facilitate adaptation steps in the economy.	Ghana, South Africa, Pakistan, etc review prices on a monthly basis, underlying formula or relevant index is public Transition to a new mechanism ideal in times of falling oil prices (cf China, 2009)
Low transparency of price regulation and of price composition	<ul style="list-style-type: none"> • Price components are only partially known (Impuesto específico a los Hidrocarburos y sus Derivados) • Principles of the pricing, involved, parties, etc hardly known • No information / monitoring by government 	Ghana and South Africa publish very detailed information on price components - this is comprehensible and ensures public confidence
High politicization	President and vice president directly involved in discussion of price levels	Pricing should be rational and comprehensible (for example, based on the formula) and monitored by an expert panel
No information on the amount of subsidy per liter	Information on the overall level of subsidies is very abstract and not disaggregated	On the occasion of Earth Day 2010, Brunei Darussalam sold fuel at unsubsidized prices - the amount of subsidy per liter has been made public (see Annex Figure 2). In recent years, Iran has sold per capita a certain amount of fuel (60 liters / month) at very low price, and any purchase above this was sold at four times the price
Inadequate compensation package	The poor benefit only to a limited extent from subsidies, but if subsidies are eliminated the poor are hit hard. The politically significant middle class has to be (at least partially) compensated, to ensure political buy-in. The measures announced by President Morales were not attractive and were not announced in advance and enforced.	Indonesia's last price increase was combined with targeted cash transfers to the poor.

Outlook for Bolivia:

- Failure of price reform is making further attempts of reform in the near future in Bolivia nearly impossible
- The resumption of price increases as announced by President Morales must be prepared very carefully and be coordinated with all relevant stakeholders (transport industry, government officials, other lobby groups)
- Focus on the 3 dimensions: reform of price regulation, increased transparency and gradual price adjustments (see chart below); requires time, at least 2 years

Outlook for the countries with ad-hoc pricing:

- Failure of reform in Bolivia makes price reform more difficult in other countries (fear of decision-makers of similar consequences)
- In countries with ad-hoc pricing reform efforts need to build a long-term (5-10 years) perspective and need to start with comprehensive transparency campaigns. Even if subsidies continue to exist, these countries shall start to introduce regular (monthly) price adjustments.
- In these countries, transparency is the crucial prerequisite for subsequent steps. The timeline must be outlined, including information on:
 1. Provide information, what plans Government has set out and the reasons behind it. There is high probability of implementation for this in MENA region, and low in say Venezuela, because low prices are rooted into the ideological system of the government
 2. Phasing out of subsidies to "201X" and announcing price increase intervals
 3. Introduction of taxation, if necessary with ear-marking



Price-, regulation- and transparency-matrix: The red (X) marked path represents the failed attempt in Bolivia to raise prices without adjustment of the price mechanism and without greater transparency. The green (✓) marked path provides a promising development with 3 dimensions: regulatory reform, increased transparency and gradual price adjustments. This, however, will take longer. (Red / green dots are an indicator of transparency (right dot refers to pricing, left dot refers to price composition))

Sources:

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<http://www.mysanantonio.com/news/article/Bolivia-s-Morales-Fuel-prices-to-rise-someday-931000.php>

<http://www.youtube.com/watch?v=oF3NZ-HtV70> (Video of protests)

Comments and feedback are highly appreciated!

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The GIZ-International Fuel Prices Observatory offers a 2-year international fuel prices survey, detailed information on prices of fossil fuels world-wide (dimensions price level, regulation and transparency) and advisory services on pricing. In addition, the necessary linkages to sustainable mobility and climate change are provided.

More on: www.gtz.de/fuelprices / Armin.Wagner@giz.de

For more information on our work, please visit:

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Annex:

Figure 1: Regional comparison of premium gasoline and diesel prices (November 2010)

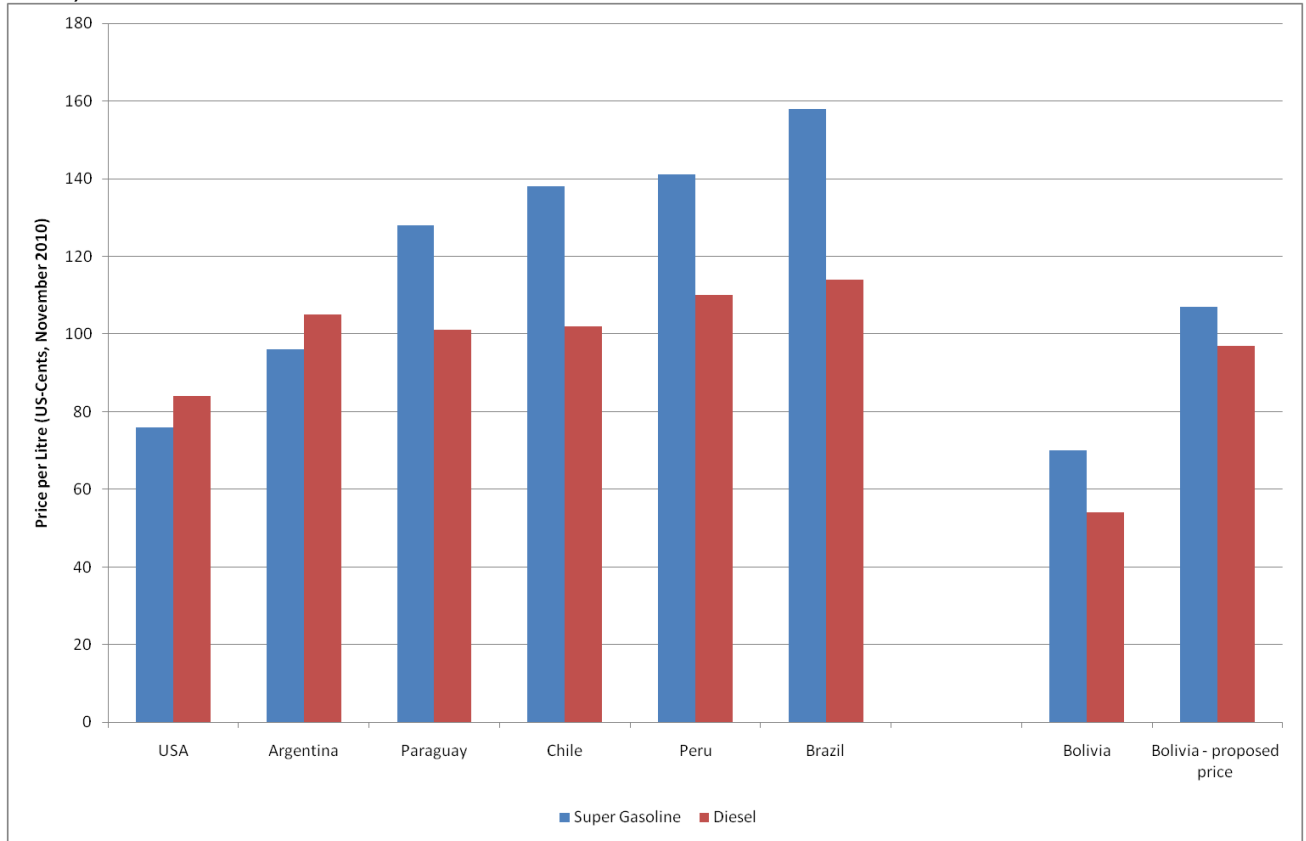


Figure 2: Campaign in Brunei Darussalam – Information on subsidized and un-subsidized prices on Earth Day 2010 (Source: Brunei Post)

