

TERMS OF REFERENCE FOR LECOP PROJECT RESEARCH

ON FUEL SUBSIDIES

1. BACKGROUND INFORMATION, PROBLEM ANALYSIS AND JUSTIFICATION

The Government of the Republic of Zambia recently made a highly contentious decision to remove Fuel subsidies, a development which has been received with mixed reactions. Government has stated that subsidies are unsustainable and a disease burden on the country's Treasury. Present literature from the International Monetary Fund (IMF) backs governments' move. According to the **2013 Energy Subsidy Reform; Lessons and Implication** it has been revealed that subsidies are a problem in practically every country in the world. Based on the same report, it is estimated that, subsidies in 2011 amounted to \$1.9 trillion, the equivalent of about 2½ percent of world GDP, or 8 percent of all government revenues.

According to government, it has already spent over K500 billion in 2013 on fuel subsidies and that the projected cost for the entire year would be K1.1 trillion¹. Among the other reasons, which government has indicated to have necessitated this move was the imbalance and leakage in the trickledown value chain of the subsidy that was being provided. Because of this situation, Government says the poor have been subsidising the rich on fuel pump prices. Government has indicated that it plans to invest the savings accruing from this decision in social programmes such as building health and education facilities, road construction so as to reduce the gap between the rich and the poor. Due to the removal of the subsidies, the cost of petrol has increased by 21 percent to Kr 9.91, diesel to Kr 9.20 and kerosene to Kr 6.83. The proportion of Zambia's population living in multidimensional poverty is currently at 64.2 percent with 68.5 percent living on less than \$1.25 a day.² This might entail that affordability of essential commodities and services consumed by most Zambian citizens is questionable. Government has also indicated that the benefits of the removal of the subsidies will not be felt immediately³.

It is also important to note that the price of crude oil and finished petroleum products have gone down on the international market due to a reduction in demand for these products from the US and China. With supply generally consistent, the reduced demand has pushed the international price lower and has contributed to countries such as South Africa making a decision to reduce local fuel prices at the same time Zambia was increasing hence, different stakeholders among which the Civil Society receiving this development with varied reactions as observed earlier. There are the proponents who strongly support the removal of these subsidies and are calling upon other stakeholders to support the development while citing the need to save funds for re-distribution as a major reason. Secondly, there are also neutralists who argue that the subsidy removal was ill-timed, abrupt and considering the current poverty levels, they are proposing that this subsidy reform path should have been done in a phased manner (after appropriate compensatory measures were put in place). Thirdly, there are also the opponents who are calling for the immediate reversal of this decision while highlighting the fragile economic state of the

¹ 2013_ Speech _Minster of Energy and Water Development _Hon Christopher Yaluma

² 2013 UNDP Human Development Report

³ State to save KR2.3 billion from scrapped subsidies; <http://www.daily-mail.co.zm/state-to-save-kr2-3-billion-from-scrapped-subsidies/>

country and inflationary effects this developed is having on most basic consumer goods and services (which the poor cannot afford) as a major concern.

However, what is clear from these varied positions is the absence of a researched position on the potential impact (both positive or negatives) of this decision on the ordinary people and the economy. Specifically, there has been a paucity of consideration regarding the counterfactuals of phasing or removal of the fuel subsidy. Therefore, research remains a key tool in accurately informing any advocacy position or awareness generation activities.

It is from this context that Consumer Unity and Trust Society (CUTS), Agriculture Consultative Forum (ACF), Economics Association of Zambia (EAZ), and Zambian Voice (ZV) are conducting a research on the removal of fuel subsidies.

2. OVERALL OBJECTIVE

The overall objective of this initiative is to contribute to a deeper understanding of the nature and dynamism of the fuel subsidy removal on the Zambian economy.

3. SPECIFIC OBJECTIVES OF THE RESEARCH

The research will aim;

- To shed light on the impact (POSITIVE or NEGATIVE) of this decision on the aggregate demand (consumption investment, government expenditure and net-export) and aggregate supply side (cost of production etc).
- Further and more specifically, the research will also assess how the removal of fuel subsidy affected the distributional broad-spectrum macroeconomic and microeconomic variables such as National income, Gross Domestic Product (GDP), employment, household income in both agricultural and non-agricultural sectors.

4. RESEARCH QUESTIONS

Below is a list of non-exhaustive research questions;

- What are the resultant consumer and producer welfare gains or losses arising from the removal of the fuel subsidy?
- How will the removal of fuel subsidy affect the distributional broad-spectrum macroeconomic and microeconomic variables such as National income and Gross Domestic Product (GDP)?
- What is the significant relationship between fuel subsidies and employment, household income (especially for the poor community) in both agricultural and non-agricultural sectors?
- Assess whether the sectors prioritized by government for re-investment are growth sectors and will be able to cushion the impact the removal of fuel subsidy on the poor in the medium and long term;

- How government can be encouraged to have clear, long-term, “scheduled” and “gradual” program of fuel subsidy reduction, not the “big-bang” total removal of the fuel subsidy.

5. METHODOLOGY

A precondition for this undertaking is that the consultant will need to make use of both primary and secondary data sources. These should be subjected to quantitative as well as qualitative instruments and methods to address the above questions and to provide solid and credible evidence. The research should not only place emphasis on the generation of knowledge but also on strengthening research (carrying the concerns of the poor) -to-policy linkages.

The consultant must provide the LECOP project team a comprehensive methodology within their application for this consultancy.

6. MANAGEMENT AND TIMEFRAME

This research is to be completed in a period of eight (8) weeks. The researcher is expected to submit a fortnightly report to the project advisory team.