

## **Fifth Roundtable with Local and International NGOs: Petroleum Pricing in Cambodia**

*April 21, 2005*

*IMF Resident Office in Phnom Penh*

A fifth IMF-NGO roundtable was finally held on April 21, 2005 at the IMF Cambodia Resident Office. The discussion centered on the pricing of petroleum products in Cambodia.

The IMF Resident Representative opened the roundtable by noting the importance of the price of energy to economic development, and that the high price of petroleum products in Cambodia compared to prices in neighboring countries reflected a large and higher tax component. At the same time, however, the IMF Resident Representative attributed the rising price of petroleum products in Cambodia during the past two years to the rising price of crude oil in international markets, and not to increased taxes. He stressed that, in fact, the lowering of the administered price on which the Customs and Excise Department (CED) calculates duties and taxes to *below* market prices has represented a reduction in the effective tax rate on petroleum products.

The IMF Resident Representative also acknowledged that the smuggling of petroleum products posed serious problems, including a substantial loss of government revenue. Indeed, he noted that the IMF had recently estimated that over US\$ 60 million of revenue was lost to smuggling in 2003. He acknowledged that the large price difference, partly attributable to higher tax rates on petroleum products in Cambodia contributed to smuggling. He insisted, however, that the IMF was of the view that a substantial reinforcement of anti-smuggling efforts by the Royal Government of Cambodia was needed before consideration could be given to lowering duty and tax rates, lest the government lose yet more revenue. In this regard, the Resident Representative felt it was worth noting that Cambodia has one of the lowest revenue-GDP ratios among comparable and neighboring countries, limiting the government's options for offsetting any potential revenue loss. Indeed, duties and taxes on gasoline and diesel contributed 0.8 and 1.3 percent of GDP, respectively, in 2003. Until effective tax enforcement measures were in place, any reduction in tax on petroleum would severely erode the already very low tax revenue.

The Director of the *Economic Institute of Cambodia* (EIC) presented the institute's research on gasoline taxation. The EIC research highlights that both taxes and distributors' gross profits contribute to the higher price of petroleum products in Cambodia than in neighboring countries. EIC reported that, in 2003, gross profits and taxes represented 13 cents and 23 cents, respectively, in Phnom Penh, compared to 4 cents and 11 cents, respectively, in Bangkok. Although the number of vehicles had increased from 18,000 units in 1994 to 99,000 units in 2003, official gasoline imports declined from 140,000 to 106,000 tons, suggesting a substantial amount of smuggling. The EIC was thus of the view that both taxes and distributor's margins contributed to smuggling, and that policymakers should give serious consideration to lowering taxes as an anti-smuggling measure. Reduced margins could also help, but the government has less direct control over these in the short run.

Having recently undertaken considerable field work in several key provinces, the IMF Multi-Sector Advisor (IMF MSA) provided preliminary pricing data that suggest there may be less scope for lowering petroleum taxes than otherwise believed. Based on his preliminary findings, reducing smuggling through price reductions would not only require elimination of all taxes and duties, but, in addition, either the gross profits margins of petroleum companies would have to fall or the government would have to provide per liter subsidies of around CR 50 (1.25 cents) to CR 100 (2.5 cents). Given the fact that Cambodians living within about 50 kilometers of the Thai or Vietnamese borders were already consuming cheap *smuggled* gasoline priced around CR 2,100 (52.5 cents) per liter, with prices of smuggled gasoline gradually increasing on a gradient to Phnom Penh, he questioned whether tax-induced price reductions would in fact benefit the poor. The main beneficiaries would be (i) Phnom Penh households (only an estimated 5 percent of Phnom Penh residents currently consume smuggled gasoline) whose income levels are 4–5 times higher than those of rural households, and (ii) urban households in general, whose income levels are 2–3 times higher than those of rural households. In addition, he felt there were other possible *short run* negative social impacts, including: (i) reduced accessibility to gasoline for the poor living in rural areas (since small retailers selling smuggled petroleum would no longer operate), and (ii) reduced rural employment and income of small retailers and transporters of smuggled gasoline. For large businesses, reductions in taxes on diesel would be far more beneficial than on gasoline.

The representative from *Center for Social Development* insisted that there were large social costs of smuggling, notably the under-employment of those involved in gasoline and diesel smuggling. He also noted that smuggling activities in general has long-term adverse consequences to the extent that they push Cambodia further into lawlessness. Thus, notwithstanding the possible negative effects on the poor noted by the IMF MSA, the government should take strong measures to reduce smuggling.

The IMF Resident Representative said he fully agreed with the representative from *Center for Social Development*, and reiterated the importance the IMF attached to eliminating smuggling. He also reiterated the IMF's view that vigorous anti-smuggling efforts were needed before any reduction in taxes could be considered.

One participant, noting again the fact that gross distributors' profits in Cambodia were comparatively high, suggested that the government should consider antitrust measures to reduce oligopolistic power of petroleum distributors in the country. He also advocated a government regulation to evenly spread gas station locations throughout the country.

The representative for *Partnership for Development in Kampuchea* asked the IMF Resident Representative how Cambodia could increase government revenues. He responded that there were several ways including: (i) broadening tax base by reducing exemptions; (ii) strengthening enforcement of the current tax system; and (iii) using competitive bidding of all government contracts, especially concessions on historical sites, lands, airports, air traffic control, and telecommunications.