A Strathmore Law Review Initiative: The Legal Implications of the COVID-19 Pandemic

The Effects of the Drop in Global Oil Prices and the Tax Laws (Amendment) Act 2020 in the Wake of the COVID-19 Pandemic

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I. Introduction

Oil is a critical resource in fuelling economic activities globally and a key input in commodity production.\(^1\) It is not unusual for the oil industry to experience volatility in oil prices.\(^2\) Currently, the global oil market is experiencing a plunge in oil prices as a result of the oil price war between Saudi Arabia and Russia.\(^3\) This is expected to keep prices at low levels for producers for the coming months. On 6 March 2020, the oil price war sprang during a meeting with the Organisation of the Petroleum Exporting Countries (OPEC) in Vienna. Russia refused to cut down the amount of oil per barrel it was pumping into the market. This yielded a retaliation from Saudi Arabia which, in turn, hit back with price markdowns to buyers with a guarantee to raise oil production by 25%, a level they have never supplied before. In response, Russia raised its output too and pumped in more oil per barrel.\(^4\)

The trend has since been going back and forth as the two countries continue to flood the international oil market. This comes during the global COVID-19 pandemic which has exerted stress on socioeconomic systems across the world.\(^5\) The oil price war has led to a massive

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oversupply of oil and oil products amidst low market demand caused by the pandemic. Estimates in May 2020 show that global oil demand is lower than that of 2019 by 19.9 million barrels a day.6 The aftermath of the oil price war has been a crash in the global oil prices to levels that have not been experienced in over a decade and an increasing lack of storage capacity.7

In Kenya, petroleum is a dominant source of energy. The government imports petroleum and petroleum products to serve its energy demands.8 The unit cost of imported petroleum is usually calculated using the Open Tender System as prescribed in Regulation 6 of the Energy (Petroleum Pricing) Regulation.9 Kenya, through an Open Tender System, designates the National Oil Corporation of Kenya (NOC) to procure petroleum which it then distributes to the different oil marketing companies who then distribute it to non-franchised petroleum retailers, otherwise known as independents.10

The Kenyan oil market, like many other countries’ markets, has been affected by the oil crisis caused by the price war and the novel coronavirus, COVID-19. The government has implemented different measures to help cushion the citizens against the harsh economic and financial effects of the pandemic.11 One measure that is central to this essay is the Tax Laws (Amendment) Act 2020 which proposes the inclusion of excise duty, fees, and other charges in computing the taxable value of petroleum products, among other changes.12 This discussion focuses on the implementation of these provisions amidst the effects of the drop in global oil prices in Kenya.

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7 Scorched Earth, ‘No one is likely to win the oil price war’ The Economist, 12 March 2020 – <https://www.economist.com/finance-and-economics/2020/03/12/no-one-is-likely-to-win-the-oil-price-war> on 23 April 2020.
II. The Impact of Reduced Global Oil Prices to the Government and Citizens of Kenya

In Kenya, the retail and wholesale prices of oil are regulated by the Energy (Petroleum Pricing) Regulations, 2010.13 The Energy and Petroleum Regulatory Authority (EPRA), guided by the Regulations, undertakes pricing of petroleum products and publishes retail and wholesale maximum prices of super petrol, diesel and kerosene on the 15th day of every month.14 In its pricing press statement issued for the period 15 April to 14 May 2020, it reported that the retail or pump prices of super petrol, diesel, and kerosene had gone down by Sh18, Sh 4.09 and Sh 18.18 per litre respectively.15 Domestic oil prices are determined by many factors, such as levies, taxes, the exchange rate and global oil prices. Wholesale and retail pricing must take into account the transportation cost from Mombasa to the nearest wholesale depot, allowed depot and pipeline losses, wholesale margins and finally, delivery rate from the nearest wholesale depot to a retail dispensing site.16 The decrease in price during the April-May period was attributed to lower average import landing costs,17 with the EPRA Director in General stating that retail prices during this period reflect the global crash in the global oil market.18 This is a clear indication of the effect of reduced global oil prices on the country’s oil prices.

Low global oil prices therefore stand to benefit oil importing countries like Kenya, since import costs decrease and consumers enjoy a relief from high oil prices. When households spend less money on petroleum, there is more money to spend elsewhere thus reducing the pressure caused by high oil prices.19 This may lower the cost of living for consumers of petroleum and petroleum products. Low oil prices can have a ripple effect on industries that utilise petroleum products. For

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17 EPRA, Press release: Maximum wholesale and retail petroleum pump prices in Kenya for the period 15 April to 14 May 2020, 2020, 1.
example, with Kenya mostly depending on subsistence food production, low oil prices can affect food prices primarily through reduced cost of transport.20

However, in the current circumstances, it should be noted that drops in local oil prices may not necessarily lower prices in related industries. Kenyans are not immune to the peculiar set of facts that the COVID-19 pandemic has introduced and its disruptions on supply and demand in certain industries. As the Kenyan Matatu Owners Association stated recently, government measures to minimise infection have cut the daily earnings of matatu owners by half due to requirements of operating at 50 percent of their normal capacity. Due to this, the Association concluded that consumers should not expect that lower oil prices will translate to lower fares.21 Other steps by the government to mitigate the spread of COVID-19 that may impact demand and supply are the Public Order (State Curfew) Order 2020 which imposes a countrywide curfew and containment orders restricting travel in and out of certain counties.22 Notwithstanding this, though lower oil prices may not completely reverse situations like the matatu problem, they may still reduce the costs at which some industries are currently operating.

The current drop in global oil prices can be distinguished from a situation where there is an increase in these prices. An increase in oil prices can raise the prices of goods that immensely depend on oil as an intermediate input since the higher production cost is passed to consumers.23 Higher production costs are an outcome of multiple factors such as increased cost of transportation, manufacturing and agricultural production.24 Higher oil prices may also lower effective household income since they spend more paying for petroleum and petroleum products, leaving less money to cater for other expenditure.

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Overall, the current effects of oil prices to the economy and households cannot be overlooked. With the current drop in global oil prices, policy measures ought to be put in place to ensure both the government and citizens of Kenya benefit.

III. Tax Laws (Amendment) Act 2020 and its Potential Effects on the Kenyan Consumers of Petroleum Products

The Tax (Amendment) Laws comes at an opportune time when the government is looking for ways to reduce the pressure exerted on the economy and the same time cushions Kenyans from the harsh economic effects of COVID-19. The Act 2020 introduces the inclusion of excise duty, fees, and other charges in computing the taxable value of petroleum products. The provisions came into effect on 15 May 2020.

As at the time of writing, one may infer changes in the pricing of petroleum products from EPRA’s May 15 to June 14 press release on maximum petroleum and retail petroleum pump prices.

Beginning with kerosene, since no cargo was offloaded from the Mombasa port during the previous period, no changes in import costs were accounted for and the existing price was maintained. With tax adjustments introduced by the Act, the maximum allowed petroleum pump retail prices for kerosene rose at an average of 2.49 per litre in the 149 towns listed by EPRA in the month May-June. Wholesale prices for kerosene correspondingly rose. For instance, the maximum kerosene wholesale price during the April-May period was 65.97 Kenya shillings per litre in Mombasa and the wholesale price during the May-June period was set at 67.86 Kenya Shillings per litre. It is evident that inclusion of the named charges therefore raised the maximum allowed price of kerosene despite the reduced global oil prices.

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25 Section 33(5) (2a) (b), Tax Laws (Amendment) Act (Act No. 2 of 2020).
26 Section 1, Tax Laws (Amendment) Act (Act No. 2 of 2020).
Contrastingly, the maximum allowable wholesale and retail petroleum prices of super petrol and diesel decreased. The retail price of super petrol decreased by 9.54 Kenya Shillings per litre and that of diesel by a more significant 19.19 Kenya Shillings per litre. This is attributed to the lower average landing cost of super petroleum and diesel imported during the previous period. Even though EPRA also factored in the higher taxable value of diesel and super petroleum, the decrease in import costs caused by the ongoing oil crash, has offset the higher taxes charged on diesel and super petroleum.30

Despite this, it should still be noted that the higher tax still takes away from the savings that consumers of both super petroleum and diesel could have gained from the lower taxable value of the previous regime. This fact, in addition to the higher maximum retail price of kerosene caused by higher taxes, corresponds to early concerns by professional service firms such as Deloitte and Ernst and Young. That is to say, that the tax amendments on petroleum products counter-acts the intended effect of the Act itself: the alleviation of the negative economic effects of the current circumstances.31 Taxes on petroleum products are a critical source of government revenue and an inclusion of excise duty, fees and other charges of petroleum widens the sources of government revenue. However, in the current context, the tax provisions applying to petroleum products have the potential to put more stress on household income given the volatile nature of global oil prices.

IV. Conclusion

From the foregoing discussion, the author proposes that since the government has an edge with the present reduced global oil prices, it should retain the money it gets from the difference in price of the previous oil price per barrel and use it as leverage to boost the economy during COVID-19 pandemic. The author further proposes an exclusion of the added charges and fees on the taxable value of petroleum products which will go a long way in relieving consumers of the higher cost

passed to them while cushioning them against possible increases in oil prices due to the price volatility of oil.32

Low oil prices raise household and corporate real incomes in a manner similar to a tax cut.33 Therefore, since oil is a feedstock for various sectors including transport, manufacturing and agriculture, reduction or omission of the charges and fees on petroleum would benefit such sectors. This may, in the long run, positively impact a wide range of consumers and business owners at different levels and households.

32 Section 33(5) (2a) (b), Tax Laws (Amendment) Act (Act No. 2 of 2020).