Deregulating the Downstream Sector of the Nigerian Petroleum Industry

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Abstract

Nigeria is endowed with abundant natural resources, particularly crude oil and gas. A major feature of the downstream petroleum sector in Nigeria is the dominance of the government in pricing, supply and investment. Nigeria currently relies heavily on the importation of refined petroleum products despite being a major crude oil exporter. Sequel to the fall in domestic output of refined petroleum products, successive Nigerian governments have spent so much yearly in subsidizing the importation of the products for onward sale at lower rates to the Nigerian populace. Considering the huge amounts spent overtime in subsidizing the consumption of petroleum products in Nigeria, the government decided to fully deregulate the retail price of petroleum having removed the subsidies on diesel and kerosene earlier. This paper provides insights into the key issues related to petroleum subsidy reforms in Nigeria. It presents the arguments for the removal of petroleum subsidy and the weaknesses of the current subsidy regime; the likely impacts of the reform measure and arguments canvassed against its withdrawal; possible options for the reform of the petroleum sector; and suggestions for successful implementation of the oil sector deregulation policy.

1.0 Introduction

Nigeria is endowed with abundant natural resources, particularly crude oil and gas. Nigeria is the largest oil producer in Africa and the seventh largest in the world. Its oil reserves are estimated at 36.2 billion barrels (2009 estimates) and with new oil wells being discovered, reserves are expected to increase to about 40 billion barrels. The country’s gas reserves are also estimated to be 187 trillion cubic feet in 2009. At the current extraction rates, it is estimated that proven and probable oil and gas reserves will last for more than 50 years, and probable reserves well above 100 years. In 2009, Nigeria’s total crude oil and condensate production was 780.4 million barrels with a daily average of 2.14 million barrels. Concomitantly, a total of 788,828,760 barrels (2.16 million barrels per day) of crude oil and condensate was lifted for domestic and export purposes (NNPC, 2009).

A major feature of the downstream petroleum sector in Nigeria is the dominance of the government in pricing, supply and investment. Nigeria currently relies heavily on the importation of refined petroleum products despite being a major crude oil exporter. This is due to the inefficiencies in the downstream petroleum sector, as reflected in breakdown and low capacity utilization experienced by the nation's four refineries, price distortions and the accompanying limited incentives to invest in refineries, uncompetitive

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market structure, high distribution costs and rent-seeking behaviour and the associated smuggling and other forms of leakages.

Sequel to the fall in domestic output of refined petroleum products, successive Nigerian governments have spent so much yearly in subsidizing the importation of the products for onward sale at lower rates to the Nigerian populace. In effect, petroleum subsidy has moved from being an implicit subsidy to explicit cost, which has increased significantly over the years, especially with rising share of imports in domestic supply. Considering the huge amounts spent overtime in subsidizing the consumption of petroleum products in Nigeria, the government decided to fully deregulate the retail price of petroleum having removed the subsidies on diesel and kerosene earlier. This would allow the prices of the petroleum products to fully reflect their market conditions, culminating in the deregulation of the downstream oil sector. An attempt in this regard was met with stiff opposition in January 2012.

This analysis aims at providing information on the key issues related to petroleum subsidy reforms in Nigeria. It presents the arguments for the removal of petroleum subsidy and the weaknesses of the current subsidy regime, the likely impacts of the reform measure and arguments canvassed against its withdrawal, possible options for the reform of the petroleum sector, suggestions for successful implementation of the oil sector deregulation policy. Accordingly, this paper provides insights into the following:

- Expected benefits of the proposed petroleum subsidy removal
- Arguments against petroleum subsidy removal
- Challenges to the removal of petroleum subsidy
- Recommendation and suggestions for effective implementation of the full petroleum price subsidy withdrawal policy.

In view of the topical nature of the issue, it is important to provide useful insights for more informed debates and decisions on the issue in the National Assembly. The research largely involved desk study: collection and review of previous studies and reports. The data for this study were derived from secondary sources. The data needs were identified on the basis of the objectives of the study. The data used were obtained from documentary sources such as reports and publications of the Nigeria National Petroleum Corporation (NNPC), publications of the National Bureau of Statistics (NBS) and the Central Bank of Nigeria (CBN). The primary method used to analyze the data collected is descriptive statistical analysis. This involves the computation and utilization of averages, ratios, percentage and average growth rates. The focus was on analysis of levels, trends, and variability of the data of interest to provide insight into their pattern of movement over time. The analysis was supplemented with appropriate pictorial diagrams such as bar charts and line charts.

2.0 Conceptual Framework and Brief Literature Review

A broad range of petroleum pricing policies exist across the world. Three basic forms of such fuel pricing are apparent: ad hoc pricing, formula-based automatic price adjustment, and liberalised markets. In most OECD countries, prices are market determined, though high excise taxes are usually levied on petroleum products. In developing countries that are net importers of oil, prices are in some cases fixed by the government or state-owned enterprises. Retail prices of petroleum products are also usually typically higher than in the absence of any taxes and government intervention. In net oil-exporting developing countries, governments maintain petroleum prices well below the free market level. The potential of liberalised systems lies in the high degree of depoliticization of prices and the elimination of direct budgetary impacts. Regardless of the question of price adjustment, the basic requirements for pricing still
apply, such as real pricing (i.e. covering purchase costs), a contribution to road maintenance and (at least partial) reflection of external costs (resulting from accidents, emissions etc).

Government control of the domestic prices of petroleum products is a common feature in developing countries. In some cases, governments directly control import levels, domestic distribution, and domestic prices. In other cases, the private sector can freely import and distribute petroleum products, but governments set domestic price ceilings and compensate private sector distributors to cover ensuing losses. It is also common for prices to be set by a formula that anchors domestic prices to import prices, with adjustments for distribution margins and domestic taxes. These pricing formulas may be implemented by either government-controlled or independent pricing boards. In order to avoid sharp and frequent changes in domestic prices, automatic formulas typically use an average of past world prices and trigger changes in domestic prices once the average change in world prices exceeds a certain range. These formulas often also include an element of taxation.

Governments that directly control petroleum product prices often impose price subsidies that keep domestic prices below border prices. This is particularly the case when international fuel prices increase sharply and governments are reluctant to pass these increases fully on to the domestic prices of petroleum products. Since petroleum products are internationally traded, the domestic supply cost is the international price, adjusted for transportation, and domestic distribution and marketing costs. The size of the subsidy is calculated as the difference between the supply cost and domestic retail price.

Whether or not the full consumer subsidy is reflected in the government budget (i.e., as an on-budget fiscal cost) will depend on the market structure of the petroleum sector and the government financing strategy. If a public sector firm is responsible for importing fuel, subsidy will be made explicit in the government budget if the government makes an explicit transfer to the public sector firm. In some cases, approved private fuel importers are also compensated for losses.

Typically the bulk of petroleum is consumed indirectly through household consumption of other goods and services that use petroleum products as inputs. Therefore, the welfare effect of higher fuel prices—or, equivalently, lower fuel subsidies—on household real incomes will depend both on the direct effect of higher prices for petroleum products consumed by households and on the indirect effect arising from higher prices for other goods and services consumed by households to the extent that higher petroleum costs are passed on to consumer prices.

The adverse impact of fuel price increases on already poor households is often highlighted as a key constraint on the removal of fuel subsidies. It is, therefore, important that the removal of subsidies be accompanied by measures to mitigate the adverse effects on the poorest households. In addition, it is important to emphasize that the budgetary savings from reducing fuel subsidies can be used to increase expenditures in areas that are typically seen as having higher priority, e.g., increasing access to or the quality of education and health services or physical infrastructure, or used to reduce taxes. In the context of reducing budget deficits, the counterfactual to fuel subsidy removal can be seen as a reduction of these social expenditures, an increase in taxes, or higher inflation, all which can have more adverse effects on the poor.

Ideally, governments should already have in place a social protection system that could be used to safeguard the real incomes of the poorest households. If such a system is in place and is well designed and implemented, then it provides the most cost-effective approach to social protection.
If such a system is not available, either because no such program currently exists or that which exists is not effective, then a government's ability to protect the poor from price increases in the short term is restricted. Introducing an effective program from scratch obviously takes time, but so too does reforming an existing program. In this situation, the gradual withdrawal of subsidies may be necessary, while a more effective social protection mechanism is developed. This can be combined with some shorter-term measures that increase the resources available to any existing informal social assistance programs delivered through existing networks of community, religious, or other nongovernmental organizations.

In addition, access costs to other public services, e.g., fees for education or health services, can be reduced or eliminated in the poorest rural localities and urban districts. In these cases, emphasis may be on primary and junior secondary school and primary health care. Public works programs can be temporarily expanded. Such programs not only protect household real incomes, but can contribute to expanding the human and physical asset base of poor households. The adverse effects of fuel price increases on the poor can also be mitigated with one-time bonus given to low-income government employees and pensioners. However, such bonuses may generate future budgetary claims if these are expected every time prices increase. Nonetheless, relative to fuel subsidies, targeting extra public expenditures using detailed information on the characteristics of the poor can substantially reduce leakage to higher income households. The particular approach used will obviously depend on the specific characteristics of each country, especially the nature of its social institutions and the extent of existing access to public services.

In order to signal to the public its intention to use the budgetary savings more effectively, government can specify the expenditures to be financed by these savings. For example, it can announce the allocation of funds to the expansion of access to quality education and health services, electricity, or roads network in rural areas. Or budgetary savings can be used to promote low-cost urban transport networks or investments in electricity, roads, and transport.

The issue of petroleum pricing is politically sensitive. Hence, avoiding wasteful public expenditures on distortionary and badly targeted fuel subsidies require insulating price setting from political pressure as much as possible. Increasing private sector participation in the import and distribution of petroleum products seems central too. The government institution responsible for monitoring the pricing mechanism is usually composed of representatives from government, oil-marketing companies, trade unions, and non-governmental organizations such as national Industrial associations, as well as various experts. Monthly price adjustments usually reduce short-term subsidies than quarterly price adjustments when international prices continually increase.

Coady et al (2006) identifies the issues that need to be discussed when analyzing the fiscal and social costs of fuel subsidies using examples from the analysis of five countries (Bolivia, Ghana, Jordan, Mali, and Sri Lanka). The also quantified the magnitude of consumer subsidies and their fiscal implications. The study found that fuel subsidies have significant social and fiscal costs and are badly targeted in all the countries analyzed. The real income burden resulting from the withdrawal of fuel subsidies is borne disproportionately by higher-income households while lower income households also suffer sizable real income decreases from subsidy removal. Thus, the paper submits that any credible policy strategy needs to address the mitigation of these adverse effects.

Other papers that have considered the issues relating to the domestic pricing of petroleum products include Okogu (1995), Gupta et al (2002), Hossain (2003), Baig et al (2007). Okogu (1995) reviewed
different approaches to petroleum product pricing, including exhaustible resource, market-based and capital-replacement methods, as well as international price comparisons. The paper concluded that while the case for a subsidy phase-out is overwhelming in Nigeria, the issue was unnecessarily politicized by past governments, thus arousing great suspicion among the public. For the policy to succeed, the Nigerian government needs to address concerns on financial accountability and invest the proceeds of higher petroleum prices judiciously in sectors directly beneficial to the bulk of the citizenry. Gupta et al (2002) finds that in major oil-exporting countries, government policies keep domestic prices below free market levels, resulting in implicit subsidies equalling 3.0 percent of GDP, on average in 1999. The paper argues that the petroleum subsidies are inefficient, inequitable and procyclical thereby complicating macroeconomic management. The authors submit that petroleum subsidy elimination may be politically difficult but countervailing measures and publicity campaigns can help engender support for the reform.

Drawing from theoretical and empirical literature, Hossain (2003) provides an operational framework and illustrates how relevant taxes/subsidies for correcting externalities and addressing equity and revenue considerations to set prices of petroleum products for a country like Nigeria. However, the paper did not make any specific suggestions for policy reform in Nigeria.

Baig et al (2007) reviews recent developments in the pass-through of international to domestic petroleum product prices, in the different fuel pricing regimes, and in fuel subsidies in a range of emerging market and developing economies. The main finding of the paper is the limited price pass-through in many countries and the consequent increase in fuel subsidies. The paper proposes that key elements of a successful strategy to contain subsidies should comprise: making subsidies explicit; making pricing mechanisms more robust; combining reductions in subsidies with measures to protect the poorest; using the resulting savings well, and transparency and consultation.

Gupta et al (2000) contain detailed discussion of alternative approaches to protecting poor households during increases in domestic petroleum prices. The authors argued that the speed of subsidy reform can be faster when an effective social protection system exists in a country. Many of the countries in their sample adopted a gradual approach to subsidy reform, while simultaneously adapting existing social protection instruments or establishing a new safety net. Coady et al (2004) provide a detailed discussion of alternative methods of targeting transfers in developing and transition economies.

3.0 Background
In the past, Nigeria, like many net oil-exporting countries failed to fully pass increases in international petroleum product prices to domestic consumers, resulting in large subsidies. Subsidy is calculated as the difference between the domestic supply cost (international price adjusted for transportation and domestic distribution and marketing costs) and domestic retail price. Figure 1 shows the trend in retail petrol and diesel prices between 1991 and 2008. Clearly, domestic prices of the two products have mostly been marked by continuous upward movement. However, the changes in diesel prices have been larger overtime. At present, petrol, diesel and kerosene sell for N65.0 per litre, N100.0 and N50.0 per litre, respectively. Nonetheless, the current indicative petrol price, based on the Petroleum Price Regulatory Agency (PPRA) template, is N98.2 per litre.

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Table 1 presents the changes in petrol prices in Nigeria between January 1989 and September 2010. The two most remarkable increases of 614.0% and 361.5% were introduced on November 8, 1993 and October 2, 1994, respectively. The seven years between 2000 and 2007 recorded 13 movements (mostly increases) in petrol prices (i.e., subsidy removal). On June 1, 2000, petrol price rose from 20 to 30 naira. This was reduced to 25 naira on June 8 when labour embarked on a strike to protest the increase and was further reduced to 22 naira per litre on June 13 when the strike persisted. Yet, on June 1, 2002, it rose again to 26 naira per litre. Barely a year later on June 20, 2003, the price of petrol was raised to 40 naira per litre. The Nigeria Labour Congress called another strike and on July 9, 2003, it was reduced to 34 naira.

Table 1: Trend in Domestic Petrol Price in Nigeria, 1999 - 2010

<table>
<thead>
<tr>
<th>Date</th>
<th>Price Per Litre</th>
<th>Change %</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1, 1989</td>
<td>N0.42 - Commercial vehicles N0.60 - Private vehicles</td>
<td>43.0%</td>
</tr>
<tr>
<td>December 19, 1989</td>
<td>N0.60</td>
<td>43.0%</td>
</tr>
<tr>
<td>March 6, 1991</td>
<td>N0.70</td>
<td>16.6%</td>
</tr>
<tr>
<td>November 8, 1993</td>
<td>N5.00</td>
<td>614.0%</td>
</tr>
<tr>
<td>November 22, 1993</td>
<td>N3.25</td>
<td>-35.0%</td>
</tr>
<tr>
<td>October 2, 1994</td>
<td>N15.00</td>
<td>361.5%</td>
</tr>
<tr>
<td>October 4, 1994</td>
<td>N11.00</td>
<td>-26.7%</td>
</tr>
<tr>
<td>December 8, 1998</td>
<td>N25.00</td>
<td>127.0%</td>
</tr>
<tr>
<td>January 6, 1999</td>
<td>N20.00</td>
<td>-20.0%</td>
</tr>
<tr>
<td>June 1, 2000</td>
<td>N30.00</td>
<td>50.0%</td>
</tr>
<tr>
<td>June 8, 2000</td>
<td>N25.00</td>
<td>-16.7%</td>
</tr>
<tr>
<td>June 13, 2000</td>
<td>N22.00</td>
<td>-12.0%</td>
</tr>
<tr>
<td>January 1, 2002</td>
<td>N26.00</td>
<td>18.2%</td>
</tr>
</tbody>
</table>
Three months later, on October 1, 2003, it was raised to 42 naira, and seven months later on May 29, 2004, it was again raised to 49.90 naira per litre. After six months, on January 1, 2005, the government further increased petrol price to 52.50 naira. Three months later, on April 7, 2005 it was marginally reduced to 52 naira a litre. Another four months later, on August 25, 2005, it was raised to 65 naira per litre, and on May 27, 2007, two days before handover to the next government, it was again raised to 75 naira per litre.

The rapidity of the adjustments in petrol prices in 2000-2007 reflects government determination to allow the product to reflect its economic costs and international prices. It is not surprising therefore that Nigeria is among the 26 countries (out of 44 countries reviewed by the IMF) that fully or more than fully passed-on increases in international prices of petroleum to domestic consumers in the period 2003-2006 (see Baig et al., 2007).

Table 2 compares the retail prices of fuel in Nigeria and some countries in Africa, Europe and the USA in 2008. The Table indicates some striking patterns. First, the prices of petrol and diesel varied widely across the countries. For instance, in Africa petrol prices per litre in 2008 varied from as low as 14 cents in Libya and 34 cents in Algeria to 130 cents in Chad. Similarly, in OECD countries, petrol prices per litre in varied from 56 cents in USA to 163 cents in Norway. Second, the level of petrol and diesel prices is generally very low in oil-exporting countries and high in developed market economies. Third, the prices of petrol are generally higher than the prices of diesel. Furthermore, the Table reveals that the price of petrol is higher in Nigeria than some other oil-exporting developing countries like Angola, Gabon, Libya, Algeria and Venezuela. Countries like Gabon, Ghana, Kenya has tax element in the retail prices of the petroleum products. Removing the 43.2% tax element from the domestic petrol price in Gabon, leaves a difference of 49.3 US cents which is by far lower than the 59.0 US cents retail price of petrol in Nigeria.

<table>
<thead>
<tr>
<th>Date</th>
<th>Price (Naira)</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>June 20, 2003</td>
<td>N40.00</td>
<td>53.0%</td>
</tr>
<tr>
<td>July 9, 2003</td>
<td>N34.00</td>
<td>-15.0%</td>
</tr>
<tr>
<td>October 1, 2003</td>
<td>N42.00</td>
<td>23.5%</td>
</tr>
<tr>
<td>May 29, 2004</td>
<td>N49.90</td>
<td>18.8%</td>
</tr>
<tr>
<td>January 1, 2005</td>
<td>N52.50</td>
<td>52.1%</td>
</tr>
<tr>
<td>April 7, 2005</td>
<td>N52.00</td>
<td>-0.95%</td>
</tr>
<tr>
<td>August 25, 2005</td>
<td>N65.00</td>
<td>25.0%</td>
</tr>
<tr>
<td>May 27, 2007</td>
<td>N75.00</td>
<td>15.0%</td>
</tr>
<tr>
<td>23 June 2007</td>
<td>N70.00</td>
<td>-7.5%</td>
</tr>
<tr>
<td>September 2010</td>
<td>N70.00</td>
<td>No change</td>
</tr>
</tbody>
</table>

It is instructive to note that in 1998, petrol was 4 times and 29.5 times more expensive in Nigeria than in Libya and Venezuela, respectively. However, the 59 US cents charged per litre of petrol in Nigeria is incomparable to the 163 US cent charged in Norway, another oil-exporting country, during the same period. The Table is even more revealing when the retail prices of diesel is considered. Unlike most of the oil-producing developing countries presented, diesel price is very high in Nigeria at 113 cents per litre.

Sequel to the fall in domestic output of refined petroleum products, successive Nigerian governments have spent so much yearly in subsidizing the importation of the products for onward sale at lower rates to the Nigerian populace. In effect, petroleum subsidy has moved from being an implicit subsidy to explicit cost, which has increased significantly over the years, especially with rising share of imports in domestic supply. Table 3 and Figures 2 and 3 show the trend in petroleum and kerosene subsidy payments between 2006 and first quarter of 2010, respectively. About 1,395.2 trillion naira was spent by the government on subsidizing domestic consumption of petroleum and kerosene between 2006 and the first quarter of 2010. Latest figure from the Petroleum Products Pricing Regulatory Agency (PPPRA) indicates that the Federal Government spent about N2.070 trillion on Petroleum Support Fund subsidy between January 2006 and November 2010. This figure excludes N98.05 billion by the Federal Government on foreign exchange differential payment as well as interest on delayed subsidy payment to petroleum products marketers during the period.
Table 3: Distribution of Subsidies, 2006-2010 (N billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>Petrol</th>
<th>Kerosene</th>
<th>Total</th>
<th>Cumulative Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>152.0</td>
<td>109.0</td>
<td>261.1</td>
<td>261.1</td>
</tr>
<tr>
<td>2007</td>
<td>188.0</td>
<td>91.0</td>
<td>278.9</td>
<td>540.0</td>
</tr>
<tr>
<td>2008</td>
<td>442.0</td>
<td>189.0</td>
<td>630.6</td>
<td>1170.5</td>
</tr>
<tr>
<td>2009</td>
<td>132.0</td>
<td>24.0</td>
<td>156.4</td>
<td>1326.9</td>
</tr>
<tr>
<td>2010</td>
<td>68.0</td>
<td>0.0</td>
<td>68.3</td>
<td>1395.2</td>
</tr>
<tr>
<td>Total</td>
<td>982.0</td>
<td>413.0</td>
<td>1395.2</td>
<td></td>
</tr>
</tbody>
</table>

Source: Budget Office of the Federation, Ministry of Finance

The nation spent about N540 billion on subsidies for the two petroleum products in 2006 - 2007; while the subsidies accounted for over N630.6 billion in 2008. However, the amount of subsidy payments declined significantly to N156.4 billion in 2009 while the amount paid in the first quarter of 2010 is equivalent to US$453.33 million. Noticeably, the Federal Government has scrapped subsidy on kerosene. From the peak of N189.0 billion in 2008, subsidy on petroleum reduced drastically to mere N24.0 billion in 2009 and no payment has been made in 2010 to subsidize domestic kerosene consumption. In effect, the subsidy on kerosene has been withdrawn just like diesel.

In 2006 total subsidy was N261.1 billion (US$2.03 billion) or 1.4% of GDP. It rose to 278.9 billion (US$2.3 billion) in 2007 or 1.3% of GDP. The subsidy level nearly tripled to N630.6 billion in 2008 (US$5.37 billion) due mainly to high oil prices and exchange rate depreciation. Thus, in 2006-2008, government subsidy payments to NNPC and other marketers of petroleum products was in the range of N1,173.2 billion (US$9.7 billion). This figure exceeds total capital allocation to priority sectors in 2009 budget (N952.9 billion or US$6.57 billion) made up of security $0.62 billion; Niger Delta $0.68 billion; Critical infrastructure $3.20 billion; Human capital development $1.11 billion; Land reform & food security $0.96 billion.

Figure 2: Trend in Petroleum Subsidy Payments, 2006-2010 (N Billion)
Considering the huge amounts spent overtime in subsidizing the consumption of petroleum products in Nigeria, the government decided to fully deregulate the retail price of petroleum having removed the subsidies on diesel and kerosene earlier. This would allow the prices of the petroleum products to fully reflect their market conditions, culminating in the deregulation of the downstream oil sector. By the period 2000-2004, the legal and institutional frameworks for the downstream petroleum sector deregulation and liberalisation were in place. For example, the government had mobilised the citizens and canvassed for support in the implementation of the deregulation and liberalisation policy and programmes. The legislature also considered and passed bills relating to the deregulation and liberalisation of the sector. For example, on May 27, 2003 the President signed into law the Petroleum Products Pricing Regulatory Agency (Establishment) Bill, 2003. Other policies, programmes and activities that were implemented by the government in the sector include:

1. Privatisation of all federal government-owned petroleum products marketing and distribution companies
2. Issuing of licences for the establishment of private refineries
3. Licensing of private Jetties and Storage Depots
4. Issuance of licences to private firms to import, market and distribute petroleum products
5. Establishment of “Mega Filling Stations” by the NNPC in selected locations nationwide
6. Privatisation of Port Harcourt and Kaduna refineries and petrochemical plants, though later reversed, and
7. Deregulation and liberalisation of prices of domestic petroleum products – under the watchful eyes of PPPRA, the Department of Petroleum Resources (DPR) of the Federal Ministry of Petroleum Resources and the Nigerian National Petroleum Corporation (NNPC).

The intention of the Federal Government to continue with the deregulation of the downstream oil sector was announced on the 27th of February 2009. The Government has since then continued to reaffirm its commitment to deregulate the petroleum sector.

4.0 Analysis of the Petroleum Subsidy Removal Policy

The debate on petroleum subsidies has received fresh impetus in Nigeria with the Federal Government’s proposal to withdraw petroleum subsidies. Expectedly, analysts have taken different positions on the
debate, depending on their orientation and affiliation. This section presents the arguments canvassed for and against the fuel subsidy removal proposal.

4.1 Arguments for Removal of Petroleum Subsidy

Some are of the opinion that eliminating petroleum subsidies is a “win-win” policy option that could improve government finances, ensure energy security and efficiency, enhance social welfare, protect the environment and ultimately promote economic growth. These are discussed briefly below.

**Fiscal Costs:** It is argued that petroleum subsidies place significant burden on the national budget as huge resources being spent on subsidy by the government could have been used to strengthen the infrastructural and economic base of the country. The funds could be invested in strengthening the health sector, expanding road network, revamping schools and all such structures that enhance economic growth and development. The fiscal implication of the subsidy regime is not sustainable. With a petrosubsidy to GDP ratio of 2.51 in 2008, it clearly cannot be described as a sustainable regime, since it puts high pressure on government’s scarce resources. The process of administering it is also cost inefficient.

**Cyclicality:** The policy of maintaining petroleum product prices below the world market has important implications for macroeconomic management. As domestic fuel prices are not fully adjusted in response to changes in world prices, subsidies will increase at this period of economic expansion in oil-exporting countries. The procyclical nature of fuel subsidies will thus exacerbate the effects of oil price shocks on economic volatility.

**Economic Distortions:** Subsidies distort price signals thereby distorting the allocation of resources and may lead to wasteful consumption and investment choices that do not reflect relative scarcities. From a purely economic perspective, subsidies send false price signals that encourage the overuse of resources; they inhibit the incentives to develop local refineries, they distort international trade, and many more. Petroleum subsidies also encourage smuggling and rent seeking by those with substantial financial means or political power (upper-income groups), thus aggravating the pro-rich bias of fuel subsidies. Smuggled subsidized fuel entail passing “windfall” from higher oil prices directly to residents of neighbouring countries.

**Equity:** Subsidies are not the most efficient means of redistributing income or of improving the poor’s access to energy. The available evidence shows that higher-income households consume larger quantities of petroleum products and electricity in oil-producing countries, and thus benefit relatively more from subsidies.

Another dimension to the equity question relates to disparity in fuel importation allocation and approval. It was alleged that companies with standard jetties and depots were being denied approval to import fuel, though small companies without investment in the downstream sub-sector continued to appear on the list of fuel importers.

**Efficiency:** Petroleum subsidies tend to be inefficient in part because they are poorly targeted. Higher-income households benefit relatively more from fuel subsidies since they consume larger quantities of petroleum products. Hence, the higher the household income, the higher the subsidy. A study by the World Bank (2006) estimated that in Venezuela in the early 1990s, the richest 20 percent of the population received six times more in fuel subsidy per person than the poorest third of the population. By distorting price signals, subsidies distort the allocation of resources and may lead to wasteful consumption and investment choices that do not reflect relative scarcities. Given that higher income groups consume the lion’s share of petroleum products, it is believed that these groups would bear the brunt of the proposed removal or any additional reduction in the subsidy. The subsidies are also inefficient in their present form because they undermine the incentives of private investors to venture into the refining of petroleum products. Inefficiency can also be defined in terms of
the disincentive it provides for current supplies (NNPC) to minimize cost. The resulting inefficient supply of petroleum products engenders inflation and transportation bottlenecks.

**Transparency:** For many years the reporting of fuel subsidies in Nigeria has not been transparent. The public should be able to see and know how much the government spends each year to subsidize the products and to identify the beneficiaries. Petroleum subsidies ought to be recorded transparently in government accounts, even for oil-exporting countries for which the opportunity cost of subsidies is the revenue forgone by not charging international prices domestically. Oil producers that explicitly recorded subsidies in the budget include Malaysia, Sudan and Yemen.

**Environmental Risk:** Environmentalists argue that subsidies increase the demand for energy sources and encourages waste in consumption, thereby exacerbating environmental degradation through increased air pollution an increased CO₂ emissions as seen in the outcome from country experiences with energy subsidy reforms. This will help policymakers with a comparative survey of the observed effects of petrol subsidy reforms for abstraction in the Nigerian case.

**Constitutionality:** Petroleum subsidy is illegal as there is no law backing it; its deduction from the federation account is not a prescription of the National Assembly and therefore a negation of the provisions of the constitution.

**Not well targeted:** The present subsidy regime is misdirected because it goes more to the rich who are heavy consumers of petroleum products, whereas the rural poor who are the ostensible targets use firewood for most of their energy needs. In addition, it has been argued that fuel subsidies are both unfair and wasteful as many Nigerians are still paying above the official price for fuel in several states in the country, contrary to the purpose of the scheme.

**No time frame:** A good subsidy programme should have a limited duration which is specified at the outset so that beneficiaries and benefactors do not get “entangled” in the subsidy.

### 4.2 Arguments Against petroleum subsidy removal

Some others are of the view that in ideal cases, subsidies serve legitimate purposes by helping achieve social goals which include: supporting poor households and marginalized consumer, protecting infant industries and sustaining employment and competitiveness in certain sectors.

- **Political point:** Though this reason is usually underplayed in most policy circles, it is a very strong motivation for the political class to sustain subsidies. Removing subsidies will necessarily put the government in political “bad” light.

- **Reallocation of resources:** from an economic and social perspective, subsidies should not be removed because they serve the purpose of reallocating resources from surplus spending units to deficit units.

- **Raising petroleum prices tends to be politically costly,** with possibilities of civil disorder, protests, and strikes. Overtime, Nigerians have been consistent in lending support to the labour unions against fuel price increases because majority live in poverty and the increase in fuel prices affect the cost of most basic goods and services. Moreover, Nigerians see fuel subsidies as one of the few benefits they receive from the successive corrupt and inept governments that failed to provide basic infrastructure like roads, schools, running water (i.e., general welfare services) etc despite the monumental inflow of oil revenues to the coffers of government over the past 40 years.

- **It encourages the consumption of energy which is regarded as a “merit” good and is seen to have a direct relation with the level of economic growth.** Since energy is an essential input in the production line, cheaper energy encourages more output and hence economic growth.
It increases the revenue of petroleum marketers: petroleum subsidies have helped to keep the demand for fossil fuels at high rates, thereby boosting the sales of petroleum marketers and affording them large chunks of the government funds in lieu of petrol subsidy; and

A petroleum subsidy has also helped to sustain employment in the downstream petroleum industry.

4.2.1 Petroleum Subsidy Reform Options:
Reform options available to the government include and not limited to the following:

- Removing petroleum subsidy and still dominating the investment climate in the downstream oil sector. This is not a worthy approach to addressing the crisis in the sector.
- Removing petroleum subsidy without dominating the investment climate in the downstream oil sector but continuing with the concept of equalization of prices across Nigeria.
- Phased removal of subsidies.
- Full deregulation that will allow the private sector to compete in the refinery of crude oil and the production of petroleum products. This will be made possible via the application of free market interplay which ensures competition and creates efficiency and at the same time product availability at just prices.

The above options are in agreement with Baig et al (2007) who remarked that a strategy to reduce domestic petroleum product price subsidies is most likely to succeed if it involves a combination of:

- Liberalizing domestic petroleum product prices, or instituting a robust automatic adjustment formula.
- Combining price increases with a well-publicized package of targeted measures to mitigate the impact on the poor, with at least some measures having immediate impact.
- Making transparent and publicizing the costs and beneficiaries of the present system of subsidies.
- Identifying priority public expenditures that are better targeted to poor and middle class constituencies and could be financed with budgetary savings from reducing fuel subsidies.
- Getting the timing and size of price increases right.

4.2.2 The Likely Effects of the Removal of Petrol subsidy:
Understanding the impacts of subsidy removal is an important foundation to guide policy makers in taking informed decision on petrosubsidy reforms. As earlier stated, reforms in this regard are likely to have impacts on four key domains of the Nigerian polity: economic, social, environmental and the political economy of the country. Subsidies can be justified if their social, political and environmental gains exceed the economic costs. Typically, removing subsidies would boost economic growth since the resources can be channelled to alternative economic activities. However, this removal may have short-term distributional effects especially on poor households that will have to spend greater proportions of their income on energy sources. There will be an increase in cost of living hence domestic products prices will be affected negatively. The effects of subsidy reduction extend beyond their immediate, first-round effects on consumers. Increases in petroleum prices would affect prices and incomes throughout the different sectors of the economy. Petroleum prices, production costs, product prices and cost of living will rise throughout the economy. Consumer demand, production, and income will most likely decline as output prices increase and consumer purchasing power decreases. Urban household groups may be the most significantly affected by the subsidy removal.

The removal of subsidies (and government budget deficit) may also trigger an increase in private sector investment, leaving real output unchanged as a result of subsidy reform. Money that is supposed to be
used by the government for the benefit of Nigerians is paid as subsidies to people who are not delivering petroleum products at the fixed prices. People are paying black market price for petroleum, government pays subsidy and people still pay inflated price for commodities available.

4.2.3 Expected Benefits of the Policy:
Reforming the downstream petroleum sector will help to:
- introduce competition, enhance efficiency and improve supply;
- reduce inefficiencies in marketing, supply, refining and distribution of petroleum products;
- avoid persistent shortage and scarcity of products;
- reduce tax rates or increase more productive spending, such as that for infrastructure and human capital formation. Eliminating petroleum subsidies could increase spending on health thereby contributing to boosting the indicators of health status;
- reduce unsustainable subsidy payment, amounting to N1.6 trillion from 2006–2009.
- address the issue that in most parts of the country, fuel prices are well above official rates;
- encourage private investment in refineries, leading to increased capacity of the Nigerian economy to meet its demand for fuel products;
- engender the establishment of new industries that would contribute to diversifying the non-oil economy and creating large-scale employment;
- reduce cross-border smuggling and other unwholesome practices of marketers and distributors, emanating from price differential between Nigeria and its neighbouring countries;
- counter false price signals that encourage the overuse of resources that inhibit the incentives to develop local refineries; and distort international trade, and many more.
- encourage private sector investment, both local and foreign.
- ensure and maintain deregulation of petroleum products to make them more available at affordable price.

5.0 Policy Recommendations, Challenges and Suggestions
Several attempts to reform the Nigerian petroleum sector overtime have faced stiff social resistance, owing in part to the general perception that eliminating such subsidies could affect the poor adversely. In June 2000, the Nigerian government increased petroleum prices by 50%, leading to a general strike and riots, followed by subsequent reversal of government policy. This scenario was repeated in 2007. This time, the government reduced the petroleum price by N5.00. in general, most Nigerians view government fuel subsidy as one major benefit they derive from the state. This explains why on at least eight occasions in the past decade, popular nationwide strike actions by Nigeria's organized Labour unions contending with Federal Government on behalf of the masses have centred on the issue of the possible reduction/removal of government subsidy on petroleum products.
5.1 Challenges to the removal of petroleum subsidies

Subsidy reform often faces several obstacles:

1. Poor social safety nets and weak capacity to target mitigating measures to the poor;
2. Opposition by vested interests;
3. Cross-border spillover effects; and
4. Ad hoc price-setting mechanisms.

Impediments to efficient distribution of the product – product import centralization in Lagos pose a lot of challenges such as the massive trucks moving into Lagos and its attendant problems. There are also hurdles to fair pricing of the products. Reform strategies need to address these issues.

A key challenge that will be encountered in the process of pursuing a petrol subsidy reform will mostly be political. Special-interest groups are likely to resist reforms in this direction with the ostensible argument that subsidies lower the cost of petroleum products to the poor, thereby satisfying the social objective of equitable resource allocation. Whereas, in practice, most of the benefits from petrol subsidies are typically enjoyed by the wealthier group with high energy demands and equipments.

While win-win reform policies are ideal in theory, it is difficult to pursue them because of the resistance that will be put up by well organized interest groups that benefit from the subsidy programmes.

Another challenge that may hamper reforms in petrol subsidies has to do with information misconceptions about the costs and benefits of the reform programme. A quick-win strategy in this regard will usually be to carry out wide consultations and information dissemination on the cost-benefit analysis of the reforms to facilitate informed debate.

Removal of petroleum subsidies will have very devastating macroeconomic effects; a key challenge is how to mitigate the negative effects of the full liberalization of the fuel market. Managing the transition from fuel subsidy has indeed been a challenge in many countries of the world. In several countries, increases in fuel prices have been followed by riots and political instability.

Successfully pursuing the reforms in the petrolsubsidy regime will require that the following key features and framings be integrated in the reform process.

1. A quantitative and system-wide cost benefits analysis of the impacts of the subsidy removal on the economy, equity and the environment. A clearly presented comparison between the costs and benefits of the reform will eliminate resistance and promote broad acceptance.
2. Aggressive communication activities to facilitate informed debates and to expose the benefits and rationale for the policy reforms.
3. Widespread consultation with stakeholders to address stakeholder specific concerns and garner support for reforms.
4. Mitigation measures to reduce the negative impacts of the reform on affected groups. A highly recommended approach would be to increase the minimum wage rate of public and civil servants to help cushion the shocks.
5. Monitoring of progress to ensure that the reform is having its intended effects and to check for unintended consequences.

5.2 Suggestions for Successful Implementation of the Proposed Deregulation Policy

The proposed deregulation policy is highly desirable. A review of international experience suggests that the reform of the downstream petroleum sector in Nigeria is most likely to succeed if it involves ensuring enhanced competition in the entire value chains of the downstream petroleum sector with a view to eliminating inefficiencies and reducing costs underlying the price of fuel products. In addition, allowing market fundamentals to determine the prices of fuel products, with appropriate regulation is a critical
trigger needed to kick-start reforms in the downstream petroleum sector. The risk of political disruption is highest when such reform is attempted without credible social protection mechanism in place and without adequate attention to building political consensus on the need for reform. Hence, the strategy should be a combination of the following:

A. Target Mitigating Measures

Since one of the main reasons why people oppose passing on higher petroleum prices to consumers is the adverse effect such price increases will have on the real incomes of poor households, petroleum subsidy reform programmes should thus identify the impact on poor households and take mitigating measures. Because it may not be feasible to quickly put in place efficient safety nets based on targeted cash transfers, a gradual strategy may initially be needed. This could include the following steps

- **Introducing a well-publicized package of targeted measures to mitigate the adverse impact of price increases on the poor** with at least some measures having immediate impact. This includes existing programs that can be expanded quickly, possibly with some improvements in targeting effectiveness (for instance, school meals, education and health user fees, subsidized mass urban transport, lower income tax rates, cash transfers to vulnerable groups, subsidies for consumption of water and electricity below a specified threshold).
- **Identifying high-priority public expenditures that are better targeted to the poor and middle-class and constituencies and could be financed with budgetary savings from reducing fuel subsidies.** These could include education and health expenditures as well as infrastructure expenditures such as roads and electrification schemes. Households that already have access to these services can benefit from investments that improve quality.

B. Overcome Vested Interests

23. **Public information campaigns can help overcome vested interests.** Such campaigns should principally aim at informing consumers about the drawbacks of existing subsidies and the benefits of reform. The government should publicizing the costs and beneficiaries of the present system and highlight that petroleum subsidy promote smuggling, shortages, black market activities, and corruption.

- Regarding the drawbacks of subsidies, in 2005 the Ghanaian government used the finding of a Poverty and Social Impact Analysis that petroleum subsidies go predominantly to high-income groups to convince the public of the need to raise petroleum prices.
- Regarding the benefits of reform, the Indonesian government ran a campaign in both 2005 and 2009 that directly linked the savings from petroleum price increases to a cash compensation program for the poor. Ghana also linked subsidy reform to increased resources for high-priority social spending.

The failure of government to check the nebulous cabal is most worrying and to reduce such failure to total removal of subsidy without subjecting the efficiency of government to serious scrutiny shows ineffective leadership and failure/ lack of integrity in governance. The government needs to demonstrate will, commitment and courage to frontally confront the numerous challenges in the oil sector, the greatest of may be corruption.

To the extent possible, government need to:
identify winners and losers in price subsidy reforms. This can be done by examining the benefits of existing subsidies for different income classes and then identifying the characteristics of winners and losers.

- Assess the political strength and the magnitude of losses and gains of each group.
- Assess the feasibility and cost of alternative measures to protect the consumption of the poor.
- Generate political support.

C. Reform Retail Price-Setting Mechanism

Reform of the pricing mechanism is essential in reforming petroleum subsidy in Nigeria. Even if petroleum price is adjusted to eliminate subsidy, it can re-emerge if prices are not adjusted continually to reflect market conditions.

Domestic petroleum product prices can be set by the market (full liberalization) or by the government, on either an ad hoc basis or according to a formula (automatic price formulas). The most robust retail domestic fuel pricing mechanism to avoid a resurgence of subsidies is to keep domestic petroleum prices liberalized, make suppliers compete for the market in a context of supporting institutional arrangements, or institute a robust automatic adjustment formula.

Presently, Nigeria has an ad-hoc fuel pricing system in place. The pricing templates are available on the official website of the Petroleum Product Pricing Regulatory Agency. Nevertheless, the determination of the rates used in deriving the product prices need to be justified and rational. At present, a number of the components, for example, margins are not empirically determined.

Also, there is need to depoliticize domestic petroleum price setting in Nigeria. Consumers tend to see domestic prices as under the government’s control and so blame the government for every increase in spite of international price developments. Highly politicised prices as observed in oil-producing countries like Nigeria, Indonesia, Iran or Venezuela, tend to be very low and do not respond to international price trends. Yet too often they fail to achieve their political goal namely, to protect the poor. Therefore, the active involvement of the civil society and the Consumer Protection Agency in fuel pricing in Nigeria is critical.

To guard against excessive price volatility, an automatic pricing mechanism that adjusts prices regularly in light of changes in international prices can be implemented. In this regard, pricing formulas are often designed to smoothen the pass-through of international prices to domestic prices. Smoothing mechanisms include moving averages, price adjustment caps and/or triggers, and price bands. The PPPRA will continue to provide indicative prices. In addition, the regulatory framework needs to be strengthened, including the capacity to detect and discourage anti-competitive behaviour.

D. Liberalize petroleum products import and distribution system.

Successful domestic fuel price liberalization requires commercializing and liberalizing import and distribution activities. A situation where the importation of all petroleum products are concentrated in one location (Lagos) is not the best. The government need to partner with the private sector in establishing more jetties and use other locations like Calabar and Port Harcourt with jetties for more efficient distribution of the products and de-congest Lagos to avoid incessant crisis that rocks the system. Hence, a
key component of creating an efficient deregulated market in Nigeria is that actual and contrived bottlenecks at the ports which are presently a huge source of demurrage charges and fraudulent practices be dismantled. Also, there is a need to allow for more competition in the supply chain, especially in the issuance of import licensing. Importers should compete on freight charges, product costs, and margins.

E. Get the timing right.

It is critical to get the timing right. To this end, a gradual strategy to liberalize petroleum products could be adopted, comprising:
(i) increasing administratively set fuel prices until they reach international parity;
(ii) establishing an automatic mechanism for adjusting domestic fuel prices in line with developments in international market prices; and
(iii) liberalizing the market for petroleum products and liberalizing imports and domestic distribution.

Abrupt large price increases may not be feasible, or desirable. A gradual, pre-determined, approach to phasing out subsidies could allow time to build up political support, design the new system and protective measures, and get the public used to the idea of petrol prices changing frequently.

Post-election period often offer useful window for governments to push through tough policy measures, as do periods of economic strength. For example, the newly-elected government in Ghana in early 2005 felt emboldened to implement a new pricing regime, after two years of frozen prices. The new government strengthened its credibility by hosting extensive public discussions on the pricing issue. As a result, the large price increase, implemented within three months after the government came to power, caused little surprise or protest. It is advisable therefore to defer the increase in petroleum prices in Nigeria till the third quarter of 2011 after a new government has been inaugurated.

F. Strengthen Governance, Institutions and Transparency.

International experience suggests that if the public trusts the government to use the savings from eliminating fuel subsidies responsibly, they are less likely to oppose the price increases (see Esfahani, 2002). Thus, successful petroleum subsidy reforms in Nigeria necessarily require convincing the people by strengthening governance, institutions, and transparency. Building up trust and institutions however takes time. What the government can do in the immediate period to garner support seems to lie in a comprehensive package that includes:
• Transparency;
• Educating and consulting the public (especially the often vocal middle class); It will be important to convince the public that compensation programs being introduced will remain in place for an extended period, regardless of the government in power.
• Using the savings well and explaining to Nigerians how previous savings from diesel and kerosene price subsidies have been properly utilized;
• Depoliticizing petroleum prices;
• Getting the timing right; and
• Obtaining regional buy-in, when revenues and mitigation responsibilities are shared.
Lessons of international experience include the following:

- Do not announce deregulation. Just get the environment ready before implementation. Like having many NNPC filling stations, resuscitating existing refineries and building new ones as well as providing functional social amenities.

- As a key component of creating an efficient deregulated market, all bottlenecks at the ports, actual and contrived, which seem to be huge sources of demurrage charges and fraudulent practices currently, need to be dismantled quickly.

- A quick-win strategy to address the political challenges will be to compensate powerful interest groups for consenting to a change in policy, or find a way to inoculate policy reforms against strong opposition as it has been used in other countries (see for e.g. Victor, 2009).

- To mitigate the effects of the full fuel price liberalization, it is critical to put in place compensatory schemes to cushion the effects of fuel price increases on the most vulnerable groups in the economy as done in many countries in similar circumstances. Effective implementation of the compensatory programme should be guided by the following principles:

  1. The costs to the national budget should not be greater than the benefits derived from subsidy removal.
  2. It should not be a permanent feature of the budget but rather a short term or once and for all payments or expenditure
  3. It should target the most vulnerable groups who will suffer most from the subsidy removal
  4. The costs of administering the compensation should be minimized. In other words, no new agency or institution must be set up for the sole purpose of administering the scheme. Rather it should be administered under existing structure of government.
  5. To be most effective, all tiers of government should be involved in the process.
  6. The implementation process must be transparent.
  7. Adequate publicity should be given to its implementation.
  8. Government must also put in place framework to ensure close monitoring of the implementation so as to get public trust.

In the light of Nigeria peculiar situations and circumstances, the government may wish to consider the following measures:

  1. With states governments, offer to pay WAEC/GCE examination fees for all secondary students in public schools for the next two years.
  2. Fees for those attending public primary and secondary schools could be paid by the governments for the next three years
  3. Mandatory one free meal per day in public primary and secondary schools
  4. A one time transport bonus for all low-income government employees and pensioners
  5. Free ante-natal treatment for all pregnant women in public health centres for one year
  6. Free school uniforms for pupils in public primary and secondary schools for two years
  7. Upgrading /construction of one rural road in each senatorial district of the country with participation of all tiers of government.
  8. Investment in the provision of mass transit system in key urban cities with the participation of the National Union of Road Transport Workers.
9. Extra funds could be used to boost community health programs in the rural community health centres
10. Expand income transfers for onward lending to cooperatives societies through existing micro-
credit schemes.
11. While not supporting direct earmarking of resources that could possibly accrue to the government
from subsidy removal, expanding the existing conditional cash transfer programs by the MDGs office;
12. Our poverty-alleviation programs and strategies must be examined. There is a need to reduce
duplication of functions among agencies; rather each agency should be made to concentrate on its
areas of comparative advantage to complement one another. There is need for instance for the
NDE and SMEDAN that provide vocational and entrepreneurial training to graduates to have
interface with agencies that can provide micro credit to enable the trained graduates put into
practice what they have been taught;
13. The current efforts at ensuring effective and effective budget execution must be sustained. On-
going and envisaged measures in this direction must be announced. The initial efforts at putting in
place performance-based budgeting system in Nigeria must also be put in the public domain. This
effort has the potential to improve the efficiency and productiveness of government’s expenditure
with positive impact on wealth creation and poverty reduction;
14. Removal of government’s participation in the pricing of fuel must be accompanied with specific
measures that would help address the issue of job creation, including:
   o All Governments at the Federal, State and Local Government levels should insert an employment
clause in the contracts for the execution of projects, which would require contractors to employ
and train specific types and amounts of the labour force to be used in their project executions. At
the end of the contract, only very few of such contractors would lay off the trained manpower;
   o Observation of African experiences by the ILO, for example in Lesotho, Botswana, Uganda and
Namibia, all demonstrate that labour-based methods are financially viable for activities like road
building and road rehabilitation.
   o Deliberate inclusion of National Content (NC) provisions in all major projects;
   o Enforcement of existing NC directives and such provisions in the JVC/PSC Agreements;
   o Control of expatriate quotas of the operating companies and their major contractors;
   o Deliberate policy to sole-source contracts to companies with facilities in-country and those
compliant with NC policy;
• Adopt a consultative approach, and be transparent in order to avoid the pitfalls of certain recent
privatization experiences in the country.
• Once and for all liberalization of petroleum price is recommended as phased subsidy removal
will be complicated by political constraints, costs of negotiations when time for review is due, it
will fuel expectations, will not give right signals to potential investors in downstream refinery
sector, the cost components of fuel products are quite dynamic, creating a “moving-target”
situation.
• As competition measures take root and more participants participate in the downstream
petroleum market, the forces of demand and supply should be allowed to determine the petrol
price. The PPPRA should continue to provide indicative prices.
• **Volatility Management:** The concepts of Petroleum Equalization Fund and Maritime
Transportation Average are not applicable in the deregulated downstream petroleum sector
regime. Strategic Fuel Reserves can be used as instrument for managing volatility when the market matures.

- Crude oil price is very volatile. Hence to prevent excessive transmission of short term volatility to the economy, there should be expansion of strategic reserves capacity that can be released to dampen short term price pressures

- The Strategic Reserve as a scheme may not be restricted to the use of only PPMC depots, but also private depots that are considered strategic

- Import large quantities of PMS in advance of price deregulation. This measure will be required to stabilize prices during initial price hike. The measure is also necessary to cushion possible initial supply disruptions resulting from public or importer resistance to subsidy removal.

- Deregulation does not imply that government should relinquish its oversight function. The appropriate government agency should oversee the downstream operations to ensure that Nigerians derive the actual benefits of liberalization

- Revive refineries

The reforms of the entire oil industry and the NNPC are captured in the Petroleum Industry Bill (PIB). An objective of the reform is to create a commercial, profit-driven national oil company which will operate along the principles of, and have a governance structure similar to private commercial companies. Therefore, it is critical to carefully consider the PIB in the National Assembly ensuring that national interest is fully protected in arriving at the final version of the bill.

**Stimulation of Domestic Production of Petroleum Products**

Almost three years after the administration of President Yar Adua promised to repair the refineries and build new ones in Lagos and Eket, the nation is still almost 100 per cent dependent on imported fuel. While no new refinery has been added, billions of Naira has been spent on the repairs of existing refineries without success. Therefore, it is advisable that urgent steps be taken to privatise the refineries. Current efforts by the Nigerian National Petroleum Corporation (NNPC) and China State Construction Engineering Corporation Limited (CSCEC) to construct three Greenfield refineries and a petrochemical plant at an estimated cost of $28.5 billion are heart-warming indeed. The three Greenfield refineries are to be located in Lekki in Lagos State, Brass in Bayelsa State and Lokoja in Kogi State, while the site for the petrochemical plant is yet to be decided. According to the NNPC Group Managing Director, the effort is aimed at stemming the flood of imported refined products currently estimated at $10 billion annually.

**6.0 Conclusion**

The issue of petroleum subsidy remains a major source of fiscal and overall policy concern in Nigeria. Even as a growing number of policymakers may have accepted the wisdom that petroleum subsidies should be removed, there are still strong interest groups that may resist the reform process. This is in spite of the evidence that removing subsidies to fossil fuels has clear economic, social and environmental benefits. This paper has highlighted the key arguments for and against subsidy removal in Nigeria. The superior argument appears to support the removal of subsidies. However, as already noted, governments may have to compensate strong interests groups to persuade them to consent to the reform agenda.
The paper suggests a pragmatic approach to dealing with petroleum product pricing. In times of increases of international prices, a package that includes liberalizing the setting of domestic petroleum product prices, or institutes a robust automatic adjustment formula, and combines price increases with a well-publicized package of targeted measures to mitigate the impact on the poor, of which at least some have immediate impact, would increase the likelihood of policy success. Additionally, international experiences in the paper indicate that implementing a transparent pricing framework, publicizing the costs and beneficiaries of the present system, using the savings well, and explaining their use to the public, are crucial ingredients in such an approach. More importantly, legislators need to reorient their constituents to accepting the inherent medium and long term advantages of deregulation in the downstream petroleum sector. Deregulation of this sector will definitely bring an end to petroleum products scarcity. Petroleum products prices may even be on the downward slide post-deregulation instead of increasing.

References


