

Energy pricing and subsidy Reforms in Nigeria

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Introduction

- Nigeria is an oil exporting, developing country. With a population of 165 million, it is the most populous country in Africa.
- The country is endowed with significant energy resources:
 - Oil reserves 36 billion barrels (2009 estimates)
 - Gas reserves 187 trillion cubic feet (2009 estimates)
 - Oil production 2.016 mbd
- The Oil sector has influenced significantly the growth contour of the country since 1970
- Oil contributed \$391b to govt. revenue btw 1970-2005.; Oil exports \$593.6b btw 1970-2005. These represent 75% of total govt revenue and 96% of foreign exchange earnings over the period.
- Apart from its direct fiscal benefits, energy sector is strategic for enhancing the competitiveness of the Nigerian economy.

Introduction contd

- The legacy of oil has also imposed significant costs on the economy
 - Price distortions
 - Volatilities
 - Dutch-disease
 - Corruption and inefficiencies
- A major feature of the sector is the dominance of the govt in pricing, supply and investment.
- In spite of cumulative efforts by successive govts, oil subsidy remains one of the most intricate socio-economic policy issues in Nigeria
- Moreso with the sharp fall in world oil price to under US\$60 per barrel

Size of Fuel Subsidy

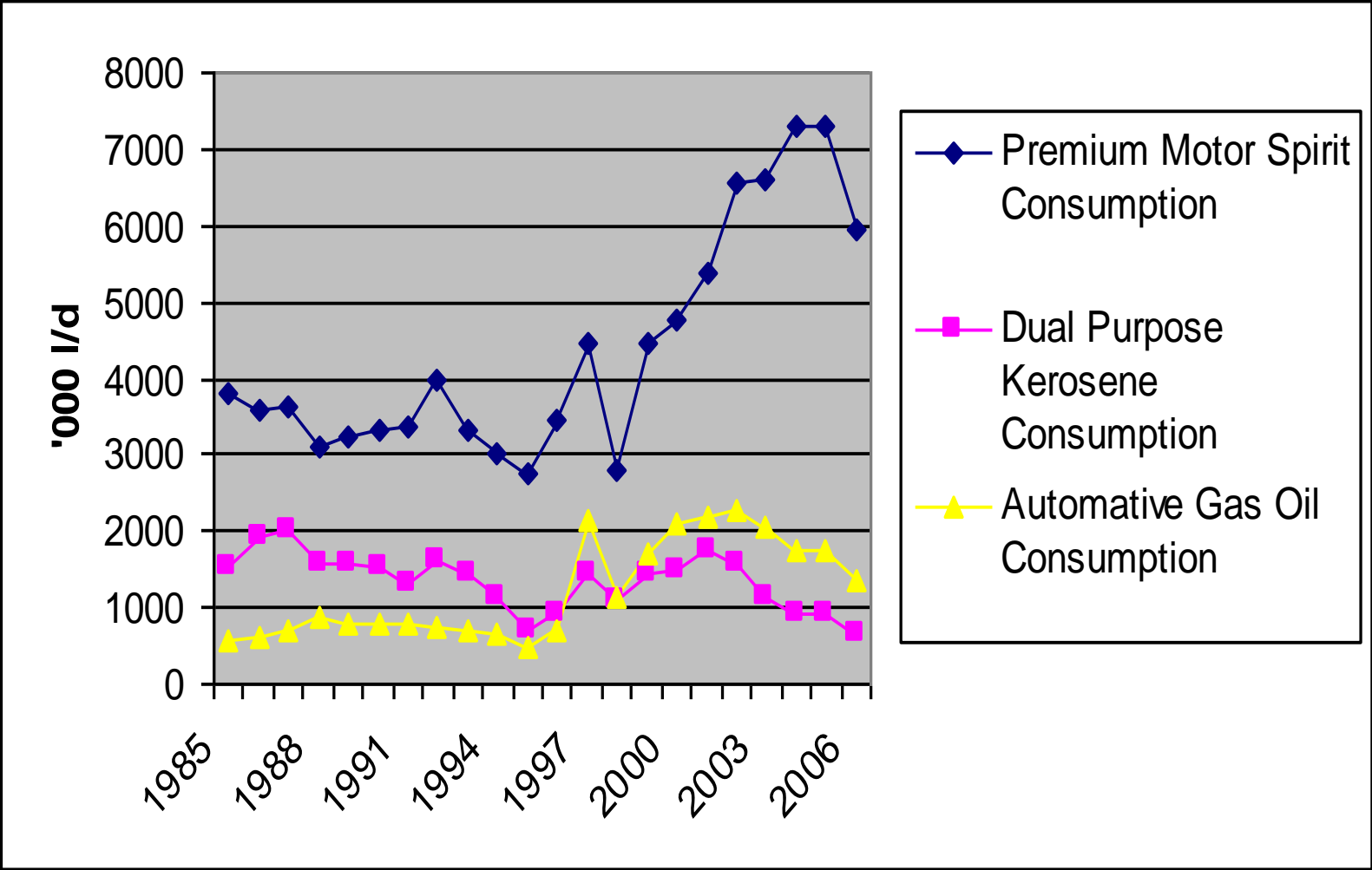
- Oil subsidy has moved from being an implicit subsidy to explicit cost
- Fuel subsidy has increased significantly over the years, especially with rising share of imports in domestic supply
- In 2006 it was N261.1 billion (US\$2.03billion) or 1.4% of GDP
- It rose to 278.9billion (US\$2.3 billion) in 2007 or 1.3% of GDP
- The subsidy level nearly tripled to N633.2billion in 2008 (US5.37 billion) due mainly to rising oil price and depreciating exch. rate
- Thus, between 2006 and 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

Costs of subsidy

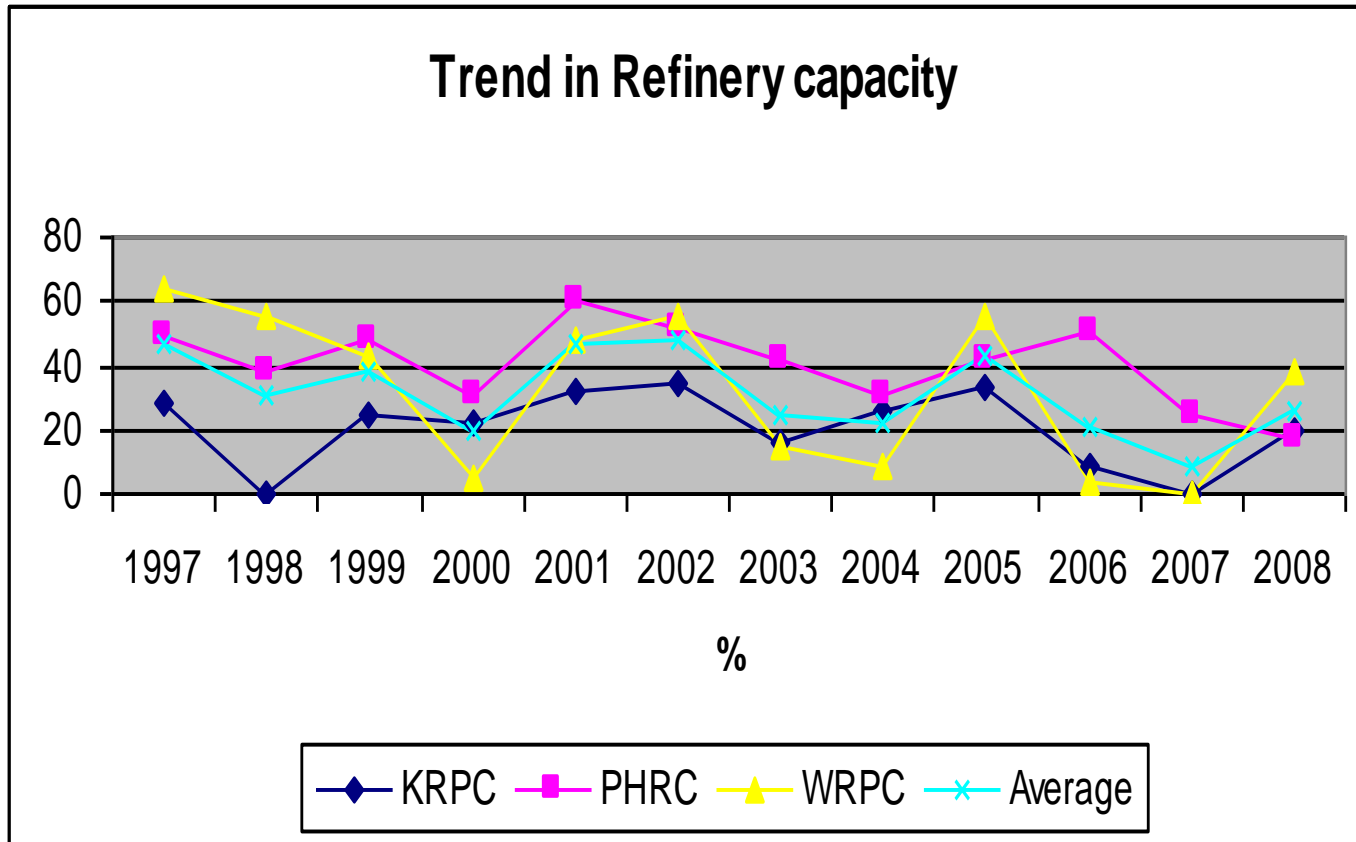
- Subsidy has resulted in substantial loss of revenue and an exponential growth in domestic oil consumption as low price does not signal real cost of consumption
- Contributed to the collapse of local refineries as price of fuel did not reflect cost of supply
- Dilapidated supply and distribution infrastructures
- Reluctance of private investors to invest in refineries
- Sporadic fuel shortages at fuel stations
- Smuggling and adulteration of products

- Attempts to remove subsidies have generated oppositions from consumers already used to cheap energy prices due to presumptions that any price increase will fuel inflation and reduce economic welfare

Trends in Consumption of Petroleum Products 1985-2006 in thousand litres per day



Domestic refinery capacity in excess of 445,000b/d.
However, combined output is below 40% for most of recent years
This has led to much dependence on imports



Pricing Structure of Fuels

Pump prices of fuels (in particular PMS) are administratively determined. Prices have lagged behind inflation rate, exchange rate changes as well as changes in product costs leading to substantial subsidy

Table 1: Pump Prices of Gasoline and Diesel in Nigeria, 1991-2008 at UScents/litre

	1991	1993	1995	1998	2000	2002	2004	2006	2008
Gasoline prices	5	2	13	13	27	20	39	51	59
Diesel prices	4	1	3	10	27	19	45	66	113

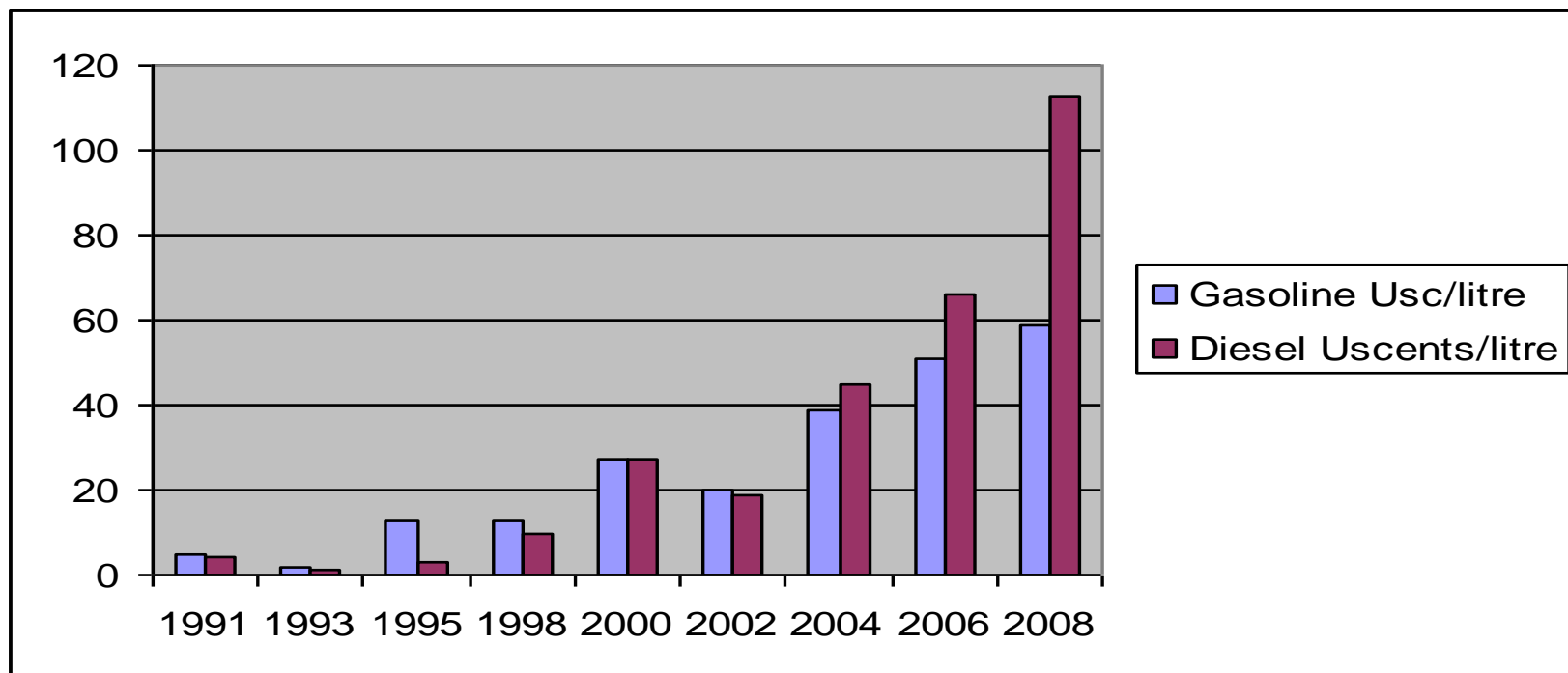


Figure 1: Comparative analysis of Trends in Gasoline and Diesel Prices in Nigeria

Table : Comparison of Fuel Pricing Structure among Ghana, South Africa, India and Nigeria

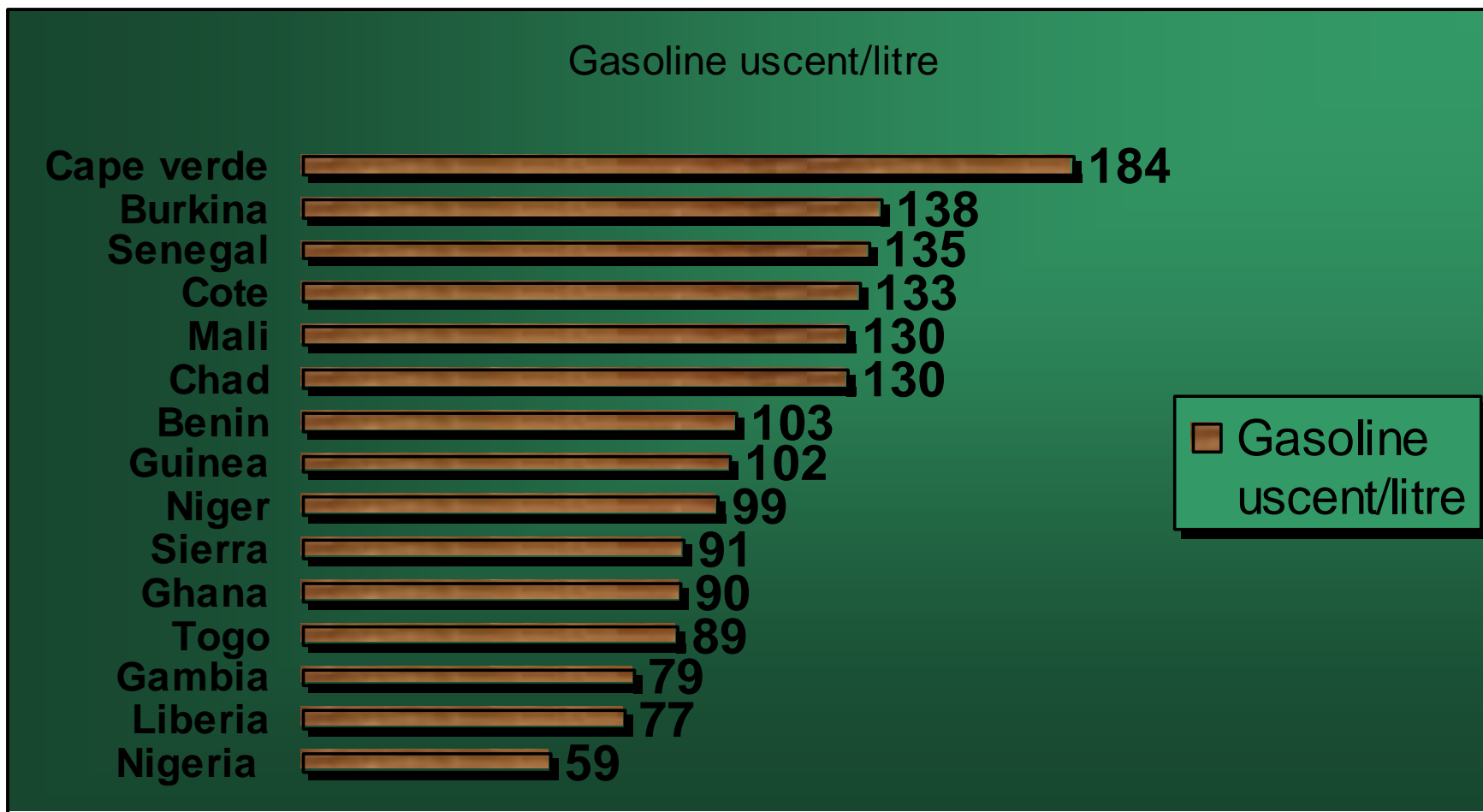
Ghana	South Africa	India	Nigeria
1. Type of Pricing Regime			
Formula	Formula	Ad-hoc	Ad-hoc
2. Period of Review			
First working day of each month	First Wednesday of each month		Government decision
3. Whether Tax			
Yes	Yes	Yes	No
4. Components of Tax and charges:			
(i)Excise duties (ii)Debt recovery (iii)Road fund (iv)Energy fund (v)Exploration fund (vi)Cross subsidy on gasoline	(i)customs and excise duties (ii)Road accident fund (RAF) (iii)Fuel Tax	(i)Excise duty (ii)Road access (iii)Import Tariff (iv)Education Cess (v)Sales Tax (vi)Octro / entry tax (vii)Royalties	None
5. Share of indirect taxes in final price			
20.4%	27.9%	23%	None
6 Margins of marketers as % of Final Price			
9.24%	15.4%	Na	19%
7. Sensitive Products			
Diesel and Kerosine. Hence there is cross subsidy tax on gasoline	Na	Diesel	Gasoline
8. Percentage change in price to trigger review			
2.5%	5%	Na	Govt decision

Petroleum Product Prices in Selected Countries in US\$ per litre¹

Country	Retail fuel price mechanism	Price per litre in US\$			Tax as % of Gasoline Retail price
		Gasoline	Kerosine	Diesel	
Cameroon+	Ad-hoc	1.07	0.68	1.00	-
Gabon*	Ad-hoc	0.91	0.48	0.71	43.2
Ghana+	Automatic	0.92	0.69	0.83	47.5
Kenya+	Liberalized	1.04	0.74	0.90	26.6
Nigeria*	Ad-hoc	0.51	-	-	-
India+	Ad-hoc	1.04	0.20	0.71	55.1
Indonesia+	Ad-hoc	0.48	0.21	0.46	15.0
Philippines+	Automatic	0.73	0.70	0.66	25.9
Russia*	Liberalized	0.62	-	0.60	30.8
Egypt+	Ad-hoc	0.22	0.13	0.13	-

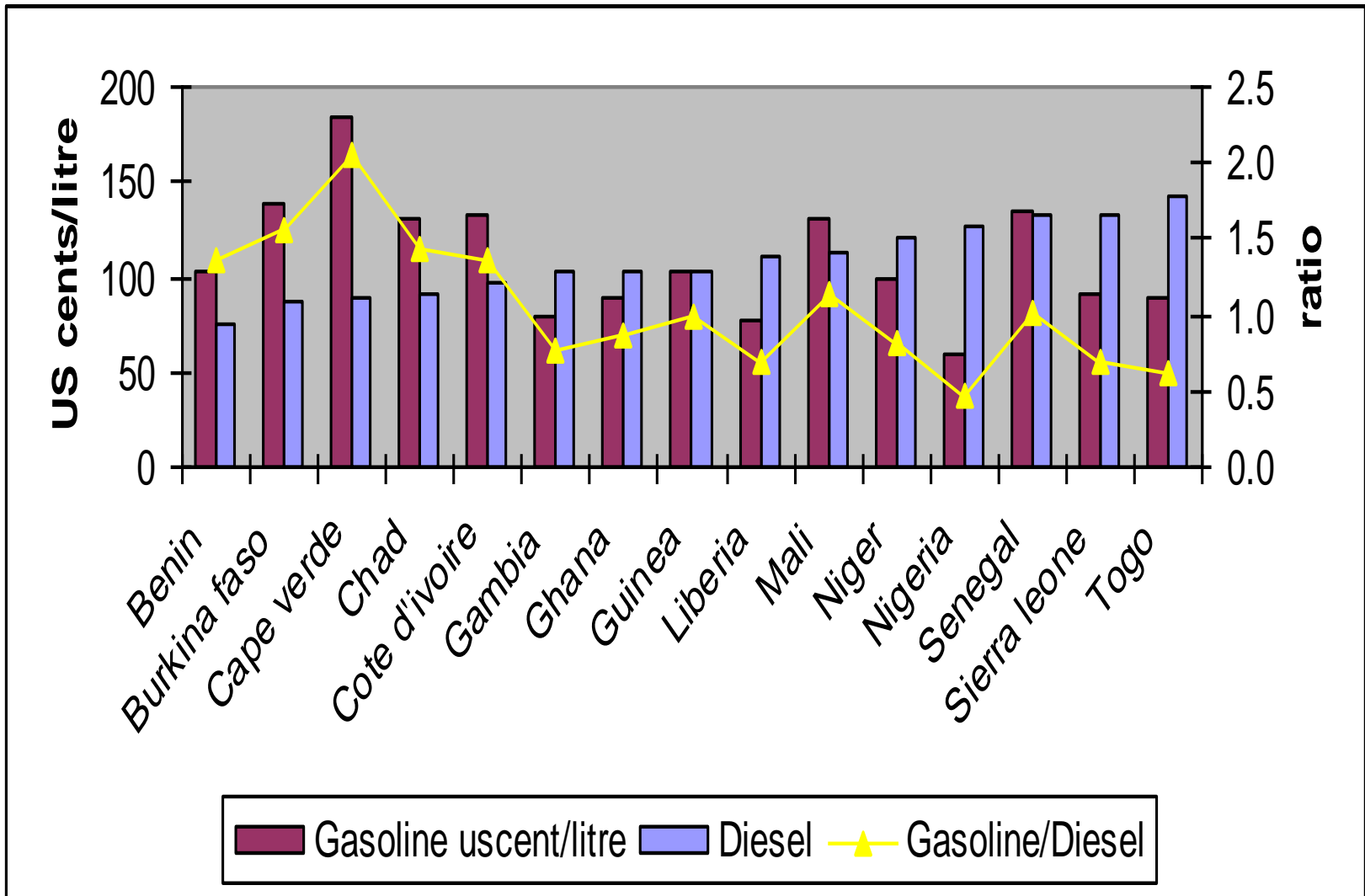
Note: + net oil importer and * net oil exporter
 1/ latest information available as at Quarter 2 of 2006

Figure 5: Comparative Prices of Gasoline in ECOWAS, 2008



Pricing structure contd

- The Petroleum Products Pricing Regulatory Agency (PPPRA) is the agency charged with the determination of the pricing of petroleum products
- The pricing structure is based on import parity pricing adjusted for cost of transportation, distribution and marketing.
- The final price is a build up of various components including product cost, freight, lightering expenses, depot charges, financing, etc
- The difference between the PPPRA determined prices and the government regulated price yields the amount of subsidy per litre that the government incurs



Key observations about pricing Structure in Nigeria

- The PPPRA pricing template has a number of deficiencies that cumulatively duplicates some items and unduly increase the landed costs of petroleum products
- These deficiencies normally discourage competition amongst product importers, while some elements in the pricing template transfer business and financial risk from operators in the sector to consumers and the government
- In addition, a number of the components, for example, margins are not empirically determined
- It guarantees rate of returns to everybody in the supply chain
- The government plans to deregulate operations and infuse competition into petroleum products marketing

Government recent efforts

- Combination of declining oil revenue and high fiscal costs of subsidy has prompted the govt to launch a renewed efforts to liberalize the fuel market. Key steps:
- Setting up of Presidential Deregulation Committee comprising of key stakeholders with a secretariat
- Appointment of 2 Technical Consultants and a Media Consultant to advise on Communication Strategy
- Recruitment of 2 external consultants to evaluate the PPPRA template
- Hiring of external consultants to carry out process audit of subsidy
- Revival of the process of privatisation of refineries
- Media Consultant has been recruited to assist on communication strategy

Where are we in the Deregulation Process?

- The consultants to review the pricing templates have submitted their report
- Selection of consultant on process audit almost completed
- Poverty and Social Impact analysis (PSIA) to be carried out
- Govt is engaging labour and other stakeholders
- Appropriate compensatory scheme to be designed
- Time frame to tackle existing supply and distribution bottlenecks and for the completion of deregulation process being considered by the government

Critical Challenges

- The greatest challenge facing the process of deregulation in Nigeria is the credibility of government
- Past promises of govt have not been implemented.
- Lack of transparency and inefficiency of government
- Inability of govt to remove some of the supply bottlenecks in the short run
- Resistance from entrenched interests and Nigerians who have come to see cheap fuel as a right

Some Recommendations

- Nigeria needs to keep to a formula based approach for determining fuel prices in the short term, while expediting actions in respect of putting in place a vibrant domestic refining industry.
- 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.
- Government should work hard to remove some of the supply constraints at the Ports.
- Some of the current charges should be waived or reduced, e.g. demurrage, NPA charges. An orderly scheduling of imports to allow for faster discharges of fuel cargoes is also recommended.
- The current low pricing regime for crude oil should allow the government to put in place some form of taxes on fuel imports.

Concluding Remarks

- Government is committed to the deregulation
- Experience has shown that indiscriminate use of energy subsidies is expensive for the economy
- Everybody in the chain loses – the government, private sector and the consumers
- We are aware that removal of subsidy will generate fierce resistance from those who are currently benefiting from it – fuel importers, government officials, labour, the rich and urban elites
- Designing an appropriate and credible compensatory programme for the genuinely vulnerable class will be helpful in the process