Analysts Data Services and Resources
...making data intelligent

POLICY **BRIEF**

NO. **005**

JANUARY 2018

KEY POINTS

- Petrol price rose from N20/litre in 1999 to N65 in 2009; N86 in 2015; N145 in May 2016; and an average price of N172 during the recent shortage.
- Now that the landing cost of petrol is N171, it has become unprofitable for oil importers to sell at the regulated price of N145.
- With the current arrangement, government will either pay subsidy explicitly to marketers or NNPC pay implicitly by selling below costs.

Nigeria can 'Permanently' End its Recurring Fuel Crisis

As Nigeria continues to experience shortage of petroleum products, especially Premium Motor Spirit (PMS, Petrol), the usual long queues are commonplace at most filling stations across the country, with the incidence higher in some areas than others. Just as it is expected of any commodity with supply less than demand, there are situations of selling above the regulated price of N145/litre, manipulation of fuel dispenser meter, emergence of black market and adulteration of fuel, among several others. Regulation and penalty against erring stations notwithstanding, the situation persists in many locations, leading to increase in transportation and input costs to households and businesses; thereby lowering welfare and profitability.

The pump price of petrol in Nigeria has increased several folds during this democratic regime. Petrol price rose from N20/litre in 1999 to N65 in 2009; N86 in 2015; N145 in May, 2016; and an average price of N172 during the recent shortage. The government's justification for price increase has usually been the need to remove fuel subsidy and channel such expenditure into more productive use for the benefit of citizens. These, as well as the argument that some unscrupulous persons were exploiting the subsidy system, were also put forward by the current government when the price was raised from N86 to N145 in May, 2016.

But now that the landing cost of petrol is N171, it has become unprofitable for oil importers to sell at the regulated price of N145. Therefore, Nigerian National Petroleum Corporation (NNPC) remains the sole importer of fuel and it is making efforts to supply the marketers, amidst several other logistical challenges it faces. Also, guided by the information of the mis-match between regulated price and landing cost, incentives for hoarding, diversion, panic buying and speculation naturally arose among marketers and consumers.

The N26 difference between the landing cost and regulated pump price is subsidy, but subsidy was earlier removed and it was not provided for in the budget. This point has been raised in many discussions in the country. However, because NNPC has been the major importer of refined fuel, it means that it has been covering the cost difference, that is, paying the 'subsidy', but not from the federal government budget. This can then explain part of the losses that the Corporation has recorded in the past.

Subsidy cannot be totally removed when the regulated price of fuel is fixed. Since the imported price of fuel is not constant and prices tend to rise over time, due to certain factors, the domestic pump price of fuel will be changing. But if the government decides to fix it at a particular price, it must be ready to bear the cost difference anytime the imported price rises above the regulated pump price. This is called subsidy. In the present case, the price was fixed at N145/litre in May, 2016 when the international oil price was $46.85pbl and the exchange rate was N197/$ and later N284/$ in June, 2016. However, crude oil price has touched $70pb and exchange rate at the Interbank Foreign Exchange Market (IFEM) is at N306 and N365 at the Investors' and Exporters' FX Window (I&EFW). Thus, both the crude oil price and exchange rate have changed, the current petrol price template is therefore no longer applicable.

With the current arrangement, government will either pay subsidy explicitly to marketers or NNPC pay implicitly by selling below costs. There are other proposals to address this problem as given by the Minister of State for Petroleum. These include asking the Central Bank of Nigeria (CBN) to allocate foreign exchange to fuel importers at a rate far below the current IFEM rate or adopting a differential pricing regime whereby NNPC sell at N145 per litre in all its outlets across the country while marketer are permitted to sell at market-determined prices. These solutions are still subsidy variants. But the suggestion from the Minister that 18 months be given to fix the refineries and other facilities to increase domestic refining capacity appears good provided it is properly followed through and with appropriate stopgap measures to moderate the effect of shortages in the interim.

Meanwhile, several arguments have been put forward justifying the need for government to continue paying subsidy on fuel in Nigeria, including:

- Nigeria is a major producer of oil; therefore citizens should not pay a high (market) price for what their country produces.

- Fuel is an important variable in production, higher price implies higher cost of production, increased prices and less competitiveness for the country.

- The country's poverty level is very high and wages are low, it will be difficult to pay a market price without unnecessarily improvising the citizens further.

- Nigeria lacks adequate power/electricity supply and the citizens use fuel to generate their own power which is already expensive for business and household activities.

- Since the country cannot produce/refine its own fuel, citizens should not be made to pay for the inefficiencies coming from inability to fix domestic refineries and establish new ones.

Despite their merits, proponents of these arguments also recognise that subsidy payments arrangement in Nigeria is bedeviled with various corrupt practices. It is therefore not unusual to hear people arguing against price increase and subsidy payment simultaneously. This seems inconsistent as the move against price increase is to further support subsidy payment. One solution therefore will be to argue for the continuous payment of subsidy and at the same time ask the government to ensure that exploitation of the subsidy schemes is discouraged and violators are duly brought to book. Otherwise, everybody should be ready to pay the market price which can sometimes be high.

There are benefits to complete removal of subsidy and paying market price though, which include:

• Money has alternative uses. The amount used in paying subsidy can be used to provide other amenities which Nigeria needs to improve the welfare of the citizens.

• The rich often consume more fuel; thus, subsidy implies that the nation's money is used to subsidize the consumption of the rich as against the poor who need more assistance.

• Whatever is subsidized will be cheaper, hence, over-consumed and this can encourage inefficiencies in the utilization of scarce resources and distort the workings of the market system.

• There must be a guaranteed source of financing subsidy, otherwise it will be unsustainable and drastic measures may be taken when government's source of finance is threatened leading to withdrawal of subsidy and unpredictability in government policies.

• As evident in Nigeria, the system can easily be exploited by corrupt government officials and private players who see opportunities to make quick money through over-invoicing of imports, diversion of imported fuel, among others.

When the two views are juxtaposed, arguments for not paying subsidy may be stronger. This is because of the difficulties in monitoring compliance and the needs to put subsidy payments to more productive use. However, the success of complete subsidy removal premises on certain assumptions and actions such as:

• Significant government expenditure to be made in visible projects and programmes that the citizens trust and feel are enhancing their welfare.

• Efforts must be made to increase the standard of living of the populace and raise their purchasing power

• Electricity supply must be significantly improved to lower fuel demand and use in power generating sets.

• Market price can sometimes be volatile, thus, appropriate measures to moderate such movements without falling into the trap of long-term price fixing.

• Local refining of fuel, which does not necessarily mean overhauling the existing refineries. More important is the attraction of private investment in the sector and ensuring that the market is not dominated by a single individual or entity.

Achieving all these may be a tall order for Nigeria, especially given the experience over the years. But the country needs to make significant achievements in many of these areas to move forward and ***'Permanently' End the Recurring Fuel Crisis***. Otherwise, we would be in and out of subsidy payments and fuel crisis, leading to policy inconsistencies.

CONTACT

+234 7037470047
info@adsrng.com, mail.adsr@gmail.com
www.adsrng.com, www.adsranastat.com

Analysts' House,
Opposite University of Ibadan 2nd Gate,
Ibadan, Nigeria

Analysts Data Services and Resources
...making data intelligent