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Policy Brief on **Fuel Subsidy 2023**

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Policy Brief on Fuel Subsidy 2023

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The Centre for Journalism Innovation and Development (CJID), formerly the Premium Times Centre for Investigative Journalism (PTCIJ), is a West African media innovation and development think (and do) tank. Founded in 2014 as a non-governmental organisation in Nigeria. The Centre has been a leader in investigative journalism, civic technology, open data, verification, safety of journalists, elections and freedom of information and expression. It has a presence in Nigeria, Ghana, Sierra Leone, Liberia and The Gambia.

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Policy Brief:

The Economics of the Petroleum Industry Act and the Nigerian Reality

Background of the Petroleum Industry Act

In 2000, President Olusegun Obasanjo set up a committee, the Oil and Gas Sector Reform Implementation Committee (OGSRC), to review Nigeria's petroleum industry and recommend ways of improving the sector. The Committee was saddled with the responsibility of reviewing the various laws that guided the oil and gas industry, with a view to consolidating and updating the laws into an omnibus regulatory framework.

The recommendations of the Committee evolved into the Petroleum Industry Bill (PIB) that was proposed by the federal executive and transmitted to the National Assembly in 2008. After 13 years in the federal parliament, a significantly revised version of the Bill was finally passed on 1 July 2021 and signed by the President on 16 August 2021 to become the Petroleum Industry Act (PIA).

PIA and the Future of Oil in Nigeria

In 1938, the British colonial government of Nigeria signed a concession contract with Shell D'Arcy for the exploration of petroleum resources across Nigeria. The

Anglo-Dutch company went to work and discovered oil in commercial quantities in 1956. Subsequently, the commercial production of crude oil started in Oloibiri, in the current day Bayelsa State, in 1958. Other international oil companies (IOCs) entered the upstream sector of the Nigerian oil and gas industry thereafter, to mark the beginning of a thriving petroleum industry. Oil soon became the largest contributor to government revenue and foreign exchange earnings in the country. Over the years, Nigeria's average oil production hovered between 1.8 million barrels of oil per day (bpd), and a peak of 2.5 million bpd, although the figure occasionally fell to disturbing levels as a result of restiveness in the Niger Delta and massive oil theft.

The first attempt at regulating petroleum activities in Nigeria was through the Petroleum Ordinance of 1889. Several other laws guiding oil exploitation in the country were also made subsequent to that. In 1959, shortly after crude oil trading began, and the government needed to secure its revenue through the taxation of this new Black Gold, the Petroleum Profits Act was enacted.
In 1969, the Petroleum Act was promulgated and this was the first attempt at a comprehensive law guiding the oil and gas industry in Nigeria. The country's profile as a oil and gas nation also continued to rise with its joining of the Organisation of Petroleum Exporting Countries (OPEC) in 1971.

While the Petroleum Act (which underwent several amendments thereafter) was the principal law for oil and gas activities in Nigeria from 1969, many other subsidiary laws were passed between 1969 and 2000 to guide different aspects of petroleum operations in the country, including the NNPC Act, which was enacted in 1977 to establish the Nigerian National Petroleum Corporation (NNPC) as the national oil company (NOC), overseeing the government's interests and participation in the industry. The thinking of government in 2000, which birthed the PIA, was the need for a consolidation of the different industry laws and to bring them in tune with modern realities in the global oil industry.
In coming into existence, the PIA therefore repealed the NNPC Act and Petroleum Profits Tax Act, among others, subject to certain sunset conditions in some of those laws, to become the overarching framework for the regulation of the Nigerian oil industry.

The PIA is coming at a time fossil fuel is under serious pressure as a source of energy. Environmental activists and sustainability champions have been vocal against the continuous exploitation and utilisation of petroleum resources, citing the consequences on the environment in terms of carbon emission, water pollution, and other forms of environmental concerns. Governments of Western countries and financiers or energy projects have come up with several policies to restrict the development of new ventures in the oil and gas space.
In addition to these challenges, which spill from the global oil and gas industry, Nigeria also faces peculiar challenges in its petroleum industry. The theft of crude has risen to unprecedented levels, with the operators (and government) losing billions of dollars in revenue.

In managing the downstream sector of the industry, the government has forced itself into a tight situation by spending a huge chunk of its revenue in keeping the subsidy regime for premium motor spirit (PMS) going. The government is therefore losing money from both upstream (through the theft of crude oil) and downstream (through subsidy finance) sub-sectors of the industry.

The PIA attempts to protect upstream oil assets, including crude oil transportation pipelines, through its Host Community Development provisions which mandate oil companies to collaborate with their host communities in setting up the Host Community Development Trust, which will be funded by oil and gas companies and used to develop these communities. The Act also provides that damage to petroleum facilities through acts of vandalism will lead to forfeiture of the entitlement of host communities. It is not clear yet whether this PIA provision will be enough to solve the crude theft issue, as the conspirators, which include community members, oil company personnel and security forces, have devised sophisticated ways of stealing fuel along multiple tracks in the pipeline network. The theft also happens on the high seas while the crude is being prepared for export.

Section 205 of the PIA requires the pricing of petroleum products, including PMS, to be done under unrestricted

free market conditions. This means that the subsidy regime has been legally abolished. This is further reinforced by the abolition of the Petroleum Equalisation Fund (PEF) by the Act. PEF was the agency of government responsible for maintaining the uniformity in the pricing of petroleum products. This it did by reimbursing petroleum products marketers the difference between the regulated price of fuel, in this instance, and the market price, alongside other ancillary costs like that of transporting the product across the country.

However, the government suspended the implementation of this provision of the PIA due to practical issues (such as supply disruptions) that would have arisen from its instant implementation. Subsidy therefore continued till May 2023, which was 21 months after the passage of the Act.

Economic Cost of Paying Subsidy

Subsidy is a form of incentive given by a government to support an industry or consumers of a certain good or service to enable their continuous access to such good or service, which would have been impossible or difficult without such support. It is usually given to lessen the burdens of the producers or consumers of the targeted product. The government pays the difference between the price the product would have been sold in the open market and the price the government decrees the producers to sell the product. The Nigerian government subsidises the prices of PMS because it is the most widely used petroleum product in Nigeria. Most public and private transportation vehicles in the country run on PMS and the challenge with the electricity sector has also meant that many businesses and households are powered through electricity generating sets that use PMS. As such, PMS is a critical fuel for the Nigerian economy and people, making government to retain the subsidy regime, even when it had deregulated the prices of other petroleum products.

The retention of subsidy for PMS has however come at a very huge economic cost to the country.

Year	Subsidy Paid (N'Billion)	PMS Regulated Price Per Litre (N)	NGN: USD Exchange Rate (Average)
2005	351	65	131
2006	220	65	127
2007	237	75/65	124
2008	360	65	117
2009	198	65	147
2010	416	65	148
2011	1,900	65	152
2012	690	141/97	155
2013	495	97	155
2014	482	97	156
2015	317	97/87	193
2016	99*	87/145	253
2017	142	145	305
2018	722	145	306

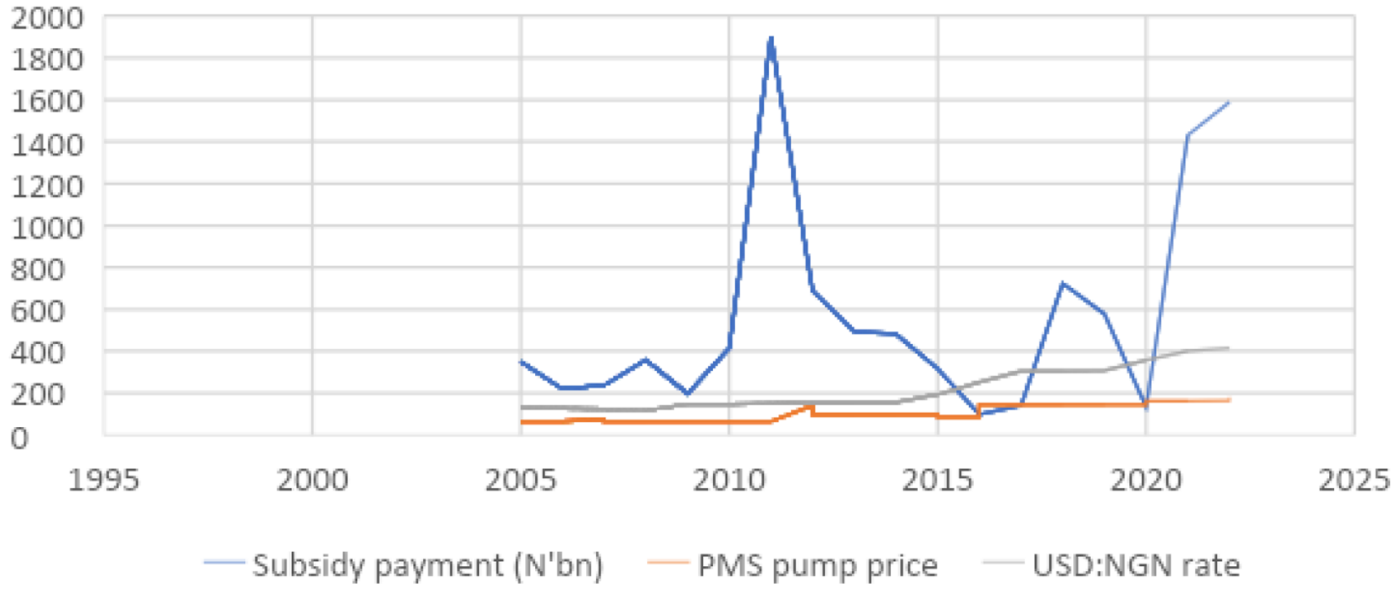
2019	578	145	307
2020	134	145-161	357
2021	1,430	161	400
Jan - June 2022	1,590**	165-180	416
	10,361		

Source: NEITI, CBN, Author Analysis

**The government called the payments 'under recovery' from 2016 before it admitted it as being subsidy payments again from 2018. Hence the figure available for 2016 and 2017 may not be the actual subsidy costs for those years.*

***The figure represents the amount paid during the period. The total claim for the period was N2.6 trillion; and there is still an outstanding N1.01 trillion relating to the period from January to June 2022, yet to be paid as at the end of June 2022.*

Trend in subsidy payment, PMS pump price ad USD:NGN exchange rate 2005-2022



Ballooning Subsidy Bill

The pump price of PMS and Nigeria's foreign exchange rate are both associated with the subsidy mechanism. Nigeria imports its refined products from the international market, making payments in US dollars. In addition to the price of crude oil itself, which directly affects the prices of products derived from it, the exchange rate also plays a part in the government's subsidy bill. Increases in crude price and depreciation of the naira against the dollar – the currency of the international market, mean higher landing costs of the product, and this widens the gap between the market price and the government-controlled price. Both factors have gone through the roof in the past three years, with the dollar escalating in value against the naira and the price of crude also at record high levels. This has resulted in a continuous ballooning of the government's subsidy bill in the past two years.

There is also the question of whether the PMS consumption data is actually correct. The subsidy system appears to have been consistently fraught with corruption over the years and one of the ways this is done is through an inflation of the PMS import and consumption data in order to make massive subsidy claims that are essentially fraudulent.

The subsidy claims as at the end of the first half of 2022 tallied at N2.6 trillion, with N1.59 trillion out of this amount recovered by NNPC from the crude sale earnings due to the government in the same period. If the second half of 2022 followed the trend of the first half, the total subsidy claim at the end of the year could be over N5 trillion, or as put by the International Monetary Fund (IMF), over N6 trillion. Meanwhile, the country budgeted N4 trillion for subsidy claims for the year.

Fiscal Impact

The government of Nigeria expected to earn a revenue of N9.97 trillion in 2022 and proposed to spend N17.31 trillion in the same period, with a deficit of over N7 billion to be financed through borrowing. The subsidy budget alone constituted 23% of the total budget for government expenditure in the year. The actual situation is grimmer,

with the actual subsidy bill projected to surpass N5 trillion on the basis of the trend witnessed in first half of the year, as mentioned above.

NNPC as the main importer of PMS and the agent of the Nigerian government in the sale of crude oil has been offsetting the subsidy bill against the revenue due to the government from crude sales, and in the period from January to June 2022, the subsidy bill had already outstripped earnings from the sale of crude, leaving NNPC with over a trillion naira to recover from the government's post-June 2022 crude earnings.

Apart from the serious negative variance in the subsidy budget, the draining of the government's crude revenue from subsidy recovery is a major fiscal challenge to the country. The implications of this range from the increased borrowing of government, which worsens the current debt service crisis, to the inability of the government to fund other social services and critical sectors like health and education.

Sustainability of Subsidy and the Political Cost

Fuel subsidy removal is a very sensitive issue in Nigeria, with economic and political costs. It is never a popular decision by the government. The events that led to the loss of popularity and subsequent defeat of President Good Jonathan in the 2015 polls, started with an announcement of the removal of fuel subsidy on 1 January 2012. The Jonathan government claimed to have removed subsidy and raised the price of PMS from N65 per litre to N141 per litre. This led to nationwide protests for more than a week, leaving the loss of lives in its wake. The government finally reduced the price of PMS to N95 per litre and came up with a social programme, called the Subsidy Reinvestment and Empowerment Programme (SURE-P), to manage the government's share of the subsidy savings. This was not enough for the government of Jonathan to suffer the loss of political goodwill it never recovered from.

In 2016, the Muhammadu Buhari government claimed to have removed fuel subsidy when it came up with a price modulation policy. It also made the state oil company, NNPC, the major importer of fuel products into Nigeria. This was to solve the problem of corruption in the subsidy payment system, in which many importers were reported to be overstating their import volumes or selling their PMS at market prices in neighbouring countries, while still claiming and receiving subsidy payments on the regulated price variance, for what was purportedly sold in Nigeria.

Despite the increases in price of PMS over the past six years under the Buhari government, the prices of the fuel were still significantly below the market prices, with NNPC deducting the cost differences from the crude oil earnings of government.

It has been clear in the past 15 years that subsidy is unsustainable due to the strain it puts on government finances, but the situation has become most critical in the past few years, triggered by the double whammy of a high oil price and devaluation of the naira on the product importation side, and an unprecedented level of crude theft that badly affects Nigeria's exported crude volume and therefore government's earnings, on the financing side.

Subsidy and the 2023 Elections

As earlier mentioned, the attempt at subsidy removal has led to the deflation of a popular government in Nigeria, and, subsequently, election loss, in the past. The Buhari government claimed to remove subsidy in 2016, with little resistance from people, although what the government did could not be called a total subsidy removal, as it still ended up paying for the under recovery by the importers. Worried by the loss of revenue available to share among their states, Nigerian governors called for subsidy removal or an increase in fuel price to as close to its actual market price as possible. The current landing cost of PMS is over N450 per litre. The total removal of subsidy will raise the price of PMS per litre above that price, also considering local distribution costs and the profit margins of the marketers.

The Federal Government has projected N6.72 billion as subsidy payment for 2023. To avoid having to spend that much, the last Minister of Finance had proposed that subsidy should be terminated at half year in 2023. Clearly, the government was not ready to remove the subsidy any time before the last general elections.

PIA and the Way Forward on Subsidy

The PIA clearly has a provision for the removal of price control on petroleum products. The government had however suspended the implementation of this provision in the Act. The economic cost of this decision is telling on government finances, whereby almost one out of every N4 spent by government in 2022 was on subsidy payment.

A period of low oil price is a good time to remove subsidy, given that prices of crude products are determined by prices of crude oil, in addition to their processing, importing and distribution costs. Local refining could help eliminate the import cost component of the prices of these products. Hence, the government could use the opportunity of the coming on stream of the Dangote Refinery to remove subsidy on crude products, but this will come with another political cost – widespread allegation by citizens against government for timing such a major government policy change on a private businessman's milestone.

Will Dangote Refinery Help?

Businessman Aliko Dangote commissioned his refinery in May 2023, a few days before the end of the government of Muhammadu Buhari. With a refining capacity of 650,000 barrels per day, which is greater than the combined output of Nigeria's four refineries at (unattainable) full capacity, this should be a welcome development to Nigeria. The refinery, according to the Dangote Group, at capacity is expected to produce over 70 million litres of PMS per day, which is higher than Nigeria's projected local demand of 66 million litres per day. However, as crude oil is traded at international rates in the markets, therefore the pricing of this main feedstock will not change. No local oil producer will necessarily sell to Dangote at a price lower than what it would sell to its international customers. Yet, there will some savings in terms of distribution costs, which could mean that the price of the refined products will be lower.

However, Dangote Refinery is not expected to produce at full capacity in the immediate term. It will also take some time before the market reacts to the Dangote entry due to supply chain gaps. There are still billions of litres of refined products that need to be sourced from imports. The drop in fuel price anticipated from local

refining is therefore not expected to come in the short term.

FG's Subsidy Removal Announcement

In his inaugural speech as president of the Federal Republic of Nigeria, Bola Ahmed Tinubu proclaimed that fuel subsidy was soon going to be a thing of the past in the country. In that national address, he was only affirming the endpoint of a process that the immediate past Buhari administration had already put in place. Nevertheless, although this was no new government policy, still some analysts had expected Tinubu would suspend the stance of the previous government and come up with a supplementary appropriation bill to fund subsidy payments beyond the first half of 2023, possibly in the first instance. As this was going to be a fairly unpopular position, the reactions that trailed the pronouncement saw to the initial refusal of petrol stations to sell fuel to the public and then a sudden spike in prices in places where it was being sold, all culminating in hikes in transport fares for commuters, and a gradual spiral in costs across board.

Recommendations

As pointed to above, the best time to remove fuel subsidy is during a period of low crude prices. The government should have fully removed this subsidy in 2015 when oil price dropped to as low as $30 per barrel. We might not have had such moment again in the next few years, and given the burden that subsidy payments have come to bear on Nigeria, we believe that the final removal of subsidy towards the end of the first half of 2023 is in order.

To manage the adverse impacts of this tough decision, the following actions may be necessary:

1. Investment of the funds that would have been used to pay for subsidy in programmes pertaining to the building of infrastructure, education, and healthcare. Visible improvements in these areas will help to build more trust in government and foster citizen appreciation of the hard decision to remove subsidy.
2. While PMS subsidy removal completes the deregulation of the downstream petroleum sector in Nigeria, the regulatory agencies need to ensure that there is no collusion among oil marketers to artificially raise the prices of PMS.
3. The regulators also need to forestall and sanction the inducement of artificial scarcity by petroleum marketers. The Nigerian Midstream and Downstream Petroleum Regulatory Authority (NMDPRA) needs to be very proactive in punishing oil product marketers who hoard fuel and create artificial scarcity.

Beyond the subsidy removal, the new Tinubu administration needs to urgently create and harmonise its policies and accountability mechanisms in the oil and gas sector, especially in the implementation of the PIA. Some of the areas requiring urgent attention include:

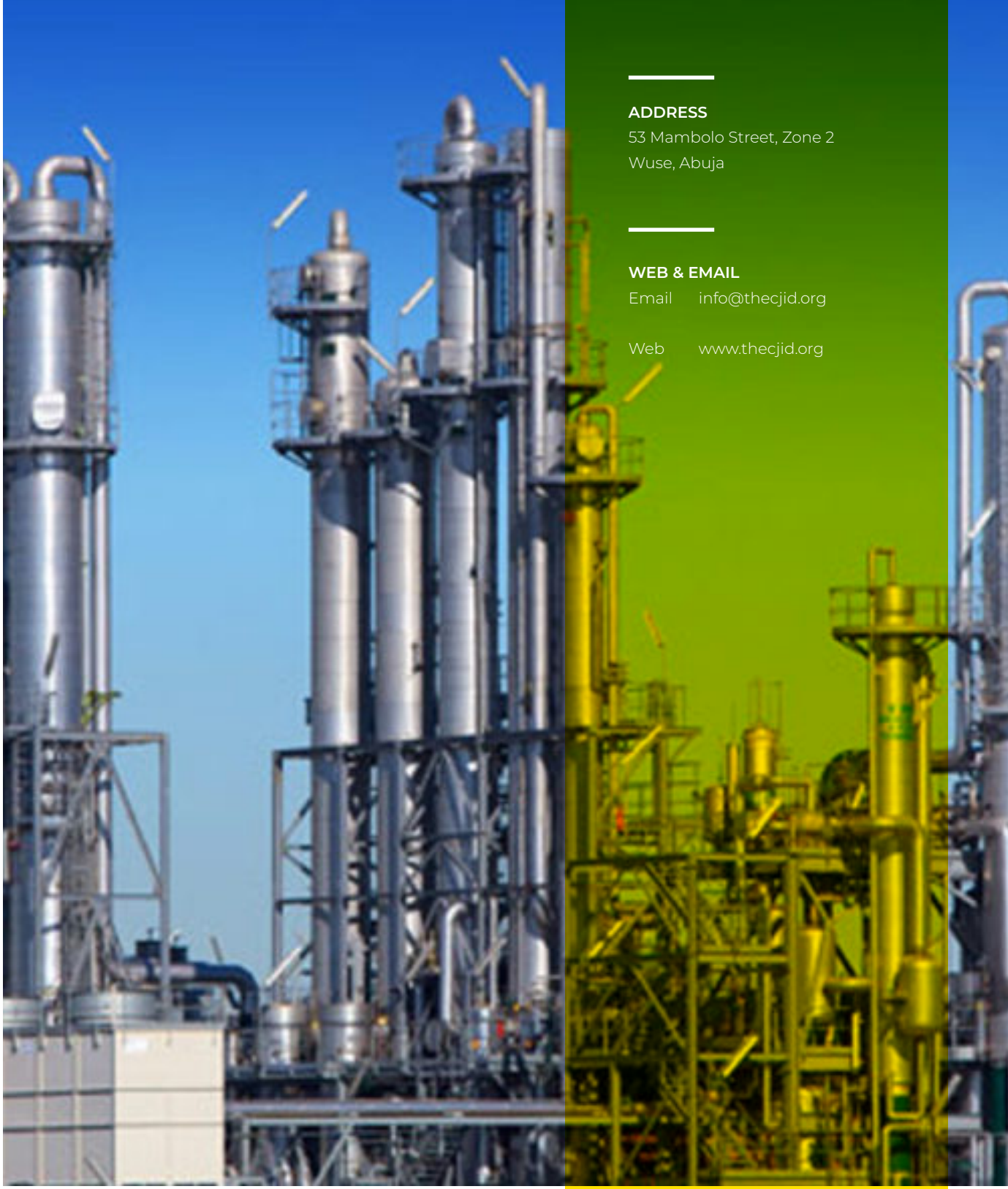
1. I**mplementing stronger frameworks for fair competition and public private partnerships in the sector:** With NNPC now operating as a commercial entity and Dangote Refinery coming on stream, there is a strong imperative to ensure fair competition by regulation. It is also critical to create platforms for a wide range of private actors to get involved in the oil and gas industry through public-private partnerships. This can be by simplifying licensing processes and making industry information publicly available to a wider stakeholder network.
2. **Renegotiating legacy agreements:** Existing joint venture agreements, production sharing contracts, gas purchase agreements and shareholder agreements in the industry are in many cases outdated and in others unfavourable to Nigeria. There is a need for renegotiations for better value retention in the country.
3. **Clarifying regulatory overlaps:** Delineating the

roles of various organisations, especially those of the Ministry of Petroleum Resources and responsibly winding down MDAs of government that no longer have a role in the new regime.

4. **Instituting a single inventory portal to aid sector accountability:** Implementing a centralised technology platform that combines records from different oil and gas industry players in one location, thereby allowing accurate data comparisons from multiple sources and enabling effective trend monitoring.

5. **Harmonising industry regulations, tariffs and taxes:** Bringing together the various taxes and levies into a single streamlined tax regime to reduce administrative burdens and improve transparency and accountability.

6. **Aligning policies and strategies with the Energy Transition Plan:** The energy sector currently has many plans that are at cross purposes with each other. The new administration must harmonise its energy transition agenda, perhaps using the current Energy Transition Plan, alongside other sectoral plans, such as the National Gas Expansion Plan (NGEP), the Gas Flare Commercialisation Plan and its frontier exploration aspirations, as identified in the PIA.



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