



ON ENERGY SUBSIDY REFORM AND SUSTAINABLE DEVELOPMENT IN NIGERIA

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ABSTRACT

Reforming fossil fuel subsidy in Nigeria offers greater opportunities in putting the country on a sustainable path of development. However, removing or reducing fuel subsidy is one knotty issue that has generated severe challenges to government over the decades. Several attempts at this direction have often met stiff opposition from entrenched interest groups. Among other things, a successful reform would require a strong political will to trade off the concentrated benefits of vested interests groups against greater benefits to the society. Achieving this end may not be an easy exercise and a number of issues/options that should be considered have been highlighted in the paper.

Keywords: Fuel subsidy, Fossil fuel, Reform, Sustainable development, Fuel prices, Nigeria.

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1. INTRODUCTION

SUSTAINABLE development constitutes the major guiding principles for public policy formulation in many countries of the world today. Attention to the long-term implications of a given policy is inherent in any definition of sustainable development, which concerns itself with balancing the welfare of both present and future generations. Instructively, energy subsidies have important implications for sustainable development. For instance, a subsidy that ultimately lowers the price of a given energy type to end-users would potentially boost its demand. This in turn can bring about some useful social benefits when improved energy access and affordability by the energy-poor households or employment by domestic industrial sectors are considered as an overriding policy concern. On the other hand, energy subsidies also carry other economic and environmental costs. A subsidy that encourages greater use of fossil fuel has serious implications on climate change and energy efficiency, while those that promote the usage of clean energies or

energy-efficient technologies may have the opposite effect on climate (United Nations Environment Programme (UNEP), 2008). It is the task of balancing the cost and benefit of energy subsidy on the environment and social welfare that constitute one of the policy dilemmas on subsidy reforms, particularly in Nigeria. Evaluating energy subsidies from the perspective of sustainable development requires that these consequences be considered as a guiding principle for policy.

The issue of sustainable development and fossil-fuel subsidy reforms in Nigeria becomes very important in the light of on-going government effort in this direction. Subsidy on premium motor spirit (PMS) has remained a challenging one in the country for the past decades and has dominated public debate in recent times. Past and recent attempts to remove petroleum subsidies in the country have always generated fierce resistance from different interest groups and consumers. Street protests, which occurred following government's recent attempts at subsidy reform on January 1, 2012 demonstrates that future public opposition to fossil-fuel subsidy reform, are likely to remain significant. Perhaps, one of the biggest hurdles before policymakers is how to manage the process of the reform in the face of persistent hostilities to such move.

It is also instructive to note that many countries of the world whose economies are strong do not subsidize fossil-fuel, rather countries that seem to be struggling and in many cases oil producing nations are the ones predominantly subsidizing this product. It had been argued severally in literature and very recently by the IMF that funds used by countries to finance the subsidy would have generated sustainable growth in these countries if they were freed and fossil fuel price allowed for market determination. On a contrary note, many have also argued strongly for the continuous subsidy of fossil fuel in Nigeria, citing inflation as an immediate outcome of subsidy removal, since fossil fuel is a product that has multi-impact on other products and whose price outcome will eventually radically impact on all related products prices in the economy. This uncertain situation calls for a discerning research to probe the desirability or otherwise of fossil fuel subsidy in Nigeria in the overall quest for the country's development sustainability.

This paper provides an insight into a wide range of (sustainability) issues arising from the present fuel subsidy regime in Nigeria. It examines the consequences of fuel subsidy and draws some useful policy options for a sustainable energy sector reform in Nigeria. In addition to this introduction, the paper is further divided into the following sections:

Section 2 – Energy Subsidy

Section 3 – Theoretical Issues

Section 4 – Fuel Subsidy in Nigeria: Stylized Facts

Section 5 – Critical Challenges and options for Reform

2. ENERGY SUBSIDY

2.1. Definition

There is no unique definition of energy subsidy. However, the most common definition is that it is a direct cash payment from the government to an energy producer or consumer with the aim of stimulating the production or usage of a given form of energy (United Nations Environment Programme (UNEP), 2008). It should be noted that this definition is narrow as it leaves out other types of government interventions that also (directly or indirectly) affect prices or cost of energy products. In a broader sense, The US Energy Information Administration (EIA) defined an energy subsidy as any government action designed to influence energy market outcomes, whether through financial incentives, regulations, research and development or public enterprise. In a similar vein, the International Energy Association (IEA) defines energy subsidy as any government action that influences energy market outcomes by lowering the cost of production, raising the prices (revenue) received by energy producers and lowers the price paid by the final energy consumers (United Nations Environment Programme (UNEP), 2008). It is clear from these definitions that in practice, energy subsidies may take different forms. Some forms of subsidies have direct impact on the cost of production (e.g. direct financial grants to producers, preferential tax treatment or tax exemptions) while others have an indirect effect on prices or cost (e.g. government regulations that skew the market in favour of a particular energy-type).

A further exploration into the meaning of energy subsidy as in Todaro and Smith (2009), is that subsidy is an assistance paid to a business or economic sector mainly by the government to prevent the decline of that industry. Also, Bakare (2012) defines subsidy as an activity which is undertaken to sell a product below the cost of production. The last definition, in a simple way, clearly describes the energy subsidy scenario in Nigeria.

2.2. Measurement

Coady *et al.* (2010) offer a very useful explanation on this. According to the authors, fuel subsidy is measured as the sum of two components: pre-tax subsidy and tax subsidy. By definition, the pre-tax subsidy is the amount by which the opportunity cost of supplying fuel is greater than the domestic price (excluding any consumption taxes). When fossil fuels are traded internationally, border prices serve as the opportunity cost. Opportunity cost at end-user level constitutes border prices plus a mark-up for distribution. Thus for oil importers, it is the gap between the cost of imports (including the cost of transportation to border plus the distribution and marketing costs) and the domestic price pre-taxes. For the oil exporters, opportunity costs constitute the revenue forgone by selling the product in the domestic market (at a lower price) instead of exporting (and therefore selling it at a higher price). The tax subsidy, on the other hand, represents a lower tax than the “optimal” fuel tax. It must be noted that the notion of optimal fuel tax will vary across countries and would, to a large extent, depends on revenue requirements of the government as well as the environmental externalities associated with fuel

consumption. It is reasonable to assume that the optimal tax should at least be as large as the consumption tax in a country (Coady *et al.*, 2010).

Practically, in the case of Nigeria, government subsidizes fuel by paying petroleum marketers (and licensed petroleum importers) the difference between the prevailing international market price (called the expected open market price (EOMP)) and government approved retail price. According to the Petroleum Product Pricing Regulatory Agency (PPPRA) pricing template for PMS, the EOMP is calculated as the sum of landing and distribution costs (Table 1). It involves all cost incurred up until product purchase, including production in foreign refineries, shipping, storage and port charges as well as the various profit margins of the marketers. As shown in Table 1, the EOMP for PMS was estimated at N135.58 per liter of fuel as at November 5, 2013, comprising of N120.09 landing costs and N15.49 distribution margin charges. Given government approved retail price of N97.00, it means that the sum of N38.59 per liter of PMS was paid by government as subsidy.

Government-approved retail price is determined through an ad-hoc manner and is often set by the presidency through PPPRA without recourse to any clear indices. Usually, flexibility are not built into the approved retail prices and any attempt to raise it at any point by the presidency often meet with stiff opposition by labour unions and the citizens, leading to compromise and lower price increases.

Table-1. Components of Current PMS Price in Nigeria (as at 5th November, 2013).

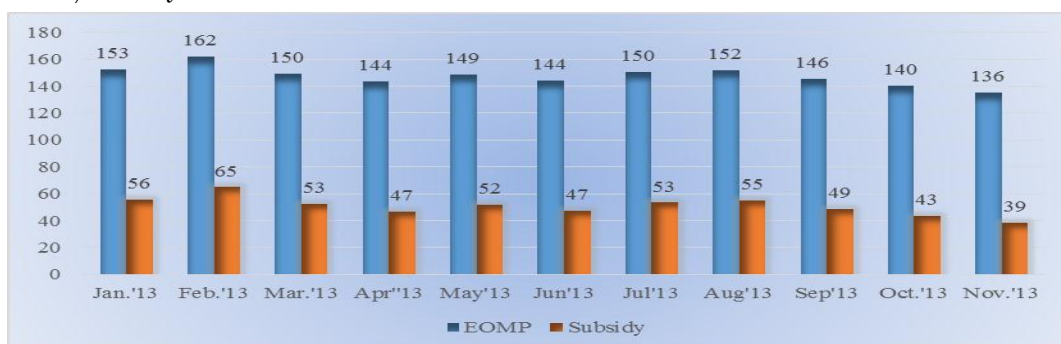
	Naira/Litre*
Cost Element:	
C+F (offshore Nigeria)	109.04
Trader's Margin	1.18
Lightering Expenses (SVH)	3.93
NPA Charge	0.62
Financing (SVH)	1.51
Jetty Depot Thru' Put Charge	0.80
Storage Charge	3.00
Total Landing Cost	120.09
Distribution Margins:	
Retailers	4.60
Transporters	2.99
Dealers	1.75
Bridging Fund	5.85
Marine Transport Average (MTA)	0.15
Admin. Charge	0.15
Total Margins	15.49
Expected Open Market Price (EOMP)	135.59
Subsidy	38.59
Approved Retail Price	97.00

Note: * Based on exchange rate of N158.85/US\$

Source: Underlying data from PPPRA Pricing Template (2013)

However, while government approved retail price is expected to be fixed, the EOMP fluctuates according to the dictates of the world oil market prices and domestic exchange rates. This fluctuations also impacts on the actual size of subsidy paid by the government at any given period. Figure 1 illuminates more on this. The EOMP increased from N153 in January, 2013 to N162 (in February), and fluctuates thereafter to N136 (by 5 November). Consequently, the estimated subsidy per a litre of fuel rose from N56 in January to N65 in February and fluctuates to N39 by early November, 2013. Ultimately, the size of subsidy also depends on the total volume of fuel imported or consumed in the country.

Figure-1. Nigeria: Expected Opportunity Market Price (EOMP) for PMS and Subsidy (per litre of fuel), January–November, 2013.



Note: The last figure is valid as at 5th November, 2013. Others are average for the respective month.

Source: Based on PPPRA Pricing Template (2013)

3. THEORETICAL ISSUES

It must be noted that for countries (including Nigeria) that are often confronted with a substantial fiscal deficits and a rising public debts, the fiscal capacity or space to sustainably subsidize fuel costs could be highly constrained. More so, with oil prices likely to remain elevated, the cost of fuel subsidies would continue to weigh heavily on government budgets, put excessive pressure on the country's foreign reserves and sparked more public borrowing. The recent increase in the domestic pump price of fuel in Nigeria from \$0.44 per liter to \$0.91 and then to \$0.61 per liter (after week-long protests across the country) tends to indicate that government can no longer sustain such high level of subsidy in the face of other critical challenges like decaying infrastructure.

In the midst of these, there are also growing evidence that some of the supposed benefits of fuel subsidy are not captured by Nigerians. In other words, the ensuing scenario of lower fuel price in Nigeria has led to intense smuggling of the product to neighboring countries. It is estimated that about 24 million liters of fuel are often lost to smugglers and black market racketeers on daily basis (Jukwey, 2012) International Institute for Sustainable Development

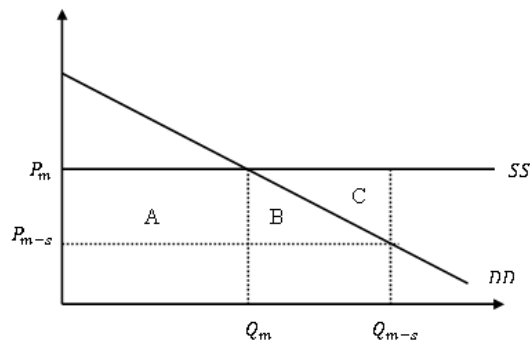
(IISD), 2012. On annual basis, this translates to 8.7 billion liters of fuel valued at more than US\$4 billion (N645 billion) a year.

Typically, energy subsidy would be desirable if the overall social welfare is increased with the subsidy than would otherwise be the case. Indeed, it is widely acceptable that judicious use of energy subsidies could help in addressing market failures or respond to social and distributional objectives, especially where social mechanisms for directly providing income support or safety nets for the poor do not exist (Komives *et al.*, 2005). However, experience around the world tends to demonstrate that in many instances, the net effects of energy subsidies, especially on fossil fuel, are often negative (Von Moltke *et al.*, 2004).

More so, the rationale for fossil fuel subsidy reform could be justified on economic efficiency grounds. Typically, an important concern about fossil fuel subsidy is its impact on economic efficiency, competitiveness and growth, the environment and overall macroeconomic management. Studies (IMF, 2013) have shown that fossil fuel subsidies could create serious distortions to market prices and result in higher energy consumption, create barriers or disincentives for investing in energy infrastructure as well as generating significant negative externalities and unintended distortions, thereby complicating the overall economic management.

The deadweight loss, which is the cost to society created by market inefficiency, in social welfare associated with fossil fuel subsidy, can be illustrated in a simple diagram as shown in Fig. 2.

Figure-2. Deadweight Loss Associated with Fuel Subsidy



If we assume that the supply of fuel¹ is infinitely elastic (which is plausible since Nigeria cannot influence the price of imported fuel determined in the international market), the introduction of subsidy (*s*) lowers the market price from P_m to P_{m-s} and increases the quantity demanded from Q_m to Q_{m-s} . The extent of the overconsumption of the subsidized fuel would depend on the elasticity of demand (DD). Notably, the introduction of subsidy raises consumer surplus

¹ Here we have assumed that the domestic supply of fuel is insignificant and can safely be ignored since most of the refined products are imported.

(by the areas A+B), but this increase falls short of the total fiscal cost of the subsidy (area A+B+C). The area labeled 'C' thus constitutes the deadweight loss associated with the subsidy.

Other implications of the distorted price (P_{m-s}) are worth noting. One is the choices that must be eventually made for the ensuing opportunity cost since the subsidy cost (area A+B+C) must be financed somehow, either through raising taxes or cutting down on other spending (including infrastructure, agriculture, health and education). Continued subsidy would thus imply some trade-off for higher taxes, poor infrastructures, low stock of human capital, etc. This in turn lowers the long-run growth prospects in the country.

Apart from the deadweight losses, lower fuel prices could induce consumers to switch to less fuel efficiency vehicles (Burke and Nishitaten, 2011). High importation and usage of less fuel efficiency vehicles in Nigeria bears serious implications for road congestions and environmental pollution. This in turn undermines progress towards combating CO₂ emissions and therefore climate change. Reduction in fuel subsidy could go a long way in encouraging the ideals of energy efficiency and conservation and help reduce the damage on climate.

In another development, it is not uncommon to notice that the subsidized product is sometimes often misallocated to other unintended uses like fueling generating sets to watch movies overnight. Also, the overconsumption could lead to faster depletion of fossil fuel resources (which is non-renewable), necessitating higher prices in the future than would otherwise be the case (IMF, 2013). A decision to produce a barrel of oil today precludes the possibility of producing it at some time in the future and today's consumption reduces the resource base available for the future. As the current stewards of these resources, present generations owe to future generations the efficient allocation of these resources over time. The ability to do this is a pricing problem which requires a competitive market framework.

More so, low fuel prices through subsidy also affect the entire supply chain. Usually, the cost structure of the oil industry is highly capital intensive and investing in the industry involves some sunk cost. Low expected profitability given the distorted market price contributes to underinvestment by potential investors, while the existing ones suffer from poor maintenance. This creates persistent shortages, reduced quality and poses a threat to security of supply. Allowing refineries to charge cost-recovery price would improve refining and operational efficiency. Insufficient cost recovery in the existing refineries in Nigeria reduced their capacity to properly maintain plant and equipment and constrained them from expanding operations to adequately address growing demand. The IMF and World Bank in Iyobhebhe (2012) theorize that deregulation and removal of oil subsidy may initially lead to inflationary pressures but as the market is opened up to investors, billions of dollars will flow into the downstream sector and more private refineries will open for business in the country. Eventually, the market will self-regulate and prices for refined petroleum products and other goods and services will adjust to natural market level as competition forces prices down. The long-term benefits will thus outweigh short term costs.

Ending fuel subsidy is also a critical policy step towards diversification of the country's energy mix. The reform is critical for transitioning to a more clean energy economy, giving renewable energy sources a brighter competitive chance by reducing the cost differentials. Above all, subsidy regimes have been attributed to encouraging widespread abuse, fraud and rent seeking leading to escalating cost, even of the subsidized product. It has been seen as a major leakage to public funds in many countries advancing such regimes. The subsidy probe carried out in Nigeria by the House of Representative provides some evidence on this. As cited in [International Institute for Sustainable Development \(IISD\) \(2012\)](#), the report indicated that the Nigerian National Petroleum Cooperation (NNPC) – the state-owned oil company and its agencies “allegedly increased the subsidy payable to its suppliers and marketers, including those who did not supply any products”. Also the report revealed that some marketers had collected over N230 billion in 2011 as subsidy claims on 3.3 billion liters of PMS that were never supplied. On another account, the Accountant-General that served during the review period made payments of equal installments of N999 million, a record of 128 times within 24 hours on January 12 and 13, 2009, totaling N127.87 billion. Within this period, only 36 marketers, each with different import and supply capacities, were said to be eligible participants. This makes the logic of equal payments inconceivable, even if there were 128 marketers. A reform of the subsidy scheme can help reduce the widespread abuse, corruption and inefficiency in the management of the country's oil fortunes.

4. FUEL SUBSIDY IN NIGERIA: STYLIZED FACTS

Nigeria is one of the leading oil-exporting countries in the world, with the sector accounting for about 25% of GDP, 75% of government revenue and over 95% of total exports. For over some decades, the country has deliberately maintained low domestic fuel prices. Reasons often advanced for this include (but not limited to): the need to accelerate industrialization through reduced energy costs to domestic industries; the desire to transfer some of the benefits accruing to the country as an oil producing nation to domestic consumers; and also, on equity grounds following the belief that low income earners would suffer most from higher energy prices. Moreover, in a country like Nigeria, where there is a very weak administrative capacity to offer social and economic support through other viable policy mechanisms, the yearning for the retention of fuel subsidy regime tends to overshadow whatever arguments put forward for its removal. What is the actual size of fuel subsidy in Nigeria? The answer is still a subject of intense public debate and controversy. Depending on the source of information, there are wide variations on how much government actually pays as subsidy to petroleum marketers. It has been alleged that figures on the volumes of imported fuel into the country have been significantly inflated and that much of the associated expenditures are in fact captured by corruption. Recent probe into the administration of fuel subsidy by the House of Representatives reveals that the scheme is mired by various degrees of corruption. However, there seems to be unanimous consensus that the size

is growing larger over the years. Available statistics indicate that the value of subsidy in Nigeria has increased from about N1.3 billion in 2006 to over N1760 billion in 2011 and to N1570 in 2012 (Table 2a).

Table-2a. Developments in Fuel Prices and Fuel Subsidies in Nigeria, 2006-2012.

	2006	2007	2008	2009	2010	2011	2012
Fuel Subsidy (billions Naira)	251	290	637	399	797	1761	1570
Fuel Subsidy (% of GDP)	1.3	1.4	2.6	1.3	2.3	4.7	3.6
Fuel Prices (Naira per Liter)							
Diesel (Deregulated)	81	90	118	94	112	152	144
Kerosene (Subsidized)	50	50	50	50	50	50	50
Gasoline (Subsidized)	65	70	70	65	65	65	97

Source: (IMF, 2013).

The slight reduction as at 2012 could be attributed to the partial fuel subsidy removal in 2011 (see Table 2a). Curiously, these figures contradict the ones calculated by PPPRA as summarized in Table 2b below. This inconsistency tends to cast doubt about the actual scope and magnitude of fuel subsidy in the country.

Table-2b. PPPRA-Reported Figures on PMS Imports and Subsidy Cost in Nigeria, 2006-2011

	2006	2007	2008	2009	2010	2011
PMS Imports (billion Liters)	9.3	10.2	11.3	14.4	15.7	21.9
Cost of Subsidy (billions Naira)	151.9	188	256.3 [†]	421.5	673	1300 ^{††}

Notes: † indicates figures from January –July, 2008 only. Other records from PPRRA lumped PMS and Kerosene (HHK) subsidy payments for 2008 together. The total sum of these two subsidies in 2008 were put at N630.5 billion. †† This figure was revised to N2.19 trillion by the Ministry of Finance (after areas of consumption in 2011 were paid in 2012)

Source: PPPRA and OPEC cited in International Institute for Sustainable Development (IISD) (2012).

In spite of these observations, one fact is certain: the amount of fuel subsidy in Nigeria is significant especially when compared to corresponding government spending on other critical sectors. For instance, the figure reported for 2012 (in Table 2a) exceeds the total allocation to other critical sectors in the 2012 budget such as education (N400.15 billion), Health (N282.77 billion), power (N161.42 billion) and transport (N54.83 billion) (see Table 3). A further critical assessment of these allocations reveals that they are much lower than the prescribed global standards and best practices. For instance, the education sector share of N400.15 billion or 8.4% of total budget falls short of the UNESCO recommended level of 24%. Similarly, the allocation to health sector (N282.77 billion or 5.90%) is much lower than the 15% benchmark prescribed by the African Union. The same could be said of the allocation to agriculture (N78.98 billion or 1.6%) which is far below 10% recommended in the Maputo declaration. This trend tends to indicate that fuel subsidy has moved from being an implicit subsidy to becoming an explicit cost to the economy.

Table-3. Nigeria: Key Sector Allocations in the 2012 Budget

	2012 Allocation (N billion)	% of Total Budget
Security	921.91	19.40
Education	400.15	8.40
Health	282.77	5.90
Works	180.80	3.80
Power	161.42	3.40
Agric. and Rural Dev.	78.98	1.60
Niger Delta	59.72	1.25
Petroleum Resources	59.66	1.24
Transport	54.83	1.13
Aviation	49.23	1.03
FCTA	45.57	0.94
Water Resources	39.00	0.82
Science and Technology	30.84	0.63
Lands and Housing	26.49	0.55
Communications Tech.	18.31	0.38

Source: (Centre for the Study of the Economies of Africa (CSEA), 2011)

As shown in Table 4, there are variations in the value of government subsidies across the various states of the federation. This is not surprising given the variations in the demographic structures of these states. A greater proportion of the subsidy is accounted for by Lagos State, which consumed over 15% of the subsidized product, followed by Abuja (over 6%). The amount of subsidized fuel consumed in Lagos State alone is about five times the number consumed in States like Ogun, Kano, Kaduna, Oyo and Rivers and over twenty times the number in many other states such as Akwa Ibom, Ebonyi, Bauchi, Gombe and many others. These figures are just crude and conservative estimates as the actual amount of fuel subsidized for each State is likely to fluctuate each month or quarter given what happens in the international oil market and the naira exchange rate as we earlier noted. Although over half of all African countries are estimated to have some subsidy in place for fuel products, statistics have shown that the relative fiscal cost of fuel subsidy in Nigeria contrasted sharply with other African countries (Figure 3). As at 2011, fuel subsidy consumed over 4% of GDP in public resources in the country (see also Table 2a). This figure more than triple the amount in 2006 (1.3% of GDP) and it constitutes about \$9 billion, or over 30 % of the federal budget. Apart from Angola, where about 5% of GDP is taken up by fuel subsidy, the level of subsidy in Nigeria is quite substantial relative to other nations under analysis.

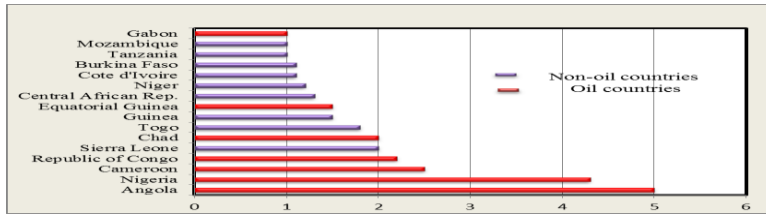
Table-4. Distribution of Fuel Subsidies in 2011 ('000 liters)

State	Amount of Liter subsidized FG for each state	% of Total	Value of Subsidy (Using N77 subsidy per liter and N150/US\$)		State	Amount Liter subsidized by FG for each state	% of Total	Value of Subsidy (Using N77 subsidy per liter and N150/US\$)	
			In Naira	In US\$				In Naira	In US\$
Abia	84,848,780	0.893	6,532,356,060	43,555,707.07	Katsina	113,976,630	1.199	8,776,192,810	58,507,952.07
Adamawa	97,042,100	1.021	7,472,241,700	49,814,944.67	Kebbi	100,904,850	1.062	7,769,673,450	51,797,823.00
Akwai	70,790,820	0.745	5,450,893,140	36,339,287.60	Kogi	194,314,340	2.044	14,962,204,180	99,748,027.87
Ibom	76,324,040	0.803	5,876,951,080	39,179,673.87	Kwara	103,908,530	1.093	8,000,956,810	53,339,712.07
Bauchi	74,818,380	0.787	5,761,015,260	38,406,768.40	Lagos	1,449,075,060	15.244	111,578,779,620	743,858,530.80
Bayelna	14,369,230	0.151	1,106,430,710	7,376,204.73	Nasarawa	65,110,780	0.685	5,013,550,060	33,423,533.73
Benue	85,019,500	0.894	6,546,501,500	43,643,343.33	Niger	288,653,880	3.026	20,044,064,350	137,908,889.07
Borno	89,239,290	0.939	6,870,695,330	45,804,388.87	Ogun	286,256,550	3.012	22,044,064,350	146,960,429.00
Cross-River	129,931,280	1.367	10,004,708,560	66,698,057.07	Ondo	106,205,310	1.117	8,177,808,870	54,518,725.80
Delta	225,148,770	2.384	17,336,455,390	115,576,368.60	Osun	124,943,170	1.314	9,620,624,090	64,137,493.93
Ebonyi	41,134,760	0.433	3,167,376,520	21,115,843.47	Oyo	340,965,890	3.587	26,233,583,530	174,890,556.87
Edo	166,752,930	1.754	12,839,975,610	85,599,837.40	Plateau	129,868,110	1.366	9,999,844,470	66,665,629.80
Ekiti	54,356,220	0.572	4,185,428,940	27,902,859.60	Rivers	370,582,710	3.899	28,534,868,670	190,232,457.80
Enugu	85,895,580	0.905	6,544,939,680	43,633,064.40	Sokoto	78,240,310	0.834	6,101,503,870	40,876,692.47
Gombe	65,984,360	0.694	5,080,795,720	33,871,971.47	Taraba	48,544,170	0.511	3,737,901,090	24,919,340.60
Imo	75,278,050	0.792	5,796,409,850	38,642,732.33	Yobe	118,686,260	1.249	9,138,842,020	60,925,613.47
Jigawa	75,968,870	0.799	5,849,602,990	38,997,353.27	Zamfara	76,320,680	0.803	5,876,692,360	39,177,949.07
Kaduna	299,720,320	3.153	23,075,464,640	153,866,430.93	Abuja	620,253,460	6.525	47,761,626,420	318,412,176.13
Kano	371,326,960	3.906	28,592,175,920	190,614,506.13	IML*	2,721,074,940	28.626	209,522,770,380	1,396,818,469.20
					TOTAL	9,505,615,550		731,932,397,350	4,879,549,315.67

Source: Centre for Public Policy Alternatives (CPPA) (2012)

Note: *IML = Independent marketer's lifting; % of Total was calculated by the Authors

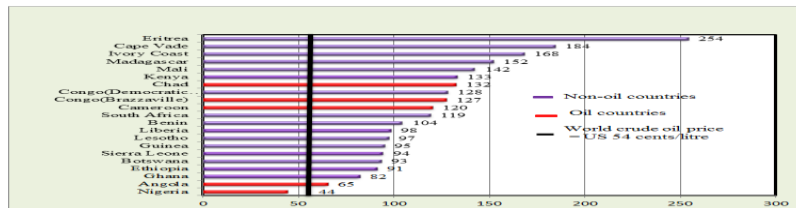
Figure-3. Size of Fuel Subsidy (% of GDP), 2011



Source: The World Bank (2012)

A substantial dispersion equally exists in the prices of fuel across countries largely because of the corresponding variation in fuel subsidies. Figure 4 captures the disparities in the prices of gasoline in some selected countries in Sub-Saharan Africa, including Nigeria. The figure shows clearly that as at 2010, Nigeria has the lowest price among African oil producers at \$ 0.44 per liter compared to other neighboring countries like Benin (\$ 1.04), Niger (\$ 1.07), Cameroon (\$1.20) and Chad (\$ 1.32). This price falls below the world benchmark level of \$ 0.54 per liter.

Figure-4. Domestic Gasoline Prices in 2010 (US cents/litre)



Source: The World Bank (2012)

5. CRITICAL CHALLENGES AND OPTIONS FOR REFORM

5.1. The Challenges

There appears to be no public argument on whether fossil fuel subsidy removal in Nigeria would not free more funds to the government. That point is very obvious, for even a desirable subsidy, if scrapped, can surely reduce government budgetary expenditure. But past and recent experience demonstrates that there are critical challenges confronting government efforts in this direction. Although the Nigerian government appears desirous to reforming energy subsidies through raising fuel prices, each of such attempts have been consistently greeted with fierce resistance by entrenched interest groups (who benefits immensely from the status quo) as well as some Nigerians who have come to view cheap energy prices as their own share of the country's rich oil wealth. In the absence of viable social safety net programmes, most Nigerians are easily convinced to believe that fuel subsidy is the only social welfare package they could enjoy from government. Thus to many, fuel subsidy is likened to a resource transfer payment which allow them to benefit from the country's oil wealth. One of the biggest challenges therefore remains how to tackle the political barriers to reform. Irrespective of the intellectual and economic

arguments in favour of reform, it can be difficult to demonstrate the economic cost of subsidy in a language that the public can easily understand (Morgan, 2007). Whereas gains from energy efficiency and environmental sustainability are abstract and sometimes difficult to demonstrate to the public, those that want to keep subsidy find it much easier to provide concrete examples of their social benefits (such as the number of jobs supported, low cost of transportation, lower domestic food prices, etc) and therefore emphasized the direct and immediate short-term impact of the reform (especially on the general cost of living). Unfortunately, Nigeria's oil fortunes remain a paradox. As the twelfth largest producer of crude oil, most of the domestic oil consumption is rather satisfied through importation of refined products. Over 98 percent of its crude oil production was believed to have been exported in 2009 (IEA, 2010) as the country lacks the capacity to refine most of its crude. The four state-owned refineries, operating sometimes at about only 20 % of installed capacity and rarely above 40%, could only satisfy about 20% of domestic demand (IMF, 2013). Ironically, for an oil-exporting country like Nigeria, an average Nigerian expects to consume the product below international market prices (even where the refined products are imported) as their own share of the oil wealth.

It must be acknowledged once more that fuel subsidy in its face-value is not necessarily bad. It is clearly justified where the net effect is positive. However, the desired impact (although difficult to measure and sometimes highly judgmental and political) depends largely on the manner in which it is applied and how it is targeted. Experience tends to show that any subsidy aimed at helping the poor and vulnerable groups should at least satisfy the following critical conditions (United Nations Economic Commission for Europe (UNCECE), 2002; Morgan, 2007; United Nations Environment Programme (UNEP), 2008):

- i. **Well-targeted** in such a manner that subsidy goes only to those who are meant and deserve to receive them;
- ii. **Efficient** in the sense that subsidy does not undermine incentives for suppliers or consumers to provide or use a service efficiently;
- iii. **Soundly based**, that is, justified by a thorough analysis of the associated costs and benefits;
- iv. **Practical**, in the sense that the amount of subsidy is affordable and that it is possible to administer the subsidy at a reasonable cost;
- v. **Transparent**, so that everyone can see the amount of subsidy and the beneficiaries;
- vi. **Limited in time** such that both consumers and producers do not get "hooked" on them and the cost does not spiral out of control;

Unfortunately, it is very obvious that the current fossil fuel subsidy regime has fallen short of almost the entire critical standards stated above. For instance, the current fossil fuel subsidy scheme is 'universal', in the sense that no conscious attempt has been made to target the scheme at the poor and vulnerable groups. As a result, the benefits tend to flow disproportionately to the higher income earners who consume more fuel. Arguments are sometimes made that even if the poor do not purchase gasoline at all or may not consume as much fuel as the rich, they would

likely be indirectly affected through increase in consumer prices occasioned by the reform. This concern is partly true as low fuel prices could help reduce the cost of public transportation as well as the cost of goods that require transportation, such as food (Iwaro and Mwashu, 2010).

However, blaming increase in consumer prices wholly on fuel price increases has not been empirically born-out. Prices of goods and the general cost of living in the country have been noticed to have increased in the past, even when there was no corresponding increase in fuel prices. Besides, recent study (International Institute for Sustainable Development (IISD), 2012) have shown that there is no guarantee of the extent to which the much expected indirect benefit related to fuel subsidy will be transmitted to final consumers. Food producers, for instance, may have lower cost of production occasioned by cheap transport fuel. But that alone does not necessarily imply that they would lower the prices of their products accordingly. In most cases, the subsidized fuel may even “leak” into usage in unintended purposes, where for instance, it benefits mostly large foreign-own and private hotels in the urban areas. More so, the supposed benefits are sometimes captured by administrators and middle-men in the supply-chain and may not even reach the final consumers. It is a common phenomenon for subsidized fuel to be sold by marketers above the official government approved price in many States in the country. Another critical (and perhaps the biggest) challenge facing the reform process is the credibility problem of government. Given government’s history of failed promises, there is deep-seated public distrust about the sincerity of renewed government intentions to re-direct spending arising from the reform to other critical areas of the economy. The government is yet to establish that it truly could live up to its commitments as demonstrated by the recent impasse in resolving the prolonged strike by the Academic Staff Union of Universities (ASUU). The fallout of the 2005 Paris Club debt relief package vis-à-vis worsening social indices in the country years after the relive also weighs heavily against government public image. It can be recalled that one of the arguments at the time was that debt serving burden was one of the major obstacles to development. Eventually, Nigeria was able to get about \$19.3 billion debt relieve package. This frees over \$1 billion in annual debt servicing which government promised to use in funding critical infrastructure and developmental programmes. However, after the relieve, not much was heard about what the funds were used for as socio-economic indicators remains worse, fuelling further speculations and suspicion. According to UNDP (2011) Nigeria remains in the low human development category, with a score of 0.459, positioning the country at 156 out of 187 countries in the sample.

5.2. Options for Reform

Fuel importation in Nigeria is a very lucrative business for few powerful individuals with high connections in government and therefore ending it would always prove politically difficult. Fuel subsidy has had a long history in Nigeria spanning over three decades and people have become used to the status quo of low fuel prices. The longer the subsidy has existed, the more

entrenched the opposition to reducing it. Government need to address the various obstacles to reform and identify practical mechanisms for overcoming public resistance. That there are clear obstacles to reform does not call for inaction if the country must grow sustainably. There are arrays of short and long term policy menus that government can consider in this regard.

- a) Fuel subsidy reform would require strong political will to take tough decisions that would benefit the society as a whole in the long-term. Reforms have always been a difficult challenge. The human nature resists change. It must be noted that there are always losers and winners in any reform. Most of the losers would certainly put up a fight of sabotage to scuttle the effort. Successful fuel-subsidy reform would require strong institutional and administrative capacity to initiate and implement tough decisions for societal interest. The political will of the Nigerian leadership was recently put to test during the fuel subsidy probe by the Ad-hoc Committee of the House of Representatives. The Committee headed by Hon. Farouk Lawan-who in turn came under serious allegation of bribery and corruption-discovered large scale fraud and abuse of subsidy funds between 2009 and 2011 by powerful and influential interest groups. The inability to punish the culprits involved in the scam further deepens the country's poor governance records that have make corruption to be endemic and constitute a cog in the wheel of the reform.
- b) The reform of fuel subsidy should be gradual and in phases in order to soften the pains of the reform on those who stand to lose out in the process and help them to adapt. Government runs the risk of exposing itself to high level protest and anger if fuel subsidy is abruptly removed. This is one basic lesson from the last attempt in Nigeria as it occurred in a quick and surprise pace. Such an abrupt move makes the harsh repercussions of the reform to be felt quickly and ignite stiff opposition from labour unions and other interest groups. While acknowledging that fuel subsidy reform is a complicated process that may always evoke strong public opposition, a gradual reform process may offer a means of reducing or softening public opposition. Nonetheless, gradual removal is not without any drawback: the benefits may be delayed and the reform runs the risk of being reversed if poorly managed ([United Nations Environment Programme \(UNEP\), 2008](#)).
- c) Government should consider introducing other compensating measures that support the real incomes of the targeted social and vulnerable groups in a more direct and effective ways. Although it is often argued that fuel subsidy has helped in reducing the cost of living for the vulnerable and poor households in Nigeria, experience have also tend to show that it does not represent the most cost-efficient means of achieving this end. It is practically clear that much of the benefits are captured by higher-income groups due to their higher consumption level. Thus, if protecting the poor and vulnerable groups in Nigeria is the key policy objective, a universal fossil fuel subsidy for all categories of households does not seem to do a good job. A reform, which frees more funds for government, offers greater opportunities to develop and expand the range of other social safety nets that effectively address the needs of the poor and

compensating them for the price increase. Conditional cash transfer programmes targeted at the most needy income groups appears to be one of the most effective instruments. The SURE-P programme introduced in the height of the recent fuel subsidy removal protest should be encouraged and sustained. However, it must be noted that it one thing to introduce a programme and another for ensuring the effectiveness and sustainability of such programme or policy. Every of such targeted policy calls for monitoring and evaluation at given intervals. The absence of such mechanism could help explain why introduced urban mass transit buses by government are currently non-existent on most roads in Nigeria.

- d) There is need for sustained broader communication and enlightenment of the general public on the overall socio-economic benefits of the reform as well as in-depth consultation with all the stakeholders in the reform process. Fuel subsidy removal is socially unpopular to an average Nigerian. Regrettably, fuel subsidy survives in part because the groups that bear the burden are unaware of the cost they are paying (Victor, 2009). Sustained and comprehensive public awareness campaign well ahead of the reform would help them to understand why the reform is necessary and how their money can be directed to other social goals. Government at all levels must be vigorously involved in the campaign effort. Such broad communications should be able to address the concerns of the stakeholders, detailed the plan use of the savings, outline mitigation measures, emphasize the broader positive impacts on environment, productivity and growth. Lessons from the last attempt at reform in Nigeria indicate that the communication campaign carried out in 2011/12 by the Presidency was not sustained. The public information campaigns on radio and TV as well as the print media were short-lived, especially after the end of the protest. The SURE-P brochure which detailed priority social spending on which the fuel subsidy savings would be spent was not timely released and did not gain wide distribution as expected. Moreover, while the SURE-P brochure outlined a detailed list of federal intervention programmes, the State and Local Governments, which stands to receive almost half of the subsidy savings, were silent, probably to secure their political seats. Ironically, the initial debate on fuel subsidy removal was strongly supported by many state governors, who at the time, needed more resources to enable them pay the new minimum wage to their civil servants. The unfortunate silence by state governors, who suddenly pretend to be 'on the side of the people' against 'unpopular policy' helps to strengthen the protest against the reform.
- e) There is need to practically demonstrate commitments towards the reform process and towards achieving the announced aims of the subsidy reform. This may not be very practicable in the short-run due to administrative constraints. However, credibility of government commitment to compensate vulnerable groups and judiciously use the accrued savings from the subsidy reform for well-targeted development interventions remains an essential ingredient for the success of the reform. Government can signal its commitment and improve the prospects for the reform in a number of ways. These include ensuring greater

accountability and transparency of the subsidy scheme when it is not fully eliminated; monitoring and disseminating information on the use of subsidy savings when it is partially and gradually eliminated; incorporating all key stakeholders in the reform process; ensuring efficient monitoring and evaluation of the social safety net programmes; timing the reform with improvements in basic amenities and improving public financial management as well as the overall governance index prior to the reform.

- f) Increasing public availability and transparency of fuel subsidy data could help overcome some of the challenges related to the reform. Presently, lack of transparency about exact amount of subsidy spending in the country has given room for spurious arguments. While some analysts have insisted that subsidy in the country is a ruse, other parties with vested interest maintained that government investment in state-owned refineries and/or measures to stop abuse by marketers are preferable to subsidy removal. Nigerians need to factually understand the scope and nature of fuel subsidy. This can be useful in at least three ways. First, availability and transparency of data can help dispel the myths and misinformation about the magnitude and beneficiaries of fuel subsidy in the country. Second, it would encourage informed discussion and debate between those with deep interest in maintaining the status quo and those interested in the reform. Third, it could also help in regaining public thrust in the reform agenda.

6. CONCLUSION

It is increasingly apparent that fuel subsidy being a “universal subsidy” for all categories of income groups does not offer the most efficient way of addressing the needs of the poor. The scheme has constituted a huge drain on government purse and ending it offer greater opportunities to expand the scope of social safety nets for the vulnerable groups and protect them from the price shock, and sustainably grow the economy. However, removing subsidy is knotty issue and could be politically sensitive and costly. Irrespective of the intellectual arguments for reform, government must pay close attention to several challenges that are fundamental to ensuring a successful reform and initiate actions to overcome them. A number of such challenges and some useful options that are crucial to the reform have been highlighted in the paper.

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