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## Premium motor spirit (PMS) subsidy removal : its potential impacts for the Nigerian economy


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## PREMIUM MOTOR SPIRIT (PMS) SUBSIDY REMOVAL: ITS POTENTIAL IMPACTS FOR THE NIGERIAN ECONOMY

### ABSTRACT

*Subsidy payments on Premium Motor Spirit (PMS) in Nigeria have impacted significantly on the revenue of the government over the years. The tempo has been on the upward trend over time, resulting in fiscal concerns necessitating immediate government attention. The economy suffered operational challenges, leading to loss of huge revenues. Several suggestions on how to address the issue have been provided by various governments over the years, but a permanent solution to the problems are yet to be achieved. Thus, this paper reviews the issues and found that, beyond the revenues concerns to the government, importing PMS into Nigeria takes about 49.0 per cent of the foreign reserves annually. It suggests initiatives that could reduce the consumption of PMS substantially, while improving production to reduce imports, and utilisation of foreign exchange, as well as removing existing subsidy.*

**Key Words:** Premium Motor Spirit, Subsidy Payment and Local

### 1.0 BACKGROUND TO THE STUDY

Generally, subsidy is a form of support either financial or non-financial, usually extended by the government to economic agents, such as institution, business, or individuals, with the aim of promoting welfare. Specifically, subsidy on Premium Motor Spirit (PMS), simply known as petrol, in Nigeria, gasoline in the United States and Europe, is the difference between the price a consumer ought to pay for the pump price of petrol and the actual price paid.

PMS is an essential item in the commodity basket of individuals and businesses for light vehicles and small size combustible generating sets, all over the world. In Nigeria, it is the major fuel used by light vehicles for transportation. It is also used in rural and urban homes and communities for self-generation of power supply in addition to their transportation needs. The Udoji Salary and Wage

increase award in 1973 revolutionised the demand for PMS in Nigeria, increasing it to an unprecedented level stretching supply capacity. The policy, which entailed substantial increase in disposable income of workers, was meant to address distortions and increase productivity in the civil service. Homes transcended from using dry-cell batteries for electrical equipment to small captive power generation requiring substantial PMS. The combined effects of these developments, created a new domestic market for PMS, increasing in tandem with the rise in the acquisitions of light vehicles and small generating sets through increase in disposable income. Over the years, PMS consumption had been on the increase, a vital commodity in the national consumption basket, and becoming a sensitive item in government's budgetary allocation.

The PMS market has become a monopoly with the government

controlling its price. This price, which is uniquely linked to developments in the international oil market, is subject to changes in crude oil price and refining cost. The PMS market, therefore, requires a robust, deep and effective commodity market, widely spread, with significant strategic commercial fuel reserve management to function properly. Government of Nigeria, as in most places, had to regulate the market given its strategic relevance in political and fiscal space.

There had been agitations for subsidy removal, but in most cases, only partial removal was achieved, due to stiff resistance mainly from labour unions and the Nigerian masses. However, the advocacy to remove Nigeria's PMS subsidy is stronger now than in the past. This is fuelled by dwindling crude oil prices, coupled with recommendations from world energy bodies with the International Energy Agency leading the campaign, various non-governmental organisations (NGO's) advocacy groups, including the Nigerian National Petroleum Corporation (NNPC).

Experience from other climes showed that Angola recently removed its petroleum subsidy and increased its pump price by 1.0 per cent. In June 2014, Egypt commenced the policy that would gradually phase out its energy subsidy in five years. Energy subsidy was US\$20 billion at mid-year 2014 in Egypt, amounting to 144 billion Egyptian pounds annually.

Justification for subsidy removal has been anchored on its continued encouragement of wasteful consumption, smuggling, discouraging investment, distorting markets, increasing global warming, benefiting few individuals and the draining of government budget, arising from the

importation of PMS.

Nigeria's PMS subsidy is visibly a pre-tax consumer subsidy, with payment drawn from crude sales and Sovereign Debt Notes (SDN). However, with declining crude oil price, coupled with crude oil theft and the production of shale oil in the US, the sustainability of PMS subsidy by the Federal Government becomes difficult (Nigerian Eastern Naval Command, in 2014).

The removal of PMS subsidy, therefore, is clearly inevitable. However, there is need to adopt well-thought steps to ensure a smooth transition, to a zero PMS subsidy in Nigeria, in terms of policy, instruments and projects to cushion the negative impact of the removal.

This paper, therefore, seeks to examine the impact of PMS subsidy removal on the Nigerian economy, and proffer some recommendations. It appraises the history of subsidy removal in Nigeria and examines the policies following these actions during the period. Following the introduction in Section 1, Section 2 reviews the related literature on the impact of energy subsidies removal. Section 3 presents the structure of fuel subsidies in some selected countries, while Section 4 outlines the stylised facts on the management of PMS subsidy in Nigeria. Section 5 evaluates the Nigerian PMS market, taking into consideration its characteristics and the interplay of market forces. The Section also analyses the demand and supply as well estimates of subsidy paid from 2009 to 2013. In Section 6, the paper examines the possible impact of the removal on various sectors of the economy, including the PMS market, in terms of demand/supply dynamics; administration of the PMS processes; government revenue; and inflation. Policy recommendations are

presented in Section 7, while Section 8 concludes the paper.

## 2.0 REVIEW OF RELATED LITERATURE ON THE IMPACT OF ENERGY SUBSIDIES

Various studies have stressed the fiscal cost, social and environmental impact of energy subsidies (International Energy Agency (IEA) 2011; International Monetary Fund (IMF) 2013a; Parry et al., 2014; World Bank 2010). However, only few empirical studies have been conducted on the impact of energy subsidies on the Nigerian economy.

Acemoglu (2014) examined a number of reasons why inefficient forms of redistribution occur in a political economy. He noted that energy subsidies warrant a separate treatment, given their peculiar features, highly regressive, and have become widespread over the recent past. He concluded that energy subsidies needed to be examined explicitly so as to evaluate effectively the effect of subsidies on the provision of public social services in an economy.

Plante (2014) adopted an open economy dynamic general equilibrium model, using oil as an input into the production function of firms. The findings suggested that fuel subsidies reduced aggregate welfare, mainly by distorting the relative price of non-tradable to tradable goods.

It is often argued that energy subsidies protect the purchasing power of the poor. However, given budgetary constraints, energy subsidies will usually come at the cost of lower spending elsewhere in the budget, including priority social sectors, like education, healthcare, and infrastructure, among others. The question, therefore, is why should the poor



support energy subsidies, a form of redistribution that disproportionately benefits upper income groups. This question seems difficult to answer considering the fact that energy subsidies will not be useful, especially if they crowd-out public spending that are relevant to the poor.

It is against this backdrop that Ebeke and Ngouana (2015) developed a simple political game theory between the elite and the middle-class to examine the conflicting allocation of public resources between energy subsidies and public social spending. They noted that high energy subsidies and low social spending may indeed emerge in equilibrium, especially in economies with weak domestic institutions, where the delivery of public good is subject to various bottlenecks. Subconsciously, the poor support that equilibrium because energy subsidies provide a small, but certain benefit to consumption, whereas the delivery of the public good is subject to leakages. The elite, knowing this, sets a subsidy rate that is sub-optimally high, thereby crowding-out public social spending.

In the same line of argument, UNEP (2003) asserted that natural resource subsidies generally have a number of perverse consequences which include the following: sending false price signals that encourage misuse of resources; hindering the development of substitutes that are more environmentally-friendly; distorting international trade; and diverting scarce financial resources from other social purposes. Yet these subsidies persist. In some cases, subsidies still serve legitimate social goals, benefiting poor or marginalised consumers, while in other cases, governments are reluctant to undertake reform for

fears that their removal may negatively affect competitiveness and employment in certain sectors. Other empirical studies have also used computable general equilibrium models (CGE) to assess the welfare impact of removal of energy subsidies. Oktaviani et al., (2007) used a CGE model to analyse the removal of fuel subsidy in Indonesia, which occurred in three stages over the period 2000-2005. Prices were increased by 12.0, 30.0 and 29.0 per cent in 2000, 2001 and 2005, respectively. They found that the short-to-medium-term macroeconomic performance of the Indonesian economy was impaired by the removal of the subsidies, due to a reduction in household incomes and increase in domestic prices. The study further revealed that the removal of fuel subsidies increased the overall incidence of poverty in the Indonesian economy from 8.9 per cent to 12.9 per cent of the population, with rural areas worst affected. They noted, however, that there was little difference in terms of inequality over the period, adding that declines in household incomes were fairly uniform across income groups. The authors therefore concluded that government should offset the impact of subsidy removal by introducing palliative measures to compensate households, especially those at the lower rung of the ladder. They, however, questioned whether the means to distribute these funds effectively exist.

Manzoor et al., (2009) used a CGE / Mathematical Programming System for General Equilibrium (MPSGE) analysis based on the specific structure of the Iranian energy sector. The modeling of the implicit subsidies was based on the assumption of an implicit rent payment to the specific government ownership

of mineral resources in oil and gas extraction. The study showed that removing energy subsidies led to the shrinking of output, hyperinflation and the reduction in urban and rural welfare by 13.0 per cent and 12.0 per cent, respectively.

Abouleinein et al., (2009) examined the impact of phasing out fuel subsidies in Egypt over a five-year period. Using a CGE model, they found that the elimination of energy subsidies, without any deliberate policy actions to cushion the effect, would reduce average annual GDP growth by 1.4 percentage points over the reference period and depressed the welfare levels of households at all levels of the income distribution. Inequality was reduced, indicating that the larger welfare effects impacted on households in the richest quartile of the distribution.

However, according to the author, it should be noted that some CGE models, do not account for the impact of the redistribution of the proceeds from subsidy removal to the poor. Thus, if subsidies are better targeted or the proceeds thereof are channeled directly to the poor, through cash transfer, the poor may benefit from subsidy removals.

Table 1 presents an analysis based on poverty and social impact evaluation implemented by the World Bank and other authors to simulate the impact of subsidies removal or increase in energy expenditure. Countries where household surveys were used to simulate the impact of subsidy removal on the bottom and top quintiles were also reported. The results showed that overall, the impact of subsidies removal was more on the poorest household (bottom quintile income group) than for the middle and top quintile income groups.

Finally, Daniel and Zachary (2013) noted that despite the strong fiscal, economic, and social rationales for the removal of subsidies, governments, particularly in the Middle East and the North Africa have struggled to abolish subsidy regimes. The reason being that subsidy reform was always greeted with popular opposition. The public, especially the poor, benefit through income support from subsidies, and therefore will revolt against any attempts at price liberalisation. Evidence of this was seen in the reform effort of the 20th century, which triggered massive and often violent street demonstrations.

However, recent literatures, particularly those from international financial institutions, have posited that overcoming this resistance is possible. Clear communication of policy changes, compensation for the most vulnerable social groups, and a gradual phase-out of subsidies should, in theory, minimise public dissent (Daniel and Zachary, 2013).

### 3.0 STRUCTURE OF FUEL SUBSIDIES IN SELECTED COUNTRIES

#### 3.1 India

Demand for petroleum products to fuel economic growth, burgeoning population and rising income, defines the economic climate of India. Majority of demand is met by domestic production in recent years, but static domestic crude oil production has necessitated an increase in importation of crude oil by refineries.

Prior to 2002, PMS prices were fixed by the Oil Coordination Committee (OCC), determined, largely, by international prices, and subsidies were generally minimal. Between 2007 and 2008, international oil prices increased sharply, with no corresponding change in domestic prices, resulting in huge subsidy payments by the government. The magnitude of fuel subsidies increased from 0.6 per cent of GDP in 2004/5 to 1.9 percent in 2007/8 and peaked at over 2.0 per cent of GDP in 2008/09 as well as in 2011/12 (IEA, 2009). Subsidies were financed through both

budgetary and non-budgetary sources. In 2004/5, subsidies were financed through absorbing losses and transfers from upstream oil companies to state-owned Oil Marketing Companies (OMCs). Subsequent subsidies were financed by government issuing oil bonds to OMCs in lieu of direct transfers from the budget, and by increasing financing from upstream companies to OMCs. In recent times, the sharp increase in subsidies has been financed mainly from the budget and by upstream companies. OMCs also used part of the profits from the sale of other unregulated fuel products to offset these subsidy losses. From 2011/12, three-fifths of all on-budget financing were in the form of direct budget transfers to OMCs, with the remainder financed by upstream transfers. By June 2008, the Central Government had reduced excise tax on petrol from 26.0 per cent ad valorem plus Rs.7.50 per litre (as at end-2004) to a flat rate of Rs.13.35 per litre.

The government of India has earmarked various strategies to remove fuel subsidies over the decade. However, a comprehensive plan to reform subsidies has not been officially implemented.

#### 3.2 Angola

Angola is the second largest crude-oil producer in sub-Saharan Africa after Nigeria with nearly 80.0 per cent of government revenue coming from crude oil export (OPEC, 2015). However, about 82.0 per cent of the consumed refined petroleum products are imported, due largely to insufficient refining capacity and refinery inefficiencies. With large imports of refined petroleum products and high international crude oil prices, landing costs of fuel are high. Thus, the government subsidises this cost, making Angola one of the world's largest fuel prices subsidisers. As

**Table 1: Poverty and Social Impact Evaluation**

Impact of Subsidies Removal on the bottom and top quintile income groups of Various countries			
Country	Energy Subsector	Effect on bottom quintile income group	Effect on top quintile income group
Armenia	Utilities	9% increase in expenditure	3% increase in expenditure
Bolivia	Hydrocarbon Derivatives	5.4% reduction in real income	
Egypt	Fuel, Kerosene, Gas, LPG	7.7% reduction in income	4.1% reduction in income
Ghana	Petrol, Kerosene, LPG	9.1% reduction in income	8.2% reduction in income
Jordan	Fuel	5.4% reduction in real income	4.1% reduction in real income
Madagascar	Electricity, gasoline, diesel & kerosene	3.2% increase in expenditure	2.3% increase in expenditure
Mali	Gasoline, diesel & kerosene	1.8% increase in expenditure	1.9% increase in expenditure
Moldova	Electricity, central heat, central gas, LPG	2.2-6.9% increase in expenditure	2.6-7.7% increase in expenditure
Sri Lanka	Fuel	2.9% reduction in real income	2.2% reduction in real income
Tajikistan	Electricity	16% increase in expenditure	

Source: Armenia (PSIA, 2001), Bolivia (PSIA, 2004), Egypt (PSIA, 2005), Madagascar (Andriamihaja & Vecchi, 2007), Mali (Kpodar, 2006), Moldova (PSIA, 2006), Tajikistan (PSIA, 2007), Ghana, Jordan & Sri Lanka (Coady et al., 2006)



at 2014, the price of gasoline and diesel were 55.0 and 67.0 per cent below the average price for sub-Saharan Africa, respectively (IMF, 2014). For imported products, the authorities calculate subsidies as the difference between the fixed retail price and the international price, augmented by domestic margins. For domestically refined products, instead of the international price, the authorities use a benchmark price that corresponds to the budgeted price for crude oil augmented by a refinery margin fixed by decree at 12.5 per cent in 2014. Total margins amount to about 43 Kwanzas (or US\$0.44) per litre on average in 2014, which appears to be high by international standards (World Bank, 2005; IMF, 2013).

Increased consumption of petroleum products leads to more budgetary spending on subsidy pay-outs. The consumption of fuel products quadruplicated since 2005, reaching 119,000 barrels per day in 2013. Diesel accounts for the bulk of consumption (63.0 per cent), followed by gasoline (15.0 per cent) and LPG (11.0 per cent). Angola spent almost 4.0 per cent of its 2013 budget on fuel subsidies.

Following the recent drop in oil prices, Angola has witnessed a gradual shift in its fuel price regime to a near free price system, reducing drastically the burden on the state of the cost of subsidies. Angola has increased fuel prices by 25.0 per cent from US\$0.61 to US\$0.76 per litre in recent months, and has saved 110.0 billion kwanza (US\$1 billion) from reduced subsidies since October 2014. A complete removal of subsidy on fuel was expected by September 2015 and state-run oil company, Sonangol, was expected to determine the price of petrol.

### 3.3 Ghana

Ghana relied mainly on imported petroleum products. Thus, provisions for fuel subsidy payouts were an integral part of the country's budgetary expenditure. Effort to liberalise Ghana's subsidised fuel price regime started in 2001 as part of the International Monetary Fund (IMF) Poverty Reduction and Growth Facility Programme, which determined domestic prices using the prevailing international price of crude. However, global oil prices soared towards the end of 2002, and the price setting regime was abandoned.

In 2003, the price setting mechanism was re-introduced and fuel pump prices went up by 90.0 per cent. By 2004, cost of fuel subsidies had risen to 2.2 per cent of GDP, and government was forced to withdraw the price mechanism once again due to the forthcoming elections then. A third attempt to liberalise fuel prices began in 2005 when the government implemented several strategies to ensure that the price mechanism worked. However, fuel subsidies were restored briefly in 2008 and reinstated in 2009. Political reasons, such as the elections, determined if government would bow to pressure to reinstate subsidies or not in Ghana's fuel subsidy regime. In early 2013, the Ghanaian Government finally introduced the removal of fuel subsidies over the first half of the year. Prices of petrol, kerosene, diesel and LPG were increased between 15.0 per cent and 50.0 per cent, until prices attained their market levels in mid-September 2013. If this was not implemented, the government would have spent about GHS 2.4 billion (approximately US\$1.2 billion) on fuel subsidies, and about 3.2 per cent of GDP (Laan, et al., 2010).

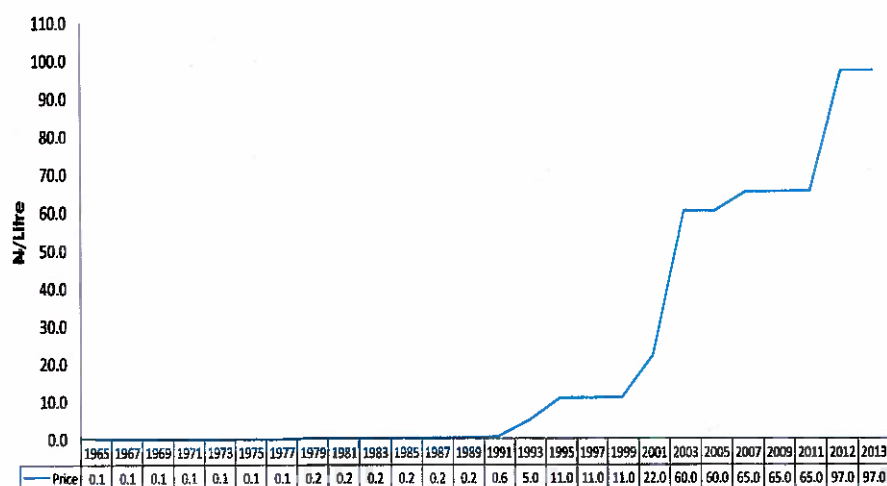
## 4.0 STYLISED FACTS ON PMS SUBSIDY MANAGEMENT

### 4.1 History of PMS Subsidy in Nigeria

Nigeria's PMS subsidy has a long history, dating back to the period when the refineries with a combined capacity of 445,000 barrels per day (bpd) began to lose production capacity at an average of 30.0 per cent in the early nineties. From that period, it began to fluctuate between 20.0 and 37.0 per cent (NEITI Audit Report, 2003).

Discovery of crude oil in 1956 at Oloibiri in Ogbia Local Government of Bayelsa State by the Shell-BP and its subsequent successful commencement of commercial production, brought Nigeria into oil prominence by 1958. The domestic demand for its derivatives led to the establishment of the first refinery in 1965 at Alesa Eleme, Port Harcourt with a capacity of 60,000 barrels per day. The refinery was owned 100.0 per cent by Shell-BP. Shortly after the civil war, PMS demand rose partly to the need for reconstruction and partly due to the effect of the "Udoji Award" when many civil servants purchased lots of vehicles. This prompted the Federal Government to dedicate 445,000 bpd for domestic consumption. Furthermore, government created the NNPC in 1977 by the Decree No. 33, to take over the Shell-BP refinery activities and established three additional refineries at Kaduna, Warri and P/Harcourt between 1978 and 1989.

The management of the PMS market is a daunting task and complicated beyond the capabilities of domestic market instruments to cope with, thus, leaving government intervention as the only feasible option. Figure 1 depicts the history of PMS Price from 1977 to 2016.

**Figure 1: Trend of Nigeria PMS Pump Price (1977 to 2016)**

Source: CBN Statistical Bulletin

Figure 1 shows the pump price of PMS in Nigeria, which stood at N0:08K/litre in 1977, rose moderately in 23 years to N0.60K/litre in 1990. After 1990, the price rose from N0.60K/litre to N11:00K/litre (1,733 per cent) in 1994. It further rose by 136.4 per cent to N26:00K/litre in 2000; and by 130.77 per cent to N60.00K/litre in 2004. Between 2006 and 2008, the price increased moderately to N65:00K/litre. In 2012, attempt was made to remove the fuel subsidy by raising the pump price to N145.00k/litre. However, the attempt was resisted and eventually fixed at N95:00K/litre, leaving government to pay the difference of an average N48:00k/litre. In January, 2015, owing to the fall in the international price of crude oil prompt, the Government announced a 10.3 per cent reduction in PMS pump price from N97.00k/litre to N87.00k/litre. This has remained the pump price of PMS until May 2016 when the subsidy was finally removed and the pump price rose to N145.00/litre.

Reasons adduced to justify each price adjustment over these years were mostly on fiscal sustainability. In 1978, when the then military administration of General Olusegun Obasanjo

increased the pump price of PMS from N0:08K/litre to N0:15K/litre, the reason given was that government needed to generate enough money to fund the 1979 General elections, expensive military transition to civilian rule as well as cover the social needs of Nigerians (Ering and Akpan, 2012). In 1982, the Shagari administration reviewed the price upward from N0:15K/litre to N0:20K/litre following a fall in crude oil price that eroded substantially the revenue base. When the Babangida administration first reviewed the price from N0:20K/litre kobo to N0:60K/litre in 1990, it was premised clearly on raising government revenue. Subsequent reviews to N0:70K/litre in 1992 and later to N3.25K/litre in that same year and eventually to N5:00K/litre in 1993 were for the same fiscal sustainability. However, the adjustment by President Olusegun Obasanjo in 1999 and sustained by Goodluck Jonathan had privatisation as major concerns.

Each adjustment by the Federal Government had always been resisted by Nigerians. The reason advanced for protesting against price adjustments has consistently been anchored on the lack of accountability by the

government. To pacify the people, therefore, the government always came up with programmes and projects, as a way of ameliorating the pains of fuel price increase.

## 4.2 Review of Policy Schemes on Subsidy Removal

The first and significant response to domestic PMS management in Nigeria was the expansion of domestic production capacity from 60,000bpd to 445,000 bpd, in 1977 through the establishment of three refineries (Warri, 1978; Kaduna, 1980; new PH, 1989) under a new corporate public company- the NNPC. This was immediately followed with the Petroleum Equalisation Fund (PEF). In addition, more recently, Nigerians were introduced to the Subsidy Re-Investment and Empowerment Programme (SURE-P).

### 4.2.1 Nigeria National Petroleum Corporation (NNPC)

The establishment of the NNPC was the first policy action of the Nigerian Government aimed at strengthening the management of the Nigerian oil sector. The NNPC was established in 1977, under the statutory instrument- Decree No.33 of the same year by a merger of the then Nigerian National Oil Corporation (NNOC), with its operational functions and the Federal Ministry of Mines and Power with its regulatory responsibilities. The decree established the NNPC as a public organisation that would manage all government interests in the Nigerian oil industry. In addition to its exploration activities, the Corporation was given responsibilities in refining, petrochemicals and products transportation as well as marketing. Between 1978 and 1989, the NNPC constructed refineries in Warri, Kaduna and Port Harcourt and took over the responsibility of refining 60,000 barrels formerly handled by the Shell petroleum.

Since its formation, NNPC has played key roles in the petroleum industry, including, the regulation of foreign and local oil producing firms, advancing technology transfer, developing local content and indigenous participation in the industry.

#### **4.2.2 The Petroleum Equalisation Fund (PEF) Management Board**

In 1979, Government encouraged major marketers to open filling stations in remote areas to expand the outreach of petroleum products. This led to distortion in the pricing of petroleum products, as the distance between the depots and the sales outlets differ across regions and locations. The development necessitated the establishment of the PEF management Board by the government to ensure uniform prices for petroleum products, across regions in the country.

The PEF management board was established by Decree No.9 of 1975 (as amended by Decree No. 32 of 1989), to administer uniform prices of petroleum products throughout the country. This is achieved by reimbursing marketer's transportation differentials for petroleum products movement from depots to their sales outlets (filling station), to ensure uniform pump price of petroleum products throughout the country. Marketers whose petrol stations are located close to depots contribute to the equalisation fund, while marketers with petrol stations farther away from depots claim from the funds. An agreed matrix is applied by all stakeholders to determine marketers who have to contribute to the fund and how much, as well as marketers who have to be reimbursed and by what amount.

#### **4.2.3 Petroleum Trust Fund (PTF)**

Following the increase in the pump price of PMS from N3.25K/litre to N11.00K/litre in October 1994 by the former Head of State, General Sani Abacha, the Petroleum Trust Fund (PTF) was set up to distribute the gains from the price increase through social and infrastructural projects in critical sectors of the economy. Thus, the PTF was created and funded from revenue generated by the increase in price of petroleum products, to evenly spread developmental projects across the country. Following the inauguration of the Board of the Fund in March, 1995, it began operations in 1996 with an initial capital of about N60.0 billion. Its mandate was all encompassing and included: the rehabilitation of roads and waterways; educational and health institutions; providing textbooks and stationaries; procuring essential drugs and vaccines; providing water supply systems; reviving the ailing agricultural sector; connecting rural areas to the national electricity grid; providing railways and telecommunications infrastructure; and ensuring consistent food supply.

Additional revenue sources for the Fund included money lent, deposited with or granted to the Fund by the Federal Government. It also included all subventions, fees and charges for services rendered by the Fund. One year after its commencement, the Fund disbursed N24.3 billion on roads, N21.2 billion on security, N7.8 billion on health, and N3.0 billion on other projects. Other disbursements included N2.2 billion on water supply, N936.0 million on food supply and N476.0 million on education. The Fund also realised a total of N1.049 billion from various investment activities (African Business; June 1998).

#### **4.2.4 Subsidy Re-investment and Empowerment Programme (SURE-P)**

Following the protest that trailed fuel subsidy removal on January 1, 2012, the Federal Government introduced SURE-P and inaugurated a committee with a mandate to spend the excess funds on projects that would have significant social impact and alleviate the suffering of people. Thus, SURE-P was established in 2012 as a social safety net programme aimed at helping poor households cope with the impact of PMS price increase, owing to the partial removal of subsidy on PMS. The Programme was, therefore, set up as an intervention fund, responsible for overseeing and ensuring the effective and timely implementation of projects to be funded with savings accruing from the partial removal of subsidy on PMS. The Programme had the following components as areas where intervention would be targeted: Maternal and child health services; Public works/youth employment programme; Urban mass transit scheme; and Vocational training schemes.

### **5.0 MARKET DYNAMICS**

#### **5.1 Supply**

The supply of PMS is currently from two sources – the NNPC and a group of private participants under the Petroleum Products Prices Regulatory Agency (PPPRA) import scheme.

##### **5.1.1 Supplies from NNPC**

It has been mentioned that from 1965, the domestic PMS supply was from the Shell-BP Port Harcourt, refining 60,000 barrels per day (bpd). By 1978, the ownership of Shell-BP Port Harcourt refinery, which was then operating at 35,000 bpd, was transferred to the NNPC. Later in the years, the NNPC production capacity of 445,000 bpd began to decline amidst increasing local consumption. The Company resorted to various



arrangements to fulfil its statutory responsibility of supplying PMS to the country. These measures included crude oil swap and crude processing, involving international refining arrangements as well as domestic production. The crude swap is an arrangement with foreign refineries that give the NNPC PMS and Kerosene (DPK) in exchange for crude. The refining arrangement, involving off-shore refiners, is the most expensive source of PMS. NNPC sends part of the 445,000 to off-shore refiners at international crude price. It pays additional processing fees and transports the refined product back home to add to the national supply stock. The last resort comes from the four refineries producing at a

capacity dependent on the technical functionality of the refineries. The structure of NNPC supply from recent statistics in Figure 2 shows that the bulk of NNPC PMS supplies came from Swap, comprising 59.0 per cent of the total supply.

Contribution from the local refinery was 22.0 per cent. This point to the fact that the 445,000 bpd dedicated crude for domestic production is grossly under-utilised.

### 5.1.2 PPPRA Supplies

#### 5.1.2.1 The Unbundled Retail Price

The PPPRA was constituted in 2003 to coordinate the importation of petroleum products to Nigeria. Besides the

NNPC, local refinery, Swap, and offshore processing, all imports of PMS, is based on quarterly allocations from PPPRA.

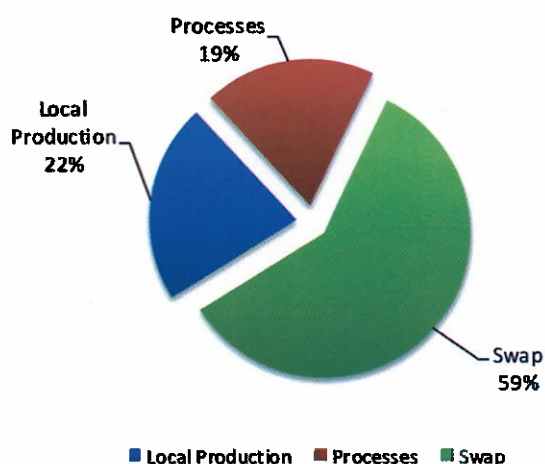
From the PPPRA template, the total cost of a litre of PMS comprise:

1. The PMS import cargo cost, measured in metric tons per US dollar (MT/US\$), varies in line with prevailing exchange rate at the time of import. According to PPPRA, this is the monthly moving average cost of products as quoted on Platts Oil gram. The reference spot market is North West Europe (NEW). It is necessary to emphasise that this component of the cost is uniquely tied to the international price of crude as they move in the same direction and magnitude as shown in Figure 3.

2. Freight is also measured in MT/US\$. It is the average clean tanker freight rate (World Scale (WS) 100) as quoted on Platts. It is the cost of transporting 30,000 mt of product from the 'NEW' to West Africa (WAF). Trader's margin of US\$10/MT is also factored into the freight cost.

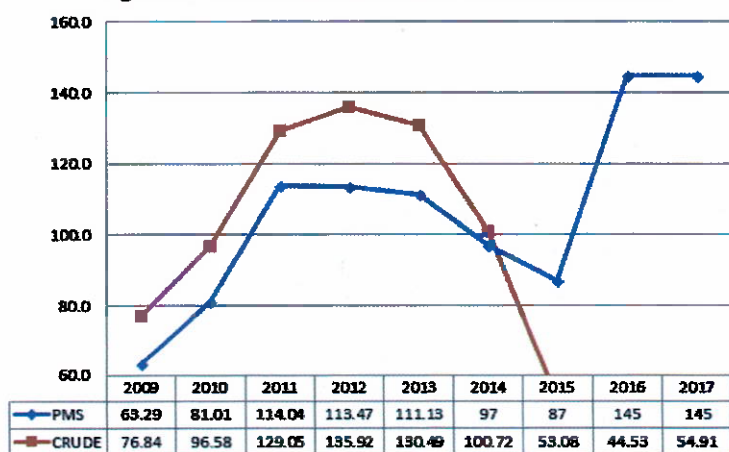
3. Lightering expenses is another item paid in MT/US\$. Ship-to-Ship/Local Freight charge is the cost incurred on the trans-shipment of imported petroleum products from the mother vessel into daughter vessel to allow for the onward movement of the vessel into the Jetty. This charge includes receipt losses of 0.3 per cent in the process of moving products from the high sea to the Jetty and then to the depot. The mother vessel expenses are based on the allowable 10 days demurrage exposure at the rate of US\$28,000 per day. The Lightering expenses also includes the shuttle vessel's chartering rates from offshore Lagos to Port Harcourt, which currently stands at N2.00 per litre and N2.50 per litre, respectively. Transshipment process is a result of peculiar

Figure 2: NNPC PMS Supply Structure



Sources: PPPRA and NNPC

Figure 3: Movements of PMS and Crude Prices



Sources: Reuters (2017) and PPPRA (2017)

draught situation and inadequate berthing facilities at the Ports.

4. Nigeria Port Authority (NPA) charge is the fourth item also in MT/US\$. It is the harbour handling charges collected by the NPA for use of Port facilities. The charge includes VAT and Agency Expenses. Currently, NPA charge attracts US\$10.50/MT on the pricing template.

5. Other costs include financing, which refers to stock finance (cost of fund) for the imported product. It includes the cargo financing based on the International London Inter-Bank Offered Rates (LIBOR) of +5.0 per cent premium for 30 days (for Annual LIBOR of 2.07 per cent and LIBOR cost of 7.07 per cent). Also included in the Finance cost

is the interest charge on the subsidy element being awaited for an allowable 60 days period at the Nigerian Inter Bank Offered Rate (NIBOR) of 22.0 percent.

6. There is also the Jetty Depot Throughput, which is the tariff paid for use of facilities at the Jetty by the marketers to move products to the storage depots. The value is currently N0.80/litre.

7. Storage Margin is for depot operations, covering storage charges and other services rendered by the depot owners. The charge is currently N3.00/litre.

After adding all the seven aforementioned costs, the total sum, which is classified as the landing cost, attracts further

charges/fees to arrive at the expected retail pump price. The additional charges/fees include: distribution margin, comprising retailers (N4.60 per litre), transporters margins (N2.99 per litre), dealers margin (N1.75 per litre), Bridging Fund (plus Marine Transport Average) (N6.00 per litre), and Administrative charge (N0.15 per litre).

## 5.2 Processing and Derivation of Subsidy

Initially, PPPRA processes transactions of marketers, and pays from the Petroleum Subsidy Fund (PSF) it manages with the CBN. In the reforms that followed the increase in pump price in 2012, this payment system was replaced with issuance of Sovereign Debt Statements. It is backed by Sovereign Debt Notes by Debt Management Office

**Table 2: PPPRA Pricing Template (2013)**

Sub-Total			Financing			Landing Cost			Other Charges	Dist. Margin	Expected
(MV)	(SVL)	(SVH)	(MV)	(SVL)	(SVH)	(MV)	(SVL)	(SVH)			OMP*
Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre	Naira/Litre
131.98	134.53	135.03	1.96	2.04	2.06	133.94	136.57	137.09	6.15	9.34	152.58
140.97	143.52	144.02	2.24	2.32	2.34	143.21	145.85	146.36	6.15	9.34	161.85
129.07	131.63	132.13	1.86	1.94	1.96	130.93	133.57	134.08	6.15	9.34	149.57
123.21	125.76	126.26	1.67	1.75	1.77	124.88	127.51	128.03	6.15	9.34	143.52
129.69	132.32	132.82	0.60	0.61	0.62	130.29	132.93	133.44	6.15	9.34	148.93
123.99	126.55	127.05	1.69	1.78	1.79	125.69	128.32	128.84	6.15	9.34	144.33
129.85	132.40	132.90	1.88	1.96	1.98	131.73	134.37	134.88	6.15	9.34	150.37
131.35	133.90	134.40	1.93	2.01	2.02	133.27	135.91	136.42	6.15	9.34	151.91
125.45	128.00	128.50	1.74	1.82	1.83	127.18	129.82	130.33	6.15	9.34	145.82
120.13	122.68	123.18	1.56	1.65	1.66	121.69	124.32	124.84	6.15	9.34	140.33
119.91	122.46	122.96	1.56	1.64	1.65	121.47	124.10	124.62	6.15	9.34	140.11
123.52	126.07	126.57	1.67	1.75	1.76	125.19	127.82	128.34	6.15	9.34	143.83

\*OMP (Overall total market price)

Source: PPPRA template Unadjusted



(DMO), with which the marketers receive payments from the CBN through the Office of the Accountant General of the Federation (OAGF).

Being an internationally traded good and a pre-tax subsidy, the ideal benchmark price for calculating Nigeria PMS, according to IMF (January, 2013), is the international price appropriately adjusted for transport and distribution costs. However, transportation and distribution costs are significant in the composite retail pump price in Nigeria. So, the PMS subsidy calculation using international import price would have to add transportation and distribution costs as well to subtract the actual cost recovery for the suppliers.

Nigerian PMS subsidy formula therefore is:

$$\text{Subsidy} = pw + \delta - pc$$

Where:

pw = the IMF recommended internal PMS Price

$\delta = \Sigma$  (freight, lightering charges, NPA charges, sum of all finance charges, jetty and storage fees)

pc = the regulated pump price (then N97.00K/litre)

PMS Pre-tax subsidy surely exists in Nigeria as the price paid by consumers is below the cost-recovery price ( $P_c < P_w + \delta$ ).

### 5.3 Pressure on Foreign Exchange

Using the Central Bank of Nigeria's window, which is the main supplier of foreign exchange, the pressure of petroleum products import on Nigeria's scarce foreign exchange is calculated and presented in Table 3. This is derived by reflecting the exchange rate on total naira used in importing, the landing cost which includes the cost of cargo import and other charges paid in US Dollar.

Figure 4 shows that PMS import based on this window was 25 per cent in 2009 and this grew yearly to 49.0 per cent in 2012 and decreased to 40 per cent in 2013. Further, PMS importation constituted about 33.0 per cent and 24 per cent of the total allocation of forex for importation of visibles in 2016 and 2017, respectively. Most of this would have been saved if supplies were all domesticated by utilising the entire 445,000 bpd.

#### 5.3.1 PMS Demand

The National Bureau of Statistics (NBS) revealed that, the major consumer of PMS in Nigeria is the transport sub-sector led by light vehicles and in states with heavy commercial and government activities. The second most common item that drives consumption of PMS is captive power from small generating sets.

Visits to Shopping centres in major cities in Nigeria give a glimpse of the heavy reliance of commercial activities using small generators fed mainly by PMS.

Data on PMS consumption of all the states in the country, including FCT is summarised and presented in conical graph form (see Figure 5). The state between Kwara and Nasarawa in the graph is Lagos and between Osun and Plateau is Oyo State.

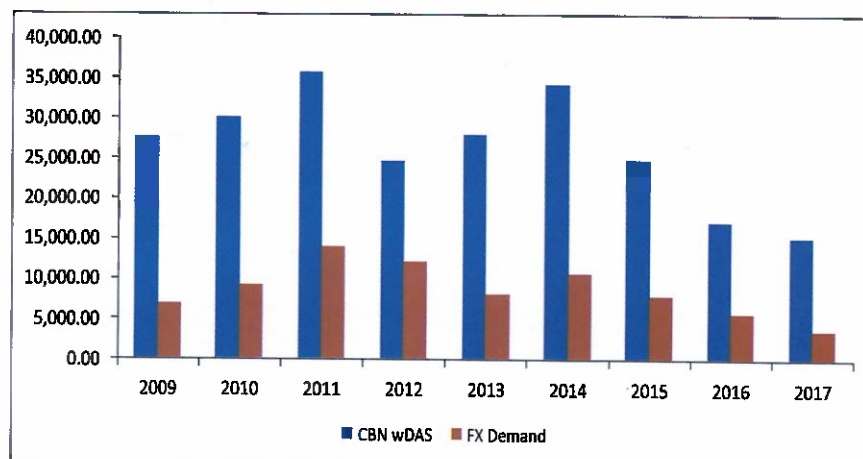
Lagos state at an average of 21.62 per cent during the sample period consumed the highest quantity of PMS relative to other thirty-six states, including FCT, followed by FCT with 9.11 per cent. Oyo and Ogun states consumed 4.16 and 3.50 per cent, respectively. Lagos and FCT alone accounted for about one-third of the national

Table 3: Fuel Import Foreign Exchange (FX) Consumption

Year	Total PMS Consumed	Landing Cost	Amount in (N' Million)	Exchange Rate \$/N	Total FX in (US\$' Mn)	Total CBN WDAS US\$ Million
2009	13,203,538,881	76.84	1,014,559.93	149.69	6,778	27,531
2010	14,361,191,832	96.58	1,387,003.91	150.48	9,217	30,172
2011	17,031,429,794	129.05	2,197,906.01	158.21	13,892	35,698
2012	14,108,831,138	135.92	1,917,672.33	157.32	12,190	24,627
2013	14,749,415,923	130.49	1,924,651.28	157.27	12,238	30,836

Sources: RSD staff computation, 2015

Figure 4: PMS FX Demand Vs. wDAS Total Supply in US\$



Sources: RSD staff computation, 2017



consumption.

### 5.3.2 The PMS Subsidy

The supply of PMS from the NNPC and the PPPRA sources indicated clearly a wide gap between the cost suppliers incurred in procuring the products and the retail price authorised by the government for dispensing. During the period under review, this gap widened to as much as N67.00/litre in 2009 and narrowed to about N48.00/litre in 2012, when the pump price was adjusted from N65.00/litre to N97.00/litre.

The analysis also brought to the

fore the roles of foreign exchange and the price of international crude in the determination of the landing cost of PMS. Depreciation in exchange rate translated into an increase in the landing cost, with pass-through effect to the pump price.

The nature of PMS subsidy in Nigeria comprises financial assistance granted to independent PMS importers in the case of the PPPRA and the NNPC local refineries by the Nigerian government to enable them supply petrol at an amount

lower than its cost. In practical terms, it means re-imbursement to PMS suppliers, the difference between total cost of import and the administered price of supply in the country.

### 5.3.3 Subsidy Payments (2009 – 2013)

Data supplied by the PPPRA indicated a yearly retail cost of PMS/litre of N91.39K, N111.70K, N145.99K, N153.52K and N147.76K in 2009, 2010, 2011, 2012 and 2013, respectively. This cost clearly indicates the effect of crude oil price and exchange rate on the retail cost of PMS/litre.

**Table 4: State by State PMS Consumption in Nigeria (2009 – 2013)**

	YEAR	2009		2010		2011		2012		2013	
S/N	STATE	QUANTITY	%	QUANTITY	%	QUANTITY	%	QUANTITY	%	QUANTITY	%
1	Abia	142,408,020	1.08	190,050,144	1.32	351,977,717.00	2.07	212,310,542.00	1.50	215,227,723.00	1.37
2	ADAMAWA	249,622,432	1.89	283,620,976	1.97	355,758,351.00	2.09	314,899,689.00	2.23	335,528,162.00	2.13
3	AKWA-IBOM	182,607,622	1.38	277,587,438	1.93	293,855,564.00	1.73	217,949,111.00	1.54	233,092,966.00	1.48
4	ANAMBRA	105,262,004	0.80	183,426,958	1.28	378,685,014.00	2.22	200,625,564.00	1.42	369,496,805.00	2.35
5	BAUCHI	198,546,005	1.50	296,234,186	2.06	377,774,882.00	2.22	303,845,083.00	2.15	465,810,615.00	2.96
6	BAYELSA	36,582,318	0.28	46,492,068	0.32	112,263,382.00	0.66	82,476,517.00	0.58	101,754,909.00	0.65
7	BENUE	93,397,254	0.71	152,676,055	1.06	231,632,579.00	1.36	173,862,710.00	1.23	169,190,228.00	1.07
8	BORNO	390,193,057	2.96	466,978,765	3.25	577,019,446.00	3.39	361,030,865.00	2.56	392,151,876.00	2.49
9	CROSS-RIVER	253,409,833	1.92	244,244,073	1.70	292,966,043.00	1.72	207,936,003.00	1.47	189,609,467.00	1.20
10	DELTA	160,788,284	1.22	157,391,555	1.10	459,541,583.00	2.70	429,158,921.00	3.04	483,898,633.00	3.07
11	EBONYI	50,141,746	0.38	76,014,443	0.53	91,546,957.00	0.54	50,633,961.00	0.36	51,918,451.00	0.33
12	EDO	292,097,739	2.21	226,048,208	1.57	308,613,674.00	1.81	360,476,604.00	2.55	364,486,100.00	2.31
13	ENUGU	141,115,342	1.07	186,395,592	1.30	275,542,869.00	1.62	258,410,191.00	1.83	259,959,825.00	1.65
14	EKITI	58,274,709	0.44	93,839,038	0.65	147,362,776.00	0.87	111,902,092.00	0.79	137,292,662.85	0.87
15	GOMBE	105,944,475	0.80	112,909,974	0.79	138,286,364.00	0.81	104,996,588.00	0.74	138,922,297.00	0.88
16	IMO	172,760,614	1.31	219,472,226	1.53	446,561,102.00	2.62	222,272,681.00	1.58	231,862,397.00	1.47
17	JIGAWA	91,655,588	0.69	123,166,680	0.86	169,346,428.00	0.99	118,766,876.00	0.84	192,848,983.00	1.22
18	KADUNA	405,939,354	3.07	458,534,531	3.19	588,057,768.00	3.45	559,714,834.00	3.97	589,474,480.00	3.74
19	KANO	576,167,660	4.36	623,564,822	4.34	781,357,896.00	4.59	630,942,172.00	4.47	647,679,038.00	4.11
20	KATSINA	220,945,170	1.67	233,010,888	1.62	344,548,873.00	2.02	341,088,138.00	2.42	440,331,940.00	2.80
21	KEBBI	161,623,296	1.22	259,886,628	1.81	343,547,610.00	2.02	287,431,842.00	2.04	443,915,634.00	2.82
22	KOGI	165,379,965	1.25	206,283,135	1.44	249,144,440.00	1.46	223,728,201.00	1.59	203,412,945.00	1.29
23	KWARA	270,257,664	2.05	261,648,755	1.82	275,876,187.00	1.62	339,537,136.00	2.41	311,839,122.00	1.98
24	LAGOS	3,714,779,063	28.13	3,883,851,856	27.04	3,339,284,740.00	19.61	2,364,755,385.00	16.76	2,617,358,921.00	16.62
25	NASARAWA	140,942,081	1.07	150,245,743	1.05	266,439,755.00	1.56	188,783,475.00	1.34	123,105,353.00	0.78
26	NIGER	198,357,091	1.50	250,149,090	1.74	343,367,972.00	2.02	372,117,295.00	2.64	395,902,620.00	2.51
27	OGUN	676,842,135	5.13	608,826,138	4.24	609,956,225.00	3.58	693,248,443.00	4.91	845,215,965.00	5.37
28	ONDO	290,230,175	2.20	331,766,005	2.31	308,775,266.00	1.81	264,993,676.00	1.88	293,154,723.00	1.86
29	OSUN	278,893,432	2.11	342,811,832	2.39	384,021,341.00	2.25	349,205,168.00	2.48	307,169,427.42	1.95
30	OYO	994,598,028	7.53	689,072,111	4.80	778,008,449.24	4.57	720,916,112.00	5.11	993,906,015.00	6.31
31	PLATEAU	195,583,290	1.48	251,081,999	1.75	280,243,285.00	1.65	254,382,758.00	1.80	282,765,857.00	1.80
32	RIVERS	512,054,859	3.88	672,585,778	4.68	1,010,166,645.00	5.93	782,639,460.00	5.55	845,848,565.00	5.37
33	SOKOTO	102,736,449	0.78	135,630,284	0.94	163,094,043.00	0.96	127,447,466.00	0.90	180,761,926.00	1.15
34	TARABA	101,505,299	0.77	78,617,090	0.55	132,101,793.00	0.78	117,622,527.00	0.83	181,034,610.00	1.15
35	YOBE	144,134,833	1.09	193,120,952	1.34	293,193,712.00	1.72	188,251,957.00	1.33	247,817,670.00	1.57
36	ZAMFARA	79,102,145	0.60	107,712,533	0.75	131,742,555.00	0.77	110,723,540.00	0.78	118,622,240.00	0.75
37	F.C.T.	1,248,659,850	9.46	1,286,243,283	8.96	1,399,766,508.00	8.22	1,459,747,555.00	10.35	1,347,046,772.00	8.55
	TOTAL	13,203,538,881	100	14,361,191,832	100	17,031,429,794.24	100	14,108,831,138.00	100	15,749,415,923.27	100
	DAILY AVG	36,174.079		39,345,731.05		46,661,451.49		38,654,331.88		43,149,084.72	



To derive the amount of subsidy paid from 2009 to 2013, the author deducted the regulated pump price from volume of PMS consumed and applied the subsidy formula as shown in equation 1. This resulted to the estimated subsidy paid within the review period as tabulated in Table 5.

Total subsidy paid during the five-year review period was N3.9446 trillion. Meanwhile, The Nigeria Extractive Industries Transparency Initiative (NEITI), in its 2013 Audit Report on PMS subsidy payments from 2009 to 2011, reported that subsidy paid for PMS total supply was N2.9530 trillion. Annualising the two payments, indicated that our

figure, derived from transactions of five years seems to be far lower than the three-year NEITI's Audit Report by N19.54 billion. However, irrespective of which number, the point of arrangement is that PMS subsidy in Nigeria consumes a big chunk of the national fiscal revenue.

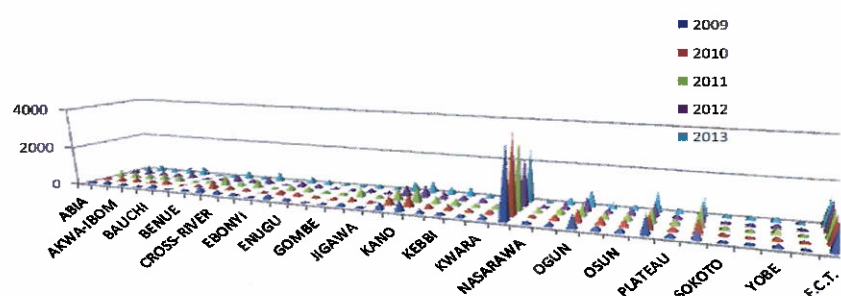
## 6.0 IMPLICATIONS OF SUBSIDY REMOVAL

The likely effects of PMS subsidy removal in Nigeria is examined through transaction processes regarding the entire scheme. Although, the potential impacts are negative in some areas, it is generally believed that the positive impacts far outweigh the negative ones. The discussion begins with the impact on the economy, administration of the scheme and relevance of its support structures and institutions, PMS market structure and the Federation Account.

### 6.1 Impact on the Economy

It is generally argued that the removal of PMS subsidy could possibly increase the pump price of PMS considerably, and affect the disposable income of the consumers. From the estimated import price of about N141 per litre, the consumer will be paying about 31.0 percent more per litre of PMS if subsidy is finally removed. Also, it will lead to the general increase in the prices of commodities and services. This argument is hinged on the unique mono-product nature of the Nigerian economy as most economic activities rely heavily on oil and gas for power and energy needs. It was observed that the upward review of the PMS pump price led to increase in commodity prices as reflected in the inflation rate. In addition, transportation costs also increased, thus adversely affecting the masses that are expected to be protected by the subsidy removal.

Figure 5: PMS Consumption State by State 2009- 2013



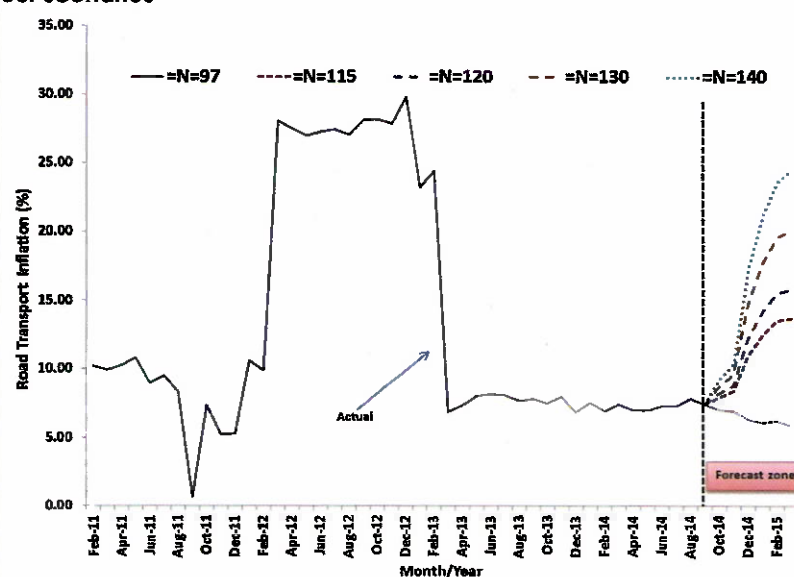
Sources: PPPRA Data reconstructed by authors

Table 5: Derived Subsidy Payment

Year	Total Consumption/litre	Retail (N) Price/litre	Fixed Price(N)	Subsidy Rate(N)	Subsidy Paid (N)
2009	13,203,538,881	91.39	65	26.39	348,441,391,070
2010	14,361,191,832	111.7	65	46.7	670,667,658,554
2011	17,031,429,794	145.99	65	80.99	1,379,375,499,016
2012	14,108,831,138	153.52	97	56.52	797,431,135,920
2013	14,749,415,923	147.76	97	50.76	748,680,352,251
Total					3,944,596,036,811

Sources: Staff estimates based on PPPRA and IMF data

Figure 6: Impact of PMS Subsidy Removal on the Economy in Four scenarios



Sources: NBS and CBN Statistics/Research Departments staff estimates.

Data from the National Bureau of Statistics suggested that road transport sub-sector of the economy is more responsive to PMS price adjustment than any other. Therefore, we took quarterly data from this sector, from February 2011 to August 2014 and using a univariate Seasonal Autoregressive and Integrated Moving Average (SARIMA) (Doguwa and Alade (2013), we forecast the likely economic impact of PMS subsidy removal in four scenario – 1) N115/litre; 2) N120/litre; 3) N130/litre; and 4) N140/litre, representing total withdrawal in scenarios. The results are presented in Figure 6.

The result showed that the cost of transportation remained at an average of 10.0 per cent with subsidy at current level. However, the removal of subsidy by an average of N18.00K/litre increased road transports inflation from 5.0 per cent to 15.0 per cent. Further subsidy removal by N23.00K/litre (N120.00K/litre) pushed the sub-sector's inflation to about 17.0 per cent. Inflation increased to more than 20.0 per cent with further price adjustment to N33.00K/litre and at total removal, inflation forecast was about 30.0 per cent. It is therefore incontestable, that PMS subsidy removal would increase road transport cost, by a significant percentage point(s).

## 6.2 Implication on Administration

Removal of the PMS subsidy would usher in tremendous changes in the administration of the scheme, leading to the cessation of several functions and procedures. The functions of PPPRA in processing transactions of marketers for subsidy payment are likely to cease as subsidy would no longer exist. The whole mechanism used for the refund of actual costs incurred by marketers in the process of product importation, which forms

the basis of PPPRA operation, will no longer be useful in a regime of no subsidy. Equally, the functions of DMO, OAGF and CBN in SDNs issuance and eventual subsidy payment will no longer exist.

## 6.3 Implications on the PMS Market

One of the significant impacts of subsidy removal lies in the PMS market. Subsidy removal translates to liberalisation. Therefore, the structural requisites for seamless and smooth functioning of a liberalised market must be in place to avoid subsequent government intervention. As the benchmark cost is tied to the international crude oil price, the volatile, chaotic and unpredictable movement of crude oil price will make price management in the present PMS market structure and condition in Nigeria difficult. Long queues are likely to emerge as suppliers would, of necessity, create artificial scarcity to make up for price differential losses due to unforeseen changes in the international crude oil price. Others may stay off the market if they do not possess the mechanism and liquidity required to operate on a smooth curve in the regime of international price volatility. The implication of this is a reduction in supply, which could lead to further increase in the price of PMS beyond the current retail pump average price of N152.00/litre. PMS subsidy removal within the current market structure would exert greater pressure on the demand for foreign exchange, especially in the short-term as importers currently do not possess the required expertise to deal with dynamics and the vagaries of international traded commodities like PMS, to their advantage.

## 6.4 Implications on the Federation Account

The obvious gain of subsidy

removal is clearly on the Federation Account where the sum of the NNPC deductions and Sovereign Debt Notes of N3.9 trillion from 2009 and 2013 (NEITI's audit report, 2013) would have been saved. With the scrapping of subsidy, (assuming the consumption figure of 15,749,415,923.27 litres of 2013 remains constant at the same average retail price), the Federation Account would be saving a total sum of N799.4797 billion annually. At an average exchange rate of N158.75/\$, this translates to US\$5.083 billion or 15.40 per cent of the US\$33.0 billion accelerated infrastructural investment requirement mapped out in the National Integrated Infrastructure Master Plan (NIIMP). It is on this premise that the call for subsidy removal is gaining momentum.

## 7.0 ANALYSIS OF CRITICAL ISSUES FOR SUSTAINABLE PMS SUPPLY IN NIGERIA

Many countries, including Nigeria, are united in the truism that subsidy pay-outs are not sustainable, but are expensive burden on the expenditure profile of government. For the countries studied, the policies employed to ease the removal of subsidies were only partially and temporarily successful. The price-setting regime proved to be only as robust as the political will behind it, demonstrating that governments will be tempted to intervene in fuel pricing for political reasons. Automatic linking of domestic and international prices, without subsequent cross subsidisation, is necessary to solve the lingering PMS scarcity.

Hence, the removal of PMS subsidy is desirable, but most challenging, especially in oil-exporting countries, including Nigeria where subsidies are seen as a channel of distributing the benefits of the country's natural



resource endowment to the citizens. However, the Government is saddled with a number of competing needs for the limited resources at its disposal. It is also clear that the budgetary allocation for capital expenditures, which include infrastructure, is not sufficient, especially given the fact that the bulk of the budget supports recurrent expenditure. Therefore, the removal of PMS subsidy will make extra funds available to create social safety nets and infrastructure improvement programmes to improve the quality of life for the masses and also propel the country to meet its developmental objectives.

The removal of PMS subsidy in Nigeria requires four critical strategic responses differing from the past fuel price adjustments. These critical interventions include: planned reduction of PMS consumption in the national basket; restructuring the current PMS market to meet the exigencies of liberalised PMS industry; domesticating production to eradicate import, creating more jobs by diversifying the economy and reducing dependence on the nation's scarce foreign resources and transparent management of money saved from further subsidy payments.

## 7.1 Curtailing Consumption of PMS

### 7.1.1 Provision of alternative transportation network

Targeting consumption reduction of 10.0 per cent per annum after supposedly unsubsidised PMS market through provision of alternative transportation like metro, BRTs, light trains in high PMS consumption areas such as Lagos, FCT, Rivers, Oyo, Ogun, Kano and Kaduna would curtail PMS consumption by an estimated 788.7 million litres in the first three years. The demand analysis in section 3.3.1 showed

that Lagos state and FCT alone consume 32.0 per cent of the total PMS consumption in the country. Replacing personal vehicle with alternative intra-city mass transit transport would go a long way in reducing fuel consumption.

Lagos state is a case study of PMS consumption responsiveness to alternative transportation. The success of Lagos state BRT, water and rail transportation from 2010 dampened PMS consumption. Figure 7 shows drastic reduction in PMS consumption in Lagos state in the years that substantial success was recorded in alternative transport system in the state.

### 7.1.2 Taking private vehicles for school children off the roads

Compelling private schools to provide safe transportation in all the schools at a moderate price will take thousands of vehicles off the roads and substantially reduce PMS consumption and its attendant foreign exchange demand pressure. An observant public analyst will attest to the fact that road usage becomes lighter during school holidays and busier during school-hours runs. This is due to increase in light vehicle usage when parents and guardians have to take their children and wards to and from schools.

### 7.1.3 Increasing electric power supply

A few shop owners that were interviewed in the commercial centres visited in Abuja and Lagos confirmed that with electricity supply, there will be no need for captive power and invariably a reduced demand for PMS. Increasing power supply anywhere has the capacity to reduce demand for PMS in self-power generation, using small generators sets.

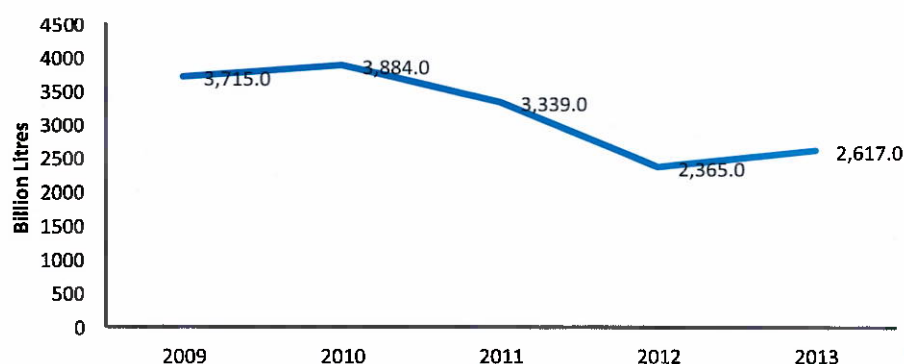
## 7.2 Increasing Local Production

The 445,000 bpd dedicated crude for domestic production is grossly underutilised. Only an average of about 30.0 per cent of it is refined locally for more than two decades. If an average of 22.0 per cent refining capacity generates 1.882 billion litres in 2013, a 100.0 per cent, local production will increase local supply by 6.6725 billion to 8.5545 billion, removing international process and Swap arrangement. The immediate and huge gains of domestic production are the US\$4.4973 billion savings in foreign exchange demand. Domesticating a huge volume of economic activity worth N2.7223 trillion is likely to impact positively on the economy through multiplier effects.

## 8.0 CONCLUSION

In view of the forgoing, the continuous management of PMS

Figure 7: PMS Consumption in Lagos State



Sources: Authors' estimate with data from PPPRA

subsidy in Nigeria remains a major challenge, but one that can be resolved. Subsidy has a negative impact on government finances and economic growth. However, the removal of PMS subsidy is not easy, but many oil-producing countries, including Nigeria have seen the expected benefits and, therefore, intend to do so. Although the potential impacts are negative in some areas, it is generally believed that the positives far outweigh the negatives if well managed. Therefore, the time is ripe for subsidy removal. What remains is the right approach and implementation of critical

requisites for this last lap of subsidy removal to be dramatically different from the past PMS pump price increase. The time is also ripe for domesticating local production by utilising the whole dedicated 445,000bpd crude, if not for anything, but for the ease of foreign exchange demand pressure this single action will bring.

Hence, targeting reduction of PMS consumption through alternative mode of transportation and increasing power supply combined with total domestication of the

production of 445,000bpd to reduce PMS demand substantially and equally reduce the pressure on foreign exchange is germane to the impending exercise of total subsidy removal. Equally necessary is retooling the market in line with successful liberalised domestic petroleum product markets in the world. Transparent use of resources derived from subsidy removal will justify the removal and create public confidence in Government.

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