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Understanding Oil Subsidy in Nigeria

A Senior Honors Thesis

Presented in Partial Fulfillment of the Requirements
for Graduation in the College Honors Program

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Oladoyin Zaccheus

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INTRODUCTION

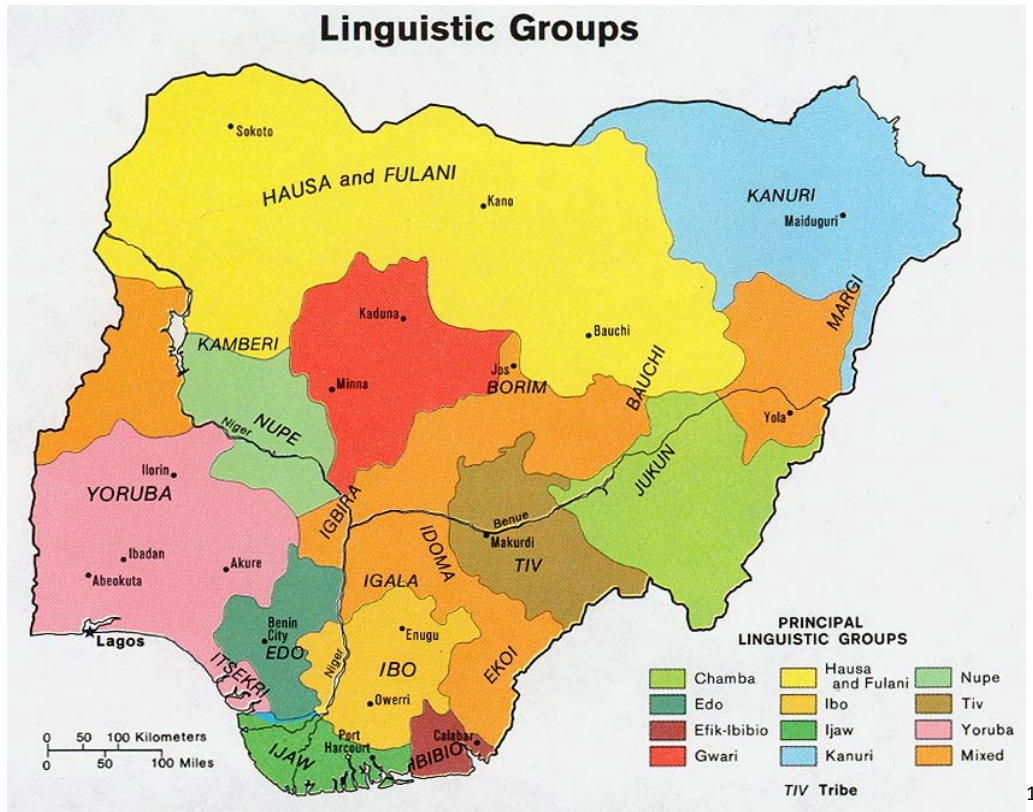
For several years, Nigeria enjoyed subsidy on gasoline. However, this came to an end on January 1st, 2012, after an announcement from President Goodluck Jonathan, that subsequently, the subsidy was to be removed. While some sort of resolution/middle ground has been reached in response to the reaction that this news generated, the concept and theory behind the oil subsidy removal is worth understanding. This research paper explains the history of the oil subsidy in Nigeria, the rationale behind its removal and subsequently, gives a few recommendations for future reference.

NIGERIA - OVERVIEW

Nigeria is the most populous country in Africa and is located in West Africa. She is bordered by Benin Republic on the West, Cameroon on the East, Niger Republic on the North, Lake Chad on the North-East and on the South is the Gulf of Guinea at the Atlantic Ocean. She is home to over 150 million with a population growth rate of about 2%. She sits on over 923,000 square kilometers of land and water. It is about the size of Alaska and Texas joined together. Nigeria as a political entity was created in 1914 as a British colony after the amalgamation of the North and South Protectorate.



Nigeria is a multiethnic country with 3 dominant ethnicities/tribes. These 3 major tribes are geographically distributed and distinct and they also represent the 3 major languages spoken in Nigeria. The Hausa tribe is concentrated in the North, Yoruba in the South West and Igbo in the South East. There exist a number of several different tribes jointly referred to as the Niger Delta tribe or the South South geographically located in the South. Overall, there are over 350 ethnic groups and 250 local dialects spoken. Consequently, English is the lingua franca since it will be presumptuous to pick one of the local languages over the others as the official national language.



Over the years, Nigeria has come to have 36 administrative states with her Federal Capital Territory in Abuja. (Alan Burns 20).

She is naturally gifted with several resources like coal, bitumen, gold, tin, iron, ore, zinc and so on. However, the most prominent of her resources is petroleum which generates about 37% of the GDP. Petroleum oil is one of the major items of trade in this country. By supplying about 8% of the oil imports in the United States, it is the U.S's largest trading partner in the sub-Saharan Africa. It has the 2nd largest GDP in Africa with South Africa in the 1st position (\$554.6 billion).²

ECONOMY

¹ Oludah Equiano <http://www.learnnc.org/lp/editions/nchist-colonial/1978>

² CIA World Fact Book <https://www.cia.gov/library/publications/the-world-factbook/fields/2001.html#ni>

Nigeria has one of the fastest growing economies in the world. According to social and economic indicators, Nigeria is both dynamic and underdeveloped. The economy has been very dependent on oil revenues since the 1970s. The economy had a consistent and height growth during much of the 20th century during which it transformed into a modern society with cash crop production, mining, manufacturing and banking. This was short lived as it suffered a decline in the 1980s due to massive devaluation of the local currency, Naira, and ever increasing inflation. The economy always strives to find a foothold due to its over-dependence on the capital intensive oil sector. Past leaders, civilian and military alike, failed to diversify the economy away from its oil dependency which provides 95% of its foreign exchange earnings and about 80% of budgetary revenues.³

Nigeria has a huge gulf between the wealthy and the impoverished. Although the country is rich in natural resources, its economy cannot meet the basic needs of the people like electricity, food, security and good and reliable transportation. According to the World Fact Book, as at 2011, an estimated 21% of the population was unemployed and 70% was below the poverty line.

International trade is crucial to the economy of Nigeria because it helps to dispose of surpluses, make specialized objects available to a wide range of consumers and share products of different ecological origins. Due to the establishment of bilateral ties with other countries, the trade scene in Nigeria has had a great pulse over the last few decades. An overview of the economy of Nigeria remains incomplete without mentioning its growing foreign investments which have left a positive effect on its trade and commercial business. The present Nigerian government has unleashed a set of economic reforms intended to bring about a radical change

³ CIA World FactBook

in its current financial growth.⁴ The major trading partners of Nigeria are China, United States, United Kingdom, Netherlands, Albania, India, Brazil and Italy.

Nigeria is the United States' largest trading partner in sub-Saharan Africa, largely due to the high level of petroleum imports from Nigeria (which accounts for 8% of U.S. oil import and nearly half of Nigeria's daily oil production). Nigeria is the fifth-largest exporter of oil to the United States. Two-way trade in 2010 was valued at more than \$34 billion, a 51% increase over 2009, largely due to the recovery in the international price of crude oil. Led by cereals (wheat and rice), motor vehicles, petroleum products, and machinery, U.S. goods exports to Nigeria in 2010 were worth more than \$4 billion.

Nigeria has an estimated budget deficit of 3.3%, public debt of 17.6% of GDP and an inflation rate of 10.8% in consumer prices. Using the Purchasing Power Parity as a parameter, the GDP is \$414.5 billion hence coming to \$2,600 per capita.⁵

OIL HISTORY

Oil was discovered in Nigeria in 1956 at Oloibiri in the Niger Delta after half a century of exploration. The discovery was made by Shell-BP. After 1960, exploration rights in onshore and offshore areas adjoining the Niger Delta were extended to other foreign companies.

Nigeria joined the Organization of Petroleum Exporting Countries (OPEC) in 1971 and established the Nigerian National Petroleum Company (NNPC) in 1977, a state owned and controlled company which is a major player in both the upstream and downstream sectors.

Pioneer production began in 1958 from the company's oil field in Oloibiri in the Eastern Niger Delta. By the late 1960s and early 1970s, Nigeria had attained a production level of over 2 million barrels of crude oil a day. Current development strategies are aimed at increasing production to 4million barrels per day by the year 2010 – NNPC⁶

⁴ 123independence day.com

⁵ CIA World FactBook <https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html>

⁶ NNPC <http://www.nnpcgroup.com/NNPCBusiness/BusinessInformation/OilGasinNigeria/IndustryHistory.aspx>

Nigeria presently has four refineries, two in Port Harcourt, one in Kaduna and one in Warri with a combined capacity of 445,000 barrels per day. However, due to lack of adequate infrastructure and existence of corruption, these refineries are underutilized. Nigeria cannot refine enough oil for her resident. As a result of this, over 90% of her crude oil is exported and this accounts for over 90% of the foreign exchange earnings and 75% of total government revenue. To this end, more than 80% of the refined end products of crude oil like gasoline, diesel and kerosene have to be imported back into the country for the residents' uses.

Crude Oil Production & Export 2001-2010 (in barrels)			
Year	Production	Export	% Export
2001	865,173,583	780,093,703	90.17%
2002	740,687,180	663,326,494	89.56%
2003	844,150,929	791,016,260	93.71%
2004	910,156,486	871,286,594	95.73%
2005	918,660,619	843,533,331	91.82%
2006	869,196,506	817,387,957	94.04%
2007	803,000,708	793,769,855	98.85%
2008	768,745,932	724,479,796	94.24%
2009	780,347,940	769,195,205	98.57%
2010	896,043,406	864,702,101	96.50%

Source: NNPC

Petroleum and oil resources play a large role in the Nigerian economy. The oil sector has singly determined the dynamics of the Nigerian economic development since the 1960s. Before oil became the mainstay, Nigeria was one of the poorest countries in Sub-Sahara Africa but the discovery of oil changed that. Since the birth of the oil regime in 1957, several hundreds of

billions have been generated. (Ikein 241) The country is the 6th largest producer of petroleum in the world; it is the 8th largest exporter and has the 10th largest proven reserves.⁷

Since the discovery of oil in 1953, it has remained one of the most sensitive issues and a major source of conflict in Nigeria. As earlier stated, Nigeria imports most of its refined oil products. This makes it relatively expensive and unaffordable for the average Nigerian. As a result of this, gasoline subsidy was introduced in 1973 to stabilize the price of fuel and insulate Nigerians from the wild fluctuation of the global market price. For 40 years, Nigerians had been paying almost half the global market price for petrol.

Refined Oil Prices from Country to Country

Country	Price/Litre in USD		
	Gasoline	Kerosene	Diesel
Cameroon+	1.07	0.68	1.00
Gabon*	0.91	0.48	0.71
Ghana+	0.92	0.69	0.83
Kenya+	1.04	0.74	0.90
Nigeria*	0.51	-	-
India+	1.04	0.20	0.71
Indonesia+	0.48	0.21	0.46
Philippines+	0.73	0.70	0.66
Russia*	0.62	-	0.60
Egypt+	0.22	0.13	0.13

Note: + net oil importer and * net oil exporter

The subsidization of fuel in itself is not a new policy among oil producing and socialist or communist countries such as China, Cuba, Egypt, Iran, Libya, Syria, Venezuela, and Yemen.⁸

Several governmental administrations have fiddled with the subsidy from time to time, following some of IMF's Structural Adjustment Programmes (SAP). SAP is a compilation of

⁷ UNICEF http://www.unicef.org/nigeria/1971_2199.html

⁸ Martin, A. "The Fuel Subsidy Crisis and its Implications for its Fight against Boko Haram". <http://allafrica.com/stories/201201120089.html>

economic policies that are preconditions for developing countries who want to borrow money from the International Monetary Fund or the World Bank. Essentially, SAP aims to reduce the borrowing countries fiscal imbalances by making some internal and external changes and generally alleviate poverty. The most common of the internal changes are privatization and deregulation.

After the oil boom in the 1970s, a comfortable middle class emerged and inflation was on the rise. In order to mitigate the inflation, the government increased wages and paid huge arrears to thousands of people. By the mid 1970's, high inflation undercut the peasantry who did not directly benefit from oil proceeds. By 1986, the Naira was highly devalued, wages were pegged, spending was restricted and state-run enterprises were to be privatized. These contributed directly to a rise in inflation. In 1988, oil subsidy was removed (under the dictatorship of Gen. Babangida). This caused transportation and related costs to increase by almost 100% and unemployment became even more common among the educated youth.

OIL SUBSIDY REMOVAL

Apparently, Nigerians did not forget this part of history when President Jonathan announced the removal of oil subsidy on 1st January 2012. Nigerians home and abroad protested vehemently to this reform. This protest was further fueled; stemming from the fact the current Minister of Information (who is also in support of the removal) was a Student Government who protested over the removal in 1988. He claimed that his actions as a Student Government then were done in ignorance and that he had been bribed by oil marketing

executives. This has led Nigerians to questioning his credibility, even now.⁹ It will be more helpful to examine the situation from the points of view of the two main stakeholders: the Government and the People.

FROM THE GOVERNMENT'S LENS

1. **It is not subsidy removal, it is subsidy reallocation:** The government wants to stop the payment of subsidy on petrol and divert that payment to other sectors of the economy like education, health, etc. The subsidy was introduced for the benefit of the masses. However, it is becoming obvious that what the masses are in fact enjoying from the subsidy is the remnants after the middlemen (oil marketers) have taken the lion share. This is one of the reasons why it is becoming increasingly expensive to pay for the subsidy. In 2006, a reported \$1.6 billion (261billion NGN) with an inflation rate of 7.8%¹⁰ was spent on subsidy. By 2010, \$4.2 billion (673billion NGN) with an inflation rate of 12.8%¹¹ was spent as payment for subsidy. This means \$29 was spent per person.

⁹ Oguefi Blogs. "Labaran Maku Repudiates His Past, to Keep His Present, and Keep His Future". http://elombah.com/index.php?option=com_content&view=article&id=9412:labaran-maku-repudiates-his-past-to-keep-his-present-and-lose-his-future&catid=25:politics&Itemid=92

¹⁰ Central Bank of Nigeria <http://www.cenbank.org/rates/inflrates.asp?year=2006>

¹¹ Central Bank of Nigeria <http://www.cenbank.org/rates/inflrates.asp?year=2010>



The unsubsidized petrol pump price is \$0.90/liter (141 NGN) but it has been subsidized to \$0.41/liter (65NGN) for consumers. The government then has to pay the \$0.50/liter difference to the oil marketers who import the petrol into Nigeria. It is projected that this payment will continue to increase if sustained due to rising global oil price. Overtime, these payments are accruing and hurting the other sectors of the economy. According to the Coordinating Minister for the Economy and Minister of Finance of Nigeria, the proceeds from the subsidy will be used for projects which include construction, completion, and rehabilitation of rail, refineries, key Federal highways, hydro stations, information technology and water.

- 2. To mitigate against the Dutch Disease:** Dutch Disease refers to “negative consequences arising from large increases in a country's income. Dutch disease is primarily associated with a natural resource discovery, but it can result from any large increase in foreign currency.”¹² A resultant effect of this disease is that so much attention is paid to the revenue generating resource due to the wealth it has brought to the country to the

¹² <http://www.investopedia.com/terms/d/dutchdisease.asp#axzz1sUqzdIcA>

detriment of the other resources in that country. For example, the table below shows how the Education sector could not get enough funding between 2000 and 2004.

Disbursement Allocation to Education Sector from 2000-2004 in USD*

Year	Allocation to Education	Fund Disbursement to Education Sector	Difference
2000	410,923,138	178,539,262.39	232,383,876
2001	464,655,009.19	280,457,417.48	184,197,592
2002	528,349,276.71	541,883,451.42	18,988,923
2003	502,879,000.34	460,265,956.52	42,613,044
2004	597,247,495.79	496,656,632.32	100,591,055

*estimates

Removal of the oil subsidy will also induce price competitiveness in the oil sector. By removing the oil subsidy, oil marketers will be forced to figure out price lowering strategies which will subsequently increase price competitiveness in the oil industry.

- 3. A step towards Deregulation of the downstream oil sector:** “Deregulation of the downstream petroleum sector refers to the reduction, or removal of government control, rules and regulations that restrain free operational activities in the sector. This does not mean a complete elimination of the laws that govern smooth operations of activities in the downstream oil sector.”¹³ It is expected that the deregulation of the downstream oil sector will help to improve the resourceful use of the scarce economic resources. This will be done by subjecting decisions in the sector to the operations of the forces of demand and supply. This will attract new sellers, buyers and investors into the market. A direct result of this will be an increase in competition, promoting overall higher productivity and lowering prices over time. References have been made to the historic success of deregulating some other sectors of the economy like

¹³ Ministry of Finance <http://www.fmf.gov.ng/component/content/article/3-trendingnews/63-faqfuelsubsidy.html>

telecommunications and banking.¹⁴ Also, by cutting subsidies and letting domestic prices rise, it is probable that the prospect of refining companies would attract enough investment opportunities. A result of this will be an upgrade so that Nigeria will not have to import 70% of its gasoline and fuel any longer.¹⁵

4. **Fight against corruption:** It is said that the subsidy on oil has encouraged corruption in the system because the people benefitting from it are mostly wealthy oil companies, the rich, smugglers and neighboring countries where the products are smuggled to. The greater the consumption, the greater the benefit. Typically, only the rich have financial power to acquire cars and in Nigeria, the rich have several cars. This increases fuel consumption per week, hence the government has to make more subsidy payment and the rich benefit more than the poor who cannot afford cars. The subsidy is meant for the benefit of the poor, the masses. Also, the oil marketers have been revealed to fake bills of laden without any vessel of oil actually coming in. This way, the government pays the subsidy on the phantom oil brought in with these vessels and the marketers pocket the money.¹⁶ Since the wealthy companies are receiving most of the benefits, the government thinks it will be easier to manage the corruption if the subsidy is taken out.

In order for this initiative to be carried out as seamlessly as it could, the government put some plans in place. For instance, news of the deregulation, which Nigerians have come to understand to be the oil subsidy removal, had been announced for a few years before

¹⁴ *ibid*

¹⁵ Bloomberg business week

¹⁶ Olajide, Tokunbo. "Nigeria's Oil Thieves in Trouble". The News.
<http://thenewsafrika.com/2012/01/23/oil-thieves-in-trouble/>

implementation. Similarly, a committee tagged the Presidential Deregulation Committee comprising of key stakeholders with a secretariat has been set up in order to help with the deregulation process. Two technical consultants and a Media consultant were hired to advise on communication strategies for the government to the people. In order to create more transparency, external consultants were hired to carry out process audit of subsidy. Plans are also underway to revive private refineries. To absorb the initial shock of the oil subsidy removal, the government also provided mass transit buses and \$63,000 (10 million NGN) in revolving loan for transportation companies.¹⁷

In the same vein, an initiative called Subsidy Reinvestment and Empowerment (SURE) Program will act as an umbrella under which all the intended projects from the subsidy reallocation will be executed. This program also provides for the implementation of short term social welfare programs like mass transit, public works (training in artisanship for youths) and social services to reduce high maternal and infant mortality rates to alleviate the impact of subsidy removal.

FROM THE PEOPLE'S LENS

News of the deregulation had been in the news off and on since around 2008. However, sufficient information in order to understand the concept or the manner/plan for implementation was not well communicated. The average Nigerian did not have an idea about what deregulation meant. It was then with mixed emotions of different proportions that most Nigerians took the news on January 1st. 2012 that the subsidy on gas was to be removed with

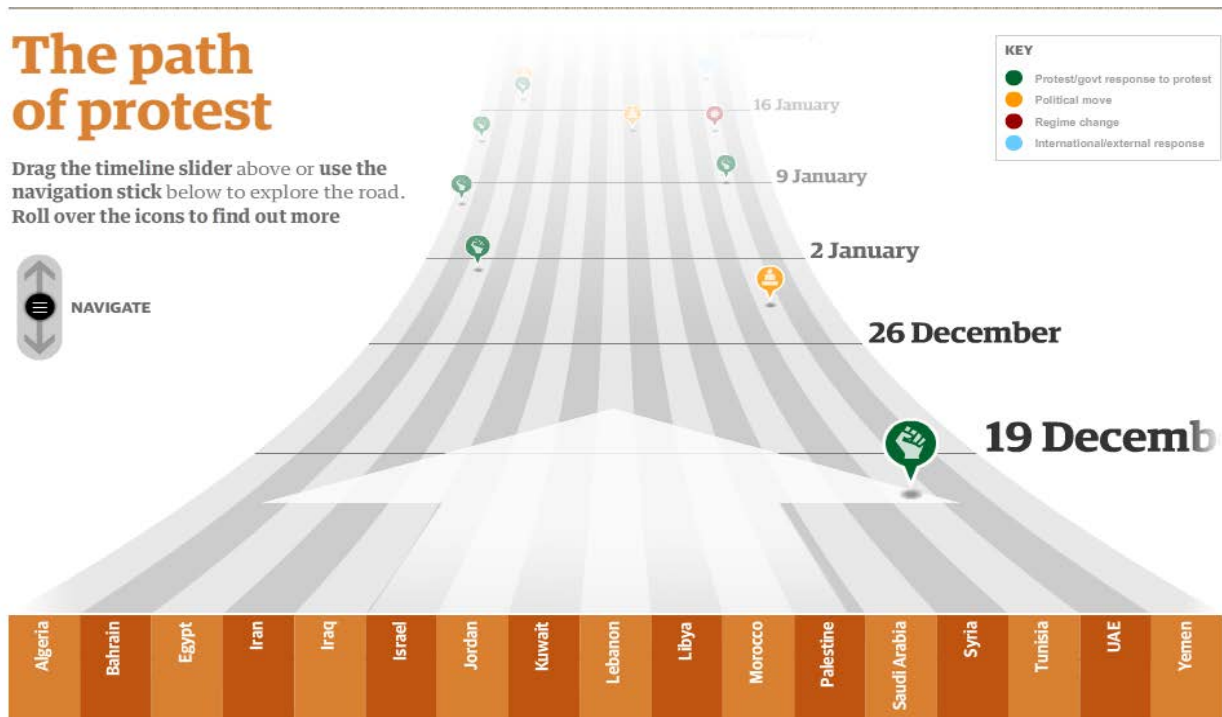
¹⁷ Ministry of Finance <http://www.fmf.gov.ng/component/content/article/3-trendingnews/63-faqfuelsubsidy.html>

immediate effect. Most prominent of these emotions was anger as Nigerians took to the street in protest to this new policy. What succeeded this protested has been likened to the Arab Spring. In fact, it was tagged the “Nigerian Harmattan” by some.

THE ARAB SPRING

The “Arab Spring” refers to the period when a couple of Middle Eastern and North African regimes began to crumble arising from the citizen’s outcries on methods of governance. It all started in Tunisia in December when “an educated 26-year old Tunisian and street vender, Mohamed Bouazizi catalyzed the revolution by setting himself ablaze after police confiscated his produce stand for not having a permit.”¹⁸ After his death, there was outcry because the people decided that they were tired of being stripped of fundamental human rights. They believed that Bouaziz was a victim of the system and in his honor, staged protests to decry the method of governance. This protest was a success as the president of Tunisia was ousted. This success had a domino effect as several other Arab and non Arab countries’ citizenry found their voices and started demonstrations in criticism of their governments too. Some of these countries include Libya, Egypt, Algeria, Jordan and Yemen.

¹⁸ Chandler, Diane. “Arab Spring Movement and True Human Freedom”.
<http://renewaldynamics.com/2012/01/30/arab-spring-movement-true-human-freedom/>



Many Nigerians felt that the one week protest that followed the President's subsidy removal announcement was an extension of the Arab Spring.

For the most part, Nigerians were highly displeased with the news of the removal. They took to the streets in what turned to be a weeklong mass protest costing the country a few billions of Naira in loss from closed operation within that time frame. For instance, Nigeria typically exports more than 2 billion barrels of crude oil per day. For the period of the protests, oil could not be exported and this resulted in a huge financial loss for the government. Protesting Nigerians felt justified in their refusal to accept this policy and gave reasons. Some of the reasons include:

1. **Loss of Purchasing Power Parity:** Simply put, without a commensurate increase in wages, they were going to become poorer. Gas prices in Nigeria are very elastic; a little change incites a huge response. By far, the price hike from \$0.41 to \$0.90 was a big change. Transportation prices would increase, cost of production would increase and by

extension, the cost of living generally would increase. The subsidy removal meant they would have to pay more for items and services without the financial empowerment to do so.

2. **Lack of government transparency:** From historic interaction between the government and the people, a huge mistrust has always been a barrier. Corruption is a big problem for the country and the citizens think that the government especially has a lot to hide. They are also very suspicious of government policies as they have come to perceive them as very dishonest. This is especially so in this case because several different figures for the subsidy payments were given out by the government to the people. For instance, \$8.9 billion (1.4 trillion NGN) was named to be the amount accrued for subsidy in 2011. However, this figure is a red herring because it also includes kerosene subsidy.¹⁹ Similarly, there was also not much clarification on how the numbers were arrived at. There is not transparency in the petroleum product pricing, and neither is there coherence among the players in the subsidy field.
3. **The timing of the announcement of the removal was insensitive:** The country was going through moments of terror from an Islamic religious sect. The sect called “Boko Haram” has claimed responsibility for several bomb explosions around the country claiming over 935 lives since the beginning of its campaign in 2009. Boko Haram literally translates as “Western education is sin” and favors the adoption of strict Sharia law and also wants the laws to be inducted nationwide. In the opinion of the people, this was a more pressing need which was not addressed as intently and quickly as it deserved as it is a direct threat on life and security.

¹⁹ Ministry of Finance <http://www.fmf.gov.ng/component/content/article/3-trendingnews/63-faqfuelsubsidy.html>

CONCLUSION & RECOMMENDATIONS

Eventually, after the protests and outcry from Nigerians home and abroad, the government decided to cap the gas price at \$0.67. While the people wanted it to be revert to the original price of \$0.41, this new price was a relatively welcome change from the \$0.90 it was initially set at. The new price was grudgingly accepted and the process is still ongoing. However, because deregulation of this sector is still very probable, here are a few recommendations for the next time the policy will be introduced.

1. **Transparency in Fuel Pricing:** Presently, Nigeria practices ad hoc pricing. This leaves a lot of room for ambiguity and inherently, corruption, as several “fees” can be appropriated as miscellaneous. Ghana, her neighbor, practices the formula based pricing. Adopting this formula pricing will increase transparency and credibility and eventually help towards building trust with her citizenry
2. **Tighten the country’s borders** to mitigate against smuggling and set up trustworthy agencies to check and balance oil marketers. This is to help reduce the amount of corruption in the system.
3. **The government can introduce more competition** into the sector especially with issuance of licenses of import licenses. Importers should have to compete for lower freight costs, product costs, margins and other like costs. This will eventually drive down the cost of gas to the consumer.

In the grand scheme of things, trust of government initiatives and parastatal is a sore topic for most Nigerians. A very applicable and profitable long run policy might be to adopt some

variation of Norway's sensible oil wealth management. Norway is an oil rich country and from the onset, legal rights of Norwegian people to the benefits of the oil found within the Norwegian jurisdictions have been established. Consequently, most oil revenue is set aside in a state petroleum fund which has been renamed a pension fund. This fund is exactly what its name implies. It is for the benefit of current and future generations of Norwegians. To allow for transparency, the Central Bank (Norges Bank) which is independent from the government, manages the funds.²⁰

Essentially, the Nigerian government has to see to it that it gains the trust of the people in order to be able to communicate its intentions effectively as well as gain support.

²⁰ Thorvaldur Gylfason. "Norway's wealth: Not just oil" <http://www.voxeu.org/index.php?q=node/1199>

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