

FREQUENTLY ASKED QUESTIONS ON DEREGULATION OF THE DOWNSTREAM PETROLEUM SECTOR AND REMOVAL OF PETROLEUM SUBSIDY¹

1. What is meant by the deregulation of the downstream petroleum 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. Rather, it means that the role of government in this sector will be limited mainly to providing regulatory oversight.

2. What is the rationale behind the government's plan to deregulate the downstream petroleum sector?

- ❖ Deregulation of the downstream oil sector will improve the efficient use of scarce economic resources 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, thereby increasing competition, promoting overall higher productivity and, consequently, lowering prices over time. The ultimate effect of this chain of activities is increased gains for the people of Nigeria who would be getting the most out of their natural resources. For example, following government's deregulation in the telecommunication, there has been a reduction in call tariffs. Similar successes have also been recorded in the banking sector with the emergence of stronger banks with unprecedented spread to several other African countries. These are classic examples of the kind of positive effects deregulation could have on the oil sector.
- ❖ Deregulation further reduces economic **waste and lightens social burdens** caused by government control. For several years, Nigeria experienced scarcity of petroleum products that crippled national economic activities, and increased the cost of doing business, several times over. The resulting scarcity inevitably leads to a flooding of the market with adulterated products, which usually leads to the damage of vehicles and machines. On many occasions, and in many parts of the country, particularly outside of the big cities and towns, a majority of Nigerians have been forced to buy petroleum products at 300% higher than their original

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price. Deregulation will help address this price scalping and a host of associated problems related to the sector.

- ❖ Deregulation of the downstream oil sector promises to be the way forward in expanding opportunities for economic growth and a competitive downstream petroleum sector if regulation in the downstream sector is limited to oversight and supervisory functions, aimed at guaranteeing quality of products and preventing consumer exploitation, then the process of deregulation could help achieve greater cost-effectiveness.

3. How important is pricing to deregulation of the downstream oil sector?

- ❖ Appropriate pricing of petroleum products is one of the major factors that will attract private investment into the Nigerian downstream petroleum sector. This is because the prices of the petroleum products will be set by independent marketers based on demands and the supply of the products. Like every other goods and services in the marketplace, independent oil marketers would be free to set their prices. This would lead to further reduction in prices for refined oil product until an appropriate market price is attained. Continued subsidization by the government will not help achieve such appropriate pricing. Deregulation through subsidy removal will lead to adjustments that will push prices towards its market-determined level. Appropriate pricing achieved through this policy will make activities in the sector more profitable and attractive to private domestic and foreign investors.

4. Is rehabilitating the refineries part of the strategy for deregulating the downstream petroleum sector?

- ❖ Yes. In the last 12 months the country's refineries have worked relatively well, and this has led to increased capacity utilization from 30% to the current 60%. This means that for 12 months now, the country's refined petroleum production capacity has been steadily on the increase. To further improve on this to an internationally accepted level of 90% capacity utilization in the next 24 months, the original contractors responsible for building the refineries have been contracted to carry out a Turnaround Maintenance (TAM) of these refineries. Specifically, TAM for the Port Harcourt Refinery will be carried out in the first Quarter 2012. This would be followed by the Kaduna Refinery and then the Warri Refinery. Thereafter, the normal cycle of TAM will be respected.

- ❖ However, research and analysis show that even if all the country's refineries were to operate at full capacity, there would still be a petrol supply gap of 15 million litres per day. Therefore, importation WILL remain inevitable until additional refining capacities are built through the on-going Greenfield Refinery Project. Discussions are currently under way with prospective investors who are willing to provide Foreign Direct Investment (FDI) to build additional refineries in the country to ensure domestic self sufficiency and the export of refined petroleum products within the next few years.
- ❖ The Petroleum Industry Bill (PIB) contains special fiscal incentives in place to encourage the establishment of new refineries around the country. Clearly, the establishment of new domestic refineries and the rehabilitation of existing ones are critical to ensuring a successful deregulation programme. A viable local refining sector will, in the long term, bring down the pump price of petroleum products below the current import parity level.

5. Are there countries that have deregulated their downstream petroleum sector and removed subsidies?

- ❖ Yes, there are examples of countries that have removed petroleum subsidies, including oil producing countries. In particular, Indonesia, Malaysia, and Ethiopia have eliminated it completely. Only recently Ghana announced that it would be removing fuel subsidies in order to sustain its fiscal consolidation.

6. Why not a staggered, phased removal of fuel subsidy, if at all?

- ❖ The removal of subsidies in phases has never worked in any country and there is a strong likelihood that it will not work in Nigeria. A partial removal will lead to partial results because investors will continue to be discouraged and the distortions and inefficiencies existing in the sector, such as smuggling and rent-seeking behavior, will continue. A gradual deregulation will imply that substantial amounts of money will continue to be spent on fuel subsidy through continued borrowing. This will imply that future generations of Nigeria would have to repay part of the debt being contracted. The optimal policy response, therefore, is to remove it once-and-for-all.

7. Has deregulation succeeded in other sectors of the Nigerian economy?

- ❖ Yes it has! The communication, banking, and aviation sectors are typical examples where deregulation has worked in Nigeria.

- Before the deregulation of the communications sector, the Nigerian Telecommunications Limited (NITEL), a government-owned company, was the sole operator for telephone lines in the telecoms sector. This period was marred by inefficiency, low telephone access, high tariffs and poor services. Once the sector was deregulated, private investors, both domestic and foreign, came in with Global System for Mobile Communication (GSM) services, resulting in high competition, which significantly improved service coverage, increased telephone access, and drove down prices.
 - Similarly, deregulation of the banking sector resulted in the emergence of strong local banks offering a variety of services, and with a high presence in several other African countries. A few of these banks are also operating in some non-African countries including the United Kingdom, the United States, and France.
 - Prior to deregulation of the aviation sector, Nigerian Airways, a government-owned and managed airline, was the sole operator. This resulted in service inadequacies that included flight delays and cancellation, poor route network and high airfares. With deregulation of the industry, there have been an increased number of airlines, wide coverage and reduced airfares. Today, people can book a flight from the comfort of their rooms.
- ❖ These are some typical examples of where deregulation have been successful in Nigeria and have created greater competition, reduction of prices and efficiency in services more possible. This too can be achieved if the downstream sector of petroleum industry is deregulated.

8. What is fuel subsidy?

- ❖ Generally, subsidy refers to the money paid, usually by government, to keep prices below what they would otherwise be in a free market system. Such intervention by government leads to a distortion that has the potential of imposing large economic costs. More specifically, fuel subsidy is the difference between the price a consumer pays for the pump price of fuel and the actual total cost of producing or importing it. For instance, the price of petrol is currently pegged at ₦65 per litre but the actual cost of supply is about ₦138 per litre at crude oil price of \$110 per barrel. Therefore, the subsidy element is about

₦73 per litre. **This means that for every litre of petrol purchased at the official price of ₦65, the government contributes ₦73.** It should be noted that only petrol and kerosene currently enjoy government subsidy, and that imported and locally produced petroleum products enjoy these subsidies.

9. Who benefits from government's fuel subsidy?

- ❖ Benefitting from government's subsidy depends largely on the level of fuel consumption. The greater the consumption, the more the benefit. In Nigeria, it is the rich, and not the poor, who benefit the most from fuel subsidy. The reason for this is that rich members of society can afford several cars, which gulp quite a lot of fuel every week. As they buy fuel for their cars, they benefit from the subsidy because government pays the difference between what they would have paid and what they actually pay. In contrast, many of the poor do not own cars while middle income Nigerians can only afford small cars that consume minimal fuel. In many cases, these latter groups depend on public transportation with low fuel consumption per person. As a result, they do not benefit much from the subsidy because they consume relatively very little fuel. The government subsidy as it currently stands benefits only smugglers and neighboring countries to which these petroleum products are smuggled.

10. Is it really true that fuel subsidy removal will affect only the rich and not the poor?

- ❖ No, but it will affect the rich more than the poor. Right now, the rich benefit more from the subsidy since they consume more fuel relative to the poor through ownership of several cars. They are therefore more subsidized relative to the poor. This means that they will face more adjustments with the removal of the subsidy compared to the poor who consume less petrol.

11. How much does the government spend on subsidy?

- ❖ Between 2006 and August 2011, total government expenditure on petroleum subsidy amounted to ₦3.7 trillion. Expenditure on subsidies increased from ₦261 billion in 2006 to ₦673 billion in 2010, which represents an increase of about 160%. Additionally, there have been unprecedented payments in 2011 that so far amounted to ₦1.4 trillion due, in part, to two key factors: increase in subsidy per litre as a result of rising global oil price, and large arrears due NNPC for household kerosene imports.

12. Is there any provision in the budget for petroleum subsidy?

- ❖ Government does not have any budget line for petroleum subsidy. However, estimates are made annually for it. In the last few years, Government has provided a notional amount in the budget for subsidy payments. The monies are disbursed from the excess crude account before distributing the remainder among the three tiers of government. Thus, the issue of disparity between the amount budgeted and the actual payments does not arise.
- ❖ Furthermore, the amount spent on petroleum subsidy is highly unpredictable, as some of the underlying factors are highly volatile (i.e. international price of crude oil, exchange rate, volume consumed, etc.). Therefore, Government's estimates can deviate significantly from actual payments because of these factors.

13. Shouldn't government fix the refineries before removing subsidies?

- ❖ Although NNPC is making efforts to fix the refineries over the next 24 months, continuation of subsidies will be counter-productive to government's effort to deregulate the sector. As long as the subsidies are maintained, petroleum product pricing will remain a disincentive to operators and potential investors in domestic refineries. In other words, there will be little incentive to fix the refineries as long as government can continue to pay for people to import refined product from abroad. Therefore, the removal of the subsidy should logically pave the way for the proper functioning of the refineries through increased private local and foreign investment.
- ❖ The fact that subsidy would be removed would create better market incentives for the old refineries to be fixed and new ones to be built. Indeed, once the downstream oil sector is deregulated, government will have no need to invest in the refineries. That becomes the responsibility of private local and foreign investors, leading to a permanent solution to the perennial problems of poor functioning of the refineries which, in fact, has been one of the major reasons why private investors have been reluctant to invest in them, despite the fact that 18 licenses have been granted for new refineries by the Federal Government.

14. Why should Nigeria remove fuel subsidy when other OPEC countries have their petroleum products subsidized?

- ❖ With Nigeria's GDP per person at \$1,600 per year and total crude production of approximately 2.5 million barrels per day, Nigeria has substantially less oil revenue per person and greater social challenges compared to other OPEC

countries. Nigeria therefore cannot afford fuel subsidies like those provided in other OPEC countries. Consequently, when compared to other OPEC countries, Nigeria, with its large population of about 167 million, is significantly disadvantaged in terms of its low Human Development Index, which is a comparative measure of life expectancy, literacy, education, standard of living, etc. For example, Nigeria's low level of human development indicates that our spending priorities have to differ from those of more developed OPEC nations, as a large number of unmet needs will have to be addressed through the judicious use of resources that will become available following the removal of fuel subsidies.

15. Why should Nigerians not enjoy low fuel prices since the country is a major oil producer?

- ❖ Crude oil price is the same for all countries whether they are oil producing or not. It is an internationally traded product, the prices are not set by the countries that produce it. Neither do oil producing countries get a discount in the international market for producing this product. Furthermore, crude oil accounts for about 80% of the final cost of fuel. Other costs include depot charges, transportation costs, chemicals, spare parts, raw materials etc. used in turning the crude into PMS or fuel. Therefore, at the current crude oil price of \$110 per barrel, the finished domestic refined fuel sold to Nigerians cannot be priced lower than the cost of the crude, *plus* the other associated costs enumerated above which are used to refine it. This is why it is difficult to price the finished PMS fuel at a cost lower than its crude form and the total cost of production.

16. Must the government remove subsidy to provide infrastructure?

- ❖ Although there is provision in the budget for capital expenditures including infrastructure, it is clearly not enough due to the poor state of infrastructure in the country and the fact that the budget is heavily tilted in favour of recurrent expenditures. Removal of subsidy will free extra cash for meeting the much needed increase in infrastructure spending.

17. What are government's plans to cushion the effects of subsidy removal?

- ❖ Unlike in the past, the Federal Government has adopted initiatives that are different from previous efforts. In meeting the core needs of the people, the Federal Government has decided to channel its own share of the budgetary savings from the elimination of fuel subsidy into a combination of specific

programmes that will stimulate the economy and alleviate poverty, through the provision of the following:

- **Critical infrastructure: The proposed infrastructure projects are Niger Delta development** projects; road development projects, rail transport projects; water and agriculture development with special attention to irrigation projects; electrical power projects focusing on hydropower, and greenfield petroleum sector projects to be located in Bayelsa, Kogi and Lagos States.
 - Implementation of safety net projects:—The planned safety net programmes include maternal and child health services, public works/youth employment programme, urban mass transit scheme, and vocational training schemes.
- ❖ The Federal Government is launching a Subsidy Reinvestment and Empowerment Programme (SURE Programme) that encapsulates all these alleviating programmes. Structures have also been developed to guarantee adequate oversight, accountability, and implementation of the various projects.

18. Why not start pilot alleviating measures to ascertain that they will work effectively before removing the subsidy?

- ❖ Government has a number of competing needs for the limited financial resources at its disposal and fiscal resources are needed to implement pilot alleviating measures. Moreover, one of the pillars of the Transformation Agenda guiding current policy stance is fiscal consolidation. To pilot the alleviating measure will require additional budgeting of finances for their implementation. Budgeting additional financial resources for pilot alleviating measures will run counter to this policy goal. Therefore, government aims to use the resources freed from the subsidy removal to implement the identified alleviating measures. This government is deeply committed to implementing these cushioning measures.

19. What assurance is the government giving Nigerians that the additional revenues realized from petroleum subsidy removal will be judiciously used?

- ❖ The skepticism is understandable. However, similar government policies in the past have worked as promised. An example is the Petroleum Trust Fund (PTF), which undertook many road, education, and health infrastructural development projects across the country. The PTF remains one of the most successful public works programme embarked upon in the country.

20. Will the removal of subsidy not cause scarcity?

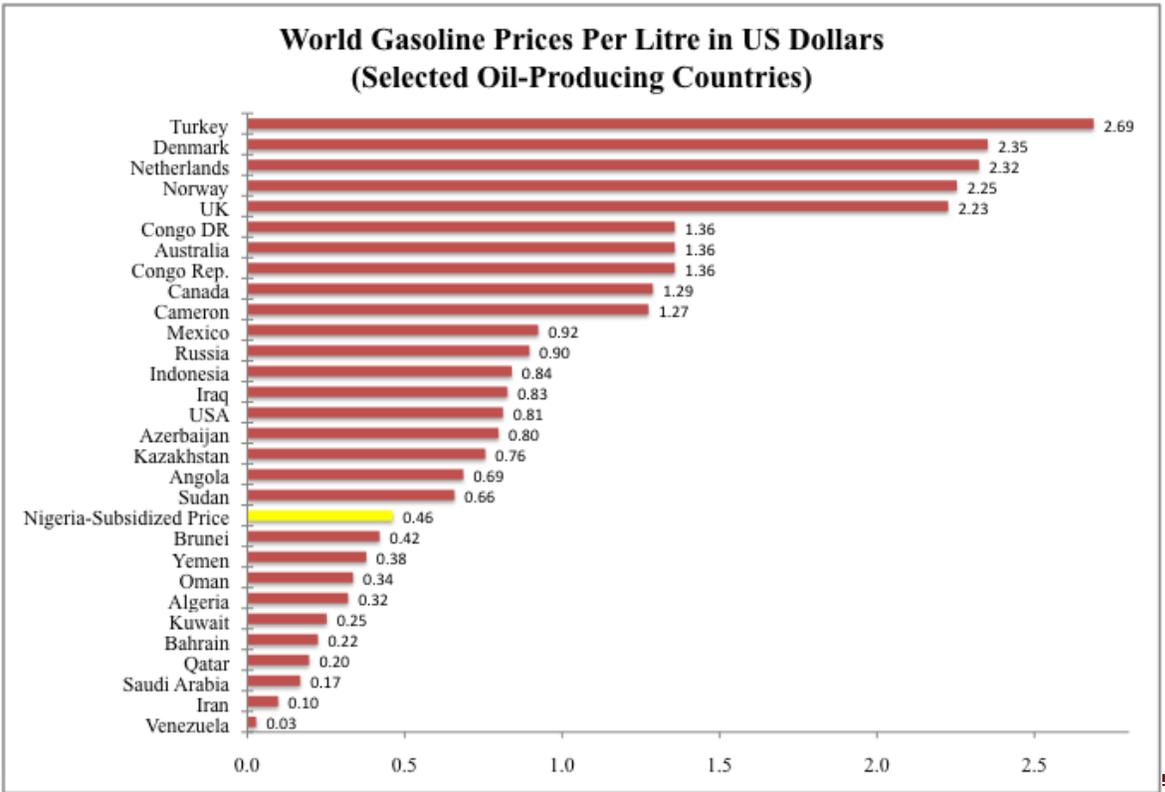
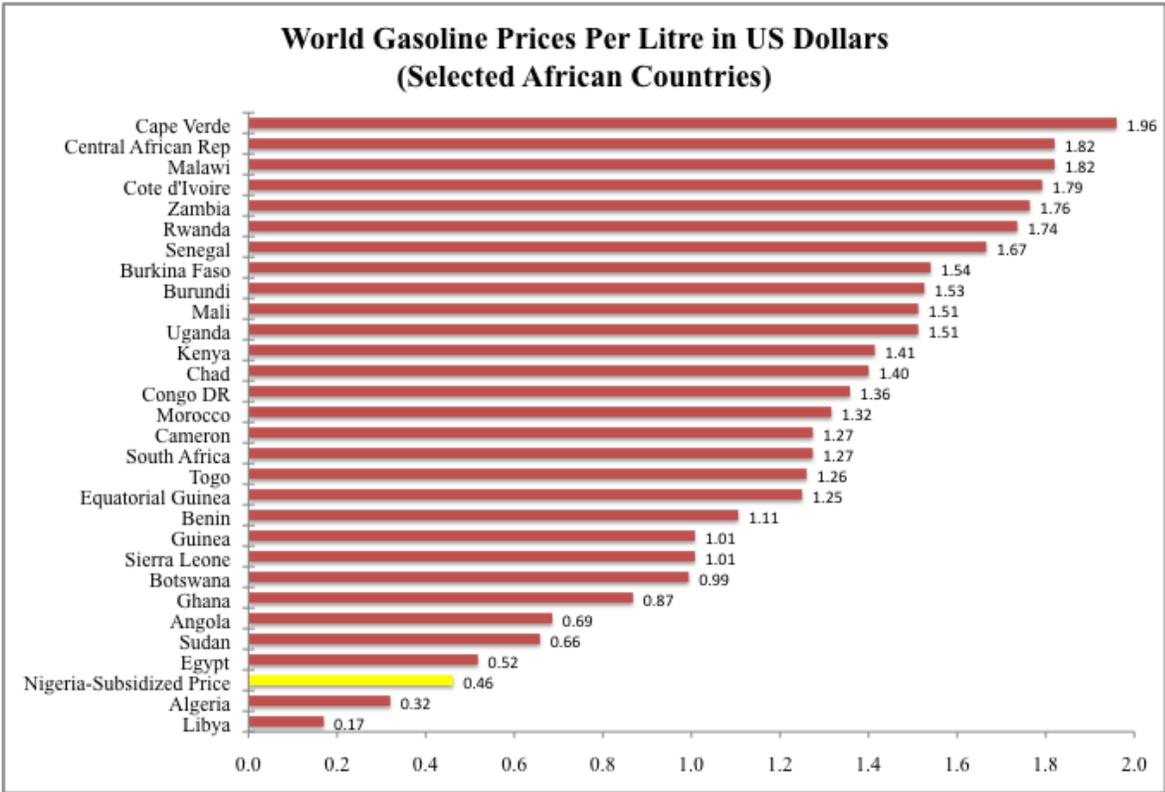
- ❖ No. The Federal Government, through the NNPC, has made arrangements to ensure adequate supply and prevent scarcity during the period leading to deregulation and beyond. The NNPC is currently maintaining a 50-day sufficiency for petrol. This means that even if petrol is neither imported nor refined locally for a period of 50 days, Nigeria will still have sufficient quantity to meet the country's daily needs.

21. How does petrol price in Nigeria compare with those of other countries?

- ❖ Petrol price in Nigeria compares favourably with those of other African countries as well as those of other oil exporting countries. The charts below show that Nigeria has one of the cheapest petrol prices across Africa, behind only Libya and Algeria. Nigeria has the lowest petrol price among its surrounding countries. The same is true of Nigeria's petrol price relative to other oil producing countries.

22. Is petroleum the only source of government revenue? Why not explore other means of revenue generation?

- ❖ No, petroleum is not the only source of government revenue but it is the major source of revenue for the entire country. Of course, government is exploring other sources for revenue generation through various policies, programmes, and initiatives that promote economic diversification and boosts development in key non-oil sectors such as Infrastructure, Agriculture and Entertainment and Tourism. The diversification from oil as the main source of revenue is in line with the government's transformation agenda.
- ❖ The results of this diversification are expected in the medium term. In addition, government is fast-tracking reforms of revenue collecting agencies by actively engaging with them to ensure that revenues are remitted fully and promptly to the Treasury. In the short to medium term, the non-oil sector is expected to contribute a greater share of budget revenue compared to the current contribution of about 30%. In any case, the way and manner we use our major source of revenue will determine sustainability of the economy and the extent to which we are able to meet our development aspirations.



23. Why is government not seeking savings through a sharp cut in government expenditure?

- ❖ Fiscal consolidation is one of the major pillars of the Transformation Agenda. This simply means that government is trying to cut down on spending by progressively reducing recurrent expenditure in favour of capital expenditures. However, government cannot afford a sharp reduction in total expenditure as this will imply reducing the capital vote, which is already insufficient to close the infrastructure gap, complete ongoing critical capital projects and begin new ones. Thus, the savings generated from subsidy removal will provide additional outlays for critically needed infrastructure.

24. If the National Assembly rejects the proposal, has the Federal Government considered the political implications of going ahead with the removal?

- ❖ Nigeria has three tiers of government and each is autonomous. The Executive Branch has the responsibility for running the economy, and will continue to consult with the members of the National Assembly. Even more important is the Executive's commitment to consulting and listening to the Nigerian people. Once the Nigerian people get all the facts right through government's extensive information sharing and enlightenment campaign, we are sure that they will support the policy because the long term benefits of this policy are clear and certain and the future of the country cannot be left adrift.

25. Is the timing right?

- ❖ If not now, when? If we procrastinate, the cost will only become higher. The right time to do the right thing is now.