Fuel Subsidy Reform, Social Safety Nets (SSNs) and Pro-poor growth

3rd CSEA Economic Policy and Fiscal Strategy Seminar
December 8, 2011

Dr. EBERE UNEZE
Objectives/key message

Introduction: Objectives of fuel subsidy reform

Fuel subsidy & social sector budgets

Strategies for successful fuel subsidy reform

Safety nets & other protection programs

Safety nets and inclusive growth

Recent subsidy reform experience

Suggestions for Discussion
Objectives

- Understand the goals of fuel subsidy reform and the important steps the Nigeria government can take to achieve successful reform

- Understand the link between Safety nets and growth, and how a well designed safety net program can help facilitate reform and inclusive growth

- Draw lessons from recent fuel subsidy reforms and suggest way forward
Per Capita GDP Growth 4%

Subsidy Reforms SSNs Program

Inclusive + Increased Growth
A well designed safety net and social program can facilitate subsidy reform, and lead to inclusive growth, if successfully implemented.
There are several objectives of fuel subsidy reform, for example:

- To reduce public expenditure and/or remove inefficiency in spending
- To increase energy efficiency
- To comply with international agreements
- Whatever the objective, it should be clearly articulated so as to design appropriate support policies
Objective of fuel subsidy reform in Nigeria

- To remove inefficiency in spending
  - Subsidy has serious fiscal implications for the economy
    - subsidy costs around N1trillion annually (5.4% of GDP 2011Q3)
  - bypasses the poor/badly targeted;
  - automobile ownership is biased in favour of the rich
  - Research by (Granado et al., 2010) on 20 developing countries shows that for Africa, the poorest 10 percent get 2.2 percent of PMS subsidies, while the richest 10 percent receive 70 percent of benefits from PMS benefits – Nigeria will not be different
  - the poor benefitting from kerosene subsidy
  - Subsidy provides incentive for smuggling – this means that Nigeria may be subsidizing other Countries
  - without subsidy government may have a more prudent budget and spend more on social priorities (pro-poor sectors)
Fuel Subsidy & Social Sector Budgets in Nigeria

<table>
<thead>
<tr>
<th>Subsidy</th>
<th>Capital budget for some critical sectors</th>
</tr>
</thead>
<tbody>
<tr>
<td><img src="image" alt="Graph showing subsidy trend from 2007 to 2011" /></td>
<td>![Table showing capital budget for critical sectors (2011)]</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Sector</th>
<th>N billion (2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>52</td>
</tr>
<tr>
<td>Health</td>
<td>56</td>
</tr>
<tr>
<td>Water</td>
<td>62</td>
</tr>
<tr>
<td>Power</td>
<td>87</td>
</tr>
<tr>
<td>Transport</td>
<td>54</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>311</strong></td>
</tr>
</tbody>
</table>
### Poverty Statistics in Nigeria, 1980-2004

#### Trends in poverty levels

<table>
<thead>
<tr>
<th>Year</th>
<th>Poverty Incidence</th>
<th>Est. Total Population (Million)</th>
<th>Poverty Headcount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>28.1</td>
<td>65</td>
<td>18.26</td>
</tr>
<tr>
<td>1985</td>
<td>46.3</td>
<td>75</td>
<td>34.73</td>
</tr>
<tr>
<td>1992</td>
<td>42.7</td>
<td>91.5</td>
<td>39.07</td>
</tr>
<tr>
<td>1996</td>
<td>65.6</td>
<td>102.3</td>
<td>67.11</td>
</tr>
<tr>
<td>2004</td>
<td>54.4</td>
<td>126.3</td>
<td>68.70</td>
</tr>
</tbody>
</table>

Source: National Bureau of Statistics

#### Relative poverty incidence by sector

![Bar chart showing poverty incidence by urban and rural sectors from 1980 to 2004](chart.png)
## PPPRA PMS Pricing Template and Subsidy (for December, 2011)

<table>
<thead>
<tr>
<th>Component</th>
<th>Price per litre (Naira)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Landing cost (A)</td>
<td>124.39</td>
</tr>
<tr>
<td>Distribution margins (B)</td>
<td>15.49</td>
</tr>
<tr>
<td>Expected open market price (A+B)</td>
<td>139.88</td>
</tr>
<tr>
<td>Retail (pump) price</td>
<td>65</td>
</tr>
<tr>
<td>Subsidy (required increase in retail price)</td>
<td>74.88 (54%)</td>
</tr>
</tbody>
</table>
## Pump Price of PMS: Nigeria & Others

<table>
<thead>
<tr>
<th>Country</th>
<th>Price per litre (Naira)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>65</td>
</tr>
<tr>
<td>UK</td>
<td>340</td>
</tr>
<tr>
<td>US</td>
<td>132</td>
</tr>
<tr>
<td>South Africa</td>
<td>202</td>
</tr>
<tr>
<td>France</td>
<td>250</td>
</tr>
</tbody>
</table>
How can government achieve successful subsidy reform? (I)

- Public debate on the costs and benefits of subsidy reform in order to secure political and societal support

  - Communicate in clear terms how the measures to mitigate the effects of de-subsidization will be used to assist the poor – requires a clear strategy

- Commission research to assess the costs and benefits to the society, estimate the direct and indirect effects of subsidy reform, identify appropriate instruments, and determine benefit level

  - Poverty and social impact assessment (PSIA) to determine the impacts on the poor and the vulnerable
How can government achieve successful subsidy reform? (II)

- Case studies to underlie best practices and how to mitigate the negative effects

- Design of policy reform - SSNs & Social Programs
  - Government needs to demonstrate that it will be able to deliver social programs in a way it has not been doing before
  - Need to announce a “sunset clause” to ensure CCTs are phased out in the long-term

- Improve institutional and monitoring systems to help implement reform and track progress towards reform

- Once successful, there should be political will to uphold reform and avoid policy reversal
Welfare impact of subsidy reform

- Direct Impact
  - Higher price of Petrol
  - Knowledge of direct impact requires information on the level of direct consumption of petrol by households in different parts of the national income distribution – reinforces the need for research

- Indirect Impact
  - Higher prices of petrol passed through other goods and services - requires a model of price-shifting behaviour

- Welfare effects can be addressed through well designed and administered safety net programs
Social Safety Nets for Mitigation & Protection

- Safety nets are “Non-contributory transfer programs targeted to the poor and those vulnerable to poverty and shocks”
  - in this case, those that will be affected by any subsidy reform

- Some safety net programs, include:
  - Unconditional cash and in-kind transfers
  - Conditional cash and in-kind transfers
  - Public works programs
  - Fee waivers for health and education
  - General subsidies
The following programs can complement SSNs:

- Increase expenditure on social services
- Increase “related” expenditures, such as:
  - Improving mass transport systems in urban areas
  - the poor lack access to efficient public transportation system, or quality roads
  - higher fuel prices may exacerbate the situation

- Intensifying rural electrification scheme and ensuring stable power supply
  - this will help increase economic activities in rural communities

- Revamping old refineries and building additional ones

Government needs to demonstrate trust and convince the citizens that these complementary programs can be delivered.
SSNs & Inclusive (pro-poor) growth

- Safety nets promote pro-poor growth by facilitating structural reforms to the economy

- Evidence that subsidy reform can result in an increase in GDP (GSI, 2010)

- By reducing inequality during reforms, SSNs directly raise growth rates – opportunity for the poor to participate in the growth process

- GDP per capita growth of about 4 percent

- However, a poverty incidence of around 50 percent suggests that the poor may not be benefitting from the growth
Per capita growth in Nigeria, 1990-2010

Average growth of **0.7%** from 1990-1999 & **3.8%** from 2000-2010
SSNs and Inclusive Growth

- De-subsidization can reduce poverty and help achieve inclusive growth through transition policies such as:
  - CCTs
  - Increased health and education budgets

- CCTs by increasing access to quality education and health, enhance human capital of those exposed to negative effects of reform (the poor)

- Fee waiver programs on education such as school vouchers or scholarships can also improve human capital

- In turn, enhanced human capital will help raise the participation of the poor in wealth creation, increase their earnings and support the propagation of economic growth
Recent Reform Experience: Ghana

- Two unsuccessful attempts to remove fuel subsidy in 2001 and 2003

- In 2004, around 2.2 percent of its GDP was spent on fuel subsidy (IMF, 2006 & GSI, 2010)

- Ghana successfully removed fuel subsidy in 2005

- Reforms succeeded because Ghana implemented several important strategies:

  - Early Research was carried out to identify winners and losers from subsidies and subsidy reform, and quantify the extent the poor will be affected – conducted a PSIA
  - Ghana mounted a strong communications campaign highlighting positive results of de-subsidization and negative implications of inaction
  - Independent institution (National Petroleum Authority) was established to manage fuel pricing
  - Policies and programs were implemented to mitigate the effects of subsidy reform
Mitigation Measures implemented by Ghana

- To compensate the poor for higher energy prices resulting from subsidy removal, the government took the following critical steps;
  - eliminated fees for public primary & secondary schools
  - increased the number of public-transport buses & put price ceiling on public-transport fares
  - put extra funds into a health-care scheme for poor areas
  - started programs to help expand electrification in rural areas
  - increased daily minimum wage from US$ 1.24 to 1.50
  - Cross-subsidization of kerosene and LPG
Reform Experience (2005): Indonesia

- By 2005 the cost of subsidy was around 5% of GDP (World Bank, 2008a) and was regressive
  - Govt reduced fuel subsidies by about US$10 billion
  - A quarter of the funds used to fund targeted unconditional cash transfer program (UCTP)
    - The UCTP was rolled out rapidly after the decision to implement it in August 2005, with the first quarterly payment made in October, 2005
    - Was met with some initial challenges, no formal channels for handling complaints
  - The remainder used for:
    - Block grants to schools
    - Basic health care & health insurance for the poor
    - A village improvement program
  - Reduced subsidy on kerosene and introduced program to increase the use of LPG
    - Compensation designed for one year and lasted for that long
How the targeting and UCTP worked in Indonesia

- Targeting was progressive:
  - government targeted 16% of the population under the poverty line (PL) and those just marginally above the PL (the near poor)
  - the UCTP reached 19 million poor and near poor (28% of the population), with fairly high errors of inclusion
  - each beneficiary family received around US$10 per month paid on quarterly basis
Lessons from Indonesia

- There are important lessons to borrow from Indonesia’s fuel subsidy reform:
  - cash transfer programs can be effective in mitigating the effects of subsidy removal on the welfare of households
  - other social programs can also help to improve the availability of services to the community
  - safety nets can help reduce the political backlash that follows subsidy reform
  - the timing and implementation of the program are also very important – high errors when programs are rolled out in a haste
Suggestions for Discussion

- How should the federal government approach fuel subsidy reform?

- What safety nets and social programs should government implement?

- Should government follow a gradual or rapid approach to reform?
End

Thank You!