

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

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Outline

- 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**



Key Message

- *A well designed safety net and social program can facilitate subsidy reform, and lead to inclusive growth, if successfully implemented.*

Introduction - Objectives of fuel subsidy Reform

- 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

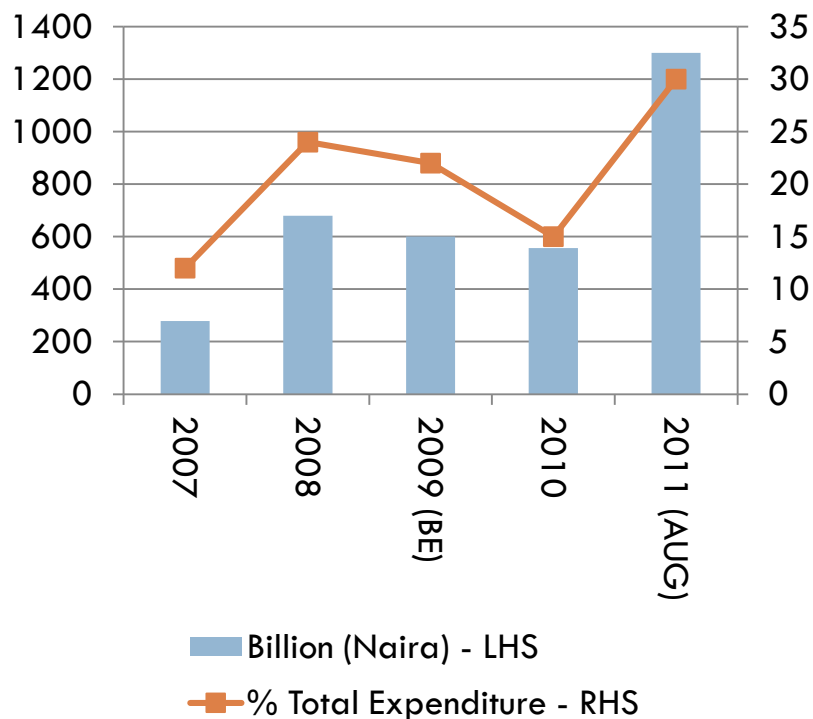
Objective of fuel subsidy reform in Nigeria

- ❑ To remove inefficiency in spending
- Subsidy has serious fiscal implications for the economy
- ❖ subsidy costs around N1 trillion 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

Subsidy

Capital budget for some critical sectors



Sector	N billion (2011)
Education	52
Health	56
Water	62
Power	87
Transport	54
Total	311

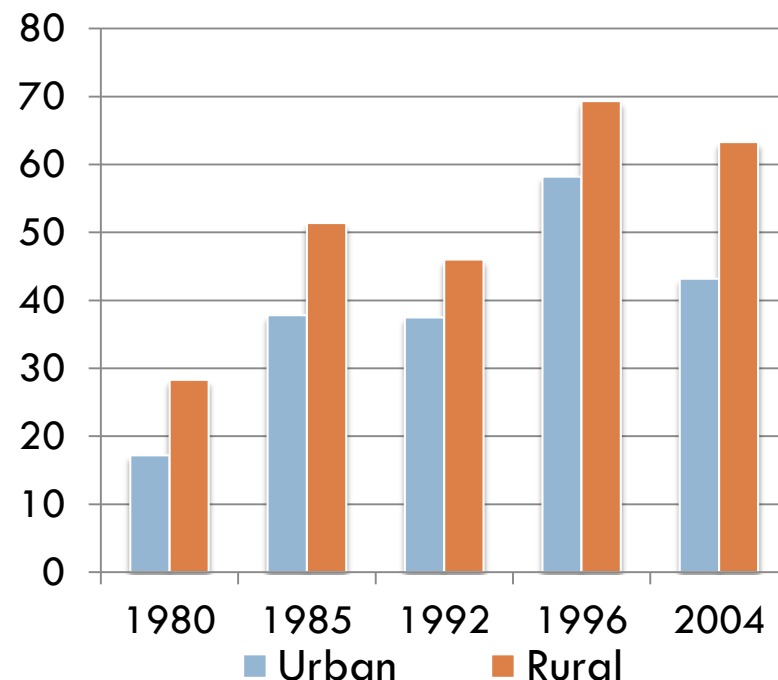
Poverty Statistics in Nigeria, 1980-2004

Trends in poverty levels

Year	Poverty Incidence	Est. Total Population (Million)	Poverty Headcount
1980	28.1	65	18.26
1985	46.3	75	34.73
1992	42.7	91.5	39.07
1996	65.6	102.3	67.11
2004	54.4	126.3	68.70

Source: National Bureau of Statistics

Relative poverty incidence by sector



PPPRA PMS Pricing Template and Subsidy (for December, 2011)

Component	Price per litre (Naira)
Landing cost (A)	124.39
Distribution margins (B)	15.49
Expected open market price (A+B)	139.88
Retail (pump) price	65
Subsidy (required increase in retail price)	74.88 (54%)

Pump Price of PMS: Nigeria & Others

Country	Price per litre (Naira)
Nigeria	65
UK	340
US	132
South Africa	202
France	250

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

Complementary public & social programs

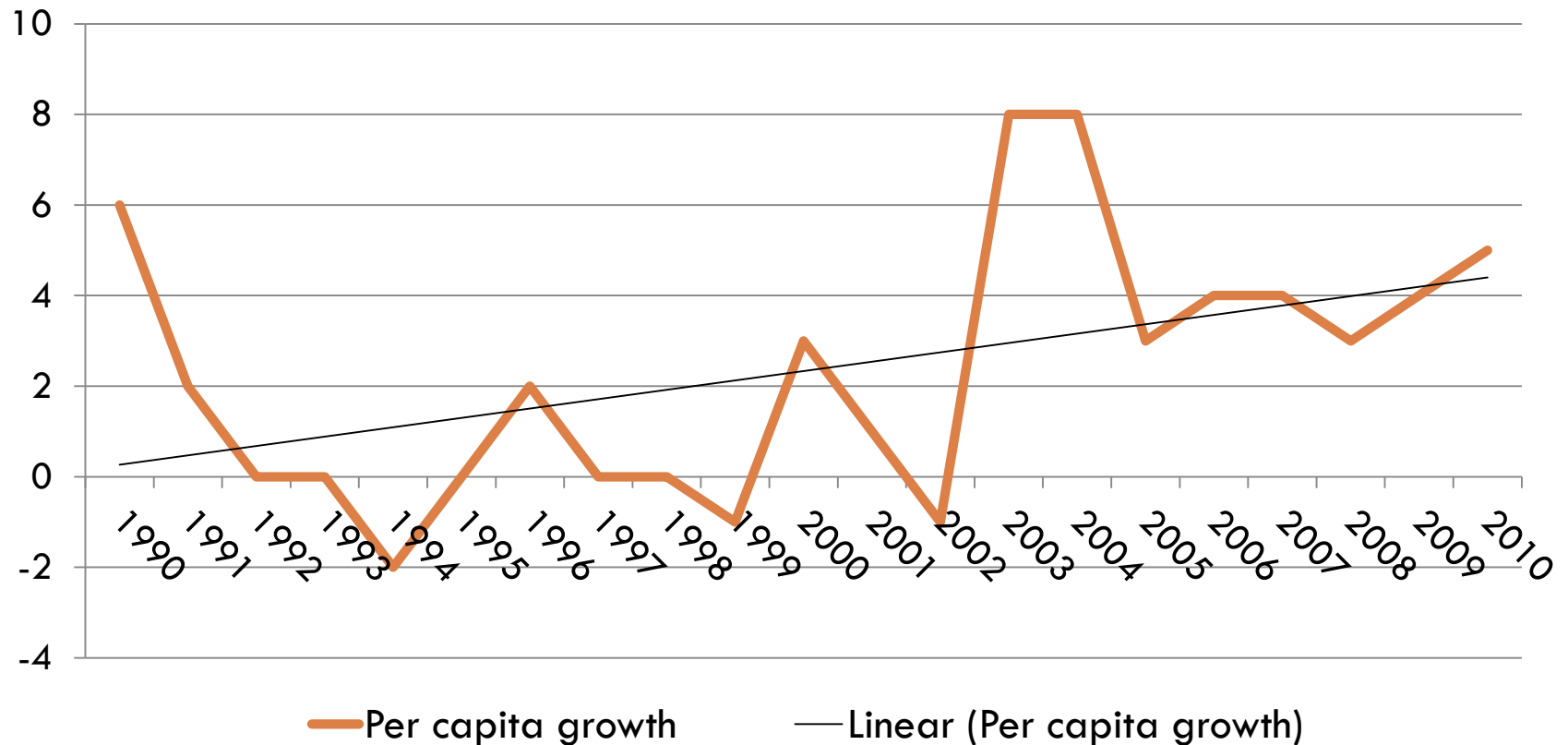
- The following programs can complement SSNs:
 - ❖ Increase expenditure on social services
 - ❖ Increase “related” expenditures, such as;
 - Improving mass transport systems in urban areas
 - ✓ the poor lack access to efficient public transportation system, or quality roads
 - ✓ higher fuel prices may 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 follow 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!