

# **Energy Subsidies in Nigeria: Opportunities and Challenges**



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## PREAMBLE

Various forms of consumer energy subsidies<sup>1</sup> are implemented in Nigeria. Three energy products are particularly subsidized: gasoline (Premium Motor Spirit –PMS), household kerosene (HHK), and electricity. In the case of petroleum products (PMS and HHK), government provided subsidies by paying petroleum products marketers the difference between the market rate and the government approved retail price<sup>2</sup>. For electricity, the government required state utility companies to charge tariffs below the costs of electricity production, then it reimbursed as part of a lump sum and by under-charging the electricity sector for the cost of natural gas<sup>3</sup>. While petroleum (fuel) subsidy has increased, other forms of energy subsidies (such as kerosene) have relatively fallen over the years. Notably, the proposed study focuses on petroleum subsidies in Nigeria, as it weighs most heavily on the Nigerian economy and the welfare of the citizens<sup>4</sup>.

As in the case of most energy subsidizing countries, the main rationale for energy subsidies in Nigeria is to protect consumers from the negative effects of increases in petroleum prices, while promoting industrial growth. Also, in line with most oil exporting countries, the provision of petroleum subsidies in Nigeria is driven by socio-political reasons – the perception that cheap petrol prices are an entitlement for citizens of an oil-wealthy country. However, despite the poverty alleviation justification for providing subsidies, there is strong evidence that Nigeria’s experience with subsidies have been marred with economic, structural, and political challenges, among others. Given that energy consumption is significantly higher in high-income than low-income households, fuel subsidies have been generally regressive, favouring the richest 20 percent four times more than the poorest 20 percent<sup>5</sup>. Also, subsidies became fiscally unsustainable overtime as it constituted one of the largest component of public expenditure in Nigeria, and thus starved core developmental sectors of needed resources. For example, estimates show that energy subsidies in 2014 budget (N971 billion) surpassed the allocation for health, education and power sectors combined (N818.69 billion)<sup>6</sup>. In addition, fuel subsidy was grossly ineffective, as there were wide variations in prices across various regions in Nigeria as well as reoccurring periods of fuel scarcity. Furthermore, the presence of fuel subsidies discouraged competition, and contributed to the neglect of the domestic refineries in Nigeria.

It is against this background that government efforts in recent years have targeted at reforming energy subsidy in Nigeria. Historically, all past regimes have made efforts to implement various forms of energy subsidy reforms, with limited success. However, the subsidy reform initiative (price modulation as opposed to subsidy removal) launched by the current administration and still ongoing, appears to be relatively successful. The present economic and fiscal crisis in the country provided a strong impetus for the implementation of the contentious subsidy reforms. Essentially,

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<sup>1</sup> Including implicit subsidy (in which the demand and supply subject to a subsidy and price fixing effect) and explicit cost.

<sup>2</sup> The subsidy represents the difference that the government pays between domestic price and international fuel price, after estimating landing costs, distributions costs, etc. – calculated by the Petroleum Products Pricing Regulatory Agency (PPPRA). This is to reduce the cost of refining

<sup>3</sup> International Institute for Sustainable Development (2015), “Citizens’ Guide to Energy Subsidies in Nigeria”. [http://cpparesearch.org/wp-content/uploads/2015/01/Citizens\\_Guide\\_to\\_Energy\\_subsidies\\_in\\_Nigeria.pdf](http://cpparesearch.org/wp-content/uploads/2015/01/Citizens_Guide_to_Energy_subsidies_in_Nigeria.pdf)

<sup>4</sup> Akinwale, Y.; Olaopa, O.; Ogundari I.; and Siyanbola, W. (2013), “Political Economy of Phasing out Fuel Subsidy in Nigeria”. *Energy and Power* 3(4): 37-43

<sup>5</sup> Siddig, Khalid, et al (2014). “Impacts of Removing Import Subsidies in Nigeria on Poverty”. *Energy Policy* 69. 165-178.

<sup>6</sup> PWC, 2014 “Nigeria’s 2014 Budget: Tax and Economic Analysis” <https://www.pwc.com/ng/en/assets/pdf/nigerias-2014-budget-tax-and-economic-analyses.pdf>

amongst other components, the reform partly deregulated the market for imported petroleum products although the government set petroleum price at N145 per litre.

A key factor that informed the dynamics of the present subsidy reform is the current fiscal crisis of Nigeria, which implied that subsidy payments could not be sustained. The decline in government revenue on the account of falling crude oil price amid falling crude oil output caused by the renewed attacks on oil infrastructure in the Niger Delta region severely constrained the government's capacity to provide subsidy payments in the 2016 Budget.<sup>7</sup>

In this regard, the objective of the study is to evaluate efforts at reforming energy subsidy policies in Nigeria to better understand the prospects for the ongoing subsidy reform. The proposed study will largely use secondary data to provide in-depth critical analyses. The rest of this study is organized as follows: Section 1 describes the background of petroleum subsidy policy in Nigeria, highlighting its history and institutional framework/administration. Section 2 discusses the features of petroleum subsidy and the rationale for its reform. Section 3 presents past attempts at reforming petroleum subsidy, while Section 4 presents current (most recent) subsidy reforms. Section 5 provides the key lessons learnt from Nigeria's experience with subsidies, and Section 6 concludes the study.

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<sup>7</sup> NNPC Group (2016), "Petrol and the New Pricing Regime in Nigeria", Energy in Brief, May 2016 Edition, Vol.6

## 1. BACKGROUND OF PETROLUUM SUBSIDY

With emphasis on petrol/ gasoline, this section provides an overview of petroleum subsidy policy in Nigeria including its history, pricing mechanism, institutional framework and policy administration

### 1.1 History of Petroleum Product Subsidies

Subsidies on petroleum products were first introduced by the Federal Government of Nigeria in the 1980s, in accordance with the Price Control Act of 1977. In line with the Structural Adjustment Program (SAP), at the time, the subsidy acted as a temporary measure to control the prices of petroleum products while the refineries underwent rehabilitation (Ezeigbo, 2014). However, the payment of subsidies for refined petroleum products continued afterwards, and most attempts by successive governments to remove the subsidies and increase prices to reflect actual market prices were met with stiff opposition by labour unions and citizens. A key driver of the continued payment of subsidies was the sustained increase in demand for refined petroleum products, amidst relative decline in local refining capacity. Thus the inability of domestically refined products to meet the huge and growing demand, led to an increase in the importation of petroleum products which are subsidized. In Nigeria, two petroleum products are subsidized: Premium Motor Spirit (PMS) and Household Kerosene (HHK).

### 1.2 Overview of Petroleum Subsidy Policy

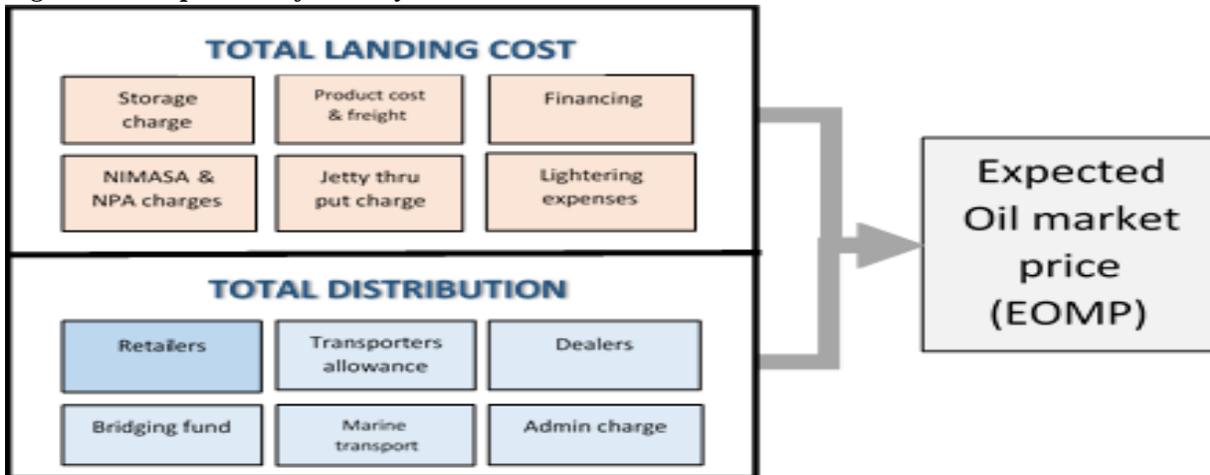
Essentially, subsidies for petroleum products are provided by paying the difference between the market price (Expected Open Market Price, or EOMP) and the government-stipulated retail price, in order for petroleum product marketers to sell fuel below the EOMP (*Figures 1 & 2*). The government through the Petroleum Products Pricing Regulatory Agency (PPRA) sets the maximum retail price for petrol arbitrarily, while the EOMP is market-determined and comprises of product costs, freight, lightering expenses, depot charges, financing, distributor margins, among others. Landing costs represent around 85% of total allowable costs in the calculation and therefore factors that affect landing costs will also affect the eventual subsidy paid. The pricing mechanism is based on Import Parity Pricing adjusted for cost of transportation, distribution and marketing.

*Figure 1: Components of Subsidy per Litre*



Source: CPPA (2011), IISD (2012), PPRA (2016)

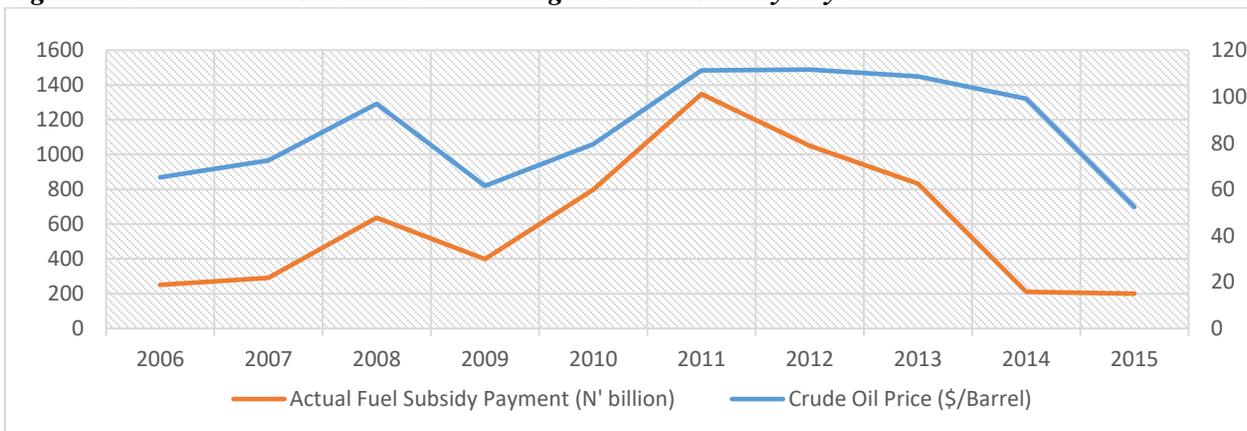
**Figure 2: Components of Subsidy**



Source: PPRA (2016)

Thus while the EOMP typically fluctuates with the global crude oil prices, the government-approved price is altered less frequently at the discretion of the Presidency (IISD, 2012). Given that domestic prices for petroleum products do not quickly adjust to market price, there is usually a gap between budgeted subsidy payments and the actual amount paid as subsidies. The deviation in budgeted and actual subsidy payment is typically driven by three main factors: changes in rate of inflation<sup>8</sup>, and changes in the Naira-Dollar exchange rate and, to the largest extent, changes in global crude oil prices, (SDN, 2015; IISD 2016). Hence, since fuel prices are fixed at nominal value subsequent increases in oil prices, and to a lesser extent, inflation and the Naira-Dollar exchange rate increases the cost of subsidy.

**Figure 3: International Oil Price Drive Changes in Fuel Subsidy Payments**



Source: CBN (2016), PPRA (2016)

Figure 3 highlight the main factor, crude oil price, which drives changes in fuel subsidy payment. Notably, crude oil price changes mostly account for the divergence in budgeted and actual subsidy

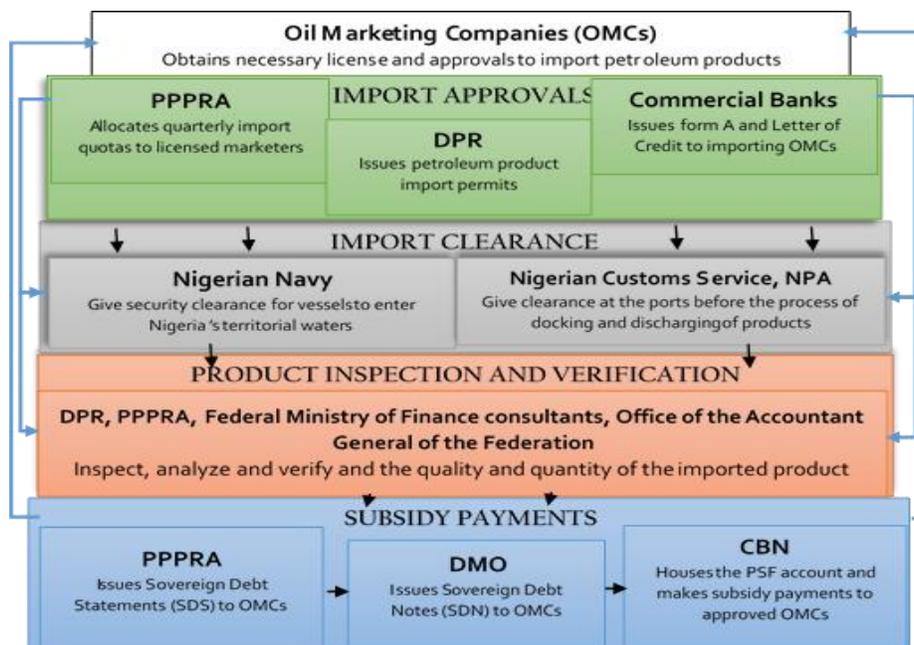
<sup>8</sup> Change in inflation rate affects Total Distribution margin which in turn influences the overall amount paid as subsidies.

payments. As the price of crude oil fluctuated through the years from 2006 to 2015, the actual amount paid as subsidies fluctuated in the same direction. For instance, in 2008 when global oil prices, and inflation rose, actual subsidy payments exceeded the amount budgeted for subsidies by over 148 per cent. Also, in 2011 when global oil prices and the exchange rate increased significantly, actual subsidy payments escalated beyond budgeted subsidy payments by over 450 percent. However, a peculiar case was in 2012 when there was a decline in the actual amount paid as subsidy (relative to the previous year), despite the increase in exchange rate, inflation rate and the price of crude oil. In this particular year (2012), the retail price of PMS was reviewed upwards from N65 to N97, and in effect, part of the subsidy burden was passed on to the final consumers of the product (See Table 1 in the Appendix for more details).

### 1.3 Administration of the Subsidy Policy

Prior to 2006, the state-owned Nigeria National Petroleum Company (NNPC) was not only charged with managing the exploration and export of Nigeria’s crude oil but was also solely responsible for the importation of refined petroleum products. In practice, after the sale of crude oil the NNPC acts independently and remits revenue from crude oil production to the government after deductions for subsidy and other costs<sup>9</sup>. In 2006, the Petroleum Support Fund (PSF) was created to accommodate private marketers (also known as the Oil Marketing Companies - OMCs) in the importation of petroleum products; this - the PSF - constitutes the framework of the Nigerian subsidy system. As shown in figure 4, there are several government agencies involved in the administration of the subsidy regime within the framework of the PSF.

**Figure 4: Framework for Subsidy Policy Administration and Process**



Source: CSEA analysis

<sup>9</sup> The NNPC continued this practice even after the introduction of the PSF. This has been the basis of several audits into the operations of the state-owned oil company.

At the core of the subsidy administration framework is the Department of Petroleum Resource (DPR) which is the government agency authorized to grant licenses to OMCs who satisfy licensing requirements. The Petroleum Products Pricing Regulatory Agency (PPRA) established in 2003, is charged with the responsibility of allocating import quotas to licensed OMCs and estimating the landing cost (ex-depot price) of petroleum products. Based on the estimates done by the PPRA, necessary payments are made from the PSF to petroleum product marketers. When estimated landing costs are below actual costs to OMCs (under recovery), withdrawals are made from the PSF to support subsidy payments. On the other hand, when estimated costs are above total costs (over-recovery), OMCs remit the excess funds they received which is deposited in the PSF.

During importation, the Nigerian Navy is charged with the responsibility of issuing clearance which gives tankers access into the Nigerian waters, while the Nigerian Customs Service is authorized to give clearance for the discharge of imported petroleum products according to stipulated quantity. At the ports, the Nigerian Ports Authority levies the relevant administrative charges, the PPRA and importers or marketers checks the quantity and value of import supplies, while government-appointed auditors or inspection agents carry out double-checks.

Upon delivery, the Ministry of Finance has the authority to pay the importers/marketers after reviewing the reports of the inspection agents/auditors. Then, the Central Bank of Nigeria (CBN) is responsible for confirming and remitting payments, alongside the Debt Management Office (DMO) charged with issuing Sovereign Debt Notes that guarantees markets payments within 45 days. While the system is quite complicated, a simplified version of the process and key agencies are presented in *Figure 4*.

Notably, due to opaqueness and inefficiency in the setting of the EOMP and the administration of subsidy regime, the pricing of petroleum products in Nigeria have been burdened with controversies. Some of these controversies include: the likelihood that the massive foreign exchange demands by the OMCs undermine macroeconomic stability; the opportunity costs of contracting debts to finance fuel importation are significant; if benefits of existing subsidy regime is skewed in favour to the rich; and the extent to which money spent on petrol subsidies diverts resources away from critical project and programs, amongst others. These issues also explain the increasing activities of vandals in the oil rich-region who sabotage crude oil facilities (in demand for their own fair share of the oil wealth), thereby aggravating the leakages in government revenue (Adenikinju, 2014; IISD, 2016). Some of these issues provided rationale for several attempts at subsidy removal in Nigeria --Section 2 provides more details.

## 2. FEATURES OF SUBSIDY AND RATIONALE FOR REFORM

In the pre-reform subsidy regime, the Nigerian government spent a substantial portion of its revenue on energy subsidies, particularly petrol/gasoline. Over the years, the Nigerian government incurred unsustainable fiscal cost as well as economic (opportunity) costs on account of fuel subsidy payments. Although fuel subsidies represent a principal welfare instrument in the country to allow poorer Nigerians benefit from the country's oil wealth, its welfare impact on the poor remains small. This sub-section presents discussion on the features of subsidy, including magnitude of government spending, source of finance, the opportunity cost, and regressivity. It also sheds light on the Nigerian government's rationale for subsidy reforms in Nigeria.

### 2.1 Magnitude of Government Spending on Subsidies

Over the past years, Nigeria has subsidized energy, especially fuel, at a substantial cost to the government. Federal government spending on fuel subsidies have constituted a significant portion of government revenue and overall Gross Domestic Product (GDP). It is estimated that total subsidy payments to fuel marketers constitute on average 1.75 percent of overall GDP, on a yearly average (*Table 1*). Actual subsidy costs have gradually increased over the years: from N251 billion in 2006 to as high as N1,348 billion in 2011. However, fuel subsidy payments fell subsequently; reaching N200 billion in 2015 and was eventually removed in 2016, largely on account of its fiscal unsustainability amid declining government revenue. Notably, as the gap between the domestic retail price of fuel and the import parity price increased, the cost of fuel subsidies has often been much higher than anticipated by the government in its national budgets (*Table 3*). Thus, actual subsidy payments have often surpassed budgeted fuel subsidy payments (IMF, 2013). In addition, the deep-rooted corruption in the country have also contributed to such divergence in actual and budgeted funds for subsidy payments. For instance, during the Farouk Lawan Committee Probe in 2012, it was uncovered that 197 subsidy transactions worth N229 billion were illegitimate, and N232 billion fuel subsidy payments to marketers was not supplied in 2011 (Ezeigbo, 2015).

*Table 1: Annual Cost of Fuel Subsidies in Nigeria*

Year	Budgeted Fuel Subsidy Payment (Naira, billion)	Actual Fuel Subsidy Payment (Naira, billion)	Fuel Subsidy (% of GDP)	Fuel Subsidy (% of Budget Allocation: Recurrent + Capital expenditures)
2006	151.9	251	1.3	10.0
2007	188	290	1.4	10.0
2008	256.3	637	2.6	11.6
2009	159.9	399	1.3	5.1
2010	278.1	797	2.3	7.5
2011	245	1,348	3.5	6.9
2012	888.1	1,049.7	2.4	23.6
2013	971.1	832	1.7	24.6
2014	971.1	211	0.4	27.2
2015	460	200	0.3	13.9

*Data Source: NBS, PPRA, IMF- Fuel Subsidy calculated based on IMF nominal GDP figures*

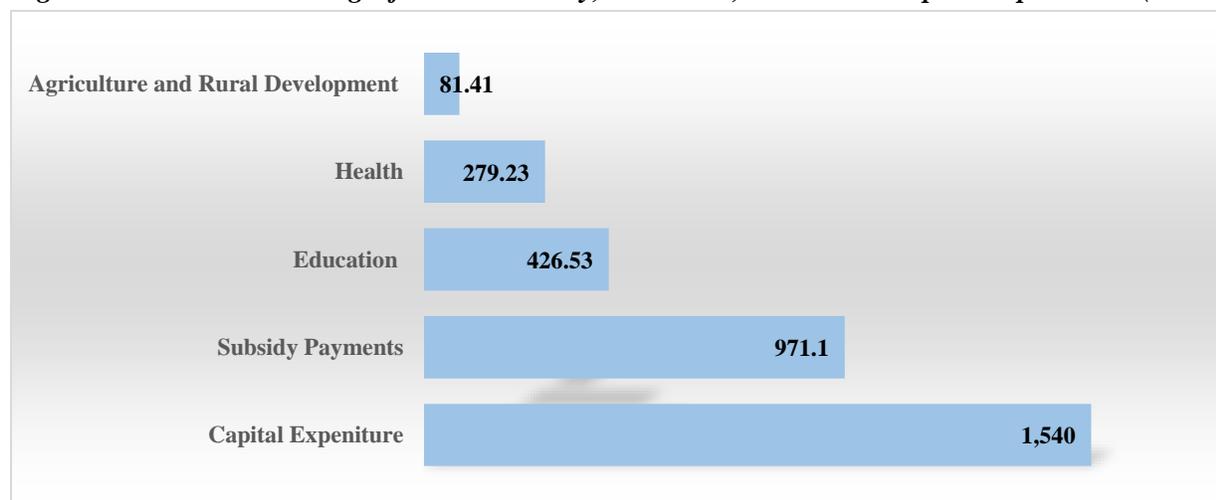
Furthermore, an analysis of Nigeria’s annual National Budget shows that a substantial portion of government revenue is directed towards fuel subsidy, with budgetary allocations for fuel subsidy payments being as high as or even more than allocations to many critical sectors of the Nigerian economy. For instance, an analysis of the 2013 budget shows that allocation for fuel subsidy constituted about 20 percent of the entire budget (*Table 2*). In that year, allocation for fuel subsidy (N971.1) was eleven times more than the appropriation for agriculture and rural development (N81.41billion), three times that of health (N279.23 billion), and twice of education (N426.53 billion) (*Figure 5*). Capital expenditure, budgeted at N1.54 trillion, was just a little above allocation for fuel subsidy. In terms of welfare, subsidy provisions in 2013 could pay the salaries and wages of about half the workforce of Ministries, Departments and Agencies (MDAs) at the federal level; which was budgeted at N1.723 trillion.

**Table 2: Federal Government Expenditure Profile (2013)**

Expenditure Profile	Naira (Billion)
1. Recurrent (non-debt)	2,410
-Allocation for Fuel Subsidy	971
2. Capital	1,540
3. Debt Service	592
4. Statutory Transfers	380
Aggregate Expenditure	4,922
Revenue Available to the FGN	3,890
Budgeted government borrowing	1,032

Data Source: DMO (2016), Budget Office of the Federation (2016), PPRA (2016)

**Figure 5: 2013 Federal Budget for Fuel Subsidy, Education, Health and Capital Expenditure (Naira, billion)**



billion)

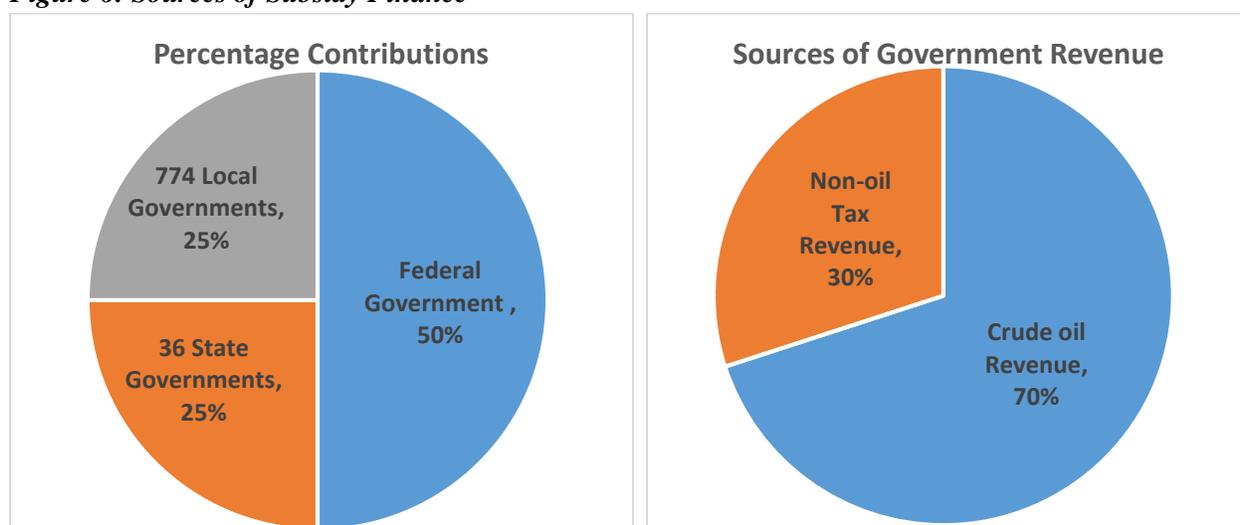
Data Source: PPPRA, 2014

Thus, government spending on fuel subsidy have been substantial, often threatening fiscal stability of the Nigerian government and investments in key sectors of the Nigerian economy.

## 2.2 Source of Subsidy Finance

Fuel subsidies are financed through the Petroleum Support Fund (PSF) funded by the three tiers of government, and supplemented with surpluses from periods of “over-recovery”<sup>10</sup>. Among the three tiers of government, the Federal Government is charged with 50 percent of the required funds, while the 36 states in Nigeria contributes 25 percent and the Local Government Areas contributes the remaining 25 percent (*Figure 6*). It is estimated that 70 percent of government revenue is derived from crude oil export earnings, while the remaining 30 percent represent non-oil revenue derived from taxpayers (Federal Ministry of Budget and National Planning, 2015).

**Figure 6: Sources of Subsidy Finance**



*Data Source: Federal Ministry of Budget and National Planning, 2015; SDN, 2015*

Notably, the excess earnings from crude oil exports during periods of boom are saved in the Excess Crude Account now replaced with three Sovereign Wealth Funds (SWF) and is used to fund government expenditure where there are shortages in government revenue. Among the three SWF funds, the Stabilization Fund is particularly designed to fund shortages in fuel subsidies (Nigerian Sovereign Investment Authority, 2015) (*Appendix, Box 1*). For instance, withdrawals were made from the Stabilization Fund for part payments on fuel subsidy in 2011.

## 2.3 Opportunity Costs of Subsidy Financing

The net benefits of fuel subsidies, among other things, should take into account the opportunity costs of subsidization, as money spent on making fuel cheap cannot be spent on other priorities. On account of low pricing of domestically produced-energy, substantial disposable funds for

<sup>10</sup> Over-recovery is when the actual landing and distribution costs to marketers is below the amount approved and disbursed by the government, such that marketers have to give back the excess they received which is then placed in the PSF.

critical sectors of the Nigerian economy and infrastructure development are forgone each year. The Central Bank of Nigeria estimates spending related to fuel subsidies in 2011 at about US\$ 12.4 billion (approximately N2 trillion); this amount represents over 39 percent of the Nigerian government's expenditure in 2011 (International Institute for Sustainable Development, 2012). A part of the money spent on fuel subsidy payments, N245 billion, in 2011 was sourced from the federation account which would otherwise have been shared by the three tiers of government in the ratio of 52.68%, 26.72% and 20.6% to fund domestic projects at a critical time (Oyedele, 2011).

Resources spent on fuel subsidies have not only drained government budget, but have also compounded fiscal deficits and ultimately contributed to debt accumulation (Faith, et al., 1995) (*Section A, Table 2*). Furthermore, especially in recent years when renewed emphasis on domestic resource mobilization have led to the gradual decline in foreign aids and grants for development, the opportunity cost of fuel subsidy have heightened. More so, potential revenue flows have been forgone on the account of fuel subsidy. Particularly, Nigeria's pre-subsidy reform regime have been a disincentive to investment in domestic refining capacity, which has had medium- and long-term effects on domestic production, and hence on future revenue stream. The ultimate ramifications of these may have been severe for the poor, as other welfare spending in areas such as healthcare and education have become unaffordable over the medium and long-terms.

Hence, the consideration of cost of fuel subsidies and their forgone alternatives have served as the main motivation for the partial removal of fuel subsidy and the establishment of the Subsidy Reinvestment and Empowerment Program (SURE-P) in 2012. According to Sure-P brochure, savings from the partial subsidy removal were invested in a combination of programs to stimulate the economy and alleviate poverty through critical infrastructure and safety net projects; which otherwise would have been forgone. It is estimated that a total of N3.18 billion naira was paid into SURE-P which generated about 116,000 jobs between 2012 and 2013 (Energy Mix Report, 2013). Nevertheless, the SURE-P program was also not a successful and credible compensation program due to corruption and mismanagement of public fund that led to its close down by the Buhari government in 2015

However, the line of reasoning that fuel subsidy in Nigeria have eroded disposable income of the government for expenditure in critical sectors of the Nigerian economy and infrastructure development is not as straightforward due to wastes in the Nigerian economy – in form of corruption. It is estimated that Nigeria loses about 39 percent of its annual fuel subsidy payments to corruption (CPPA, 2012).

#### **2.4 Beneficiaries of Petroleum Subsidy: Regressive or Non-Regressive?**

The benefits of fuel subsidies in Nigeria is believed to flow disproportionately to those who consume more fuel, as energy subsidies in Nigeria are universal – that is, no attempt to target the subsidy to a particular group. Consequently, energy subsidies, particularly on fuel/petrol, has been

one of the most contentious public policy debate in Nigeria. While welfare, poverty alleviation and even election cycle politics has been the main motivation for fuel subsidies, it is often argued that fuel subsidy benefits the higher income groups the most with little or no benefits to the poor. Although poverty is multidimensional, the poor constitutes 53.5 percent of the Nigerian population living below the poverty line of US\$ 1.90 per day (about N500 per day) based on 2009 estimates by the World Bank (2016). Thus, although fuel subsidy is the principal welfare mechanism and resource transfer payment to allow ordinary Nigerians benefit from the country's oil wealth, a sizeable number of the 174 million Nigerians who have access to fuel subsidies have very low incomes.

Nevertheless, the proponents of fuel subsidy in Nigeria have argued that fuel subsidy benefit the poor as a removal of subsidy would lead to a spontaneous increase in general price level and decline in the general standard of living. Cheap fuel primarily reduces the cost of transportation and thus provides the indirect benefit of reducing the costs of goods that require transportation such as food. Citing a case, the announcement ] on 1<sup>st</sup> January 2012 that fuel importers would not be paid for supplying petroleum products instantly caused a panic and an instant increase price of petrol at the black market ranging between N138 and N250 per litre of petrol across states (Onyishi, et al., 2012). Accordingly, cost of transportation instantly increased and hyperinflation of the prices of consumer goods and services followed. For instance, according to Daily Nation newspaper, the fare from Ilorin to Abuja by bus increased from N2,000 to as high as N4,000 on 2<sup>nd</sup> January 2012. Thus, in the absence of fuel subsidies, the poor and low income earners suffer indirectly and this compounds poverty.

However, opponents of fuel subsidy posit that fuel subsidy largely favours people in higher income groups as they own cars, run generators more, use more fuel, live in bigger houses and consume more energy. In contrast, the poor often residing in the rural parts of Nigeria, tend to use more of charcoal, kerosene, firewood, use less transportation, live in their own small homes, source food from their immediate local and farms. Report by the National Bureau of Statistics on household expenditure lends to this case (*Table 3*). Thus, fuel subsidy gives rich consumers more financial incentives to consume more energy, therefore creates deadweight loss<sup>11</sup>. The majority of benefits are likely to accrue to the better off, who can afford to purchase gasoline at quantity. The poor are unlikely to purchase gasoline at all, and can only hope to capture indirect benefits. However, there is no guarantee of the extent to which indirect benefits related to fuel subsidies will be passed onto final consumers. Notably, the Nigerian National Petroleum Corporation (NNPC) have stated that the removal of fuel subsidy will benefit the nation because the money realized from it can be used to provide better mass transit and road systems, improved health care, good schools, food security and new job opportunities that will better benefit the poor (NNPC, 2005). Moreover, some of the benefits of fuel subsidies are not even captured by Nigerians as large quantities of oil products are smuggled across Nigerian borders and sold for a profit in neighbouring countries. It is believed

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<sup>11</sup> Deadweight loss is the cost to society in form of welfare loss as a result of market inefficiency in the allocation of resources

that approximately 24 million litres of fuel are lost to smugglers and black market racketeers daily, 8.7 billion annually, valued at N645 billion per year (International Institute for Sustainable Development, 2012).

*Table 3: Breakdown of Average Household Expenditure in Nigeria*

Expenditure	% of Total Expenditure	
	Urban	Rural
<b>Rent</b>	16.2	9.0
<b>Food</b>	55.4	72.0
<b>Water</b>	0.3	0.0
<b>Clothing</b>	4.9	4.7
<b>Household Goods</b>	3.7	4.8
<b>Other Services</b>	6.9	2.6
<b>Health Expenditure</b>	0.7	0.8
<b>Education Expenditure</b>	0.7	0.5
<b>Entertainment</b>	0.5	0.2
<b>Energy</b>		
<b>-Fuel Light</b>	6.0	3.2
<b>-Transport</b>	4.9	2.3
<b>Total</b>	<b>100</b>	<b>100</b>

*Source: National Bureau of Statistics, 2012*

Studies on fuel subsidy in Nigeria have also collaborated that fuel subsidy benefit those who are able to increase their fuel consumption as fuel prices fall. For instance, Nwachukwu and Chike (2011) find that fuel subsidy factors account for 50 percent of fuel demand in Nigeria; thus, increases in fuel subsidy significantly increases demand for fuel subsidies. A survey in 2014 assessing the benefits of subsidy to peasants also find that many households had been unable to benefit from the supposed welfare gains of cheap fuel as the poor distribution of the products hampered the access to the subsidized products by consumers in local areas (Lawal, 2014). Other studies have also shown that, among the rich, fuel subsidy in Nigeria benefits the middle class the most; having little or no impact on the poor (earning below N600/day) and the wealthy. Specifically, through a scenario building assessing the impact of subsidy removal across income groups in Nigeria, it was estimated that the middle income groups (Working Class, Lower Middle Class, Upper Middle Class) earning between N18,000 – N500,000 were the greatest beneficiaries of fuel subsidy in Nigeria (CPPA, 2012). This is because their consumption of petrol, especially in fuelling cars and generators, represent the highest. Even in the absence of corruption, attributed as the main problem with Nigeria’s fuel subsidy regime, a majority of the benefits of fuel subsidies may not still accrue to the poor as such economic interventions only contribute to the widening of the gap between the poor and the rich in Nigeria<sup>12</sup>.

Thus, fuel subsidy in Nigeria is deemed fairly regressive with little or no benefits to the poor who constitute a greater proportion of the Nigerian population (*Appendix, Box 2*). The latter argument has driven the gradual removal of fuel subsidy, among other factors; causing petrol price to

<sup>12</sup> See Leadership Newspaper (2015). “The Opportunity Costs of Fuel Subsidies” Retrieved: <http://leadership.ng/opinions/editorial/460856/the-opportunity-costs-of-fuel-subsidies>

gradually rise from 9 kobo<sup>13</sup> in 1980 to 97 naira in 2015<sup>14</sup>. The growing sentiments that fuel subsidy in Nigeria is regressive and would be better reinvested in infrastructure projects, amid the instability in oil price and production and the gross dearth of government revenue, led to the exclusion of fuel subsidy allocations in the 2016 budget.

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<sup>13</sup> Kobo is the minor unit of the naira which is sub-divided into 100 kobo)

<sup>14</sup> See figures for Premium Motor Spirit. National Bureau of Statistics

## 2.5 Government's Rationale for Petroleum Subsidy Reform

The Nigerian oil sector and economy stand a chance at being revamped, if ongoing subsidy reform (exemplified by the exclusion of fuel subsidy allocations in the 2016 budget) are sustained and implemented in consonance with broader institutional reform. Based on government's own estimate, about 1.64 billion are being saved monthly due to subsidy removal<sup>15</sup>. In addition, allocation to fuel subsidy has dropped to zero in 2016<sup>16</sup>, compared to about NGN1.35 trillion in 2011 alone<sup>17</sup>. In essence, there are already positive gains accruing to the economy due to the reform. Thus, if the reform is sustained, other potential benefits that it could spur include, but are not limited to:

i. *Improved economic performance*

With subsidy in place, there is limited scope for government to save during oil boom that could have engendered better fiscal management in periods of economic downturn. Thus, the increase in public saving if judiciously managed will help reduced government fiscal burden, thereby boost investment which is crucial for economic growth. The resources that are freed up by subsidy removal can be more productively channelled towards critical economic sectors such as education, health, agriculture, infrastructural development and employment generation. This will undoubtedly contribute to economic growth and rapid development of these critical sectors.

ii. *Poverty and inequality effect*

Successful energy reform will lead both direct and indirect welfare improvements. Since phasing out the subsidy, government has rolled out a number of social security measures, namely: Home Grown School Feeding (HGFS), N-power (a skill acquisition programme) and national cash transfer programme (NCTP). There are also plans to assist the vulnerable groups such as women and youth, through programme such as Government Enterprise & Empowerment Programme (GEEP) and STEM Bursary Programme. While these programmes are still at the early phase of their implementation, it is argued by the government that they hold huge potential towards improving the overall welfare of poor households which are being targeted. However, none of this programme is directly linked to the ongoing subsidy reform. In fact, some of the programmes such as HGFS are simply scale up of subsisting programmes, while N-power is part of the electioneering of the Buhari administration. Nevertheless, it is arguable that if subsidy is still in place, the capacity of government to implement these alternative transfer policies will be likely impossible.

Indirectly, the poor also benefits from the resulting economic growth and job creation accruing from the reform. In addition, eliminating economic distortions and corruption in the energy subsidies will ensure macroeconomic stability and improve resources flows to the poor. Overall,

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<sup>15</sup> <http://www.thisdaylive.com/index.php/2016/05/15/kachikwu-subsidy-removal-to-save-n16-4bn-monthly-for-govt/>

<sup>16</sup> Ibid

<sup>17</sup> IMF (2013)

the welfare improvement from the subsidy reform will considerably reduce the level of poverty and inequality in Nigeria.

iii. *Boost investment in the Oil sector*

Prior to the reform, the consensus among researchers and policymakers points to fuel subsidy and lack of clear policy framework as the major obstacles to the development of the Nigerian oil sector (The International Institute for Sustainable Development, IISD, 2012). This is because subsidy creates economic uncertainty and distortion, which discourage potential investment opportunities. Thus, a holistic subsidy reform will eliminate this bottleneck, thereby galvanizing foreign and domestic investments in the oil sector. In addition, the reform will encourage further private sector participation in the oil sector downstream value chain.

iv. *Environmental gains*

Nigeria also stands to gain from the reform in the areas of environmental sustainability. As part of the sustainable development goals (SDGs), environmental sustainability has been underscored as a crucial adaptation measure to reduce global warming. Thus, by removing fuel subsidy, domestic energy consumption is reduced, which helps in mitigating the effect of global warming. This is even more exigent, because Nigeria presently lacks a clear and coordinated policy framework on climate change (see GIZ, 2013). In essence, subsidy reform could have the unintended but positive effect of helping the country in meeting its SDGs targets.

### **3. PAST SUBSIDY REFORM EPISODES/ATTEMPTS**

The inefficiencies and economic distortions associated with energy subsidies have been widely recognized by different administrations in Nigeria, which have accordingly introduced various reform initiatives. In fact, in the past 20 years, a number of energy reform programmes have been initiated, with the aim of deregulating the energy sector as well as completely removing the fuel subsidy. In this section, we detail the past subsidy reform initiatives between 1999 and 2015. This covers the democratic regimes in the fourth republic and provides a proper context to dissect the political economy issues as well as juxtapose the past reform to the ongoing initiative.

#### **3.1 The President Obasanjo Administration**

The President Obasanjo regime on six different occasions adjusted the price of Premium Motor Spirit (PMS) in a process to gradually phase-out the fuel subsidy. The initial attempt was an increase in fuel price from ₦20 to ₦30 on 1<sup>st</sup> June, 2000. However, there were massive protest against the increase by the labour unions and public, resulting in downward review of the price to ₦22. Undeterred, the government made further partial subsidy removal by revising the price to ₦26 in January, 2002 and to ₦42 in June, 2003. Three more upward adjustments were made in 2004 and 2007, to push the prices of subsidy to ₦75.

Despite the persistent review, the reforms were aimed at reducing rather than completely eliminating the energy subsidy. The reform also draws enormous opposition from the labour unions that resisted the fuel price increase. Government respond to these protests by negotiating with the labour union for a more modest increase than initially proposed. Overall, government could not fully achieve its intended PMS price level, as there were pushbacks. A major shortcoming of the reform in this era is the absence of multi-stakeholder approach in its engagement and poor communication strategy with the public. In many instances, engagement with stakeholders takes place after public pronouncement of the price adjustment and are mainly targeted at pacifying the public. Moreover, there was no complementary social safety net to cushion the effect of the drastic price change. The overall process is also lacking in appropriate public financial reform to mitigate endemic corruption in the disbursement of public expenditures. An issue in subsidy reform is the distrust in efficient utilization of resource, as such inadequate response to it prevents full implementation of subsidy reform.

#### **3.2 Jonathan Administration (2011-2015)**

In the four years of Yar'adua/Jonathan administration (2007-2011), the government was mute on subsidy reform. In fact, the administration began by reversing the price increase implemented by the Obasanjo administration from ₦75 to ₦65. However, the substantive Jonathan administration (2011-2015) commenced a comprehensive energy subsidy reform process. The process encompassed a multi-stakeholder approach, with broader engagement with private sector and public at large. Government also embarked on a massive media campaign to seek public buy-in.

The Government justified the removal of the subsidy on PMS on the ground that it “will free up to about ₦1.2 trillion in savings, part of which can be redeployed into providing safety nets for poor segment of the society to ameliorate the effects of subsidy removal (Olawaju & Ogunesa, 2011:1). Moreover, it was considered that only the removal of fuel subsidy would guarantee the successful implementation of the medium term Fiscal Framework. However, there are opposing views to subsidy removal. One key argument from the socialist and moralist perspective is that fuel subsidy is one of the only ways in which Nigerians (especially the poor) benefit from the country’s natural resource endowments. Another key argument was that Nigerians were not against the removal of subsidy, but that successive governments have not utilised the savings from such actions in a way that benefited Nigerians, and stressed that the removal of the subsidy should be accompanied by measures to ensure proper accountability (Economic Intelligent Unit, 2013).

Amid the dialogues and deliberations, the Federal Government on the 1st January, 2012 announced the total removal of subsidy on PMS which raised the price of petrol from ₦65 per litre to ₦142. This set-off a catalyst of events that disrupt and upend the reform process. The following day, the Nigeria Labour Congress (NLC) and Trade Union Congress (TUC) reacted to the sudden announcement of subsidy removal of oil by embarking on a strike action which disrupted normal activities over the period. New media reports indicated that there was no commercial activities in the Federal Capital Territory and other states across the nation (including Lagos, Abeokuta, Kaduna and Kano) as shops, offices, schools and petrol stations around the country were closed. Streets remain deserted as commercial vehicle operators, taxi and commercial motorcyclist, popularly called Okada abandoned their tools of trade, many residents who did not take part in the protest stayed indoors (Abutu, 2014). Government-owned radio and television stations for most part of 2nd January, 2012 remained off as only senior officers reported for duties. In diaspora, there was also rally against the removal of subsidy by Nigerians in San Francisco in Los Angeles on the 12th January, 2012.

Following eight days of the strike and protests, the Federal Government reduced the price of petrol from ₦142 to ₦97. In addition, the government put in place the Subsidy Reinvestment and Empowerment Programme (SURE-P) as a way of assuring Nigerians that the savings from the subsidy removal would be spent on activities that will have a direct impact on the lives of poor and vulnerable Nigerians. A portion of the SURE-P funds also accrued to States and Local Governments for use in developmental projects (Economic Intelligent Unit, 2013). There was also comprehensive investigation by the National Assembly into management and disbursement of the subsidy payment. This led to discovery of massive corruption and mismanagement of the funds. While this reveal the inefficiencies in energy subsidy, it also reinforces and strengthens the argument of proponents to subsidy removal. This therefore created reform fatigue and prevented further efforts at subsidy reform.

## 4. DISCUSSION OF THE CURRENT REFORM EFFORTS

The most recent attempt to reform the inefficient energy subsidy in Nigeria was introduced by the Buhari administration in 2016. This section provides a critical assessment of the reform initiative. The discussions centre on the institutional and policy components of the reform as well as the political economy factors that govern the implementation process. Also, a comparison of the past and present reform efforts is carried out to highlight the distinguishing features in the ongoing reform.

### 4.1 The new pricing mechanism: Price Modulation

Over the past three decades, price control mechanism has been used in the determination of petroleum prices in Nigeria. Price control involves government setting a fixed petroleum price over long time span, irrespective of the EOMP. Since welfare concern is the rationale for introducing price control, petroleum price is usually set below the EOMP, leading to subsidy regime. However, effective from January, 2016, Nigerian government introduced a new petroleum pricing mechanism described as “price modulation”. The idea of pricing modulating scheme was first proposed by the Mantu Committee in 2005, with the aim of instituting a formal mechanism for determining petroleum prices within a short-run pre-set band<sup>18</sup>. Given the broader political agenda of the committee, the proposal was not implemented at the time. However, with the crash in the crude-oil prices, government introduced the modulation framework in order to phase out the subsidy regime which was widely considered to be inefficient and susceptible to corruption. The implication of introducing the price modulation framework at this period ensures the negative effect of subsidy arising from increasing price will be minimal; although recent forex crisis is reversing this trend, as it has led to subsequently rise in oil prices and inflation pressure in the economy.

In its present form, the ongoing subsidy reform is not markedly different in its objectives from the previous petroleum pricing regime. The new pricing regime continues to operate under the institutional and policy frameworks of the past. The key and distinct component of the present reform is the elimination of fuel subsidy, which is now being replaced with a price modulation framework. Thus, excluding the goals relating to subsidy management, the core objectives of Petroleum Support Fund (PSF) still subsist. Accordingly, the objectives of ongoing energy reform in line with PSF include:

- To stabilize the domestic prices of petroleum products against volatility in international crude oil and products markets;
- To create a level playing field for active participation of NNPC & other Marketers in products supply and distribution;
- To guarantee effective products availability and distribution nationwide.

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<sup>18</sup> <http://allafrica.com/download/resource/main/main/idadcs/00090420:6176ff2694df0407b96095a771b69f7d.pdf>

The price modulation framework still slightly deviates from a fully deregulated pricing regime. According to Ojameruaye (2015), the price modulation involves a more regular revision of petroleum prices to reflect changes in the import price of the petroleum and other determinants of the EOMP. Similarly, Agbon (2015) noted that under the price modulation regime, government will continue to set the bottom commodity price by tweaking the price components, but the final fuel price will be determined by the marketers and traders. *Table 4* highlights the key differences between the subsidy and price modulation regimes. Essentially, price does not automatically adjust to market fundamentals under the price modulation regime, but will change more rapidly overtime to reflect the EOMP. In the intervening periods, however, government intervention might be necessary, implying that a temporary price control mechanism might be implemented. Thus, price modulation lies within the two extreme measures of complete deregulation and price control.

In line with the new pricing policy, petroleum price has been adjusted twice over the past one year. The first adjustment was a downward review from NGN87 to NGN86-86.5 in January, 2016. This reduction reflects the fall in product cost and freight component of the EOMP. The second review, which was implemented in May 2016, is an upward review from the initial band to a new one which ranges between NGN135-145. This subsequent adjustment reflects the effect of naira depreciation on the EOMP. More importantly, the ongoing reform also completely deregulates the supply chain for the petroleum importation, by allowing entry for any Nigerian entities. This is to ensure competition at the distribution ends of the petroleum products supply chain.

**Table 4: Comparison of the past and the present pricing regime**

<i>Subsidy regime</i>	<i>Price modulation regime</i>
<b>PRICING</b>	
The price is fixed at a given rate	Price is set at within a band, over which individual marketers can set their pump prices
<b>REVIEW PERIOD</b>	
Pricing template was not reviewed, until subsidy payment becomes a burden to the government	Pricing template is be quarterly revised, to reflect market fundamentals.
<b>DEREGULATION OF SUPPLY CHAIN</b>	
Importation was restricted to NNPC and selected oil marketers	The market is deregulated to allow all any Nigeria entity to import, subject to existing quality specification and guidelines from the regulatory agencies.
<b>SUBSIDY PAYMENT</b>	
Since petroleum price is set below the EOMP, subsidy is always paid by government.	Petroleum price is adjusted more regularly in line with EOMP; hence, subsidy payment could be incurred in the interim,

*Source: Authors' Analysis*

Compared to the past subsidy regime, the present pricing approach has a number of advantages. First, it ameliorates the effect of crude oil volatility on consumers and marketers. A key argument by the proponents of subsidy regime against deregulation is that the global crude oil prices fluctuate too frequently, which create uncertainty that could be exploited by marketers. Thus, price modulation provides a reasonable corridor for market participants to adjust, while sharing the burden of price volatility between the government and marketers. Second, the new pricing approach combines the best features of both price control and deregulation regimes. It retains temporary role for government intervention. However, with regular adjustments, the opportunities for arbitrage and exploitation of market distortion are significantly reduced. Third, with government participation significantly limited, the subsidy regime could be gradually phased out. This will help free up public resources for more productive economic activities.

However, there are still areas of concern regarding the new pricing regime. For example, the use price band are still considered by many stakeholders as price control mechanism, which could undermine policy in future (First Bank of Nigeria, 2016). Also, while the framework proposes a quarterly review, there have been no revision in the past three quarters despite worsening forex crisis in the country. In fact, many oil marketers have publicly voiced their disappointment with the lack of price review since the second quarter of 2016. On a negative note, this could suggest reform fatigue might have set in, owing to negative growth and rising inflation recorded over the past three quarters. Alternatively, this could imply, based on government argument, that the effect of forex has not push the EOMP above the price band set in the 2016Q2. Overall, sustaining the reform will require concerted effort on the part of government through regular monitoring and evaluation of the reform performance vis-à-vis its overarching objective.

#### **4.2 Timing considerations and communication strategy**

Two of the most critical components for a successful subsidy reform are timing and communication strategy. Timing of the reform can literally mean the calendar period or the prevailing socio-economic condition at the period when the reform is being introduced. The duo concepts of timing have implication for the possible outcome of the reform. In case of the ongoing reform, its effective date was January 2016 and the country was in middle of economic recession at the time. Given that the initial price adjustment, under the new pricing regime, was a downward review, there was little resistance to the price modulation policy. Also, the prevailing economic condition helped government to signal that it has limited fiscal buffer to continue the fuel subsidy policy. Another pertinent timing consideration is the introduction of the energy reform in tandem with the implementation of various anti-corruption initiatives within the public sector. In many ways, this consideration is crucial given the trust and credibility concern around past energy reform initiatives and has no doubt contributed significantly towards the smooth implementation of the ongoing reform.

A well-designed communication strategy is also crucial to reform success. In this regard, the ongoing reform seems to be lacking an effective communication strategy. The reform announcement was not preceded by extensive public outreach or awareness campaign. It is also lacking a substantive policy document that clearly detail the government policy objectives for the oil sector, more broadly. Consultations and consensus building was only limited to key stakeholders in the oil industry<sup>19</sup>. This a clear departure from the communication strategy adopted in the past, especially the 2012 subsidy reform. Prior to the subsidy removal in 2012, government embarked on consultations and dialogue with stakeholders and the public. The government used radio jingles, newspapers and television adverts to inform the public about the benefit of subsidy removal. While issue of trust and concern regarding corruption still doomed the reform initiative, most experts acknowledged the innovativeness of its communication strategy<sup>20</sup>. In this regard, the ongoing reform process could learn greatly from the past initiative with respect to its communication strategy. For example, providing a policy document accessible to the public and other stakeholders will go a long way in enhancing the transparency and wider acceptance of the present reform.

### 4.3 Comparison of Past and Present Subsidy Reforms

*Table 5* compares the price adjustment and key highlight of the present reform with those implemented during the Obasanjo administration (1999-2007), Yar'ádua administration (2007-2010) and Jonathan administration (2010-2015). Also, reported in *Table 5* is the reform outcome—extend of success of the reform. Following IMF (2013), the reform is regarded as successful if it leads to sustained reduction in subsidies for at least a year. Likewise, the reform is designated as being partially successful where issue of subsidy re-emerged or reform is partly rolled back due to opposition to it.

In terms of objective, all the reforms were aimed at eliminating fuel subsidy and allowing market mechanism to determine the price. All the past reforms were based on gradual subsidy removal. Despite this piecemeal approach, all the past attempts was partly successful, as there were pushbacks due to mass protest against them by the public and labour unions, leading to the reversal of the initial price changes. In contrast, the present reform is more encompassing, as it completely removes fuel subsidy. Remarkably, the present reform has been more successful than the past initiatives, as there has been no pushback despite its broader approach. The remarkable progress made with the present reform seems paradoxical, given its weak communication strategy and public engagement.

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<sup>19</sup> <http://guardian.ng/lead-story/buhari-consults-marketers-others-on-fuel-subsidy/>

<sup>20</sup> Ohaeri, V. (2016, May 16). Petrol subsidy reform: Doing right thing wrongly. *Premium times*. Retrieved online from: <http://opinion.premiumtimesng.com/2016/05/16/petrol-subsidy-reform-right-thing-wrongly/>, Accessed on: Dec 21, 2016.

**Table 5: Comparison of Past and Present Subsidy Reforms**

<b>Administration</b>	<b>Reform Episode</b>	<b>Price adjustment</b>	<b>Reform Highlight</b>	<b>Reform Outcome<sup>21</sup></b>
Obasanjo Regime	Between 2000-2007	Series of piecemeal price adjustment and pushback—overall price increased from NGN20 to NGN75	Percentage of federal government spending on transfer reduced from 19.5% in 1999 to 4.5% in 2006	Partially successful
Yar'ádua Regime	2007	Price was reduced from NGN75 to NGN65	Subsidies payment as a percentage of GDP increased from 1.3% in 2006 to 1.4% in 2007	No subsidy reform
Jonathan Regime	2011-12	Price was initially increased from NGN65 to NGN140, but later pushback to NGN97	Subsidies declined from 4.7 percent of GDP in 2011 to 3.6 in 2012	Partially successful
Buhari Regime	2016	Price adjusted from NGN97 to maximum of NGN145, no pushback	Subsidy payment now accounted for zero percent of the GDP or the government budget	Successful - <i>in terms of the absence of strong opposition to induce a pushback ( for over a year )</i>

Source: IMF (2013), Authors update

<sup>21</sup> The short-term outcome from the various subsidy reform initiative has been the immediate ease of fuel shortages problem. This positive outcome is due to both demand and supply side effects. On the demand side, subsidy removal leads to fuel price increase, which reduces demand. On the supply side, higher prices create incentive for marketers to import more and also reduces the incentive to hoard the products.

## **5. ENERGY REFORM PROBLEMS AND PROSPECTS**

Global experiences of countries implementing energy subsidy reform indicate mixed outcomes, largely driven by the political economy factors. In the Nigerian case, the outcome of the ongoing reform is also underpinned by the prevailing political framework. Specifically, the interplay among actors, incentive structure and interest-power nexus all interacted in shaping the reform process. This section discusses the political economy of the present energy subsidy reform and the factors behind its relative success.

### **5.1 Political Economy of Reform Implementation**

While there are strong economic justifications for subsidy reform, in many instances, the political economy factors often derail reform efforts. This is because reform changes the existing status quo, which will no doubt negatively affect some key actors, even when the poor and the larger public stands to gain. In the Nigerian case, reform failures have largely been attributed to resistance by powerful interest groups both within and outside the oil sector. In what follows, we briefly discuss the role and impact of key proponents and opponents to the present reform.

#### ***5.1.1 Main drivers and proponents of the reform efforts***

##### *i. Executive*

As the policy arm of government, the executive is responsible for initiating and implementing subsidy reform. The federal government implements the reform through two key agencies: PPPRA and NNPC. PPPRA role involves setting parameters and codes of conduct for all operators in the downstream petroleum sector; these include determining the petroleum price and regulating the supply and distribution of petroleum products. NNPC, on the other hand, is responsible for managing government existing joint venture with private sector and multinationals in the areas of oil exploration, production and refining. Thus, it plays a pivotal role in the supply chain of petroleum products.

Given the fiscal burden imposed by subsidy payment, executive arm of government has been the major proponent of subsidy removal. Government finance will therefore benefit from subsidy removal, as additional funds could be mobilized and channelled to critical economic sectors. The state and local governments are also in support of eliminating subsidy, as they are responsible for 47.2 percent of subsidy payment. Invariably, subsidy removal will also free up resources for development finance at the sub-national levels.

##### *ii. Parliament*

Another important supporter of the present reform is the parliament. Although, subsidy reform is within the purview of the executive, the parliament's support is crucial as it has power in appropriation determination and oversight responsibility over the various agencies of government.

In fact, parliament, in the past, has opposed various subsidy reform initiatives. For example, during reform of 2012 by the Jonathan administration, the parliament's opposition to the initiatives led to establishment of a committee that investigated the subsidy regime. While the depth of corruption and mismanagement in the subsidy regime were revealed as a result, this also had the adverse effect of lending credence to the opponents of the reform because it revealed the inability of the government to manage resources well. For the parliament, reform would only be attractive if the mobilized resources are used productively to benefit members of their constituencies.. However, given the dwindling government revenue, the unsustainability of fuel subsidy had become more evident; making the reform inevitable. The majority leader of the House of Representative, Hon. Gbajabiamila's, argument in support of government stand highlights the parliamentary dilemma concisely as follows:

*“overwhelming evidence on the ground had shown that subsidy was not sustainable, ..., by the time a graphic picture of what was happening, with facts and figures, was reeled out, and what was about to happen if we continued this way, much as I resisted, it was clear to me that we might not even have a country in a couple of months.”<sup>22</sup>*

iii. *Private sector in the Oil Industry*

The present reform unexpectedly has the overwhelming backing of the private sector stakeholders in the oil industry such as the oil marketers, importers, distributors, retailers, multinational oil corporation, investors among others. Proponents of past reforms have linked oil marketers, importers and distributors as the key beneficial of subsidy and therefore derail reform effort. Thus, getting the support of these important stakeholders have greatly enhanced implementation of the present reform. This overwhelming private sector support could be alluded to various economic and political factors which have altered the dynamics within the oil sector. First, with the dwindling government revenue, private marketers were faced with an increasing share of subsidy burden. For instance, as at May, 2016, a total of NGN48.2 billion is being owed to marketers, as part of the outstanding petroleum subsidy payment for 2015. The strong anti-corruption stance of the present government might have reduced the loopholes for fraudulent practices that have characterized the subsidy implementation in the past.

Second, the forex crisis has exacerbated the negative effect of subsidy regime on the private sector. Specifically, majority of the oil marketers and dealers cannot access the forex at the official rate and at the same time they cannot sell profitably with subsidy in place, if they acquire forex through the parallel market. Third, apart from the reform helping private sector participants to mitigate the aforementioned risks and problems, the new pricing regime helps to deregulate the downstream sector of the petroleum industry. This allows any private entity to import oil, subject to existing quality specifications and other guidelines issued by PPPRA. Fourth, subsidy removal eliminates

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<sup>22</sup> <http://punchng.com/rebs-summon-kachikwu-fuel-subsidy-removal/>

the macroeconomic instability and uncertainty that have hindered full private sector involvement in the overall downstream sector value chain of the oil industry. In essence, the reform occurred at a period in which interest of various stakeholders are aligned, thereby by helping government to build a broader consensus.

iv. *International Development Institutions*

World Bank and IMF are no doubt the major proponents of subsidy reform globally. This in part is due to pro-market lineage of the Bretton Woods institutions. However, a number of studies have found fiscal policy in developing countries to be pro-cyclical and fuel subsidy has been observed to play a key role (see Konuki & Villafuerte, 2016; Thornton, 2008). Also, recurrent fiscal crisis in most developing countries, necessitating World Bank and IMF intervention, have led to calls for reforms. Given these experiences, international development institutions are candidly in support of the subsidy reform in Nigeria<sup>23</sup>.

**5.1.2 Main Opponents of the Reform and their Concerns**

i. *Labour union and civil societies*

As with past reforms, the main opponent to the present initiative comes from the labour unions, under the auspices of the Nigeria Labour Congress (NLC) and the civil societies. The concern of these stakeholders is that high fuel prices will generate inflationary pressure which will reduce the welfare of their members and public in general. There is also distrust about government commitment to mitigate subsidy effect using social security measures or even if the accruing resources will be judiciously utilized. Furthermore, labour unions often use their opposition to subsidy reform to negotiate for improve salary for workers. For the civil societies, opposition to subsidy is also used as an opportunity to push for greater transparency and accountability in the public-sector management. Government has been managing its disagreement with labour unions and civil societies through extensive dialogue and consensus buildings. Despite this effort, the position of the two parties remains wide apart, as labour union official stands is still against the reform.

However, government has benefited tremendously from the ongoing fragmentation of the labour unions in Nigeria. During the dialogue, while a faction of the union (Ajaero led group) settled for a reconciliatory relationship with the government, the other group (Ayuba led faction) resorted to industrial action to press government to reverse its decision. This friction explains the weak support and mobilization that attended the industrial action that preceded the reform. Overall, labour unions and the civil societies are stakeholders, whose buy-in are crucial to the reform success. This implies that, despite their present differences, government needs to continually engage these important stakeholders to find some common ground.

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<sup>23</sup> <http://venturesafrica.com/full-text-of-speech-delivered-by-imf-boss-christine-lagarde-at-national-assembly/>

*ii. Opposition parties*

Nigerian main opposition party—People Democratic Party (PDP) also object to the ongoing subsidy reform. Their disagreement can be attributed to two reasons. First, as part of building vibrant democratic institution, opposition parties are essential in pressuring the government to consider the welfare implication of its policy. In this regard, opposition party is concerned about the possible negative effect of the subsidy removal on poverty and inequality. Second, the opposition party may also be against the reform in retaliation to the ruling party previous stance on subsidy reform. Specifically, in the past when the present ruling party was still in the opposition camp, subsidy reform initiatives were vigorously opposed leading to their failure. In essence, political rather than economic factors seem to be the basis for the position of the opposition party. Given this stand, government seems be reluctant in seeking the buy-in of the opposition parties in the reform process, rather it has been leveraging on the present unified structure (since the ruling party controls both the executive and the legislative arms).

## **5.2 Explaining the Relative Success of the Recent Energy Subsidy Reform**

It is paradoxical that recent subsidy reform has been more successful than the previous attempts, despite the similarity in their approaches and even weaker communication strategy compared to the past efforts. However, from a political economy perspective, this paradox between inputs into reform process and outcome could be accounted for by a number of factors:

*i. Coincidence of reform timing with fiscal stress*

The present reform was introduced at a period of enormous fiscal stress, as a result of crash in the crude-oil prices. As Alesina and Drazen (1991) and Hamann and Prati (2002) argued, the probability of reform being successful increases during periods of economic crisis. This is because in the absence of economic crisis the opponents of reform face lower economic costs and higher benefit by delaying the reform process. Thus, reforms are difficult to implement during economic boom. However, the dynamics change during economic crisis, as lack of reform imposes a higher cost on the economy.

This argument partly explains the impressive progress so far recorded in the present reform. Over the past three years, the Nigerian government has experienced dwindling revenue, as a result of crashed in global crude-oil prices. The problem is further worsen by the low production due to vandalism of oil infrastructure in the Niger-Delta region. With oil revenue accounting for about 72.4 percent of government revenue and over 90 percent of foreign exchange, problem of access to forex magnified, leading to a spiral of naira depreciation. In essence, increased fiscal stress as a result of forex crisis and weak revenue, provide a compelling reason for government to implement subsidy reform. Also, the crisis helps underscore the unsustainability of energy subsidy, thereby diminishing the strength of opposition to the reform effort.

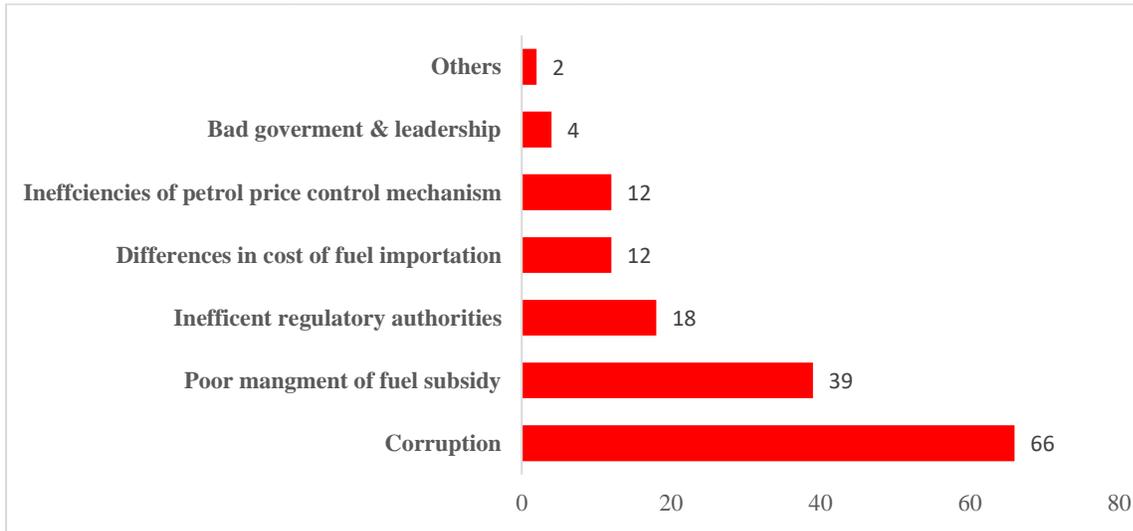
ii. *Coincidence of reform timing with political realignment and weak position of the opponents to the reform*

The vast literature on drivers of successful reform have also emphasized role of political realignment. Political realignment occurs when a political party strengthened their position in implementing a preferred agenda, such as in the case of political consolidation in the post-election periods. The historical feat achieved by President Buhari, in defeating an incumbent candidate is an example of the political realignment that preceded the subsidy reform. Moreover, the reform was introduced at a period when the potential opponents are weak. For example, the Nigeria Labour Congress was at the time factionalized into two groups, with each claiming legitimacy as the true representative of the workers. Similarly, the main opposition party is also besieged, at the time, by various internal crisis. As such, the main opponents to the reform are unable to effectively coordinate in order to impede the reform process.

iii. *Government credibility and anti-corruption stance*

A key factor often cited in the failure of the past reforms is the perceive corruption and lack of trust regarding government intention (see IMF, 2013; Osita, 2012). In a survey conducted by NOI-Polls (2015), 52 percent of the respondents indicated that have not benefited from the previous fuel subsidy removal. In Figure 7, we report the various reasons that respondents identified as hindering Nigerians from benefitting positively from the fuel subsidy removal. The result averages responses of participants classified along age group, geo-political zone and gender. The result clearly shows that corruption is perceived to be the key reason hindering Nigeria from benefitting from subsidy reform. However, Buhari administration was elected with a key agenda to eliminate corruption and has since its inception displayed firm anti-corruption stance, even though criticism abound. This might have helped to a large extent to secure the buy-in from the public, which further enhances the success of the reform.

**Figure 7: Reasons Nigerians do not fully enjoy fuel subsidy reform (%)**



Data source: NOI-Polls (2015)

*Note: Respondent are allowed to make multiple choice in no particular ordering. Therefore, each bar represents the percentage of respondents that selected a particular reason.*

*iv. By-effect of the past reforms*

Despite the failure of the past reforms, they have helped bring to the fore the inefficiencies with energy subsidies. For example, unlike in the past, the present reform was able to secure the buy-in of the key dramatis personae in the oil sector. Also, embarking on various anti-corruption initiatives prior to the reform similarly earned the initiative needed credibility among the populace. In essence, previous reform attempts no doubt provided the present government valuable insights into likely obstacles to the reform implementation and therefore they prepared accordingly.

## 6. LESSONS LEARNT

Given the relative importance of energy subsidy reforms in the policy discourse of various economies, the experience of the reform within and across countries presents profound insights and lessons on the dynamics of policy making – both in the context of the implementing countries and in general. Lessons from countries that have implemented subsidy reforms point to the importance of compensating/mitigating measures, prevailing economic conditions, political will, communications strategy/consultations, implementation strategy, credibility/trust as key determining factors (see IMF, 2013). The degree of importance of these factors in determining the success or failure of the reform depends on the context, as country experiences vary considerably. Thus, there seems to be no overarching strategy, as the outcome of subsidy reforms is largely dependent on individual country's circumstances (IISD, 2008; Terkimbi, 2015).

Nigeria has had several attempts at petroleum subsidy reform, with varying degrees of success (see Section 3). The 2011/2012 reform was notable for sparking widespread debate and resistance amongst several stakeholders, and has provided important lessons on subsidy reforms which has been widely studied (see Ogbu 2012; IMF 2013; Terkimbi 2015). The reform, as implemented under the Jonathan administration, has also demonstrated the complex interplay of social, political, and economic factors in the Nigerian polity. Importantly, the lessons drawn from the reform pointed to various forms of deficiencies, including the short duration of the public communication campaign strategy, negative image and perception of the government by the public, inadequate research and analysis to provide a compelling case for subsidy reform, among others (IMF, 2013; Terkimbi, 2015). Lessons from the countries that have successfully implemented fuel subsidy reforms were largely due to their ability to resolve some of these issues<sup>24</sup>

However, the present reform in Nigeria was driven by economic and fiscal crisis that provided a strong impetus for the implementation of the contentious subsidy reforms. The present reform underscores the importance of three factors that have been pointed out in literature on subsidy reforms: The prevailing economic conditions, political landscape, and the trust/image of the government. Country experiences of the effect of the prevailing economic conditions on subsidy reforms have been rather mixed. Favourable or improving economic conditions led to the successes in cutting subsidies in Peru and Turkey. In a similar vein, adverse economic conditions led to the emergence of subsidies on diesel in Brazil in 1999, a halt in the implementation of subsidy removal in Iran in 2012, and a reversal in cutting subsidies in Yemen in 2005. In contrast, unfavourable economic conditions following the Asian financial crisis in 1997 enhanced the success of the energy subsidy cuts in Indonesia in 1998.

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<sup>24</sup> Effective communications strategy to gain public support played a key role in the relative successes of subsidy reforms in Indonesia, Niger, Philippines, and Yemen. Transparency and credibility of the payment and pricing processes contributed to the successes witnessed in Peru and South Africa, respectively. Research and analysis that demonstrated the costs and benefits of the subsidies provided a convincing case for reforms in Ghana (See IMF, 2015; David, et al., 2017; Rentschler & Bazilian, 2017)

Specifically for Nigeria, the adverse economic condition that prompted subsidy reform was marked the huge plunge in global crude oil prices, which began in June 2014. This led to a dramatic fall in foreign reserves and government revenue, causing widespread fiscal crisis. As at June 2015, 23 out of 36 states were unable to meet up with recurrent expenditure, particularly the payment of salaries of public sector workers. The crisis was further exacerbated by the re-emergence of oil-pipeline vandalism in the Niger-Delta region, leading to a rapid fall in crude oil production; and the imposition of foreign exchange restrictions which caused FOREX scarcity and rapid depreciation of local currency, Naira. The petroleum marketers were faced with difficulties to obtaining FOREX for their importation. The subsidy regime at the time became highly difficult to manage, and thus a reform that would lead to an upward price adjustment became imminent. Consequently, the government decided to implement a price modulation that led to the increase in petroleum prices from 86.5 naira to 145 naira in January 2016, and now 150.69 naira in May 2017.

The immediate reaction to the recent subsidy reform provided some profound insights into the political economy dimension of governance in Nigeria. The timing of the reform, which coincided with a serious economic crisis, a change in the political landscape, and a renewed sense of optimism amongst the general public, yielded results that were in contrast to the preceding reform in 2011/2012. Ogbu (2012) pointed out that trust-deficit and credibility concerns were the key drivers of the lack of success of the 2011/2012, where the general public simply had serious doubts on the transparency of the subsidy payments, as well as the ability of the political administration to meet its commitments to provide mitigating measures. The present reform witnessed a dramatic turn-around, where the citizenry were less skeptical about the transparency and credibility of the reform. The usual opponents of subsidy reforms, the NLC, opposition parties, and NGOs, were less vocal about the demerits, which signaled that the trust-deficit witnessed in the previous reform has diminished considerably. The change in the perception of the public on the government seemed to be connected with the anti-corruption stance of the newly-elected president, Buhari, who campaigned strongly on the need to tackle the issues of transparency in various aspects of governance in Nigeria, particularly the oil sector.

Thus the relative success of the present reform can be attributed to the interplay of economic and political reasons. The economic conditions made it highly difficult to maintain the subsidy regime at the time, while the change in government and the perceived credibility of the present government helped to achieve some considerable public support and minimize the opposition to the reform. The overwhelming roles of these factors dampened the fact that the present reform was not free from deficiencies such as lack of effective communication and consultations, rapid implementation, and unclear compensating/mitigating measures that could have otherwise marred the success of subsidy reforms.

However, the success of the present subsidy may be short-lived given that the government subsidy payments have begun to increase (CSEA, 2017). This was as a result of the hoarding of petroleum

products by marketers and importers, which led to severe petrol scarcity for the Nigerian masses and forced the government to begin to subsidize the import of refined petroleum products again. The payments have grown the rebounding of oil prices and government revenue. It is foreseen that the government may include subsidy payments into federal government budget for 2019. This signals the need for putting appropriate structures in place (such as building in world-class refineries and/or credible compensation arrangements) prior to subsidy removal to avert manipulations from importers of refined petroleum products. The credible and clean compensation arrangements will require i) a good system of identifying people uniquely lagging for all the population, ii) universal financial inclusion to enable transfers (particularly via mobile money) iii) the use of automated systems (as seen with the new e-wallet fertilizer subsidy payment in Nigeria), as well as iv) transparent and reliable budget process to identify oil rents and commit them to transfers. However, Nigeria capacity to implement a credible compensation arrangement is low at present for these reasons: i) Nigeria ranks low on financial inclusion measures - only 40 percent of people over 15 have any sort of financial account, ii) In a country of about 186 million people, only about 16 million are covered by the national ID despite several attempts (World Bank, 2017). Nonetheless, there is a potential for mobile telecom coverage given that there are 86 million unique subscribers, representing 46 percent of population or 80% of the population over the age of 18 (GSMA, 2018).

In sum, the key lesson to be learnt from the ongoing subsidy reform is that adverse economic conditions could be exploited as a unique opportunity for institutional reforms that could curb the long-standing inefficiencies in the public sector in Nigeria. However, appropriate structures must be erected to support transitioning from a pre-subsidy to a post-subsidy era. Nigeria can draw lessons from India, in creating a credible compensation transfer scheme, –having shifted successfully from energy price subsidies to direct transfers to consumers. In the context of Nigeria, mobile money transfer compensation scheme has the highest potential for credibility. In addition, the petroleum subsidy reform has shown that the popularity of a particular government, and the perception on credibility play crucial roles in the acceptance or rejection of reforms.

## 7. CONCLUSION

The study examined energy subsidies reforms in Nigeria, with focus on petrol/fuel/gasoline. Due to the opaqueness, economic inefficiencies and fiscal unsustainability of the pricing and administration of fuel subsidy in Nigeria, there has been a number of controversies and reform initiatives in the past decades. The ongoing reform initiative introduced by President Buhari in 2015, particularly due to the fiscal crisis, is centered on price modulation as opposed to subsidy removal. Despite controversies in the reform strategy and resistance by powerful interest groups, the present subsidy reforms shows potential to revitalize the oil sector and the Nigerian economy as a whole. Going forward, the ongoing subsidy reform presents an opportunity for institutional reforms that could curb the long-standing inefficiencies in the public sector.

Importantly, Nigeria's present subsidy reform have shown several deficiencies, including: the short duration of the public communication campaign strategy; negative image and perception of the government by the public; and inadequate research and analysis to provide a compelling case for subsidy reform, among others. Notwithstanding, the present reform relative to previous attempts by successive government largely due to the timing of the reform, which coincided with: a serious economic crisis, a change in the political landscape, and a renewed sense of optimism amongst the general public. Thus, yielded results that were in contrast to the preceding reform in 2011/2012 where the citizenry were more skeptical about the transparency and credibility of the reform.

Hence, the Nigerian case underscores the importance of three factors in the literature on subsidy reforms: the prevailing economic conditions, political landscape, and the trust/image of the government. One key lesson to be learnt from the ongoing subsidy reform is that adverse economic conditions could be exploited as a unique opportunity for institutional reforms that could curb the long-standing inefficiencies in the public sector. However, appropriate transitional structures are necessary for a successful long-term energy subsidy removal. In the Nigerian case, structures such as the refurbishment and construction of old and new refineries as well as a clean and credible compensation/transfer scheme (especially mobile money transfers) uniquely targeted to poor masses.

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## APPENDIX

### **Box 1: Nigeria's Three Sovereign Wealth Funds (SWF)**

The Excess Crude Account was replaced with three sovereign wealth funds –the Future Generation Fund, the Nigerian Infrastructure Fund, and the Stabilization Fund– in 2012.

#### **1. Future Generations Fund (FGF): 40% of SWF**

To invest in and grow a diversified portfolio of assets that would provide the future generations of Nigerians with a solid savings base, as the country's hydrocarbon reserves deplete.

#### **2. Nigeria Infrastructure Fund (NIF): 40% of SWF**

To invest in domestic infrastructure projects (such as healthcare, transportation, energy and power, water resources and agriculture) that meet targeted financial returns and contribute to the development of essential infrastructure in order to stimulate the growth and diversification of the Nigerian economy, attract foreign investment, and create jobs for Nigerians.

#### **3. Stabilisation Fund (SF): 20% of SWF**

To act as a buffer against short-term macro-economic instability associated with considerable government revenues derived from hydrocarbon exports.

Source: Nigerian Sovereign Investment Authority

### **Box 2: Nigeria's Rationale for Fuel Subsidy Removal**

The government summarized the case for subsidy removal in the SURE brochure:

- Fixed prices have led to a huge unsustainable subsidy burden.
- Fuel subsidies do not reach intended beneficiaries, and they benefit the rich mostly.
- Subsidy administration has been beset with inefficiencies, leakages, and corruption.
- Subsidy costs have diverted resources away from investment in critical infrastructure.
- Subsidies have discouraged competition and stifled private investment in downstream petroleum.
- Huge price disparity has encouraged smuggling to neighbouring countries.

Sources: SURE-P Brochure, IMF

**Table 1: Key Factor Driving Rise in Fuel Subsidy Payments**

	Crude Oil Price (\$/Barrel)	Official Exchange Rate (₦/\$)	Inflation Rate (%)	EOMP (₦)	Budgeted Fuel Subsidy Payment (₦' billion) (A)	Actual Fuel Subsidy Payment (₦' billion) (B)	(A-B)
2006	65.15	127.38	8.38	N/A	151.9.00	251.00	(99.10)
2007	72.47	124.62	5.42	N/A	188.00	290.00	(102.00)
2008	96.85	117.69	11.53	N/A	256.30	637.00	(380.70)
2009	61.49	147.24	12.59	N/A	159.90	399.00	(239.10)
2010	79.51	148.81	13.76	N/A	278.10	797.00	(518.90)
2011	111.26	152.33	10.85	142.55	245.00	1,348.00	(1,103.00)
2012**	111.65	155.94	12.24	169.13	888.10	1,049.70	(161.60)
2013	108.64	155.75	8.52	144.07	971.10	832.00	139.10
2014	99.02	156.95	8.06	111.40	971.10	211.00	760.10
2015	52.35	193.09	9.01	134.69	460.00	200.00	260.00

Source: CBN (2016), PPRA (2016)