

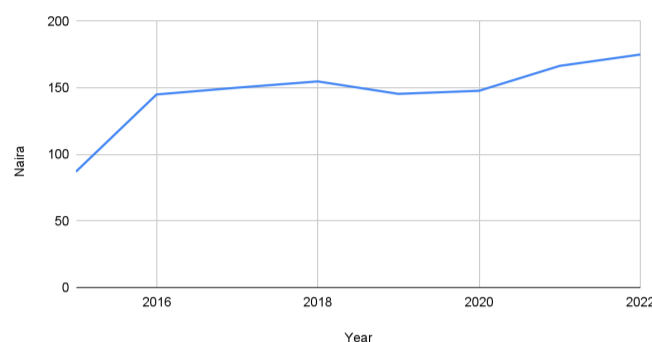


Tax Bites



The fuss about petrol subsidy - and what does the average Nigerian need to understand about it?

National average fuel price per litre



We have attempted to provide our understanding of the current petrol subsidy situation in such a way that all Nigerians can appreciate the situation and make informed decisions for the country's overall interest.

Subsidy and its history in Nigeria

Subsidies are direct or indirect payments made by the government to private firms or individuals to offset costs. Subsidies are driven by promoting economic and social policy objectives.

Subsidy has always been a part of the Nigerian story which makes it difficult to eliminate completely. It comes up during political rallies when politicians promise "free healthcare, free education, free electricity" and culminates in actual interventions such as cheap education, cheap electricity and cheap petroleum products. However, nothing is really free. On the one hand, citizens pay little or nothing for some of these products, but the government on the other hand has to pay heavily for the difference through tax and other revenue. Hence what is free to one party in the economic equation is being paid for by another. In reality, the payment comes from those who think they paid nothing for the product. Sometimes, the payment even comes from their progeny if the government has to borrow.

Most countries across the globe have implemented some form of subsidy at some point in their history. Subsidies can be an effective tool for managing socioeconomic challenges if implemented properly. But the implementation of subsidies in Nigeria has left more questions than answers.

The Nigerian economy, subsidy and its resultant effects

The Nigerian economy has been subsidized in various ways for many years and this includes the oil and gas industry, education, electricity, transportation, telecommunications etc. Fuel subsidies began in the 70s and became institutionalised in 1977, following the promulgation of the Price Control Act which made it illegal for some products (including petrol) to be sold above the regulated price.

Subsidy was a buzzword during the election campaigns for many politicians in the 70's to the late 90's, with lots of promises of national freebies on the premise that Nigeria is blessed with mineral and natural resources. More than 30 years after, those promises have proven to be detrimental as nearly half of Nigeria's population are living in abject poverty in the midst of subsidy - a paradox of the Nigerian nation.

In a bid to be popular and to feign the promise of a good life to citizens, several administrations from military to democratic subsidised items like electricity, food, petroleum products, education, water etc. A generation of Nigerians were raised with an entitlement mindset rather than demand for innovation or quality.

This has been a double-edged sword for many government businesses as they have had to be privatised when they could neither meet minimum quality requirements nor operate profitably for the benefit of Nigerian citizens. Suddenly, after privatisation or deregulation, such sectors become a revenue goldmine for the government through taxation, process improvement, innovation and creativity, employment for citizens etc. Maybe it is true "the government has no business doing business"? Perhaps, the government's business should be to ensure that the business environment is fair for all players and roll out policies that stimulate economic activities and attract foreign and local investment.

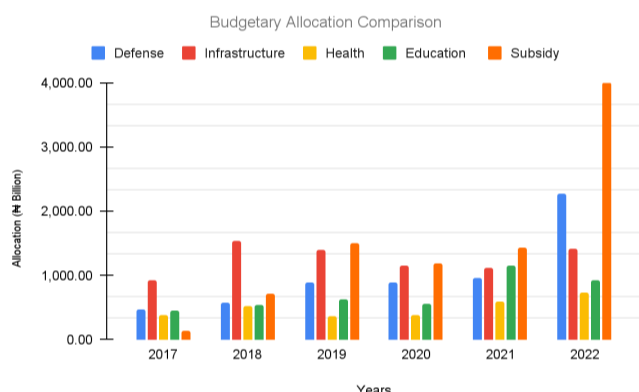
The laws of demand and supply should drive a free market economy. Subsidy in some form may be required to cushion the effect of price on consumers if driven by data and channelled to those who are vulnerable. However, providing a blanket subsidy for certain products in the downstream sector of the oil and gas industry (specifically petrol) has resulted in huge annual costs with minimal value to the Nigerian economy as a whole. From subsidising people with cars to encouraging people to use fuel powered generators at the expense of paying for cost-reflective electricity tariffs, there is a lot wrong with the current concept of subsidy. The

business case of subsidy removal is complete when you add the grim allegations of corruption and diversion associated with subsidy. Otherwise, Nigeria would continue like the simpleton who is determined to fetch water into a hole-ridden container and expects it to get filled.

Thus, the signing into law of the Petroleum Industry Act by President Muhammadu Buhari in August 2021 introduced some refreshing innovations including the removal of subsidy by 16 February 2022. However, on 24 January 2022, the Federal Government decided to postpone for another 18 months and adjusted the 2022 Appropriation Act to allow for subsidy payments to recommence. This raised some concern for the industry, especially the ease through which the government reversed a salient provision of the Petroleum Industry Act (PIA). Would investors be concerned that other salient provisions of the PIA would be set aside easily without a flinch? The subsidy removal conversation will be revisited again in August 2023, just two months after the swearing in of a new President of the Federal Republic of Nigeria.

Is fuel subsidy good or bad for Nigeria?

This question can only be answered properly when the fiscal, economic and political issues are considered holistically. In 2021 N1.77 trillion was spent on fuel subsidy, a 477% increase from N307bn in 2015; whereas in 2022 the government will spend 24% (N4 trillion) of its total projected expenditure (16.6 trillion) on fuel subsidy leaving a measly 29.84% (N4.95 trillion) for capital projects. In light of this fact, subsidy retention does not seem to be the way to go for Nigeria at such a critical time when there is a need to invest in capital projects and encourage local and foreign investors with policies that will stimulate economic activities.



In an economy that does not produce, subsidy has a socialist effect, for example:

- It does not address the real issues of why prices of the subsidised goods are high and unaffordable to the average Nigerian like the overdependence on imports and suboptimal production;
- It does not create positive consumer behaviour and sometimes could lead to exacerbation e.g. when the cost of diesel is high, people opt for petrol generators and this in turn increases the demand for subsidised products. Similarly, multiple cars get on the road (instead of public transportation) because of the cheap product and this leads to traffic congestion and lack of investment in public transportation infrastructure
- It consumes funds which can be used for sustainable development projects.
- Petrol subsidy specifically does not protect the poor; it is counterproductive to retain a universal price subsidy on fuel since the rich consume more fuel than the poor. If in fact the government chooses to retain subsidy, it must be based on accurate data and targeted at those who really need it.
- It creates arbitrage which can lead to corruption. The significant difference between the price of PMS in Nigeria vs its neighbouring countries creates an opportunity to earn super-profit for smugglers and incentivises diversion.

As long as the government does not match subsidies with investment in infrastructure and deliberate actions at increasing the disposable income of its citizens, funds will be consumed in a debt trap that cannot be serviced because the citizens will keep clamouring for subsidy due to their limited purchasing power.

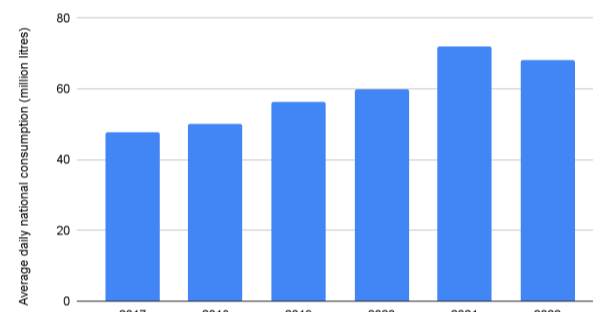
According to a World Bank report, "subsidising PMS creates inefficiencies that slow medium-term growth. To finance the subsidy, the government must increase its borrowing, raise additional revenue elsewhere, or reduce spending on other public goods and services, hindering growth and weakening the fiscal accounts. By stabilising retail prices, the PMS subsidy prevents consumers from adjusting their purchasing behaviour in response to changes in the cost of supply, and creates financial incentives to over consume PMS, resulting in a loss of consumer surplus. The subsidy also distorts relative fuel prices, encouraging the use of PMS even when other

energy sources would be more efficient."

The report further addresses a very critical issue - that "Nigeria is the only country in the world with a universal price subsidy that applies exclusively to PMS. Universal price subsidies for liquid fuels are almost always regressive, as the rich consume far more fuel than the poor. PMS subsidies are especially regressive because PMS is used primarily in light and medium-duty motor vehicles, which are rarely owned by the poor. Since raising PMS prices tends to have minimal adverse effects on poor households, governments worldwide have typically prioritised eliminating PMS subsidies over those that apply to other fuels. However, Nigeria has done the opposite - eliminating all subsidies for liquid fuels other than PMS."

According to a report, households in the bottom 40% of the income distribution account for less than 3% of all fuel purchases. By contrast, three-quarters of all fuel sold in Nigeria is consumed by private firms, public transportation services, government agencies, and other business entities, and a substantial share is smuggled out of Nigeria for resale in neighbouring countries. It states further that by creating a large price differential between Nigeria and its neighbours, the government is effectively subsidising criminal activity while also preventing the formation of a legitimate market for crossborder PMS transportation and sale." In our report on the cost of corruption in Nigeria, we estimate that by 2030 corruption could cost up to 37% of the country's GDP.

Average daily national consumption (million litres)



It is estimated that the cost of fuel subsidy in 2022 will exceed government's spending on education, healthcare and social protection for Nigerians. This is against the backdrop of fuel pump price having increased from N87 per litre as of December 2015 to N175 by September 2022, showing an increase of 95.4 per cent. Earlier this year, the Honourable Minister of Finance, Budget and National Planning stated that the country's consumption of petrol amounted to 65.7million litres daily as of January 2022. This figure as of August 2021 stood at 48.9million litres daily. There is an urgent need for restructuring the downstream petroleum sector.

Way forward - to subsidise or not?

According to Statistics Times, Nigeria is the 8th most affordable place to buy PMS in the world at the rate of \$0.42 per litre. The decision to remove or retain subsidy is a very petulant subject which can be viewed from an economic, social and political lens. Despite the obvious reasons why the current state of fuel subsidy should be discouraged and expired, there is the dilemma that making a pragmatic choice could lead to loss of sympathy in a pre-election dispensation. While it may be easy to point out that critical decisions such as this should be data-driven, such decisiveness would require stakeholder engagement and perhaps a phased approach to subsidy withdrawal.

Conclusion

The decision to retain or remove subsidy ultimately rests in the power of the executive arm of government and we hope that relevant stakeholders such as the labour unions, pressure groups, social commentators and the average Nigerian will consider the necessity for the removal of subsidy at such a time as this. The aftermath in the short term will be tough but if the government reciprocates with social interventions, complete transparency and effective administration of savings from subsidy, its removal may result in more positive and sustainable outcomes for citizens. Otherwise, we risk bestowing to our children a massive debt as their heritage because of poor decision-making and short-term gratification.

For a deeper discussion, please contact:



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