Fuel subsidies in Nigeria

There are better ways to help the poor (and the economy and the environment)

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The downturn in oil prices over the past year has hit Nigeria’s public budget hard. When money is tight, it seems obvious that governments should first phase out programmes that are expensive and have low benefit to their intended beneficiaries.

Subsidising gasoline fits the bill perfectly, and The Economist has been among a number of commentators urging the recently elected President Muhammad Buhari to reform these subsidies. But Buhari has rejected reform this quarter while promising to review the literature and information—what gives?

There are three main factors: efficiency; other pressing issues, such as corruption; and social welfare alternatives.

How efficient are fuel subsidies?

Like many other countries, Nigeria began controlling the price of gasoline and other fossil fuels decades ago, largely to provide stable and secure prices to families and small businesses.

Also in common with other countries, these price controls became more expensive as demand—some of it driven by cheap, subsidised prices—grew exponentially, and as world oil prices increased, notably in the past decade. What started...
out as a relatively small programme ballooned, with Nigeria’s gasoline import subsidy alone costing over US$13 billion 4 (Naira 2.19 trillion) in 2011.

The gasoline subsidy is also highly inefficient: the 85 per cent of Nigerians living on less than US$2/day gain little directly, given they do not consume much gasoline. And spending on health, education and development are sacrificed to pay for the costly fuel subsidy. Perhaps counter-intuitively, subsidies also lead to scarcity, with long queues at service stations earlier this year providing yet more evidence of how inefficient these policies are at helping people.

In short, the fuel subsidy doesn’t work very well at achieving its intended objectives. There are strong arguments in favour of re-directing the subsidy towards public expenditure that would more effectively lift millions of Nigerians out of poverty. But that is challenging.

The question of corruption
To get a sense of why reform is so difficult, let’s consider some recent history. Nigeria’s previous administration attempted to double gasoline prices overnight at the beginning of January 2012. The resultant public protests included a two week national strike and had a simple message: deal with corruption first. This argument—led by a broad grouping, including trade unions—was that there was no need for people to pay for holes in the national budget when this could be made up by reducing corruption, including for example when significant parts of Nigeria’s crude oil production disappears before it gets near the public purse.

President Buhari is attuned to that message. His election platform and subsequent statements have focused squarely on corruption more generally. In his words, “such an illegal yet powerful force soon comes to undermine democracy because its conspirators have amassed so much money that they believe they can buy government. We shall end this threat.”

Yet corruption and subsidies are tightly intertwined. Official and unofficial analyses of the 2011 gasoline import bill identified at least US$5bn of subsidies to imports which never existed, from ships which never landed their cargo to over-reporting and leakages through the whole supply chain. Justifiably, gasoline consumers do not see why they should pay more if such robbery persists. But trying to choose one problem to fix first—corruption or subsidies—will almost certainly be harder than tackling them both individually and immediately.

President Buhari noted that much had been written and advised on subsidy reform, but that it ‘lacked depth.’ In effect, this reflects two concerns: that there may be significant impacts from subsidy reform on the poor and vulnerable; and, relatedly, that reforming subsidies may cause serious shocks to the economy through inflation, lower GDP and other economic indicators. These are serious concerns, but an examination of the scale of these impacts in Nigeria and across the world shows that when impacts are quantified they are often far lower than perception. In most cases, the rate of change (the size of any individual price increase) is more significant than the scale of the change (the total price adjustment that needs to be achieved over the long term). As such, a steady but gradual phase-out of subsidies is normally best.

What are the alternatives?
All of this leaves one pressing question: if subsidies are so costly and inefficient, what are the alternatives that can take their place, and can these alternatives be delivered? Protestors against reform admit that very little of the benefit goes to the poor and vulnerable they are representing. But tellingly they also hold to the view that at least the poor are getting something, and alternatives would not even deliver that.

So what should President Buhari do next? The key is to recognise subsidies for what they are—a highly inefficient form of social assistance—and to work on developing better alternatives. Identifying and building on existing social spending programmes that are working well is a good first step, as is increased investment to enhance capacity for the development and implementation of new social programmes.

Many countries have been down this path, even when corruption levels have been uncomfortably high. Subsidy reform in Indonesia, Thailand and Viet Nam has all proceeded in parallel with the development and implementation of better welfare systems, such increasingly well-targeted cash transfer programmes.

Transitioning from subsidies to a targeted, efficient welfare system is a significant undertaking with major stakes involved. Investing in the expansion of existing programs, the creation of new programs and systems to identify the needy and deliver benefits will touch on themes as diverse as energy access, gender5, urban-rural wealth divides and the differences in needs between states.

Complex questions also exist about what share of resources should be invested in social assistance, to protect the poor, and what share into boosting and diversifying the economy, thereby lifting households out of poverty through economic growth. If he feels it is lacking, President Buhari is right to demand deep and rigorous analysis on these matters.

There is much that can be learned from international experience. It is now up to Nigerian and international policy-making communities to listen and to help deepen the information and options available.

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