

PUBLIC POLICY BRIEF

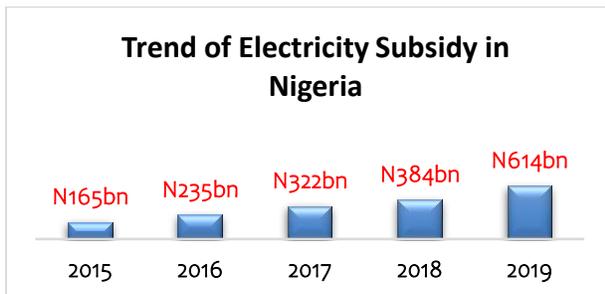


Summary

In the past three (3) weeks, the narrative across the socio-economic and political landscape of Nigeria has been on the need for far-reaching reforms in the country. What began as a call for the reform of the police force under the #EndSARS movement soon morphed into the call for broad-based reforms in the country. In this edition of the Public Policy Brief, we focus on reforms in the administration of energy subsidies in the country, a discussion which has been on the front burner of economic and political debates. We discuss the need for well-designed strategies for the success of the reform efforts by the current administration. In simple terms, we need to get it right this time. In the short term, government's reform strategy should be based on comprehensive research and be designed in consultation with stakeholders. To ensure widespread acceptance by the public, reforms should be implemented taking the following factors into consideration: timing of its implementation, clear public communication strategy, and transparency in the use of funds accruing from the savings. In the medium term, government should ensure the effective implementation of the subsidy reform and its durability. Specific policy measures include the need to establish an effective monitoring mechanism, need to galvanize support for passing the Petroleum Industry Bill (PIB) into law, the importance of the effective Implementation of the Power Sector Recovery Programme (PSRP), and the need to boost local refining capacity to eliminate petrol import.

Introduction

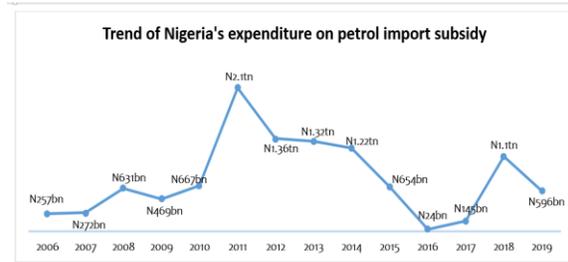
The reform of energy subsidies (electricity and petrol imports) has far-reaching implications for the Nigerian economy. It is critical for ensuring improvements in energy supply across the nation and for the actualization of the economy's largely untapped growth potential. Government has expended huge amounts on energy subsidies over the years without large scale improvements in power generation, transmission and distribution across the country. According to the Nigerian Electricity Regulatory Commission (NERC), total tariff-related revenue shortfall by players in the electricity industry, which represents subsidy paid by the Federal Government, amounted to N1.72 trillion between 2015-2019. The figure increased steadily from N165 billion in 2015 to N614 billion in 2019.



Compiled from various sources: NERC, PwC, Author's Computation

Also, about N10 trillion has been expended on petrol subsidies between 2006 and 2018 according to the Petroleum Products Pricing and Regulatory Agency (PPPRA), and Nigerian National Petroleum Corporation (NNPC). The chart below shows the trend of petrol import subsidy in the country. Subsidy payments increased from N257 billion in 2006 to hit N2.1 trillion in 2011. Reform efforts by the government in 2011/2012 led to a partial phasing out of subsidies. Over the next couple of years, the amount spent on petrol subsidies decreased steadily hitting a trough of N24

billion in 2016, before skyrocketing again to N1.1 trillion in 2018.



Compiled from various sources - Daily Trust, BudgIT, NNPC

Moreover, the administration of subsidies is also problematic. The first problem is that the true beneficiaries of subsidies are not the poor, who enjoy price reductions on the consumption of PMS or electricity, but rather the rich, including the wealthy players in the energy industry.

According to the World Bank, 80 percent of government expenditure on electricity subsidy benefits the richest 40 percent in the country. Also, the existence of subsidies discourage investment in the energy sector. The inability of players to charge cost-reflective tariffs for electricity serves as a disincentive for investors in the sector, while the existence of petrol import subsidies prevents investment in local refining capacity and distribution.

Energy subsidy reforms is therefore imperative for Nigeria to be able to attract investors into its energy sector and free up financial resources for government to expend on development projects that will benefit the populace, especially the extreme poor. However, because reforms also come with associated costs to the populace, they must be well formulated and Government must be able to galvanize support from key stakeholders and interest groups in the country. The failed attempts by different Administrations over the years to implement comprehensive energy

subsidy reforms point to the need for well-designed strategies for the success of the reform effort of the current Administration. Getting it right this time around will involve embarking on short-to-medium-term measures to harness the benefits of subsidy removal while mitigating its negative effects.

Short Term Policy Measures

In the short term, government's reform strategy should be designed in consultation with key stakeholders and interest groups. In order to ensure widespread acceptance by the public, reforms should be embarked upon putting the following factors into consideration: timing of its implementation, clear public communication strategy and transparency in the use of savings accruing from subsidy removal. Specific policy measures include:

1. Conduct an In-depth Research on Energy Subsidy Reform

Government needs to anchor its justification for the removal of subsidies on scientific evidence based on findings from comprehensive research and not just on mere logical explanations or popular opinion. The general public does not know the intricacies associated with energy reforms. As such, government needs to provide evidence of how the benefits derivable from removing the subsidies they have enjoyed for decades outweighs the costs they will have to incur in the short to medium term. This will also help the government to engage the organized private sector and civil society groups in informed debates on energy subsidy reforms.

Apart from helping to set the stage for an evidence-based debate on reforms, a well-coordinated research is crucial in determining the associated costs of subsidy, the strategy for equity and efficiency in the distribution of benefits across the populace, and the economic impact of its removal on households

and businesses. Credible sources of macro and micro level data, as well as robust methodologies should be adopted. Findings from the research should then be validated by industry experts and other key stakeholders before it is presented to the general public. Examples of studies that can be conducted include consumers' willingness to pay for improved electricity services and an economic impact analysis of the effect of energy subsidy reforms on macroeconomic and welfare indicators in the country.

2. Engage Key Stakeholders in a Nation-wide Dialogue

The success of an energy subsidy reform process is hinged on the government's ability to gain the support of the citizens. This will involve engaging different groups such as the organized private sector, labour and trade unions, youth groups and the civil society in an inclusive nation-wide dialogue process where they all get to participate in the formulation of the subsidy reforms.

This engagement should be done early in the reform process, before the agenda for the reform strategy is agreed upon by the government. Announcing a subsidy reform without due consultations with stakeholders and their engagement in the reform formulation process will usually result in a backlash from the general public and will frustrate any future attempts by the government to initiate reforms.

3. Ensure the Right Timing for the Implementation of the Reform Programme

Aside from the need to establish consensus with key stakeholders, government also needs to determine the right timing and pace of implementation of an energy subsidy reforms. The attempt at energy subsidy reforms by the government in 2012, where fuel prices were raised by 115 percent, faced stiff opposition, resulting in widespread protests. However, the

increase in electricity tariff around the same period was successful, without any major resistance from the public. The recent reform attempt by the government has also faced stiff opposition by different interest groups. A major reason for this is that the timing is deemed inappropriate, considering the fact that many are currently facing economic hardship due to the effects of the COVID-19 pandemic.

While the phasing out of both PMS and electricity subsidies can be justified on the premise that government can no longer sustain their funding due to a drastic drop in its revenue to historically low levels, the timing of their removal casts doubts over the success of the current reform. Currently, the removal of electricity subsidy has been suspended, while controversy still trails the petrol subsidy removal. Assuming that petrol subsidy removal eventually pulls through, government should consider the gradual phasing out of electricity subsidy, starting from late 2021 when the economy would have begun to recover from the economic downturn triggered by COVID-19. This would also afford government the time to put measures in place to mitigate the negative effects of its removal on the populace, especially on the extreme poor.

4. Embark on Comprehensive Public Enlightenment Campaign

Government needs to embark on a comprehensive public enlightenment campaign before the implementation of energy reforms in order to communicate the benefits of the subsidy removal to all economic agents as well as how it intends to mitigate the short-term costs that will be incurred. Specifically, the campaign should focus on informing Nigerians about how the government intends to utilize savings from the subsidy and the specific initiatives that will be embarked upon to mitigate the effect of subsidy removal on individuals, households and businesses.

5. Establish Mitigating Measures

Government should also establish well-designed measures to mitigate the negative effects of subsidy removal on the populace. It should ensure the effective targeting of the poor, who will bear the greatest burden of the subsidy removal, in the design and implementation of social programmes. Social safety net programs such as provision of free primary health care services, waiver of school fees for pupils in public schools, public works programmes, women and youth empowerment programmes, investment in rural health and electrification facilities should be adopted and effectively implemented by the government.

Medium Term Policy Measures

In the medium term, government should ensure the effective implementation of the subsidy removal and ensure the durability of its reform effort. Specific policy measures should include:

1. Establish Effective Monitoring Mechanism

Government should establish a framework for monitoring and auditing the funds that accrue to the federation account as savings from the subsidy removal and ensure that they are used for the projects agreed upon during the consultation and reform formulation process. This will help ensure transparency in the administration of the funds.

2. Galvanize Support for the Passage of the Petroleum Industry Bill (PIB) and Ensure its Effective Implementation when Signed into Law

Stakeholders in the energy sector need to galvanize support for the quick passage of the Petroleum Industry Bill (PIB) which contains provisions for large-scale reforms in the oil and gas industry. When implemented, the Bill will

facilitate the commercialization of a reformed NNPC and improvement of the governance structures in the industry. This should result in improvements in efficiency of the NNPC and transparency and accountability in the administration of the country's oil resources.

3. Commit to the Effective Implementation of the Power Sector Recovery Programme (PSRP)

The Power Sector Recovery Programme (PSRP) is a programme launched by the Federal Government with objectives that include restoring the power sector's financial viability, improving power supply in the country, attracting investment into the sector, and strengthening its institutional arrangement. \$750 million in International Development Association (IDA) funding was secured from the World Bank under the Power Sector Recovery Operation (PSRO). It is expected that the PSRO will result in increased electricity supply in the country, improvement in the power sector financial viability and a reduction in the amount expended by the government on electricity subsidies. Government needs to provide the institutional and fiscal support to the IDA to ensure the effective implementation of the PSRO and by extension, the PSRP programme.

4. Boost Local Refining Capacity in order to Eliminate Petrol Importation

In the medium term, government should boost local refining capacity through public-private partnerships. Part of the proceeds from oil subsidy savings should be used to refurbish the country's refineries. Also, joint ventures should be formed with private sector organizations where the latter will be responsible for the day-to-day running of the refineries. The recent decision by the Federal Government to divest majority of its stake in the nation's four refineries to private investors

is a step in the right direction. The government however needs to follow through on this and ensure that credible investors are brought in to manage them.

4. Other Measures to Explore

Given that there is no single recipe for energy subsidies reforms, there will also be need to

I. Develop a comprehensive energy sector reform plan with clear long-term objectives and an analysis of the impact of reforms.

II. Implement price increases that are phased-in overtime with the use of simple price capping mechanism.

III. Ensure that the Gencos and Discos are also efficient in their processes in order to remove the producer-related subsidies.

IV. Implement institutional reforms that depoliticize energy pricing, such as the introduction of automatic pricing mechanisms.

Conclusion

The need for energy subsidy reforms in Nigeria cannot be overemphasized given that its attendant benefits far outweigh the cost to be borne temporarily by the populace. However, with the failed attempts by previous administrations to fully deregulate the electricity and petrol subsectors, the current administration needs to pay attention to the formulation and execution of strategies that will guarantee the success of its current reform effort. It is imperative to get it right this time!

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