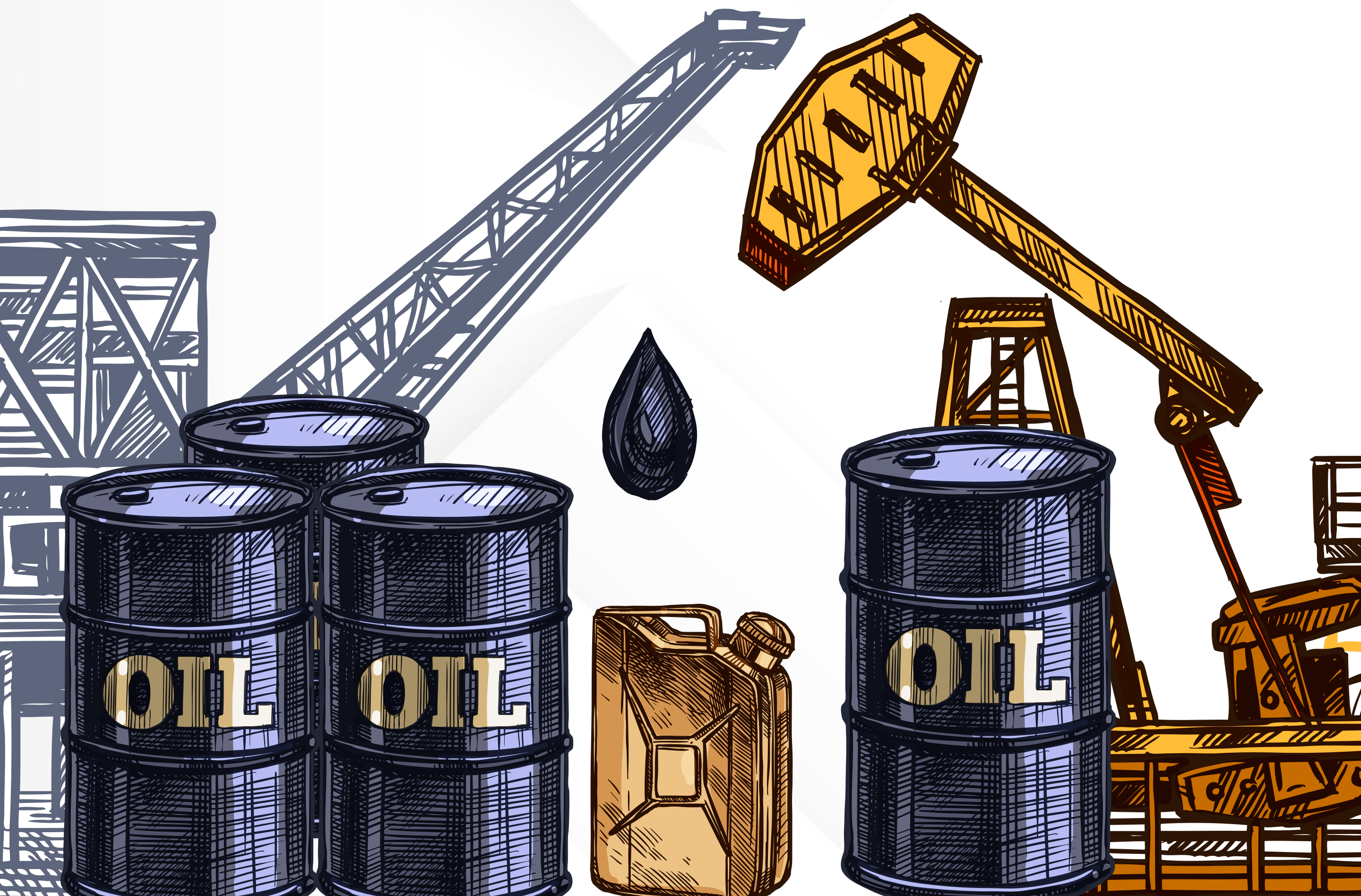
THE
ENERGY SUBSIDY PANDEMIC



By
Emmanuel Effiong

Governance and political leadership are often characterized by policy terms and jargon that go over the heads of a large majority of the electorate, especially the uneducated. Most people cannot be bothered about making sense of fancy terms and seemingly complicated public policies; the elected officials should handle that – that is why they get the big bucks. Every once in a while, however, there comes a policy or invention of government that has far-reaching implications on even the most disinterested member of society and provokes widespread reactions. One such policy that even if grossly misunderstood or minimally understood by the African populace, is quite a hot topic for newspaper stand debates and general discourse is the Subsidy Regimes employed by countries across the continent.

The Oxford Dictionary defines subsidy as a sum of money granted by the state or a public body to help an industry or business keep the price of a commodity or service low. It could also refer to a pricing structure, where the total cost of a good or service, is not borne by either the consumer or the producer of the product. Subsidies come in various forms; governments could offer subsidy programs on fertilizer or petroleum products, whereby the government bears part of the cost of the service. This measure is done to reduce the burden on households and businesses. In the case of fertilizer, it could be done to reduce the cost of engaging in farming operations and boost the productivity of agricultural output. Government can also set a guaranteed minimum price to incentivize farmers to produce a particular product, by paying an amount beyond the market price.

Given the skewed poverty dynamics in Africa's vast population, with 480 million of its 1.4 billion people living below the extreme poverty line, it is understandable why governments would have to employ subsidy schemes on essential commodities. Contrastingly, the African continent is blessed with abundant natural resources, which ideally should result in comparatively lower prices of commodities refined from these resources. However, a dearth of infrastructural development and technological capacity has eroded this would-be advantage. Energy sources and agricultural/food products are two of the most subsidized commodities on the continent. In this article, we will understudy and analyze the subsidy regimes around these in three African countries – Nigeria, Kenya, and South Africa with a scorecard of the subsidy payments in these economies, the effects of removal, and articulate some recommendations in light of current socioeconomic trends.

NIGERIA

In the past decade alone, Nigeria has spent over $45 billion on fuel subsidies. The country is projected to spend more than $15 billion in 2023, according to the Ministry of Finance, Budget, and National Planning. Ab initio, the price of fuels like petrol was purely determined by market forces and attendant costs which led to a variance in the purchase cost in different parts of the country. Therefore, fuel subsidies were introduced in the early 70s as a social construct to ease the fuel price burden on the populace. The spike experienced in Nigeria's population growth rate since the turn of the millennium has increased the energy demand in the country. This development has substantially increased the burden of sustaining the subsidy regime, which to a large extent, has limited the ability of the government to supply basic social amenities like good roads, schools, hospitals, and other infrastructure necessary for societal development.

$45 BILLION
fuel subsidies

Since its introduction, it could be argued that the fuel subsidy has been a curse rather than a blessing as it has imposed enormous fiscal pressures on Nigeria's macroeconomic outlook, with payments for fuel subsidies accounting for close to 2% of the nation's GDP. Additionally, the twin evils of fraud and corruption have been a feature in Nigeria's subsidy implementation schemes, highlighted by a 2012 report by the Presidential Committee on Verification and Reconciliation of Fuel Subsidy Payments between 2009 and 2011. The report indicated that nearly $4.3 billion was spent annually to subsidize petrol; these funds could not be accounted for and were never utilized by Nigerians.

The challenge with implementing the subsidy regime in Nigeria has been the inability to ensure that the beneficiaries fully capture the gains. In many instances, funds are expended for products that are not received or diverted to markets where subsidized goods are sold at a higher price. In some cases, goods are diverted to neighboring countries where prices sell for close to N400 per liter, relative to Nigeria, where products are sold at N180 per liter. With the governments burdened by a high fiscal deficit, questions have been raised on whether the funds expended on subsidies could be better used in other areas that will generate additional revenue for the government, support economic growth and improve human development. With interest payments at over 100 percent of the government's revenue, there is a compelling need to increase the revenue base by curtailing expenditures on subsidies to improve the government's fiscal position. Whoever emerges as President of Nigeria in the forthcoming presidential elections in February, will reduce the expenditure on subsidies in a gradual phase out, which would further aggravate inflation in the short term.

As indicated in the Figure below, Nigeria's National Oil Company (NOC), the NNPC, had not remitted a single dollar into the federation account in 2022, making Nigeria one of the few oil-producing states not to benefit from the increase in global oil prices this past year. Nigeria has spent over $11 billion in subsidy payments throughout 2022.

Source: Reuters (from NNPC FAA Spreadsheets)

KENYA

Like most of its neighbors in Africa's eastern hemisphere, regional powerhouse Kenya depends on refined energy products such as gasoline, diesel, kerosene, and jet fuels imported mainly from the Middle East by oil marketing companies. The Kenyan government issues open tenders for the supply of these energy sources after a demand estimate and assessment have been done for each import cycle. Data from the state-owned Kenya Pipeline Company (KPC) for 2021 indicates that 6.15 million liters of refined petroleum were imported into the country, worth about $3.48 billion. Ninety-three oil marketing companies are recognized by the KPC and are the only ones eligible to bid for the government's tenders. The winner orders the products, which it stores and distributes via the network of the KPC to other marketers according to demand quotas. Since many established marketing companies do not have a country-wide reach, smaller-scale distributors and retailers have been included in the marketing ecosystem to fill that gap, getting fuel from the more giant oil marketers and taking the same countryside.

6.15 MILLION LITERS

refined petroleum

$3.48 BILLION

Kenya's fuel subsidy scheme, known as the Fuel Stabilization Fund, became operational in April 2021 to stabilize consumer prices against unpredictable global oil market swings, thereby shielding Kenyan consumers from high prices. Without the existence of this fund, then the forces of demand and supply would push the retail prices to be above the price formula price established and managed by the Energy and Petroleum Regulatory Authority, EPRA. As stated in its policy articulation document, the fund was to remain as long as international crude oil prices rose and stayed above $50 per barrel, which has been the case from early 2021 until date. KSh 5.40 ($0.4) would go towards the stabilization fund from each liter of petrol and diesel sold by oil marketing firms. Without the fuel stabilization fund, there would be a projected 10% - 13% increase in the commodity's price in the urban areas of Kenya.

Compensation from the fund to oil marketing firms is based on a certain percentage of their respective fuel costs. Since the fund became fully operational in April 2021, the government has paid oil marketers a total of KSh 49.164 billion ($399.7 million).

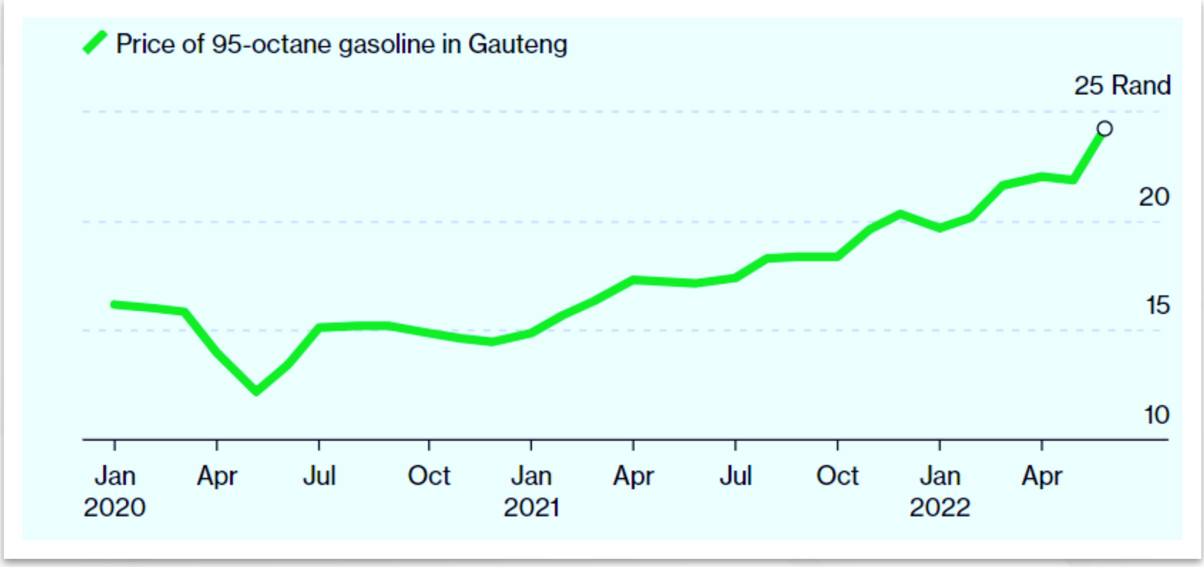
Source: Kenya Government Archives

On the 14th of September 2022, a day after his inauguration as the country's fifth president *(pictured)*, President William Ruto announced the removal of the petrol subsidy in the country, which increased the price of the commodity by 13% in the country. The country regulators, however, retained diesel and kerosene subsidies, helping cushion low-income earners who use these fuels for electricity cooking and public transportation. The president had implored Kenyans to bear the brunt of the increased petrol prices with the understanding that the subsidy regime was unsustainable, and that the government would re-direct funds initially earmarked for petrol subsidy into social impact projects. While Kenyans are struggling with adjusting to the hikes in petrol prices, initial protests and resistance to the policy have since died as the Ruto administration gets to work to salvage an ailing economy.

South Africa

The fuel sector subsidy regime in South Africa is primarily based on the Coal-To-Liquid (CTL) industry. The CTL industry is monopolized by Sasol, a company minority-owned by the South African government. Two subsidy estimates are presented: one based on the market price support to liquid fuels produced from coal and the second based on the carbon tax exemption for Sasol. Based on the subsidy regime, each time a motorist fills up their tank in South Africa, about 5% of the bill is paid to Sasol. Between 2016 and 2020, Sasol received ZAR 1.552 billion ($89.45 million) through the Basic Fuel Price, the price paid to petroleum and synthetic fuels producers. In addition, the company received an indirect subsidy of over ZAR 6.5 billion ($375.1 million) due to an exemption from the Carbon Tax Act 15.

In the face of rising global inflation and the ever-growing global push for investment in renewable energy to offset the effects of climate change, the South African government had decided to wean itself off the CTL system gradually and remove subsidy payments for fuel. The savings are expected to be deployed to infrastructure for renewable energy sources in 2022. The country also announced an end to fuel subsidies by May 2022, which was extended to August 2022 to manage the economic headwinds experienced from the disruptions caused by the Russian/Ukraine war.



Source: Bloomberg

Vaccinating The Subsidy Pandemic

One might wonder why the author refers to the subsidy regimes adopted across the continent as a "pandemic" when it is intended to alleviate economic pains for the masses. But the reality is that the subsidy regime implementation schemes adopted across the continent enrich just a few key players in the oil sector and deplete the respective national budgets of much-needed resources and revenue to provide social amenities and develop infrastructure. Therefore, this "pandemic" needs to be "vaccinated" by urgent reforms to the subsidy regimes in these countries. Mostly arguments against fuel subsidy reforms are primarily centered around the extra price strains on consumers' income, which was the main trigger for the *Occupy Nigeria* subsidy removal protests of 2012) and concerns about the integrity of government to utilize erstwhile subsidy funds for the greater good. While there are sufficient grounds for the legitimacy of these arguments, a more holistic view of the subsidy issue paints a less-than-dire picture and lends adequate voice to the call for subsidy reforms and removal.

For energy sources with trade value like gasoline, the subsidy applied is the difference between the landing cost and the price at which the product is sold to retail distributors. A key concern about removing the fuel subsidy in Nigeria has been the likely inflationary impact, as higher gasoline prices could have corresponding effects on the prices of other goods and services. With the high losses incurred in the subsidy program along with the diversion of production, the question has been whether the program is achieving its intended purpose given its high cost. Could it encourage unsustainable habits, particularly for high-income earners with multiple cars? Suppose the funds, for example, are used to support a massive irrigation program in Nigeria which could result in multiple farming seasons, increased agricultural productivity, and employment generation. In that case, the country could be better off channeling resources in this direction as less than 1 percent of arable land in Nigeria is irrigated.

The recommended resolution would be the liberalization of the downstream petroleum sector in African economies. This will checkmate the widespread corruption and regulatory malpractices that have defined the industry, especially regarding subsidies. With liberalization, the government's involvement in the sector will move from direct participation to indirect, as is happening in another network industry, the telecommunication sector. Other players who hitherto were not included in the subsidy regime but could benefit the market would now be able to participate. The downstream petroleum sector should be able to attract global players who would compete on improving the quality of service as well as alternatives to reliance on petrol. Today, these telecommunication firms are Africa's most significant contributors to domestic investment, employment, and tax revenue. Liberalization would also largely allay the fears that government would siphon monies previously utilized for subsidy payments, as, by its very definition, the government will be limited in access to funds in the sector.

To articulate what a post-subsidy era economy will look like in the long term, experts maintain that first, there will be an influx of new private companies in the sector that will bring innovation, efficiency, competition, investment, and new jobs. Next, we will have a sector with new and modern infrastructure, including refineries, pipelines, depots, storage tanks, and petrol stations. Above all, these countries' economies and respective budgets would be re-focused on social impact initiatives and projects.

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