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Relevance lost? The Petroleum Equalization Fund in Nigeria☆

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ABSTRACT

This paper traces the origins of the Petroleum Equalization Fund (PEF) in Nigeria and describes the environment in which it has operated. The paper argues that the PEF has failed to live up to its mandate of equalizing the prices of petroleum products across the country. This is in part because such equalization schemes create arbitrage opportunities which are always prone to exploitation. The rentier nature of the Nigerian state and the prevalence of corruption in the country have added fodder to such exploitations. The consequence of the above is that PEF has simply become one of the inefficient channels of subsidizing the price of petroleum products in Nigeria. This paper therefore recommends that the starting point in the efforts by the Nigerian government to undertake petrol subsidy reform in the country should be to abolish the PEF.

Introduction

In recent times, several factors have entwined to negatively impact on the price of crude oil.[1] As a consequence of the above, the price of the commodity which was almost US$115 in June 2014 is now below US$50, a drop of more than fifty percent. This sharp drop in the price of oil has resulted in the deterioration of the economies of many of the "oil producing countries whose budgets depend on high prices are in particular trouble." Such countries include Russia which has seen its currency, the rouble tumble. Other concerned oil producing countries include Nigeria and Venezuela. "Nigeria has been forced to raise interest rates and devalue the naira" while "Venezuela looks ever closer to defaulting on its debt" (Economist, 2014). The deterioration of the economies of several oil dependent states has brought to the fore the need for such countries to adopt more prudent fiscal policies and diversify their economies away from oil dependency. Specifically, the focus on subsidy reforms is justified by the three strand evidence that: 'large subsidies create problems for governments in their domestic accounts and often in their balance of payments'(Bienen and Gersovitz, 1986: 43); by lowering end-use prices, subsidies 'encourage increased energy use and reduce incentives to conserve energy efficiently'(Vagliasindi, 2012: 1); and that in developing countries, petrol subsidy is a costly approach to protecting the poor due to substantial benefit leakage to higher income groups (Kebede, 2006).

The international oil price crisis has thus reawakened the call for petroleum price reforms in most of the oil dependent economies. Whereas in the past most of those economies put in place various forms of subsidies in reaction to abundance of oil rents, the present realities have call for a rethink of those policy. In Nigeria, for instance, one such contentious subsidy scheme that is overtly due for reform is the Petroleum Equalization Fund (PEF). The Fund which was established via the promulgation of the Petroleum Equalization Fund (Management) Board etc. Decree Number 9 of 1975, was designed to make prices of petroleum products across the country uniform.[2] According to the enabling Act, the PEF is a statutory fund 'which is to be applied for the reimbursement of petroleum marketing companies for

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[1] "Four things are now affecting the picture. Demand is low because of weak economic activity, increased efficiency, and a growing switch away from oil to other fuels. Second, turmoil in Iraq and Libya—two big oil producers with nearly 4 m barrels a day combined—has not affected their output. The market is more sanguine about geopolitical risk. Thirdly, America has become the world's largest oil producer. Though it does not export crude oil, it now imports much less, creating a lot of spare supply. Finally, the Saudis and their Gulf allies have decided not to sacrifice their own market share to restore the price. They could curb production sharply, but the main benefits would go to countries they detest such as Iran and Russia. Saudi Arabia can tolerate lower oil prices quite easily. It has $900 billion in reserves. Its own oil costs very little (around $5–6 per barrel) to get out of the ground" (Economist, 2014)

[2] Section 2 Petroleum Equalization Fund (Management Board etc) Decree Number 9 of 1975.

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any losses suffered by them arising from the sale of petroleum products at uniform prices throughout Nigeria'.[3]

Recent attempts at deregulating the Nigerian petroleum industry brings to the fore the debate on the future of the PEF.[4] Specifically, in 2012, the government of President Goodluck Jonathan forwarded a Petroleum Industries Bill (PIB) to the Nigerian National Assembly for its consideration. This bill, which was based on the report of a 2000 Oil and Gas Implementation Committee (OGIC) set up by the federal government, is a reform legislation which aims to replace the existing myriad of legislative and administrative instruments in the Nigerian oil industry with one omnibus legislation (Lukman, 2007: 3). The main essence of the bill is to promote the emergence of an open and transparent oil industry for the benefit of the majority of the citizens.[5] The reform is based on the evidence of some defects in the lase and practices applicable in the industry. Although section 100 (1) of the PIB makes it explicit that PEF will continue to exist, section 100 (4) states that the PEF would be scrapped without any further legislation whenever "the government decides that petroleum product markets have been effectively deregulated." At this point, the Minister of Petroleum "shall take the required actions to ensure that the Equalization Fund ceases to exist and its assets and liabilities transferred to the government to be controlled and managed by the Ministry and at such time the provisions of the sections of the Act shall stand repealed". This provision of the PIB is based on the expectation that with the full deregulation of the downstream sector of the oil industry in the country, petroleum products would then be sold at market-determined prices that even out all sorts of subsidy-related and non-subsidy related costs. At that point, marketers can be allowed to sell the products at margins that reflect transport and insurance costs.

Given the fact that PEF is one of the channels through which government subsidizes the prices of petroleum products in Nigeria, it is not surprising that its fate is now entwined with the ongoing contentious and divisive debate over the removal of subsidy on petroleum products in Nigeria.[6] Critics base their view on the ground that rather than promote uniformity in the prices of petroleum products across the country, the PEF along with wider government subsidies on petroleum products have created incentives for both system operatives and regulators to exploit the petroleum products market in order to earn arbitrage profits. The consequence of this is that the prices of petroleum products in the country have rarely been effectively equalized since the establishment of PEF. There is also strong claim that the PEF has simply become one of the inefficient channels of subsidizing the price of petroleum products in Nigeria. Proponents of maintaining the status quo argue that it represents the only tangible benefit of oil wealth for most Nigerians" (Gillies, 2009: 3) and that the idea of calling for a full deregulation of the petroleum industry in Nigeria "is a clear call for anarchy."[7] The *Independent Petroleum Marketers Association of Nigeria* (*IPMAN*) *has also made explicit its opposition to the abolition of PEF arguing that* "it will create imbalance in the country".[8] This is because "Nigerians, especially in the northern part of the country, will pay more for the products than their counterparts in the South."[9] This is especially because most of the oil wells, refineries and depots are located in the Southern region of the country. The contradiction in the above reactions explains why attempts to deregulate the petroleum industry in the country have always proved unpopular. In January 2012, for instance, there were widespread riots in the country following the announcement by the Government that the pump price of a liter of petrol had been increased from an equivalent of US$0.43 to US$0.94. This forced the Government to immediately bring down the price to US$0.65.[10]

This paper demonstrates that the introduction of PEF was in the main influenced by political factors rather than economic considerations originally advanced by the then military government at the launch of the Fund in 1975. Although the then Nigerian Head of State, General Yakubu Gowon defended the policy mainly on economic grounds, evidence in this paper suggests that the reality was more complex.[11] The emergence of the PEF was arguably an extension of the age-long politics of resource sharing and revenue allocation in the country. In a federal system such as Nigeria, the interplay of political interests is unavoidable due to the fact that only nine southern states out of the 36 federating states produce the resources and the wealth of the nation (Phillips, 1971: 390). It is in those nine states that crude oil which accounts for about 75% of the country's consolidated budgetary revenues and over 90% of export revenue in the country is produced.[12] Based primarily on political considerations, equalizing the prices of petroleum products across the country was thus a logical extension of the oil rent induced by the increasing emphasis on "need" and "national interest" which occurred at the detriment of the "derivation principle" as the basis of revenue allocation among the constituent regions of Nigeria. 'The principle of derivation requires that all revenues which can be identified as having come from, or can be attributed to, a particular region should be allocated to it, provided that adequate and reliable data for this identification are available (a crucial requirement)' (Phillips, 1971: 390). A popular argument for introducing "need" and national interest' as basis for revenue allocation is that under a strict derivation principle, according to Phillips (1971), 'the more needy regions will be starved of resources. When fully applied, the derivation principle is therefore likely to lead to greater interregional economic disparity and to contribute to the instability of the federation'.

In the light of the current uncertainties surrounding international crude oil prices, this study which critiques the origins and operations of PEF in Nigeria aims to provide important lessons for other oil dependent economies that may also soon need to rethink their subsidization of their petroleum products. It also holds important lessons for countries that have recently emerged as oil producers.[13] To achieve its objective, the paper is divided into four additional parts. Part One critiques the theory and characteristics of rentier states while Part Two documents government involvement in pricing and subsidizing petroleum products in Nigeria. Part Three critiques the practice of petroleum equalization in Nigeria and Part Four concludes the paper.

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[3] Section 2 Petroleum Equalization Fund (Management Board etc) Decree Number 9 of 1975.

[4] See, PIB: FG to scrap NNPC, PTDF, PPPRA, DPR, others", The Sun. (April 30, 2013), downloaded from, others http://sunnewsonline.com/new/cover/pib-fg-to-scrap-nnpc-ptdf-pppra-dpr-others/ (January 16, 2014).

[5] Nigeria Extractive Industries Transparency Initiative (NEITI) (undated, p.6).

[6] See Nwachukwu and Chike (2011, p.2796) and Siddiq et al. (2014, p.165). See also "Questionable clauses: NASS dumps Denzani's PIB" Sunday Trust (August 25, 2013), downloaded from http://sundaytrust.com.ng/index.php/news/14132-questionable-clauses-nass-dumps-diezani-s-pib> (January 16, 2014).

[7] See 'PIB: Why proposed regulation should leave PEF and PPPRA intact' Vanguard (October 6, 2009). Downloaded from <http://www.vanguardngr.com/2009/10/pib-why-proposed-legislation-should-leave-pef-and-pppra-intact/> (January 28, 2014).

[8] See "Nigeria: We're Against Scrapping of Petroleum Equalization Fund — IPMAN" Daily Trust (July 22, 2013) Downloaded from <http://allafrica.com/stories/201307221497.html> (January 16, 2014).

[9] See "Questionable clauses: NASS dumps Denzani's PIB".

[10] In Nigeria "subsidized gas is one of the few benefits trickling down from an infamously corrupt government that has pocketed billions of dollars in oil profits, with little to show for it." For the poor therefore, fuel subsidy means "some sense of ownership in a national resource, oil, in which roughly 80% of the economic benefit has flowed to 1% of the population, according to some estimates" (New York Times, January 16, 2012).

[11] Announcing the decision of the government to equalize petroleum prices all over Nigeria, the then Head of State, General Gowon asserted thus: "differentials in prices of petroleum products should not hamper dispersal of industries throughout the country". Also, "Industrialists will no longer use it as an excuse for not wishing to establish far afield nor will it impede the speedy implementation of various development projects of the state governments" (see Daily Times, 1973, pp.1 and 31).

[12] The statistics on the contributions of oil wealth are based on the World Bank Data and strived from http://www.worldbank.org/en/country/nigeria/overview

[13] Such countries include: Ghana, Mozambique, Tanzania, Kenya and Uganda (see KPMG, 2013, p.4).