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DEREGULATION AND APPROPRIATE PRICING OF PETROLEUM PRODUCTS IN NIGERIA: CHALLENGES AND OPPORTUNITIES

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ABSTRACT: *In October 2003, the government of Nigeria announced the deregulation of the down-stream sector. Prior to that time, the sector enjoyed heavy subsidy from government; and in the opinion of critics, this brought about inefficiency in the system. The notable outcome of this inefficiency was the insufficient supply and irregular pricing of petroleum products.With deregulation in place, the economy is liberalized to promote competition amongst petroleum products marketers.Another import of deregulation is that government's interventions such as special treatment of government owned oil companies, price controls, and restrictions to trade are being removed. Increasingly, the private sector is participating in our more competitive petroleum markets. It is in this context that this study synthesizes the challenges and opportunities offered to Nigerians through deregulation.*

INTRODUCTION

Nigeria has a long history of oil or refined petroleum products marketing, dating back to seventy years; early 1930s when precursors of Shell and Mobil engaged in the distribution of petroleum products. Up till 1995, the local fuels market was largely regulated. Pump price of fuels such as Premium Motor Spirit (PMS) or Petrol, Kerosene, Diesel were fixed by government. Within the same period, the bulk of domestic fuel consumption was supplied by local refineries. But due to the parlous state of the refineries, the bulk of local fuel requirements is now met by importation. Massive importation started from 1996 under the late General Abacha's regime.

In 1998, the erstwhile military regime of General Abdulsalam Abubakar moved towards deregulation (which the industry had always desired) by allowing the oil marketing companies to import fuel directly. In the past, this was the exclusive pressure of government through the NNPC. However, importation was unattractive to the major marketers due to the local fixed price regime. The major and the independent marketers began to import fuels directly following the new policy. This helped to stem the growing supply shortfall, which had caused serious economic problems, and aggravated the country's economic down turn. In 1999, however, the rising crude oil prices in the

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international market made the oil marketing companies stop import of fuels, particularly petrol, diesel and kerosene. By the second half of 1999, the NNPC had become the major importer of fuels for domestic consumption, which it had to do for strategic reasons: to avoid a political backslash that may have security implications. Even at that, the hike in fuel price has been a recurring decimal as the oil marketers complain that they are operating at a loss.

Finally in 2003, the government announced a full deregulation of the petroleum downstream sector. Yet it claims that a subsidy of N14 is spent on each litre of petrol. It is in this connection that this study explores the policy of deregulation within the context of appropriate pricing of petroleum products with a view to spotlighting the challenges and opportunities existing therein.

The down stream activities involve the petroleum products refining, distribution, and marketing. These activities are often carried out by Major Marketers (example, Shell, Texaco, Mobil etc) and Independent Nigerian Marketers who number about 500 and control less than 30% of the market. The down stream sector utilizes facilities like refineries, depots, pipelines, network, petro-chemical plants, and transport facilities. Many indigenous companies are found within this sector because it is relatively less-capital intensive and less technical. This sector is an area, which the government of Nigeria has made considerable investment over the years, particularly since 1970; yet the major challenges of the sector remain the non-commercial pricing environment, and lack of resources to maintain and manage the infrastructure properly.

The focus of the government's policy on the down stream sector can be summarized as follows: (a) to maintain self-sufficiency in refining, (b) a need to ensure regular and uninterrupted domestic supply of all petroleum products at reasonable prices, and (c) to establish infrastructure for the production of refined products for export. The down stream sector has been a major problem for the country over the past 6 years as the NNPC has found it impossible to maintain the country's four refineries, and to provide adequate supply of PMS, Diesel, and Kerosene nationwide. The NNPC recently completed the third phase of their national pipeline distribution system.

However, large segments of the distribution system are in urgent need of maintenance. Two of the country's refineries, at Kaduna and Warri, have petrochemical plants, which utilize refine by-products to produce carbon black, polypropylene, linear alkyl benzene, and a host of other products. It is recognized that for an olefin-based petrochemicals plant to be viable in Nigeria it must be developed by cracking natural gas liquids in the olefins plant.

DEREGULATION OF PETROLEUM DOWN STREAM SECTOR IN NIGERIA

According to Gbosi (2004) in Oluleye (2005) deregulation does not mean the absence of regulation. Rather, it means the deliberate informed process of removal or mitigation of restrictions, which are obstacles or non deterministic and tend to reduce efficiency or competitive equities. In other words, economic deregulation is "the deliberate and systematic removal of regulatory controls, structures, and operational guidelines, which may have militated against growth, operations and efficient allocation of resources in the economy".

It follows therefore that the deregulation of the economy or its component comes as a result of the belief that factors of production, goods and services will be optimally priced and allocated where these prices are freely determined in a competitive environment. The major factor that usually calls for deregulation is the imbalance between demand and supply in the product and factor market (Gbosi, 2004). Adidu and Oghene (2005) observe however, that some measures of control are necessary in deregulation to avoid the outcome of monopolies, oligopolies, or the formation of cartels. This is particularly why government must also put in place anti trust laws to avoid negative consequences. According to Scheneier (2002), deregulation encourages companies in essential services to cut costs and extract customers.

From the foregoing, deregulation of the petroleum down stream sector would mean opening up of Nigerian petroleum industry to competition. It will require that all aspects of production, refining, distribution and dispensing of petroleum products be self-financing (Obasanjo 2003). Prior to deregulation in the down stream sector of the oil industry, there was low capacity utilization of Nigeria's state-owned refineries and petrochemical plants. Even now, the four refineries can only produce 17 million litres per day whereas 30 million litres are consumed in Nigeria per day. Also, the sorry state of our petroleum products pipeline in terms of disrepair, neglect, and repeated vandalization made deregulation inevitable.

In addition, there were clear cases of institutional corruption, with the frightening emergence of rich oil Mafia that controlled crude oil. A case in point was the insatiable corrupt military task force that assisted the diversion of crude oil and petroleum products. Agbebaku, Edeko and Aghemelo (2005) have noted that it was this state of affairs that led the administration to set for itself aspirations for the down stream sector of the oil industry as follows: (a) to provide gainful employment and enable Nigerians to acquire technical know-how in refining and distributing business, (b) to establish facilities and infrastructure for the production of refined products targeted at the export market and support to domestic chemicals, (c) to maintain self sufficiency in refining, (d) to create value added from these activities; and (e) to ensure regular and uninterrupted domestic supply of petroleum products at reasonable prices (PPCU, 2003).

To actualize the above aspirations, the government released some funds into the oil and gas industry, but all to no avail. As a result of this fiasco, the government considered deregulation as another viable option. The main objectives of deregulation in the down stream sector of the Nigerian petroleum industry include: (a) to transit to a liberalized market, (b) to ensure arms length transaction among business unit, (c) to ensure cost recovery and reasonable margin for each business unit and promote competition and efficiency (PPCU, 2003). Agbebaku *et al* (2005) have observed that government's desire to achieve the above objectives led to the setting up of the special committee on the Review of Petroleum Products Supply and Distribution. The committee recommended the establishment of the Petroleum Products Pricing Regulatory Agency to promote deregulation in the down stream oil sector.

APPROPRIATE PRICING OF PETROLEUM PRODUCTS

Appropriate pricing policy requires the elimination of all forms of subsidies on goods and services. Forces of demand and supply are allowed to play a predominant role in the determination of the prices of goods and services that were hitherto controlled. Prior to the price adjustment in August 2005, the government claimed that it subsidizes each litre of petrol to the tune of N14. At present, the oil marketers still claim that petroleum products are not appropriately priced because of the opposition of labour and civil society. This explains why the history of petroleum products pricing in Nigeria has been a chequered experience.

People of Nigeria tend to be in favour of regulation as a way of curbing the excess of petroleum marketers and give them access to their God-given resources. Parkin (1998) in Oluleye (2005) argues that the main factors that affect the demand for regulation are consumer surplus per buyer, number of buyers, producer surplus and number of firms. The larger the consumer surplus per buyer that results from regulation, the greater is the demand for regulation by buyers. Also, as the number of buyers increases, so does the demand for regulation. It is in the light of the above situation that the special committee on the Review of Petroleum Products Supply and Distribution recommended the establishment of the Petroleum Products Pricing Regulatory Agency (PPPRA) as a legal framework to help realize the above benefits. Consequently, the Petroleum Products Pricing Regulatory Agency (establishment) Act 2003 was enacted by the National Assembly. This ushered in the PPPRA.

The PPPRA is the tool used by government to seek for appropriate pricing of petroleum products. The specific functions of the agency are to: (i) establish an information and data bank through liaison with all relevant agencies to facilitate informed decisions on pricing policies, (ii) moderate volatility in petroleum products pricing, while ensuring reasonable returns to operators, (iii) overseeing the implementation of recommendations and programmes of government, (iv) establish parameters and codes of operators, and (v) maintain constant surveillance over all key indices relevant to pricing policies.

Others include to periodically approve benchmark prices for all petroleum products, identify macro-economic factors in relation to pricing of petroleum products and advising the government on appropriate strategies for dealing with them, establish linkage with key segments of the Nigerian society and ensure that their expectations enjoy the widest possible understanding and support, prevent conspiracy and restrictive trade practices that are harmful to the sector, and playing a mediating role for all stakeholder in the sector (PPPRA Act, 2003).

CHALLENGES OF DEREGULATION IN THE DOWN STREAM

Challenges of deregulation and appropriate pricing of the petroleum down stream in Nigeria may not all be obvious in the short-run, but in the medium or long term. These are as follows:

High Price of Petroleum Products: There has been a steady increase in the price of petroleum products since deregulation set into the Nigerian economy in 1986, and was formalized in the down stream sector in 2003. We do not hope it will cease, at least, in the short-run because the elimination of price control by the government will perforce allow the forces of demand and supply to determine the appropriate price for petroleum products. For the avoidance of doubt, President Obasanjo has advised Nigerians, in his 45th independence anniversary address, not to expect a decrease in the recent price hike of petroleum products despite the death of some civil right leaders (example, Chima Ubani) during a rally against the hike in price of petroleum products.

Unstable Exchange Rate: The petroleum down stream sector will suffer in the environment of unstable exchange rate for as long as our demand for international medium of exchange-dollar and pounds exceeds supply. The situation is aggravated by the fact that oil is sold in hard currency in the foreign market. Nigeria sells crude oil in the international market, and imports about 45% of petroleum products for local consumption. With deregulation in place, oil marketers will intensify importation of these products to meet local needs. This means that we can not escape the vagaries of unstable exchange rate. Moreso, as the exchange rate is expected to reflect the economic situation or health of a country at a particular point in time since the essence of it is to correct the balance of payment problem.

Depreciation of our Currency: With the growing influence of hard currencies in the foreign market, and as long as we make oil the mainstay of our economy, the naira will continue to depreciate in this regime of deregulation until a time when oil marketers will not depend on foreign supplies. This means that our refineries will need to become functional and new ones built. The government must seek to discourage import of refined products. Rather, we should refine and export to enable our currency appreciate.

Unemployment: It is feared that deregulation will worsen the unemployment situation in the country. This is possible, but only in the short-run. In the long run, more investors will come into the sector, and they will build more facilities which will require the services of people.

Inflation: Deregulation of the petroleum down stream sector will certainly result in higher price level, at least in the short-run. This is because the elimination of controls enables prices to tend towards equilibrium, which is definitely higher in the short-run than the previous (controlled) price level.

OPPORTUNITIES OF DEREGULATION IN THE DOWN STREAM

In the long-run the deregulation policy will have enough time to adjust itself to the desired level in the following ways:

Induce the Oil Marketers to Produce for Export: So far, about 18 licenses have been released to private organizations to build refineries. If these refineries are built as planned, it is obvious that crude oil will be refined for export. This will mean more foreign earnings for both the government and the individual organization concerned.

More Employment Creation: Building more refineries would further translate into more employment opportunities for Nigerians. It is not only in refineries, but also in other activities of the down stream sector like transportation, pipelines, depots, jetties and vessel, etc. Even at the level of fuel stations, more jobs will be created for Nigerians.

Development of Internal Resource Base: Industrialists will look inwards for their basic raw material. This is possible because the basic raw material for the refineries is crude oil, and this is produced locally. It then follows that the majority of other resource inputs may be sourced locally as industrialists get more encouragement to develop the economy.

Keen Competition: Deregulation of this sector is certainly going to engender keen competition in the financial markets or more strictly in capital market because investors will be looking out for oil related firms that are financially healthy in terms of profitability (dividends payment and bonus). And firms will hardly be healthy if they do not enjoy some marketing advantages (success). Another aspect of this competition will lead to better product and service offering as well as competitive price to the consumer. The price that is currently on the increase will certainly plummet as deregulation matures in the sector. What is currently happening in the telecommunication industry is a case in point. We can all recall that when GSM started, the price of the products and services offered was much higher than what is currently the case.

Deregulation Guarantees a Profitable Return on Investment: New investments are encouraged and attracted into the industry. This is particularly necessary in this age of globalization. Given the right environment, like the one offered by deregulation, globalization will result in foreign direct investments. This means that foreign investors will only be attracted if they are sure of adequate returns on their investments. A corollary to the above is the expansion of plant capacities, as new entrants will be admitted into the industry. The combined efforts of new entrants and capacity expansion will result in increased supply. An increased supply related to demand puts a downward pressure on price to the extent that the new price will be much lower than what it was before deregulation. The government has consistently argued that Nigeria is constantly facing fuel crisis due to the activities of petroleum products smugglers across the bother. Government feels that raising the price of petroleum products to economic price or price at the border countries will be a disincentive to smugglers. This means that deregulation of the petroleum down stream sector presents an opportunity to correct this anomaly.

Deregulation in the petroleum down stream sector seeks, essentially, to introduce a market economy, increase economic efficiency, establish democracy, guarantee political freedom as well as increase government revenue. There is also a presumption that economies based on private prosperity are institutions for preserving individual freedoms than economies where the productive apparatus is socially owned. This is the stance of Bhaji and Milanovic (1991) and Ijaiya (1999). But Bello (2005) has argued that government can not be effective with the policy unless it restricts itself severely to the areas of governance and within the duty provided by the guidelines for the operation of economic activities, and these economic activities are better performed by private individuals. This is indeed the context in which the deregulation of the petroleum down stream sector in Nigeria is considered worthwhile and desirable.

CONCLUDING REMARKS

Though a case has been made for deregulation, minimal regulation is necessary until such a time when the system has stabilized. This is required to avoid or reduce corruption. This has worked in the telecommunication sector, which has a commission to regulate its affairs.

In the case of petroleum down stream sector, there is need to have similar regulatory commission to be Petroleum Products Regulatory Commission (PPRC) rather than PPPRA. This is so because PPPRA is at variance with the tenets of deregulation by giving the impression that price is still being regulated. This is without prejudice to the minimal control being advocated.

Price increases on petroleum products should be reflective of the major economic indices like the state of infrastructures, the inflationary rate, the par capita income as well as production and refining capacities, and not just the international price index. Increases in the price of petroleum products, and of course the withdrawal of subsidy should be gradual to avoid disruptions in the economy.

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Table 1: Petrol Price Increase in Nigeria

Date	Price Per Litre	Regime	% Increase
Jan. 1966 – Sept. 1978	$8^{4/5}$ Kobo	Gen. Aguiyi Ironsi	-
		Gen. Yakubu Gowon	-
		Gen. Murtala Mohammed	-
October 1, 1978	$15^{1/3}$ Kobo	Alhaji Shehu Shagari	73.9%
April 20, 1982	20 Kobo	Gen. M. M. Buhari	31.0%
March 31, 1986	$39^{1/2}$ Kobo	Gen. Ibrahim Babangida	97.5%
April 10, 1988	42 Kobo	Gen. Ibrahim Babangida	6.0%
January 1, 1989	42 Kobo for Commercial vehicles and 60 Kobo for Private vehicles.	Gen. Ibrahim Babangida	43.0%
December 19, 1989	60 Kobo for all	Gen. Ibrahim Babangida	43.0%
March 6, 1991	70 Kobo	Gen. Ibrahim Babangida	16.6%
November 8, 1993	₦5.00	Chief Ernest Shonekan	614.0%
November 22, 1993	₦3.25	Gen. Sani Abacha	
October 2, 1994	₦15.00	Gen. Sani Abacha	361.5%
October 4, 1994	₦11.00	Gen. Sani Abacha	
December 20, 1998	₦25.00	Gen. Abdulsalami Abubakar	127.0%
January 6, 1999	₦20.00	Gen. Abdulsalami Abubakar	
June 1, 2000	₦30.00	Gen. Olusegun Obasanjo	50%
June 8, 2000	₦25.00	Gen. Olusegun Obasanjo	*
June 13, 2000	₦22.00	Gen. Olusegun Obasanjo	*
January 1, 2002	₦26.00	Gen. Olusegun Obasanjo	18.2%
June 20, 2003	₦40.00	Gen. Olusegun Obasanjo	53.0%
July 9, 2003	₦34.00	Gen. Olusegun Obasanjo	*
October 1, 2003	₦38.50 & ₦42.00	Gen. Olusegun Obasanjo	
May 29, 2004	₦49.90	Gen. Olusegun Obasanjo	