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The Petroleum Industry Bill and the Deregulation of the Downstream Oil and Gas Sector in Nigeria

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Introduction

Nigeria, a country with a population of more than 150 million people has an abundance of natural resources, especially hydrocarbons. It is the 10th largest oil producer in the world, the third largest in Africa and the most prolific oil producer in Sub-Saharan Africa. The Nigerian oil and gas industry can be broadly divided into the upstream (exploration and production) and downstream sectors (refining of crude for domestic consumption)[1]. While the upstream sector is a fully "deregulated" environment, with exploration and production activities optimally driven by economic and market forces, the downstream sector is yet to have a deregulation experience. Largely dependent on oil – which supplies roughly 95% of the foreign exchange earnings – the upstream oil industry is the single most important sector in Nigeria's economy.

According to the British Petroleum Statistical Review of World Energy, Nigeria had proven oil reserves of 37.2 billion barrels as at December 2010 equivalent to 2.68% of the world's reserves[2]. This vast quantity of oil has generated billions of dollars in revenue over the last forty years since crude oil was discovered in Nigeria.

[1] The downstream sector comprises of the activities which take place from the loading of crude petroleum at the terminal, to the use of oil by the end users and includes transportation, supply, refining, processing, storage, distribution and marketing of petroleum products. See Part X of the Petroleum Industry Bill, Draft Bill, 2008

[2] www.bp.com/.../bp.../statistical_energy_review_2011/../statistical_review_of_world_energy_full_report_2011.pdf - Similar last assessed January 29, 2011.

However, due to inefficient administration, mismanagement, corruption, abuse of natural monopoly powers, smuggling, bureaucratic bottlenecks and excessive subsidization, the downstream oil and gas sector that is saddled with the regulation and supervision of the refining of crude oil in the country is at the edge of collapsing.

Background

As an economic concept, deregulation postulates *"the removal of government control in a sector of the economy, thereby allowing for a free and efficient marketplace, resulting from the factors of demand and supply to control price"*. *"It is also the removal of price control regulations that distort the free operation of the market and discourage private sector investors from investing in the sector"*[3]. In the instant case, it is the recent attempt at the removal of the direct regulation of the price of Premium Motor Spirit (PMS or "petrol") by the Federal Government of Nigeria.

While over the years, many Nigerians have opposed the implementation of the deregulation policy in the oil and gas industry, international finance institutions and donor agencies like the World Bank and International Monetary Fund (IMF) have been very harsh in their criticisms of successive governments that have sustained the policy for a single inherent flaw they condemn as inimical to the growth of the Nigerian economy – subsidy[4].

In 2008 alone, the payments for subsidy by the Nigerian government in order to maintain a uniform price regime in the sale of petrol and kerosene throughout the country was put at over ₦630 Billion – an amount equivalent to about 50% of the capital budget of the Federal Government[5] in the same period. In 2009, the Government was said to have spent $4 Billion on fuel subsidy, which equaled 60% of total government capital expenditure[6]. As at the last quarter of 2011, the government announced that it had spent over ₦1.4 Trilion on fuel subsidy. Also, the Petroleum Products Pricing Regulatory Agency (PPPRA)[7] earlier last year stated that the government had spent over ₦3.5 Trillion on fuel subsidies in the last five years[8].

On January 1, 2012, President Goodluck Jonathan took the bold step of deregulating the downstream sector, resulting in the sudden increase of the pump price for petrol from ₦65.00 to ₦141.00, an increase of about 115%, thus removing the subsidy

[3] Investwords.com: "Meaning of Deregulation". Online dictionary at http://www.investorwords.com/1420/deregulation.html

[4] Louis Iba: "Fuel Subsidy removal: the pains vs the gains" at http://odili.net/news/source/2012/jan/3/503.html

[5] Ibid

[6] Nwakego, J: "Why Nigeria needs to deregulate its downstream oil sector". Online news reported on December 29, 2010 at http://www.iq4news.com/nwakego/why-nigeria-needs-deregulate-her-downstream-oil-sector

[7] The PPPRA determines the pricing policy and regulates the supply and distribution of petroleum products in Nigeria

[8] Oluwatosin. O.O: "Major Causes and Effects of Engineering Change Orders on Nigerian Petroleum Industry Projects". Online report at http://web.sbe.hw.ac.uk/currentstudents/dissertations/files/2010/L-O/Obideyi%20O/Obideyi_Oluwatosin%20Final_MSc_Dissertation.pdf

on petrol. The PPPRA stated that, "by the removal of subsidy on petrol, the downstream sector of the petroleum industry is deregulated for petrol"[9].

As it is with such economic reforms globally[10], a cross section of Nigerians reacted to the sudden change with agitations and several protests were undertaken by the Labour Unions and Civil Society in various parts of the country. This resulted in a national broadcast on January 16, 2012 wherein President Goodluck Jonathan reduced the price of petrol from ₦141.00 to ₦97.00 – pointing to the operation of partial deregulation.

In view of the foregoing analyses, this newsletter examines the deregulation of the downstream sector under the Petroleum Industry Bill, its merits and demerits as well as optional modes of deregulating the oil and gas sector.

The Downstream Oil and Gas Sector under the Present Regime

Nigeria's downstream oil sub-sector presently has four refineries with an approximate production capacity of 445,000 barrels per day[11]. However, these refineries operate at just 30% of their full capacity and as such; there is always a shortage of refined products, with imports typically used to offset domestic demand. Nigeria has a robust petrochemicals industry based on its substantial refining capacity and natural gas resources. The petrochemical industry is focused around the three production centres of Kaduna, Warri and Eleme, Port-Harcourt[12].

In Nigeria, while the petroleum industry is regulated by the Ministry of Petroleum Resources ("MPR"), another government agency known as the Directorate of Petroleum Resources ("DPR"), is vested with the responsibility of regulating and supervising all operations carried out under licenses and leases in the oil and gas sector. This includes exploration, production as well as marketing of crude and refined products. Another relevant player in this sector is the 100% Federal Government-owned Nigerian National Petroleum Corporation (NNPC), vested with exclusive responsibility for upstream and downstream development, to wit; exploiting, refining and marketing of Nigeria's crude oil. NNPC acts as a monopolistic corporation with full control over the operations of private investors in the sector and also supervises/manages government investments in the industry[13]. The sector operates under a price fixing regime, uniform pricing, as well as bridging reimbursements.

The Deregulation of the Downstream Oil and Gas Sector under the Petroleum Industry Bill

The Petroleum Industry Bill ("PIB" or the "Bill") is based on the report of the Oil and Gas Reform Implementation Committee ("OGIC") set up by the Federal Government in the year 2000 to carry out a

[9] Lousi Iba, Ibid
[10] Okafor, Loretta: Deregulation of the Nigerian Downstream Sector: Keeping Faith with a Global Trend. Article of the Petroleum and Product Pricing Regulatory Agency (PPPRA) at http://www.pppra-nigeria.org/articledetails.asp?ArticleID=16
[11] Nigeria Business Exchange: "Overview of the Nigerian Oil and Gas Sector". Online report at http://www.ngex.com/business/public/newsinfo.php?nid=9
[12] Ibid
[13] Ibid

comprehensive reform of the oil and gas industry. It provides the new legal framework for the organization and operation of the entire oil and gas industry in Nigeria. It is expected that once the PIB is passed into law, about 16 other legislations will be repealed.

One of the key features of the PIB is the deregulation of the downstream sector of the oil and gas industry. The operation of a free market price system in a deregulated downstream sector is not entirely new to Nigeria. On the discovery of commercial quantity of oil and gas in Nigeria in 1956, the country operated a free market price system up until about 1973. Also in 1997, after General Sani Abacha, then Head of State, joined the World Trade Organization, the sector underwent some form of deregulation though not completely successful.

The PIB provides for the Nigerian Petroleum Inspectorate ("NPI") which shall grant licenses for the design, procurement, construction and operation of all facilities including refineries, process plants and petrochemical plants as the technical regulator[14] and the PPPRA as the commercial regulator of the downstream sector. S. 136 (1) of the PIB provides for the transformation of NNPC into an integrated oil and gas company to be known as the Nigerian National Petroleum Company Limited (the "National Oil Company") that is accountable and transparent. The PIB recommends the deregulation of the downstream industry, where refining and sales of fuel is carried out, to allow the market forces of demand and supply determine the prices of petroleum products.

[14] S. 289 of the Bill

S. 349 of the PIB provides for a National Transport Logistics Company ("NTLC") which will own products pipelines and depot systems formerly owned by the Petroleum Products Marketing Company ("PPMC") and gas pipelines formerly owned by the Nigerian Gas Company (NGC). The NTLC will be wholly owned by the Federal Government of Nigeria. The Bill further provides that the product pipelines and depot segments transferred to the NLTC will be divided into segments[15] which are then to be licensed out to facility management companies whilst the gas pipeline system will be licensed to a gas facility management company[16].

All licensed petroleum marketing and refining companies will be given access to the deregulated petroleum system on commercially viable terms under the PIB[17]. Open access will also be extended to all regulated jetties, loading facilities and storage depots operated by the facility companies and other licensed regional storage depot companies[18]. The Bill makes it mandatory for all licensed marketing and refining companies to share existing capacity in the said jetties, import terminals, loading facilities and storage depots based on their needs.[19] Where petroleum companies or refining companies fail to utilize the capacity, this will be forfeited and such capacity given to other parties willing and capable of utilizing same.

The Bill further provides that licensed petroleum companies will have equal access

[15] S.349 of the PIB
[16] S.350 of the PIB
[17] S.351 of the PIB
[18] S.351(2) of the PIB
[19] S.352(2) of the PIB

to jetties, loading facilities and storage depots owned by the refining companies and designated as regulated open access facilities[20]. According to the Bill, the NLTC and the regional storage depot will not be allowed to discriminate between customers or classes of customers regarding access, tariffs, prices, conditions or services except on ground defined as justifiable and identifiable by the PPPRA[21].

The above highlighted provisions would ensure competition in the downstream sector; thereby allowing players to participate at every segment of the value chain and removes entry barriers in the supply and distribution of petroleum products, thus laying the foundation for deregulating the downstream sector.

Merits of Deregulation

Some of the merits of deregulation are as follows:

- Dismantle the natural monopoly of the state owned enterprise by privatizing and deregulating price controls.

- Creation of competition in the downstream sector by encouraging more companies to get involved and eventually supplying the market at competitive pricing levels.

- Eradicate waste and corruption by reducing the cost government spends on subsidizing the sector which presently is as high $1.5 Billion annually, and can consequently use the resources freed up to attend to other competing socio-economic needs of the populace in the areas of power generation, transportation, education, health, etc.

- Boost in Foreign Direct Investment in the Nigerian economy.

- Private sector participation in refinery ownership, operation and management in Nigeria will be encouraged by the government to meet the shortfall in refined petroleum products which has been the major reason of government's reliance on importation.

- Deregulation will not only guarantee constant supply of petroleum products to Nigerians but will significantly nourish the economic growth of the country. It is estimated that the demand and consumption of petroleum grows at an annual rate of 12.8%, however, the country has seldom had a period of complete availability of petroleum products nationwide[22]. In the last 12 months the country's refineries have produced about a paltry 30% of its total capacity.

- Deregulation will allow the market forces of demand and supply to determine prices of petroleum products, thus enhancing competition in the Nigerian market. Consequently, competition will enable the marketers to operate

[20] S.352 of the PIB
[21] S.354 of the PIB

[22] Wikipedia: Petroleum industry in Nigeria; Downstream sector at http://en.wikipedia.org/wiki/Petroleum_industry_in_Nigeria#Downstream

more effectively and efficiently to the overall benefits of Nigerians[23].

Demerits of Deregulation

The demerits of deregulation are as follows:

- Over the years, the Nigerian economy over has been programmed to revolve around the supply of 'cheap' petroleum products. An average household in Nigeria depends on subsidized by-products of crude oil such as petrol and kerosene for domestic and commercial use. Thus, adjusting to a hike in petrol price will be difficult without a commensurate increase in wages.

- Transportation cost is estimated to go up and such increase will result in a spiral effect on other sectors – all other businesses in fact revolve around the transport sector.

- Inflation rate is set to rise which will result in hyper inflation as prices of goods and services are bound to skyrocket beyond the reach of many. Even the naira may not be spared as much money will be chasing fewer goods.

- There would be abuse of consumers by operators. Hoarding and arbitrary increase of prices were very prevalent even under a regime where government was the sole provider of the fuel, and was also paying them subsidies. In some states, a monopoly situation would definitely arise and in some other states there would be gang ups by operators to rip-off consumers. In order to curtail these anomalies, the regulatory institutions in the oil and gas sector would have to ensure the protection of the rights of consumers.

Modes of Deregulation

Towards transforming the Nigerian petroleum industry in tandem with global trends in deregulating and restructuring, the following modes of implementation could be advanced:

***Deregulation of the Supply Side*:**

With the inefficiencies prevalent within the state-owned petroleum agencies vested with the responsibility of refining, supplying and distributing refined products in Nigeria, the government could decide to maximize supply sources for refined products in the country[24]. In this regard, government's monopoly of refining, pipeline operations and primary distribution from state-owned storage facilities will be unbundled. Thus, private investors, both indigenous and foreign, would take over such state-owned facilities in their current state of dilapidation, disrepair and poor performance and operate same efficiently with future profit margins attainable.

Under this mode, private refinery operators will procure crude oil at competitive rates and also sell refined products at competitive

[23] Ibanga., I, "*The Economics of Privatizing and Deregulating the Nigerian Downstream Oil Sector*"available at http://www.florin.com/valore/ifiokibanga.html .

[24] Kombo M.B: Modes of Deregulation in the Downstream Sector of the Nigerian Petroleum Industry.

rates in line with international prices as determined by the refinery operators. Private importers will also procure the excess refined products and sell same at deregulated prices in line with prevailing market prices. All barriers to new entrants into private refining, pipelines and various facility operations will be eliminated. With the promotion and implementation of anti-monopoly policies under such deregulated scheme, and the existence of competition among private refiners, the demand for petroleum products would be met and sustained. This will invariably lead to reduction in prices of petroleum products in a competitive environment[25].

Partial Deregulation of Demand Side:

Under this model, the Federal Government will restructure the existing refineries, pipelines and other state-owned facilities to enable them compete with private refineries built and managed by private investors. Government's monopoly, control and coordination of the importation of petroleum products will be eliminated by law. All price fixing, uniform pricing and bridging subsidies by the Government will also be eliminated. Barriers to new entrants into wholesale or retail marketing of petroleum products will also be eliminated[26].

The emergence of post-deregulation private refineries in Nigeria will be dependent on the policies in place by the Federal government with respect to price of crude oil allowed to both private and state-owned refining entities. With the current disparity between the open market price of crude oil and that conceded to the state-owned refineries, this will be a disincentive to private investors in the refining sector. As such the creation of a competitive playing environment for all parties needs be encouraged.

***Complete Deregulation of the Downstream Sector*:**

In this case, with the gross inadequacies inherent in the sector, government will be required to restructure all state-owned refineries, pipelines and other facilities prior to their unbundling and final acquisition by private investors. With the government's desire to maximize supply sources for refined products market in the country, as well as promote the storage of reserves, NNPC will need to be unbundled and run as a profit making competitive entity. All NNPC joint venture contracts with international oil companies operating in Nigeria will be replaced with Production Sharing Contracts. The role of DPR will also be redefined to enhance its capacity to effectively monitor and enforce compliance as an independent agency of the Federal Government.

The government will establish an independent downstream policy formation and enforcement agency with the sole responsibility of monitoring the sector, post-deregulation. Private investors may import refined products and sell same at competitive prices. All barriers as obtainable presently to new entrants will be eliminated, including legal impediments, overbearing procedures for granting private refining licenses and other potential investors in the downstream sector. All state-owned facilities such as pipelines, jetties, storage facilities must be availed to private operators at non-discriminatory tariff rates

[25] Ibid
[26] Ibid

under Third-Party-Access provisions. Also, all price fixing and control mechanisms will be eliminated.

***A hybrid of a combination of various competitive initiatives*:**

Another option could be a hybrid of the models discussed above, with benchmarks geared towards the international petroleum market. The removal of all legal impediments and bureaucratic procedures that inhibit meaningful participation of private investors in the petroleum industry must be dismantled and abolished by requisite laws. Access to state-owned facilities under non-discriminatory terms must be promoted and implemented. The functions of policy formation and regulation enforcement covering technical and economic components of the industry must be separated and assigned to different and independent agencies.

Comparative analysis of Deregulation in other sectors

Over the past years, deregulation has been introduced in other sectors of the Nigerian economy, with climaxing successes recorded. Some of these sectors include communications, banking and aviation.

Telecommunication sector

Until 2001 when the Nigerian telecommunications sector was deregulated, the sole telecommunications provider was the Nigerian Telecommunications Limited ("NITEL") and it was fully owned by the Federal Government. The NITEL regime, especially the last days, witnessed inefficiencies, low telephone access, high tariffs and notoriously poor services. Upon deregulation of the sector, private investors, domestic and foreign, introduced what was operational globally; the Global System for Mobile Communication (GSM) services. This resulted in high competition amongst service providers who initially charged high rates for both Subscriber Identity Module cards and related services. However, with full competition introduced to the sector via deregulation, call costs has manifestly reduced with all service providers competing via various promotional initiatives including further price reduction, per second charges and billing, improved service coverage, increased telephone access amongst others.

Banking sector

The Nigerian banking sector was in a critical state before its deregulation. There were numerous banks with operational licenses which however lacked a solid base required for such strategic institution. Deregulation resulted in the emergence of stronger local banks offering variety of services. The change further witnessed the presence of several African and international banks from the United Kingdom, United States and the Middle East expanding their horizon to provide novel services in tune with global trends in Nigeria via mergers and acquisitions. The sector is yet clamouring for further changes as a result of the stiff competition between the few players.

Aviation sector

Prior to the deregulation of the aviation industry, Nigerian Airways, a state-owned entity was the sole operator within the sector. Fraught with inept service delivery including flight delays, cancellation, poor route network and high fares, the industry was moribund. Post-deregulation, the sector has witnessed an incredible transformation with increased number of airlines, routes, gross reduction in fares, online booking and check-in services, with appreciable competitive initiatives for patronage.

In all the sectors above, the introduction of deregulation have been successful with the presence of greater competition, reduction in prices, increase in quality and efficiency of services. The Nigerian oil and gas sector can benefit in this regard where deregulation is achieved and properly implemented.

Conclusion

The economic benefits associated with deregulating the downstream sector cannot be overemphasized. One of the spin-offs from an unsubsidized downstream sector is huge savings from subsidy payments and pundits have advised that the funds would be divested into developing other sectors of the country; especially in the area of infrastructure and employment.

Significantly, according to HSBC's global research department on the fall of world economies in the next 40 years, Nigeria is positioned to rise up the global economic ladder from its present 48th position to 37th in 2050 with reference to the projected gains of deregulating the downstream sector[27].

It is no longer news that NNPC cannot meet domestic demand for petroleum products from our refineries. Even at full production capacity, the refineries fall short of national demand thus creating a gap for exports. The available options to solve this problem are either structural expansion of our refineries; construction of additional refineries or both. However, the investment required for these cannot be provided except under a deregulated regime.

Like Brazil, Argentina and Venezuela, it is time for Nigeria to deregulate the downstream sector of the oil and gas industry so as to enable Nigerians harness the full benefits of deregulation. The onus therefore lies with the National Assembly to pass the PIB into law in order to provide a legal framework for deregulation. Furthermore, the Federal Government must work in concert with the relevant regulatory agencies and private sector to ensure a proper implementation of a deregulated downstream sector for Nigeria to achieve the projected economic growth and development.

[27] Kevin, Voigt: World's top economies in 2050 will be… reported by CNN on January 12, 2012 at http://business.blogs.cnn.com/2012/01/12/worlds-top-economies-in-2050-will-be/?iref=obinsite

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