PRICE CONTROL IN THE NIGERIAN PETROLEUM SECTOR AND MACROECONOMIC STABILITY

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Abstract

This paper examined the policy of fixing the prices of petroleum products by the governments since 5980 to date. It was discovered that price control had become a periodic ritual in Nigeria that had never achieved the objectives purportedly given by the government for employing that policy. Instead price control in this sector had led to consistent macroeconomic instability leading to rising inflation rates, rising balance of payments deficits and in turn external debts, rising labour unrest and loss of several man-hours, among others. The paper showed that these instabilities could not be avoided given the prediction of simple prices theory, as well as the fact of the predominance of the petroleum sector in the Nigerian economy. The insincerity of government in following such a policy was pointed out as being unfortunate. The paper therefore concluded that price control in petroleum sector, and indeed in any sector could not work, and in fact had never worked anywhere. Accordingly, it was suggested that Government forthwith should disengage from using price control. Instead the private sector should be allowed to import the finished products and establish their own refineries and sell at market-determined prices side by side the NNPC's products, just as is now happening in the telecommunication sector. This, it was maintained should deregulate the market while infusing efficiency in the NNPC or lead to its liquidation in the downstream petroleum sector.

Introduction

The Petroleum Sector of the Nigerian economy had since the early 1970s been playing a predominant role as a source of government revenue, and foreign exchange earner, such that every sneeze in this sector makes the economy to catch cold. A glance at the following tables buttresses these points.

Table 1; Nigerian's Revenue from Crude Petroleum 1970-2000 (Nm)

Year	Oil Revenue	Total Revenue	Oil Revenue as % of Table Revenue
1970	166.6	634.0	26.28
1975	4271.5	5514.6	77.46
1980	12353.8	15234.0	81.09
185	10923.7	14689.1	74.37
1990	71887.1	85249.3	84.33
1991	826664	1000991.6	8.1.86
1992	164078.1	190453.2	86.15
1993	163102.4	192.769.4	84.09
1994	160192.4	201910.8	79.34
1994	160192.4	201910.8	79.34
1995	2779902.3	459987.3	60.85
1997	4168IL1	582811.1	71.52
1998	324311.2	463608.8	96.95
1999	724422.5	949187.9	76.32
2000	159167.8	1906159.7	83.50

Source: CBN, Annual Report and Statement of Accounts, various years.

A close look at Table 1 above readily shows that on the average, the petroleum sector accounted for above 80% of overall government revenue.

Furthermore, the petroleum sector has remained the major foreign exchange earner for the Nigerian economy since the early 1970s (Anyanwu; Oyefusi; Oaikhenan; Dimowo, 1997:60).

Table 2: Crude Petroleum' Contribution to Nigeria's Gross Domestic Product at 1984 Factor Cost

(1970-1995)

Year	Annual Total GDP (Kb)	Crude Petroleum GDP (Nb)	Crude Petroleum GDP Growth Rate	% of Crude Petroleum
1970-74	58.2	10.1268	3.2	17.4
1975-79	73.7	17.9091	7.2	24.3
1980	73.7	16.104	-21	22.0
1985	68.92	10.38	0.8	15.06
1990	90.34	11.65	12.2	12.90
1991	94.64	12.72	9.2	13.44
1992	97.44	13.06	2.7	13.41
1993	100.63	13.09	0.2	13.09
1994	104.04	12.75	-2.6	12.62
1995	103.30	12.851	0.8	12.44

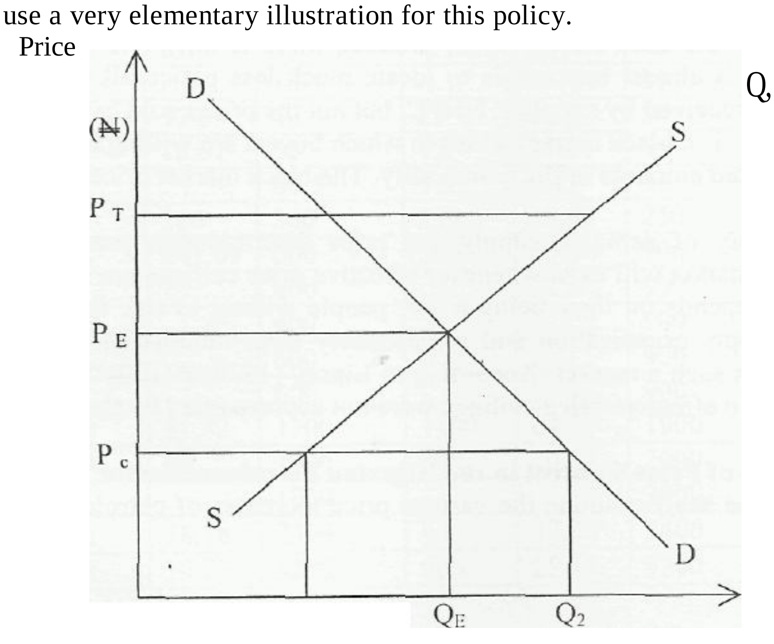
Source: Central Bank of Nigeria Annual Reports and Statement of Accounts, Various Years.

It is instructive that the petroleum sector accounted for only about 12% of the overall GDP. By implication, the Nigerian economy had continued to depend precariously on this wasting and non-replenishable asset.

The purpose of the introductory section of this paper is to highlight the overwhelming predominance of this sector in the Nigerian economy, and therefore the unavoidable macroeconomic instability attendant on ill informed and ill-conceived petroleum related policies.

The Concept of Price Control and Its Implications

Since the dawn of history, governments have passed laws regulating the prices at which certain commodities have been sold. There are theoretically two positions -Maximum price and Minimum price legislations. Maximum price legislation is concerned with setting maximum permissible prices above which no seller could sell. These prices are often called price ceilings. Government's intentions for theses price ceilings include inter alia, to hold down prices of certain commodities considered essential, in order to protect the consumers, or more generally to hold down inflation rates. Whatever the motivation for the policy, the theory of demand, supply and price determination makes some very clear and general predictions about the consequences of price control or price fixing. Let us use a very elementary illustration for this policy.



Quantity (Kg) Fig. 1:

Policy Implications of A Maximum Price Legislation.

In Fig. 1 there are three possibilities. First, without government interference the forces of demand and supply at Q_e. This is the popularly called Equilibrium Price and the Equilibrium Quantity. At this price the market is completely cleared. There are neither surpluses nor shortages.

However, if the government fixed the price of this commodity above the equilibrium price, say at P_t, there will be excess supply. Our concern is with the price fixed at P_c, called the price ceiling. At this price the quantity demanded exceeds the quantity supplied by Q, Q_2 or Q_2-Qi focusing more closely on the implications, let us examine some salient points.

i. Effects on Quantities Demanded and Supplied

From the diagram above we note that the quantity supplied falls from its equilibrium position of Q_E to Q, while the quantity demanded rises from Q_E to Q_2. Hence there arises an Excess Demand.

Since sellers cannot get enough supply of the product there must develop a form of rationing as is done with petroleum products by the Nigerian National Petroleum Corporation (NNPC). We all see and read the daily allocation of this products to the various states in Nigeria.

When the retailers of the particular commodities are compelled to sell to the first customers who arrive, then long queues necessarily develop as obtains in our filling stations, and allocation will be on the basis of luck.

ii. The Problem of Black Market

Under certain circumstances, price control with or without rationing is likely to give rise to a Black Market, that is, a market in which commodities are sold illegally at prices above the legally prescribed ones. This happens readily because there are usually many retailers with few manufacturers. In the case of petroleum product, there is only one manufacturer or importer, the NNPC. Hence it is almost impossible to locate much less police all the retailers. Government can control the price received by supplier, NNPC, but not the prices sold by thousands of retailers.

From Fig. 1: a black market arises in which buyers are willing to pay more than the controlled price for the limited amounts of the commodity. The black market price fetches far more profit for the retailers.

Our theory of demand, supply and price determination predicts that the potential for a profitable black market will exist whenever effective price ceilings are imposed. The actual growth of such a market depends on their being a few people willing to risk the heavy penalties by running black-market supply organization and a reasonably large number of persons prepared to purchase goods illegally on such a market. According to Lipsey (1979, P. 120) "...there has never been a case documented where effective price ceilings were not accompanied by the growth of a black market".

Table 3: History of Price Control in the Nigerian Petroleum Sector

In this, we shall examine the various price increases of petroleum products in Nigeria since 1980.

Table 3: Increases in Petroleum Product Prices 1980-2003

	Premium Motor Spirit (Petrol)			Dual Purpose Kerosene (DKP)			Automatic Gas Oil Diesel (AGO)		
Year	Price	Change in Price	% Change in Price	Price	Change in Price	% Change in Price	Price	Change in Price	% Change in Price
1980	15.30k			10.50			11.00		
1981	15.30			10.50			11.00		
1982	20.00	4.7k		30.50			11.00		
1983	20.00			10.50			11.00		
1984	20.00			10.50			11.00		
1985	20.00			10.50			11.00		
1986	39.5k	19k		10.50			12.5k	1.5	
1987	39.5			10.50			29.5	17	57.63
1988	42k	2.5	6.33	15	4.5	30	35	5.5	15.71
1989	42			15			35		

1990	60	9	37.65	40	25	62.5	50	15	42.29
S991	70	10	16.67	55	15	27.27	55	5	9.09
1992	70			60.5	5.5	9.17	55		
1993	322	252	360	300	239.5	79.83	250	195	78
1994	1100	778	241.61	600	300	50	900	650	72.22
1995	1100			600			900		
1996	1100			600			900		
1997	1100			600			900		
1998	1100			600			900		
1999	2000	900	81.82	1700	1100	64.7	1900	1000	52.63
2000	2200	200	10 .	1900	200	10.53	2000	100	5
2001	2200			1900			2000		
2002	2600	400	18.18	2300	400	17.39	2400	400	16.67
2003	3400 •	800	30.77	3200	900	28.13	3200	800	25

Sources

1. CBN Annual Reports and Statements of Accounts.
2. NNPC Statistica Annual Reports in (1997-2002).
3. Anyanwu, J.C.; Oyefusi, A.; Oaikhenan, H.; Dimowo, F.A. (1997). The Structure of Nigeria Economy (1960-97). Onitsha.
4. The Guardian Newspaper, Mon, Oct. 12 1998 P. 41.
5. Sunday Vanguard, Aug. 3 2003 P. 40-41.

From Table 3 certain salient facts can be deduced:

(a) Increase in the prices of petroleum products became a major policy thrust of the government from 1986. Furthermore between 1989 and 1994, there were six separate price increases at an average percentage increases per year of 447.5% for petrol, 935.7% for kerosene and 1183.3% for diesel. This was the era of the Structural Adjustment Programme (SAP).
For four years, 1995-1998 there was no adjustments in the prices of petroleum products until Mr. Obasanjo became president in 1999. Between May 29, !999 when he was sworn in as president and about six weeks ago. he had increased the pump price of petroleum products four times culminating to the current price of 1434.00 for petrol, 1432.00 tor kerosene and **N32.00 for diesel.**

Reasons for Price Increases

Several reasons had been proffered by the government to justify these price increases. Prominent Among these are:

i. To reduce the incidence of smuggling of the products across the borders by removing "excess" profits.
ii. To reduce local consumption of the products and accordingly enhance exports.
iii. To raise the level of revenue accruing to the government thereby enabling the government provide more infrastructure facilities like roads, electricity etc.
iv. To instill efficiency in the transport system by de-emphasizing private transportation while encouraging mass transit.
v. To remove corruption in the handling of petroleum products domestically, vi. To finance the repair and maintenance of the refineries thereby enhancing domestic production.
vii. To remove the subsidies on petroleum products.
viii. To deregulate the downstream sector of the petroleum market thereby bringing in the private sector both in the production and distribution of the products.

According to Alabi Williams (Sunday Guardian Feb. 25, 2001 P. 16), "by deregulating the importation, the government aims at bringing in the private sector while prices of products should be based on import parity adjusted as follows;

i. The difference in the current pump price and import parity should be narrowed through the intervention of the petroleum products and prices regulatory committee (to be established), ii. The price should subsequently and on quarterly basis be reviewed until a stable price based on export parity which will trigger the participation of all interested parties in the importation is achieved. At this point, according to him, total deregulation should have been achieved and subsequent market volatility will be self-adjusting or equilibrating.

Adjustments in Petroleum Product Prices and Macroeconomic Stability

Among any nation's many socioeconomic goals are those relating to the performance of the economy. There are therefore prominent economic goals universally accepted by every nation. These include: Attainment of full employment; achievement of price stability or the avoidance of harmful inflation; attainment of balance of payment equilibrium in the external sector; attainment of optimum rate of economic.growth.

The Nigerian economy had been caught up in a web of macroeconomic instability occasioned by rising inflation rates, rising unemployment rates, continuous depreciation of the naira, rising balance of payment deficits leading to rising external debts.

While it is not being claimed that changes in petroleum product prices alone were responsible for these instability, yet the relationship between petroleum product prices and every other price in economy is unquestionably very significant. For instance the relationship between petroleum product price and cost of production, the price of consumer goods, and demand for higher are well known. This is popularly called spiral inflation.

According to Oshiomhole (Sunday, Vanguard, Aug3, 2003 P. 40-41).

i. Independent marketers cannot bring about competitive pricing because the market is a monopolistic one with the NNPC as the sole supplier.

ii. Using the international export price parity is inherently destabilizing owing to its volatility, iii. The use of exchange rate of the naira is also inherent volatile introducing further instability in the economy.

Hence Oshiomhole concluded that since the Government cannot guarantee:

i. International price stability for crude oil.

ii. Exchange rate stability for the naira.

iii. The functioning of the nation's refineries.

iv. Sufficient supply of petroleum products to match demand, attempt at price fixing shall only end up introducing instability in the economy.

However, Oshiomhole seemed to stop at fighting price fixing for the identified adverse consequences. He has inadvertently supported price fixing, but was only concerned for what should be "appropriate". Our position goes beyond Oshiomhole''s arguments, and maintains that the idea of price fixing in the sector must always end up introducing instability. This conclusion was arrived at from our analysis of the implications of price control under section two.

Recommendations and Conclusion

As demonstrated in Table 3, the fixing of prices of petroleum products by the government had persisted since 1986, with which each fix attracting a measure of instability in the economy. Of particular importance is the destabilizing effects of inflation, unemployment, labour unrest, depreciation of the naira exchange rates, rising external debts, among others.

These consequences are unavoidable, granting the predominance of petroleum in the Nigerian economy. So the overriding question becomes this -why should the government persist in a policy that obviously had never achieved macroeconomic stability necessary for growth and development. It is the view of this paper that government's true objective for price fixing is hidden. This certainly has to do with short-term goal of generating revenue to maintain itself. So price fixing, in the final analysis benefits the politicians in power, not the economy. The government is now caught in a vicious circle as Oshiomhole put it, "price fixing has become a periodical ritual for the government".

This paper hereby makes the following recommendations:

1. Government should forthwith disengage from the policy of fixing prices for petroleum products since this can never work and had not worked anywhere. Alternatively Government attention should be focused on repairing the nation's four refineries and'making them function optimally.
2. The private sector should be allowed to import petroleum products and sell at market-determined prices, side by side with government's supplied products just as we have it in the telecommunications sector. It is only a question of time for the forces of demand and supply to establish market-determined prices for this product.
3. Furthermore, the private sector should be allowed to establish their own refineries and sell at market-determined prices. We wish to state categorically that the government efforts to attract the private sector into the petroleum market can never work by price fixing.

Although these suggestions may appear too harsh, yet in the long run they will free the economy from the excruciating pains of controls, corruption and mismanagement. At the end of the day, the government owned refineries should have entered a competitive market, and if unable to perform shall become liquidated while consumers already have alternative suppliers of the product.

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