OTL DOWNSTREAM AFRICA 2009

Keynote Address

BY

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Protocol

Introduction

I am truly honored to have been invited to give the keynote address at the 2009 OTL Africa conference. I would like to begin by thanking the organizers of this event for beaming the searchlight on the downstream sector in Africa. As we know, given the size of Africa, the downstream sector is a far cry from where it should be. In particular, for us in Nigeria, we have grappled with solving the issues around the downstream sector for decades. It is therefore with great expectation that I look forward to your deliberations at this forum.

Downstream in Africa

Refining in Africa has a chequered history. In fact, prior to 1954, there were no refineries in Africa. Trading companies would bring in imported products from their refineries abroad and distribute to regional markets. However, between 1954 and today, some progress has been made with the construction of about 50 refineries (the largest being the 300,000bpd Sonatrach Skiilda Refinery built in 1983 and expanded in 1993) with a total refining capacity of just over 3 million barrels a day. More than half of these refineries are owned by Governments or agencies of Government while the rest are owned by private companies with the trio of Shell, Total and ExxonMobil being very prominent.

In spite of this growth in refining capacity, however, refining markets in Africa still remain largely underdeveloped, unconnected and governed by multiple frameworks that range from fully deregulated markets to highly regulated ones, from market-based pricing to highly subsidized ones. This structure has ensured that the markets remain relatively inefficient. The long-term challenge for us – and I am happy that OTL Africa is doing its bit to facilitate this – is how we can collectively build an integrated market with similar policies that will enable the efficient flow of goods and services in the downstream sector across the continent.

Early History of the Downstream Sector

As in other African countries, downstream activity in Nigeria started on a modest scale in 1905 when Mobil (then Socony) came into Nigeria to market kerosene. At that time the market was unregulated with no restrictions on where, how and at what price products should sell. The company remained the dominant player in the sector until the early 1950s when other marketers came on the scene. Following the discovery of crude oil in the late 50s and the expanding demand for refined products, establishment of a refinery in Nigeria became commercially viable. This led to the establishment of a 50/50 joint venture refining company, the Nigerian Petroleum Refining Company (NPRC), by Shell and British Petroleum in 1960. At that time, product distribution was mainly through road tankers and railways as product distribution through pipeline was non-existent.

The NPRC built a 38,000b/d petroleum refinery at Elesa-Eleme, near Port Harcourt to refine local crude oil into five petroleum fuel products. Construction of the refinery commenced in 1963 and production started two years later, in 1965. Crude oil processed in the NPRC refinery was a portion of the production destined for export through Shell-BP's Bonny Island export terminal. By a special contract agreement among all the five major products marketing companies, they procured crude oil from Shell-BP. The crude oil was transported by pipeline to the NPRC Refinery for processing based on the quantity processed, at an agreed unit price per ton of crude oil. The major marketers also, at their own cost, arranged the timely evacuation of the products from the refinery, mostly by the sea to Lagos and the remaining by road tankers.

The refinery was de-bottlenecked in 1973, in order to increase its crude oil processing capacity from 38,000b/d to 60,000b/d. The domestic demand for petroleum products which steadily increased was satisfied by the NPRC refinery for some time. Just prior to this, in 1970, the Federal Government acting as a member of OPEC compulsorily acquired and paid for an equity share of 60 percent in all private international companies (including NPRC) working in the Upstream and Downstream sectors of the Petroleum Industry in the country.

The rapid expansion of economic activities in the 70s (end of the Civil War and the oil boom) led to a significant increase in demand for petroleum products. The shortfall in supply resulted in severe shortages all over the country. To solve the shortage problem and ease the suffering of the consumers, the Government significantly increased its stake in the sector by taking over the Port Harcourt refinery in 1978 and building two new refineries in Warri (1980) and Kaduna (1989) respectively. This resulted in a phenomenal 600% increase in refining capacity from 60,000 to about 445,000 b/d within a decade. With this dramatic expansion, the country was not only able to meet its domestic petroleum products requirements but also had quantities left over for export.

Along with the building of the refineries, the Nigerian Government also embarked on the construction of a gigantic pipeline network distribution system (about 5,000km) as well as depots in strategic locations across the country. The massive supply and distribution network put in place by Government enabled the country to meet products supply at a uniform price hence introducing the concept of uniform pricing across the country. This era marked the advent and entrenchment of regulation and state control of Nigeria's petroleum products, supply and distribution.

Outcome of the Government Entry into the Sector

Ladies and Gentlemen, this essentially captures the events that brought us to a market with two key characteristics: regulated prices and uniform prices across the country. As we have seen, these two characteristics have had a profound impact on the downstream industry. Even though the foregoing interventions were clearly required at the time they were made, the benefits were not sustainable over the long term. In fact, price regulation and the Governments' involvement in the management and ownership of the refineries and downstream infrastructure gave rise to the following:

- A crowding out of the private sector
- Severe under funding for existing infrastructure
- Poor maintenance of refineries and
- Low innovation

These, in turn, led to shortfalls in supply and a widening gap between market driven and official prices of petroleum products thereby fostering corruption, rent-seeking behavior and other forms of sharp practices.

In trying to cure the wide gap between market and official prices of refined products, the Government has had to resort to fairly sharp increases in prices from time to time. Unfortunately, in a period of rising crude oil prices, the price gap shows up again almost as soon as it is closed forcing the Government to either raise prices again or bear an ever increasing subsidy burden. In 2008 alone, for instance, the amount spent on subsidies of refined products amounted to over N600 billion!

In addition to the huge subsidy burden and the resultant opportunity cost, the lack of investment and growth has prevented the sector from playing its role as an engine of economic development. Given the country's abundant oil and gas reserves, Nigeria could easily have been a downstream hub for the continent. Unfortunately, this is far from the case as Nigeria now imports large proportion of her refined products for domestic consumption. Where products derived from refined petroleum products could have formed the basis for new industries and large scale employment, our refineries, when they run, have remained producers of rudimentary products.

In summary, the industry today is characterized by the following:

(i) **Government Monopoly and Dominance**: The government (through NNPC) has a reduced, but still dominant role in importation, marketing and distribution of petroleum products. Storage facilities, product pipelines and other downstream logistic facilities which are mainly state owned are in various stages of despair. However, there have been significant private sector investments in infrastructure facilities in the last few years largely as a result of the partial opening-up of the sector through the policy of liberalisation.

(ii) **Price Subsidy:** Product prices are still largely subsidized resulting in large payments to oil marketing companies every year. Although the subsidy regime ensured that Nigerians were immune from the impact of spiraling oil prices, it has also encouraged sharp practices and discouraged investments in refining.

(iii) **Supply and Demand Gap**: Due to the poor state of the state-owned refineries and the dearth of investment in new refining capacity, Nigeria's dependence on imported petroleum products has grown to embarrassing proportions. Nigeria remains, perhaps the only OPEC country which still imports most of its domestic refined products!

(iv) Mismanagement of existing refineries and dearth of investments in refineries by private sector have combined to place the nation in this state of dependence.

(v) **Outdated Port and Vessel Reception Facilities**: The existing Nigerian ports can no longer support the quantum of products imported due to inadequate receiving facilities. This has given rise to lightering expenses, high demurrage and several security violations by vessels. This has also been responsible for disruption in product supply and increased distribution costs.

What Next?

Ladies and Gentlemen, I believe it is clear that the current state of the industry cannot continue. We believe that a functioning industry should result in the following:

- Self-sufficiency in refining
- Regular and uninterrupted domestic supply of petroleum products at reasonable prices
- Creation of a favorable investment climate for local and foreign capital in a manner that would ensure optimization of our downstream potential.
- A self financing and self sustaining downstream sector.
- A downstream sector that guarantees return on investment and reasonable returns to investors.

We believe that these aspirations can be realized through the twin-process of deregulation & liberalization of the downstream petroleum sub-sector. Two strategies are currently being pursued in this regard: completing the deregulation process in the short term and implementing the recommendations of the OGIC Reforms in the medium-long term.

You will recall, ladies and gentlemen, that the deregulation process began in 2003 with the setting up of the PPPRA to midwife the programme. Some success was achieved as can be seen in the growing contribution of the private sector to the industry. Significant amounts have been injected into the sector through the construction of downstream reception, storage, distribution and marketing facilities. However, no significant investment has been made in the production side in spite of the various incentives offered by the Government although it is true that work is still ongoing on several private refineries.

One of the areas that require improvement is product pricing. The PPPRA had been charged with fixing prices based on an agreed process. However, this has not worked as well as hoped as disputes have arisen between marketers and PPPRA on one hand and PPPRA and the Nigerian public on the other on what the “correct” price should be. As you are all aware, the Federal Government of Nigeria has decided to fully deregulate pricing not only to eliminate the huge amounts of money being spent on subsidies but also to provide the environment for investments in the industry.

To go the route of a fully deregulated industry will require a strong legal and regulatory framework. It is in this regard that the full recommendations of the Oil and Gas Reforms Implementation Committee, which is now encoded in the Petroleum Industry Bill (PIB), will be implemented. The PIB makes provisions for a plethora of laws to guide the industry as well as two regulatory agencies, The National Midstream Regulatory Agency and the Petroleum Products Regulatory Agency to regulate the midstream and downstream sectors respectively.

In order to ensuren that post deregulation prices remain reasonable and affordable, Government has embarked on areas of initiatives to reduce the structural cost of production, storage, transportation and distribution of refined products.

In the area of production, Goverment is carrying out refurbishment of the refineries and the rehabilitation of the road network leading to the refineries. For the refineries to function efficiently after rehabilitation its important to build the right skill and competences within NNPC. Its for this reason that the Nigerian National Corporation has embarked on a transformaqtion program to provide the skill required within the refineries as well as the broadern NNPC.

In the area of storage and transportation, Gorvernment is embarking on completing repairs on damaged pipelines and also put the framework in place to ensure construction of facilities by private sector for example, Masters Energy has just completed the construction of a private facility in portharcourt. When fully operational we expect this to contribute significantly to availability of refined petroleum products in the South-South and South-East of the country.

In the area of distribution, there are plans by NNPC Retail to increase the number of their distribution outlets significantly.

Furthermore, Goverment is also actively encouraging the diversification away from the orthodox fuels, in this regard, CNG stations are expected to roll out in Benin before the end of this year, this will reduce dependence on PMS and diesel for automotive fuels.

As i speak to you a forum is ongoing in Abuja on encouraging the increase consumption of Liquefied Petroleum Gas (LPG).

LPG will serve multiple purposes: As cooking fuel, as substitute for PMS and diesel in automotive as well as industry and commercial sectors. These are all medium to long term plans.

It is worth to also note that Government is embarking on massive rehabilitation of roads, railways and the dredging of the River Niger.

All These intervention will ensure effective and efficient distribution of products to all parts of Nigeria.

Lessons Learned from Downstream Reforms

The process of deregulating and liberalizing the downstream sector has certainly been a challenging one and is likely to remain so. The partial opening-up of the sector and limited withdrawal of government's dominance was achieved with some amount of pain including nationwide strikes, labour-unrest and in some cases, upheavals that assumed threatening dimensions. The effort also exposed the acute dependence of the nation on petroleum products and its impact on other facets of the economy.

Some of the lessons learned by the Government in its efforts to reform the industry include the following:

- Need to carry along critical stakeholders like the Labour Unions (NLC) and other civil society organizations.
- Agreement with stakeholders on measures to cushion the impact of price subsidy removal. This could include interventions in the areas of mass transportation, road

network, provision of social amenities, and other programmes targeted at the low and middle income groups.

- Strong supervision and oversight of the market by a regulatory body is required to curb the real threat and potential for abuse by operators, mostly Marketers. This is to ensure that the consumer is not short changed, as experienced in the past.
- Reduction of structural costs through massive investments in sector infrastructure Government and stakeholders must ensure the upgrading of ports and storage facilities to ensure the maintenance of standard and reduce cost.
- Provision of alternatives to locally refined imported products such as Auto and cooking LPG, LNG, and other gas products and bio fuels which are cheaper and readily available.
- Intensified public enlightenment and education of Nigerians on deregulation and its benefits.
- The need to build essential structures that will ensure the success of the policy such as the open access common carrier regime cannot be over emphasized.

Conclusion

Ladies and Gentlemen, we believe that deregulation is still the best solution for the industry in spite of the short term pains it might bring to the people. We are convinced that the benefits far outweigh the disadvantages. These benefits include:

- Improved Product availability and capacity Utilisation
- Encouragement of private capital investment into the sector
- Competitiveness
- Employment opportunities
- Reasonable and sustainable returns on investment to all operators
- Elimination of subsidy resulting in increased social and infrastructural development.

I wish to again thank the organisers of the 'OTL African Downstream' Conference for organising this event and to encourage you to continue to seek ways to put the african downstream business on the global map.

God Bless You All

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