JEL Classification Numbers:
E65, F41, 055

Summary of
WP/94/115

"Macroeconomic Policies and Smuggling: An Analysis of Illegal Oil Trade in Nigeria" by Jian-Ye Wang

This paper examines the relations between macroeconomic policies and smuggling. The study is based on observations of unofficial cross-border trade in petroleum products between Nigeria and neighboring countries in West Africa. Such trade has long been noted to have adverse effects on price and output structures, exchange rates, and public finances in the region.

Available statistical evidence indicates that despite the periodic upward adjustment in the domestic sale prices of petroleum products and substantial trade liberalization in Nigeria under the country's Structural Adjustment Program, the main incentive for smuggling--the price differentials of petroleum products between Nigeria and its neighbors--rose in 1986-93. Oil smuggling from Nigeria to neighboring countries persisted or even grew over the period.

To explain this pattern, the paper develops a simple model focusing on the links among smuggling, public finances, and the Government's monetary, exchange rate, and oil pricing policies. The model shows that a vicious circle emerges. Inappropriate domestic oil pricing policy gives rise to implicit oil subsidies, which provide the incentive for smuggling. The smuggling worsens the Government's financial position, and monetary financing of the fiscal deficit accelerates domestic inflation and currency depreciation. The Government's attempt to fix the prices of petroleum products is tantamount to indexing the implicit oil subsidy to the exchange rate, which pushes up the cross-border oil price differentials. Smuggling then increases, exacerbating the fiscal imbalances. This process eventually forces the Government to abandon the previous oil prices. In the absence of a fundamental fiscal correction and reform of the oil pricing policy, the vicious circle continues. Macroeconomic indicators of Nigeria in 1986-93 support this analysis.

The model is also used to shed light on the impact of the devaluation of the CFA franc on cross-border oil trade. The paper concludes with policy implications for financial stabilization and adjustment in Nigeria.