

The Microeconomic and Macroeconomic Implications of Fuel Subsidy Removal in Nigeria

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ABSTRACT

This paper examines the microeconomic and macroeconomic implications of fuel subsidy removal in Nigeria 2023 while adopting a desk review method using discourse analysis methodology. The paper offers some insights into the implications of fuel subsidy, drawing from the interplay of economic, political, environmental, and societal factors necessitating a holistic approach. The removal of fuel subsidy in Nigeria has prompted a profound shift with far-reaching implications across economic, social, and environmental circles. Nigeria, as an oil-dependent economy has long relied on fuel subsidy to ensure affordable fuel prices for its citizens. However, in recent years, the country has faced numerous challenges including the rising rate of inflation, unemployment and increase in poverty rates. Based on these challenges, the decision to remove petroleum subsidy has had a significant impact on the economy. To achieve the objective highlighted in the paper, the background of the problem was discussed, review of related literature was undertaken, and possible recommendations were suggested towards mitigating the severe effect of fuel subsidy removal on the general living standard of the citizens and the economy.

Keywords: fuel, subsidy removal, economic implication, Nigeria, microeconomic, macroeconomic.

JEL classification: D00, E60, H20, H30, N77.

INTRODUCTION

Fuel subsidies are a form of government intervention to reduce the cost of fuel by providing direct financial support to oil companies, and as such, subsidize the product to consumers. Petroleum pricing is a significant issue in Nigeria, as the country heavily relies on oil for its economic stability. The government had implemented fuel subsidies to keep the price of fuel affordable for citizens, as well as to stimulate economic growth.

The Nigerian economy has been subsidized in various ways for many years and this includes fuel, education, electricity, forex etc. Fuel subsidies began in the 1970s and became institutionalized in President Obasanjo's regime in 1977, following the promulgation of the Price Control Act which made it illegal for some products (including fuel) to be sold above the regulated price.

There have been several attempts by previous governments to remove the fuel subsidy, for example, President Olusegun Obasanjo attempted to remove fuel subsidy in year 2000 but was marred by protest. Similarly, Goodluck Jonathan announced the removal of fuel subsidy in 2012 but was confronted with massive protest by labour unions. In 2021, President Mohammad Buhari made plans to remove fuel subsidy from 2022, but it became an issue that equally elicited different reactions from the citizens.

Thirteen years after diesel was deregulated, kerosene subsidy was removed in 2016. However, the subsidy on Petroleum Motor Spirit (PMS) has proven to be the biggest challenge to the managers of the Nigerian economy. On an annual basis, a substantial portion of the national inflow is committed to funding the subsidy scheme. Of course, there are good reasons for the astronomical growth in subsidy amount – price of crude oil in the international market, volume of PMS consumed albeit debatable, and Naira devaluation are some of the drivers. However, these subsidies have become increasingly unsustainable in recent years, which necessitated its removal on May 29, 2023.

On May 29, 2023, the first inaugural address by President Ahmed Bola Tinubu, emphasized the need to remove fuel subsidy with immediate effect came with several implications. In his words on the said day and I quote “We commend the decision of the outgoing administration in phasing out the petrol subsidy regime which has increasingly favoured the rich more than the poor. Subsidy can no longer justify its ever-increasing costs in the wake of drying resources. We shall instead re-channel the funds into better investment in public infrastructure, education, healthcare and jobs that will materially improve the lives of millions”. Those words brought the end of fuel subsidy in Nigeria.

Statement of the Problem

The International Energy Agency stated that the global fuel subsidy is estimated at over \$1 trillion in 2022 from about \$325 billion in 2018. The quoted amount is significantly higher than the value of global aid which was estimated at over \$204 billion in 2022 and much more than the combined government revenue of developing countries especially in the Sub-Saharan Africa. All these expenses have led to calls to stop global fuel subsidy so that the saved funds can be put to other productive ventures in developing countries (Mouhoud and Couharde, 2020).

In Nigeria, the key sectors of the economy suffer due to low earnings already consumed by inflated subsidy payments. The trade deficit of \$20 million recorded in November 2022 from the low crude oil export receipts calls for the quick removal of petrol subsidy in order to develop local production capacity, stop fuel import dependency and improve balance of trade (Abayomi, 2023).

Fuel subsidy was clouded with corruption, manipulation, lack of transparency and mismanagement of public funds. Over N3.92 trillion was allocated for petrol subsidy between January 2020 and June 2022, this amount surpasses the combined federal budgets for capital infrastructure, healthcare, education, agriculture and defence throughout the 30-month period. Nigeria spent about 10 trillion Naira on petroleum subsidies between 2006 – 2018. It gulped N5.82 trillion from 2021 – 2022 and N3.36 trillion being proposed for the first six months of 2023. These figures indicate a significant drain on the government’s finances, impeding its ability to invest in crucial sectors which could bolster economic growth and people’s well-being. Nigeria did not profit from the surge in oil prices due to low oil output and the spike in fuel subsidy expenses. A stop to fuel subsidy could bring about positive developmental changes and bolster both micro and macro economy and economic growth.

Objective of the Study

The objective of this study is to analyse the microeconomic and macroeconomic implications of fuel subsidy removal in Nigeria. The paper adopts a desk review method using discourse analysis methodology. The examination of the paper showed that fuel subsidy removal would free up monetary resources for other sectors of the economy to thrive, reduce overdependence on imported products, reduce pressure on exchange rate, encourage domestic refineries to produce from its petroleum products, generate employment, develop critical public infrastructure from saved subsidy funds, reduce government borrowing and curb lack of transparency and accountability in the payments of fuel subsidy.

Benefits of Fuel Subsidy in Nigeria

There are several positive effects associated with the fuel subsidy in Nigeria, which have made it popular among citizens.

1. Cheap Fuel Prices

The primary benefit of the fuel subsidy is its ability to make fuel prices cheaper for Nigerians. By shouldering the costs of fuel importation and refining, the government could keep fuel prices at a level that is manageable for ordinary citizens.

2. Minimise Inflationary Pressures

By keeping fuel prices low, the subsidy will also help to control inflation. Since fuel prices significantly influence the costs of goods and services, maintaining affordable fuel prices will indirectly contribute to keeping overall price levels stable.

3. Promote Economic Growth

Lower fuel prices can stimulate economic growth and development in Nigeria. By reducing the cost of transportation and production, the fuel subsidy can encourage businesses to expand, create jobs, and contribute to overall economic growth.

Negative effects of Fuel Subsidy in Nigeria

Despite its benefits, the fuel subsidy in Nigeria has also had some negative effects on the country's economy and governance.

1. Pressure on Government Finances

The fuel subsidy had become a significant financial burden on the government. The cost of maintaining the subsidy had increased over the years, putting a strain on the country's fiscal resources.

2. Lack of Fiscal Transparency

Fuel subsidy payments have been marred by issues of corruption, lack of fiscal transparency, misappropriation, and mismanagement due to weak oversight mechanisms, as some individuals and companies take advantage of the system to make illicit gains. While the concept of subsidy itself is noble, its administration in Nigeria had suffered serious allegations of mismanagement, lack of accountability and transparency.

3. Impede Growth in the Oil Sector

The fuel subsidy had also hampered growth and development in the oil sector. By keeping fuel prices artificially low, the subsidy discouraged investment in the domestic refining industry, further perpetuating Nigeria's reliance on imported fuel.

LITERATURE REVIEW

Arguments from literature shows that oil subsidy has both positive and negative effects in the economy (Flamini, V., & Sears, L. 2015). Other studies have argued that fuel subsidy removal in Nigeria could cause inflation and reduce economic welfare (Adenikinju, 2009).

Fuel subsidies are regarded as part of an implicit social contract between citizens and the state in many

countries, including Nigeria (Beblawi and Luciani, 1987; Hertog, 2017; Luciani, 1990; Fattouh et al., 2016; Moerenhout et al., 2017). Therefore, reducing or eliminating fuel subsidies without improving social welfare protection may be considered a unilateral change in the social welfare contract, and can lead to protest, public unrest, and political instability (Moerenhout, 2018 and Luciani, 1990). However, fuel subsidy removal is contentious because there is the argument that fossil fuel subsidy is a form of aid because it makes fuel more affordable for the poor.

Hashim (2021) studies the economic implication of fuel subsidy removal in Nigeria; and revealed the growing antagonism from people towards the removal of fuel subsidy, the study also discovered that the oil sector in Nigeria was characterized by gross corruption, insufficient supply, smuggling and inefficiency.

Babatunde (2019) studies the macroeconomic implications of oil price shocks and the extant fuel subsidy regime for Nigeria. He employed the New-Keynesian dynamic stochastic general equilibrium (DSGE) model of estimation and concluded that oil price shocks generate significant and persistent impacts on the product output, leads to higher macroeconomic instabilities and generates non-trivial implications for the response of monetary policy to an oil price shock.

Adewunmi et al. (2014) conducted a study on the impact of the fuel subsidy removal on the socio-economic development in Nigeria and used a price pass-through model, the study employed the error correction model to investigate both the short and long-run impact of fuel subsidy removal on socio-economic development from 1980 – 2012. The result showed that the fuel subsidy removal does not have short-run impact but long-run progress on the social well-being of Nigerians.

There are international studies that have also examined the effect of fuel subsidy removal. Harring et al. (2023) examined cross-country attitude towards fossil fuel subsidy removal and found that the public would have positive attitude towards subsidy removal if there were optimal use of the saved fiscal revenues.

Antimiani et al. (2023) showed that fossil fuels are still highly subsidised in EU countries, and there are deliberations to remove fossil fuel subsidies and re-use the revenues to foster the technological transition to a sustainable and decarbonised EU economy.

MICRO AND MACROECONOMIC IMPLICATIONS OF FUEL SUBSIDY REMOVAL IN NIGERIA

The removal of fuel subsidy simply means that the government will no longer pay for the difference between pump price and the actual cost of importing fuel anymore. It technically means full deregulation of the downstream sector to pave way for vibrant competition by other interested investors. With the removal of fuel subsidy, fuel will have to be sold in accordance with the prevailing market price based on the actual cost of importation. Removal of subsidy according to Government, will reduce corruption, increase government savings and investment in infrastructure, and reduce poverty and hardship. However, there are positive and negative microeconomic and macroeconomic implications of the subsidy removal in the economy. This is as detailed below.

Microeconomic Implications of Fuel Subsidy Removal in Nigeria

There are beneficiary microeconomic implications of the removal of fuel subsidy as explained below.

1. Free up resources for other sectors of the economy

The government can free up resources saved from the removal of subsidy to invest in other critical sectors like healthcare, education, security, agriculture, and infrastructure. This will not only improve the standard of living for citizens but also enhance economic growth.

2. Availability of petroleum product

Removal of subsidy will incentivize private sector investment in the downstream sector, leading to increased local refining capacity and improved product availability in the medium to long term. This will result in low pricing that reflect in actual market condition due to competition as well as increase private firm participation.

3. Reduce smuggling and associated security risk

Continued fuel subsidy has created an inducement for smuggling of fuel to nearby countries where it can be sold at much higher prices. This has resulted in security risks, as smuggling has also led to illegal refining, pipeline vandalism, and other criminal activities. By removing the subsidy, the incentive for smuggling will be reduced or eliminated, which will lead to a reduction in security risks associated with fuel smuggling.

4. Equitable resources for individuals, households, and firms

The rich benefit more from the subsidy than the poor as they have the capacity to buy more vehicles thereby using more fuel to run them; removal of the subsidy creates an opportunity to redistribute this benefit directly to those who need it more.

Detrimental Effects of Fuel Subsidy Removal – Microeconomic Implications

1. High Cost of Living

The main implication of the removal of fuel subsidy is the probable increase in the cost of living as increased fuel prices will likely lead to higher costs for goods and services. The direct impact of the subsidy removal will be high cost of transportation while the indirect impact may be increases in prices of goods and services.

2. Perceived Public Protest

The fuel subsidy removal has already generated public unrest, this may continue if the government fails to convince its citizens of the long-term benefit of the policy. Additionally, removing the subsidy could lead people to perceive the government as insensitive to their needs. There is also a risk that the removal of the subsidy could lead to a rise in fuel smuggling and other illegal activities.

Macroeconomic Implications of Fuel Subsidy Removal in Nigeria

There are beneficiary macroeconomic implications of the removal of fuel subsidy as explained below.

1. Minimise government borrowing

Fuel subsidy has been a major source of government expenditure in Nigeria, with huge sums being spent annually to keep petrol prices artificially low. This has led to the government borrowing heavily to finance the subsidy, which in turn increases the country's deficit. By removing the subsidy, the government can reduce its borrowing and the associated huge deficit, freeing up resources for other important sectors.

2. Improve the local currency and reduce imported inflation

The massive importation of fuel increases the demand for foreign exchange. One of the medium to long term impacts of the subsidy removal is the reduction of fuel purported consumed in Nigeria as cheap, subsidized fuel will no longer be available for smuggling. This reduced volume will translate to a reduction in demand for foreign exchange which will lead to a stronger Naira. This will also reduce imported inflation and its pass-through effect, as the cost of importing petroleum products is a major contributor to inflation in

Nigeria.

3. Boost sovereign credit rating

Nigeria's sovereign credit rating has been adversely affected by its low revenue, high debt levels, rising deficit, and vulnerability to oil price shocks. Removal of the subsidy will increase government's revenue, reduce borrowing and the associated deficit, leading to an improvement in the country's sovereign credit rating and lower cost of borrowing and creates good image for the country.

4. Influence AfCFTA to export to other African countries

The African continental free trade area (AfCFTA) agreement provides the principle for Nigeria to competitively export refined petroleum products to other African countries. With the removal of fuel subsidy, Nigeria can influence the AfCFTA agreement to increase its exports of refined products, generate foreign exchange which will in turn enhance economic growth.

5. Increased players in the downstream sector

Along with the increase in investment flow to the downstream sector, deregulation of the downstream sector will stimulate increased activities that will lead to more profitable downstream companies. This will result in improved tax revenue both from the companies, their employees, vendors, increased foreign direct investment and other players across the value chain as this would spur economic growth.

6. Increased Investment in the downstream sector

Removal of subsidy will create an enabling environment for private sector investment in the downstream sector, leading to the development of local refineries and the creation of jobs. This will enhance the country's energy security and reduce dependence on imported petroleum products.

Detrimental Effects of Fuel Subsidy Removal – Macroeconomic Implications

1. The saved funds may not be used to develop critical infrastructure, education, and healthcare as misappropriation of funds and lack of accountability are still in their strides in Nigeria.

2. Rising Inflation

Increase in the prices of fuel could impact on the cost of goods and services which will in turn lead to inflation and reduce purchasing power of consumers.

3. High unemployment rate and poverty margin

A critical underlining negative impact of the removal of petrol subsidy is that it is certainly going to widen poverty bracket in Nigeria, particularly amongst the poor masses and the excluded citizens with the ravaging unemployed youth.

RECOMMENDATION AND POLICY RESPONSE ON THE FUEL SUBSIDY REMOVAL IN NIGERIA

Effective Palliatives

It is not the poorest people in villages that will be most impacted as they normally have very limited touch point with petrol consumption (they move around by trekking or using bicycles to their farms, shops, and market with only a very few owning motorcycles or vehicles). The recommended palliatives are:

a. Increase minimum wage – this will ensure that there is support by workers and limit the resistance by the Labour Union

b. Increase the monthly income threshold for PAYE exemption purposes – currently N30,000 per month is exempted from PAYE which can be increased to 100% (N60,000) per month. This will alleviate the impact of subsidy removal on the employed poor. Also, small business will benefit by way of tax exemption on their equivalent profits for direct assessment.

c. Government should guarantee the provision of FX to importers of petroleum products at the official exchange rate using the FX savings from the current imaginary petrol consumption that have been eliminated from subsidy removal. This will bring the price down and in turn moderate the inflationary impact of the increase in petrol price.

While the minimum wage increase and high tax exemption threshold will affect the revenue of states, the higher revenue to be shared from subsidy savings will more than compensate.

Implement the Social Protection Programme

The National Bureau of Statistics stated that more than 128 million Nigerians live below the poverty line. Nigerian government must ensure that persons with disability are specially considered in the social protection programme.

Encourage and promote the use of alternative sources of energy

Encourage and promote the use of alternative sources of energy like compressed natural gas (CNG) to reduce the over reliance on petrol. CNG is considerably cheaper than petrol and this could result in huge savings for vehicle owners. Immediately provide affordable and safe public transportation system across the country.

CONCLUSION

The 2023 fuel subsidy removal has sparked concerns about the potential negative effects on the cost of living and public unrest. However, it may also serve as an opportunity for Nigeria to reform its oil sector and take a more fiscally responsible approach to managing its resources.

While removing the fuel subsidy has some potential advantages, it also has its disadvantages. The government must carefully consider the impact of removing the subsidy and take steps to mitigate any negative effects. Effective palliatives should be a positive step towards mitigating the impact of removing the fuel subsidy. However, additional measures need to be implemented to ensure that society is adequately prepared to surmount the effects of this policy change. The focus should be on finding a solution that balances the need for economic growth and development with the need to ensure that Nigerians have access to affordable fuel.

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