

Influence of Fuel Subsidy Removal on the Economy of Nigeria

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Abstract

In Nigeria, fuel subsidy removal has been a controversial issue because of its critical and severe effects on all sectors of the Nigerian economy. Some advocate that the removal of fuel subsidy will increase poverty while some argue that it will enable government to have more resources for other projects. This study assessed the influence of fuel subsidy removal on the economy of Nigeria. The study applied exploratory research design and relied mainly on qualitative method of data collection. Secondary data were analyzed by means of qualitative content analysis. The economic theory served as the theoretical framework of the study. The study revealed that removal of fuel subsidy has direct and indirect economic consequences, including increased poverty, increased cost of living and low level of employment; and recommends that government should ensure transparency and accountability in the management of funds saved from subsidy removal. The study recommends that government should use funds saved from complete fuel subsidy removal judiciously in improving the critical sectors of the economy such as health, refineries, education, security, agriculture and infrastructures like electricity, roads, railways, seaports and air ways.

Keywords: Nigeria economy, fuel subsidy, high cost of living, increased poverty, government.

INTRODUCTION

Crude oil discovery in commercial quantity at Olobiri in Bayelsa State in 1956 and other major oil wells made Nigeria to become an oil producing country. The production and exporting of crude oil enable Nigeria to earn a lot of foreign exchange and this led to the abandonment of other sectors especially agriculture which had been the major source of foreign exchange to the country. Since then, more than 90% of our foreign exchange are derived from crude oil export. Nigeria has four public refineries to process her crude oil but due to their mismanagement the country has been relying on imported petroleum products to meet the needs of her citizens.

However, the prices of imported petroleum products are determined by international market forces, which made the imported products expensive for Nigerians. To curtail the expensive prices of the imported petroleum products such as petrol, kerosene, diesel and aviation fuel, the government introduced fuel subsidy. Ovaga and Okechukwu (2022) described fuel subsidy as discount on the market price of fuel offered by government, to allow citizens pay less than the market price of fuel. The issue of fuel subsidy has attracted global attention among scholars, analysts and policy makers because of its enormous burden on government and severe impact on citizens' wellbeing, national and global economy.

In 1973 there was oil price shock when the price of fuel increased tremendously in the international market, the then Nigeria government reacted by introducing fuel subsidy in 1970s to cushion the effects on the masses and the economy. Since then, fuel subsidy has been implemented by successive governments, as a way to alleviate the financial burden on citizens and stimulate economic growth. However, critics argue that the subsidy often benefit the wealthy more than the poor and that lead to environmental degradation by encouraging excessive fuel

consumption. Additionally, the high cost of fuel subsidy puts a strain on government budgets, diverting funds that could be used for other important social programmes, such as healthcare, agriculture, security and education.

There was a campaign about fuel subsidy removal during President Goodluck Jonathan regime which lingered and started on 12th December 2011. Namadi Sambo the then vice President headed a meeting with National Economic Council (NEC) which comprises of the Vice President, Governors, Ministers and Central Bank of Nigeria, and in one of their meetings they decided that fuel subsidy should be removed by January 2012. On January 1st 2012 the federal Government gave Nigerians shocking news on fuel subsidy removal, thereby causing a very long queue at the filling stations and fuel was sold for N140 and above per liter. This was reversed due to nationwide strike. The payment of for fuel subsidy has increased tremendously since then, in 2022 it was N4 trillion (US\$6.088 billion) which represent 23% (per cent) of the national budget of N17.126 trillion (US\$25.87 billion) (Ozili and Obiora, 2023). This huge drain on national fund is not sustainable, hence the then President Buhari government decided a complete fuel subsidy removal with effect from June 2023, but was announced by the current government led by President Tinubu on his swearing day in May 29th 2023. This caused a lot of uproar, mixed feeling, anger, frustration and panic among Nigerians.

Some believe that the subsidy removal was necessary to enable government have enough funds to promote the economic growth and manage the affairs of governance. On the other hand, some criticize it because of the chain effects on the economy and the masses, as well as the insincerity and non-transparency of the government. Despite the diverse views and public outcry, the government insisted that there is no going back to subsidy regime and that they will use the funds saved from subsidy removal to improve critical sectors of the economy such as infrastructure, education, health, security and agriculture, and the provision of palliatives to the most vulnerable people in the country.

Currently, some literature on fuel subsidy removal stressed the merits and demerits of the policy. Some observed the negative effects of subsidy removal and support the implementation of subsidy. While some encourage the removal as the funds saved will be used for other sectors of the economy. For example, Umar and Umar (2013) advocate for subsidy removal as they believe that it is a wasteful spending, distorts fiscal planning and increases inequality, as it favours the wealthy more than the poor. Equally, Adekunle and Oseni (2021) opined that removal of subsidy reduces carbon emission to the environment due to reduced consumption of the products as the prices have increased. On the other hand, Umeji and Eleanya (2021) affirmed that fuel subsidy removal has not improved the standard of living of the masses. Similarly, Ovaga and Okechukwu (2022) observed that a set of people are against the repairing of refineries and building of new ones in order to continue importation of fuel, for their own gain and continuous breeding of corruption.

Omotosho (2020) opines that fuel subsidy removal might lead to higher macroeconomic distortion occasioned by rising energy prices and inflation in Nigeria. Additionally, McCulloch et al (2021) observed that many Nigerians opposed fuel subsidy removal or reforms as they do not trust the transparency and capability of the government because of high level of corruption.

Regardless of evidence in literature, there is little or not enough discussion about the influence of complete fuel subsidy removal on the economy of Nigeria since May 29th 2023 it was announced. Controversy about how the total fuel subsidy removal is affecting the Nigerian economy was the way and manner in which it was removed without proper studying of the situation and the provision of alternative measures. Hence, there is a need to ascertain and comprehend the influence of fuel subsidy removal on the economy of Nigeria.

Review of Related Literature

Fuel Subsidy Removal

Subsidy can be described as any deliberate procedures that allow consumers to pay less than the official market price. Tax cuts and exemption, price restriction and grants are examples of subsidies that come in different forms. According to Adebisi (2011) some subsidy removal has indirect impact on prices of goods which tilt the market in favour of some specified goods and government sponsored programmes. In other words, subsidy is a deliberate policy of government for their citizens and those living in a particular country to pay less than the actual market price in order to reduce the effects of high market price on them and the economy. It is necessary to observe that Nigeria is not the only the country that removed fuel subsidy, other countries employ subsidy removal policy such as Indonesia, Malaysia and China. Chelminski (2018) stated that fuel subsidy removal in Indonesia in 1977 resulted in

nationwide protest and violent riots that led to the resignation of then government in 1988. Between 1998 and 2013 it was found that removal of fuel subsidy by 25% led to 0.259% increase in poverty in Indonesia (Dartanto, 2013). Reallocation of subsidy payments to low-income earners may improve social welfare but reduces economic development (Fathurrahman et al, 2017).

Other studies by Haring et al (2023) which analysed the effects of fuel subsidy removal showed that the public attitudes to subsidy was positive if they were optimistic that the saved money could optimally be used. Chatri (2014) examined the economy-wide effect of fuel subsidy removal on the power sector in Malaysia and observed that this resulted to increase in the price of electricity and declined in consumer demand for electricity and this led to decreased in gross domestic product. Fossil fuels are highly subsidized within EU countries and there is campaign to remove fuel subsidy to use the revenue to encourage technology transition to decarbonized and sustainable EU economy (Antimiani et al, 2023). A study in China by Lin and Li (2012) showed that fuel subsidy removal will have negative effects in China.

Government uses subsidy removal to encourage production and consumption of certain products, protection of local producers from foreign ones, as well as stimulating growth in the desired sectors of the economy. Also, it is used by government to make essential products accessible and affordable to the masses. Hence, various Nigerian governments subsidizes petroleum products in order to make them cheaper and affordable to her citizens and to avoid the possible negative chain effects the high international prices of the imported petroleum products could cause to the economy if not done (Ozili and Obiora, 2023).

In the developed economies, environmental concerns, international trade issues and maintenance of competitiveness, are some of the major considerations in the design of the policy of petroleum subsidy. While in the developing countries, poverty alleviation, citizens welfare, election cycle politics are the major concerns of the government in the policy making. The renewed emphasis on governance reform advocated by Breton Woods Institutions (Centre for Public Policy Alternatives, 2012) constitutes another driver of the policy. This advocates the implementation of policy on various environmental challenges such as renewable energy incentives and carbon emission. The Breton Woods Institutions represents a shift towards addressing the issues of accountability and transparency in policymaking, as well as systemic problems.

Centre for Public Policy Alternatives (2012) outlined that most successful countries in the implementation of subsidy removal are done on gradual bases after careful study of the effects and consequences on the welfare of the citizens and economic considerations, effective communication and feedback, followed by a strategic approach to policy making. This is because of sensitive and critical role of subsidy removal on the welfare of the people, economic structure and level of development of critical infrastructure. Also, social and cultural factors are considered before implementation of change in policy for the success of such exercise. But the current leadership of Nigeria apparently did not carefully study the consequences and effects of complete fuel subsidy removal, and did not make proper arrangement for the alternative measures to reduce the effects before the removal. If the refineries are working well and meeting our local needs, we shall not to import fuel, not to talk of subsidy; if public electricity supply is steady; we shall not even need generators not to talk of fueling them.

Theoretical framework

The Economic Theory of Subsidies

This theory was propounded by Arthur Cecil Pigou in his seminal work "The Economics of Welfare," first published in 1920. Pigou's theory emphasized the use of government intervention through subsidies (and taxes) to align private incentives with social welfare, addressing situations where private market outcomes do not reflect the true social costs or benefits of economic activities. This approach is foundational in welfare economics and has influenced a wide range of policy applications. The theory stated that when a good or service is subsidized, its price is altered, which in turn affects how much is consumed. In order to address some market failures, subsidies may be implemented. For example, if research and development experiences positive spillovers that result in the agents conducting the research not reaping the full benefits, they will conduct less research than is optimal. A subsidy can encourage them to conduct more research, ensuring that the socially optimal amount is conducted. While subsidies

are sometimes appropriate and helpful, inefficient subsidies disturb economists because they lead to circumstances in which the price of a good or service “does not correspond to the overall cost to the society of producing or consuming a little more or less of the good or service” (Fischer & Toman, 2000 in Agu et al, 2018). Stated differently, the efficient allocation of resources is not achieved when price do not equal marginal cost. Thus, inefficient subsidies are a problem that needs to be addressed because doing away with them can improve society as a whole. Subsidy policies, even when enacted with the best of intentions, are rarely the most effective ones. According to McKenzie and Mintz (2011) in Agu et al (2018) waste can occur when subsidies do not produce the desired effect on behaviour or instead encourage actions that would have occurred regardless of the subsidies. Subsidies can also skew how resources are allocated by directing activity away from other areas and towards those that receive subsidies.

Positive effects of subsidy removal

One of the positive effects of fuel subsidy removal is that the saved funds can be used in the development of critical public infrastructure in Nigeria. Before the complete removal of subsidy in Nigeria in 2023 the government does not have enough of funds for the building of necessary infrastructure hence, they resorted to internal and external borrowing. But when the subsidy was removed there were sufficient funds for infrastructural development. According to Majekodunmi (2013) many economics scholars agreed to this assertion that subsidy removal releases funds for public infrastructural development.

Another positive effect of subsidy removal is use of the saved funds for development of other sectors of the economy such as healthcare, education, agriculture and security (Gidigbi& Bello, 2020; Ogunode et al, 2023). Prior to the removal of subsidy, enough funds were not available to the government.

The issue of budget deficit could be abolished with the removal of subsidy. In the past years, the successive government have been using budget deficit to augment the implementation of the annual budget, the current removal of subsidy could lead to budget surplus.

The reduction of government borrowing is one of the positive effects of fuel subsidy removal. Prior to the complete removal of subsidy in 2023 more than 90% of Nigeria revenue were used to service debts, which is not sustainable in any economy (Okongwu &Imoisi, 2022).

Another positive effect of subsidy removal is the creation of employment. The deregulation of the downstream oil sector would allow more private companies to import fuel at competitive rate. These companies can hire more staff in the running of their affairs, thereby creating more employment for the citizens.

The removal of subsidy would enable government have enough funds to repair the existing refineries which are capital intensive to undertake. The saved money from subsidy removal can also be used to build fresh refineries to supply enough petroleum products for local consumption thereby saving foreign currency that would have been used for importation of these products. The reduced import shall put less pressure on our local currency and this could lead to increased exchange rate or to boost the value of our local currency (Akinola, 2018).

Subsidy removal reduces the consumption of petroleum products hence reduction in air pollution and carbon emission in Nigeria. This could encourage ongoing campaign against global warming and climate change (Omitogun et al, 2021).

Negative effects of subsidy removal

High Cost of Living

One of the major consequences of complete fuel subsidy removal is high cost of living. The pump price of petrol in Nigeria before the current fuel subsidy removal was N190 per liter, after the removal it moves to N537 and then to more than N700 per liter. The increase in energy cost occasioned by the subsidy removal leads to high cost of transportation as well as increased cost on the users of petroleum products. This drastically affects cost of goods and services across the nation, as we are experiencing now in Nigeria. This is the reason we have unprecedented high rate of inflation in Nigeria. To feed for an average Nigeria is very difficult. The high inflation will reduce the disposable income of individuals and businesses hence weaker consumer demands for goods and services and ultimately slow the rate of economic growth (Houeland, 2020).

Increase in Poverty

One of the severe consequences of fuel subsidy removal is increased level of poverty, the most affected are the masses and the middle class. Since the removal of subsidy millions of Nigerians have been moved from middle class to lower class (poor people). The level of hunger and hardship in Nigeria is unprecedented in the history of Nigeria except perhaps during the Nigeria civil war. The income of workers and small scale business people are still static and this worsens their situation (Ozili& Obiora, 2023). The government that is supposed to provide palliatives to cushion the effects of subsidy removal seem not to be ready or playing lip service at the expense of the vulnerable people that is dying because of hunger and hardship. It is sad that one year after the complete removal of subsidy there is nothing much the government has done to assist the citizens despite the billions of dollars, they saved from subsidy removal.

Low level of Employment

Another negative consequence of fuel subsidy removal is that it leads to low level of employment. The subsidy removal affects greatly the small and medium scale industries especially those that use energy in their production or services, as national electricity supply is very unreliable(Houeland, 2022). The high cost of petroleum products increases the cost of production which reduces the profit of these firms and forced them to sell their goods and services at very high cost. Also, the low purchasing power caused by fuel subsidy removal reduces the purchasing power of the people. The combined effects of high cost of production, low profit margin and low purchasing power by the consumers of the products is not sustainable for the firms hence they have to retrench workers, and at extreme situation close down their businesses. All these lead to low level of employment for the citizens.

Conclusion

The complete removal of subsidy in Nigeria has generated a lot controversy because it is very sensitive and has severe consequences to citizens. Some analysts advocate for the removal to enable government have enough funds for the projects and programs of the administration while some criticize the policy as government failed to provide effective alternatives and palliatives before the removal. Regardless of these diverse views the removal of fuel subsidy has positive and negative effects on Nigerians and the economy. Some of the positive effects of the removal are that funds are saved by the government to enable her to build the critical sectors such as refineries, health, education, agriculture and infrastructures like electricity, roads, railways, seaports and air ways. Conversely, some of the negative effects of the subsidy removal include high cost of living, increase in poverty and low level of employment.

Recommendations

1. Government should ensure accountability and transparency in the utilization of funds saved from complete removal of fuel subsidy by reducing cost of governance, corruption and channeling the funds to projects and programmers' that will reduce high cost of transportation and high cost of energy, by the provision of alternative to fuel, such as gas, solar and electric powered vehicles.
2. The funds should be judiciously used in the building and improvement of the critical sectors of the economy such as health, education, security, agriculture and infrastructures like electricity, roads, railways, seaports and air ways.
3. Government should ensure that existing refineries are repaired to work optimally and new ones built, as well as encourage private participation in the building and management of refineries of different capacities to meet local demands and for exports.
4. Government should provide palliatives to most vulnerable citizens by way of grants to cushion the severe effects of this complete removal of fuel subsidy and provide low interest loans to small scale business people to stimulate the economy and provide more employment.
- 5 Workers salaries in both the public and private sectors, across all levels should be promptly increased to enable them cope with the high cost of living.

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