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FUEL SUBSIDY AND NIGERIANS' WELFARE

Musa Abdullahi Sakanko

University of Jos

Akomolafe Femi Augustine

Federal University Kashere, Gombe

Sufiyanu Umma Yahaya

IBB University Lapai

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INTRODUCTION

The fuel subsidies can be traced back to the mid-20th century when many countries sought to promote economic growth and development. These subsidies were often a response to increasing energy prices or to shield the population from the impact of fluctuations in global oil prices. Fuel subsidies have been a prevalent policy measure implemented by governments worldwide to provide financial support and mitigate the impact of rising fuel prices on consumers and industries (Coady et al., 2019). These subsidies often involve selling fuel at prices lower than market rates, resulting in lower transportation and production costs for citizens and businesses (G20, 2016). While fuel subsidies are aimed at assisting low-income individuals and promoting economic development, their actual impact on welfare is a subject of ongoing debate. Proponents argue that subsidies can alleviate poverty and reduce income inequality by making essential goods and services more affordable for vulnerable populations (Arze del Granado et al., 2015). In this view, fuel subsidies are seen as a means of redistributing wealth and promoting social welfare.

On the other hand, critics argue that fuel subsidies can lead to several adverse effects on welfare and broader economic outcomes. Subsidies often create economic distortions, encouraging excessive consumption and discouraging investments in energy-efficient technologies (Davidova and Ivanova, 2019). These inefficiencies can hinder economic growth and environmental sustainability in the long term. Additionally, fuel subsidies can exacerbate fiscal imbalances in countries with limited financial resources, diverting funds from other social welfare programs (Coady et al., 2015). As a result, some studies have shown that these subsidies benefit wealthier segments of the population more than those intended to be protected (Kojima et al., 2019).

In recent years, there has been a growing recognition of the need to reform or phase out fuel subsidies to achieve more sustainable economic and environmental outcomes (Coady et al., 2019). Policymakers are exploring alternative strategies, such as targeted cash transfers or direct support to low-income households, to protect the most vulnerable while reducing the negative consequences of fuel subsidies on welfare. Fuel subsidies have been widely criticized for their negative impact on welfare. They often result in distortions in energy markets, leading to inefficient resource allocation and increased environmental harm (Kojima & Koplow, 2019). The subsidies encourage excessive consumption of fossil fuels, contributing to air pollution and greenhouse gas emissions (Bento et al., 2019). Studies have shown that fuel subsidies disproportionately benefit higher-income households rather than targeting the intended low-income groups (Baker et al., 2018). This regressive nature of fuel subsidies exacerbates income inequality and fails to effectively alleviate poverty.

Moreover, fuel subsidies strain government budgets and divert resources that could be better utilized for essential public services like healthcare, education, and infrastructure (IMF, 2019). The financial burden of maintaining fuel subsidies may lead to increased public debt or reduced spending in other critical areas, further compromising welfare. In countries where fuel subsidies are prevalent, they often discourage investments in renewable energy sources and hinder the transition towards cleaner and sustainable alternatives (Coady et al., 2017). This dependency on subsidized fossil fuels impedes progress towards meeting climate change mitigation goals.

Empirically, evidence from various countries indicates that the removal of fuel subsidies can lead to increased fuel prices, which may result in higher transportation and commodity costs, potentially affecting the cost of living for households (Coady et al., 2017). Studies in Indonesia have shown that the elimination of fuel subsidies led to an initial spike in inflation, impacting the purchasing power of low-income households (Achmad et al., 2019). However, over the longer term, the removal of fuel subsidies also resulted in a more targeted social assistance program, where the government redirected funds from subsidies to direct cash transfers, improving the overall welfare of vulnerable groups (Coady et al., 2015). On the other hand, some research suggests that fuel subsidy removal can stimulate economic growth and lead to a more equitable distribution of resources. In Iran, the removal of fuel subsidies helped reduce energy consumption, which led to increased investment in renewable energy and improved the country's fiscal sustainability (International Monetary Fund, 2021).

CONCEPTUAL ISSUES

Concept of Subsidy

Fuel subsidy refers to the financial assistance provided by the government to reduce the cost of fuel for consumers, typically by offering fuel at a lower price than the market rate (Smith et al., 2018). Fuel subsidy can be understood as a form of government intervention in the energy sector aimed at stabilizing domestic fuel prices and mitigating the impact of rising international oil prices on consumers (World Bank, 2017). It refers to the fiscal support provided by governments to the energy sector, either through direct cash transfers to consumers or through price caps on fuel products, with the objective of making fuel more affordable to the public (IEA, 2019). The IMF (2020) defined it as the gap between the domestic retail price of fuel and its production cost, which is covered by the government through budgetary allocations or other mechanisms. Huang and Tan (2016) coined fuel subsidy as the financial assistance provided by governments to reduce the burden of high fuel prices on consumers, with the aim of promoting social welfare and maintaining political stability.

Nigeria Fuel Subsidy

The fuel subsidy in Nigeria began in the 1970s when the country experienced a surge in oil revenue following the discovery of significant oil reserves. As a major oil-producing nation, Nigeria adopted a subsidy policy to keep domestic fuel prices artificially low, aiming to alleviate the economic burden on its citizens and promote social welfare.

Initially, the fuel subsidy program was well-intentioned, designed to provide affordable energy to the population. However, over the years, mismanagement, corruption, and inefficiencies in the system led to various challenges. These included increasing fiscal deficits, diversion of subsidized fuel to neighbouring countries for profit, and fraudulent practices in the subsidy payment process.

One significant turning point in the fuel subsidy history occurred in 2012 when the Nigerian government attempted to remove the subsidy entirely. This move was met with widespread public protests as citizens expressed concerns over the potential impact on the cost of living and the economy.

Subsequently, in an effort to curb the rising costs of the subsidy, the government implemented several reforms. These included the introduction of targeted subsidy programs, the establishment of the Petroleum Products Pricing Regulatory Agency (PPPRA) to monitor fuel prices, and efforts to reduce smuggling and illegal oil sales.

Despite these measures, the challenges persisted, and fuel subsidy removal remained a contentious issue. The debate revolved around finding a balance between fiscal responsibility and the welfare of the citizens. The subsidy also became a subject of criticism from international financial institutions and experts, who argued that its removal would be necessary for economic sustainability and fiscal prudence.

Nigeria Fuel subsidy and welfare.

Fuel subsidies in Nigeria have been a longstanding policy aimed at reducing the cost of fuel for consumers. The snapshot table described the contending relationship between the subsidy and welfare indicating variables in Nigeria from 2010 to 2022.

Table 1: Snapshot of Nigeria Subsidy and Welfare indicating variables.

Year	Subsidy ₦	Poverty \$5.50	Hunger	Per Capita Income
2010	667 billion	90.8	8.20%	\$2,280 = ₦1,710,000
2012	1.36 trillion	90.5	9.10%	\$2,728 = ₦2,046,000
2015	654 billion	89.5	9.20%	\$2,680 = ₦2,010,000
2018	1.1 trillion	90.8	10.40%	\$2,126 = ₦1,594,500
2020	864 billion	89.0	12.70%	\$2,075 = ₦1,556,250
2022	4.4 trillion	95.1	27.3%	\$2,184 = ₦1,638,000

Data Source: World Bank (2022); Addeh (2023). *Note, the 750 Naira exchange rate to a dollar was used.*

The table shows a continuous decline in per capita income, rising poverty, and hungry even though subsidy increases over the years. The poverty headcount ratio at \$5.50 a day is the percentage of the population living on less than \$5.50 (4,125) a day in 2011 international prices. The recent statistic classified the country hungry under four components while including undernourishment, child wasting, child mortality, and 31.5% child stunting. The essence of subsidy is to reduce prices for essential goods and services which can free up more disposable income. This, in turn, may help alleviate poverty and hunger by providing some relief to low-income families and necessities becomes more accessible. The rising poverty and hunger coupled with fluctuating per capita income is an indication that the fuel subsidy does not transmit a considerable effect on the larger percentage of Nigeria over its reign regime.

However, effective subsidies should have stimulated several significant effects on the economy and provided some relief to citizens such as:

Affordability of Basic Needs: By reducing the cost of fuel, subsidies can make transportation and energy more affordable, benefiting low-income households that heavily rely on these resources for their daily needs (e.g., commuting to work, cooking, and heating).

Economic Growth: Lower fuel prices can stimulate economic growth by reducing production and transportation costs for businesses, leading to potential job creation, and improved overall economic conditions.

Poverty Alleviation: Lower fuel costs can directly alleviate the financial burden on low-income families, freeing up funds for other essential goods and services.

Affordable Energy: Fuel subsidies can make energy more affordable for low-income households, reducing their expenditure on transportation and cooking fuel. This, in turn, can alleviate poverty and improve the standard of living for vulnerable populations.

Social Equality: Fuel subsidies can promote social equality by providing assistance to those who rely heavily on fossil fuels for basic needs. This helps prevent energy poverty and ensures that all segments of society have access to essential energy resources.

Price Stability: Subsidies can stabilize fuel prices, protecting consumers from sudden and sharp price fluctuations. This stability can benefit the economy by reducing inflationary pressures and enhancing overall economic stability.

Industrial Development: Subsidized fuel can support industries that heavily rely on transportation or energy-intensive processes. This can foster economic growth, job creation, and higher income levels, ultimately benefiting welfare.

Food Security: Fuel subsidies can positively impact agriculture by reducing the cost of production and transportation. This can lead to increased food availability and affordability, thereby contributing to food security.

Health and Environment: In some cases, fuel subsidies may encourage the adoption of cleaner energy sources, which can have positive effects on public health and the environment by reducing air pollution and greenhouse gas emissions.

Maladies of Nigeria's fuel subsidy

Nevertheless, Nigeria's fuel subsidies have also been associated with various challenges:

Fiscal Burden: Subsidies can place a considerable burden on the government's budget, diverting funds that could have been allocated to other crucial sectors such as healthcare, education, and infrastructure.

Corruption and Mismanagement: The subsidy system in Nigeria has been prone to corruption and mismanagement, leading to inefficiencies and leakages in the system.

Market Distortions: Subsidies can distort the market, discouraging investment in alternative energy sources and inhibiting the development of a competitive and sustainable fuel market.

Inequity: Fuel subsidies tend to benefit wealthier individuals more than the poor since higher-income households consume more fuel and thus receive more significant subsidies.

Budgetary Constraints: High subsidy expenditures limit the government's ability to invest in critical sectors such as education, healthcare, infrastructure, and social welfare programs, which are crucial for the country's development.

Vulnerability to Oil Price Volatility: Nigeria's reliance on oil revenues makes the economy susceptible to fluctuations in global oil prices. As oil prices rise, the cost of subsidizing fuel also increases, straining the government's finances further.

Opportunity Cost: The funds allocated to fuel subsidies could be better utilized to develop renewable energy sources, infrastructure, and other sustainable initiatives, which would have long-term benefits for the economy and the environment.

Policy Reversals: Frequent changes in subsidy policies and sudden removal or reintroduction of fuel subsidies have led to uncertainties and disruptions in the energy sector and the overall economy.

Mitigations for Nigeria's fuel subsidy crisis

Addressing these challenges requires comprehensive and strategic reforms in the energy sector and broader economic policies. Some potential solutions could include:

Gradual removal of subsidies: Phasing out fuel subsidies over time can help ease the financial burden on the government and promote a more sustainable energy policy.

Social safety nets: Implementing targeted social safety nets to support vulnerable populations during the transition away from subsidies can help alleviate the immediate impact on those most affected.

Diversification of energy sources: Investing in alternative and renewable energy sources can reduce dependence on fossil fuels, making the energy sector more resilient and sustainable in the long run.

Efficiency improvements: Encouraging energy-efficient practices and technologies can lead to reduced consumption and lower overall costs.

Transparency and accountability: Ensuring transparency in the management of energy funds and holding authorities accountable can help prevent corruption and mismanagement of resources.

Public awareness campaigns: Educating the public about the reasons for subsidy reforms and the benefits of sustainable energy practices can garner support and understanding.

Dialogue with stakeholders: Engaging in constructive dialogues with various stakeholders, including the oil and gas industry, consumers, and civil society, can help develop inclusive and effective policy solutions.

Investment in refining capacity: Enhancing domestic refining capabilities can reduce the country's reliance on fuel imports and mitigate the impact of fluctuations in international oil prices.

CONCLUSION

In conclusion, the issue of fuel subsidy and its impact on the welfare of Nigerians is a complex and multifaceted one. While the intention behind fuel subsidies is often to alleviate the financial burden on citizens, the reality is that they can have both positive and negative consequences.

On one hand, fuel subsidies provide immediate relief to consumers by reducing the cost of transportation and essential goods and services. This can particularly benefit low-income individuals and families who heavily rely on affordable transportation for their daily needs. Additionally, subsidies can have a positive effect on the overall economy by stimulating consumer spending and promoting economic growth.

However, it is important to recognize the long-term drawbacks of fuel subsidies. The funds allocated to subsidies often place a significant strain on government budgets, diverting

resources that could otherwise be spent on critical sectors such as education, healthcare, and infrastructure development. As a result, the quality and accessibility of public services may suffer, ultimately impacting the overall welfare of the population.

Furthermore, fuel subsidies tend to disproportionately benefit higher-income groups who consume more fuel, rather than effectively targeting the most vulnerable segments of society. This regressive nature of subsidies can exacerbate income inequality and hinder efforts to achieve equitable socio-economic development.

To ensure the welfare of Nigerians, it is vital to adopt a comprehensive and sustainable approach to energy pricing and subsidy reform. This approach should involve phasing out fuel subsidies gradually, while simultaneously implementing targeted social safety nets and support programs for the most vulnerable populations. Moreover, it is crucial to invest in alternative energy sources and infrastructure to reduce reliance on fossil fuels in the long run, promoting a more sustainable and environmentally friendly future.

Ultimately, striking a balance between short-term relief and long-term sustainable development is essential to improve the welfare of Nigerians. By carefully evaluating the costs and benefits of fuel subsidies and implementing well-designed policies, the government can work towards a more equitable and prosperous society for all its citizens.

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