

Evaluating the Challenges and Prospects of Fuel Subsidy Removal on Nigeria's Economy

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Abstract

Nigeria's fuel subsidy program has been a contentious issue for decades. While intended to benefit citizens, its implementation has faced challenges like corruption and fiscal burden. This paper examines the potential outcomes of fuel subsidy removal, focusing on both the difficulties it presents and the economic opportunities it creates. The paper used secondary data such as books, journals, newspapers and magazines, and content analysis as its methodology. Neo-liberalism was adopted as the possible framework that guide the study. Neo-liberalism is a policy model that encompasses both politics and economics. It is a political and economic philosophy that emphasizes free trade, deregulation, globalization and a reduction in government spending. The Findings discovered some challenges of fuel subsidy removal which includes: increased cost of living, potential social unrest, high transportation cost and the impact on vulnerable populations. It then investigates the potential benefits, such as reduced government spending, improved productivity in the oil sector, increased revenue generation, alleviate fuel theft, adequate resources, reduces government borrowing, increased investment in other critical sectors like infrastructure, and a more efficient fuel market. The paper recommends that the Federal government should fast track the rehabilitation of refineries, enforce new national minimum wage in all the sectors including private sector and introduce subsidy in transportation sector as against temporary palliatives introduced by the federal government to cushion the effects of fuel subsidy removal.

Keywords: Subsidy, Fuel Subsidy, Fuel Subsidy Removal, Economy.

Introduction

Fuel subsidy is increasingly seen as an opportunity for consolidating public finances and fostering sustainable economic development. One of the crucial issues of energy market in oil exporting developing countries is the high level of subsidies on petroleum products and low efficiency in energy use. In spite of cumulative efforts by successive governments, oil subsidy remains one of the most intricate socio-economic policy issues in Nigeria (Adenikinju, 2009).

Fuel subsidy removal dates back to 1978 when the then military government of Gen. Olusegun Obasanjo reviewed upward the pump price of fuel which was at 8.4 kobo to 15.37 kobo, 83% increased. The concern

was for government to generate enough money to run the administration particularly when it was preparing for the 1979 democratic elections and also to cater for the social needs of Nigerians.

Subsidy became a national buzzword in 2012 when then-President Goodluck Jonathan announced its removal. Fuel prices increased from N65 (\$0.14) to N140 (\$0.30) per litre and triggered almost two weeks of protests known as Occupy Nigeria, causing Jonathan to reverse the decision.

Attempts to remove petrol subsidy by past administrations triggered protests and stiff resistance. After swearing-in on May 29, President Bola Tinubu suddenly and unceremoniously removed fuel subsidy in

Nigeria. The nation's refineries are non-functional, thereby necessitating the continuous importation of refined petroleum. Fuel importation strains the local currency while the subsidy primarily favored the cabal and was a leeway for arbitrage and the illicit transportation of petrol to neighboring countries.

Nigeria did not profit from the surge in oil price due to low oil output and the spike in fuel subsidy expenses. As the country's total public debt nears N80tn, it is not surprising why Governor Godwin Obaseki raised the alarm that it would be a miracle for the Federal Government and state governments to pay salaries beyond June this year (2023) without resorting to massively printing money or removing fuel subsidy. Either of these decisions will bring more hardship and pain to Nigerians, particularly workers.

Such a dilemma and a tough decision, the government is confronted with continuing the subsidy or deepening an unsustainable fiscal deficit or risking potential social and economic unrest by its removal. Notwithstanding, the subsidy had to go. Fuel subsidy removal could save Nigeria around N7tn annually which could be channeled into infrastructure, education and health.

As it stands, the elimination of fuel subsidy brings both challenges and opportunities. The withdrawal of fuel subsidy led to a 150 per cent to 200 per cent surge in fuel costs (N500 – N600) across the country. Small and medium-sized enterprises are facing difficulties in accessing affordable power.

Methodology

The study utilized qualitative research method to investigate, explain and understand the problem under study. Qualitative method research exposes the researcher to variety of data which includes virtually any information that can be captured other than numerical in nature. The data collection was mainly from the secondary sources such as books, journals, newspaper and other internet sources. The method of analysis adopted was content

analysis.

Conceptual Clarifications

Subsidy is basically concerned with an amount of money paid by government to suppliers (providers or producers) of a product or service to enable them to sell their products or services to final consumers at a price determined by the government which is lesser than the true supplied costs.

The OECD (2005) defines a subsidy as a benefit provided by the government to consumers or producers to help lower their costs or supplement their income. According to the IMF's Manual on government finance statistics (2001), subsidies are payments made by the government to enterprises without expecting anything in return, based on their production levels or the value of goods and services. They can be used to impact production levels, selling prices, or the overall profits of businesses.

Subsidy is defined as any measure that keeps prices for a good or product below market level for consumers or producers. Subsidies can take different forms like grants, tax reduction or exemption and price control (Alozie, 2009). Oxford Advanced Learners Dictionary (2001) defined subsidy as money paid by a government or an organization to reduce the cost of service or that of producing goods so that their prices can be kept low. In addition, Bakare (2012) points out that, to subsidize is to sell a product below the cost of production.

A fuel subsidy is a financial aid provided by the government to reduce the cost of fuel for consumers. This subsidy aims to make fuel more affordable for the general population, stimulating economic growth and alleviating financial burdens for individuals and businesses. By subsidizing fuel, governments can stabilize prices, control inflation, and support key industries that rely on affordable energy sources. However, fuel subsidies can also be controversial as they can lead to budget deficits, distort market prices, and encourage overconsumption of fossil fuels, thus impacting the environment negatively. Therefore, the implementation and

management of fuel subsidies require careful consideration to balance economic, social, and environmental objectives. (Parry, I.2014).

Based on the definitions provided earlier, a fuel subsidy in Nigeria refers to selling petrol at a price lower than the cost of importing it, while maintaining a consistent price across the country.

Fuel subsidy removal on the other hand, is the process of ending government financial assistance for fuel, causing prices to rise to market levels. This leads to increased fuel costs and can have economic and social impacts.

Economy is a complex system of interrelated production, consumption, and exchange activities that ultimately determines how resources are allocated among all the participants. The production, consumption and distribution of goods and services combine to fill the needs of those living and operating within the economy. Therefore, economy encompasses all the activities related to the production, consumption as well as trade of goods and services.

Theoretical Framework

The study adopted Neo-liberal theory in explaining the policy of fuel subsidy removal in Nigeria. Neo-liberalism is a policy model that encompasses both politics and economics. It is a political and economic philosophy that emphasizes free trade, deregulation, globalization and a reduction in government spending. Neo-liberal seeks to maximize the role of the private sector in prioritizing world economy (Cohen, 2007). Neo-liberalism seeks to transfer control of the economy from public to the private sector under the belief that it will produce a more efficient government and improve the economic health of the nation (Prasad, 2006). Neo-liberalism became prominent following the establishment of the Mont Peleri Society in 1947, its founding members include Friedrich Hark, Milton Friedman, Karl Popper, George Stigler, Ludwig Von Mises, and James Buchanan (Andrew, 2009; Stanford Encyclopedia of Philosophy,

2021). The neo-liberal thought is a term used to signify the late 20th century political reappearance of the 19th century ideas associated with free-market capitalism after it fall into decline following the outbreak of World War II. It is also associated with the policies of economic liberalization, including privatization, deregulation, globalization, free trade, monetarism, austerity, and reductions in government spending in an attempt to increase private sector involvement in economic drive of a nation (Bloom, 2017). Manning (2022) described the term as, “a policy that encompasses both politics and economics, and favors private enterprise and seeks to transfer the control of economic factors from the government to the private sector”. “In essence, any liberal policy that targets efficient functioning or free market capitalism or that focused on limited government spending, regulation and ownership of major means of production and distribution is known as neo-liberal thought” (Manning, 2022).

In essence, Neo-liberal theory emphasizes free markets and minimal government intervention in the economy. When it comes to fuel subsidy removal in developing countries, neo-liberal assumptions suggest that subsidies distort market forces by artificially lowering the price of fuel. This can lead to overconsumption, inefficient resource allocation, and market inefficiencies.

According to neo-liberal theory, removing fuel subsidies can help correct these distortions by allowing the market to determine the true price of fuel based on supply and demand. This, in turn, can lead to more efficient resource allocation, reduced wastage, and increased competition in the energy sector.

Furthermore, neo-liberal economists argue that fuel subsidies are often regressive, benefiting the wealthy more than the poor. By removing these subsidies, governments can redirect the saved funds towards targeted social programs that benefit the most vulnerable segments of society.

In view of the above, Nigeria as one of

the developing countries, considered it fit, right and timely to remove fuel subsidy in order to allow private sector participation and save more funds that could be channel to develop other sectors of the economy.

Rationale for subsidy retention

Like other energy subsidies, fuel subsidy is often retain mainly to serve the social goal of reducing fuel cost and increasing access among poor with the aim of achieving desirable social goals. In view of this, Goldstein and Estache (2009) and IEA (1999) provide a discussion of possible rationale for subsidy. Major ones include:

1. Supporting the poor and improving equity.
2. Achieving energy security: The provision of a subsidy to a particular source of supply may improve its competitiveness and hence reduce dependence on other sources of energy, notably imported fuels.
3. Correcting local externalities: Fossil fuel use primarily in the power, Industrial, and transport sectors is associated with negative local Externalities, largely associated with indoor and outdoor air pollution.
4. Reducing emissions of greenhouse gases.
5. Supporting domestic production and associated employment: Where a Domestic energy industry is no longer competitive with the world market and foreign energy can be imported more cheaply, or former export market have disappeared, then government have resorted to production subsidies.

According to the synthesis report by the UNEP and IEA, (2001), Government intervention, which may involve the use of subsidy, is intended to remedy market failures, either by addressing their causes or by trying to replicate the outcome of a perfect market. Social considerations such as concern for the poor, sick or otherwise disadvantaged may also provide a rationale for subsidizing energy. Most governments consider that access to a reasonably priced

minimum supply of modern energy services is socially desirable. In practice, all energy subsidy programs are ultimately justified on one or more of the following grounds:

- I. To protect employment in a particular indigenous industry or sector against international competition or promote job creation.
- II. To stimulate regional or rural economic development.
- III. To reduce dependence on imports for energy-security reasons.
- IV. To lower the effective cost of and/or provide access to modern energy services for specific social groups or rural communities as a means of welfare support.
- V. To protect the environment.

World Bank (2010) posits that subsidy is retained in an economy for welfare or pro-poor framework. It further stated that the Governments need to make the appropriate accommodation for the population demographics and distribution when planning policies on subsidies, especially understanding those who would be affected and how they would be affected. This is because “governments that have rushed subsidy reforms without preparing the population for the changes, and without providing targeted support to particularly disadvantaged groups, have often had to reverse the policy in the face of widespread opposition.”

Ojameruaye (2011) presents the following as some of the economic, social and political reasons the government provide subsidies or subventions to producers, suppliers or provider of certain products or services:

- a) To control price inflation and thereby prevent a decline in the real income and living standards of consumers, especially lower income households.
- b) To smoothen the process of long term structural change or transformation in certain industries and prevent a decline in the production of some agricultural crops such as cotton.
- c) To encourage the provision and

consumption of “merit” goods and services which generate positive externalities (increased social benefits)

- d) To prevent industrial action, protests and riots that can lead to political instability. Labor unions, non-governmental organizations and the poor generally try to resist any attempt to reduce or eliminate subsidies. A particular problem with energy subsidies is that, once established, they become difficult to reduce or remove, especially when they have been given on a universal Basis.

Kojima (2009) and the IMF (2008) noted that, when faced with the large oil price increases prior to the August 2008 peak, many developing countries preferred to stay with a subsidy scheme, or even to increase or re-introduce subsidies or decrease taxes, despite the enormous fiscal burden this represented. Because of potential opposition from beneficiary groups, government have to take their likely reaction in to account in determining the objective of any plan to alter the subsidy level.

Rationale for Subsidy Removal

The following are the rationale behind the removal of oil subsidy in 2016 by president Buhari administration.

1. It will ensure private sector participation in the importation of petroleum products which will free-up the market, empower many Nigerians and also allow government focus on other key sectors of the economy.
2. It will ensure the ready availability of petrol at all times for all Nigerians as Nigeria will be saturated with petrol and there will be no diversion by marketers
3. It will curb the greed for higher profits and sabotage by a few players in the oil industry removal and positively affect the economy.
4. It will ensure competition in the

industry and market forces will drive down the price of petrol in the long run as witnessed in the telecoms sector for the benefit of Nigerians

5. It will permanently banish queues from petrol stations across the nation and free the country from the endless pains and sufferings that comes with lining up for fuel. Naij news (2016).

Fuel Subsidy Removal Challenges

Fuel subsidies have been a contentious economic and political issue in many countries, including Nigeria. For years, Nigeria has implemented fuel subsidies as a means to provide cheaper petroleum products to its citizens. However, the removal of fuel subsidies have significant challenges on the economy, society, and government finances.

One of the primary challenges of fuel subsidy removal is the immediate impact on the cost of living. Fuel is a vital commodity in Nigeria, and any increase in the price of fuel will have a ripple effect on the cost of other goods and services. With costs rising over 400% due to subsidy removal last year, Price of commodities took similar turn, and because they are more widely used locally, the impact of this increase affected the majority of Nigerians already living below the poverty line. The impact will be a steep increase in the cost of living, which will have a devastating impact on households and small businesses, further plunging more people into untold suffering.

Another challenge is the potential for social unrest. Fuel subsidy removal has historically been met with protests and strikes, with citizens calling for a reversal of the policy. This is because the removal of the subsidy is often seen as a betrayal by the government, which has failed to provide alternative solutions to the problems created by the removal. Social unrest can lead to disruption of economic activities, the loss of lives and property, and a general destabilization of the country, as it seems the timing is wrong because our refineries are still non-functional. A clear justification was the massive protests carried out across Nigeria on 27 and 28 of February, 2024 by

labor unions over hardship instigated by fuel subsidy removal.

Furthermore, fuel subsidy removal could lead to an increase in inflation. Inflation refers to the rate at which the prices of goods and services increase over time. As the cost of fuel goes up, so will the prices of other goods and services, as was observed with the removal of subsidies as the primary source of energy for medium- and large-sized organizations. This can lead to a rise in inflation, which can have long-term economic consequences such as a decrease in purchasing power, reduced economic growth, and increased interest rates.

Another challenge is the potential impact on small businesses. Small businesses are the backbone of innovation and the emerging economy status of Nigeria, which cuts across the formal and informal sectors. Small businesses are particularly vulnerable to the removal of fuel subsidies because they often rely on fuel for transportation, utilities, and power. An increase in the cost of fuel could lead to higher operating costs, making it more difficult for small businesses to survive or remain profitable. This could have a negative impact on job creation and economic growth.

Finally, the removal of fuel subsidies poses a challenge to the government's ability to effectively manage its finances. Ethical and moral issue hampered Nigeria's development over the years. The subsidy has been a significant drain on the country's finances, and its removal could help reduce the government's spending. However, the government must ensure that the funds saved from the subsidy are used effectively. Failure to do so could lead to increased corruption and mismanagement of public funds. There is a promise for some intervention fund disbursement to Nigerians to cushion the early effect of subsidy removal. However, such payouts have been sources of corruption in the past, thereby making Nigerians doubt the impact of such payouts.

Opportunities of Fuel Subsidy Removal on Nigeria's Economy

We have examined the short to long term

impact of the removal of fuel subsidy on the economy at large:

Short term opportunities Reduces government borrowing and the associated huge deficit:

The 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.

Adequate or availability of resources for investment in other critical sectors:

With the removal of fuel subsidy, the government can free up resources that would have been spent on the subsidy to invest in other critical sectors such as education, healthcare, security and infrastructure. This will not only improve the standard of living for citizens but also enhance economic growth.

Reduce/remove incentive for smuggling and associated security risk:

Subsidy has created a huge incentive for smuggling of fuel to neighboring countries where they can be sold at 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.

Long Term Opportunities Stronger Naira and decline in 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.

Investment flow to 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.

More profitable downstream players: 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 and other players across the value chain.

Product availability: Removal of subsidy will incentivize private sector investment in the downstream sector, leading to increased local refining capacity and improved product availability.

Improved 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.

Leverage on the AfCFTA to legally export refined products rather than crude oil to other African countries: The African Continental Free Trade Area (AfCFTA) agreement provides a platform for Nigeria to competitively export refined petroleum products to other African

countries. With the removal of fuel subsidy, Nigeria can leverage the AfCFTA agreement to increase its exports of refined products, thereby generating more income.

Conclusion and Recommendations

The removal of fuel subsidies in Nigeria is a complex decision with multifaceted implications. While it can lead to positive outcomes such as improved productivity in the oil sector, increased revenue generation, alleviate fuel theft, adequate resources and reduces government borrowing. It also poses challenges in terms of inflation, social unrest, high transportation cost and the potential negative impact on low-income individuals. Any decision to remove fuel subsidies should be accompanied by a well-thought-out strategy that considers mitigation measures for the vulnerable population and promotes sustainable economic growth. It is based on this, the study put the following recommendations as the possible solution of managing fuel subsidy removal in Nigeria

1. There is need for the government to ensure that refineries are functioning effectively and efficiency before removing fuel subsidy. Assuming refineries are functioning prior to the policy, Nigerians wouldn't have suffered like now. With the removal of fuel subsidy now, Government need to fast track the rehabilitation of refineries to ease the suffering of the masses.
2. The government should pinpoint areas where there are wastes in governance, such as the distribution of booty and largesse under the guise of allowances. The proposed spending in the 2023 budget to pay for fuel subsidies should be adjusted and reprioritized in a way that addresses social needs and enhances the wellbeing of all citizens.
3. To mitigate the effects of the policy, the government should also introduce subsidy in the transportation sector. Basically, the government should work to make sure that the minimum wage is enforced in all sectors,

including the private sector. If this is done, it will moderate the impact of the policy that will have on the general populace.

4. Deregulation can also be accomplished in stages, which would mean that the current increment would be spread out over a period of six years or longer. If this goes down, there won't be a significant impact on policy because there won't be much of one
5. Law enforcement organizations like the ICPC and EFCC should have full authority and adequate funding to carry out their duties. Indeed, they should ensure that saved funds realized due to fuel subsidy removal have been appropriately utilized without any corruption.
6. The federal government of Nigeria should focus on and adequately develop other sectors, such as the educational, agricultural, communication, transportation, tourism, health, and provision of social amenities and infrastructure, which will significantly increase employment opportunities and the standard of living of the populace. The above miracle cure will significantly alleviate the suffering in Nigerians instead of palliatives that is considered as temporary measures.

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