FUEL SUBSIDY AND IMPLICATIONS FOR SOCIAL SPENDING IN NIGERIA: A RESEARCH NOTE

Risikat Oladoyin S. Dauda, Ph.D.
Professor, Department of Economics, University of Lagos, Nigeria

Abstract

The issue of reforming critical sectors of the Nigerian economy, especially the petroleum industry, has grown in prominence recently. It has triggered debate among policy analysts from different parlance arguing in favour or against reforms. Policy analysts and key stakeholders have re-echoed the need for fuel subsidy reform, given its socio-economic cum political implications. Fuel subsidy can exact a fiscal burden on the government, crowding out investment in social factors like education and health. This paper is a research note exploring the implications of fuel subsidy removal on social spending in Nigeria. Some suggestions are proffered for consideration by the government, which will help offset the accompanying socio-economic pressures of fuel subsidy reforms.

Introduction

COVID-19 has remained the central focus of every government recently. This necessitates the rolling-out of socio-economic policies and strategies to cushion the debilitating impact of COVID-19 on the populace. There seems to be a quick recovery for most economies, contrary to the predictions of many Economists. For instance, Nigeria's gross domestic product (GDP) growth is projected at 1.1 percent for 2021. Still, in the first three quarters of 2021, Nigeria's GDP growth hovers around 3.2 percent (See World Bank's Nigeria Development Update, December 2020 and National Bureau of Statistics Report, 2021). The Nigerian economy grew by 3.98 percent (year-on-year) in real terms in the fourth quarter of 2021. The fourth quarter growth rate in 2021 was higher than the 0.11 percent growth rate recorded in the fourth quarter in 2020 by 3.87 percent points and lower than 4.03 percent recorded in the third quarter of 2021 by 0.05 percentage points (National Bureau of Statistics Report, 2022). Nonetheless, quarter on quarter, real GDP grew at 9.63 percent in the fourth quarter of 2021 compared to the third quarter of 2021, indicating a higher economic activity than the preceding quarter (National Bureau of Statistics Report, 2022). This notwithstanding, pre-pandemic socio-economic phenomena comprising poverty, illiteracy, human misery, unemployment, insecurity and ethnic fractionalization, among others, are still glaring with exacerbating impacts on the Nigerian economy.

The issue of reforming critical sectors of the economy, especially the petroleum industry, has taken a phenomenal stance in Nigeria and other developing economies. It has triggered debates among policy analysts from different parlance arguing in favour or against reforms. Policy analysts and key stakeholders have re-echoed the need for fuel subsidy reform, given its socio-economic cum political implications. Fuel subsidy can exact a fiscal burden on the government, crowding out investment in social factors like education and health. Within this context, this paper explores Nigeria's fuel subsidy and its implications for social spending.

Conceptualizing Fuel Subsidy

The issue of subsidies has gained momentum in the last three decades, especially in developing economies. Subsidies can mean the cash transfer payments that the government provides to the consumers and producers. The government often subsidizes fuel so that the high prices of fuel do not create any burden on the producers or the consumers. According to World Bank (2010), a fuel subsidy is when the government cushions the cost of fuel production by lessening charges paid by customers and increasing income for fuel producers. The essence is to keep fuel prices below the international market to encourage consumption and control price levels. Energy constitutes a necessity in driving productivity by business and household use. Subsidizing the fuel price can be economically appealing because it cuts down on fuel prices to minimize the impact of international oil price fluctuation.

The literature identifies two categories of subsidies. These include producer subsidies and consumer subsidies. The producer subsidies are when the government increases the market price that producers receive, while the consumer subsidies arise when the price paid by consumers is below the market price. Subsidies dynamics allow the government to regulate the market price of goods and services, thereby constraining the operation of the free market. In the view of Amin and Chawdhurey (2016), fuel subsidy measures aid economic activities by keeping prices low, controlling inflation, and minimizing economic shock from the fluctuation of international oil prices. In the same vein, fuel subsidies encourage fuel consumption, intending to expand investment in the real sector. Onyeizugbe and Onwuka (2012) assert that the main essence of fuel subsidies is to alleviate poverty and improve citizen living standards.

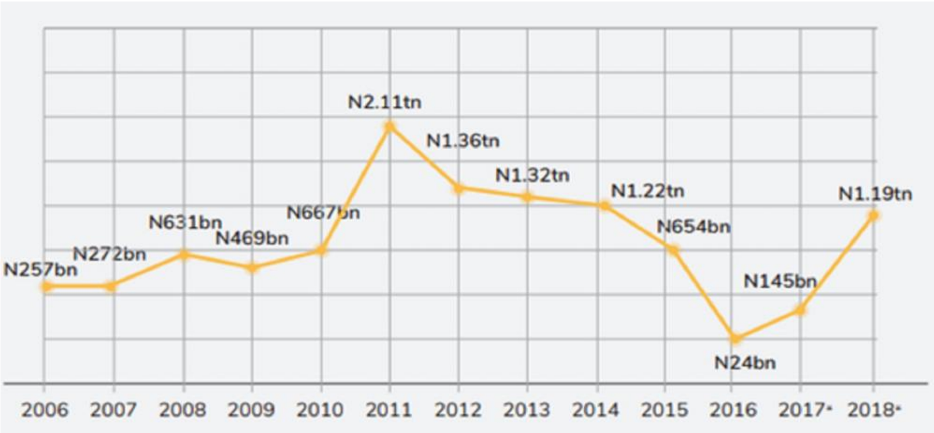
On the contrary, McCulloch et al. (2020) put that the cost associated with subsidies outweighs the benefits. The reason is that it tightens the fiscal burden of the state because the fraction of the price that consumers are supposed to pay to enjoy the use of petroleum products is paid by the government. This hinders investment in social capital like education and health. Aside from this, the environment is at risk of excessive fuel consumption triggered by low prices. This argument around fuel subsidies, fluctuation of international oil prices, the fiscal burden of developing nations, poor living standards, and current economic realities triggers debate among policymakers and international monetary organizations on fuel subsidy reforms.

Overview of Fuel Subsidy and Social Spending in Nigeria

Stylized Facts on Nigeria's Fuel Subsidy

Nigeria is ranked 15th oil-producing economy globally. The nation is a top importer of fuel for domestic consumption (See Worldometer, 2021). To augment the domestic fuel prices, the Nigerian government introduced fuel subsidies in the 1970s to respond to the oil price shock in 1973. However, despite numerous attempts at reform, Nigeria has never successfully removed gasoline subsidies, in large part due to robust and widespread opposition to the reforms.

Figure 1: A 13-year breakdown of Nigeria’s expenditure on petrol import subsidy

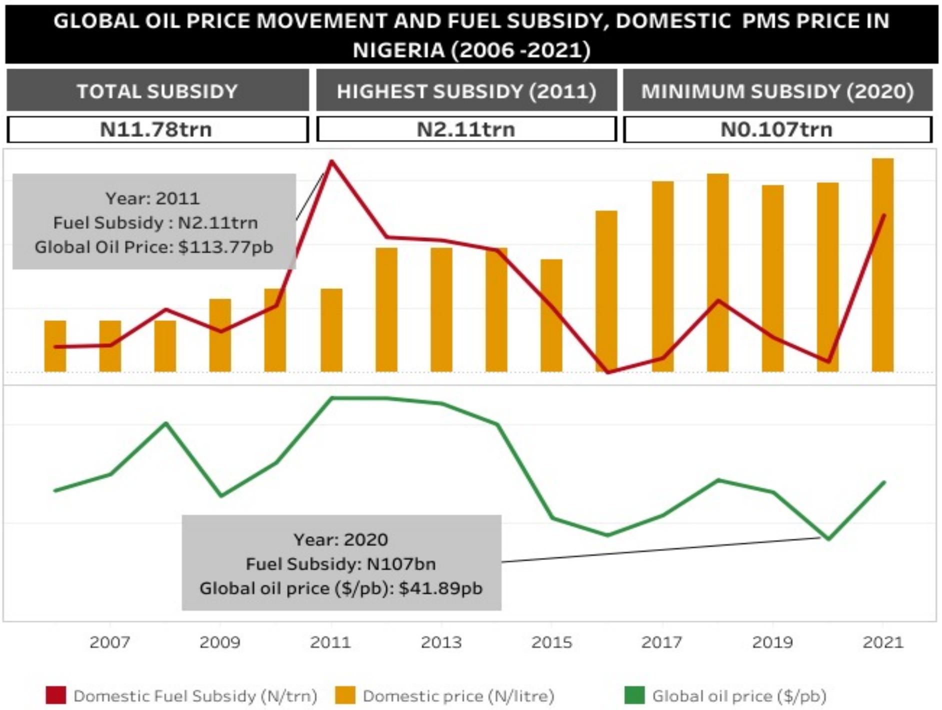


Source: Daily Trust; NNPC Monthly Report

From Figure 1, Nigeria's petrol import subsidy has risen from N257 billion in 2006 to an all-time high of N2.11trillion in 2011. However, between 2012 to 2016, fuel subsidies decline from N1.36 trillion to N24 billion. The 2016 subsidy remains the lowest in the trend. The reason is not far from the fact that the Nigerian economy slid into recession in 2016. Fuel subsidies continued to rise between 2017 and 2018 as the value moved from N145 billion to N1.19 trillion, respectively. A recent estimate shows that N3.0 trillion has been spent on fuel subsidies. The huge amount of spending by the government on fuel subsidies has generated controversies among experts. Some policy experts argued that such spending could be removed and invested in education and health to drive social capital investment. While some others, especially the citizen, believe that reforming fuel subsidies in Nigeria will necessitate a rise in fuel prices which will propel general inflation.

Figure 2 presents the co-movements in global oil price, fuel subsidy costs and domestic PMS price between 2006 and 2021. The figure shows some similar trends and complicated relationships among global oil price, fuel subsidy costs, and domestic PMS price during the study period. Based on this evidence, it is logical to conclude that although fuel subsidy appears to be a fiscal burden, but it reduces the pass-through impact of global oil price increases on domestic fuel prices. On the one hand, and on the other hand, it is noteworthy that higher subsidy cost is not a fall-out of oil price increase alone; it could result from exchange rate depreciation. On the other hand, since Nigeria became a net importer of oil and non-oil goods, there has been a Naira devaluation continually. Resolving domestic production problems and occasional malfunctioning of some plants in the refineries, which has manifested in below-optimal utilization of installed capacities, will reduce the exchange rate's pressure and volatility. Consequently, if the domestic currency is stable and stronger, and there is an increase in global oil price, the net effect of subsidy removal on consumer welfare would be minimal. This, by implication, suggests the need to overhaul the existing ageing refineries characterized by obsolete technology and construct new ones to reduce the dependence on imported fuel products.

Figure 2: Global Oil Price Movement and Fuel Subsidy, Domestic PMS Price in Nigeria (2006-2021)

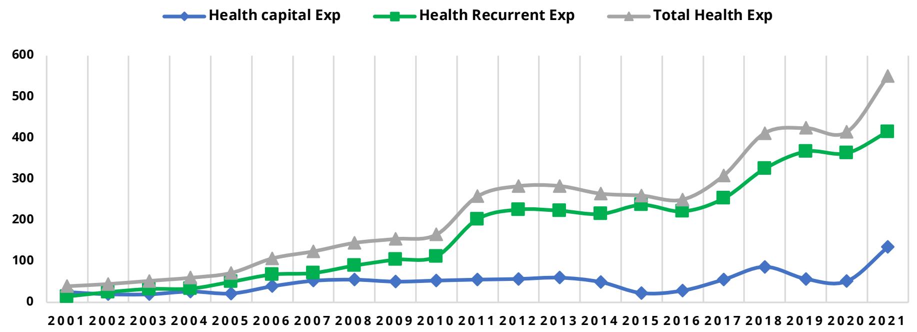


Source: Author's compilation from Central Bank of Nigeria Statistical Database

Recent Trends in Health and Education Spending in Nigeria

Health and education are critical social capital investments. They are needed to drive human capital development that will, in turn, trigger economic productivity. Annabi et al. (2011) and Gong et al. (2012) emphasize the importance of social sectors like education and health in an economy, especially in developing nations. Education and health directly promote economic growth through higher individual income owing to increased labour productivity, marginal productivity, working hours, and duration of production activity. This buttresses the fact that social investment is critical for every nation. More so, this investment is driven by the government, which is why every government budget and allocate funds to the sectors. However, the situation in Nigeria is not different. The government spends annually on health and education. This is to ensure an improvement in health and a reduction in illiteracy levels. Government spending on the health sector is presented in Figure 3.

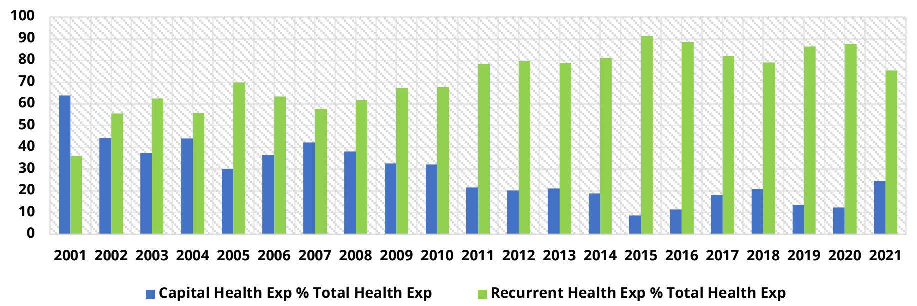
Figure 3: Health Sector Spending (N'Billion)



Source: Author's Computation in Excel using data from BudgiT, 2022

Figure 3 indicates that total health expenditure is rising in Nigeria. The evidence shows that between 2001 to 2021, public health spending moved from N39.27 billion to about N549.83 billion. However, disaggregating the health expenditure into capital and recurrent spending, recurrent expenditure has continued to overwhelm the capital expenditure. This finding implies that government spending is concentrated on maintaining the day-to-day activities of the health sector rather than investing in a capital project to ensure the sector is equipped with the state of the art facilities. Figure 4 shows the percentage of capital and recurrent expenditure as a percentage of the total spending. Figure 4 further shows that government spending on the maintenance of the health sector is greater than the investment in the health sector. This has substantial implications for the health outcomes in Nigeria.

Figure 4: Capital and Health Expenditure (percent of Total Health Expenditure)



Source: Author's Computation in Excel using data from BudgiT (2022)

The implication of insignificant investment in the health sector is glaring with deteriorating health outcomes. According to the BudgiT Health Sector Analysis Report (2021), about 2,300 less than five years old and 145 of childbearing age die every day in Nigeria. However, in most cases, death can be prevented. Further, the report indicates that about 50 percent of maternal death in Nigeria is due to unsafe abortion, preeclampsia and eclampsia, and obstetric haemorrhage. Similarly, the UNICEF report reveals that Nigeria has one of the highest numbers of newborn deaths in Africa, with a neonatal mortality rate of 37 per 1000 live births and approximately 250,000 deaths every year. Similarly, 124 children per 1000 never see their fifth birthday. As a result, this makes the under-5 death rate in Nigeria one of the highest globally. Health outcome in Nigeria is pathetic compared to some developing economies in the world. In Figure 5, the study presents life expectancy ratio data comparing Nigeria and two African countries, Ghana and South Africa.

Figure 5: Life Expectancy at Birth (years)

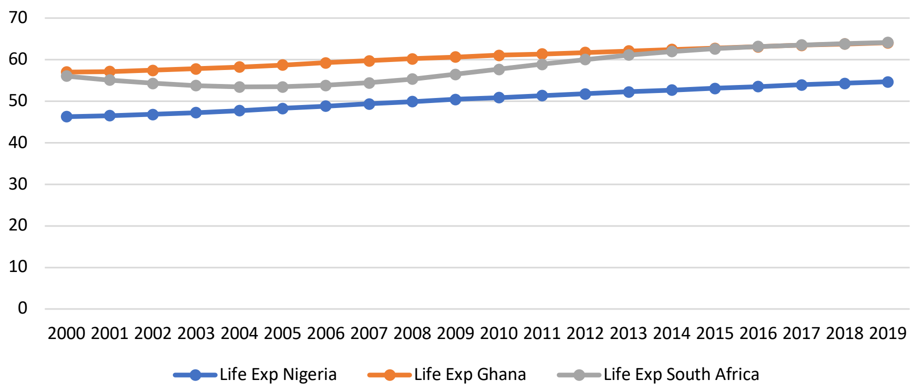


Figure 5 shows that Life expectancy in Nigeria has been improving during the analysis period. Despite the improvement, it is noteworthy that this increase leaves much to be desired compared to Ghana and South Africa. This is worrisome because Nigeria is the wealthiest African nation in terms of GDP size. Further, despite the increase in total health expenditure in Nigeria, budgetary allocation to the sector is still far below the 15 percent budgetary allocation of the 2001 Abuja declaration. In Figure 6, the study presents health expenditure as a percentage of total government spending from 2001 to 2021. Figure 6 shows that Nigeria's healthcare budgetary allocation is miniature and far below the 15 percent 2001 Abuja declaration. This may be the reason for deteriorated health outcomes in Nigeria.

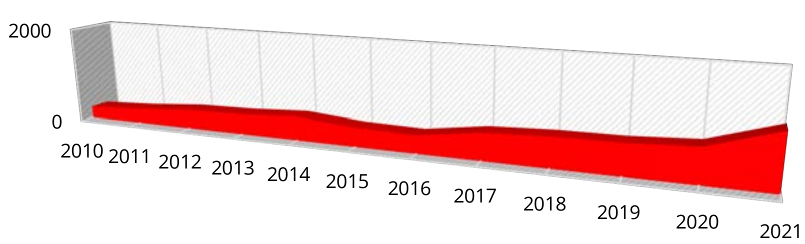
Figure 6: Health Expenditure (percent of Total Expenditure)

Source: Author's Computation in Excel using data from BudgiT (2022)

The Education Sector

The education sector has deteriorated over the last two decades due to inadequate funding. However, the essence of education investment and financing in the Nigerian state cannot be overemphasized. With adequate funding, training of teachers, provisioning of infrastructure in all schools (primary, secondary, and tertiary levels), teaching and learning aids can be guaranteed, and incessant closure of public schools due to strike actions can be avoided. In Figure 7, the study shows the public spending on education between 2010 and 2021. Evidence shows that public expenditure has maintained an upward trend from N249.09 billion in 2010 to about N1,096 billion in 2021.

Figure 7: Education Expenditure (N'Billion)

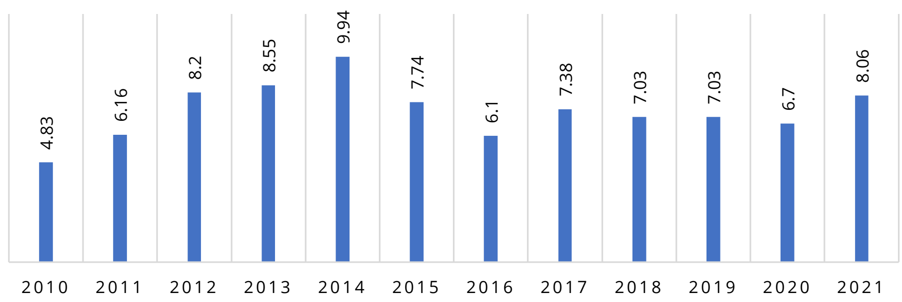


Source: Author's Computation in Excel using data from BudgiT (2022)

The upward trend in public spending has not changed the narrative of the education sector. According to The BudgiT Education Sector Analysis, the education system in Nigeria is not functioning at the optimal level. As a result, it has constituted a threat to the country's social and economic development. The out-of-school children and half-baked graduates Nigeria produces transcends into high unemployment rates, which is a ripple effect of the decay in the sector. According to UNICEF, one in every five of the world's out-of-school children lives in Nigeria. This depicts the severity of the education sector crisis in Nigeria. Aside from this, 10.5

million children aged 5-14 years are not in school. Within the age of 6-11 years in Nigeria, only 60 percent regularly attend primary school. Similarly, only 35.6 percent of children aged 36-59 months could access early childhood education. According to a data report from Statista (2022), the literacy rate in Nigeria was about 62 percent of the total population in 2018. This means that about whooping, 38 percent of Nigerians are illiterates. This evidence has a negative implication on the socio-economic development of the nation. However, one of the identified challenges of education in Nigeria is underfunding. For a clear understanding of the situation, the study presents budgetary allocation to the education sector in Figure 8 from 2010 to 2021.

Figure 8: Budget Allocation to Education (percent of Total Budget)



Source: Author's Computation in Excel using data from BudgiT (2022)

Figure 8 shows that between 2010 and 2021, the education sector received the highest allocation in 2014, with about 9.94 percent. The education sector spending in Nigeria falls below the UNESCO standard of 15 percent to 20 percent. This exposes the underfunding nature of the sector and the deterioration of public schools in Nigeria.

4. Conclusion and Policy Implications

In this paper, attempts have been made to investigate the implications of fuel subsidy removal on social spending in Nigeria. The stylized facts indicate that fuel subsidies in Nigeria tighten the fiscal burden of the government. Figures 1 and 3 show that between 2008 and 2021, government spending on fuel subsidies exceeded total health sector spending in Nigeria. Reforming fuel subsidies in Nigeria can ease the financial burden on the government to invest in the health sector. As capital investment in the health sector increases, health outcomes will improve in Nigeria and arrive at a win-win situation. Similarly, Figures 1 and 7 show that between 2010 and 2021, Nigeria's fuel subsidies exceeded government spending on education. By implication, the social sector (health and education) receives insignificant investment from the government due to fuel subsidies. Fuel subsidy reform in Nigeria can change the narrative of the education and health sectors in Nigeria, especially now that the sectors are more vulnerable to COVID-19. Fuel subsidy reform is expected to discourage fuel consumption, reduce greenhouse gas emissions, and improve environmental quality.

Specifically, what must be done to ensure the implementation of a fuel subsidy reform strategy for a win-win situation in Nigeria? Succinctly, it is noteworthy to state that fuel subsidies reform requires strategic steps and actions to offset the accompanying socio-economic pressures successfully. Within this context, the following strategic measures are suggested:

- There is a need for a comprehensive consultation and public enlightenment campaign. Removal of fuel subsidies is a politically sensitive issue. As a result, there is a need for a constructive public information campaign that involves consulting and educating the populace on the need for subsidy removal and the potential gains to households and the economy. The masses need to know that fuel subsidy benefits the higher income groups the most, and its removal will reduce incentives for smuggling, black market activities, shortages and corruption; spur new investment in the downstream sector; increase government revenue and, by implication, improve social welfare spending; scale-up investments in both hard and soft infrastructures; promote fiscal sustainability and sustainable economic growth which are necessary conditions for poverty alleviation.

- The government must ensure the consumer protection agency is functional and continue to monitor market prices of goods and services. This is because fuel subsidy removal will trigger inflation in the short run, which will trigger a marginal increase in transport costs, thus leading to a rise in the cost of production and food prices. This, by implication, will bring about a decline in disposable income and social welfare. In addition, the agency must put in place an appropriate mechanism to protect consumers against arbitrary price increases and sharp practices of producers who may want to cut corners by reducing product quality.

- Lessons of experience from fuel subsidy reforms from Ghana, Gabon, Mozambique, Iran, India, Brazil, Indonesia, etc. should be studied. Conscientious efforts should be made to investigate why some countries succeed and why others fail.

- There must be a robust social welfare package to cushion possible inflation effects. The universal fuel subsidy is a very costly approach to protect the welfare of low and middle-income households. Accordingly, measures to mitigate the sufferings of the poor and vulnerable groups should be put in place. Infrastructure that benefits low-income households and the vulnerable groups should be provided; Education at all levels and primary health care programmes should be well-funded; Health care delivery services should be expanded in rural areas; Access to food subsidy programmes and cash benefit to the poor and vulnerable groups should be expanded; Investment in rural electrification should be prioritized among others.

- The government must show true honesty and commitment toward reforms and investment in social factors. One significant way of responding to the plight of low and middle-income households is to facilitate their seamless access to basic and social needs that are crucial for their survival and comfort.

- There is the need to resuscitate the existing ageing refineries characterized by obsolete technology and construct new ones to reduce the country's dependence on imported petroleum products.

References

Amin, S., & Chowdhury, T. (2016). The Socio Economic Impacts of Fossil Fuel Subsidy Reform in Developing Countries: The Case of Bangladesh.

Annabi, N., Harvey, S., & Lan, Y. (2011). Public expenditures on education, human capital and growth in Canada: An OLG model analysis. Journal of Policy Modeling, 33(6): 852-865.

Gong, L., Li, H., & Wang, D. (2012). Health investment, physical capital accumulation, and economic growth. China Economic Review, 23(4): 1104-1119.

McCulloch, N., Moerenhout, T., & Yang, J. (2021). Fuel subsidy reform and the social contract in Nigeria: A micro-economic analysis. Energy Policy, 156, 112336.

National Bureau of Statistics (2021). Nigerian Gross Domestic Product Report Q3 2021, Abuja

National Bureau of Statistics (2022). Nigerian Gross Domestic Product Report Q4 2021, Abuja

Onyeizugbe, C. Z., & Onwuka, E. M. (2012). Fuel subsidy removal as an imperative for enhancing business development in Nigeria. VSRD International Journal of Business & Management Research, 2(9): 454-461.

Statista (2022). https://www.statista.com/statistics/1124745/literacy-rate-in-nigeria-by-zone-and-gender/ (Accessed on 20th January 2022).

World Bank (2021) https://www.worldbank.org/en/country/nigeria/publication/nigeria-development-update-ndu (Accessed on 20th January 2022).

World Bank, (2010). Subsidies in the Energy Sector: An Overview, Background Paper for The World Bank Group Energy Sector Strategy.

Woldometer, (2021). https://www.worldometers.info/oil/oil-production-by-country/ accessed on 20th January, 2022.

Acknowledgement

The author is grateful for research assistance from Ekundayo P. Mesagan, Pan Atlantic University, Lagos and Precious Emmanuel of MGIG Global Research, Lagos. The author also thanks the anonymous referees whose comments have enriched the paper.