

Prices of petroleum products in nigeria economics essay



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INTRODUCTION

The prices of petroleum products in Nigeria have been a source of contention and controversy. Meanwhile, the Nigerian economy which used to depend on the agricultural sector decades ago now depends heavily on the oil sector which, the International Monetary Fund (IMF) says accounts for over 95 percent of export earnings and about 65 percent of government revenues.[1]

The removal of subsidies on petroleum products remains a contentious issue in Nigeria.

The Federal Government of Nigeria has of recent attempted to liberalize the price of the various fuels prior to the end of 2010 or in early 2011 implying that the Government will no longer pay subsidies to importers of refined oil products. The total cost of importing the refined oil is shared between the government and the importers thus reducing the overall cost to the

importers and enabling them sell at a lesser price than would have ordinarily
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been sold in the absence of subsidies. The ultimate beneficiaries here are the Nigerian consumer as well as the Nigerian economy.

A Nigerian currently pays N65 per litre (slightly less than US\$0.5) for PMS used to run their cars and power their generators but the cost of importing the petrol and getting it to the petrol stations is said to cost over N90 or \$0.60 per litre. The government thus gives subsidy to cover the difference, reducing the cost to the importers enabling them still gain profit from the business as well as keeping prices down for the consumers.

Giving subsidy for fuel began during the military rule and has surprisingly remained the most sustained acts of the government. The government has never been seen to support any industry in a sustained manner helping it maintain its comparative advantage region wide and still continue being globally competitive. The economic as well as social impact of the weakened refining sector has been offset by the subsidies. Even though the Nigerian government saw itself having to pay almost as much as the other regional governments for locally used fuel, the burden of the additional costs were not transferred to the consumers giving it an advantage over the other West African countries. The country thus retained its position as the economic hub of the Economic Community of West African States (ECOWAS) region. But the accumulation of infrastructural and institutional inefficiencies and wide spread systemic corruption began to set in even as regional countries were beginning to put their act together and outdo Nigeria in several important sectors. Ghana from 2006, with better policies implemented and steady electrical power supply, has become the magnet in the West African region for foreign direct investment. Several multinational corporations and even <https://assignbuster.com/prices-of-petroleum-products-in-nigeria-economics-essay/>

Nigerian entrepreneurs have now chosen Ghana as their location of choice for their headquarters.

A reform package for the petroleum industry known as the Petroleum Industry Bill (PIB) is now being deliberated upon in the Nigerian National Assembly. The PIB includes a plan to stop the payment of oil subsidies to importers and deregulate fuel prices. The objective of this PIB is to once again restore Nigeria to its economic leadership position of the region. The bill is meant to enhance the performance of the industry by improving crude extraction and oil exploration and encouraging more private investment, especially in the downstream sector where Nigeria needs to revive existing refineries and build new ones capable of meeting all domestic and international demand for refined products.

Most of the public attention received has been focused on one aspect of the reform bill - the government's intention of removing fuel oil subsidies. Consumer advocates, especially the trade unions, have condemned the removal of this subsidy. There is a general support for the PIB, but the removal of fuel subsidy is not being accepted. If the price deregulation goes through, there would be at least a 54 percent increase in the price Nigerians must pay for petrol, kerosene and diesel. The US \$1. 97 per gallon or \$0. 43 per litre, which it costs now to buy gas at the pumps, will increase to between \$3. 04 and \$4. 54 per gallon. The unions are apprehensive of the effects that these price increase will have, speculating that high inflation will follow.

Suffice it to say that the Nigerian economy (which includes the oil industry) is crippled, dragged down by political unrest, militant mutiny, infrastructural and institutional inefficiency and corruption. The oil and gas industry suffers from these as well. The government desires to fix these issues now with reforms based on the PIB but critics fear that fuel price deregulation, which will no doubt lead to price increases - will deteriorate the economy further, unless government pays attention to the broken down refineries and revives them- a task that would demand honesty, time and a huge amount of resources. The government's promise of revived refineries seems far-fetched seeing that previous attempts at this, which gulped billions of dollars, have not been productive. The unions are therefore advocating for at least four refineries to be repaired and in full use before the price reform is undergone.

However, advocates of the proposed reforms inside government seem anxious to resuscitate this industry. They believe that the implementation of the PIB reform package as a whole would do this. They believe that by resuscitating the industry, there would be a greater inflow of FDI as well as increased competition which would lead to increased efficiency and the acceptance and implementation of the PIB is the right place to start. The private importers of petroleum products as well as the domestic marketers also seem keen about the planned deregulation. For them, it is because presently, the government continues to be sluggish in making payments leaving them to bear the cost of importation alone before the subsidy payments finally go through. In 2009, The Central Bank of Nigeria's audit of commercial banks showed oil marketers to be the major borrowers (albeit defaulting ones) from the banks. These oil vendors, in turn, put the blame on

the government's failure to pay subsidies at the appropriate time. The Petroleum Products Pricing Regulatory Agency (PPPRA) was accused of often taking years to effect payment and in some cases did not pay in full. Marketers thus believe that deregulation will ensure marketers recover their investments and profits directly and quicker. By extension, therefore, the commercial banks would also recommend that this deregulation to takes place.

On the other hand, the Nigerian consumer sees price deregulation as an easy way out for a government that continuously remains reluctant to pay out over N400 billion every year in subsidies to the oil marketers. Consumer groups are convinced that deregulation means Nigerians in the near future will be paying the price for government and industry failures - failed public enterprises due to the inefficiency in government processes. A clear example is the case of the Nigerian National Petroleum Company (NNPC) which, for a long time, had the singular license for the importation of refined petroleum products into the country. This caused a number of supply and distribution hiccups leading to the issuance of licences to private individuals and corporations for the business. However, these private operators handle just about 30 percent of the total imports with the bulk of the subsidies still going to the NNPC.

Basically, the oil and gas sector is crucial to Nigeria for revenue generation, investment and country wide growth and development. The Nigerian economy is heavily dependent on the oil sector, which accounts for 95 percent of government revenues. Even with the substantial oil wealth,

Nigeria ranks as one of the poorest countries in the world, with a \$1, 000 per capita income and more than 70 percent of the population living in poverty.

BACKGROUND OF THE STUDY

By the time Nigeria became politically independent in October 1960, agriculture was the dominant sector of the economy, contributing about 70% of the Gross Domestic Product (GDP), employing about the same percentage of the working population, and accounting for about 90% of foreign earnings and Federal Government revenue. The early period of post-independence up until mid-1970s saw a rapid growth of industrial capacity and output, as the contribution of the manufacturing sector to GDP rose from 4. 8% to 8. 2%. This pattern changed when oil suddenly became of strategic importance to the world economy through its supply-price nexus.

Crude oil was first discovered in commercial quantities in Nigeria in 1956, while actual production started in 1958. It became the dominant resource in the mid-1970s. On-shore oil exploration accounts for about 65% of total production and it is found mainly in the swampy areas of the Niger Delta, while the remaining 35% represents offshore production and involves drilling for oil in the deep waters of the continental shelf. Nigeria has proven reserves of about 32 billion barrels of predominantly low sulphur light crude, which at current rate of exploitation could last another 38 years. The intention is to expand the reserves to 40 billion barrels and production capacity to 4 million barrels per day (mbd).

The massive increase in oil revenue as an aftermath of the Middle-East war of 1973 created unprecedented, unexpected and unplanned wealth for

Nigeria. Then began the dramatic shift of policies from a holistic approach to benchmarking them against the state of the oil sector. Now, in order to make the business environment conducive for new investments, the government began investing the newfound wealth in socio-economic infrastructure across the country, especially in the urban areas. As well, the services sector grew. The relative attractiveness of the urban centres made many able-bodied Nigerians to migrate from the hinterland, abandoning their farmlands for the cities and hoping to partake in the growing and prosperous (oil-driven) urban economy. This created social problems of congestion, pollution, unemployment and crimes.

The national currency, Naira, strengthened as foreign exchange inflows outweighed outflows, and foreign reserves were built up. Up until 1985, the Naira was stronger than the US Dollar. This encouraged import-oriented consumption habit that soon turned Nigeria into a perennial net importer, which became a major problem when oil earnings decreased with lower international oil prices. External reserves collapsed, fiscal deficits mounted and external borrowing ensued with the “ jumbo loans” taken in 1979. Most of Nigeria’s macro-economic indices became unstable and worrisome.

Several policy initiatives to address the defective structure and inefficiencies were taken, but poorly implemented and sometimes contradictory (with cases of self-interest motivated reversals). These created new distortions and further weakened the inchoate institutions for policy implementation.

The average Nigerian therefore, became so sensitive to petroleum oil and all the variables surrounding it, to the extent that any development in the

international oil markets invites an almost instantaneous reaction from domestic economic agents and policy makers alike.

In essence, policy formulation appears to respond to the oil situation or attempt to take advantage of it. This usually takes the form of “ expand expenditure when oil earnings increase, maintain the position when there is a dip in earnings and seek a desperate way out when there is crisis.” Another dimension to the oil issue is to “ look for opportunities in the oil sector to enhance Government revenue”. Invariably, everything points in the direction of oil.

STATEMENT OF RESEARCH PROBLEM

The Nigerian oil sector can be categorized into three main sub-sectors, namely, upstream, downstream and gas. The most problematic over the years has been the downstream sector, which is the distribution arm and connection with final consumers of refined petroleum products in the domestic economy. The incessant crisis in supply of products culminated in the decision by Government in 2003 to deregulate the downstream sub-sector. However, the manner of its implementation has been controversial because it ignores the economic realities in Nigeria.

The over-dependence on oil has created vulnerability to the vagaries of the international market. In particular, the place of oil in the psyche of the average Nigerian has become more profound since the “ imperfect” deregulation of the downstream segment of the Nigerian oil industry in 2003. The contradiction is more glaring now with the recent rise in crude oil prices at the global markets, which meant more external earnings for Nigeria, but

also increased the expense burden on imported refined petroleum products! It is such contradictions (perhaps aberrations) that make the Nigerian economy appear strange at times, as policies seem to ignore what appears obvious to do. As such, policies designed to address the deficiencies and defects in the structure end up being poorly articulated and/or implemented because of regional, political or rent-seeking selfish interests. Obviously, it is the same rent-seekers that continually sabotage the reinvigoration of the domestic refineries, making Nigeria to depend on importation of refined products to meet the domestic need.

OBJECTIVE OF STUDY

To ascertain how the Nigerian oil and gas industry has fared

SOURCES OF DATA AND RESEARCH METHODOLOGY

Based on the nature of the study, the extracted data for the study are mainly from secondary sources particularly from Central Bank of Nigerian (CBN) statistical bulletin Bureau of Statistics publications.

The research is based on exploring the basic causal relationship between petroleum liberalization and economy growth. Variables are allowed to interact among equations to test for multi-collinearity. Estimation is by the ordinary least square (OLS) technique of estimation.

Further, the effect of higher petroleum prices on the aggregate price level, real growth, and income distribution is appraised within a multi-sector computable general equilibrium (CGE) model.

SIGNIFICANCE OF THE STUDY

At the end of the study, the outcome will be useful in the following ways:

It will be of immense use to policy makers because it will further enhance their knowledge on the impact of petroleum liberalization on the Nigerian economy.

It will assist in highlighting how the nation's vulnerability in the oil sector can be curbed. It is known that Nigeria's hydrocarbon resources are the mainstay of the country's economy but production and growth of the oil and natural gas sectors are often constrained by many factors including instability in the Niger Delta (the southern region of the country). The oil industry is primarily located in the Niger Delta where it has been a source of conflict. Local groups seeking a share of the oil wealth often attack the oil infrastructure and staff, forcing companies to declare force majeure on oil shipments. At the same time, oil theft, commonly referred to as " bunkering" leads to pipeline damage that is often severe, causing loss of production, pollution, and forcing companies to shut-in production. The industry has been blamed for pollution that has damaged air, soil and water leading to losses in arable land and decreasing fish stocks.

The outcome of the study, also, will be of importance to international community, local and international oil and gas administrators, economic development experts, and others in related fields of study.

PLAN OF THE STUDY

This research study is divided into five separate chapters. The first chapter is the aspect of the study that deals with the introduction to the study. It serves as the overview of the entire research work. Chapter two covers a comprehensive review of relevant opinion of eminent scholars and schools of thought on the subject matter.

Research methodology is presented in chapter three. The adopted methods of research and models are described in this chapter including the methods used in gathering and analyzing the data. In chapter four, data related to the study is presented and analyzed. This section reports the result of the policy simulation. The fifth chapter contains the summary of the study including the presentation of findings of the research and recommendations.