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HIGH PRICE OF PRETROLUEM PRODUCTS AND INFLATIONARY SPIRAL IN NIGERIA

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Abstract

The removal of the fuel subsidy by the government which prompted increases in petroleum products in the country and subsequent rises in the prices of goods and services in the country. The aim of this study is to ascertain whether there is a direct relationship between the increase in petroleum products and the general inflationary spiral across the country. The methodology for the study is descriptive survey using qualitative research methodology. Secondary literatures on the subject were revealed to ascertain the findings of scholars earlier on the topic. The results from the study showed that there is a direct relationship between increases in petroleum products and [redacted] inflationary spiral in the country. The study concluded that there is need for the monetary policymakers to come up with effective policies in place to manage the spiral effects of inflation which is on the increase on daily basis.

Keywords: Costs, Goods, Inflation, Nigeria, Petroleum, Spiral

Introduction

One of the fallouts of the inauguration of President Bola Tinubu is the removal of subsidies on the price of petrol which is the major source of vehicle energy in the country. This removal saw an increase of the price of this product from a little above one hundred Naira per litre to its present price of the neighbourhood of six hundred Naira per litre. An increase that had created some imbalances between the supply and demand of most products in the economy. This is coming at the time that like most other economies there had been COVID-19 pushed consumer inflation and that of the Ukraine triggered further increases since the Nigerian economy is import dependant.

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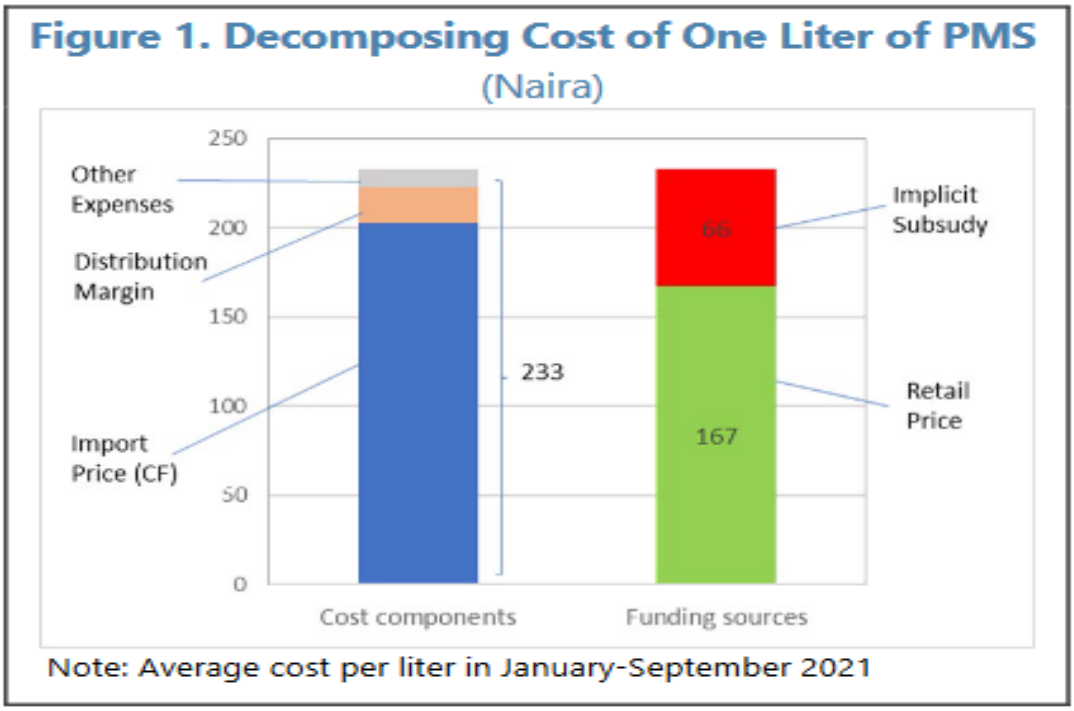
All attempts to remove fuel subsidy in the country have proved abortive. According to the International Monetary Fund (IMF) (2022) in June 2020, the Nigerian federal government (FGN) announced that it removed the fuel price cap. However, it did not follow through with introducing a market-based pricing mechanism and, as oil prices rose, considerable fiscal costs built up from implicit subsidies resulting from the difference between higher prices of imported fuel products and regulated pump prices. As there is no provision for subsidy payments in the 2021 budget, such costs are being borne by the national oil company (NNPC), which are deducted from the oil revenues accruing to the Federation Account. This removal is shown in the figure below.



Source: The International Monetary Fund (IMF) 2021 Nigeria: Selected Issues, p. 4

The aim of this article is to examine the impact of the high cost of petroleum products on other goods and services in the country. This essence is to ascertain whether the high cost of the petroleum products could be the main drivers of inflationary spiral or was the high cost of the products and services attributable to other cause and whether the inflation expectations a response to other factors salient in the economy. Melek, Dillon & Smith (2022) had in a study on the impact of high cost of gasoline post COVID-19 in the USA found that an increase in the national price of this product could impact negatively on the costs of products in

the country. This means that there could be a positive relationship between the cost of petroleum products and inflationary spiral in the economy. The Nigerian experience may not be far from this situation.

Methodology

This is a basic research which is descriptive in nature as attempts would be made to unravel the essential elements and characteristics of the issues of the study (Dionco-Adetayo, 2001). This research is interested more in describing the impact of the variables within the armpit of the study. This study will therefore be qualitative and secondary literatures on the subject would be reviewed so that a meaningful conclusion could be arrived at. This would be mainly papers that have looked on the relationship between petroleum price increases and inflationary spiral in the Nigerian environment.

Inflation and the Nigerian economy

As younger students in school we were made to see inflation from two perspective which were that of high price as a result of the demand for a product being higher than the supply or rather just to see it as rising high cost of products. Looking at the removal of subsidy by the government and the resultant rising prices of the petroleum product, it could be easier to see inflation as a rising cost of products as a result of fiscal or monetary policy of the government. Little wonder that Bawa, Abdullahi & Ibrahim (2016) argued that Inflation means continuous rise in general price level of goods and services in an economy; and is of primary concern to all stakeholders. Inflation even in the absence of economic shocks, displays the tendency of reproducing itself from one period to the next.

Inflation has been a major challenge to the Nigerian economy right from the time of independence to date and it gets worst with each passing year. Bawa et al (2016) had further revealed that inflation is premised on the distortions that high inflation can exert on domestic macroeconomic conditions, with the potential to derail the economy from the path of sustainable economic growth and development. They concluded that inflation adversely affects the overall growth, financial sector development and the vulnerable poor segment of the population. In this way, it has the tendency to induce uncertainty, discourages savings, promote consumption, poses serious threat to macroeconomic stability and result in high social costs in the Nigerian economy, as we are in continuum facing in this country.

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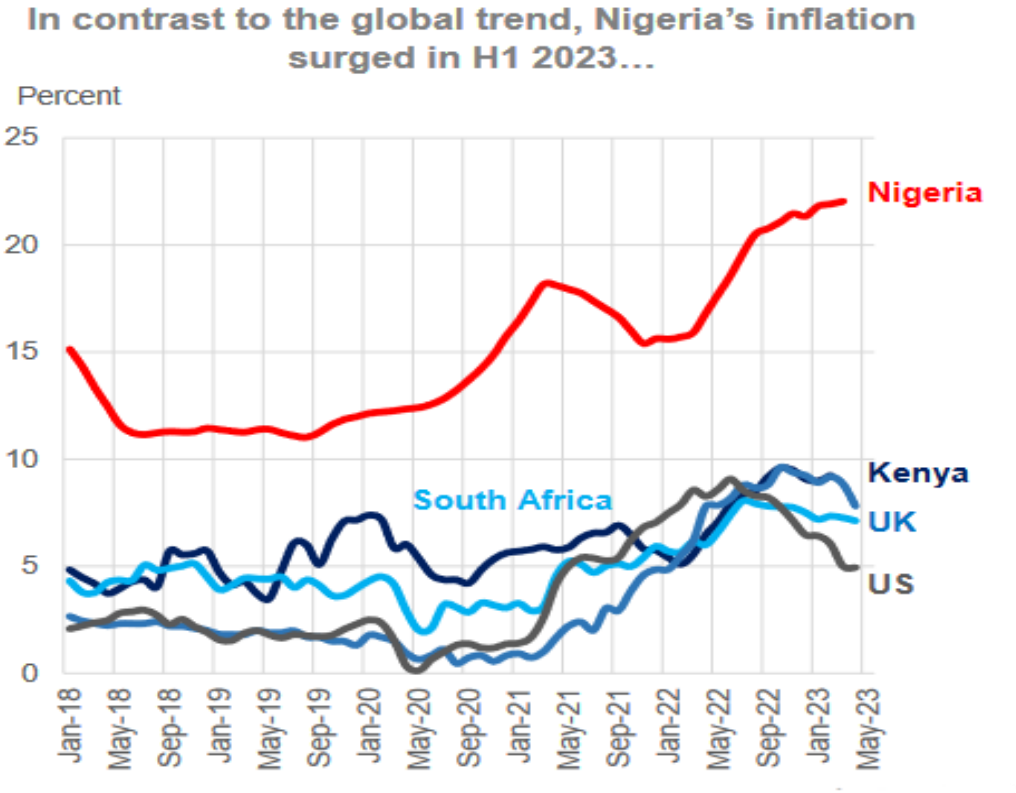
According to the Bureau of Statistics (2023) in January 2023, the headline inflation rate rose to 21.82% compared to December 2022 headline inflation rate which was 21.34%. Looking at the trend, the January 2023 inflation rate showed an increase of 0.47% points when compared to December 2022 inflation rate. However, on a year-on-year basis, the headline inflation rate was 6.22% points higher compared to the rate recorded in January 2022, which was 15.60%. This shows that the headline inflation rate (year-on-year basis) increased in the month of January 2023 when compared to the same month in the preceding year (i.e., January 2022). Going through the years there are substantive evidence to show that this has been the trend year in year on.

In looking at the inflationary trend in Nigeria compared to other countries including those of Africa, the World Bank (2023) concluded that the high inflationary rate in the country was as a result of monetary and fiscal policies of the government. These policies had rather that helped in mitigating inflation had cause it to be on the rise. The Nigerian situation could be depicted as in the figure below.

Figure 2: Inflationary spiral in Nigeria compared to other countries



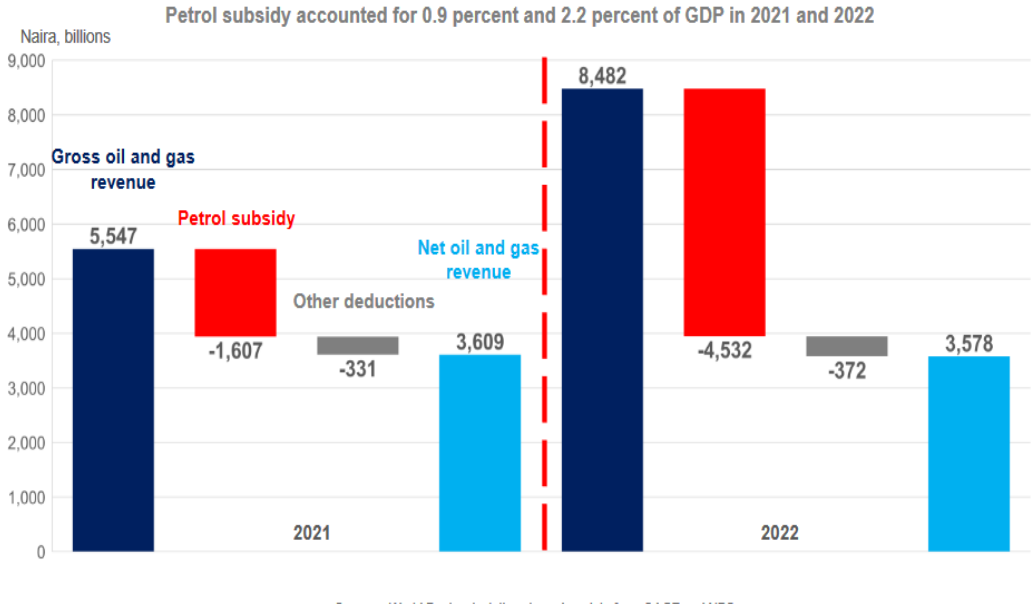
Source: CBN, WDI, FMDQ and World Bank, 2023

INCREASE OF PETROLEUM PRODUCTS IN NIGERIA

It is has become historically that one of the first policy and major policy of any new administration in the country is to increase the prices of petroleum and the reason for doing is always the same to remove subsidy and ease out fund funds for developmental purposes. Incidentally and ironically the results from such exercises in the past had been same. Little or no impact in improving the standard of living of the people and create more developments in the economy.

The World Bank (2023) had asserted that the petrol subsidy gulped 0.9% and 2.2% of the country's GDP in 2021 and 2022 as shown in the figure below.

Figure 3: Percentage of Subsidy to the Nigerian GDP

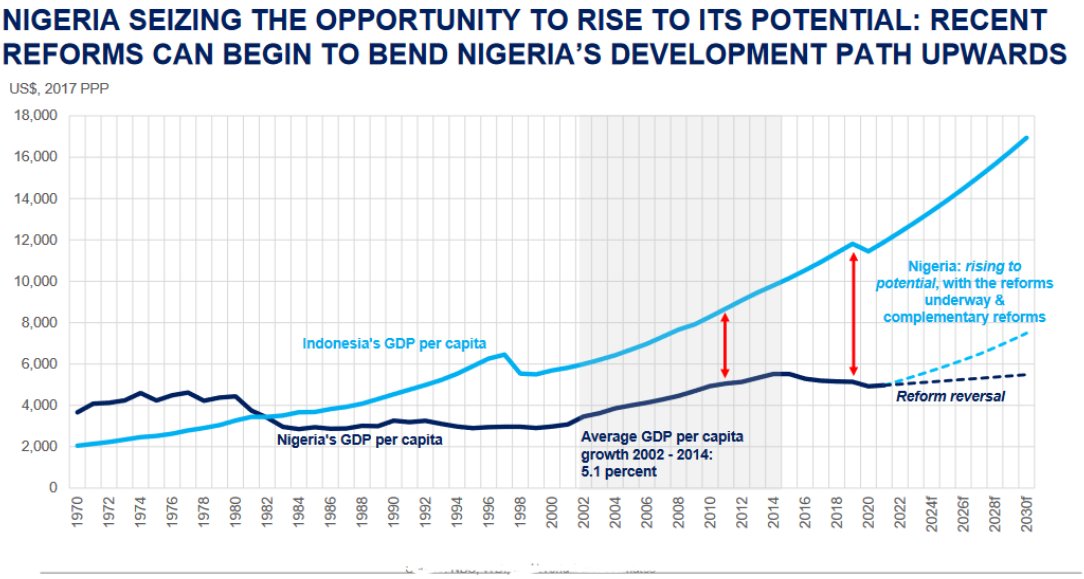


Source: World Bank (2023) calculations based on data from OAGF and NBS

Even with the release of fund to the system there is concern that the high debt profile and the high import dependence of the economy could posed further threat to the economy. Hence, the issue of inflationary spiral could even increase than ever. According to Ogu, Adagiri, & Abdulsalam (2023) in Nigeria, the economy could hardly produce output to meet up with economy's demand and which is highly foreign dependent, might be faced with more inflationary pressures due to excess demand and when taxes are increased as the producers may get involved more in rent seeking economic activities rather getting involved in the real sectors of the economy which can tackle the problem of low productivity and unemployment.

Nevertheless, the World Bank (2023) there is a light in the tunnel from the present reform. The World Bank posited that the present reform has the tendencies to grow the Nigerian economy as shown in the figure below.

Figure 4: Opportunities and Potentials in the Nigerian economy



Source: NBS, WDI and World Bank Estimates, 2023

Empirical reviews on increase of petroleum products and inflationary spiral in Nigeria

In an empirical study in India, Sarmah & Bal (2021) based on a structural vector autoregressive framework on the monthly data from April 1997 to July 2016, this study attempted to show the impact of crude oil price on the rate of inflation and economic growth in India. The results from the study showed that the crude oil price has a positive impact on the rate of inflation whereas an inverse relation exists between crude oil price and economic growth. Further, these scholars segregated the crude oil price into two components, that is, positive and negative partial sum of oil price through the nonlinear and asymmetric autoregressive distribution lag framework, and a similar kind of result was derived in the case of positive partial sum of oil price on the rate of inflation and economic growth, while a significant negative relationship is found in the negative partial sum of crude oil price on economic growth. Thus, from the policy perceptive, the scholars suggested that policymakers should focus on reducing the consumption of crude oil and using renewable energy for accelerating the economic growth. They added

that this would not only prevent the domestic economy from international oil price fluctuations and inflation but also assist in achieving sustainable environmental goal of reduced crude oil use.

In a study titled: Petroleum products prices and inflationary dynamism in Nigeria carried out as far back as 2015, Eregha, Mesagan & Ayoola (2015) posited that it was well documented in the literature that there exists a positive relationship between oil price and inflation. In this study, they found that the price of Premium Motor Spirit (PMS) remained stable in Nigeria until the entry of the military into the administration of the country when the then military heads of state arbitrarily increased the prices of petroleum products. They also found that there exists high positive relationship between the prices of PMS and AGO and inflation in Nigeria. They then concluded that rises in petroleum products prices, especially PMS and AGO, significantly impact inflation in Nigeria. With this result, they recommended that government should shelve the idea of removing subsidy on PMS for now and focus on deregulating the downstream sector to attract private investment with the aim of encouraging local refining of petroleum products instead of importing them. This, they argued, would in turn reduce domestic prices for petroleum products and consequently inflation.

As earlier noted each administration that comes to power in Nigeria would increase the price of petroleum products so as to generate more refunds for its expenditures. Inflation rate in Nigeria is quite unstable as this may have been caused by increase in the price of petroleum products. In a study titled: Impact of changes in petroleum product prices on inflation in Nigeria Mensah et al (2021) employed Autoregressive Distributed Lag model for the data analysis and the scope of the data used from the analysis of the study ranges from 1980 to 2016 to look at the relationship between increase in price of petroleum products and inflation in the country. The study found that petroleum pump price has a positive impact on inflation and the result is statistically significant at 5% level of significance; given the fact that virtually everyone is directly or indirectly connected to the usage of petroleum products, therefore the increase in price of petroleum products affects everyone in the country. The study then found that the prices of Automotive Gas Oil (AGO) and Bonny Light Crude Oil has a positive relationship with the level of inflation in Nigeria. This study concluded that since these petroleum products are imported, the prices of these products would directly increase the prices of other goods in the Nigerian society.

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In another study on the impact of petroleum products price changes on prices of food items in the Nigerian economy, Kyarem & Dodo (2023) observed that there seems to be disequilibrium between food items and petroleum price changes in Nigeria. Every petroleum price change is followed by a rise in the prices of food items and increased poverty. The study used the annual time series data from 1991 to 2021 adopting the ARDL approach to determine the long-run and short-run relationship between the price of premium motor spirits and the price of food items in Nigeria. The results with aid of the unit root to showed that the price of premium motor spirit has a positive and significant impact on food items during the short run but in the long run, the prices of premium motor spirits have a positive and insignificant impact on the food items in Nigeria. This is in line with the results of the Toda and Yamamoto (1995) causality tests that showed that there was a unidirectional causality running from the price of food items to the price of premium motor spirit and from the exchange rate to the price of food items. In this regard, the scholar argued that the government should implement policies that encourage agricultural productivity which has great potential of boosting food supply so as to reduce the price of food items across the country. This way, timely increases in petroleum prices would generate more revenue without inflationary trends in food items. This will go a long way to reduce the hardship being faced by majority as a result of the increase petroleum products across the country.

Discussions

The findings from available literatures on the effect of increase of petroleum product and inflationary spiral have shown that there is a positive relationship between both variables. This may be as a result of the fact that inflationary expectation by the people following an increase could prompt businesses to actually increase the prices of their products and services, hence rising input costs, they are likely to set higher prices in the immediate to protect their profit margin. More so, according to the Nobel laureate economist Robert E. Lucas individuals form their expectations about aggregate inflation based on their source of information on current state of the economy (Lucas, 1972, 1973, 1975). The Nigerian situation is not an exception to this position.

Melek, Dillion & Smith (2022) argued that gasoline, which we call petrol, is one such salient good, the price of which consumers frequently observed at retail gasoline station. Melek et al (2022) further revealed that several studies have

documented a strong relationship between the price of gasoline and households' inflation expectation (Hastings & Shapiro, 2013; Georganas, Hearly & Li, 2014; Coibion & Gorodnichenko, 2015; Binder, 2018). The volatile nature of the petroleum products as observed by Melek et al (2022) contributes to this correlation, as consumers are more likely to remember extreme movements in prices and use them to form expectations about the future (Bruine de Bruin, van der Klaauw & Topa, 2011).

Conclusion

The increase in the prices of the petroleum products have affected the prices of every other commodities and unfortunately it has not impacted positively on economic growth of the economy as had been envisaged by the government. It is pertinent to note that the spike in petroleum products prices following the assumption of office by the present government accentuated the similarities of inflation that could be seen in war torn countries like Ukraine. Nevertheless, there is need for the monetary policymakers to come up with effective policies in place to manage the spiral effects of inflation which is on the increase on daily basis. All facets of lives are being affected including that of dying. For instance, the higher the inflation the higher the number of deaths in the society. The higher death strains are caused by the inability of the people in the society to afford basic things of life such as food, medication, recreation, etc.

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