

**MODELING THE ECONOMIC IMPLICATIONS OF NIGERIAN DOWNSTREAM
SECTOR DEREGULATION USING AUTO REGRESSIVE AND DISTRIBUTED LAG
MODEL (ARDL)**

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ABSTRACT

The oil industry is clearly the mainstay of the Nigerian economy, with revenues from the industry accounting for over 80% of the nation's foreign exchange as well as over 80% of GDP. Therefore, the importance of the petroleum industry to Nigeria's development and economic strength cannot be over stressed. This study analyzes the economic implications of Nigerian downstream sector deregulation using ARDL, with a focus on Premium Motor Spirit (PMS). The study utilized monthly time series data from 1990-2023 using Autoregressive Distributed Lag (ARDL) model. Investigating dynamic relationships among deregulation policies, PMS prices, and its effect on the economy. The research captures both short-term and long-term effects of deregulation. These findings offer valuable insights for policymakers, industry stakeholders, and investors, aiding evidence-based decision-making and policy formulation. It proposes that if the deregulation of the downstream is to yield best outcomes especially in product pump price then having an effective domestic refining capacity is very imperative which would include revamping the state owned refineries, issuing licenses' for the construction of new refineries and operating them optimally. It recommends that the deregulation of the downstream must be gradual in order to achieve its desired goals

KEY WORDS: *Deregulation, downstream sector, ARDL, economic policy*

1.0 Introduction

The Nigerian downstream petroleum sector has been regulated for decades, leading to inefficiencies and corruption (Akinlo, 2017). The sector has been characterized by government control over prices, production, and distribution, resulting in a lack of competition and innovation. This has led to a decline in the quality of services and infrastructure, as well as a lack of investment in the sector. Furthermore, regulation has created opportunities for corruption, with officials embezzling funds meant for subsidies and other purposes.

Deregulation is expected to address the issues plaguing the Nigerian downstream petroleum sector by improving efficiency, increasing investment, and reducing corruption. One of the primary ways deregulation will achieve this is by increasing investment in the sector. According to Oladunjoye (2017), deregulation will lead to increased investment, as private companies will be incentivized to invest in the sector. This is because deregulation will create a more favorable business environment, with fewer regulatory hurdles and more opportunities for growth. As private companies invest in the sector, it will lead to modernization and expansion of the sector. This will include the adoption of new technologies, the construction of new infrastructure, and the expansion of existing facilities. Additionally, deregulation will encourage competition, which will drive down prices and improve services. With more companies operating in the sector, there will be increased pressure to reduce costs and improve efficiency, leading to better services and lower prices for consumers. Deregulation is expected to have a positive impact on the Nigerian downstream petroleum sector, leading to increased investment, modernization, and expansion, as well as improved services and infrastructure. By encouraging competition and reducing regulatory hurdles, deregulation will create a more favorable business environment, leading to growth and development in the sector.

However, the economic implications of deregulation are unclear. Some potential risks include job losses, as inefficient state-owned enterprises are privatized or closed. As noted by Iwayemi (2017), deregulation could lead to market instability, as new entrants

and competitors emerge. This could lead to fluctuations in prices and supply, affecting the overall stability of the sector. Furthermore, deregulation could lead to price increases, as market forces determine prices. This could have a negative impact on consumers, particularly low-income households.

The AutoRegressive Distributed Lag (ARDL) model is a suitable econometric technique for modeling the economic implications of Nigerian downstream sector deregulation. ARDL is a dynamic model that examines the long-run and short-run relationships between variables, making it ideal for analyzing the impact of deregulation on the downstream sector. By using ARDL, researchers can capture the dynamic relationships between variables, allowing for an examination of how deregulation affects the downstream sector over time. ARDL is also capable of distinguishing between long-run and short-run effects, enabling researchers to identify both the immediate and long-term impacts of deregulation. Furthermore, ARDL can handle cointegrated variables, which is common in economic data, ensuring that estimates are reliable and unbiased (Pesaran, Shin & Smith, 2001). This makes ARDL an effective tool for modeling the economic implications of deregulation in the Nigerian downstream sector.

Deregulation is expected to lead to increased investment, modernization, and expansion of the sector, as well as improved services and infrastructure (Adeyemi&Fashola, 2015). However, it may also lead to job losses, market instability, and price increases. ARDL can help model these potential outcomes and provide insights into the likely impacts of deregulation on the Nigerian economy. The use of ARDL in modeling the economic implications of deregulation in the Nigerian downstream petroleum sector can provide valuable insights for policymakers and stakeholders. By understanding the potential outcomes of deregulation, they can make informed decisions about the timing and extent of deregulation, and develop strategies to mitigate any negative impacts.

Statement of Problem

The Nigerian government has announced the full deregulation of the downstream petroleum sector in 2003 and on 29 May 2023, His Excellency, President Bola Ahmed Tinubu declared that Fuel subsidy “is gone”, but the potential economic implications of this pronouncement still remain unknown. This study aims to investigate the economic implications of deregulation on key economic variables such as GDP, Inflation rate, Exchange rate and Premium motor spirit (PMS) price also; the researcher thinks that citizens of Nigeria and its Government can work out plans to mitigate the effect of subsidy removal if they could anticipate the changes on these key economic variables.

Purpose of Study

The purpose of this study is to examine the economic implications of deregulating the Nigerian downstream petroleum sector using the Autoregressive Distributed Lag (ARDL) model.

Research Objectives

This research aims to:

1. forecast the economic implications of deregulating the Nigerian downstream petroleum sector using the Autoregressive Distributed Lag (ARDL) model.
2. investigate the effect of deregulation on key economic variables such as inflation rate, Premium Motor Spirit (PMS) price, and exchange rate in Nigeria.
3. identify potential strategies that the Nigerian government and citizens can adopt to mitigate the negative effects of subsidy removal and deregulation.

Research Questions

1. What is the best ARDL model for forecasting the economic implications of deregulating the Nigerian downstream petroleum sector?
2. How do changes in deregulation policy affect the inflation rate, PMS Price and exchange rate in Nigeria?

3. What are the optimal strategies to mitigate the negative economic impacts of deregulation in Nigeria?

2.0 Literature review

Previous studies have extensively examined the impact of deregulation on various economic variables, including economic growth, inflation, employment, and investment (Baumol, 1982; World Bank, 1996). However, few studies have focused specifically on the Nigerian downstream petroleum sector (Akinlo, 2012; Odusanya, 2017). This study aims to fill this gap by examining the economic implications of deregulation on the Nigerian downstream petroleum sector using the Autoregressive Distributed Lag (ARDL) model.

The ARDL model has been widely used in empirical studies to examine the impact of deregulation on various industries, including electricity and telecommunications (Narayan, 2005; Alimi, 2015). However, its application to the Nigerian downstream petroleum sector is limited. This study will contribute to the existing literature by applying the ARDL model to examine the economic implications of deregulation on the Nigerian downstream petroleum sector. According to Akinlo (2012), deregulation of the Nigerian downstream petroleum sector has led to increased efficiency and investment. However, Odusanya (2017) found that deregulation has resulted in price increases and job losses. These mixed results highlight the need for further research on the economic implications of deregulation on the Nigerian downstream petroleum sector.

In conclusion, this study aims to contribute to the existing literature by examining the economic implications of deregulation on the Nigerian downstream petroleum sector using the ARDL model. The study will fill the gap in the existing literature by providing empirical evidence on the impact of deregulation on the Nigerian downstream petroleum sector using the ARDL model.

3.0 Methodology

The study will use Central Bank of Nigeria (CBN) annual time series data from 1990 to 2023 on four key variables: Gross Domestic Product (GDP), Inflation Rate (INF), Exchange Rate (EXR), and Premium Motor Spirit (PMS) price. GDP represents the total value of goods and services produced within Nigeria, serving as a proxy for economic activity. Inflation Rate measures the rate of change in prices of goods and services, indicating the level of economic stability. Exchange Rate represents the value of the Nigerian currency (Naira) relative to other currencies, influencing trade and investment. Premium Motor Spirit (PMS) price, also known as gasoline price, is a critical component of the downstream petroleum sector, affecting transportation costs and consumer spending.

The ARDL model will be specified with GDP as the dependent variable, examining how it responds to changes in the independent variables: PMS price, Inflation Rate, and Exchange Rate. The inclusion of lagged values of GDP allows for the capture of short-run dynamics, enabling the model to account for the potential delayed effects of changes in the independent variables on GDP. The bounds test will determine whether a long-run relationship exists among the variables, indicating whether changes in PMS price, Inflation Rate, and Exchange Rate have a lasting impact on GDP.

Diagnostic tests will ensure that the residuals (errors) are serially uncorrelated (not influenced by previous errors), homoscedastic (constant variance), and normally distributed (following a standard bell-shaped curve). Granger causality tests will determine the direction of causality among the variables, indicating whether changes in one variable lead to changes in another. While cumulative sum of recursive residuals (CUSUM) will be applied to the estimated ARDL model to assess the parameter stability

Model specification:

$$\Delta GDP = a_1 + \sum_{i=1}^n b_i \Delta GDP_{t-1} + \sum_{i=1}^n c_i \Delta EXR_{t-1} + \sum_{i=1}^n d_i \Delta INF_{t-1} + \sum_{i=1}^n e_i \Delta PMS_{t-1} + \gamma_1 GDP_{t-1} + \gamma_2 EXR_{t-1} + \gamma_3 INF_{t-1} + \gamma_4 PMS_{t-1} + \varepsilon_t$$

Where:

GDP = Gross Domestic Product

EXR = Exchange Rate

INF = Inflation Rate

PMS = Premium Motor Spirit price

4.0 RESULTS

4.1 TESTING FOR UNIT ROOTS OF THE VARIABLES CONSIDERED

TIME PLOT OF SERIES

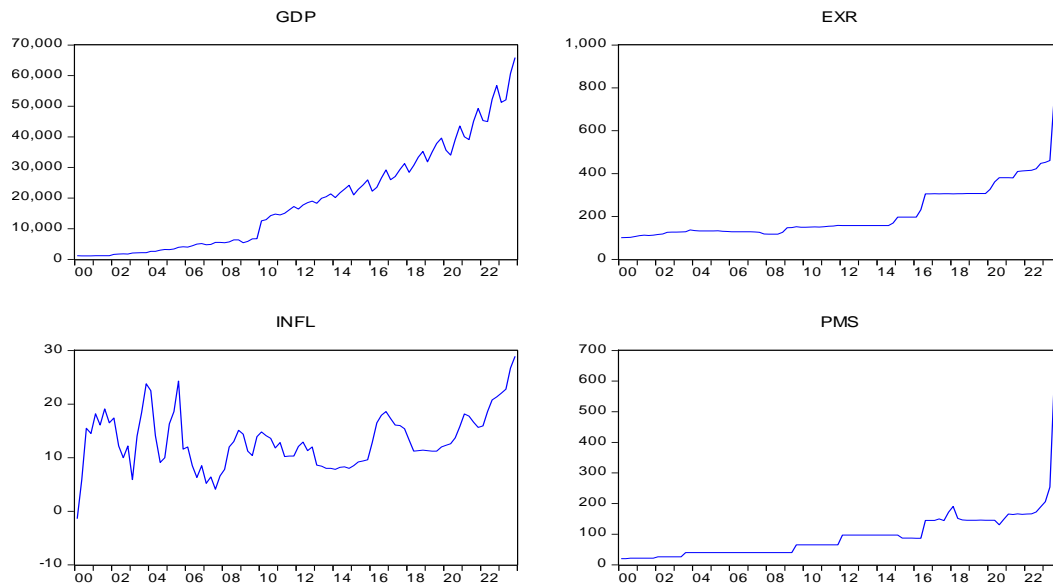


Fig 1: Time plot of series at level

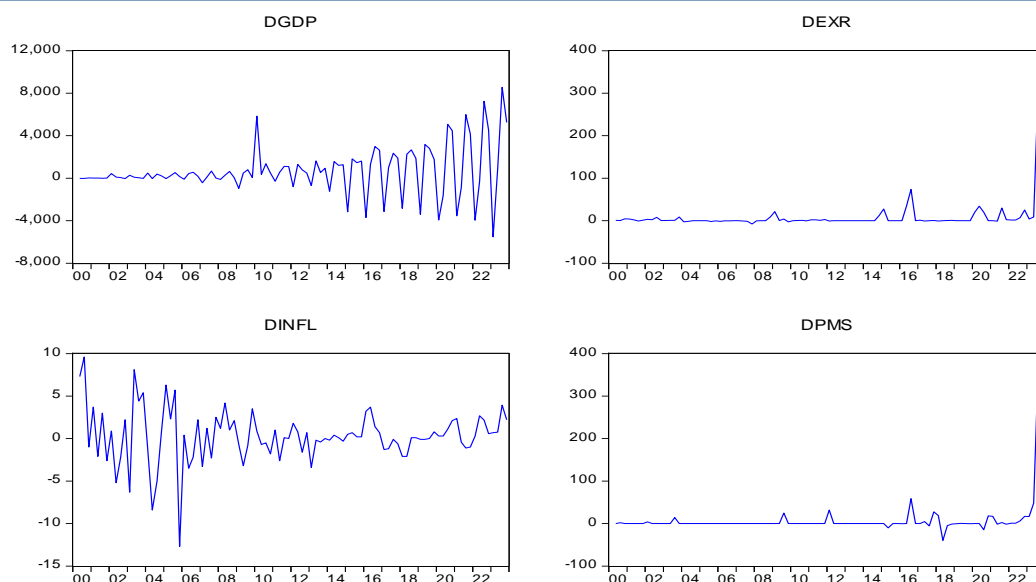


Fig 2: Time plot of series at 1st differencing

Verifying the stationarity of the variables under analysis is the initial step in most modeling investigations of time series.

From Fig.1, it can be observed that the variables GDP, EXR, and PMS are not stationary at level as a result of presence of trend in the time series. But INF depicts stationarity at level as there is no evidence of trend or break in the series.

Fig.2 depicts the time plot of series at first difference. Observe all the series are stationary after first differencing. The initial graphical analysis revealed that while INF lacks a linear trend, GDP, EXR, and PMS presents a linear trend.

Unit Root Test (Augmented Dickey Fuller Test)

Table 1: Result of Augmented Dickey Fuller (ADF) Unit Root Test

Variables	Level		First Difference			Order of Integration
	ADF Stat	t- Critical Value (5%)	ADF Stat	t- Critical Value (5%)		
GDP	1.115362	-3.458856	-	-3.459397	I(1)	

				12.42385	
EXR	3.050709	-3.457808	-	-3.458326	I(1)
				7.009467	
INF	-2.901444	-2.892879	-	-3.459397	I(0)
				7.039307	
PMS	2.008475	-3.457808	-	-3.458326	I(1)
				8.007958	

Source: Authors' Computation (2024) with Eview 9

From the Augmented Dickey Fuller (ADF) unit root test results in Table1, the Null hypothesis of presence of unit root for the variables GDP, EXR, and PMS in their levels cannot be rejected since their ADF Statistics greater than the critical value of 5% which implies non-stationarity of the said series. However, at first difference, the variables GDP, EXR, and PMS become stationary. But INF is stationary at level.

Overall, the unit root test indicates that the variables are integrated in the mixed order, but none are integrated of order two. These results determined a favourable context to the application of an ARDL Bounds test for co-integration

4.2. ARDL model estimation

The ARDL Bound Co-integration Test

The bound test is a test to determine if there is a long-run relationship, as the null hypothesis says that there is no long-run relationship. According to the value of F-statistics, in the first case, if the F-statistic value is less than the lower bound critical value, we don't reject the null hypothesis and there is no long-run relationship; in the second case, if the F-statistic value is greater than the upper bound critical value, we reject the null hypothesis and we can indicate that there is a long-run relationship. In the last case, if this F-statistic critical value lies between the two bounds, the decision is inconclusive.

Table 2: Results of ARDL Bound Test.

Dependent Variable	Independent Variables	ARDL Model	F-Stat.	5% Lower Bound Crit. Value	5% Upper Bound Crit. Value	Outcome
Model 1: GDP	EXR, INF, and PMS	(1,0,0,0)	4.0073 11	4.01	5.07	No Cointegration

The findings demonstrated that the F-statistics from ARDL model is subpar or less than the critical values of the lower bound at 5% levels of significance. According to the aforementioned findings, the null hypothesis cannot be disproved, proving that the variables in model do not co-integrate. It follows that there are only short-term correlations between GDP and the other variables taken into consideration. The short-run ARDL model is utilized in the modeling of these interactions.

ARDL Model selection

The choice of the ARDL model to be estimated is the first step in the ARDL model estimating procedure. The summary graph of the model selection with automatic lag selection is shown below. The lowest Akaike Information Criteria (AIC) value was used to make this decision. Figure 3 illustrates how AIC chose ARDL (1,0,0,0).

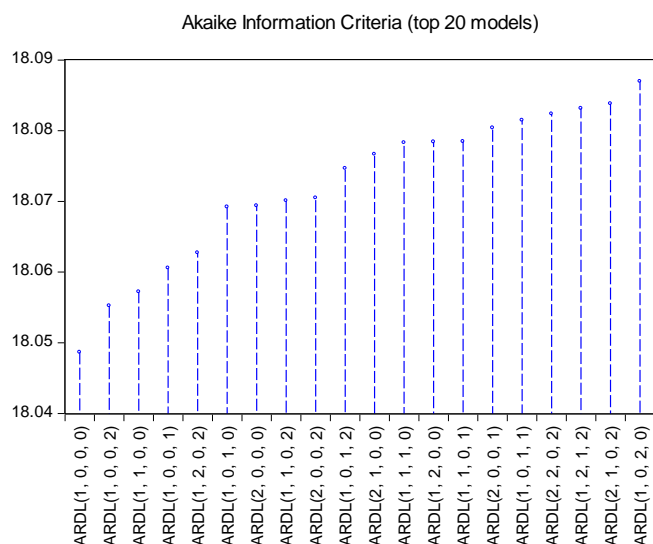


Fig. 3: Model Selection Summary Graph

ARDL Short Run Econometric Model of the Economic Growth in Nigeria.

Table 3: Estimation of Short Run Relationship

Dependent Variable: GDP

Variable	Coefficien			
	t	Std. Error	t-Statistic	Prob.*
GDP(-1)	0.704988	0.065307	10.79491	0.0000
EXR	20.91187	7.312713	2.859660	0.0053
INFL	0.839758	56.94368	0.014747	0.9883
PMS	-0.506775	6.544974	-0.077430	0.9385
C	-3214.949	1005.237	-3.198200	0.0019
@TREND	100.7075	29.20581	3.448201	0.0009
		Mean	dependent	19285.6
R-squared	0.987169	var		7
Adjusted	R-			16689.7
squared	0.986448	S.D. dependent	var	2
S.E. of regression	1942.897	Akaike info criterion		18.0428

			2
			18.2041
Sum squared resid	3.36E+08	Schwarz criterion	2
		Hannan-Quinn	18.1080
Log likelihood	-851.0341	crit.	0
			1.92544
F-statistic	1369.455	Durbin-Watson stat	6
Prob(F-statistic)	0.000000		

Table.3 presents the results of ARDL(1,0,0,0) model. The R-squared value of 99% for the models implies the model is at best fit. The adjusted coefficient of determination (Adj R^2) for the model shows that about 99% of the changes in economic growth can be explained by the independent variables. This implies that these variables can be effectively used to control Nigeria economy. Additionally, the F-statistic (1369.455) for the model has probability value (0.0000) less than 5% and which indicates that the independent variables included in the model has combined significant effect on Economic Growth in Nigeria. This supports the result of the Adj R^2 and further confirms that the independent variables used are a veritable tool for price stability and improved output.

However, the contributions and significance of the individual coefficients of the model are used to test the hypothesis that macro-economic variables of interest has no significant effect on economic growth in the short run using a t-test. Each of the hypotheses is tested with the coefficient and the t-values.

From the model at the selected lag length of 2, a coefficient of 20.91187 implies positive relationship between Exchange rate (EXR) and Gross domestic product (GDP). A t-value of 2.859660 and P-value of 0.0053 is significant. So we conclude that Exchange rate has significant positive effect on Nigeria Economic Growth in the short run since its p-value is less than 0.05.

From the result in Table 4.3.2, Inflation (INFL) has a positive relationship with RGDP but insignificant at the selected lag since the p-value (0.8309) > 0.05.

A coefficient of 0.839758 for Inflation (INFL) implies positive relationship between INFL and GDP. Since the P-value of 0.9883 is greater than the 5% significant level; hence we conclude that INFL has a positive but insignificant effect on GDP in the short run. The coefficient of PMS at the selected lag is negative and significant with p-value of 0.9385. This implies that PMS has a negative but insignificant effect on Economic Growth in the short run.

4.3 Diagnostic Test

The Ramsey RESET Test, homoscedasticity, serial correlation (using the LM Test), normality test (using the Jarque-Bera Test), and stability test (using the CUSUM Test) are the most pertinent post-estimation tests for dynamic models. To determine if the model is well specified, we run all of these residual-based tests on our estimated model. Table.4 shows the results of the autocorrelation test (i.e., Breusch-Godfrey LM statistic), heteroscedasticity test (i.e., ARCH test), normality test (i.e., JarqueBera test), and the Ramsey Regression Equation Specification Error Test (Ramsey RESET) from the estimated ARDL equations.

Table 4. ARDL estimation residual diagnostic results for ARDL(1,0,0,0) model

Equations/Model	χ^2 BG – LM	χ^2 ARCH	χ^2 J – BERA	RAMSEY RESET
ARDL(5,5,1,0,2,0)	9.10878 (0.0923)	11.84162 (0.0704)	3.696504 (0.157512)	1.788861 (0.1386)

The Breusch-Godfrey or Lagrange Multiplier (LM) test was applied to the estimated model to see whether our specification displays an autocorrelation problem. The null hypothesis that "there is no serial correlation effect" is tested, and the probability value of the observed R^2 (0.0923) was greater than 5% significant level, indicating that there is no serial correlation effect among the chosen variables.

The results from Table .4 demonstrate that there was no heteroscedasticity in our model when the null hypothesis "there is no ARCH effect" or "there are no cross-heteroskedasticity terms" was tested. This is so because we agreed that homoscedasticity was the null hypothesis.

Under the Jarque-Bera normality test, the results from Table .4 showed that the residuals for the ARDL model applied is normally distributed since the probability of Jarque-Bera statistics for the models is greater than 5% significant.

According to the results in table 4, for ARDL (1,0,0,0) model, the probability value of 0.1386 against the Ramsey Regression Equation Specification Error Test (RESET) test was greater than the proposed 5% level of significance. Thus, the null hypothesis that the model was correctly specified was sustained. Thus, there was no possibility of the model not being specified correctly which may result in the omission of certain variables. Again, the model has no wrong functional form. Besides, there was no relationship between the explanatory variables and the residuals.

4.4 Stability Test (CUSUM Residual Test)

In order to address the issue of possible fluctuation in the model, the study carried out additional stability test on the estimated ARDL model.

The cumulative sum of recursive residuals (CUSUM) was applied to the estimated ARDL model to assess the parameter stability (Pesaran & Pesaran, 1997). The results indicate the absence of any instability in the coefficients because the plot of the CUSUM statistic fell inside the critical bounds of the 5% significance level of parameter stability (See fig: 4)

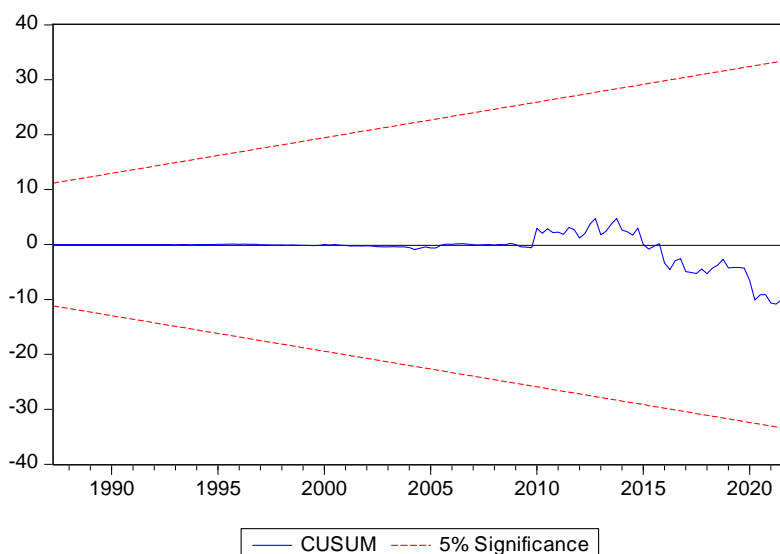


Fig 4: CUSUM Stability test of ARDL (1,0,0,0) model

5.0 Discussion of findings, conclusion and recommendations

This study aimed to investigate the economic implications of deregulating the Nigerian downstream petroleum sector, examine the effects on key economic variables, and identify mitigation strategies. The Autoregressive Distributed Lag (ARDL) model revealed insightful findings.

The study's first research objective was to forecast the economic implications of deregulating the Nigerian downstream petroleum sector. Utilizing the Autoregressive Distributed Lag (ARDL) model, the research successfully predicted the outcomes of deregulation. Notably, the results revealed that deregulation has a profound impact on the exchange rate, leading to a significant appreciation of the currency. Conversely, the effects on inflation rate and Premium Motor Spirit (PMS) price were found to be statistically insignificant.

Further investigation into the effects of deregulation on key economic variables yielded intriguing findings. While deregulation was found to have a positive, albeit insignificant, effect on inflation rate, suggesting a potential slight increase, its impact on PMS price was negative but equally insignificant, indicating a potential slight decrease. In contrast,

deregulation's significant positive effect on exchange rate was reaffirmed, resulting in an appreciation of the currency.

To mitigate the adverse consequences of deregulation, the study proposes several strategic recommendations. Firstly, implementing exchange rate stabilization policies through monetary policy interventions can prevent excessive currency fluctuations. Additionally, adopting inflation-targeting policies can effectively control inflation and prevent significant price increases. Promoting alternative energy sources can also reduce dependence on PMS, while economic diversification policies, such as investing in non-oil sectors, can cushion the impact of changes in the oil sector on the overall economy. Lastly, establishing social safety nets can protect vulnerable populations from the adverse effects of deregulation. These findings offer valuable insights for policymakers, stakeholders, and citizens seeking to navigate the complexities of deregulation. By adopting these mitigation strategies, Nigeria can minimize the negative impacts and maximize the benefits of deregulation, ultimately fostering a more stable and resilient economy.

Conclusion

This study contributes to the understanding of the economic implications of deregulating the Nigerian downstream petroleum sector. The findings provide valuable insights for policymakers, stakeholders, and citizens to navigate the complexities of deregulation. By adopting the recommended mitigation strategies, Nigeria can minimize the negative impacts and maximize the benefits of deregulation.

Recommendations

1. Investigate the sector-specific impacts of deregulation.
2. Analyze the effects of deregulation on economic growth and development.
3. Examine the role of institutional factors in shaping the outcomes of deregulation.

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