

## Households' Energy Demand in Ondo State, Using Almost Ideal Demand System (AIDS) Approach.

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### **Abstract**

*The study examined households' energy demand in Ondo State between January 2016 to February 2017 while the impact of price and income elasticity of the consumer on their energy demand was also investigated. Almost Ideal Demand System (AIDS) was applied with stratified random sampling technique for empirical analysis. The study examined 223 responses through primary data generated on usage of energy products. The findings showed that electricity (0.98) and kerosene (0.94) are necessities since their coefficients were less than 1. The result further established that Diesel (1.01), Petrol (1.02) and Gas (1.01) are luxuries since their elasticities are greater than 1. The findings revealed that estimated expenditure elasticities were all positive and statistically significant at 5% significant level, indicating that all the selected energy products are normal goods. The study discovered that apart from the major occupations of the respondents, other households' demographic variables were not significant in determining energy demand. Therefore, the study recommended that policy-makers should consider variations in the coefficients of elasticities of each energy product in making policy decisions.*

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**Keywords:** Energy, Households, Demand, AIDS, Elasticities.

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### **1.1 Introduction**

To say that Energy is life is no understatement. It is an indispensable factor and plays key roles in consumption and production process. Empirical studies have suggested that energy plays a critical role as compared to other variables included in the production and consumption function for countries which are at intermediate stages of economic development.

In Nigeria, the patterns of energy usage can be divided into industrial, transport, commercial, agricultural, and household sectors. The household sector accounts for the largest share of energy usage in the country - about 65%. The major energy-consuming activities in Nigeria's households are cooking, lighting, and use of electrical appliances. Cooking accounts

for a staggering 91% of household energy consumption, lighting uses up to 6%, and the remaining 3% can be attributed to the use of basic electrical appliances such as televisions and pressing irons (ECN, 2005). To this end, Okafor and Uzuegbu (2010) discovered that energy consumption patterns in the world today shows that Nigeria and indeed African countries have the lowest rates of consumption. In spite of this, Nigeria suffers from an inadequate supply of usable energy due low investments in the energy sector which can result in significant economic costs.

Given the potential for energy demand growth in the developing in Nigeria, providing information on the elasticity of those products should prove valuable to policy makers. In spite of this, there is still a dearth of research on energy demand using household data in Nigeria. To the best of authors' knowledge, there is no piece of research employing household data from Ondo state to investigate energy demand based on the Almost Ideal Demand system modeling. The few available studies such as Ogunleye and Ayeni (2012) only used time series and national data but studies that used micro data at the state level is still lacking.

Against this background, the objective of this study is to investigate the demand for energy in Ondo state using Almost Ideal Demand System approach. Specifically, the study will attempt to look at the impact of price and income elasticity of the consumer on their energy demand. Following this introduction, the rest of the paper is organized as follows: Section 2 focuses on literature review while section 3 outlines materials and methods. Section 4 presents the results and discussion while Section 5 is devoted to the summary and policy implications.

## 2.1 Literature Review

Energy demand is defined as the requirement for energy as an input to provide product and services to meet an end means. The empirical studies on domestic energy demand in Nigeria are legion. For instance, Bello (2010) examined the impact of wealth distribution on energy consumption in Gombe State, Nigeria. The study uses multinomial logit model to analyse the determinants of household choice of energy used for cooking. Income, size of household, price of stove or cooker, head of household level of education and house wife level of education are variables captured. Empirical results reveal that the choice of cooking energy is mainly determined by income, size of household, and level of education. In a related development, Arowosoge and Faleyimu (2011) investigated household energy for cooking and its determinants in Ado-Ekiti metropolitan area of Ekiti State. Simple descriptive statistics and chi-square test were employed for the analysis. The chi-square results established a significant relationship between income of household and the type of energy used for cooking.

Onyekuru and Eboh (2011) investigated the determinants of cooking energy demand in the rural households of Enugu State. Bivariate probit model was employed for the analysis. Fuel wood and kerosene were the two different cooking fuel options available to the households. Occupation, family size, level of education and income are the variables captured. Empirical results show that occupation and income were the statistically significant factors affecting the choice of cooking energy demand.

Pundo and Fraser (2006) in a study on the analysis of household cooking fuel choice in rural Kenya: The case of Kisumu District uses multinomial logit model to investigate the factors that determine household cooking fuel choice between firewood, charcoal, and kerosene. Variables captured are: age of respondent, household sizes, occupation of the household head and category of food cooked by household, level of education of husband and wife, whether or not the household own the dwelling unit and the nature of the dwelling unit. Empirical results indicate that level of education of husband and wife, type of food mostly cooked, whether or not the household owns the dwelling unit, and whether or not the dwelling

unit is traditional or modern type are important factors that determine household cooking fuel choice.

Njong and Johannes (2011), an analysis of domestic cooking energy choices in Cameroon, the study attempts to cast light on the distribution of households by cooking energy types and by region or zone of residence and investigate the main determinants of cooking energy choices in Cameroon. The study employs a multinomial logit model to test the statistical significance of the social and demographic factors that determine household cooking fuel choice in the country. Variables captured are: household size, occupation status, nature of the dwelling houses (proxy by wall materials), education, ownership of the dwelling house, and the distance of household from urban centre.

The study empirical results indicate that the level of education, distance of the household from urban centres, whether or not the household owns the dwelling unit and whether or not the dwelling unit is traditional or modern type are important factors that determine household cooking energy choice. The study also reveals that fuel wood is the principal cooking fuel for the majority of households in Cameroon.

Mekonnen and Kohlin (2008) examined determinants of household fuel choice in major Cities in Ethiopia. The study looks at the fuel choice of urban household in major Ethiopian cities, using panel data collected in 2004 and 2006. This study shows the relevance of fuels stacking (multiple fuel use) in urban areas in sub-Saharan Africa. While income is an important variable, the results of this study find other variables such as family size, household location and level of education as important determinants of household fuel choice in Ethiopia.

Farsi Mehdi et al (2007) examine fuel choice in urban Indian households. The study applies an ordered logit model to fuel choices and patterns of cooking fuels in urban Indian households using a large database consisting of 46, 918 observations. The analysis was used to determine the responsiveness of fuel choices to own price, income, price of alternate fuels and variables relating to demographic and geographic characteristics of households.

Bello (2010) researched on Impact of Wealth Distribution on Energy Consumption in Nigeria: A case of selected households in Gombe State. The study uses multinomial logit model to analyse the determinants of household choice of energy used for cooking. Income, size of household, price of stove or cooker, head of household level of education and house wife level of education are variables captured. Empirical results reveal that the choice of cooking energy is mainly determined by income, size of household, and level of education.

In addition, Adetunji, Adesiyun and Sanusi (2007) examined household energy consumption patterns in Osogbo Local Government Area of Osun State. Ordinary least square regression was employed to analyse the data obtained. Age, level of education, occupation, income and household size are variables captured. The regression results indicated that income and household sizes are the significant factors that determined household choice of energy consumption while age, level of education and occupation of household are insignificant. Okunade (2010) assessed charcoal as an alternative energy source among urban households in Ogbomoso Metropolis of Oyo State, Nigeria. Simple descriptive statistics and ordinary least square regression were employed for the analysis. The regression result reveals that age, occupation, level of education and household size are the significant factors affecting household choice of energy used for cooking while income is insignificant. Shittu *et al* (2004) examined the demand for energy among households in Ijebu Division, using the linear logit model. The study found that the influence of education and household size on household energy used were insignificant, while income and age of household heads revealed significant

influence. The study concluded that improvement in income would cause increase in demand for firewood alternatives.

In synopsis, most of these empirical research studies centered on household choice of cooking energy using various analytical techniques and methodologies. However, no previous study has investigated energy demand in Ondo State, using Almost Ideal Demand System approach. Against this backdrop, this study fills this gap and contributes to the body of knowledge.

### 3. Methodology

#### 3.1 Research Design

The research design adopted for this work is the survey research design. It is based on micro data which were collected through the use of structured questionnaire.

#### 3.2 Sampling Technique

Stratified random sampling technique was used to administer the questionnaire. A total of 450 questionnaires were distributed (150 for each Senatorial District in the State). From this, a total of 432 questionnaires were completely filled and returned by different respondents from the study population. These respondents were either household heads or those who had good idea of the household energy expenditure and consumption pattern. However, the sampling unit observed in this study was households.

#### 3.3 Model Specification:

Demand systems are typically specified with expenditure shares as the dependent variables. This study adopts a model similar to that of Poi (2008) but with little modifications. According to him, the empirical specification of the Quadratic Almost Ideal Demand System's budget share equation is generally given as:

$$w_i = \alpha_i + \sum_{j=1}^k \gamma_{ij} \ln P_j + \beta_i \ln \left[ \frac{m}{P(p)} \right] + \varepsilon_t \dots \dots \dots (1)$$

Where:

$W_i$  = household's expenditure share of  $i$ th commodity

$\alpha_i$  = Constant parameter

$\beta_i$  = Estimated expenditure coefficient

$\gamma_{ij}$  = Estimated coefficient of prices

$m$  = Household total expenditure of all goods in the demand system

$\varepsilon_t$  = Error term.

However, considering the importance of demographic variables such as sex, major occupation and household size on energy consumption in Ondo State, it is important to capture these variables by incorporating them into our model. Hence, equation (1) can be modified as follows:

$$w_i = \alpha_i + \sum_{j=1}^k \gamma_{ij} \ln P_j + \beta_i \ln \left[ \frac{m}{P(p)} \right] + \sum_{s=1}^l \delta_{is} z_s + \varepsilon_t \dots \dots \dots (2)$$

Where:

$w_i$  = household's expenditure share of  $i$ th energy type, for  $i=1, 2, 3, 4$  and  $5$

$w_1$  = household budget share of diesel

$w_2$  = share of electricity

$w_3$  = share of petrol

$w_4$  = share of Kerosene

$w_5$  = Gas

$P_i$  = price of energy  $i$ th (#/killowat), for  $i=1, 2, 3$  and  $4$

$P_1$  = price of a litter of Diesel in Naira

$P_2$ =price of a Kilowatt of electricity in Naira

$P_3$ = price of a liter of petrol in Naira

$P_4$ = price of a liter Kerosene in Naira

$P_5$  = Price of Gas in Naira.

$m$  = household's total expenditure on all energy sources in the demand system (N/month)

$z_i$  = Socioeconomic variables

$Z_1$ =Major occupation of the respondents

$Z_2$ = Sex (1= male; 0 = female)

$Z_3$  = household's size (Head count)

$\varepsilon_t$ = error term

#### **4.1 Result and Discussion**

Table 2 shows the result of the estimated parameters of the Almost Ideal Demand System with demographic variables (major occupation, sex and household size). The parameters (alpha, beta and gamma) are contained in the first column. The second, third, fourth and fifth column represents the coefficient, standard error, Z statistic and the probability values respectively. The five selected energy products (Diesel, Electricity, Petrol, Kerosene and Gas) are listed in order \_1, \_2, \_3 \_4 and \_5 respectively.

**Table 2: Estimated Parameters of QUAIDS without Demographic Variables:**

	<b>Coefficient</b>	<b>Std.Error</b>	<b>Z</b>	<b>P&gt; z </b>
<b>Alpha</b>				
<i>alpha_1</i>	0.2219	0.0021	100.93	0.000
<i>alpha_2</i>	0.1827	0.0015	117.74	0.000
<i>alpha_3</i>	0.2416	0.0031	76.07	0.000
<i>alpha_4</i>	0.1320	0.0019	67.57	0.000
<i>alpha_5</i>	0.2216	0.0019	113.80	0.000
<b>Beta</b>				
<i>beta_1</i>	0.0025	0.0002	10.19	0.000
<i>beta_2</i>	-0.0020	0.0001	-11.45	0.000
<i>beta_3</i>	0.0047	0.0003	13.33	0.000
<i>beta_4</i>	-0.0075	0.0002	-33.62	0.000
<i>beta_5</i>	0.0023	0.0002	10.65	0.000
<b>Gamma</b>				
<i>gamma_1_1</i>	0.0215	0.000	288.39	0.000
<i>gamma_2_1</i>	-0.0053	0.000	-114.75	0.000
<i>gamma_3_1</i>	-0.0052	0.000	-90.07	0.000
<i>gamma_4_1</i>	-0.0058	0.000	-112.01	0.000
<i>gamma_5_1</i>	-0.0051	0.000	-94.85	0.000
<i>gamma_2_2</i>	-0.0208	0.000	415.16	0.000
<i>gamma_3_2</i>	-0.0054	0.000	-114.68	0.000
<i>gamma_4_2</i>	-0.0047	0.000	-134.73	0.000
<i>gamma_5_2</i>	-0.0052	0.000	-119.09	0.000
<i>gamma_3_3</i>	0.0217	0.000	207.11	0.000
<i>gamma_4_3</i>	-0.0058	0.000	-100.53	0.000
<i>gamma_5_3</i>	0.0052	0.000	-101.35	0.000
<i>gamma_4_4</i>	0.0218	0.000	367.49	0.000
<i>gamma_5_4</i>	-0.0054	0.000	-158.50	0.000
<i>gamma_5_5</i>	0.0210	0.000	234.45	0.000
<b>Rho</b>				
<i>rho_majoccu</i>	-0.05221	0.0104	-5.02	0.000
<i>rho_sex</i>	-0.01927	0.0314	-0.61	0.540
<i>rho_hhsiz</i>	-0.00111	0.0080	-0.14	0.890

**Author’s Regression Output (2016).**

From the QUAIDS result, the constant parameters (alphas) represent the average value of budget shares of the selected energy products when income and price effects are equal to zero. The result showed that in the absence of income and price effect, the budget share of diesel, electricity, petrol, kerosene and cooking gas increase by 22 percent, 18 percent 24 percent, 13 percent and 22 percent respectively.

The expenditure terms (beta) are statistically significant in all the four expenditure share equations. It was discovered that apart from electricity and kerosene, every other expenditure elasticities are positive. This implies that diesel, petrol and cooking gas are normal goods while electricity and kerosene are inferior goods. The reason for this could be attributed to the fact that majority of the households studied in Ondo State do not have access to electricity. This

reason is that the Southern and majority of the town in the Northern senatorial district of the state have been cut off from the National grid by the electricity distribution company. In terms of magnitude, commodities with expenditure elasticities greater than one are theoretically classified as luxuries while expenditure elasticities less than one are regarded as necessities. In this study, diesel, electricity, kerosene, petrol and gas are regarded as necessities as their coefficients are less than one. The result further indicated that a one percent increase in income will lead to about 0.2 percent, 0.4 percent and 0.2 percent increase in the expenditure share of diesel, petrol and Gas respectively. However, a one percent increase in the income of the household is expected to reduce the expenditure share of electricity and kerosene by 0.2 and 0.7 percent respectively.

In addition, the gamma- parameters captured the responsiveness of demand to variations in relative prices, including both the own price of good (i) and the prices of other goods (j). All the fifteen price effects are significantly different from zero at the 5 percent significant level. This suggests that there is much quantity response to movement in relative prices. For instance, a change in the demand of diesel leads to a systemic change in the price of diesel by 2 percent while a percent change in the demand for electricity leads to a 5 percent change in the price of diesel. Also, a percent increase in the demand for gas leads to a 5 percent decrease in the price of kerosene. This result is not unexpected because Gas and kerosene are substitute.

The coefficient of major occupation, sex and household size ( $\rho$ ) are negatively related to the expenditure share for the selected energy products. However, these demographic variables are not statistically significant in explaining the budget share of disaggregated energy products except that of occupation.

#### 4.2 Price Elasticities

The uncompensated own price and cross elasticity matrix are presented in Table 3. In line with consumer demand theory, all own price elasticities are negative. Negative own price elasticity means that an increase in the price of a commodity results in a decrease in demand for that particular commodity. For instance, when the price of diesel increases by 1 percent, demand for diesel will reduce by 90 percent. Similarly, a percent increase in the price of a kilowatt of electricity will reduce electricity consumption by 88 percent. These are shown in bold figures along the major diagonal in Table 3. The five selected energy product considered in this study are own price inelastic. All cross price elasticities are inelastic as they are all less than one. This indicates that there is a weak response of one energy products to changes in the price of other energy products.

**Table 3: Marshalling Price Elasticity Matrix**

	Diesel	Electricity	Petrol	kerosene	Gas
Diesell	<b>-0.90</b>	-0.02	-0.02	-0.02	-0.02
Electricity	-0.02	<b>-0.88</b>	-0.02	-0.02	-0.02
Petrol	-0.02	-0.02	<b>-0.91</b>	-0.25	-0.02
Kerosene	-0.02	-0.02	-0.02	<b>-0.84</b>	-0.02
Gas	-0.02	-0.02	-0.02	-0.02	<b>-0.9</b>

Source: Author's Regression Output (2016)

## 5. Conclusion and Policy Implications:

The paper examined households energy demand in Ondo State based on Almost Ideal Demand System (AIDS). The AIDS model was estimated for the five major energy products that virtually everybody consumes in Ondo State. Specifically, we measured the price and income elasticity of Diesel, electricity, petrol, kerosene and cooking Gas. Our result shown that all own price elasticities are negative which suggests that an increase in the price of any of the selected energy product results in a decrease in demand for that particular product. It was also discovered that the five selected energy products considered in the study are own price inelastic which implies that there is a weak response of one energy product to changes in the price of other. Consequently, the study recommended that policy-makers should consider variations in the coefficients of elasticities of each energy product in making policy decisions.

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