

## Global Economic and Financial Recovery in the Oil and Gas Sector

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### Abstract

*The global financial crisis, which later transformed to an economic crisis diffused into the Nigerian economy via trade with already affected foreign countries. The major export commodity in Nigeria is crude oil, which also accounts for the largest percentage of government revenue. This paper attempts a review of the Global Economic and Financial Crisis and its impact on the Oil and Gas sector of the Nigerian economy. It was discovered that the oil and gas sector is the major channel through which the crisis hit the Nigerian economy. There was a decline in oil prices during the period of the crisis but this cannot be particularly attributed to the crisis because oil prices were never stable even before the crisis. The crisis period was also characterized with reduced GDP. Nigerians also contributed to the impact of the crisis on their domestic economy as a result of their withdrawal of deposits from banks, thereby making less credit available for investment. The aftermath of the crisis was managed by prompt government actions, but this might not be the end of such crisis, so policies should be put in place to forestall future economic shocks. Some of the policy recommendations are: diversification of the economic base, focus shift to boosting agricultural output, institution of appropriate monetary, fiscal and exchange rate policy measures, targeted assistance to the poor, efficient use of the country's resources and accountability*

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**Keywords:** global financial crisis, channel, economic base, policy measures.

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### INTRODUCTION

The recent global economic crisis started in the USA and Europe as a result of the credit crunch experienced in the global market in July, 2007. This spread to other parts of the world. There was thus a global financial meltdown in early 2008, which led to the crash of the global stock market and the collapse of major financial institutions. The impact of the crisis was felt in Africa by 2009, as the second-round effects of the shock started unfolding. There was low demand for commodities and the prices of exports reduced. Inflow of foreign direct investment declined and remittances from abroad reduced, financial institutions became insolvent. According to Sanoussi (2009), the meltdown experienced in the African economies did not originate from the global financial crisis. He noted that many African countries, including Nigeria would not be affected by the crisis because their integration with the global economy is generally weak. Also, the interest of Asian countries like China and South Korea in Africa in recent times may likely prevent Nigeria from being hit by the impact of the financial crisis that is being experienced by the advanced countries of the West. However, he failed to consider the trade relations of Nigeria with these advanced countries, especially in crude oil which is the major export commodity. Presently, export earnings are the highest source of Nigerian government revenue (Between 1980 and 2009, export earnings account for an average of 70% of GDP (CBN Statistical Bulletin, 2009). Prior to the crisis,

the contribution of the oil and gas sector to GDP was N 7,533,042.6 million in 2007 and in 2008, which marked the beginning of the crisis, it was N9,097,750.7 million. It became N7,319,262.7 million in 2009 after the crisis (GDP figures for 2007, 2008 and 2009 (Source: National Bureau of Statistics, 2009). Incidentally, the period of the downward trend in the oil and gas sector contribution to GDP coincides with the inception of the global financial crisis in Nigeria. This suggests that the financial crisis which metamorphosed into a global economic crisis affected the oil and gas sector.

The main purpose of this paper is to provide a descriptive analysis of the situation in the Nigerian oil and gas sector in the pre and post-crisis periods. This is in order to shed light on the extent to which the global economic crisis has affected the Nigerian economy, recommend ways out of the crisis and suggest policy measures to be instituted by the government in order to forestall future occurrences of external shocks. Therefore, following the introduction in section I, section II reveals the genesis of the global financial crisis and the nature of the crisis, with the resultant recession. Section III examines the impact of the crisis on the Nigerian economy; particularly the oil and gas sector, while section IV looks into measures taken in order to ameliorate the effects of the shocks and how to avoid future crisis. The concluding section suggests policy

options to be taken in order to prevent further external shocks.

### Evolution of the Global Financial Crisis and Transmission into the Nigerian Economy

Financial crisis are experienced as periods of shocks in the financial market system. These shocks inhibit the smooth functioning of the financial system. This was the recent experience in the United States in mid-2007, which transformed into a global economic crisis. The financial crisis emanated from an increasing default level in the repayment of sub-prime loans and over extension of credits. Also, Adjustable Rate Mortgages (ARM) increased as against the anticipation of borrowers. As a result of increase in loan packaging, marketing strategies and incentives, borrowers were encouraged to assume difficult mortgages with the intention of refinancing them at more favourable terms in the nearest future. Interest rates however started rising and housing prices was on the decline between 2006 and 2007 in many parts of the United States and refinancing became very difficult. There was increase in loan defaults, home prices failed to rise as expected and adjustable rate mortgages (ARM) interest rates reset higher. As the balance sheets of major financial institutions were negatively affected and hence deteriorated, their capacities to make new loans or roll over existing ones were sharply reduced (Oyejide, 2009). The crisis was transmitted through interconnected global markets at first to industrialized countries like Europe and East Asia and later to other

countries of the world. At the same time, the financial shocks led to a credit crunch in the global financial market, resulting in an economic recession which diffused into many other regions and countries. By 2008, economic activities had declined in advanced countries, countries in the transition stage and developing countries of the world. Nigeria was not left out. The global economic crisis took its toll on the Nigerian economy via trade with other countries especially trade in oil and gas.

### Impact of the Crisis on the Nigerian Economy

The impact of the global economic and financial crisis was felt in Nigeria in form of reduction in the volume and price of oil, decline in capital flows, low remittances from abroad, cut in foreign credit lines and low commodity prices. The Oil and Gas sector being the major export earning sector in Nigeria was the channel through which the global economic and financial crisis came into the country. There was decline in Nigeria's GDP. This affected Nigeria's trade partners, like the Republic of Benin and Niger Republic. In addition, pessimism on the part of the Nigerian citizens contributed to the global financial crisis impact on the Nigerian economy as people started withdrawing their monies from banks. Thus, there was less credit available for investment. Also, the tight monetary policies restricted banks with regards to the issuance of credit facilities. The table below presents the trend of GDP over a period of ten years; including periods before and after the crisis.

Table 1 Gross Domestic Product at Current Basic Prices (N 'million)

Activity Sector	2001	2002	2003	2004	2005	2006	2007	2008	2009
<b>1. Agriculture</b>	1.6	3.36	3.63	3.9	4.77	5.94	6.76	7.98	9.19
<b>2. Industry</b>	1.87	2.04	3.04	4.61	6.10	7.49	8.09	9.72	7.97
(a) Crude Petroleum & Natural Gas	1.67	1.80	2.74	4.25	5.67	6.98	7.53	9.1	7.32
(b) Solid Minerals	6.00	7.07	8.41	13.05	17.3	27.28	31.45	36.19	40.61
(c) Manufacturing	199.08	236.83	287.74	349.32	412.71	478.52	520.88	585.57	612.61
<b>3. Building &amp; Construction</b>	40.74	47.99	58.91	166.08	215.79	250.33	266.46	306.58	347.69
<b>4. Wholesale &amp; Retail Trade</b>	642.7	772.44	922.15	1484.42	1868.2	2741.79	3044.77	3503.18	4091.82
<b>5. Services</b>	572.67	692.18	843.69	1246.72	1620.1	2143.49	2502.83	2785.65	3106.82
<b>TOTAL (GDP)</b>	4725.09	6912.38	8487.03	11411.07	14572.1	18564.59	20657.32	24296.33	24712.67

Source: National Bureau of Statistics (NBS)

\*Forecast

From table 1, it is evident that GDP in the oil and gas sector had been on the increase in the years preceding the crisis but, there was a sharp decline in 2009 when the impact of the crisis was greatly felt in

the Nigerian economy. Considering the growth rate of crude oil and natural gas, it will be observed that growth rate in 2007 was 7.8%. The figure rose as high as 20.8% in 2008, whereas in 2009, there was a

great decline in the rate of growth to -24.3%. Growth slowed down in 2009 as a result of weak demand, decline in government revenue and tight monetary conditions. This gave rise to the reduction in availability of credit to the private sector. The crisis led to the postponement of projects and delays in the completion of on-going ones as predicted in (Balouga, 2009). National and International Oil Companies slowed down activities with the aim of evaluating the stability of the world economy and prospects for oil prices. Some oilfield service companies trimmed down their workforce in a bid to adjust costs during the period of the crisis. The Niger Delta troubles also affected oil production in Nigeria adversely despite the creation of the Ministry for the Niger Delta and the general amnesty declared by the Federal Government. Also, the Organisation of Petroleum Exporting Countries (OPEC) quota cut introduced in December, 2008 contributed to reduction in oil production and invariably the decline in the contribution of the oil sector to GDP. However, the impact of the crisis was cushioned by the continued operation of the non-oil sectors, particularly agriculture and telecommunication.

#### **Household Welfare and Poverty Impact of Oil Price Shocks**

As regards the impact of oil price shocks on poverty, household income and consumption volume (expenditure) were used in a study conducted by Ajakaiye and Fakiyesi (2009). The results of the simulations on household welfare show that the oil shocks have led to a significant increase in poverty level. Also, further studies conducted by Ajakaiye and Fakiyesi (2009) on the impact of the oil price shock on household income show that adverse oil price shocks have severe distributional consequences for the Nigerian economy. Household income according to the study consists of wages, profits, transfers and other income. Factor remuneration represented the main source of income for households. The results show an overall decrease in household income in Nigeria.

The oil sector which serves as the mainstay of the Nigerian economy, has experienced a plunge in the international price of crude oil. This has meant a huge decline in foreign exchange earnings. Some experts are predicting that oil prices may still come down to as low as US\$30 per barrel over the coming years. Rather than increasing, the reserve has been depleting since the crisis. This has led to reduction and scarcity in the foreign exchange offered for sale in the Wholesale Dutch Auction System (WDAS). This reduction has however intensified speculative tendency at the WDAS thus, introducing instability into the market and triggered further depreciation of the naira foreign exchange rate. The overall impact is less budgetary allocation at all tiers of government to growth and development enhancing programmes and

high cost of importation for critical infrastructure development. It is expected that the Nigerian economy would have recovered from the shock of the global financial crisis by 2010 and that the growth rate of GDP with regards to crude oil and natural gas would be as high as the 2008 value, if not higher (CBN, 2008).

#### **Avoidance of further External Shocks**

The fall in oil prices in 2009 affected the value of Nigeria's exports. There was a decline in exports and growth in import also slowed down as a result of falling international prices for many commodities and reduced domestic demand. The Nigerian Government thus dropped the projected crude oil benchmark down. Also, some items of expenditure were removed from the 2009 budget in order to resolve the problems ensuing from the crisis. Decline in oil prices is however no new phenomenon in Nigeria; prices of oil had never been stable. The Nigerian government has been managing the issue of instability in oil prices. However that of decline in exports is new. Little can be done in this regard by the Nigerian government because it cannot in any way increase the level of demand for its products by foreign countries. The only solution will be the stabilization measures employed by Nigeria's trading partners to increase their income, which will in turn affect their demand for foreign commodities. These measures include policies put in place in form of taxation, government spending (fiscal policy) and monetary policy instruments, which either enhance or discourage the consumption of foreign commodities. For example, high import duties and stringent government regulations, discourages demand for foreign products, while reduced import duties encourage the consumption of foreign commodities.

From the experience of the current crisis, Nigeria should learn that the stability of the domestic economy depends on the stability of the economy of its major trading partners. Thus, the global economic crisis has brought into limelight the need for standing policies which will be automatic stabilizers against such unforeseen crisis in the future. There is need for the Nigerian Government to suspend the deregulation of the downstream sector and ensure the efficient use of our local resources. Our refineries should be put in good order so that oil export from Nigeria will have an enhanced value which will attract more foreign exchange. Also, the economic base should be diversified into areas like manufacturing, agriculture, information and communication technology, iron and steel, power supply, solid minerals. Furthermore, credit should be made available to small and medium scale enterprises for investment purpose.

#### **CONCLUSION**

The Nigeria oil and gas sector is the major channel through which the global economic and financial

crisis crept into Nigeria. This is because the Nigerian economy is mainly dependent on oil revenue. Therefore, the oil shocks immediately affected the whole economy. In order to forestall such future occurrences, the following policy recommendations have been put forward:

- Diversification of the economic base. The Nigerian Government needs to institute measures to reduce oil dependence as some other countries have tried to do and improve the non-oil sector considerably. Government should therefore shift focus to significantly increase agricultural output as a means of bolstering economic growth across the country. There is an urgent need for government to diversify the economy away from being a monoculture of oil and gas.

- Determination of appropriate monetary, fiscal and exchange rate policy responses. In view of the serious adverse effects of negative oil price shocks on the Nigerian economy, government needs to determine the appropriate monetary, fiscal and exchange rate policy responses.

- Management of fluctuations in exchange rate. Short-run policies in monetary and fiscal policy must seek to manage fluctuations in the exchange rate to minimize uncertainty.

- Targeted assistance to the poor. This can help mitigate the impact of oil price shocks on them, while avoiding the problems inherent in generalized subsidies.

Other measures include:

- Restructuring of the oil and gas sector
- Priority should be given to efficiency in resource use and accountability
- Sensitization campaigns should be held to check the poor maintenance culture of Nigerians and the issue of violence in the Niger Delta
- There should be good planning to ensure that government spending does not result in economic instability.

These identified measures should be looked into with all sense of seriousness because it is uncertain that this will be the end of crisis in the global market.

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