The Global Financial Crisis and the Oil and Gas Sector of the Nigerian Economy

By Jean Balouga*

Some of the channels through which the global financial crisis are affecting Nigeria are the reduction in volume of, and price of oil, low commodity prices, exit and reduction in capital flows, cut in tourism, cut in foreign credit lines and low remittances. Reduction in the demand for, and price of, oil in particular is providing a platform for reduced macro-economic performance through its usual channel of government revenue and foreign exchange earnings. In budget terms, the average price of oil hovered just above US $ 40, less than the benchmark for the 2009 budget.

Impact on Nigeria

In Nigeria, the budgetary crisis caused by steadily dwindling oil revenue, may make it difficult for the government to put into joint venture operation the US$5 billion it allocated for the purpose in the 2009 federal budget of N3.1 trillion. Although the Nigerian National Petroleum Corporation (NNPC) claims it has, in collaboration with the Federal Ministry of Finance, secured all the financial instruments necessary to raise the balance of US$5.87 billion required to meet government equity commitment to joint-venture projects in 2009, the global financial climate makes it doubtful if such funding can be successfully accessed.

As we go through early 2009, operators will likely take a restrained approach to E&P activities. Though most projects are evaluated and based on long-term horizons, the on-going crisis could cause postponement of projects and delays in the completion of on-going ones. Both National Oil Companies and International Oil Companies may adopt a wait-and-see attitude as they evaluate the stability of the world economy and the prospects for oil prices. Some small international companies and state-owned operators may also be hamstrung by tightness in the credit markets. Overall, oil companies in the international arena will be less aggressive in the first half of 2009 than they were in the same period in 2008.

Global service companies are unlikely to continue their investment in infrastructure and hiring, especially in emerging markets. Certain segments of the oil service industry are expected to slow down more than others, with production-oriented products and services likely to remain in low demand. With the continuing downturn and the slow pace of activity likely in the E&P sector, prospects do not look particularly bright for the Nigerian oilfield service sector in 2009. Just as it happened last year, oilfield service companies, some of which are already trimming their workforce may not have much to do this year unless there is a turnaround.

The fear among indigenous companies in the service sector is that if this trend continues, gains made in government's Nigerian-content drive may be lost. Experience and skills acquired by indigenous firms through opportunities for the handling of contracts, which the Nigerian-content policy opened up for them may be lost, if there are no further avenues to put them to test.

The Federal Government's delay in producing a new, comprehensive economic programme reflects the fact that the country stands at a crossroads between implementing tough, unpopular market reforms and pandering to nationalistic and pro-subsidy interest groups. In addition, the challenges presented by the crisis combined with lower oil prices have caused uncertainty among Nigeria's policymakers. For his part, President Yar'Adua has listed seven priorities for reforms. Of these, arguably the greatest challenge will be to find a solution to the country's electricity supply problems. The government expects the private sector to play a key role, although private companies look set to take a cautious approach, given the challenging operating environment. Until they become fully involved, the government has committed itself to large subsidy payments to keep electricity prices low for end users.

Economic Growth

The troubles in the Niger Delta, which have intensified since April 2008, are likely to depress oil production further. The reason is that despite increased production from new offshore fields, the creation of the Ministry for the Niger Delta and a general amnesty declared by the Federal Government, no solution to the region's troubles is in sight, and the rebel militias are likely to continue their campaign. In addition, the OPEC quota cut introduced in December 2008 will put pressure on the authorities to reduce production. As a result, economic growth in Nigeria will come to depend much on the performance of the non-oil sec-

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tor, particularly solid minerals and agriculture as has been the case in the past three years or so. Although growth in this sector should remain comparatively robust, it is likely to slow markedly in 2009. Less access to finance will restrict investment and constrain previously buoyant sectors such as banking and construction. Growth in Nigeria's resurgent banking sector is also likely to slow. Although not directly exposed to toxic assets, the country's financial institutions will suffer from worsening investor sentiment and lower consumer confidence.

External Sector

The slump in oil prices in 2009 has caused a large contraction in the value of Nigeria's exports to US$28.2bn, from US$76.3bn in 2008. Import growth will also slow, owing to falling international prices for many commodities and lower domestic demand, but the traditional trade surplus is forecast to turn to deficit. Meanwhile, the services and income accounts will remain firmly in deficit, although the income deficit will shrink in line with the fall in oil prices and concomitant lower profit remittances from the international oil companies operating in Nigeria.

States

The oil revenue accruable to all tiers of government is on the decline: N30.894 billion in May 1999, N196.383 billion in May 2004, N746.745 billion in May 2008, and N435.40 billion in January 2009, to the lowly amount of N285.58 billion distributed in February 2009. Also, the value of the 13 percent derivation fund accruable to oil-producing states was N23.64 billion in January, 2009, much less than the sum of N35.08 billion that accrued to the concerned states in December, 2008. (The sharp reduction observed in the February 2009 allocations would have been more drastic but for the depreciated exchange rate applied in the conversion of the oil proceeds).

The challenges are glaring. How realistically can these states finance their budget deficits? Would they cut their budgets as some are already considering? They are already considering borrowing either from the banks or from the public through bonds. To what extent will such intent be fulfilled without jeopardizing the proper execution of the budgets especially their recurrent expenditure segments? How would the states respond effectively to the teachers' demands for a salary increase as agreed to with the Governors last year?

Government's Response

Although there was a delay in the formulation of policies that could have shielded the economy from the effects of the crisis in the belief that it would not affect Nigeria, Nigeria is slowly coming to terms with its effects. The Yar'Adua administration is re-working the 2009 budget in line with global realities. With oil prices now in a free fall, the government is set to drop its projected crude oil benchmark down. As part of cost-cutting measures, government plans to remove some items of expenditure from the budget while recurrent overheads and capital expenditure would be pruned. Important changes in the 2009 budget include the cancellation of overseas training, a 20% cut in the emoluments of all top federal government functionaries (from the President to the Permanent secretaries), a ban on the purchase of new cars for government functionaries and agencies, and no vote for new capital projects for ministries, departments and agencies. On the other hand, the federal government has set aside N200 billion for big-time farmers and planned a social security net so that job losers, displaced Nigerians and other indigents may be given allowances to cushion the effect of the meltdown. Government has started using part of the funds in the Excess Crude Account to supplement revenue allocation to the three tiers of government in months when available revenue falls short of the budgetary provision; it is laying emphasis on priority areas such as power, health, the Niger Delta and dredging of the Niger River. It has drawn up plans to defend the country's banking system amidst fears that bad loans, racked up during a frenzy of stock market speculation, could put some lenders in danger and is contemplating the creation of an assets management company, backed by state and private funds, that could offer to buy bad debts.

The CBN has embarked on "emergency" measures to bolster the liquidity of the system by easing the monetary policy rate from 9.75% to 8 percent. It has cut the cash reserve requirement for banks by half, from 2% to one percent and banks' minimum liquidity ratios by 5% to 25 percent. These emergency measures are aimed at improving liquidity conditions in the domestic economy as well as responding to the complex mix of external and domestic financial developments affecting Nigeria.

However, Sebastian Spio-Gebrah faulted CBN's moves, saying that they are inflationary (Nigeria's core inflation rose from 2.5% in January 2008 to 8 percent in January 2009) adding that, this policy might lead to agitation by civil servants for an increase in wages, which the government may not be able

to do. Moreover, according to him, these measures do not address the growing worry by many Nigerian savers who may lose substantial sums of money to some of the middle-tier banks who may be facing an "insolvent" crisis in addition to the more generalized financial sector "liquidity" problem. For example, over the past six months the non-performing loan ratios of many banks have risen. In response, some of the most stressed ones have dramatically increased the interest rates they pay to depositors, while also dramatically cutting back on lending. This deeply-worrying phenomenon may have necessitated the adoption of the unprecedented policy of interest-rate controls on both deposits (max.15%) and credit (max.22%). Regrettably the loosening of liquidity has not done anything structurally to address the underlying bank-toxic-loan problem which triggered the liquidity problem in the first place.

Major capital projects highlighted in the 2009 budgets of the 36 states of the federation may suffer a severe setback if revenue accruing to them continues to dwindle. Capital projects are expected to be the first casualty as expenditure on investment is expected to be cut in the states.

Many states have already begun the process of reviewing their expenditures with projects to boost infrastructure at the top of the chop block: roads, urban renewal and water-supply projects are being suspended, as states grapple with the challenges of lean resources. Urban renewal projects in some states – dualisation of existing roads and electricity projects using solar energy may be hardest hit by the capital projects rationalization.

Traditionally, internally-generated revenue (IGR) is a marginal revenue area for the states. Only 14 states generate more than 10 percent of their total revenue from IGR, with the exception of Lagos, whose IGR is 60% of its total revenue. Yet a bloated retinue of personal aides for governors, weak structure for accountable governance to curb corruption, and the seemingly intractable problem of ghost workers, have made states maintain huge recurrent costs, which often account for more than 60 percent of their yearly budgets. This is being looked into.

Now, following the decline in allocation to states, the drive for IGR is escalating in all of them. Hitherto overlooked sources of funds are now being resurrected. (The statutory areas states can derive revenue remain income tax, levies on land, fees etc.). The tax base is broadening. In spite of all their efforts, it looks increasingly likely that many states will continue to experience revenue shortfalls that will put many of their programmes at risk.

Conclusion

The Nigerian oil and gas sector is perhaps the flank through which the global financial crisis has hit Nigeria hardest. The reason is that the Nigerian economy is so tied to oil revenue that oil shocks immediately impact on virtually all economic prices in significant magnitudes. What is required now is to ensure that the government reform progamme is expedited. The restructuring of the oil and gas sector, in particular, will streamline the operations in the oil industry such that major tasks of policy, (de)regulation, commercial operations and national assets management, etc., are carried out by separate public entities. For now deregulation of the downstream sector should be put on hold. Priority attention should be given to efficiency in resource use and accountability, provision of infrastructure and reinvigoration of the peace process in the Niger Delta. In addition good planning should ensure that government spending and its financing do not result in economic instability, that requisite diversification of the economic base is allowed to take place – particularly in the areas of power supply, agriculture, petroleum refining, petrochemicals, information and communications technology, iron and steel, manufacturing - and people's empowerment through small and medium enterprises. Government should close the $100billion infrastructural gap now 80% GDP without delay and speed up the public-private partnership arrangement, whose benefits include project efficiency, appropriate risk allocation and sharing, the privilege of leveraging on private sector strengths and tapping on the pool of private sector funds. Because the CBN's interest rates have not yet translated into increased spending on interest-sensitive investment and consumption, there is no alternative to fiscal policy if government wants to reverse the current downturn. The resulting increase in the national debt is the price that we, and future generations, have to pay for the mistakes that created the current economic situation. When the crisis is over Nigeria will have a substantially higher debt-to-GDP ratio. At that point it will be necessary to develop policies to gradually reduce the relative level of government spending in order to shift the fiscal surpluses and reduce the debt burden. The ideas are there. It is just the will and sincerity that may be lacking. According to Price (2009), if we rein in corruption, rein in unnecessary expenditures, follow simple cannons of political and economic governance, work at our infrastructure, and diversify our economy we shall overcome.

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