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GLOBAL OIL PRICE CRASH: A SURVEY OF CHALLENGES FOR NIGERIA

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Abstract
The recent oil price crash that started in June 2014 destabilized the Nigerian economy which heavily depends on revenue generated from oil for managing the affairs of the nation. This paper aimed at finding out the causes of the present oil price crash, how Nigeria is affected by the oil price crash, and the way forward. The paper utilizes documentary research method where the data used for analysis in the piece were collected from government's documents and relevant literature. It also makes analysis using the Emmanuel Wallenstein's conception of World-System. The paper argues that the major causes of the present oil price crash include: excessive supply, increased geopolitical risks, shift in OPEC's objectives, and significant US dollar appreciation among others. It argues further that the Nigerian economy is negatively affected in the following ways: it leads to sharp decrease in government revenue; it leads to contraction of Government expenditure and it also leads to inflation. The paper concludes that reliance on single commodity for foreign earnings is not good for Nigerian economy due to risks associated with the global economy. The paper recommends that Nigerian government should diversify the economy by focusing on other sectors that could help her generate more foreign earnings and reduce over reliance on the oil sector. Sectors to give attention include agriculture, industries, and solid minerals.

Keywords: *Oil price crash, global oil price, Challenges, Nigeria.*

Introduction

Global oil price has been characterized by shocks which led to its fluctuation. It suffered five major crashes from 1980s to the current period 2016/2017. The major crashes suffered by oil price in the global market include; 1985-86 caused by excess supply as a result of increase of production by Saudi Arabia, 1998 weakening demand as a result of Asian crisis, 2001 caused by uncertainty as a result of September 11 terrorist attack, 2008 caused by severe contraction in global demand, and the current one that started mid June 2014. A number of scholars have been debating on the causes, consequences, and policy responses to the oil price crash in the world. However, scholars vary on their explanations of what exactly causes the oil price crash. While some (example, Dale in Omoregie 2015) are of the opinion that it is caused by the supply factor (others attribute it to the demand factor (example, Kilian 2008), with some attributing it to both factors (example, Baffes et al 2015, Sungurov 2015, Husain, 2015).

Since the discovery of oil in 1950s, the share of oil in the Nigeria's total exports has been increasing to the extent that by 2015, oil accounted for 71 percent of total exports, and 80 percent of Nigeria's foreign earnings. Oil has been the major source of government revenue and foreign exchange earnings (CBN, 2016). The current oil price crash that started in June 2014 destabilized the Nigerian economy which heavily depends on revenue generated from oil for managing the affairs of the state. This paper is aimed at finding out the causes of the current oil price crash, the challenges facing Nigeria as a result of this crash, and to recommend the possible way forward.

Literature Review

Oil price crash is a sudden fall in the price of crude oil in the global market. Historically, global oil price had suffered some major crashes that include the 1985-86, 1998, 2001, 2008-09 and 2014 to date (Baffers et al 2015, Sungurov 2015). Baffers (2015) believe that demand and supply factors have been responsible for oil price crash. He argued that supply shocks thoroughly accounted for twice as much as demand shocks in explaining the drop in oil price during the recent episode. He identified some factors that lead to the increase in global oil supply:

First, rapid growth in unconventional oil from unconventional sources - Sea (North Sea), Gulf of Mexico, in the 1970s and early 1980s, the high oil prices of 1970s made the use of technology to extracts oil from these sources profitably. During the 1973-83, North Sea and Gulf of Mexico together added about 6mb/d to global market. However, unconventional sources added to the global oil market during 2004 to 2014. Canada oil Sands oil output reached almost 4mb/d in 2014, up from 3mb/d in 2004.

Second, change in OPEC policy: OPEC has continuously produced above its target, and it decided to abandon price targeting in November (Baffs 2015, Sungurov 2015). The group's crude production rose to 30.48mb/d in December, 2014. However, OPEC's production in August 2016 reaches its highest in recent history. The cartels output reached 33.50mb/d from a revised 33.46mb/d in July (Reuters in This Day, 2016).

Third, geopolitical risks; United States and Saudi Arabia have joint interest in giving a geopolitical signal to Russia, Iran, and Syria. The increase in supply by Saudi Arabia/OPEC leads to decline in oil price steeply in June 2014 (Baffes 2015, Sunguron, 2015). Another Geopolitical factor is the Middle East and Eastern European conflicts which weighed less heavily than expected on oil supply. For instance, Libya, despite internal conflict, added 0.5mb/d of production in third quarter of 2014. In Iraq, oil output is less likely to be disrupted by ISIS, because the group has been handled. Iraqi oil output tends to be stable, 3.3mb/d during 2014, the highest average since 1979, when it reaches 3.5mb/d. Also sanctions and counter sanction imposed on Russia as a result of Russia-Ukraine conflict had little impact on European oil and national gas (Baffers, 2015).

From the demand side however, the factors responsible the decline in oil prices are as follows: First, appreciation of the US dollar: Between June 2014 and January 2015 the US dollar appreciated by more than 10% against major currencies in trade weighted nominal term. This strength of US dollar weakens oil demand in countries that are not using dollar, and stronger supply from non-US dollar oil producers (Baffes 2015). Second, decreasing demand by OPEC members. January release showed significant cuts on November demand by France, Mexico, Japan, and Brazil (Sungurov, 2015).

Kilian (2008) argued that oil price shock is caused by macroeconomic condition – oil market demand condition. He argued further that limiting the causes of oil price shocks to supply is not real, the shocks of demand for crude oil are so important. He added that it is not just in most recent period but also during earlier oil price shocks. However, not only the 2014 oil price crash was caused by supply factor, the 1985-86 crash was also caused by the same factor, when Saudi Arabia supplied more than the target to the global market, and subsequently the price declined. Considering the various factors that lead to increase in supply, the current episode of oil price crash is caused largely by supply factor and the trend is likely extend to some period of time.

Dale (in Omeregie, 2015) argued that total recoverable resource given is not real. He continued that estimates of recoverable resources are consistently increasing due to new discoveries and improvement in technology and technical knowhow. Total world proved reserve of oil in 2015 is more than double what was available in 1980.

Husain et al (2015) argued that supply factors have played a larger role than demand factors in driving the 50 percent drop in crude oil price between mid 2014 and early 2015. However, it continues to be the major factor through 2016. He attributed the decline in the crude oil price to the following: excessive supply resulted partly from non-OPEC developments (examples US shale, Canada sands etc.), higher than expected output from OPEC member countries such as Iraq, flows of money into oil and the weaker than expected demand in EU and Asia.

Omoregie (2015) concluded that the recent oil price crash is caused by excessive supply. That when asked why Saudi Arabia lower oil prices, the Saudi oil minister replied that neither Saudi Arabia nor OPEC is capable of setting the price of oil, the price of oil is set by market. Therefore, the role played by OPEC in determining the price of oil seems to be taken away by invisible forces - the market. This implies that oil producing countries are only struggling to survive. OPEC members like Saudi Arabia is already adjusting, trying to maintain its status and advance its interest.

Theoretical Framework

Wallenstein's conception of World-System is a very relevant framework in understanding and analyzing politics associated with the oil in the global economy. In his conception of World System, he argued thus:

> A World System is a social system, one that has boundaries, structures, member groups, rules of legitimation and coherence. Its life is made up of conflicting forces which hold it together by tension and tear it apart as each group seeks eternally to remold it to its advantage. It has the characteristic of an organism, in that it has a life span over which its characteristics change in some respects and remain stable in others. One can define its structure as being different time strong or weak in terms of the internal logic of its function, (Wallenstein 1976:229).

The relevance of this theory to the study finds expression in the fact that it could be used to analyze the competitive nature of global market with respect to the oil price and quantity supplied which leads to fluctuation of the price and affected the oil producing states (Nigeria inclusive). Considering the causes of global oil price as argued above, the global economy consists of actors (economically strong and weak), each trying to maximize its advantage over another. Oil being strategic product and with increased value in the global market becomes an instrument of increasing not only economic power, but also political power and influence. Dominant oil producers have been using the oil to advance their interest. A good example is the Saudi Arabia which is a major global oil producer and was in favour of lower oil price for more or less two reasons. First, was to weaken countries such as Iran, Russia, and Syria, because of ideological differences (Sunni versus Shiit), and to favour her Allies (in West and Middle East), the lower oil price would limit their economic and military capabilities, thereby limiting their threat. Second, Saudi Arabia and other major oil producing states (especially OPEC members) see new oil producing states (from unconventional sources) as for their emergence is affecting their control of the market. Therefore, they believe that maintaining lower price of oil over a long period will kick them out of the market. Therefore, global oil price crash is caused by the competition between countries of the world each tying to increase its advantage (economically and politically) to the disadvantage of others.

An Overview of the Nigerian Economy

Agriculture has been a key sector of the economy of Nigeria and many African countries. It has been a source of employment, livelihood as well as development of their population. It also provides subsistence for two–third (2/3) of Nigerians who are low income earners (Ogunbayo et al, 2014; CBN/NBS, 2006, in Ugwu and Kanu, 2012).

Colonial administration made a great impact on agricultural development with emphasis place on research and extension services. However, colonial economy in most African countries was structured to improve the economies of metropolitan powers (Akpan, 2012).

Since independence, Nigerian government has been making so many efforts to improve the agricultural sector which had been declining since the discovery of oil in the 1950s. Another cause of decline of agricultural sector has been the lower price of agricultural produce in the global market.
In early 1960s, the share of agricultural sector to Gross Domestic Product (GDP) was 62.5 percent and between 1999 and 2002, the share fall to about 40 percent of the GDP, and it fall to 20.9% in 2016 (CBN 2003, Bello-Iman and Obadan 2003, and NBS 2016).Various administrations made an attempt to diversify the Nigerian economy by focusing on the agricultural, oil and manufacturing sector and solid minerals.
Various policies were introduced by various administrations to revive the declining agricultural sector and develop manufacturing sector. These polices include: Agricultural Development Projects (in 1960s), Operation Feed the Nation (in 1970s), National Directorate for Employment (in 1980s), National Economic Empowerment and Development strategy (in 2004), vision 20 20 20 (in 2007), Transformation Agenda (2010), and currently diversification agenda. Despite these policies introduced by various administrations, oil remained the major source of revenue and foreign earnings. This is a result of so many problems that include; the lack of political will on the side of the Nigerian political leaders, corruption, inadequate funding of policies and programs, inconsistency in economic policies, ethnicity among others.
However, over these periods crude oil continued to account for increasing proportion of export through 1970s, increasing from 13% in 1955 to 35% in 1965, to 93% in 1975 to 96% in 1985 (library of congress country's studies, LCCS, 2004), and to 71% in 2015 (NBS 2016). This shows that oil dominates Nigeria's exports and serves as the major source of revenue.

Nigerian economy is import oriented economy which depends on other countries for most of manufactured goods consumed and on oil for revenue generation. This is why it is tagged mono-economy. The economy is currently in recession as a result of the current oil price crash. It is characterized by uncertainty and instability ranging from flight of capital by foreign investors to shortage of foreign exchange (which led to fall in the value of Naira), cost of imported and locally produced products (with some more than doubled), and contraction of government expenditure (capital and recurrent) as a result of shortage of revenue, among others. These problems made it difficult for the common man to live a better life as a result of increase in poverty and unemployment. 1n 2016 for instance, 110 (about 61.1 percent) million Nigerians were living in poverty (Osinbajo in DailyPost, 2016), up from 60.9 percent in 2010 (Reuters 2012). Also Nigerian unemployment was recorded at 13.3 percent in the second quarter of 2016, up from 12.1 percent in March, highest since 2009. Youth unemployment increased to 24 percent from 21.5 percent (Trading Economics, 2016). This made it difficult for many Nigerians to eat good three meals a day. This is because even the high income earners are faced with the problem of decrease in the value of their incomes (by almost a half or more).

The Challenges facing Nigeria
Nigeria is faced with many challenges as a result of oil price crash. The following data is used in understanding and explaining the challenges facing Nigeria.
The following Table presents the oil revenue received by the Federal government of Nigeria (annually) in N billion from 2011-2015 (fourth quarter), and second quarter 2016.

Table 1

2011	2012	2013	2014	2015	2016
N2408.1	1823.6	1538.4	1466.2	830.81	537.19

Source: Extract from CBN Economic Report Fourth Quarter, 2011, 2012, 2013, 2014, 2015, and Second Quarter 2016.

The following table represents the average quarterly oil price (fourth quarter) from 2011 to 2015, and Second Quarter 2016 (in US$)

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Table 2

2011	2012	2013	2014	2015	2016
112.28	112.73	113.11	77.74	44.08	46.44

Source: Extract from CBN Economic Report Fourth Quarter, 2011, 2012, 2013, 2014, 2015, and second quarter 2016.

From the above tables (1&2), it is obvious that declining oil price has direct relation with the revenue generated by Nigerian Government as presented in table 1. Therefore, global oil price crash leads to so many challenges to Nigeria which includes the following:

First, it leads to a transfer of wealth from oil producing countries to oil-consuming countries. A decline in the price of oil gives the oil consuming nations a chance of saving a lot of money into their economy. These savings could be injected into the economy for more growth and development. On the other hand, oil producing state like Nigeria suffers from the oil price decline because the revenue generated from sales of oil has been reduced. This would lead to less money in the hands of the people, low saving and less growth and development. It was estimated that a $10-a-barrel fall in the oil price transfers around 0.5% of world GDP from oil exporters to oil importers (Omoregie 2015). However, oil price has failed by more than $60-a-barrel from $113.11-a-barrel in 2013 to current price $46-a-barrel. Which means the GDP transfers to oil importers by the producers is about 3%. It was also estimated that a drop of $30 in the oil price (prolonged for a year) would transfer more than $400 billion from oil exporters to importers (Omoregie 2015). China, Japan, EU and India have been the major importers of crude oil and are now the beneficiaries, while countries like Nigeria, Venezuela, Ecuador and others suffer from the crash. The above data for instance show a subsequent decline in the revenue generated by Nigeria from the sale of crude oil. The revenue declined from N2408.1 billion in 2011 to N830.81 billion in 2015 when the crude oil price was at $112.28 and $44.08 respectively.

Second, it leads to the drop of Nigeria's foreign reserve. Nigeria's stock exchange foreign reserve dropped from about $37.3 billion in 2014 $ 26.6 in 2016 (CBN 2016). This fall in oil prices also implies that CBN's monthly foreign earnings has fallen from as high as $3.2 billion to current levels of as low as $ 1 billion (CBN, 2016). This leads to shortage of foreign exchange and subsequently devaluation of Naira to N197.00 to $1 official rate. However, the CBN has been in dilemma. It decided to provide the foreign exchange to meet the following needs:

- Mature letters of credit from commercial banks
- Importation of petroleum products
- Importation of critical raw material, plants, and equipments, and
- Payment of school fees, and related expenses

The dollar was sold at 197 to the above categories. However, the demand of dollar in the market was still higher than the supply, especially by oil importers, this forced the NNPC to introduce policy that anybody can import oil and the CBN give the oil importers a chance of sourcing their foreign exchange from the parallel market at the bench mark of N280 to a $1 dollar. The Naira is currently exchanged N415 to N420 a $1 dollar in parallel market. Also the supply of dollar by CBN was limited to Banks, BDCs are excluded. In August 2016, the CBN revised it policy where it directed banks to sell the dollar to BDCs. As of November 9^{th} 2016, CBN sold dollar at 305 official rates (CBN, 2016), however it is exchanged at parallel market at N465 as of November 8^{th} 2016 (Naija Observer, 2016).

The foreign exchange crisis however has the following implications: raises the prices of goods imported for household consumption. Prices of goods consumed by Nigerians have skyrocketed. The price of rice which is one of the imported foods mostly consumed by Nigerians was almost doubled. For instance, a bag of rice which was sold at N10000 Naira in 2015 was sold at 20000 and above in 2016 and early 2017. A bag of maize which was sold at N 3500 Naira in 2015 was sold at N17000 in 2016 and early 2017. A bag of cement which was sold at N1500 in 2015 is now sold at N2300 (British Broadcasting Corporation, 2016). Though

the there is slice reduction in the prices of food stuff due to harvest season, which is likely to be permanent. This implies that the purchasing power of Nigerians has reduced. This in turn leads to low living standard and increase in number of people living in poverty. According to Economy Watch (2016) over 62% of Nigerians live in extreme poverty. Many Nigerians find it difficult to eat three meals a day.
Third, it leads to capital flight. The decline in oil price puts fear in the minds of foreign investors. According to Reuters (in Economy Watch, 2014) selling off of Nigerian stocks valued at N101.2 billion Naira ($583.5 million) by foreign investors in October following the drop in the oil price. Foreign portfolio investment had declined by 86% in the past year, while foreign direct investment had reduced by over 50% (The Cable 2016). These weights greatly on Nigerian economy which has been struggling to diversify and reduce the unemployment rate. This breeds another difficulty. This implied that more jobs would have been lost as a result of flight of capital and decline in foreign direct investment. This would make many people poorer. It would also lead to contraction of economic activities which would affect the economic growth.

Fourth, contraction of government's recurrent and capital expenditure; Form the above data it is clear that the revenue generated by government from the sales of crude oil has reduced from N2408.1 in 2011 to N830.81 in 2015; this implies that government has to reduce its spending to some extent. For instance 2015 to 2017 medium term expenditure framework (MTEF) had been affected. After the submission of 2015 budget proposal to the National Assembly for consideration in September 2014, the price of crude oil crashed. This resulted in the withdrawal of the document (MTEF) for adjustment of the crude oil bench mark of $78pb. About two weeks later, the price further crashed below $70pb and this made government to further review the bench mark from $78pb to $73pb. The price declined further, forcing government to review the oil bench mark to $65 a dollar. However, the current administration benchmark in the 2016 budget is $38 dollar to a barrel with a deficit budget forcing the government to borrow from China to finance capital projects. However, as a result of decline in the share of states in the Federation Account, many states find it difficult to manage the affairs of their governments. Important sectors such as education and health are underfunded and this makes it difficult for segment of the population to access medical facilities and sound education. Daily Trust (2015) reported that major challenges facing Nigeria's primary health care include dilapidated structures, shortage of staff, unskilled personnel, lack of drugs and equipments, and poor referral system. In his remarks at the Second National Executive Committee meeting of the APC in Abuja, President Muhammadu Buhari observed in reference to the unfavorable economic situation in the country which his government was battling to stabilize, thus: "On the economy, the fall of oil prices after Nigeria has made itself mono economy is a disaster. I wonder why people could not believe that in Nigeria; about 27 out of 36 states have difficulties in paying basic salaries of their workers" (Punch, March 25, 2016).

This would affect not only the salary earners, but also the entire society. Because reduction in purchasing power of the working class would lead to less money in circulation, less money in the hand of people and low living standard, this would in the end affect economic growth.
Fifth, employment opportunity will be limited. Public sector has been the largest employer of formal labour. Therefore, with cut in government expenditure due to decline in crude oil price, new jobs will continue to decline. Employment in the private sector will also be affected because reduction in purchasing power will affect the level of production by the private sector. Unemployment rate in 2016 is 12.1% up from 10.4% in the fourth quarter of 2015, reaching the highest 2009, and youth unemployment rate increased to 21.50% from 19% (NBS 2016, in Trading Economics August, 2016).

Conclusion

Global oil price crash has been occurring and it weighs on the countries that depend on oil for revenue generation. This current oil price crash is different from the previous episodes because, it is dominantly caused by supply factor as a result of increase in crude oil supply from unconventional sources and as a result of geopolitics. This is a signal to oil producing states that new competitors will be emerging, for more oil is discovered and geopolitical risks are also not likely to end soon. Therefore, dependence on oil for revenue is not good for Nigeria considering the uncertainties and risks associated with oil in the global market.

Recommendations

Based on the findings of this paper, the following recommendations are hereby made:

First, government should diversify the economy so as to reduce over dependence on the crude oil and focus on the development of other sectors such as agricultural, industrial, and solid mineral. This will provide alternative sources of foreign earnings and more revenue which will in turn, solve the problem of inadequate revenue, uncertainty caused by oil price crash, shortage of foreign currency that led to inflation, unemployment and poverty, and contraction of capital and recurrent expenditure.

Second, government should formulate policies that would develop infrastructure – good roads, electricity etc, this will lead to the provision of healthy environment for investment. Investment from local and foreign investors would reduce unemployment and poverty; it would also improve the revenue generation by government due to taxes from various sectors of the economy.

Third, OPEC should be re-organized by inviting the new oil producers from unconventional sources so that they can take collective action as they used to do. This will give them a chance of determining the supply of the oil in the global market, and in turn revive the price of the oil.

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