



OIL PRICE MOVEMENTS AND NIGERIA'S ECONOMIC INDICATORS

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Abstract

This study examines the impact of changes in oil price movements on GDP and Unemployment within the context of the Nigerian economy. The methodology approach adopted was library research, focused on content review of extant literature. From the review of literature, findings and recommendations were arrived at. This study concludes that oil price movements do not significantly affect the economy on the whole since unemployment level in the country is still very high. However, there is a direct relationship with GDP because as oil price rises GDP also rises. Since Nigeria is a mono cultural economy and the price of oil has been falling in recent time, it is recommended that Nigeria should embrace other sectors of the economy like agriculture and solid minerals.

Keywords: Oil prices, diversification, GDP, unemployment

1. INTRODUCTION

Oil has become the key factor of the economy because of the role it plays in the economic and political future of Nigeria. It is instructive to note that oil sector in Nigeria was initiated at the beginning of the century, however it was when the civil war ended that the sector played a role economically in the sphere of things.

In 1960 Nigeria had her independence which came up with challenges caused by differences in various factors within the southern and the northern geo-political zones. The cause of these can be traced to oil discovery. Oil discovery in Nigeria has had various impacts on her economy. However, the level of its impact on economic performance is a function of the oil price therefore there is need to appraise the measure of price of oil on the economic performance of the Nigeria.

The dependence of Nigeria on oil for generation of income clearly has serious effects on her economy. More so oil is a significant commodity in Nigeria's economy because it provides a power that can be used both domestically and industrially. Consequently change in price of oil will therefore have effect on the economy.

This work is necessitated as a result of limited studies on the impact of energy shocks in countries exporting oil like Nigeria, unlike other work on oil-importing countries (Olomola & Adejumo, 2006). Besides, the study attempts to query into the general conclusions of many recent studies that oil price fluctuations/market disequilibria have no impact on the Nigerian economy (Ikla, 2012; Chuku *et al.*, 2010; Olomola & Adejumo, 2006).

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1.1. Statement of problem

The discovery of oil in large quantity in Nigeria has made the economy to be mono cultural since the economy entirely depends on oil. It should be noted that oil has contributed to exports to the tune of about 90%, Gross Domestic Product (GDP) to the tune of about 25% and revenue to the tune of about 80%. So therefore, price changes has a significant effect on the economy of Nigeria. In the 1990s as the price of oil increased by US\$1, her earnings in terms of foreign exchange by about US\$650 million and revenue also increased by US\$320 million (Umar & Kilishi, 2010).

Literature have it that from 1971 to about 2005, She had gained over US\$390 billion in fiscal revenue as it relates to oil (Budina & Wijnbergen, 2008). Despite the fact that she gained in terms of fiscal revenue, she had nothing to show because she has a population that lives in abject poverty and her economy was at a standstill (Okonjo-Iweala & Osafo-Kwaako, 2007). Torvik and Verdier (2006) describe as a resource curse – a paradox of poverty amidst plenty resources. Why? A challenge that Nigeria suffered from in depending on oil is the Dutch Disease Syndrome (DDS) – the structural economic imbalance resulting from poor management of oil revenue, and perhaps its shocks. Windfalls that result from volatile oil price surges/shocks overwhelmingly flow through the economy; expand the oil industry and penalise the non-oil industry (Miero & Ramos, 2010).

The price of oil has been changing more than any other commodity since the end of World War II. The market forces of demand and supply in the world as well as OPEC activities tend to have effects on oil prices. Changes in the price of oil in the world market has had negative effect on the budget of Nigeria which has consequently made her to review her budget benchmark downwards as it relates to price (Umar & Kilishi, 2010). Consequent upon this, the study is aimed at ascertaining whether oil price movements have impact on Nigeria's performance indicators. The objective of this study generally is to evaluate movements of oil price and Nigeria's economic indicators. The specific objective therefore is to appraise if oil price movements brings about commensurate effect on GDP and Unemployment.

2. LITERATURE REVIEW

In 1960 Nigeria gained her independence at a time when oil had little or no impact in her economy. Oil was discovered in large quantities at Oloibiri in 1956, but production started in 1958. Nigeria became a member of Organization of the Petroleum Exporting Countries (OPEC) in the year 1971. The economy of Nigeria depends to a large extent on oil since it accounts for an estimate of about 90 percent of her revenue in terms of export, nearly 90 percent in terms of foreign exchange and earnings and about 80 percent in terms of revenue (Ayadi, 2005).

For over forty years, Nigeria had witnessed significant increase in her oil and gas activities. Her activity on the onshore is centred around the Niger Delta region which has provided colossal riches for her. It is imperative to stress that though the Niger Delta region that produces this oil have difficult land terrain, its impact in terms of development to the country in terms of earnings, employment and other infrastructures are significant. Literature has it that Nigeria has made about 600 billion dollars from oil since its discovery (Atakpu, 2007). It is obvious that all through the years, the main source of revenue for her is oil and hence proceeds from the earnings have been used in providing infrastructures and for improving the well being of her citizenries.

Literature has it that price of oil shocks have effect on growth and on a country's performance that export oil like Nigeria. This impact is known as the Dutch Disease Syndrome. Windfalls from sharp surge in oil price cannot sweep through a developing economy that is yet to be diversified and large enough to absorb the inflow without causing inflation. Resource pull effect and spending effect result when large inflow from oil export hits a less diversified economy (Miero and Ramos, 2010). The booming export sector (trading internationally) experiences rise in marginal productivity and thus pay factors employed relatively more than other sectors do. As a result, factor inputs/resources are pulled to the booming sector to the detriment of other tradable sectors and sectors that are not tradable, thus resulting in an economy that is de-industrialized.

As a result, output of industrial sector declines while prices of domestic products rise. As domestic price level (P) rises, real exchange rate ε (EP/P^*) rises, rate of nominal exchange (E) and level of foreign price (P^*) remains constant (Blanchard, 2007). The appreciation in the real exchange rate penalizes exports of other tradable sectors as they become relatively more expensive in the international market, and hence less competitive (Miero and Ramos, 2010).

The country's poor policy formulation results in structural imbalance of the economy. This imbalance refers to a situation where the non-oil sector declines while the oil sector booms. This phenomenon is termed the Dutch Disease Syndrome (DDS). Nigeria has been exhibiting this phenomenon since the 1970s. The relative boom of the oil sector encouraged excessive government spending (Budina and Wijnbergen, 2008); and this resulted in inflation and real exchange rate appreciation.

Ibrahim (2007) identifies weak linkage between the oil industry and other sectors in Nigeria. He blames this on the low level of technological development in the country. This results in limited growth of the downstream sector. As a result, the avenues through which downstream oil sector could have forward and backward linkages with other sectors are thus limited. Consequently, growth differential in oil and non-oil sectors is inevitable, and may explain backward development of the economy.

Soremekun and Obi (1993) as cited by Ayadi (2005) opines that Nigeria operates a mono-cultural economy as a result of the emergence of oil and consequently, it has raised the economic contradiction of the Nation. As a result of these contradictions, it has led to situation of national crisis where some parts of the country feel cheated. Forrest (1995) further observes that Nigeria has experienced its fair share of unforeseen consequences as a result of large windfall proceeds from oil. It ranges from by passing taxes and investing on unproductive ventures. Reliance in oil has led to loss of public accountability and neglect of other sources of revenue etc. Aiyegoro (1997) records that oil discovery in Nigeria have led to over expanded public sector, unrealistic public projects, currency depreciation, poor price and wage control as well as weak public policy which distorts the financial markets. Omotoye (1997) supports this view by noting that the emergence of oil in Nigeria led to the neglect of the agricultural sector (Ayadi, 2005).

The classic supply side effect and the income transfer channel have been used to buttress the inverse relationship between oil price movements and aggregate economic activity. The prominent is the classic supply-side effect which suggests that as oil prices increases availability of basic input to production reduces. However, it explains why oil price rises slows GDP growth and stimulates inflation as shown in the work of Brown and Yücel (1999). Studies carried out by researchers in Nigeria shows that oil price movement on key macroeconomic variables are not statistically significant (Olusegun, 2008; Christopher & Benedikt, 2006; Philip & Akintoye, 2006). Bawa and Mohammed (2007) records that Nigeria's oil wealth have not contributed much to the economy because its GDP per capital is lower than what it was as at independence in 1960. However, their work is limited because it does not provide empirical evidence and hence it can be said that their work was based on mere assumptions which are not statistically verifiable (Baridam, 2008 and Eromosele, 2004).

The price of oil has been changing since 1999 and there are factors that have led to these changes but they are not limited to:

- (i) The restriction of crude oil production by OPEC and facilitating cooperation among members
- (ii) Demand for oil by Asians
- (iii) Reducing non-OPEC production.

The market of the world reacted to this by increasing prices and thus prices of crude oil increased and went above US\$30/b towards the end of 2000. OPEC embark on measures to stabilize prices at a range of between US\$22/b and US\$28/b by increasing or reducing production and increasing output

by non-OPEC producers in particular reference to Russia. Due to the September 11 2001 event crude oil prices plummeted, despite increases by non-OPEC producers and reduction of quotas by OPEC member countries. Subsequently, prices moved to the US\$25/b range, however in 2004, prices moved beyond this range, with the Brent crude selling above US\$40/b per barrel during the year (Umar & Kilishi, 2010).

Factors that have contributed to oil price movements includes: The persistent decrease in the dollar, the tension of the Middle East, the high demand for oil by China and uncertainty about the future of yukos. It is imperative to stress that as the dollar falls against other major currencies, price of oil tends to increase. However, movements in oil price does not necessarily transform to changes in domestic end user prices of oil products, because of the changes of domestic demand and supply, domestic policies such as subsidy and price regulations. Hence, changes in prices of oil do not have significant impact in the domestic economy through the domestic end user prices.

3. FINDINGS

Oil price significantly affect economic growth at all levels. There is no gain saying that as the prices of oil increases, revenue/income for the economy also increases which provides additional resources that can be used to promote economic growth. On the other hands, oil price shock negatively affects the economy. The negative impacts may be explained from the uncertainty that shock introduces in the economy and its impact on the government budget. Oil price shocks often destabilize government fiscal operations, which may in turn negatively affect other economic plans and outcomes. While negative shock may result in cut in planned government expenditures (e.g. on infrastructure) positive shocks may overheat the economy as government may expand its fiscal operations to mop up the excess revenues.

There is no gain saying that oil price has influence on GDP and unemployment. It is instructive to note that as price of oil rises the GDP of the nation increases while as oil price decreases GDP also decreases. This is to say that the relationship that exists between oil price movements and GDP is a direct relationship. However, oil prices increase has not brought about a commensurate level of employment in Nigeria. Hence, it can be said that no relationship exist between oil price movements and unemployment.

4. CONCLUSIONS

Before oil was discovered in Nigeria, the economy of Nigerian was agricultural driven. On discovery of oil, there was a shift to oil consequently the agriculture which hitherto provided revenue for the economy was abandoned. With the romance of oil by the government of Nigeria, can it be said that oil has done more harm than good to the economy? Though, oil has contributed and is still contributing its quarter to the Nigerian economy, the economy is not where it ought to be.

The study concludes that the relationship between oil price movements and GDP, is a direct relationship suggesting that as price of oil increases GDP also increases. On the other hand, no relationship exists between oil price movements and level of unemployment, suggesting that even if oil price increases, it does not have any reciprocal effect on employment.

5. RECOMMENDATIONS

With the continuous fall of the price of oil in the world market, it will not be out of place for Nigeria to think of focusing on other sectors of her economy that will provide revenue for her to be able to produce the greatest good to the greatest number of people in line with the utilitarian theory.

Agriculture is an area that Nigeria can explore because she has vast land that is suitable for agricultural production and government should provide machines to farmers so as to encourage commercial agriculture and they can go further by providing basic infrastructures and provide

farmers with fertilizers for agriculture to thrive as this will go a long way in boosting her revenue profile as some of this agricultural products can be exported to various countries of the world.

Nigeria is blessed with natural resources which include solid minerals. Nigeria has not done much in the area of harnessing its solid mineral sector. If this area is harnessed it will go a long way in improving her economy instead of solely relying on oil as a source of revenue.

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