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CPPA –NNRC Policy Dialogue on the Implications of the Falling Oil Prices

The Centre for Public Policy Alternatives (CPPA), a Lagos-based think tank held a policy dialogue in partnership with the Nigeria Natural Resource Charter (NNRC) on Tuesday, 10th March 2015. The dialogue, titled "**Implications of the Falling Oil Prices for policy in Nigeria**" had in participation, experts from across the oil and gas industry, policy analysts, reputable academics, former government officials, the media as well as other members of civil society.

The primary objective of the policy dialogue was to engage key stakeholders in conversations for the purpose of identifying policy implications of the falling oil prices for Nigeria. Such policy highlights will be useful in advocacy and strategic engagement efforts with the government of Nigeria. The policy dialogue also serves the dual purpose of being a dissemination platform for assessing the governance of Nigeria's petroleum wealth based on findings from the recently completed 2014 NNRC Benchmarking report.

Activities of the day were organized around two panel discussions, where each session lasted about 90 minutes. The first panel focused on implications for the oil industry itself with the main question: "**What does $60 per barrel mean for Nigeria's oil industry?**" This question was supported by sub-questions about the manner in which companies, particularly local indigenous ones, would be adjusting to the new price trend; the effect of reduction in exploration and production projects on the country's reserve and production targets; and the potential setbacks, if any, for the proposed Petroleum Industry Bill (PIB).

The second panel tried to answer the question: "**What do lower oil prices mean for Nigeria's macroeconomics?**". Again, this main question was supported by sub-questions including: can Nigeria take the opportunity of lower prices to reform petrol subsidies? How is the fall in the Naira affecting the economy and what can be done to mitigate its negative impact on citizens? Why is the Excess Crude Account an insufficient lifeline this time, and how can we improve it in the future?

Some of the **most important** general points raised during the panel sessions are that:

1. This dialogue is topical. According to the Chair of the NNRC, **Mr. Odein Ajumogobia, SAN**, while it's not surprising that there are fluctuations now, with similar cases since 1979, the current situation highlights the importance of planning. The biggest question is **"how have we managed to mitigate risks?"**
2. <u>Role of OPEC</u>: For a long time, the Organization of the Petroleum Exporting Countries (OPEC) had played a balancing role in global petroleum affairs. However, changes have been witnessed since the start of the millennium. The rise of new technology for shale

oil production is matching OPEC's influence. When OPEC met in 2014, it refused to cut production, thus creating the global surplus that led to declining prices.

3. Industry performance: These are not good times for the country on all industry indices. Nigeria is not doing well in both upstream and downstream sectors.
4. Lack of savings: There isn't enough fund in the Excess Crude Account to cushion the domestic effects of the impact. The importance of saving for a rainy day has been long neglected by the government.
5. PE of Oil: The centrality of oil to governance in Nigeria cannot be undermined. One critical element, which had been missing in Nigeria's macroeconomic analysis, is the political economy of oil. "Normal economic logic alone does not work perhaps because of Nigeria's own sense of 'exceptionalism'". The country now faces a perfect storm: the triage of an existential threat to geographic (security), political (elections) and economic (revenue) survival, says **Tunji Lardner**, member of the NNRC Expert Panel.
6. Several companies are going out of business in the service sector and the banks may not be able to help due to high interest rates. According to **Mr. Gbite Adeniji**, Group Lead of the NNRC Expert Panel Core Sector group, we are at the beginning of a major storm. Contractors are beginning to lay off staff. The implications remain that projects will be cut, while the optimism that brought those new players [indigenous companies] into the industry are dampening.
7. Nigeria's Debt rose from $10.4 billion in December 2014 to $11.4 billion by February 2015. Some states are also in debt: Lagos state has the highest debt with about N117bn while Kogi state has the lowest debt value. These figures draw our attention to the need for stabilization and planning.
8. Lack of economic coordination: **Prof. A. Ekpo**, member of the NNRC Expert Panel, also noted that but for lack of economic coordination especially between the Central Bank of Nigeria and the Ministry of Finance, the risks would have been foreseen. The government presented a $65 benchmark price for the budget at a time when the price of oil was around $50 per barrel. "The practice of neo-liberalism by the government has failed and means that there is need to reform the entire economic system."
9. One of the shocking examples of impact from the proposed 2015 budget is seen in the announcement of a budget cut for the Ministry of Works from N100 billion down to N11 billion. What this means is that there will be no additional roads or bridges constructed this year.
10. According to **Henry Adigun**, one of the panel discussants, Nigeria is a country with so much waste in many aspects of the economy. It is important for individuals to rethink their budgets by being more prudent. Such improved micro-economy can then offer benefits for the larger macro-economy.

According to some of the Expert Panel members, including **Lois L. Machunga**, **background factors responsible** for the current situation include:

1. A steady growth in demand for crude oil was maintained until 2007 when that demand started slowing down with the global financial crisis.
2. Advances in global energy efficiency and the push towards energy sustainability have also enhanced the decline in oil demand, according to **Dr. Olufemi Olarewaju**, one of the panel discussants,
3. The downgrading of GDP growth in most unexpected places: China, Japan, EU and the U.S., which upgraded its GDP by 0.5%,
4. High surplus including shale oil boom in the United States that affected Nigeria's exports to the same country. From 9% of oil imports coming from Nigeria in 2013, the US moved to 1% by 2014, finally,
5. Geo-politics of oil from the middle East - Saudi Arabia's refusal to hedge production as a result of its huge reserves and low costs of production – instability in Libya, events in Russia and Iran, re-invention of US-Cuba relations and growing riots in Venezuela have all impacted the current system.

Impact of falling oil prices on Nigeria

From the discussions, a number of opinions have also been generated concerning aspects of Nigeria's economy that will be most impacted by the current crisis. These include the following:

- **Exploration and Production (E&P):** Exploration and production will be affected. Once companies can no longer take risks, they will be forced to announce cuts. For example, Conoco has announced an 18% budget cut, Shell has announced $15 billion cuts, while about 40 companies in America announced a total of 45% cuts in E&P.
- "According to Moody's, if crude prices reach below $30 per barrel, Exploration and Production cuts will be 25% to 30%," says Lois L. Machunga.
- Only 7 wells were drilled last year.
- **Reduced Investments:** According to experts within the oil and gas industry, investments have been reduced in the sector. In 2014, ExxonMobil cut investments in Nigeria by 15%. NNPC cut investments and also advised its Joint Venture partners to cut their investments particularly in community projects by as much as 40%.
- **Food prices and inflation**: In 1985, when oil could not be sold, there was inflation. Nigeria's foreign reserve had helped reduce the domestic impact of crude oil volatility on prices. At that time, the foreign reserves were less than $7 billion and Nigeria survived. However, since 2011, Nigeria has struggled and actually depleted its foreign reserves of approximately $50 billion. Rising costs coupled with inflation stemming from devaluation of the Naira will have domestic impact.
- **Gas Master Plan:** Government revenue stream cannot be maintained if oil drops to $40 per barrel. Other projects will be affected, especially the gas master plan which is expected to feed electricity reform projects.

In response to the question on the **role of the proposed Petroleum Industry Bill** in resolving some of the issues in this low price regime, experts responded that a reformulated and probably streamlined PIB into a far less expansive reform package might provide significant solution. Fiscal terms will improve of necessity for IOCs and the PIB should try to move from a regressive system to a progressive system.

Solutions

At the end of deliberations, participants at the policy dialogue were able to suggest a number of ways in which the current situation could be tackled within the policy perspectives of governance and accountability. Some of these are highlighted below.

1. Government should seize this opportunity to cut down on public spending including wage freezes, scaling down government services, and imposing fiscal measures. This is the most ideal and foremost option if government is to secure legitimacy in any of its other measures.
2. Secondly, Government should seize the opportunity to increase tax in order to improve the fiscal regime. This may be in the form of simply widening the tax net without nominal increases in the tax code. For example, the informal sector which contributes as much as 30% to the Internally Generated Revenue (IGR) of Lagos need to be keyed into formal tax templates. The efficiency of the tax regime needs to improve considerably.
3. It will be important to consider constitutional reformation and the actual practice of fiscal federalism, as most states are not economically viable. Also, unique states like Lagos that can show the example of economic viability are being constrained by the current federal system. This period can provide the turning point or tipping point required for such fundamental policy and political restructuring.
4. The country must be ready to operate a federal system that encourages stronger units with a weaker center in order to discourage the rentier and welfare mentality.
5. There is the need to take advantage of the current drop in oil prices to diversify the economy. When oil prices were already about $54 per barrel, Nigeria was still proposing a budget with about $60 benchmark. This is inconsistent.
6. Nigeria needs good leadership that can secure citizens trust through accountability. Queries surrounding the Excess Crude Account concern operations and management of the fund much more than its legality. Under the current administration, Nigeria earned the equivalent of what it earned over a period of 15 years before now. Yet the ECA is only $1.16 billion presently.
7. Nigerians are too casual about government and need to rid themselves of their sense of entitlement. Things will remain the same until Nigerians act. Nigerians must demand good governance.

The next significant challenge is to deepen advocacy and strategic engagement. Efforts to bring suggestions to the fore must be supported significantly by all stakeholders particularly the media. Policymakers need to be aware of the gravity of the situation and the importance of good policy formulation in order to mitigate risks and plan for the future.

NNRC-CPPA Policy Dialogue Team