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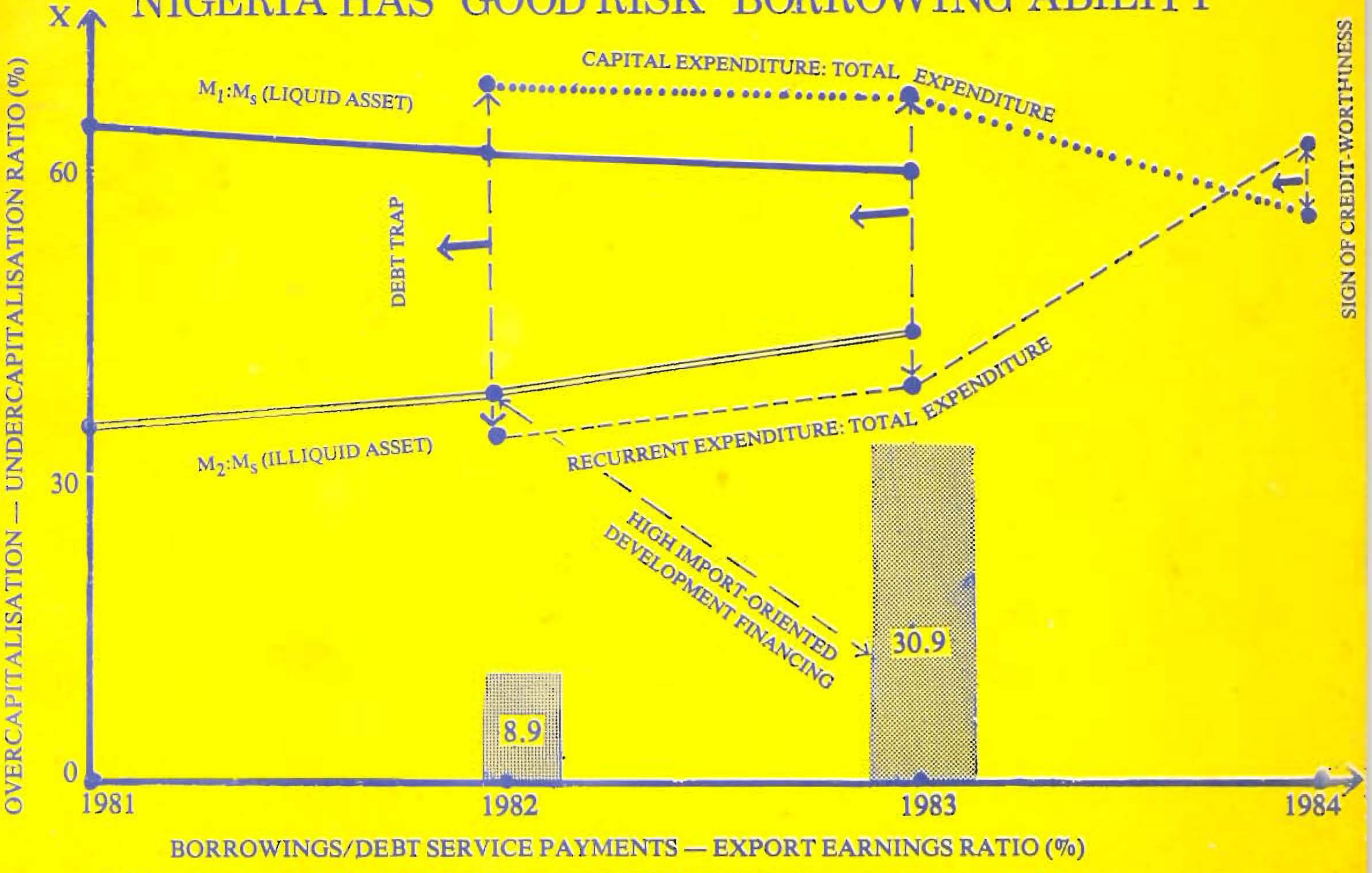
NIGERIA HAS "GOOD RISK" BORROWING ABILITY



EXPENDITURE ON IMPORTS OUT OF EVERY NAIRA CREATED (M_S) = 68 KOBO

(KEY TO BE FOUND INSIDE)

SKILL AND SERVICE

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KEY: NIGERIA HAS "GOOD RISK" BORROWING ABILITY

Expenditure	1982	1983	1984
Capital expenditure (₦ million)............	7925	7220	4660
% share in total expenditure (%)	69.5	67.8	47.4
Recurrent expenditure (₦ million)............	3475	3435	5171
% share in total expenditure (%)	30.5	32.2	52.6
Money Supply (Ms) (₦ million)			
M_1 (currency in circulation & demand deposits)	10555	10360	
M_2 (savings and time deposits)	6838	7464	
M_1 as % of Ms	·60.7	58.1	
M_1 as % of internal debt*............	70.3	46.6	
Debt Trap			
Size of debt trap (measured by ratio of capital expenditure -- locked up capital -- to recurrent expenditure -- unlocked capital)...	2.3:1	2.1:1	0.9:1
Capital expenditure — external debt ratio**............	1:5:1	0.9:1	
Debt service payments as % of export earnings (%)	8.9	30.5 ***	
Marginal propensity to import		0.68	
Marginal propensity to produce goods and services		0.32	

OVERALL RESULT

Unlocking of Capital leads to Size reduction of DEBT TRAP
indicates CREDIT WORTHINESS ⟶
backed up by Government measures to RESTRUCTURE THE
NIGERIAN ECONOMY to reduce overdependence on imports.

NOTES:* 70 per cent and 47 per cent of internal loans were utilised for providing liquidity (M_1) in years 1982 and 1983 respectively.

**In 1982, one naira of external debt financed 1.5 naira work of capital expenditure: in 1983, one naira of external debt financed 90 kobo of capital expenditure -- the result of import restrictions and consequent operation of industriesat less than optimum capacity.

***Corresponding figures for 1981 were as follows: Brazil; 33.6%; Mexico; 29.5 %.

STRATEGY FOR OPTIMIZING RETURNS IN THE NIGERIAN PETROLEUM SECTOR: ECONOMIC AND FINANCIAL MANAGEMENT ANALYSIS*

BY

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INTRODUCTION

Oil exploration started in Nigeria in the year 1908 when a German company called Bitumen made an abortive attempt. In late 1950s oil was discovered in Nigeria, and 1.8 million barrels of oil valued at N176 million was exported from the country in 1958.[1]

The oil companies which prospected for oil included Shell D. Arcy (1938), Mobil (1955) and subsequent entrants Agip, Phillips, Elf, Tenneco, Ashland and Sunray. The geological work done showed that the Sourthern part of Nigeria, principally the Niger Delta Region had much of the Nation's petroleum potential. Activities shifted to this region.

In 1953, Shell B.P. hit an oil rock in Akata, Cross River State. In the mid-50s oil was discovered in Oloibiri and Bomu in the Rivers State; Nigeria thus became established as an oil producing territory. The Niger Delta subsequently has been inundated by prospecting firms in search of petroleum in this area representing American, British, Dutch, Italian, French, German and Japanese interest.[2]

Government plays a significant role in the Nigerian oil industry by granting licences to prospective companies. Further, Government established the Nigerian National Oil Corporation (NNOC) in 1971 and the Ministry of Petroleum Resources in 1975. The Ministry determined petroleum policies while the Corporation was empowered to explore, produce store and market crude petroleum and its refined products.[3] In 1976, following reorganisation in the oil industry the NNOC and the Ministry were merged to create the Nigerian National Petroleum Corporation (NNPC) by decree.

In deriving a strategy for optimizing returns from the oil industry we have to look at both Nigerian oil pricing strategy and also her continued membership in the Organisation of Petroleum Exporting Countries (OPEC). The pricing strategy would be consistent with optimizing

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* The author is indebted to Professor M.R.K. Swamy for very useful comments and advice.

~~behaviour if it seeks to increase prices when demand is inelastic~~ and to reduce prices when there is a glut - - a lack of effective demand in the market. A higher price when demand is inelastic would lead to output/revenue maximum. A lower price in a glut situation manifesting high elasticity of demand would enhance revenue, since at a lower price a greater quantity would be discharged.

The OPEC is an international cartel encompassing 13 countries of which Nigeria is one. It is a central agency appointed and to which the countries concerned delegate authority not only to decide on the price at which their crude oil could be sold but also to decide on allocation of production quotas to each. The operation of cartels generally have been in the direction of restricting output in order to maintain high prices.

OPEC was established in 1960 to perform the following functions:

(i) to protect the revenue of producing member countries as far as possible from the effects of disequilibrium arising from excess of supply over demand. This it tries to achieve through fixing prices and quantity to be produced by each member country; and

(ii) to enable the growing movement of developing countries to reduce so far as possible, the influence of Western industrialised countries on their economies and societies. It tries to bring this about by accelerating the general enhanced position of influence that the government of the producing countries have obtained.

Nigeria joined OPEC only in 1971. Even before joining OPEC, by Decree Number I of 1967, the terms of the OPEC were imposed on the oil companies prospecting in Nigeria. The effect of this was to compel the companies to agree to a posted price as against the realized price for oil as the basis for computing taxes, royalties and rent, and to treat royalties as a business expense rather than a full tax offset as was formerly the case. Through these changes the Federal Government was seen as surrendering part of an anticipated increase in production rates in order to gain a greater percentage increase in tax revenue per barrel.[4]

PRICING AND OUTPUT POLICY

Table I below shows a distribution of output, exports and prices of Nigerian petroleum products between 1970 and 1981. The prices have shown an upward trend, ₦1.33 per barrel in 1970 to ₦22.44/barrel in 1981. The only exception to the upward trend was the drop from ₦1.94/barrel in 1971 to ₦1.81/barrel in 1972.

On the other hand total production had not shown a consistent upward trend. In 1970, 395,836,000 barrels were produced. This grew to

~~513,620,000 barrels~~ in 1981. Thus while prices rose by almost 2,000 per cent during this period (1970-1981), output grew by less than 100 per cent. Growth in prices have quite outdistanced growth in output. Demand (including demand for domestic consumption and exports) was highly inelastic dictating the high prices. The high prices are thus justified in terms of maximizing total revenue from the petroleum sector. The total revenue in the last column of Table I below shows a fairly consistent upward trend except for 1975, 1978 and 1981.

As can be seen in Table I between 1975 and 1981 output has actually fallen while prices have risen. Output (which represents demand for domestic and external use) fell from 651,507,000 barrels to 513,620,000 barrels reflecting the low effective demand resulting from the world oil glut; while prices rose from ₦7.27 per barrel to ₦22.44 per barrel. The high prices of petroleum in the world market even in the face of world oil glut is consistent with economic rationality.

TABLE I

PRODUCTION, EXPORTS AND PRICES OF NIGERIAN CRUDE OIL

Year	Production ('000 barrels)		Exports		
	Annual	Daily Average	Total ('000 barrels)	Price per barrel (₦)	Value (₦ Million)
1970	395,836	1,084	383,455	1.33	509.6
1971	558,679	1,531	542,545	1.94	1,053.0
1972	643,207	1,757	650,980	1.81	1,176.2
1973	750,593	2,056	723,314	2.62	1,893.5
1974	823,318	2,256	795,710	6.74	5,365.7
1975	651,507	1,758	627,839	7.27	4,565.1
1976	758,058	2,071	736,823	8.58	6,321.7
1977	766,054	2,099	744,413	9.50	7,072.8
1978	692,269	1,829	667,387	8.09	5,401.6
1979	842,474	2,308	818,727	12.51	10,166.8
1980	752,498	2,056	698,163	19.28	13,523.0
1981	513,622	1,430	443,214	22.44	10,280.3

SOURCES: (a) Nwankwo, G. O. (Prof.) "The Petroleum Industry in Nigeria's Economy", Central Bank of Nigeria Bullion (Lagos, October-December 1982).

(b) Nigerian National Petroleum Corporation, Annual Reports; 1970-1981 (Lagos).

NIGERIA IN OPEC

OPEC was born in 1960 in Bagdad, Iraq, as a child of expediency. The agreement setting up OPEC was sequel to the unilateral reduction in oil prices by multinational oil companies in 1959 and 1960. The multinational corporations then controlled all operations in the oil industry only to suit their foreign interests. The founda tion members of OPEC were five, today the Organisation has grown in strength and membership into 13 broken into four zones:

(1)	Africa	:	Nigeria, Libya, Algeria and Gabon
(2)	Middle East	:	Saudi Arabia, Iraq, Iran, Kuwait, Qatar and the United Arab Emirates (U.A.R.)
(3)	Far East	:	Indonesia
(4)	Caribbean and Latin America	:	Venezuela and Ecuador

Generally OPEC has been able to gain control for the fixing of the quantity to be produced, the prices and have co-ordinated a unified oil policy of member nations. OPEC now exercises full control over the selling price of their crude oil. In 1964, it achieved its first major break-through by pressing on the oil companies to agree on a uniform rate for royalties throughout the member nations and towards the end of the 1960s OPEC had an extensive measure of control on the oil companies. In 1970 OPEC Members' national oil companies were controlling about 3 per cent of their oil companies' operations, by 1975 the figure has risen to 60 per cent, and presently it is about 90 per cent.

PETROLEUM ECONOMIC INDICATORS:* NIGERIA AND LIBYA

The growth in control of the oil industry by the OPEC saw continuous rise in crude oil prices and revenue for its members. For instance, in 1970 while the Government take per barrel was N0.64 for Nigeria, a non-OPEC member at the time, the same figure for Libya was N1.12/barrel, an OPEC member. Nigeria joined OPEC in 1971 and since then, the Government take per barrel has grown to parity with the figure for other OPEC members. The posted prices have also grown for Nigeria. The posted prices which are notional magnitudes based on planned and not realized prices are the basis for computing taxes, royalties and rent.[5] Thus Nigeria by joining OPEC and implementing OPEC terms has considerably enhanced revenue from the petroleum sector. These are as shown in Table II below.

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* It is pertinent to mention here of Nigerian-Libyan techno-economic collaboration entered into about 15 months ago: under the agreement recently signed, the two countries will establish shortly a Joint Bank and a Holding Company. Also, the first meeting of the Joint Commission of Ministers of Foreign Affairs, National Planning and Petroleum is scheduled to be held in Tripoli in April 1984.

TABLE II

GOVERNMENT TAKE PER BARREL AND POSTED PRICES OF CRUDE OIL: NIGERIA AND LIBYA

(₦ per barrel)

Year	Government take per barrel		Posted prices per barrel	
	Nigeria	Libya	Nigeria	Libya
1970	0.64	1.12	2.420	2.550
1971	1.56	1.67	3.178	3.399
1972	1.74	1.93	3.409	3.620
1973	2.88	2.80	8.404	9.061
1974	7.44	11.03	14.691	15.768
1975	10.51	9.77	13.070	16.060
1976	10.47	11.36	13.160	12.620
1977	12.87	11.93	14.570	14.200
1978	12.48	12.41	14.120	13.850
1979	21.59	21.59	25.610	25.600
1980	32.77	32.77	39.233	38.300
1981	34.90	34.90	40.408	40.720
1982	35.10	35.10	39.244	40.950

SOURCE: Organisation of Petroleum Exporting Countries, Annual Statistical Bulletin (1982).

NIGERIA'S OVERDEPENDENCE ON CRUDE OIL

Federal Government revenue as percentage of total revenue grew from 26 per cent in 1970 to 62 per cent in 1981. This proportion was 82 per cent in 1974 and 81 per cent in 1981. The strategy is increased prices and reduced output quotas for members in order to maintain the prices at high levels.

Nigeria's oil reserves grew from a figure of 9.3 billion barrels in 1970 to 16.7 billion barrels in 1980. Although the re-serves reached a high mark of 20.9 billion barrels in 1974, this has been drawn down to 16.7 billion in 1980.[6] These reserves represent 2.5 per cent of world total reserves with life years of 33 years.[7] Thus by the year 2013 exactly 33 years from 1980, Nigeria's oil reserves will be expected to deplete. Since oil is a depleting asset, the price and output strategy of OPEC is patently in the direction of maximizing revenue as it has built-in conservation strategy for Nigeria. High prices and low output would increase the life years of our depleting oil assets. Compared to other OPEC countries, the life years of our oil assets are among the lowest. The corresponding life years for some other OPEC and non-OPEC countries are as follows:

Saudi Arabia (47), Kuwait (193), Iran (114), Mexico (65), U.A.E. (58), Iraq (91), Libya (58), etc.[8] The imminent terminal horizon of oil assets dictates the need for a conservation strategy which is reflected by present OPEC strategy, viz, high prices, low output.

RECENT TRENDS

Today OPEC has lost its cohesion. The most recent price cut in 1983 is the first price reduction in OPEC's-25 year history. The price reduction was necessitated by the glut in the world market that manifested itself most viciously in 1982/83 selling season. The OPEC production has fallen from an average of 31 million barrels per day in 1979 to 14 million barrels per day in 1983.[9] Part of the decline in demand is due to world economic recession and part to a further shift from oil to other energy resources by the consumers. More importantly OPEC has lost a big chunk of the oil market to non-OPEC members. In 1980, OPEC accounted for 60 per cent of oil consumed in the non-communist world, but now (1983) it sells only less than 40 per cent of this. Big new producers like England, Mexico and Norway have taken up the balance - - they are closer to the consumers and are seen as more reliable.

These countries would readily cut prices in order to keep revenues up, as England did in May 1982 precipitating a price war as it were. OPEC members can no longer be trusted to adhere to the cartel's price structure as they try to compete with these new rivals. Nigeria for instance, unilaterally reduced her price to compete with British price cut in May 1983 without reference to OPEC, although this was later ratified as the new OPEC price in the subsequent London OPEC meeting. Other OPEC members followed suit in order to maintain their grounds in a shrinking oil market. Secret discounting on agreed OPEC prices have been the order of the day.

This trend has called to question the ability of OPEC to maintain high prices in the oil market. Since OPEC presently contols about 40 per cent of the market, it can still maintain substantial influence in the market. OPEC does not now dominate the market as it did before and up till 1980. The presence of alternative competitors reduces the elasticity of demand for OPEC oil. Thus prices cannot now be maintained at the highest level consistent with profit maximum. Prices would have to fall, but not to a perfectly competitive level since OPEC can still act in unison to keep prices fairly high. More co-operation with non-OPEC members can work in the interest of high prices and enhanced revenue. Competition would reduce the revenue situation instead of enhancing it. Co-operation is seen as a better strategy. The extent to which OPEC can still manipulate prices from

~~henceforth would depend on whether OPEC succeeds~~ in co-operating with non-OPEC members or decides to compete with consequent price war and falling prices and revenues.

As shown in Table III, the growth in oil revenue has plateaued off from 1980. Also both the share of oil in total government revenue and the share of oil in Nigeria's export revenue are very significantly high proportions of the respective revenue magnitudes. The share of oil in Government revenue was 82 per cent in 1974 and 62 per cent in 1981, while the share of oil in the export revenue ranged from 83 per cent in 1973 to 98 per cent in 1981. Thus the economy is seriously vulnerable to shocks from the external sector relating in the demand or lack of demand for Nigerian oil.

TABLE III

CONTRIBUTION OF THE CRUDE OIL SECTOR TO THE NIGERIAN ECONOMY

		1973	1974	1975	1976	1977	1978	1979	1980	1981
1.	Average daily production of crude oil (million b/d)	2.01	2.21	1.74	2.05	2.11	1.85	2.27	2.21	1.3
2.	Total Federal Government revenue(₦ billion)	1.7	4.54	5.51	6.77	8.08	7.37	10.91	15.80	14.75
3.	Share of crude oil in total Government revenue (per cent)	60	82	78	79	75	63	81	70	62
4.	Exports (₦ billion)	2.3	5.8	4.9	6.8	7.6	6.3	10.1	12.8	10.5
5.	Share of oil in exports (per cent)	83	93	94	93	93	90	93	96	98
6.	Imports (₦ billion)	1.2	1.7	5.7	5.1	8.1	8.1	7.1	8.7	10.8
7.	Trade balance (₦ billion)	1.1	4.1	1.2	1.7	0.5	-1.8	3.0	4.1	-0.3
8.	Annual average of external reserves (₦ billion)	0.33	1.86	3.81	3.55	3.13	1.51	2.16	4.71	4.89

SOURCE: Central Bank of Nigeria, Annual Reports and Statement of Accounts (various issues).

The demand for Nigerian oil reached its lowest ebb most recently. Average daily production was 1.3 million barrels per day in 1981, 1.0 million barrels per day in 1982 and about 1.2 million barrels per day in 1983.[10] These are much lower than the figures for 1974 (2.21 million barrels per day) and for 1978 (1.85 million barrels per day). The recent drop in demand reflects the slight (one per cent) drop in world energy demand for the periods 1979-1983. This drop in world energy demand led to a more than 40 per cent drop in demand for OPEC oil.[11]

NIGERIA'S OVERDEPENDENCE ON MONOSECTOR (CRUDE OIL) IS TO BE REDUCED

It is necessary to diversify the nation's revenue source in order to strengthen its capacity to absorb the impact effect of further shortfalls in demand for oil. Further diversification would be in the direction of maximizing our revenue base. Fluctuations in the demand for oil will be evened out if revenue sources are diversified.

(i) in the first instance efforts should be made to intensify Nigeria's non-oil exports especially of cocoa, groundnuts, cotton, palm oil produce, tin, and semi-manufactures. If this is done to the extent that the share of crude oil in Nigeria's Government revenue and exports are respectively less than 50 per cent, then the economy would be in a better position to absorb the frequent shocks from the external sector;

(ii) it may be necessary to invest in Western industrialised economies using our external assets. Instead of holding these assets in more liquid form earning little or no interest, they can be invested in profitable projects in Western industrialised economies thereby earning further foreign exchange;

Such projects could include downstream operations in oil refineries and accompanying distribution net works like petroleum service stations and also in some non-oil projects.

In periods of low sales the nation could utilise foreign exchange earnings from such profitable ventures to augment the reduced returns from oil sales and thus be provided with a more elastic foreign exchange to finance development projects. Kuwait and Venezuela (OPEC countries) have done this to their financial benefit. Nigeria can do the same to optimise her returns from the oil sector.

CONCLUSIONS

* Up till 1980, the demand for OPEC oil was inelastic. OPEC controlled about 60 per cent of free world demand and manipulated both prices and output in their own favour. The high prices that were generated reflected the monopolistic power of OPEC in the world oil market. Presence of non-OPEC competitors since 1980 has drawn a wedge on OPEC price strategy. OPEC's share of free world market has fallen to 40 per cent, but OPEC is still a significant factor in the market. Co-operation between OPEC and non-OPEC producers as evidenced in the May 1983 London OPEC parley would still work in the general interest of world oil producers. Competition would lead to lowering prices and depleted revenue.

* It is expected that world oil demand will pick up after economic recovery from the present (1983) recession. It is estimated that world demand would grow to 80 million barrels per day in 1985.[12] OPEC oil is expected to continue to be an important factor in the world market for oil, and consumption in OPEC and other developing countries is expected to rise.

* The strategy of high prices and low output of OPEC is still a maximizing strategy, in enhancing revenue among OPEC countries. Demand elasticities would continue to be low as OPEC manipulates output to maintain acceptable prices. Nigeria's membership of OPEC has been beneficial to the Nigerian economy. Continued membership would be in the economic interest of the Nation.

* Recently there has been a call for OPEC to raise Nigeria's oil production quota from the present ceiling of 1.35 million barrels per day to a higher figure. The quota did not take into consideration the needs of the Nigerian economy as evidenced by a high population figure. OPEC quotas are largely a reflection of the respective countries' oil reserves and past output magnitudes without significant weights given to the population base of participating member countries. This is why a sparsely populated country like Saudi Arabia (population: 10 million) was given a quota of 6.4 million barrels per day while Nigeria, a highly populated country (population: 100 million) was given a quota of 1.35 million barrels per day. This paper contends that the quota given to Nigeria does not reflect Nigeria's high financial needs and that an appropriate quota should do so since a country's financial needs would determine her willingness to continue as a member and reduce an often utilised resort to overshooting production quotas thus destabilizing the cartel arrangement. In recognition of Nigeria's worsening balance of payments problems and her large population base, OPEC, through Nigeria's request, should consider raising the nation's production quota to 2.3 million barrels per day. This figure should be considered since Nigeria can produce this quantity (1979 Nigeria's output quota) and in recognition of the high financial requirements to resuscitate the ailing Nigerian economy.

* Also there has been a call for the setting up of an Organisation of African Oil Exporting Countries. This Organisation would comprise African members of OPEC to wit: Nigeria, Libya, Algeria and Gabon. This Organisation could function as a pressure group within OPEC and not as a cartel within a cartel. Since there is a parrallel Arab arrangement - - The Organisation of Arab Oil Exporting Countries, the setting up of the African variety would be a step in the right direction.

* Nigeria should explore further avenues for more bilateral barter agreements involving the import of technology, equipment, manpower and the exports of oil since those arrangements do not normally fall within the OPEC oil quota. Such barter arrangements would help conserve the naion's depleted foreign exhange reserves. A barter arrangement could be used to modify the Kaduna refinery to process 100 per cent Nigerian crude. Foreign technology could be imported from Japan, India, Indonesia, etc. to help transform the Kaduna refinery to a stage of independence from the heavy Venezuelan crude. Arrangement for processing Venezuelan heavy crude should be seen as temporary and not be relied upon as a long run solution since in praxis the import has been irregular and leave refining outfit unemployed from time to time. For the purpose of achieving self reliance in domestic oil refining capacity, the oil policy should stipulate that 100 per cent Nigerian crude should find their way into our fefining outfits.

As almost every OPEC member has full control over their oil assets, Professor M.R.K. Swamy has recommended for Nigeria's complete take over of 100 per cent shares of all oil prospecting companies in Nigeria. Presently government has about 70 per cent share participation in the petroleum industry.[13] He also recommended 100 per cent take-over by the Federal Government of all retail marketing of petroleum products as he argued that Nigeria's expertise in marketing is competitive in the world.[14] This would be a logical culmination of the trend of State control in OPEC countries. Nigeria should not be left out in adopting OPEC terms as today 90 per cent of assets of oil companies in OPEC member countries are controlled by their respective State-owned national oil corporations. Complete control would plug the leakages from the oil sector, conserve revenue and reduce profit repatriation.

Nigeria's continued membership of OPEC and complete adoption of OPEC terms is a logical consequence of the optimizing tendency of OPEC strategy in the light of world economic circumstances. Further it is recommended that Nigeria's revenue sources be diversified in order to strengthen the capacity of the nation to absorb external shocks from the external sector and also enhance revenue. In this direction non-oil exports should be strengthened and investments of Nigeria's external assets in productive outlets in developed capitalist economies should be considered a la Kuwait, Venezuela strategy to enhance earnings of foreign exchange to augment foreign reserves during low demand periods.

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10. The 1982 and 1983 export figures are estimates: See "Present State of Nigerian Economy", The Nigerian Journal of Financial Management, Vol. 2 No. 1. (June 1983).

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