

# Recent nigerian development and the dutch disease economics essay



Nigeria is the second largest economy in Africa, with a GDP of \$244 billion (2011 – according to World Bank) behind South Africa with a GDP of \$408. 2 billion. It is the largest economy in the West African region, its population accounts for over 60% of the total population of this region. Following Nigeria's independence from Britain in 1960, the country has had over three decades of military rule which led to political rascality, bad governance, abuse of office and power, criminal corruption, mismanagement and waste, misplaced priorities, fiscal indiscipline, weak control, and monitoring and evaluation mechanisms. However, economic reforms over the past decade have put Nigeria back on track towards achieving its full economic potential. The reforms of the past decade, which included negotiation and defrayment of the " Paris Club" debt of about \$30 billion, setting up of Economic and Financial Crime Commission (EFCC) to fight corruption, recapitalization of financial institutions, liberalization of real sectors and privatization of companies owned by the government, have played a significant role in repositioning the economy.

Nigeria's GDP at Purchasing Power Parity (PPP) has more than doubled, from \$170. 7 billion in 2005 to \$413. 4 billion in 2011, although estimates of the size of the informal sector (which is not included in the official figures) put the actual numbers closer to \$520 billion. Correspondingly, the GDP per capita doubled from \$1, 200 per person in 2005 to an estimated \$2, 600 per person in 2011 (with the inclusion of the informal sector, it is estimated that GDP per capita hovers around \$3, 500 per person). According to the World Bank, the real GDP stood at \$244 billion in 2011. However, these significant improvements in GDP have not translated into reduction in employment,

which stood at 24% of the labor force (67. 2 million) as of 2011, according Nigerian Bureau of Statistics.

The following paper will analyze the reasons for this paradox movement of stable/ rising unemployment and GPD growth in the recent years.

Furthermore it will describe recent majors undertaken by the Nigerian government to fight unemployment and ensure sustainable growth within the country and will end with a prediction for the future development of the country.

## **Recent Nigerian Development and the Dutch Disease**

### **Macroeconomic trends in Nigeria**

Historically, Nigerian economy has been an agrarian economy with agriculture dominating GDP at least until the 1970s. Also, up until the 1960s agriculture was the pre-dominant exporting sector of the economy contributing to as much as 95 % of exports.[1]

The discovery of oil reserves in the late 1950s and the Arab oil embargo in 1973 led to an oil boom era. In the macroeconomic environment, the Nigerian Economy is characterized as having a very important and large share of their GDP as dependent on Crude Oil and Gas production (40. 9% in 2011 current prices). Furthermore a vast majority of its exports is related to this sector (around 95% of exports since 1970s). The second largest sector in the economy is agriculture, which currently represents 31% of the economy, down from 60% in the 1960s. Other manufacturing goods account only for 2% of the GDP (see Exhibit 1). A notable change in recent years beginning

mid-2000s has been the emergence of the telecom and retail industries as a significant contributor to GDP growth.[2]

Analyzing reports on Nigeria's recent macroeconomic trends, we see potential discrepancies in perception of sector contributions arising from the use of real GDP numbers based on 1990 basic prices. Usually the basis for real GDP calculation in the rest of the world is 2005 basic prices. The discrepancies are reflected in the fact that if one consider the contribution of petroleum to real GDP in 2011 at 1990 prices it only accounts for 14. 8%, compared to contribution to nominal GDP where it accounts for 40. 9% (see exhibit 1). Therefore to determine the impact of crude oil exports within the Nigerian economy we will consider nominal numbers, knowing that the commodity price of oil cannot be influenced by the Nigerian government. Crude oil prices rose between 1990 (23. 7 USD / barrel) and 2011 (91. 4 USD / barrel) by 13. 6% p. a.

Exhibit - Comparison of 2011 GDP in current and basic prices

### **Nigerian Oil Boom and “ Nigerian Disease”**

Based on these facts, we can reasonably conclude that the “ Oil Boom” experienced by Nigeria since the 1970s has created a deindustrialization process that has affected both the manufacturing and agricultural sectors, replacing almost 100% of the exports, and leaving the country relying almost exclusively on oil as the source of foreign currency; a situation that has been characterized by a real exchange rate appreciation[3]. These circumstances can be explained by the effects of “ Dutch Disease”; a claim that has been supported by many economists.

## Exhibit - Global Competitiveness Index (CGI) for Nigeria

Besides the notorious dependence of Nigeria on oil exports, the Nigerian economy also has noticeable flaws in infrastructure, institutions, and education which have left them in 127th place in the Global Competitiveness Index (GCI) published by the World Economic Forum. As shown in exhibit 2, Nigeria is even below the sub-Saharan Africa average, which would not be expected, given the size of its economy, population and natural resources[4].

The same report also shows that the most important factor affecting businesses is the access to financing. Nigeria has an inflation rate of around 11%, coming down from levels of 20% at the beginning of the decade, and nominal interest rates from banks between 15% and 22% (see exhibits 3). The Nigerian productive sector experienced several adverse factors, which translated into increased production costs, with negative implications on the supply side and the local industry competitiveness. This has deepened the cycle of dependence on imports for most manufactured goods, and a reliance almost exclusively on Oil for exports as an incoming source of foreign currency in order to pay for the imports.

## Exhibit - Nigeria CPI and Bank Lending Rates

Furthermore, economists have identified other "unique" characteristics in Nigeria's situation, characteristics that cannot be completely explained with the traditional Dutch Disease theory, such as the soaring unemployment rate (23% in 2011). This has been called the "Resource Curse" or "Nigerian Disease"[5], a phenomenon in which on top of deindustrialization, the

country faces severe political and institutional instability, which are <https://assignbuster.com/recent-nigerian-development-and-the-dutch-disease-economics-essay/>

paradoxically accompanied by a very low development of infrastructure and erroneous fiscal and public debt policies[6].

## **Recent reactions of the Nigerian government**

Recent events have changed the direction of the country's development. Government awareness of the effects of the Dutch disease in the economy has caused them to attempt to balance the public deficit, save part of the oil export income in sovereign funds as well as invest in infrastructure. These decisions were partly motivated by the shocks received from oil price fluctuations during the last decade, which have affected exchange rate and fiscal income. The following passage only describes a few selective policies implemented by the government.

The Nigerian Disease caused low productivity in industries other than those related to oil. Infrastructure, communication and retailing, which have proven to be the engines of a developing economy and its productivity, were only partly built up in the commercial centers of Abuja and Lagos (Reardon, Timmer und Berdegue 2004). Before this, there was hardly any existing infrastructure in the country. Furthermore, also a result of the Nigerian Disease, the sectors (besides oil) were suffering from very low productivity. Therefore, the production costs in these industries were significantly high compared to international businesses operating in Nigeria, which resulted in low competitiveness or discontinuation of businesses. According to Verdoorn's law, rising productivity increases (industrial) employment. Stating this, the law also implies that rising productivity leads to a rising output or GDP increase (Rowthorn 1979). Given these statements, the Nigerian government needs to increase productivity in these sectors in order to lower <https://assignbuster.com/recent-nigerian-development-and-the-dutch-disease-economics-essay/>

unemployment, raise GDP and establish long-term sustainability within the country.

The Nigerian government spent 2 billion Naira (\$12 Million USD) between 1999 and 2007 directly on infrastructure, which enabled sectors like Telecommunications and Retailing to develop (Garbacz und Thompson 2007). Furthermore in 2012 the World Bank granted a loan of \$200 Million USD to Nigeria for further investment into infrastructure (Akosile 2012). These policies as well as ones described below are aimed at causing a multiplier effect within the economy. At the same time, to avoid the crowding-out effect, the Nigerian central bank held the currency and interest rates stable but focusing on a down sloping trend from the past high interest rates. This was possible as they held huge reserves of the dollar as well as a fund generated from revenues of the petroleum industry to ensure monetary measurements towards changes in the interest rate.

To ensure further government spending away from oil and to strengthen other sectors, the government initiated the Subsidy Reinvestment and Empowerment Program (SURE-P) in February 2012. This program is aimed at the reinvestment of subsidy savings from petroleum/oil related industries into infrastructure and social safety nets. By the end of November 2012 they were able to reinvest 62 billion Naira (\$396 Million USD), which went mainly into building up communication, infrastructure and power supply, as well as community services and vocational trainings (SURE-P 2012).

Besides lack of investments in infrastructure and development of productive sectors, another contributor to the low productivity was the significant

degree of corruption in the country. Due to the set up of the Economic and Financial Crimes Commission (EFCC), Nigeria was able to remove itself from the G8-list of “ non-cooperative countries” in 2006. The EFCC aims at discovering corruption in the private and public sector, with a view to ensuring the recovery of misappropriated funds.

Together with its central bank, the Nigerian Government introduced a mixture of several fiscal and monetary policies. One example of these is YouWin, which was founded in 2011. Facing a double digit and greater than 20% interest rate for loans, entrepreneurs (especially young entrepreneurs) were not able to establish their businesses. As a result, the government introduced YouWin, which provides financial assistance in terms of equity for small start-ups. This leads in the end not only to new SME businesses within the country but also to further employment. The Ministry of Finance of Nigeria, the initiator of the program, expects to generate 80, 000 -110, 000 entrepreneurs throughout the duration of the program (YouWin 2013).

The government also embarked on comprehensive reforms of the tax system and the oil & gas sector with a view to sanitizing the system and improving internally generated revenues.

These monetary and fiscal programs will increase aggregate demand and aggregate supply in Nigeria, which will lead to a decreasing unemployment and a sustainable economy in the future. Institutions like the EFCC will play a significant role in decreasing inequality and poverty in the country, which has been proven as a barrier for significant and sustainable growth in the future (Ravallion 2001).



## **Nigeria Dutch Disease – Looking Forward**

The recent efforts of the Nigerian government appear to be in the right direction. The budget for 2013 was tagged “ Budget of Fiscal Consolidation with inclusive growth[7]“. A review of this budget shows that close to 68% will be spent on recurrent expenditure, which has been the trend in recent past (71% in 2012).

Our recommendations to deal with the current problem that Nigeria is facing are restrictive fiscal policies and gradual expansionary monetary policies. However, the restrictive fiscal policies should focus on cutting government recurrent expenditure and aggressive spending on infrastructure, which is critical to the development of the economy. This will improve the product base and reduce the cost of doing business as well as encourage micro entrepreneurs to grow and hire more people. This also reinforces the effect of initiatives like SURE-P and YouWin to have an effect on lowering unemployment within the country.

Considering the current debt to GDP ratio of approximately 20% and mainly internal debt, Nigeria can sustain the current fiscal deficits in the short run but must seek to generate surpluses in the medium term. The tax reform embarked on few years ago, that has resulted in internally generated revenue growth from N1trillion (about \$6. 5billion) to N4. 6 trillion (about \$30billion) over 8 years, should be pursued vigorously. The reforms will plug all leakages and increase government earnings to support expenditure on infrastructure, without external or internal borrowing, to avoid crowding out private investments over time.

In addition, the Petroleum Industry Bill (PIB), which seeks to sanitize the petroleum industry (which has been the mainstay of the economy) and also increase government earnings, should be passed into law without further delay. Our recommendation is that additional earnings should be invested in the Sovereign Wealth Fund and gradually used to support the economy in periods of economic shocks. Furthermore, institutions like EFCC should be strengthened to fight corruption and ensure that government earnings do not end up in private pockets and frittered away to underground economy.

The recommended gradual expansionary monetary policy will reduce the cost of borrowing and support the private sector to invest in the production value chain as government improves the state of infrastructure and this will reduce unemployment (which current stands at 24%) and the associated social vices.