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The Political Economy of Nigeria's Oil Dependency and Its Implication on Economic Diversification

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Abstract **Review Article**

Nigeria is the largest economy in Africa, but it suffers from resource curse or Dutch disease where she is unable to leverage on her resource endowments to diversify into many other sectors of the economy. Her industrial capacity is very low due to infrastructure shortage. But the foregoing are motivated by rent-seeking and vested political power holders who rather will support implementing import-dependent policies. Consequently, it is difficult to adopt the latest technology and liberalize the economy for inclusive participation of the citizenry. Utilizing the New Institutional Economic (NIE) perspective, secondary sources of information and content analysis, the paper ascertained that protectionist policies of protecting nascent industries have not worked for Nigeria. For instance, closing the borders to protect local rice producers rather caused rice price volatility and inflation among others. Hence recommends a radical revolutionary change in the political economy will necessitate the needed reforms. All emerging economies in Asia passed through this stage of development.

Keywords: Oil, Dependency, Economy, Economic Diversification, Economic Growth.

1.0 INTRODUCTION

The current economic crises in Nigeria under Presidents Buhari and now Tinubu administration have heightened to unprecedented levels, the need for Nigeria to diversify her economy away from oil. Nigeria's currency is at the weakest in its history at N900 per 1USD. All attempts by the new administration to foster new monetary policy have rather worsened the situation. The economy worsened after the removal of subsidy from petrol, the floating the exchange rate and the pursuit of foreign direct investment across the world. Nigeria chases FDI rather than attract them. The inflation rate is 29%, the highest in its history and with oil theft of about 400,000 bpd, and a debt service ratio of 96%, that is, 96% of Nigeria's revenue is used to service interest on her debt. Nigeria urgently needs to first protect her oil industry – her major revenue earner and then diversify her economy.

Before now, there was the challenge of COVID-19 pandemic and crash in oil price which put Nigeria's revenue outlook in precarious condition. In effect, Nigeria has historically neglected other opportunities and options for improved economy and attendant improved development and welfare of the society and the citizenry at large. Currently, unemployment is at 40% (not considering the retooling of the model recently used by the NBS that unemployment is at 5%. The new model factored the underemployed and those who engage in any form of task with monetary reward whether taxed on untaxed)

Either as a cause or consequence of poor economic management, Nigeria has also been bedeviled by all forms of crime and criminalities – terrorism, banditry, killings and kidnappings, armed robberies, extortion and so many others. Nigeria is adjudged the poverty capital of the world with about 60% of the citizens in multidimensional poverty [UNDP, 2023], it is the country with most out-of-school children and infant mortality rate [Unicef, 2022]

What is really unclear that borders conspiracy theories is the reason for poor on non-formulation and/or implementation of policies to make a more robust and productive economy. The paradox at the moment is that Nigerians are known to be highly entrepreneurial and productive. Evidence abound about their exploits in diaspora. Thus why the loss of leadership or political will to improve the economy? What does it take to do the needful?

This article concerns the political economy of oil dependency and its implications for diversification. By this, it discusses the role of oil in Nigeria's economy, the obstacles (political) to diversification, the successful experiences of countries that did and what Nigeria should do should it decide to muster the political will. The rest of this paper is organized as follows: section 2 is theoretical explication, which describes the role of institution in the dependent quagmire faced in Nigeria. Section 3 describes the Nigeria's Oil Economy Situation and Prospects. Section 4 discusses the politics or political economy that hinders diversification away from oil. Section 5 highlights what other countries elsewhere did and succeeded. In Section 6, Nigeria's economic scenario is contrasted with other countries successes and concludes by recommending pathway for sustainable growth.

2.0. Theoretical Explication

The paper is guided by the New Institutional Economic (NIE) perspective, which develop as a self-conscious movement in the 1970s, traces its origins to Coase's analysis of the firm (Coase, 1937), Hayek's writings on knowledge (Hayek, 1937, 1945) and Chandler's history of industrial enterprise (Chandler, 1962), along with contributions by Simon (1947)

It attempts to extend economics by focusing on the institutions (that is to say the social and legal norms and rules) that underlie economic activities. The NIE assume that individuals are rational and that they seek to maximize their preferences, but that they also have cognitive limitations, lack complete information and have difficulties monitoring and enforcing agreements. As a result, institutions form in large part as an effective way to deal with transaction costs.It considers the processes by which structures, including schemes; rules, norms, and routines, become established as authoritative guidelines for behaviour of the state. Different components of institutional theory explain how these elements are created, diffused, adopted, and adapted over space and time; and how they fall into decline, misuse and mal- functioning of the state policies. As a result, both formal and informal institutions play a role in how well the economy performs (Menard *et al.*, 2008:1). NIE takes into account the effect while conventional economics is more concerned with costs and results.

In an effort to address the issue of Nigeria's Oil Dependency and Its Implication on Economic Diversification NIE turns to the function of institutions to analyze the Political Economy of Oil Dependency of Nigeria's economy. Resourse-rich Nigeria that in theory should diversify more quickly than resource-poor nations. This hasn't happened, though. That is the influence of politics on the oil-dependent economy and constrains the will for diversification away from oil.

3.0. Nigeria's Oil Economy – Situation and Prospects

Since Nigeria discovered oil in the 1950s and became a major producer at the end of the Biafra War in the late 1960s, she has continued to depend on oil at the expense of developing other sectors of the economy. Her oil revenues rose from 10% of GDP in the 1960s to 30% in 1980s. In this period, she increased her production by 5% and thus her export capacity by 24% [IMF, 2023]. As at 2019, oil revenue was 84%.

Oil revenue can be used to develop other sectors of the economy. For instance, there is a strong positive correlation with oil price movements. When oil prices are high, the oil sector can provide enough foreign exchange to meet the demand of the non-oil sector for necessary imports of factors of production, and it can raise fiscal revenues and contribute to the economy through government spending. When oil prices are low, economic activity is generally subdued as a result for foreign exchange crunch and low government spending. This is the situation in a Tinubu-led economy. See figure 1.

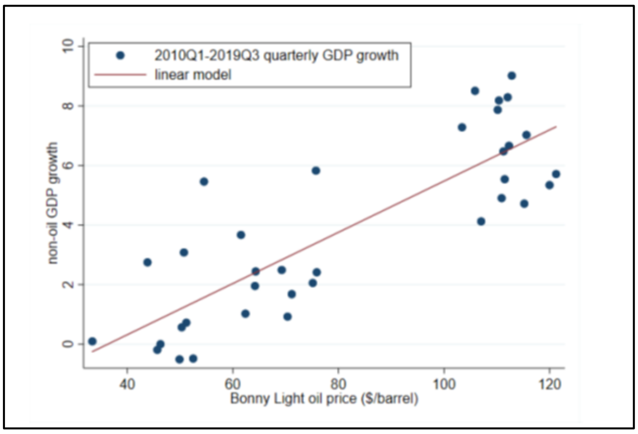

Figure 1: Oil Price and Non-Oil GDP Growth
Source: Haver analytics; and IMF staff calculations, 2022.

There are other indirect benefits of oil economy. For instance, at least 30% of the economy indirectly depends on the oil sector through oil price movements. Manufacturing and service sectors benefit more from higher oil prices while agriculture and finance sectors benefit less. Among publicly-traded companies, the share of revenues of oil-related industries could be as high as 60%. Decomposing this**,** oil and gas industry accounts for 23-41% of total revenues of all listed companies. And industries that are indirectly related to oil, such as construction, power generation, etc., the share of revenues could be as high as 60%. The dominant role of oil-related industries in Nigeria's stock market implies that oil deeply affects the winners and losers of the economy, the allocation of financial capital, and household financial wealth, with distributional consequences for investment, finance, and the labor market.

Despite the foregoing opportunities, Nigeria's export remains dominated by oil and fundamentals for it to develop other sectors is stagnant. Since Nigeria became a major oil producer in the 1970s, hydrocarbon products have persistently accounted for 90% of Nigeria's exports (Figure 2). Of non-hydrocarbon exports, the composition has changed little over the past three decades and a large share remains agricultural and mineral commodities, such as cocoa beans, wood, rubber and fertilizer (Figure 4). A battery of development policies to promote non-oil exports, including the Structural Adjustment Program (SAP) between 1986 and 2000, the National Economic Empowerment and Development Strategy (NEEDS) between 2004 and 2017, and the Economic Recovery and Growth Plan (ERGP) more recently, have had limited impact on export diversification. See Figure 2 for evidence

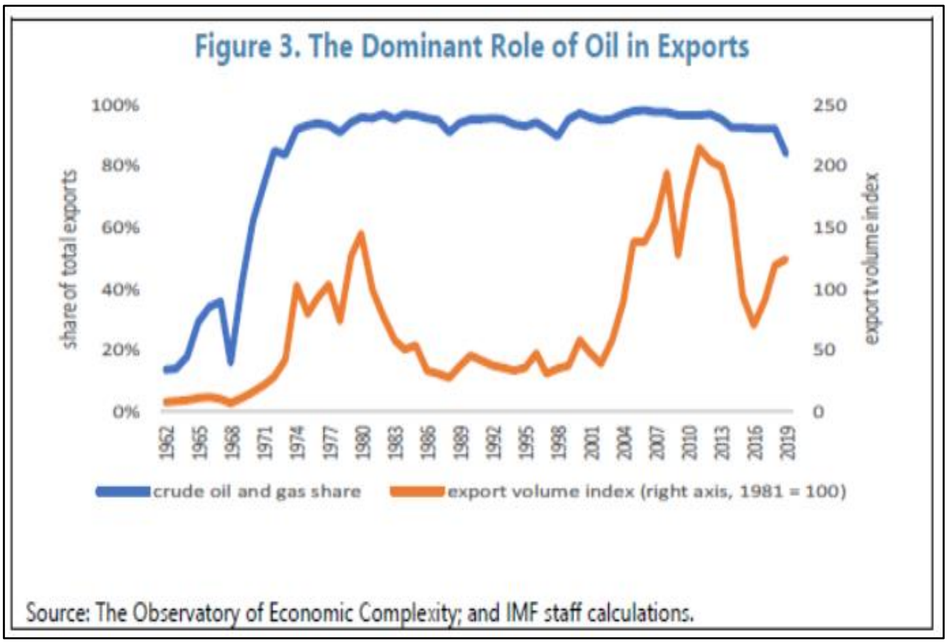

Figure 2: The Dominant Role of Oil in Exports

Dictated by oil proceeds, fiscal revenue as percent of GDP gradually fell amid the secular decline in oil prices. This economic decline is measured as fiscal revenue as a percentage of GDP which fell as oil prices fell trendwise, since 2008. And more than half of Nigeria's oil proceeds therefore has been in decline, yet fiscal dependence on oil has not reduced. As earlier indicated, the government has found it difficult to leverage on oil revenue to develop other non-oil sectors. It is noteworthy that despite the oil revenue, Nigeria suffers gross fiscal deficit as she continued to borrow from international and local partners. Nigeria's debt burden is about $40bn. This deficit and debt makes Nigeria's economy very vulnerable. This is worsened by sustained mismanagement of oil revenue. For instance, there are no remittances to the government by NNPC and then there are several opaque operations and sleaze that make the diversion of oil funds very easy. The recent development is the oil theft – stealing of oil directly from the oil wells

In effect, since independence, Nigeria has tried, albeit weakly, to be a diversified economy**.** This is evidenced in the first National Development Plan for the period 1962-68. Succeeding national development plans from the 1960s to the 1980s focused on promoting local production and indigenous businesses through import substitution. Since the turn of the century, agriculture self-sufficiency, power, energy, and transport sector development, as well as private sector growth have been at the forefront of the minds of successive governments, as embodied in their development strategies from NEEDS and Vision 20: 2020 in the early 2000s to ERGP more recently in 2017. However, diversification has remained largely elusive and growth performance uneven over time, causing Nigeria's income per capita to fall behind countries that once used to trail Nigeria (see Figure 3).

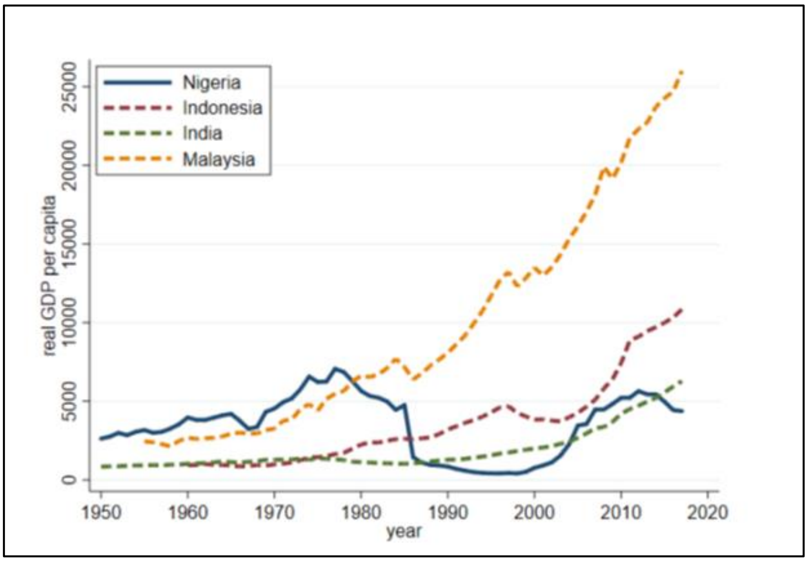

Figure 3: Real GDP per Capita: A Long View
Source: Penn World Tables 9.1; and IMF staff calculations.

4.0. The Politics and Political Economy in Nigeria That Makes Diversification Difficult

The political economy of Nigeria is challenged by the resource curse or Dutch disease. The politicians are the masterminds. Thus there is often between sacrificing long term gains for short term gains. It has been difficult to follow through on strategic long term plans. Lack of political will or entrenchment of politician's vested interests discourages technical competence to manage and hence diversify the oil economy to other sectors. Nigeria has been renowned to focus more on exporting her natural resources without a clear plan to add value to them locally. Thus they import the manufactured goods from countries they exported these raw materials to. For instance, Nigeria exports crude oil but does not refine petrol. Some other examples are in the non-oil sector. For instance, about 96% of the tomato paste consumed in Nigeria is imported.

Nigeria's political landscape or structure hardly makes it possible for the economy to diversify. For instance, the polity moved from regional resource control, so that they remit to the Federal government to the converse, where the Federal shares the revenue to the state, using diverse disproportionate political formula. Some of which are demographics, ethnicity and religion. In fact, it can be argued that these formula are both causes and consequences of poor fiscal federalism, especially when political considerations are made. In either resisting or trying to join this political configurations, vested interests, difficult to break up are made. Rent-seekers emerge and Institutions are weak or non- existent. For instance, the near absence of local government as a tier of government and ineffectualness of the Judiciary and Legislature as independent arms of government. Consequently, a perverse redistribution of wealth that favors the rent-seekers ((the politicians and their acolytes) at the expense of economic growth ensues (Tornell and Lane, 1999). Putting it simply, corruption pervades the polity and the economy

The consequence of corruption is manifest. As earlier indicated, the sleaze, nepotism and malfeasance, bribery create room for some the more powerful state and non-state actors to capture the state (IMF, 2019). Politicians seek to perpetuate themselves in office as priority and will use state resources to do so with impunity.

Another political economic implication is that the government run by corrupt and state-capturing politicians do not favor or lack the political will to follow through policies that favor those that trade in imports. For instance, Nigerian Refineries are unlikely to work ever, if there are no interests that enjoy the importation of petrol. How can an oil- producing country like Nigeria not have one functioning refinery? This rent-seeking behaviour is also reflected in some other oil-related sectors. Another instance is that the importers of generators will fight any implementation of policies that will bring about constant supply of electricity. In effect, without strong institutional safeguards, economic rents associated with natural resources create incentives for bribes and state capture (IMF, 2019). Where natural resources generate vested interests, economic policies influenced by those vested interests reinforce the status quo. (Peter and Olivier, 2006). Sometimes radical changes are more needed than incremental ones. That is to say, a revolution will be more necessary than the cyclical evolution.

5.0. Successful Country Experience of Diversification

The Southeast Asian countries of India, Indonesia and Malaysia had similar economic trajectories as Nigeria in the 1960s. In fact, Nigeria's GDP per capita was bigger than theirs. As at the mid-90s, they had all overtaken Nigeria in terms of economic growth and development. They were long done with the economic policies of import substitution Nigeria half-heartedly currently pursues as a strategy to reduce import-dependence. Thus, Nigeria has increasing long list of banned inputs or manufactured goods. But changing social and economic realities indicated by one of or a combination of economic crises, social consensus, and external environment culminated in their radical move away from mediocre policy to implement policies needed for higher growth and more diversified economy.

Each of Malaysia, India and Indonesia depending on exporting raw materials for revenue. They had low share of industrial of industrial employment (around 10%), Nigeria currently has 12%. And they imposed tariffs to protect domestic nascent industries, such as the processing of agricultural and mining products, production of steel and cement, etc. Currently, Nigeria bans imports of similar products, including processed meat and vegetables, steel drums and pipes, and cement. And they each had Heavy Intervention of the State. The government was directly involved in the production process and markets. They implemented policies that protected a few major producers of consumer and capital goods (Tijaja and Faisal, 2014; Felipe, Kumar and Abdon, 2013). Today, Nigeria's state intervention takes the form of protectionist trade policies and credit support. Tax incentives for pioneer industries, import ban, foreign currency restrictions, and minimum loan-to-deposit ratio are main policies to prop up domestic industries.

The protectionist policies didn't work, rather it got worse which led to series of economic crises – riots which led the government to open up their economies. They were each forced to liberalize their economies and allow participation and investment of foreign companies. Each of the aforementioned countries also sought to emulate the political and economic success of the Asian Tiger countries that had liberalized their trade and benefited from technology transfer as foreigners invested in their countries, and liberalization, in turn motivated diversification of the economy as more players entered diverse sectors

6.0. CONCLUSION AND RECOMMENDATIONS

Protectionist policies of protecting nascent industries have not worked for Nigeria. For instance, closing the borders to protect local rice producers rather caused rice price volatility and inflation. Despite Nigeria's economic challenges due to her politics, she is still a huge country with potentials. She is Africa's largest economy. She accounts for more than 20% of Africa's household consumption and 15% of manufacturing output. Its large market size is attractive to foreign and domestic investment. Technological change is accelerating. E-commerce revenue in Nigeria has doubled each year since 2010. Business-to-business market is rapidly growing (Bughin, Chironga, and Desvaux, 2016).

Recommendation: Way Forward for Nigeria

Nigeria however, should emulate successful developing countries that pursued industrialization. State intervention should be limited to fixing market failures only, industrialization should have a clear export orientation, and policies to promote domestic industries should ensure competition and strict accountability (Cherif and Hasanov, 2019). Productivity gains are at the heart of true industrial policies. To achieve sustained growth, new goods and new technologies should be introduced continuously, and the buildup of human capital should be emphasized throughout. Policies should steer factors of production in technologically sophisticated industries and encourage competition in both domestic and international markets. Nigeria's productivity has remained low in the past decade, particularly in the non-oil sector (Figures 9 and 10).

Nigeria should further pursue structural reform policies, which includes trade and completion policies. Nigeria therefore should close infrastructure gaps, and significantly lower corruption in all ramifications, by building strong and independent institutions and devolving all powers to the arms and tiers of government – the Local Government, the Legislature and Judiciary. This will enable decentralization of political powers and allow more participation and innovation for diversification.

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