

## **Effects of Declining Fortunes of Crude Oil Price on Economic Stability in Nigeria.**

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### **Abstract**

*This study focused on the effect of declining fortunes of crude oil price on Nigeria economic stability. The study was guided with the following specific objectives: to determine if declining fortunes of crude oil induced by inflation affect the economic stability of Nigeria, to examine if crude oil price declining fortunes induced by foreign direct investment affect economic stability of Nigeria and to ascertain if oil price declining fortunes caused by crude oil price affect the economic stability of Nigeria. The researcher adopted ex post facto research design in analysing the time series data which were secondary data. Findings review those declining fortunes of crude oil induced by inflation does not significantly affect the economic stability of Nigeria, crude oil price declining fortunes induced by foreign direct investment does not have significant effect on economic stability of Nigeria and crude oil price declining fortunes caused by crude oil price has significant effect on the economic stability of Nigeria. Base on the finding the researcher recommend that government should diversify the economic base from oil to non-oil as a necessary condition for sustainability and growth of Nigeria economy and government should improve the security in the Niger Delta area with a view to boosting oil output, hence leading to increase oil revenue and by implication ensure economic stability through economic growth.*

**Keywords: Crude Oil Price, Economic Stability, Inflation, Exchange Rate, GDP**

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### **I. Introduction**

Crude oil price declining fortunes are predominantly defined with respect to price instability resulting from changes in either the demand or supply side of the international oil market (Yusuf, 2015). Oil price declining fortunes is defined as the standard deviation of oil prices in a given period while an oil price shock is a manifestation of extreme declining fortunes (Ebele, 2015). For the purpose of this study which focuses on oil price declining fortunes as opposed to shocks, it is reasonable to understand the distinction between both measures in terms of the size of price deviations. Acute deviations in oil prices, such as those seen in early 2008 are termed shocks, while relatively minor price deviations are referred to as price declining fortunes (Ebrahim, Inderwildi & King, 2014).

The trends and dwindling of oil price in the global market has become a source of concern for oil producing countries including Nigeria. The price of crude oil had dropped precariously from a peak of \$104 per barrel by the third quarter of 2014 (Okeke, 2015). Specifically, the OPEC average monthly basket price of oil peaked at \$107.89 per barrel in June, 2014 dwindled very sharply to \$59 per barrel at end-December, 2014 (Okeke, 2015). It further decelerated to \$54.4 by end-March, 2015, resulting in Nigeria experiencing a sudden and significant drop in revenue inflow from oil sales (Okeke, 2015). The oil price dropped down further to USD 49.49 in at the end of 2015, then it further dropped to USD 40.68 in 2016 and started rising again in 2017 at USD 52.51 (Baron, 2018). Nigeria, a mono-cultural and a hydrocarbon economy depends largely on revenue realized from oil to sustain her teeming population and the economy in order to foster physical, political and socio-economic development (Umar, Aliyu & Ahmad, 2016). Despite the fact that Nigeria is the 6th largest oil producer, the country also imports oil from other countries. The surplus of exporting value over the importing value makes Nigeria a net oil exporting country (Akpan, 2009).

There are several factors, both economic and political, that can cause declining fortunes in oil prices. OPEC is widely seen as the most influential player in oil price declining fortunes, but basic supply and demand factors, production costs, political turmoil and even interest rates can play a significant role in the price of oil.

Economic stability implies the vulnerability of macroeconomic variables to shocks. It is the tendency of macroeconomic variables such as GDP, inflation, exchange rate, interest rate etc to be unstable and weak in terms of withstanding shock (Ifeonyematalu, Ogu and Ojima, 2019). It is a situation whereby little shock in

the economy subjects the macroeconomic variables to fluctuations and uncertainty. Studying the relationship of between crude oil price declining fortunes and economic stability is significant for investors to take necessary investment decisions and for policy makers to regulate financial markets more effectively.

The recent dwindling in global crude oil prices which started in July 2014 has adversely affected Nigeria, especially in the areas of foreign reserves, currencies crisis, declining government revenue, and ultimately, threat in terms of ability to meet financial obligations as at when due. Oil price fell from its all-time high of USD105.87 in 2013 to USD 96.29 in 2014 and further fell to USD45.06 in 2019 (OPEC, 2019). This means between 2013 and 2018 oil price declined sharply by more than half (64.5%). The resultant effect has been a large out pour of policies among policy makers and debate among economists on the best policy intervention to reverse the situation. In response to this, the Nigerian government devalued its currency by 8% from N155 to N168 in October 2015, following the global oil price dwindling and depletion of foreign exchange reserve and economic downturn, in order to revive the economic situation. The Nigerian foreign direct investment depreciated consistently from 45.19% in 2016 to -42.98% in 2019 (Kneoma, 2019).

This inflation rate is the highest reading since 2005, as cost of housing, food and non-alcoholic beverages and transport surged mostly due to oil price declining fortunes. Against this backdrop this study is set to examine the effect of oil price declining fortunes on the economic stability of Nigeria.

### **Objective of the Study**

The broad objective of this study is to determine the effect of declining fortunes of crude oil price on Nigeria economic stability. The work will be guided with the following specific objectives.

1. To determine if declining fortunes of crude oil induced by inflation affect the economic stability of Nigeria.
2. To examine if crude oil price declining fortunes induced by foreign direct investment affect economic stability of Nigeria.
3. To ascertain if oil price declining fortunes caused by crude oil price affect the economic stability of Nigeria.

## **II. Review Of Related Literature**

### **2.1.1 Crude Oil Price Declining Fortunes**

Crude oil is a liquid fuel source located underground. It is extracted through drilling. Oil is used for transportation, heating and electricity generation, varied petroleum products, and plastics. Crude oil is a base component of transport fuel, plastics, chemicals, and petroleum products. Like other prices of commodities, the price of crude oil experiences wide declining fortunes in times of shortage or oversupply. In oil prices Research shows that declining oil prices make oil-rich states less bellicose Low oil prices could also make oil-rich states engage more in international cooperation, as they become more dependent on foreign investments.

The influence of the United States reportedly increases as oil prices decline, at least judging by the fact that "both oil importers and exporters vote more often with the United States in the United Nations General Assembly" during oil slumps.

Oil prices declining fortunes (OPF) is defined as the standard deviation of oil prices in a given period while oil price shock manifestation of extreme volatility. For the purpose of this study which focuses on oil price volatility as opposed to shocks, it is reasonable to understand the distinction between both measures in terms of the size of price deviations. Acute deviation in oil prices, such as those seen in early 2008 is termed shocks, while relatively minor price deviations are referred to as price volatility (Erahim, Inderwildi and King, 2014).

### **2.1.2 Concept of Economic Stability**

The concept of economic stability is uncertain due to its nature and it's subject to different interpretations. Therefore, variability of policies having impact on economic stability can be interpreted differently. Different policies being implemented within the body of economic stability are interrelated and they influence each other (Pasini, 2013). It is not easy to explain the concept of economic stability. In its broadest definition, economic stability is the situation where there are no extreme fluctuations or volatility in macroeconomic variables.

With the indicators being chosen here, it seems possible to reach definition in the narrowest senses. However, regarding this subject no consensus has been reached in the literature as well. While economy grows, having a small ratio of inflation in deemed as sable with respect to the economic aspects. Besides, achieving full employment makes contribution to the stable condition of economy in the narrow sense. Economic stability is divided into internal stability and external stability. Internal stability provides to price stability in manifested in form of inflation and unemployment. The other aspect of economic stability namely external stability is ensured the balance of payments (Aylin, 2017).

### 2.1.4 Declining Fortunes of Crude Oil Induced by Inflation

Falling oil prices also weakened the overall foreign earnings of the African oil producing countries, resulting in rising inflation rates given the, demand did not fall for food items. Interestingly, African countries are classified as food –insecure countries (Akpan, 2009). In this instance, the prices of goods and services continued to rise as oil price fell, whereas during periods of high oil prices, the goods and services did not fall, indicating that oil price changes have a nonlinear effect on domestic prices. In 2016, the inflation rate in Angola, Libya, and Nigeria hit double digits. Notably, the inflation rates are usually volatile as there are various reasons for why it can change.

### 2.1.5 Declining Fortunes of Crude Oil Induced by Foreign Direct Investment



**Figure 1: Oil Price Trends**

A foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets in a foreign company. Looking at both crude oil and foreign direct investment the link between these determinants of economic growth is underdetermined as a result of divergence discovery in literature review studies like: Mehta (2014); Kari & saddam (2014) olure, gbadebo & Ajiteru (2015); Elheddad (2016); Quero-virlaa (2016); Asiedu (2015); Al-Mihya (2017); Muhammad and syed (2012) confirmed that there is a relationship between foreign direct investment and oil price fluctuation. A positive relationship is said to exist between foreign direct investments and oil price fluctuation. This relationship is either positive or negative. A positive relationship is said to exist between foreign direct investment and oil price fluctuation when the price bring about increases in growth, reducing unemployment, and lessen inflation level (Quero-Virlaa, 2016) as the positive change in oil price attracts foreign investors. On the other side, declining oil prices reduces foreign direct investment inflows in an oil exporting country.

### 2.1.6 Declining fortunes of crude oil induced by crude oil prices

The declining fortunes of oil tends to increase a whole, and this strengthening trend has a significant correlation with the influence mechanism of crude oil price, that is, the structure of fluctuation sources. During the sample period, the fluctuation of crude oil prices is evolving dynamically, which is mainly the results of the joint action of supply fluctuation source and financial factors affecting oil price fluctuation source. Along with the gradual increase of the prices of crude oil, the oil price fluctuations tend to be more dynamic (Razek and Michieka, 2019).

### 2.1.7 Oil Prices Fortunes and Economic Stability in Nigeria



**Figure 2: Oil Price Percentage Growth**

The literature on oil price declining fortunes and its attendant consequences on economic stability are quite broad continued to expand. As Adelman (2000) notes; crude oil prices have been more liable to change than any other commodity oil (although in principle it ought to be less unpredictable). He notes that though oil price movements have always occurred mainly due to seasonal changes in demand, such movements were small.

Kolawole (2002) seems to be in full agreement with Adelman (2000), pointing out that disagreements

on production quotas and members mistrust have fuelled volatility. Ayadi (2005) does not think differently either, in his opinion, speculation surrounding OPEC meetings can also induce volatility. He revealed that whenever OPEC meetings approach, volatility drifts upwards and therefore blames the frequency of OPEC meetings and quota adjustments in recent years as a crucial causal factor.

## **2.2 Empirical Review**

Afaha, Aderinto, Oluwole, Oyinlola & Akinlola, (2019) x-rayed the emergence of coronavirus (COVID-19) disease and its impact on the current price of oil and gas products in the international market. This COVID-19 pandemic had revealed many weaknesses in the world's major global economies, and its attendant effect is conspicuously visible and cut across several institutions and industries: from the financial institutions to health, agriculture, tourism and hospitality, electricity, oil and gas. The core objectives and motivations for the study were to examine the impact of the covid-19 outbreak on the Nigerian oil and gas sector and its implications, and analyse the effects and implications of covid-19 and the resulting oil price decline on Nigeria's trade flow. The findings from the study revealed that crude oil prices had reduced to record low of \$22 per barrel and this obviously has revenue impacting effects on the Nigeria economic system. Also, there is reviews of the prices of the premium motor spirit (PMS) or fuel downwards to cushion the rampaging impact of the pandemic on individual and business activities. Although the government has come up with emergency policies to reduce the impact of the disease on the economy.

Ibrahim, (2018) investigated the relationship between oil price fluctuation and output performance in Nigeria during the period 1970 to 2015. It synthesizes the standard neoclassical growth model and the Keynesian national income identity by augment the typical production function to include oil price as one of the factors of production and then super-impose the augmented production function on the Keynesian national income identity. The Two Stage Least Square (2SLS) estimation technique that accounts for the plausibility of endogeneity was adopted in the study. The ADF unit root and Johansen cointegration tests were used to determine the time series properties of the data used in the study. Findings suggest that oil price impacted positively on aggregate output but negatively on agricultural, manufacturing and service sector suggesting that fluctuation in oil price create uncertainty in the production capacity of the productive sectors and it also undermines the effectiveness of the government fiscal management of crude oil revenue. The study, therefore, recommends that the Nigerian government need to diversify its export revenue base in order to minimize the over reliance on crude oil. Also, the country needs to develop the local capacity of its refinery so as to reduce the importation of refined petroleum which serves as input to most productive sectors of the economy.

Karaki (2017) investigated the relationship between oil price and unemployment in the USA and its States. The study used different econometric approaches such as nonlinear structural equation and structural vector autoregressive (SVAR) estimation methods and found no evidence against the null hypothesis of symmetric effect. It was also found that oil supply shocks worsened unemployment situation, while oil demand shocks reduced unemployment rate across most of the States in the USA. However, oil-specific shocks had a little effect on unemployment in the States.

Augustine (2015) examined the nexus and the magnitude of the effects of fluctuation in the exchange rate on oil price and on how it impacts the Nigeria's economic performance. The study evaluated the effects of exchange rate fluctuations on crude oil price as well as on economic performance, simultaneously. The variables employed are Gross domestic product of Nigeria, Oil price, Real exchange rate, and Trade openness, Inflation, Terms of trade, World gross domestic product, and World crude oil production. The ordinary least square and the two stage least squares estimation techniques were employed. The study found that real exchange rate has a positive effect (1.2%) on the Nigeria's economic performance. It was discovered that a 1% increase in the price of oil would positively influence the economic performance of Nigeria by the magnitude of 4%. The R<sup>2</sup> shows that 82% deviation in the gross domestic product was captured by the explanatory variables whereas the J-statistics of the model is insignificant, thus, confirming the relevance and validity of the instruments used.

The impact of oil price volatility on macroeconomic activity in Nigeria has also been examined by Apere and Ijeoma (2013) using exponential generalized autoregressive conditional heteroskedasticity (EGARCH), impulse response function and lag-augmented VAR (LA-VAR) models. The paper finds a unidirectional relationship between interest rate, exchange rate and oil prices. However, a significant relationship between oil prices volatility and real GDP was not found. The paper concludes that that oil price volatility is an important determinant of real exchange rates and in the long run, while exchange rate rather than oil price volatility affects output growth in Nigeria. Hence, they found evidence that international oil price influenced economic growth in Nigeria within the sample period.

Ani, Ugwunta, Oliver and Eneje (2014) in a study on Oil price volatility and economic development: Stylized evidence in Nigeria investigated chiefly the causal relationship between oil prices and key macroeconomic variables in Nigeria in a multivariate framework using times series data from 1980 to 2010. The study adopted the Granger causality and the ordinary least squares respectively. After ensuring data stationarity,

the results suggest that in the short run, changes in the gross domestic product (GDP) is not influenced by oil price volatility, nor do we find evidence of influence on key macroeconomic variables. Again the findings indicate that there is a positive but insignificant relationship between oil price and the Nigerian Gross domestic product. Overall oil prices have no significant impact on real GDP and exchange rate in Nigeria. The result suggests that Nigeria has a special case of the Dutch Disease, where a country seems good fortune proves ultimately detrimental to its economy.

### 2.3 Theoretical Framework

This study was anchored theoretically on Hotelling Exhaustible Resource Theory as most suitable for this study. Harold Hotelling Theory was propounded in (1931) and it considered exhaustible resources to be an asset, which could either be extracted today or in the future. Hotelling’s rule assumes that producers and owners of resources are only motivated by profit, and that production is about earning money. The theory also assumes that exhaustible resources should be treated as assets or investments that could increase in value. This is why you compare the future prices of oil with bonds or to save money in a bank. In other words you compare the price development of the exhaustible resource with the development of interest rates of other investments (Hotelling, 1931). Who developed this theory and when was it developed?

### III. Methodology

The study examines the effect of declining fortunes of crude oil prices on Nigerian economic stability 1990-2020. For this study, ex post facto research design was adopted. This is because the study attempts to explore cause and effect relationship where causes already exist and cannot be manipulated. Ex-post facto research is a systematic empirical inquiry in which the scientist does not have direct control of independent variables because their manifestations have already occurred or because they are inherently not manipulated. Inferences about relations among variables are made, without direct intervention, from commitment variables of independent and dependent variables. This research used secondary time series data in examining the macroeconomic effect of declining fortunes of crude oil prices on Nigerian economic growth.

The Ordinary Least Square (OLS) models to establish the interactions among these variables are: The OLS model is commonly used for forecasting systems of interrelated time series and for analyzing the dynamic impact of random disturbances to the system of variables. The mathematical representation of a OLS is:

$$y_t = A_1 y_{t-1} + \dots + A_p y_{t-p} + Bx_t + e_t \tag{1}$$

Where,  $y_t$  is a  $k$  vector of endogenous variables, and contains the oil prices, and GDP as given an order,  $A_1, A_p$  and  $B$  are matrices of coefficients to be estimated.

$$GDP_t = b_0 + b_1 INFL_t + b_2 FDI_t + b_3 OP_t + U_t \tag{2}$$

Where,

GDP = Gross Domestic Product

INFL = Inflation

FDI = Foreign Direct Investment

OP = Oil Price

$b_0$  = constant term/parameter intercept

$b_1, b_2$  and  $b_3$ , = coefficient of the parameters estimates.

$U_t$  = Error Term

Apriori Expectation:  $b_0 > 0, b_1 > 0, b_2 > 0$ , and  $b_3 > 0$ .

### IV. Presentation Of Regression Result

Available data on Nigeria Economy Stability (GDP), Inflation Rate (INF), Foreign Direct Investment (FDI), Oil Prices (Oil\_Price) we have corrected and use for the purpose of this analysis.

**TABLE 1: OLS Test**

Variable	Coefficient	Std. Error	t-Statistic	Prob.
INFL	1144.317	1815.580	0.630276	0.5374
FDI	-44418.28	8961.393	-4.956626	0.0001
OIL_PRICE	725.1472	295.4724	2.454196	0.0260
C	70634.98	37243.56	2.896569	0.0061

R-squared	0.647578	Mean dependent var	58204.71
Adjusted R-squared	0.581499	S.D. dependent var	42616.21
S.E. of regression	27569.12	Akaike info criterion	23.46364
Sum squared resid	1.22E+10	Schwarz criterion	23.66278
Log likelihood	-230.6364	Hannan-Quinn criter.	23.50251
F-statistic	9.800051	Durbin-Watson stat	1.269589
Prob(F-statistic)	0.000658		

**SOURCE: Researchers Own Computation (E-View version 10)**

From table 4 above the variables of the intercept under co efficient of C is 70634.98 shows that the effect of declining fortunes of crude oil on the Nigeria Economy Stability will experience a 70634.98 unit increase when other variables are held constant. This is to say that when other variables are constant, the Nigerian Economy Stability (GDP) will be 70634.98.

Inflation rate (INFL) is 1144.317. This shows that the variable is positively related to the Nigerian Economy Stability. This means that a unit increase in the inflation rate is followed by an increase in the Nigerian Economy Stability (GDP).

The co-efficient for Foreign Direct Investment is -44418.28. This shows that the Foreign Direct Investment is negatively related to Nigerian Economy Stability. It indicates that a unit increase in the Foreign Direct Investment is followed by a decrease in the Nigerian Economy Stability (GDP).

Furthermore the value of Oil Price is 725.1472 which show a positive relationship with Nigerian Economy Stability (GDP). This implies that a unit increase in inflation has an exact 725.1472 unit impact on Nigerian Economy Stability (GDP).

## V. Conclusion And Recommendations

### 5.1 Conclusion

The general conclusion that emerged from this study is that crude oil price in Nigeria during the period under review though had significant impact on economic growth, have not been able to maximize the economic potentials of Nigeria. The result revealed a positive relationship between oil price and GDP, while foreign direct investment had a negative relationship with GDP. Also revealed was a positive relationship between oil price and GDP and also inflation and GDP based on our findings during the period under review.

### 5.2 Recommendation

Based on the findings of this study, the following recommendations were made:

1. Government should diversify the economic base from oil to non-oil as a necessary condition for sustainability and growth of Nigeria economy.
2. Government should improve the security in the Niger Delta area with a view to boosting oil output, hence leading to increase oil revenue and by implication growth of the economy.
3. Nigeria should focus on its endowment of gas resources, in order to diversify its revenue base. The current practice of flaring gas during oil extraction should be discontinued. The country has a huge deposit of gas, which it could harness to generate electricity and thus promote industrialization.

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