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The Impact of Petroleum on the Balance of Payments

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Nigeria's transformation from a predominantly agricultural to an oil economy has had many significant social and economic effects. In this paper, an attempt is made to analyse one of such effects: the impact on the country's balance of payments.

The most fundamental change in the structure of the Nigerian economy in recent years has been the ascendancy of mining to the position of the leading sector. To a very large extent this development arises from the rapid growth rate of petroleum mining, the performance in the other sub-sectors of mining being relatively unimpressive. Production of crude petroleum which amounted to 0.77 mn barrels per day in 1963 had risen to 2.0 mn barrels per day in 1973, representing an annual compound growth rate of 36.3 p.c. in a decade that was marked by a three-year civil war [1]. At over 40 p.c. the contribution of petroleum to GDP in 1974 was higher than that of agriculture. And by that year Nigeria had become the world's sixth largest and Africa's largest producer of petroleum [2].

For most developing countries, the inadequacy of foreign exchange constitutes a bottleneck in the process of development. The crux of this problem, as aptly put by Meir, is that "In the course of development, the rate of growth of national output and the demand for imports tends to exceed the export-based capacity to import ... especially during the early phases when the increase in investment is sizeable and structural changes are considerable. The poor country then confronts a conflict between accelerating its internal development and maintaining external balance." [3] Due mainly to the impact of petroleum on its balance of payments, Nigeria has in recent years been spared the constraint of foreign exchange on the development process.

1950–54: Continuous Trade Surplus

Table 1 summarises the main trends in Nigeria's balance of payments over the period from 1950 to 1973. From this table, three facets of the country's trade balance can be identified: 1950 to 1954, 1955 to 1965, and 1966 to 1973. In the period from 1950 to 1954, the trade account was characterised by continuous surplus. The post second world war boom in the market for primary products had led to substantial increases in their prices and in Nigeria's foreign exchange earnings. This period of increased foreign exchange earnings coincided with one of limited demand for foreign exchange. There was as yet no commitment to planned rapid industrial development, hence the importation of capital goods was on a relatively small scale. As part of the country's contribution to the Sterling Area's conservation of hard currencies during this period, "no goods may be imported into Nigeria unless permission has been granted by the import licensing authority" [4]. The buoyancy of the export market coupled with the restriction on imports made the running of surplus on trade account inevitable. The bulk of the surplus so earned was held as reserves in London in the form of Sterling balances. Although the services account was in deficit, this was more than offset by the surplus on the trade and capital accounts. Thus Nigeria's overall balance of payments remained in surplus throughout the first sub-period.

1955–65: Depletion of Foreign Exchange Reserves

The post war boom in primary products came to an end in the mid-1950s. From then on, the terms of trade for such commodities assumed a downward trend. Even though the quantity of most Nigerian export commodities increased, there was no commensurate rise in export earnings. On the other hand, a number of forces were operating toward the enlargement of imports in this period of relative stagnation in export earnings. The constitutional changes of 1954, which gave Nigeria a greater degree of political autonomy, ushered in a

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[1] Federal Ministry of Economic Development, Third National Development Plan 1975-80, Lagos 1975, p. 135.

[2] The Petroleum Economist, Vol. XLII, No. 1, Jan. 1975, p. 10.

[3] G. M. Meir, International Trade and Development, New York 1963, p. 74.

[4] Department of Commerce and Industries, Nigeria Trade Journal, Vol. 1, No. 2, 1953, p. 20.

Table 1
Nigeria's Balance of Payments, 1950–1973
(in mn N£)

Category	1950	1954	1955	1960	1965	1966	1968	1970	1972	1973 [1]
Visible Trade	51.6	65.8	– 12.6	– 101.0	– 5.6	62.0	34.6	173.0	477.5	1,024.1
Invisible Trade	– 12.0	– 14.2	– 12.0	– 36.2	– 127.2	– 183.8	– 237.2	– 268.0	– 772.7	– 887.3
Unrequited Transfers	5.2	4.8	6.6	– 3.4	5.4	3.4	34.4	45.0	– 14.3	– 29.1
Current Account	44.8	56.4	– 18.0	– 140.6	– 127.4	– 118.4	– 168.2	– 50.0	– 309.5	107.7
Capital Transactions	5.2	20.8	19.2	68.0	132.0	96.8	160.0	61.2	269.4	59.2
Net Change in Official and Banking Assets [2]	– 50.8	– 78.2	6.2	73.4	– 23.8	17.6	– 6.0	– 58.6	40.8	– 165.5
Errors and Omissions	0.8	1.0	– 7.4	– 0.8	19.2	4.0	14.2	47.4	– 0.7	– 1.4

[1] Provisional. [2] A minus entry indicates increase in assets / decrease in liabilities. A plus entry indicates decrease in assets / increase in liabilities.

Source: Central Bank of Nigeria, Annual Report; Federal Office of Statistics, Digest of Statistics and Annual Abstract of Statistics.

new era in which increased emphasis was placed on the economic development objective. Consequently, "since the mid-50s, there has been a marked expansion of capital expenditure by the Government to promote the economic development of the country" and the gathering upsurge of development has resulted in considerable increase in demand for imports [5]. The relaxation of import controls in the second half of the 1950s gave additional stimulus to this demand. Owing to the influence of the above-mentioned factors, Nigeria's trade balance moved into deficit in 1955 and remained so for the next decade, i.e. up to 1965. Throughout this period (except for 1965) the country's balance of payments was also in deficit because the net inflow of capital was insufficient to offset the substantial and growing deficit on the current account.

The deficit in the balance of payments was financed mainly by drawings upon the reserves accumulated in the pre-1955 period. By 1964 these reserves, having been depleted by almost a decade of continuous balance of payments deficit, stood at a dangerously low level and the inadequacy of foreign exchange became a serious constraint on the country's economic development. A wide range of monetary and fiscal measures were instituted by the authorities to curtail the volume of imports [6]. The foreign exchange constraint on the development process would have become more acute in subsequent years but for the ameliorating influence of petroleum on the balance of payments.

1966–73: Rapid Growth of Petroleum Export Earnings

Although the search for petroleum in Nigeria commenced as far back as 1937, the commodity did not appear on the country's export list before 1958. In that year, 245,000 tons of crude petroleum valued at N£ 2 mn were exported. The commodity's contribution to total export earnings in the year under consideration amounted to just 0.7 p.c. Production and export of petroleum however increased very rapidly in the following years. By 1965, when 13 mn tons valued at N£ 168 mn were exported, crude petroleum had become Nigeria's most valuable export commodity, accounting for 25.4 p.c.

[5] Nigeria Trade Journal, Vol. 7, No. 2, 1959, p. 75.

[6] Central Bank of Nigeria, Annual Report, 1965, pp. 10 and 11.

Table 2
Contribution of Petroleum to Nigeria's Balance of Payments, 1965–1973
(in mn N£)

Category	1965	1966	1967	1968	1969	1970	1971	1972	1973 [1]
Visible Trade	109.2	144.8	109.0	54.2	236.2	464.8	929.8	1,141.2	1,797.3
Invisible Trade	– 72.8	– 115.8	– 102.6	– 56.4	– 96.2	– 81.2	– 329.2	– 527.3	– 624.6
Unrequited Transfers	–	–	–	–	–	–	–	–	–
Net Contribution to Current Account	36.4	29.0	6.4	– 2.2	140.0	383.6	600.6	613.9	1,172.7
Capital Transactions	34.8	57.8	91.0	26.0	– 33.4	– 130.4	4.0	195.8	64.5
Net Contribution to Balance of Payments	71.2	86.8	97.4	23.8	106.6	253.2	604.6	809.7	1,237.2

[1] Provisional.

Source: Central Bank of Nigeria, Annual Report, 1965–1973.

of the total export earnings [7]. The growth of petroleum export earnings was the major factor in the reversal of the trade balance from deficit into surplus in 1966 [8].

In 1967 the upward trend in the production and export of crude petroleum was interrupted by the country's political crisis and civil war. However, the interruption lasted for only a short period, the upward trend being resumed in 1969 with the liberation of oil producing areas by the federal troops and the opening up of new oil fields. At 96.2 mn tons, the quantity of crude petroleum exported by Nigeria in 1974 was roughly four times the 1969 level and over seven times that of 1965 [9]. A corollary of the growth of export volume has been the rise in export earnings. Along with other members of OPEC, Nigeria has also benefited from recent increases in the price of oil. Thus throughout the 1970–74 Plan period, "export values exceeded Plan projections . . . This improvement was due almost entirely to increase in both the price and output of crude oil." [10] The substantial earnings derived from petroleum export are reflected in the growing surplus on Nigeria's trade account.

Contribution to Current Account

Table 2 shows, in some detail, the contribution of petroleum to Nigeria's balance of payments during the period from 1965 to 1973. The oil sector's visible trade surplus (i.e. excess of petroleum export earnings over the value of oil companies' visible imports) rose by more than tenfold from N£ 109.2 mn to N£ 1,797.3 mn over this period. The important point worth noting is that the trade surplus for the oil sector exceeded in any given year that recorded in Table 1 for the entire economy. This supports our earlier assertion that Nigeria's visible trade account would have continued to be in deficit but for the intervening influence of petroleum.

In evaluating the contribution of the petroleum sector to Nigeria's balance of payments, it is essential to take into account not only its effect on the visible trade balance but also on the invisible trade balance and capital transactions. Table 2 reveals a persistent deficit in the services account of the oil sector, the deficit rising from N£ 72.8 mn in 1965 to N£ 624.6 mn in 1973. A by-product of the large foreign investment in the sector has been the considerable amount accruing to foreigners in the form of profits and dividends. The high growth rate of petroleum mining has also led to sharp increase in outpayments on other items in the services account. To a large extent, the growing deficit in Nigeria's services account is due to the relatively large outpayments for the petroleum sector services. However, the sector's contribution to the country's current account has remained substantial and positive because its visible trade surplus has generally exceeded the deficit in the services account.

Attraction on Foreign Investment

Nigeria's petroleum resources exert a major attraction on foreign investors. Much of the country's inflow of foreign capital has been into the development of these resources. In 1968, for example, the oil sector accounted for as much as 90 p.c. of the total net foreign private investment [11]. As a result, the capital transactions account of the sector was marked by a surplus in all but two years of our review period. The deficit sustained in that account in 1969 and 1970 and the sharp fall in the surplus in 1973 seem to have been due to the reduced rate of foreign investment and the rise in capital repatriation associated with the uncer-

[7] Central Bank of Nigeria, Annual Report, 1967, p. 67.

[8] Another important factor has been the growth of import substitution made possible by the country's fast pace of industrialisation.

[9] Federal Office of Statistics, Review of External Trade, Nigeria, 1969, p. 12, and 1974, p. 13.

[10] Third National Development Plan 1975-80, op. cit., p. 15.

[11] Central Bank of Nigeria, Annual Report, 1968, p. 70.

tainty of the crises years and the increased indigenisation of the sector. Even in these years, the net contribution of the oil sector to Nigeria's balance of payments was still considerable. And generally, the net contribution has tended to increase over the years, rising from N£ 71.2 mn in 1965 to N£ 1,237.2 mn in 1973.

The improved Nigerian balance of payments position, attributable mainly to the impact of petroleum, is reflected in the growth of the country's external reserves. In spite of the depletion of the reserves in recent years arising from the repatriation of capital by foreign owners of indigenised enterprises, the level of reserves amounted to N£ 438.4 mn at the end of 1973 as compared with N£ 186.2 mn at the end of 1965 [12]. In the 1975–80 Plan period, reserves are expected to rise at an average of about N£ 3.3 bn per year [13]. Thus, although the scale of planned capital expenditure in the Plan period (N£ 30 bn) is roughly ten times the preceding one, it is "quite clear that there will be no savings and foreign exchange constraints during the Third Plan period and beyond" because of the expected contribution of the petroleum sector [14].

Conclusions and Policy Considerations

Nigeria's balance of payments position has in recent years been significantly altered by developments in the petroleum sector. The visible trade account, on which the country sustained a deficit throughout the decade from 1955 to 1965, has since 1966 been marked by a growing surplus, mainly because of increased petroleum export earnings. Although the sector accounts for a large part of the persistent deficit in the overall invisible trade account, the considerable amount of foreign capital attracted into the development of petroleum resources and the massive surplus earned on the sector's visible trade account have generally more than offset the impact of this on the balance of payments. Hence, for example, the net contribution of the sector to balance of payments rose from N£ 71.2 mn in 1965 to N£ 1,237.2 mn in 1973. And with the resultant growth of reserves, foreign exchange has ceased to be a constraint on Nigeria's development process.

There is no doubt that if the current growth rates of production and export of petroleum continue and the world supply-demand conditions for the commodity remain unaltered, the contribution of petroleum to Nigeria's balance of payments and development process will increase further. The projected annual increase of about N£ 3.3 bn in external reserves during the Third Plan period may therefore not be unrealistic.

Although the balance of payments prospects for Nigeria in the immediate future appear to be quite good, there exists some cause for concern. A corollary of the rapid rise of petroleum on Nigeria's export list has been the decline of agricultural export commodities. In 1950, the nine major agricultural commodities on the export list (cocoa, groundnuts, groundnut-oil, palm kernels, hides and skins, rubber, timber and raw cotton) accounted for 86.4 p.c. of total export earnings. By 1974, their combined share had fallen to 5 p.c. [15]. And a more disturbing development is that over this period there was also a decline in the absolute export earnings of many of these commodities (e.g. groundnuts, groundnut oil, raw cotton, hides and skins, palm oil and palm kernels). In contrast, crude petroleum alone accounted for as much as 92.7 p.c. of total export earnings in 1974 [16].

Excessive reliance on a single commodity for foreign exchange earnings and strong balance of payments position is dangerous for any country. This is particularly so when, as in the case of Nigeria, that commodity is a wasting asset such as petroleum. Advancement in technology and rising oil prices may lead, sooner than expected, to the establishment on a commercial basis of new sources of energy. Unfortunately, because of euphoria created by the "oil boom", sufficient concern appears not to have been shown about the "decay" of traditional exports. Until recently, the export of major agricultural commodities was heavily taxed through surpluses accumulated by the Marketing Boards and the payment of export duties [17].

To diversify the Nigerian export base a reverse policy is now essential. Such a policy implies that the massive funds made available to Nigeria by the "oil boom" should be used partly to provide incentives for increased production and export of traditional products. In order to increase the linkage effects and export earnings of such products, the objective should be to export them in processed rather than raw form. Since market accessibility is vital for the attainment of this objective, Nigeria's commercial policy should be geared toward ensuring the necessary market for the processed products. It is in this regard that the Nigerian membership of the ACP (African, Caribbean and Pacific) group of countries, which successfully negotiated among other things the free entry of their exports into the world's largest market – the EC – is significant.

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12 Central Bank of Nigeria, Annual Report, 1965, p. 58, and 1973, p. 98.

13 Third National Development Plan 1975-80, op. cit., p. 47.

14 Ibid., p. 48.

15 Federal Office of Statistics, Review of External Trade, Nigeria, 1974, Table 4.

16 Ibid.

17 Central Bank of Nigeria, Annual Report, 1973, pp. 14 and 74.