

Oil Economies: Venezuela and Nigeria

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Abstract: *The American economy's 'unconventional' discovery of shale gas is what set the stage 'slippery' for most traditional oil suppliers. The paper will focus on two such economies namely, Venezuela and Nigeria.*

Nigeria

Oil exports account for about 75% of the country's revenue and 35% of its GDP. With United States' decision to stop importing oil from Nigeria and the falling crude oil prices, the economic outlook for the economy has further dampened. To add to its woes, Nigeria has been facing labor union strikes demanding improvement in infrastructure, working conditions, etc. Nigeria is also scheduled to go for elections on 28 March, 2015 and a change of power threatens the economy's stability, because the same party has ruled Nigeria since 1999.

Venezuela

Oil accounts for 95% of Venezuela's export earnings. Falling oil prices has hit their economy hard due to mounting debt and lower cushion for public finances. The government spends far more than its oil revenue. Fiscal deficit amounts to 20% of the GDP. Inflation in the Venezuelan economy has hit the roof and the scarcity index for food and other basic goods remains high. For an economy like Venezuela, which is highly dependent on imports of necessary commodities such as medicines and food, finding creditors is likely to be a Herculean task.

Reasons for an increase in oil price in 2013

Oil prices were as high as \$ 100 per barrel in 2013 and still increasing. This was a bit surprising considering that the world economies had recently faced a severe recession. According to me, the main reason for the oil price increase was the supply constraint. In 2013, emerging economies such as India and China saw an increase in their demand for oil and petroleum, they being a necessary commodity. However, the overall oil production

could not be increased because the supply of oil remained relatively inelastic.

The increase in the supply of oil began to slow down in 2005. This created a situation of excess demand and hence, an increase in oil prices. The supply of substitutes of oil such as biofuel and natural gas could not make up for the shortage of oil. The other reason for high prices was the adverse situation in Iran, a country that is responsible for exporting around 2.4 million barrels of oil a day. It exports its oil to big economies such as India, China and the EU. In a world where there was already shortage of crude oil supply, additional lag in supply just exacerbated the situation.

Reasons for a fall in the oil price

The price of oil has decelerated sharply since the beginning of 2014, when it was \$115 per barrel. It is now priced at \$49.80 per barrel. The oil price has fallen by 30% since then. A lot many vicissitudes in the global events has resulted in this sharp decline. As per Forbes, "According to recent estimates, Saudi Arabia needs the price back to \$99.20 a barrel to break even. Even at that point, many OPEC nations would still be in the red." Despite such dire needs, the cartel has still maintained low prices.

The answers of course lie in the standard demand-supply chase. The world demand for oil has fallen due to the general negative outlook and slowdown. Most developing countries are now cutting back on energy subsidies in view of rising budget deficits. India is a major example of such a move. Hence, higher costs have further encouraged lower demand. Slowing growth in China too has contributed to the overall slump because of the fall in demand. Countering the expectations, Libya has increased its oil output, which has increased the total supply of oil. America is the surprise entrant with its shale gas revolution. To quote The Economist, "America has become the world's largest oil producer. Though it does not export crude

oil, it now imports much less, creating a lot of spare supply.” As a result, imports by OPEC have been cut by half. OPEC’s internal infighting has also kept the prices low. Saudi Arabia and Kuwait don’t want to lose their share of the oil market. They are consequently unwilling to cut down on production. Being the most puissant of the lot, they have hectored the smaller economies into giving in.

The worst hit are the economies of Nigeria, Venezuela, Iran and Russia, which are largely dependent on the export revenue from oil to fuel their economy.

Case Study 1- Venezuela

Venezuela or the Bolivarian Republic of Venezuela is a country located on the Northern coast of South America. It is the fifth largest member of the Oil and Petroleum Exporting Countries (OPEC) in terms of oil production. The Venezuelan economy is largely based on petroleum and manufacturing sectors. Revenue from oil exports accounts for nearly 50 percent of the country’s Gross Domestic Product (GDP) and 97 percent of its export earnings.

After 1960, the oil market was taken over by OPEC and the 7 companies that belong to the OPEC members are called the “New Seven Sisters” of the oil industry. *Petróleos de Venezuela, S.A. (PDVSA)* (Petroleum of Venezuela, S.A) which is a state owned oil and natural gas producing company is one of the “New Seven Sisters”.

An overview of the Venezuelan Economy: 1980-2013

Just before the oil crisis of 1980-1990s, all was well for Venezuela. There was a boom in the oil market and Venezuela being one of the biggest oil producers, was benefitting from the boom. It was a time when its currency, Bolivar, peaked against the US dollar. Venezuela was seen a model democracy.

The era of Hugo Chavez

Late Hugo Rafael Chavez Frias was the President of Venezuela from 1999 to 2013. He belonged to the United Socialist Party of Venezuela⁶².

In 1980s, Venezuela struggled through falling oil prices, increasing foreign debt and decreasing welfare

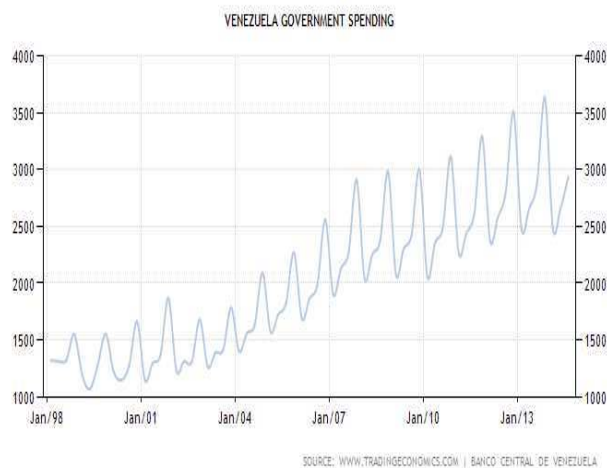
of the nation. After Hugo Chavez assumed office in 1998, he planned the economy of Venezuela. Venezuela, which was previously under the US rule, played a pivotal role in recovering oil prices by holding an OPEC Summit in Caracas. Therefore, Venezuela secured a vital source of income for its economy. After this, the Chavez Government went on to overturn what is referred to as the “the most perverse and antinational system of oil production”, *la apertura petrolera* (the petroleum opening). By opening the petroleum sector, the PDVSA gave transnational oil companies the right to extract oil while giving an insignificant portion back to the Venezuelan state. According to this policy, it meant that even if oil prices recovered slightly, most of the profits went to transnational companies. The Chavez government took complete control over the PDVSA by implementing Currency Exchange Control (CEC). This was done in order to avoid capital flight⁶³. This led to a rapid increase in the oil production and ultimately an increase in the International Reserves (IR) of Venezuela. He shut down most of the manufacturing sector and invested more in oil, making Venezuela more oil dependent.

Venezuelan economy expanded at an average of less than 3 percent a year during Chavez’s long tenure as President, even when the oil prices soared as high as \$150 a barrel in 2008. The IMF predicted that the economy would grow at an approximate rate 2 percent in 2011.

The 2008 financial crisis hit major economies such as the United States, which is one of prime exporters of Venezuelan oil. This affected the Venezuelan economy adversely. Post 2008, the Venezuelan economy experienced a recession for 2 years (2009-10). The recession was fuelled by the economic crisis and the electricity crisis, brought on by a prolonged drought. Venezuela imported most of its necessities, which were disrupted because all the countries from where Venezuela imported were severely hit by the crisis. This led to fall in welfare for the Venezuelan population and hence, oil production took a toll. The government under Chavez was handicapped. They couldn’t do anything. Even if they ramped up the production, it wouldn’t do any good because the major countries to which Venezuela exported were down. They didn’t have the money to buy the oil. This was made worse by the fact that Chavez’s socialist government spent insane amounts on social welfare and development and the government ran a deficit throughout.

In 2011, the economy was finally able to reach the 4 percent mark for economic growth. It proved all the predictions wrong. While the developed nations struggled through poverty and ever-increasing unemployment, in Venezuela, it was just the opposite. The growth rate was on an upward trend.

Income inequality gradually declined in Venezuela under the Hugo Chavez government and his socialist reforms. The Gini coefficient⁶⁴ that measures the income inequality fell down to 0.397, which is the lowest Gini coefficient in the region. Although the income disparity declined, but there wasn't much income to be equally distributed. "Venezuela is the fifth largest economy in Latin America, but during the last decade, it's been the worst performer in GDP per capita growth," says *Arturo Franco of the Centre for*



International Development at Harvard University in 2013.

Post Chavez period (2013)

2013 and 2014 were very crucial years for all economies around the world, especially for the oil producing economies such as Venezuela.

2013 was characterized by increasing crude oil prices. This was a result of a mismatch between the demand and supply of crude oil. All over the world demand for crude oil increased, especially in emerging economies such as India and China. Petroleum being a necessity, the demand for it was more or less inelastic⁶⁵. However, the supply was a constraint and

could not be matched with the increasing demand. This, along with the fact that the Iran's political scenario hindered its oil exports, created a situation of excess demand, which led to a sharp increase in prices. However, the situation in Venezuela was far from the best.

Venezuela faced a very high inflation rate, which was close to 50% in October 2013. The Chavez government with its socialist objectives left a hole in the government's pocket. The fiscal deficit was so huge that even with high petroleum prices, the government was in tatters. Since the Bolivar is not a hard currency⁶⁶, the inflation led to its devaluation. According to *Kenneth Rapoza for Forbes*, "The devaluation of the currency in the case of Venezuela represents a reallocation of resources from the private to the public sector, which is practically the only exporter thanks to oil giant PDVSA. Private consumption moderated from 7.0% growth in 2012 to just 3.2% yearly growths in the first." Even the International Reserves were dwindling.

To add to the misery of the Venezuelan people, President Nicolas Maduro, successor of late Hugo Chavez, didn't acknowledge that Venezuela was, in fact, in trouble economically. He followed Chavez's footsteps without realizing what it would do to the economy. He continued with the social welfare programs and made a statement blaming the private sector for the country's economic problems.

Present Scenario (2013 onwards)

2014 saw a drop in the oil prices. The worst hit were the economies of Venezuela, Nigeria, Iran and Russia who are largely dependent on the oil exports to fuel their economies. It was assumed that the OPEC would intervene to cut down the supply and bring the oil market back in equilibrium but nothing like that was done. In an OPEC meeting in November 2014, Saudi Arabia, which is the second largest crude oil producer in the world decided not to cut down on its production of oil because they didn't want to give up their market share of oil. This caused the prices to crash even further.

Venezuela was in for a world of trouble. The fact that their President wouldn't act on the already high inflation didn't help the situation either. By the end of

2014, the inflation rate was as high as 65 percent. The fiscal deficit was worse than ever. In order to cover up the deficits, the government had borrowed huge chunks of money and now is in a situation where it would not be possible to pay the debts. The skyrocketing inflation has led to a devaluation of the Venezuelan currency (the Bolivar costs around 90 USD in the black market). On top of all this, the government under Maduro isn't willing to cut down on social expenditure such as subsidies. The government spends way more than the revenue it generates from exporting oil. Venezuelan economy is characterized by scarcity of certain necessary goods such as medicines and food. With all that has been happening around the world, the scarcity is worse than ever. The Bolivar has lost its value in the black market (around 80 to 90 Bolivars per US dollar), the inflation is soaring and hence the people of Venezuela are unable to afford a lot of basic necessary goods.

Conclusion

The worst is not over for Venezuela, it seems. According to the *Latin Focus Consensus Forecast* panelists, inflation is expected to peak at around 79 percent by the end of 2015. According to forecasters, the oil prices are unlikely to increase in the near future. There is resentment among the people of Venezuela as they are unable to afford a lot of necessities of life. In the coming year, the scarcity is going to get worse in the light of the facts presented above. Taking all of this into consideration, I think that Venezuela is in for a hurricane of protests and strikes. The people are unhappy with the government, who is unwilling to take the initiative and solve the woes of the economy. The Petro Caribe program (2005) allows many Caribbean states to buy oil from Venezuela on a deferred payment basis. This essentially meant that some countries could buy oil from Venezuela by paying some amount upfront and the rest of it in a period of 2-3 years. The PetroCaribe has resulted in huge deficits for the Venezuelan government. Although, the deficits from PetroCaribe is not as much when compared to the losses caused by huge fall in price of oil. According to the country's foreign minister, Rafael Ramirez, "Venezuela is perfectly capable of sustaining the PetroCaribe agreement". This, in my opinion is highly unlikely, considering where the Venezuelan economy stands.

Even a small blow to the economy can make matters much worse. China, which is one of the major lenders for Venezuela has now refused to lend any more money to the Venezuelan government.

There is hope for the economy if the government intervenes to cut back on its expenditure and adopt policies to reduce inflation. Only when the inflation is reduced, can the Bolivar regain its value and scarcity can be controlled to some extent. The country should also try to boost its manufacturing sector. However, it is easier said than done. It had been seen that even in times of a booming oil market, the fiscal deficit was close to 17 percent of GDP. Even, the manufacturing sector requires initial investment for which the government does not have money. Therefore, it is safe to say that even if the government adopts all the desirable policies, it will be long before the economy is put back on the path of recovery.

Case study 2: Nigeria

BACKGROUND

The Nigerian economy presents an irony of sorts also called as the 'resource curse' by economists. While it is replete with legion natural resources on one hand, on the other it is struggling with gouging poverty. The modern part of the economy is said to be dependent on oil while the traditional sector of the economy thrives on agriculture. Until 1960s oil was yet to be discovered and agriculture was the prime driver of the economy. Oil is now major component of the Nigerian economy. It accounts for 95% of Nigeria's export earnings and for 65% of total government revenue. The Nigerian government has been accused of corruption and inefficiency because of which proportionate gains are not spread out and eventually on the 1% are benefitted. Despite the augmenting revenue from oil, investment in agriculture has declined such that there is a need to import food.

THE 1980S ERA: FALL IN OIL PRICES

With the oil crisis in the 1980s, revenue fell sharply. Inflation was already doing rounds. Consumer goods, including necessary commodities, became extremely expensive. Government's focus on the industrial sector, at the expense of the agricultural sector, caused severe shortage of food, such that it had to be imported. Also,

most of the workers had shifted to the urban sector to work in the industries. This caused a shortage of workers in the agrarian rural sector and created an ever increasing unemployment in industrial sector. The government defaulted on its loans. More debt began to mount because food had to be subsidized. Immigration, especially from West Africa, was stopped to save jobs. The urban unemployment rate rose to 28 percent in 1992, and crime also increased as 31.4 percent of the population lived below the poverty line. The Government further implemented Structural Adjustment Program, to reduce Nigeria's dependence on oil and to create a basis for sustainable non-inflationary growth. But, this further worsened the situation by increasing inflation and unemployment. Spending on education and health care reduced considerably. As per *The New Nigerian* "GNP per capita per year decreased 4.8 percent from 1980 to 1987, which led in 1989 to Nigeria's classification by the World Bank as a low-income country". Presidential elections being terminated in June 1993, Sani Abacha became the authoritarian ruler. The next 6 years would prove mean even more detrimental for the economy. Gross corruption and violation of fundamental rights of its citizens, abated Nigeria's tarnished reputation further on. Unemployment and poverty reached higher levels than ever before. Very little of the revenue from oil exports reached the common man. A large amount of this money was embezzled to Swiss banks.

The 2000s: getting back on track

The election of a civilian president, Olusegun Obasanjo, in 1999 was the first steps towards achieving economic stability. Incidentally, inflation rates fell to 6.1% and the foreign exchange rate stabilized to N92.00 per dollar. The new president aimed to reinstate global confidence in the economy and bring back credibility in the government. While his attempts at getting debt relief failed, he did manage to pass anti-corruption bill in the legislature. He privatized inefficient and corrupt state owned companies. With the help of the World Bank, Nigeria succeeded in recovering US\$458 million of public money stashed off abroad.

In 2003 he introduced National Economic Empowerment Development Strategy (NEEDS) program. It encapsulated the range of social and

economic reforms that the president wanted to introduce. Major concerns were fighting off poverty, fuelling the economy and luring foreign investors.

The reforms could not bring any major shift in the economy. Unemployment instead rose from 12% to 19%. The manufacturing sector collapsed and the number of Nigerian graduates increased year on year. Infrastructure deficit still plagued the economy. Foreign capital did not inundate the Nigerian economy as had been expected. This is in part because of the high cost of doing business in Nigeria and a lack of transparency in economic decision-making in the country. GDP per capita in 2006 was same as in 1980. *The BBC reported in 2005 that* "Nigeria is one of the world's biggest oil exporters, but it is also one of the world's poorest countries, with the majority of the population living on less than \$1 per day."

In 2005, Nigeria reached an important agreement with the Paris club regarding debt relief. Nigeria agreed to pay the Paris Club \$12.4bn (£8.2bn) in exchange for the remainder of its \$30bn official debts being written off. This helped the country remove its name from the international black credit list. In 2006 it settled the remaining debt becoming the first African country to do so.

Before the financial crisis, the fragile economy was regaining investor confidence. Oil prices had been on an upward trend. But catastrophe came in the form of the 2008 financial crisis. Price of oil was at \$147 around the time. But due to speculative pressures it fell to \$50 per barrel. Consequently the government experienced a shortfall in revenue and also in foreign exchange reserves. The stock markets crashed and panicked foreign investors withdrew their money from the economy. Inflation shot up to 15% from 6%.

Post the financial crisis, the economy had again stabilized. Capital markets are bullish and most indicators are fine.

Oil revenue still accounts 70% of government revenue and 90% of its exports. The recent fall in oil prices due to shale gas revolution, global slowdown have again clouded the troubled economy. Nigeria failed to take any lessons, from the first time, in diversifying its economy. Even the annual budget of the government is based on the oil price benchmark. It is 68 dollar per

barrel for 2015, IMF recently cut Nigeria's forecast from 7% to 5% for 2015. Their official currency, Naira, has been depreciating and is currently being traded at N208 for every dollar. It has depreciated by almost 16% since June and the government refuses to devalue the currency. Reserves are enough only for the next 6 months as a result. With oil revenue falling, foreign exchange earnings are likely to fall down too. Their current account surplus has been positive since 1970 but, excluding oil, the balance is mostly negative.

Nigeria exports 2 million barrels per day. Nigeria's oil was prized for its low sulphur content and unfortunately, oil discovered in America is also low in sulphur content. As a result price of oil with low sulphur content has fallen more. Nigeria has also lost its entire share of oil exports to the United States.

Election, between President Goodluck Jonathan and General Muhammed Buhari of the opposition APC scheduled for February 14th, are also preventing the government from raising interest rates or devaluing the currency. The dollar reserves, as a result, are dwindling fast. Nigeria is also dealing with its militant Islamist group Boko Haram - which has caused havoc in Africa's most populous country through a wave of bombings, assassinations and abductions - in an

attempt to overthrow the government and establish its rule. They have been dominating the northern region for the past 5 years and recently kidnapped 200 girls in Chibok region in the northern state of Borno, Nigeria's northern region is hence poorer than its southern region. While the southern regions house multi-nationals and a growing middle class, the northern is poverty stricken. Another major economic loss to Nigeria is that agriculture is mostly concentrated in the northern states. Due to the presence of Boko Haram, production is slowing down.

Conclusion

Nigeria's overdependence on oil export revenue is its Achilles heel. Nigeria's economy has been undulating along the fall and rise in oil prices. The economy needs to invest in sectors such as agriculture, which has already been the mainstay of the economy. 35% of the population is employed in agriculture while the sector has a potential to absorb more people. Nigeria has a huge infrastructure deficit and the oil revenues need to be directed to build better roads, highways, factories etc. The country should ease rules for foreign investment by bringing transparency, reducing red tapism and corruption. Nigeria has abundant natural resources known and unknown. The bureaucracy needs to optimize on its wealth.

Impact Evaluation of Spaghetti Bowl Effect on South Asia-East Asia Trade

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Abstract: Trade relations between South Asia and East Asia have seen an upward trend since the start of the millennium. Before 2000, there was only one trade agreement, the Bangkok Agreement, connecting South Asia and East Asia. As per the current data in 2014, the number of operational trade agreements linking the two sub regions has grown to 10. Economists have pointed out that due to their overlapping conditionalities, these proliferating trade agreements are causing trade diversion and thus leading to overall loss of benefit for the trading nations. This phenomenon is referred to as 'spaghetti bowl syndrome'. In order to study its impact, this paper

carries out an econometric analysis (by using gravity model) of the trade flow between a selected group of South Asian and East Asian countries. The results show that the increasing number of trade agreements is indeed negatively affecting the trade relations between South Asia and East Asia.

1. Introduction

As this paper is about the poor trade relations between South Asia and the rest of Asia, particularly East Asia, it is imperative that we briefly delve into the history of economic, political and cultural relations between the two sub-regions (East Asia and South Asia).