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Emerging Challenges Of Economic Recession In Nigeria: Is There A Way Out?

Gbatsoron Anjande & Simeon, T. Asom
Department of Economics
Benue State University, Makurdi

ABSTRACT

Economic recession is accompanied by a drop in the stock market, an increase in the rate of unemployment, stagnant wages, decline in gross domestic product (GDP) and high inflation. Nigeria like many developing countries is struggling with economic recession. The paper looks at the challenges of economic recession in Nigeria which has affected many aspects of the economy and examined the lessons the country has learnt so far. It suggests that Nigeria should carefully assess the country's exposure to economic instability in other countries so as to apply appropriate measures; policy options available to the country to resolve the predicament include fiscal and monetary policies

INTRODUCTION

Although there is no official definition of economic recession, we may say that economic recession is a period of general economic decline and is typically accompanied by a drop in the stock market, an increase in the rate of unemployment, stagnant wages, decline in gross domestic product (GDP) and high inflation. Economic recession leads to increases in the cost of food and fuel which brings millions of people back into poverty. Today Nigeria like many developing countries is facing recession. The challenges of recession are so fierce that there is fear that the challenges facing Nigeria now may lead to an economic crisis becoming a social and or even health crisis. The effects of the economic recession in Nigeria are increasingly evident: skyrocketing prices of goods and services without corresponding rise in earnings has led to increase in prices of basic food items, private financial flows are falling, foreign direct investment and remittances are dwindling; and exports from the country are down in terms of price and volume. The consequent effects of unemployment and decreasing revenues impact on household income, government spending and the capacity of the private sector to contribute meaningfully to the growth of the GDP thus causing the country's economy to nosedive.

Economic recession is not a new phenomenon. Through time, different parts of the world and even the entire world had been confronted with economic crisis that led to recession. In fact, the trade theory put forward by Joseph Schumpeter claims that the trade-cycle is made up of booms and recessions and is simply a by-product of economic progress. According to (Kindleberger and

Aliber(2005), some of the major recessions since the 20th century include: Shanghai rubber stock market crisis (1910), the great depression (1930), the oil crisis (1973), the Latin American debt crisis (1980), the black Monday (1987), United States savings and loan crisis (1989-91), black Wednesday (1992-93), Mexican Peso crisis (1994-95), Japanese banking crisis (1997), Asian financial crisis (1997-98), Russian financial crisis (1998) and the US financial crisis (2008-09).The latest of these economic crises (2008-2009)whichbegun in the United States andsoon through globalization spread to the whole western world has not yet bottomed out. It is the one that has dramatically caused the slowdown of the economies of the developing world today.US with an estimated GDP of $14 trillion contributes about 25% of world output and has the largest industrial complex, if it contracts by 1% this implies a direct output loss of approximately$14 billion which is equivalent to the GDP of Pakistan, the 47th largest economy in the world (Abdul, 2009).

Sanda (2009) explains that the factor behind the global financial crisis was the slump in the US mortgage industry.

In a globalized world, there is hardly any country that is immune from the shock waves of the global economic recession. Initially, owing to the fact that the level of integration of developing countries into the global economy is less, it was believed that their susceptibility is generally not very profound. However, Laishley (2009) quoted the Nigerian Minister of finance Mansur Muhktar who said "We thought we were safe from the impact of the crisis on the financial sector but, today, no country is safe." The global meltdown has impacted (and still impacting) on the economy of developing countries in several ways.

CHALLENGES OF ECONOMIC RECESSION IN DEVELOPING COUNTRIES

The deepening economic recession with its attendant problems of high inflation, growing unemployment and high volatility of commodity prices in the world market has severely affected Nigeria's economic growth. Today, Nigeria is groping with the challenges posed by the current recession. Some of these challenges include:

Collapse of Commodity Prices

For Nigeria like most developing countries primary products are the main export and revenue earners. The global economic downturn has caused a drastic decline in the prices of these commodities. For example, crudeoil prices dipped under $37.57 per barrel as at 20th February, 2009 from peak of $147 per barrel in 2008.This represents a significant shock for Nigeria as oil account for more than 80 per cent her export earnings. This has definitely led to cuts in government spending. Such cuts in government spending in the wake of the economic crisis are common among developing countries and they comprise some of the risks threatening the economy of developing countries. For a country like Nigeria, for instance, the US economy constitutes more than 20 per cent of the global domestic product (GDP) and consumes more than 20 per cent of the global oil supply with Nigeria as the leading supplier in Sub-Saharan Africa (Sasore, 2005). With the US not patronizing, there is considerable drop in demand for oil which is impacting negatively on prices and consequently Nigeria's revenues.

Setback on Government Programmes

As a greater percentage of the governments' revenue in developing countries is generated from the export of primary products, the sharp fall in their prices has continually forced the governments of these countries to revise their budgets several times. It is quite clear that the current recession has a negative effect on both short-term and long-term programmes of the governments in affected countries. The shortfall in revenues will also lead to abandonment, postponement or outright cancellation of large investment projects. This is already having a negative multiplier effect on: employment, on achieving vision 2020, and other programmes of the government in these countries. Also, revenue contraction could lead to a decline or inability to achieve infrastructural development which would in turn worsen the infrastructure finance gap; thereby making it difficult to actualize the various development goals.

Declining Economic Growth Failure to meet MDGs and other Internationally agreed Development Goals

The current economic recession has reduced the rate of economic growth in developing countries. Statistics show that GDP growth rate projection for Nigeria as at March 2008 was 5.30 % for the year 2008 and 3.30% for the year 2009 (Accenture, 2009) which were all below the required ratio. As of August, 2016 the Nigerian National Bureau of Statistics (NBS) had announced that the Nigerian economy had gone into recession. According to NBS the GDP growth rate for Nigeria slid from -0.36 per cent in the first quarter to -2.06 per cent year- on- year (Punch August 31, 2016).And based on latest estimates of economic outlook of Sub-Saharan Africa, the GDP growth rates at constant market prices was estimated at 5.7%, 2.8%, 6.7%, 3.5%, 3.9%, and 3.5% for 2010, 2011, 2012, 2013, 2014, and 2015 respectively(see African Statistical Year Book 2016).This slow growth rate would further darken the prospects of meeting internationally agreed targets like the MDG targets.

Declining Capital Inflow in the Economy

There is a sharp reduction in investment and confessional resources. The capital inflow include: Foreign Direct Investment and portfolio investments, inward remittances, bilateral and multilateral aid resources, amongst others. Certainly, with a projected decline in FDI, the hope of developing countries to raise huge sums of money through FDI to realize their developmental objectives may go unfulfilled. To worsen the situation, is the negative volatility of primary commodity prices, considering that most FDI inflows to these countries are directed to the primary sectors. Aid resources are often the soft target when developed countries face a major financial crisis. Also, inward remittances from citizens in Diaspora are bound to decline: this definitely has implications for Banks. The revenues that banks generate by way of commission on remittances will dwindle. It also has serious implications for the countries because remittances which used to be larger than revenues from most export commodities will become smaller coupled with declining earnings from exports.This will put pressure on the exchange rate consequently worsening the economic outlook for the developing world.

Capital Market Downturn

It has been discovered that these is apositive linkage between the capital market of anation and its economic growth as cited in the worksof Olaoye, (Olowookere and Osunubi, 2007; Kalu,2009; Nwachukwu, 2009).

Capital market has been affected by the current economic recession. From August, 2008, the value of the share trading on the capital market has speedily come down from about ₦13trillion to just a little over ₦ 4trillion. Worsening economic prospects and a far more cautious attitude by investors has led to the flight of capital from many countries. Foreign investors withdrew some $4 bn from the Nigerian capital market in 2008 (Laishley, 2009). Banks are the most affected since they hold about 65% of the value of the entire Nigerian stock market. Banks are desperately sourcing for money, having being affected in the stock market with an exposure estimated at ₦1 trillion. Also, capital market downturn might have second round effects on the balance sheet of banks by increasing provisioning for bad debt and decrease in profitability. The Nigerian capital market has been bearish since the inception of the current global financial crisis. Specifically, since April 2008, the capital market recorded downward trend in its major indicators.

According to CBN, total market capitalization fell, from N19,077.4billion in 2013, to N16,875.1billion in2014 and shows tendency to further decline in 2015. The market recorded a huge loss of about N3 trillion on August 22, 2008, which is larger than the total FGN Budget for 2008. It picked thereafter but the current recession has pushed it back from N19, 077.4 billion in 2013 to N16, 875.1 in 2014.

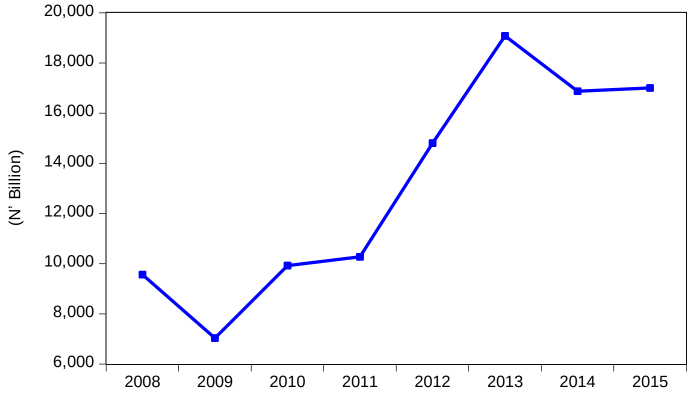

Figure 1: Total Annual Market Capitalisation in Nigeria

Source: CBN Statistical Bulletin 2014

Pressure on Exchange Rate

There is pressure on the exchange rate due to drastic fall in price of primary commodities since 2008. This has led to dwindling capital inflows, and decline in commercial bank lending, increasing importation, disinvestment by foreign investors, capital outflow, and appearance of speculators who believe that exchange rate may depreciate further amongst others. So, the pressure is two sided- supply side and the demand side as reflected in the above factors. Curbing demand pressure on exchange rate could push up rates and increase pressure to depreciate the currency to boost government revenue, exports and curtail speculative demand and dwindling external reserves. This in turn has reduced the use of reserves as intervention tool in exchange rate management. The value of the Naira has depreciated from 183.3 to 315.5 naira to the US dollar between January 2014 and October 2016.

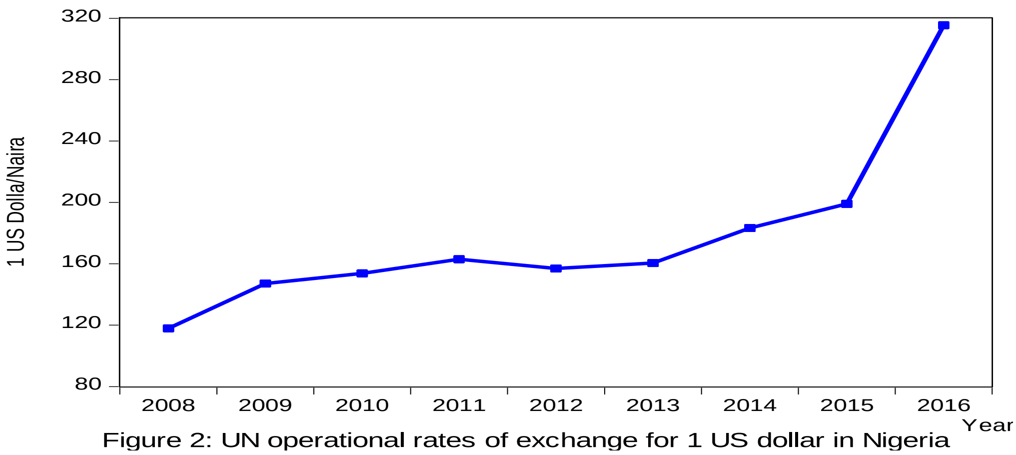

Figure 2: UN operational rates of exchange for 1 US dollar in Nigeria

Source: https://treasury.un.org/operationalrates/

De-accumulation of Foreign Reserves

According to Central bank of Nigeria (2009), Nigeria's foreign reserve has gone down from $53 billion in 2008 to about $47 billion in 2009. Several factors, including fall of oil price are responsible for it. It could deplete further if there is political pressures to spend the excess crude. The loss in valuation of Nigeria's reserves may result from counterparty risk, frequent and large intervention to smoothen volatility of the Naira increases drawdown and un-curtailed withdrawal by the fiscal authorities and servicing of foreign commitments. In addition there will be resultant effect of low accretion to the external reserves due to the fall in crude oil prices as well income generation and safety concerns on external reserves. The tendency of renewed external debt accumulation and the resultant effect of debt servicing on the external reserves is also not unlikely in this case.

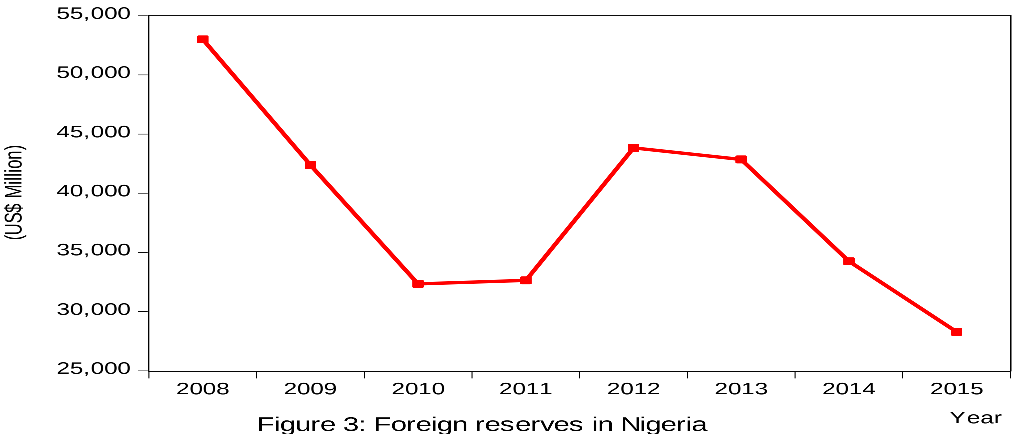

Figure 3: Foreign reserves in Nigeria

Source: CBN Statistical Bulletin 2014

Criteria for ECOWAS Common Currency:

The ECOWAS convergence criteria is the criteria used in assessing the degree of country performance in the implementation of the agreed policy measures under the ECOWAS Monetary Cooperation Programme (EMCP) to achieve a single monetary zone (Englama and Sanni, 2007). Nigeria might miss two out of the four ECOWAS convergence criteria for common currency. For instance, inflation is now at double digit as there was an upward swing of the year-on-year headline inflation from 14.0 per cent in January to 14.6 per cent in February 2009 (CBN, 2009)[1]. Relaxed monetary policies by the Central Bank may promote liquidity in the system which could fuel inflation especially in food and energy prices. Also imported inflation from abroad may result due to Nigeria's high import dependency

Also, GDP growth rate projection for Nigeria as at March 2008 was 5.30 % for the year 2008 and 3.30% for the year 2009 (Accenture, 2009) which were all below the required ratio

Difficulty in Credit Management

Credit management difficulties have surfaced as the recession bites harder since there is a slowdown in foreign credit line to domestic banks due to the vagaries of the economic recession. The implication of this is higher cost to the Central Banks if they engage in credit guarantee and reduced savings by the public. In addition, fiscal deficit and crowding out of private sector credit may result and the tendency of the financial sector hoarding cash if liquidity squeeze occurs (Mordi, 2009).

Loss of Investor Confidence

The declining fortunes of Nigeria capital market have made many investors to be risk-averse. There is reduced appetite for risk among investors. The implication of this is that many investors would be willing to invest their capital in financial products with reduced risk such as government bonds. On the other hand, some investors may decide to deposit their cash in banks that would enable Deposit Money Banks to carry out their intermediation roles more effectively.

Policy Issues and Lessons for Nigeria

Several actions have been taken to cope with the challenges posed by the economic recession. At the global level, the group of twenty most developed economies (G-20) met and decided to mobilize about one trillion US Dollars (US$1 trillion) towards revamping the global economy. Similarly, several countries implemented series of bailout packages, especially in USA and within the European Union to serve targeted corporate entities, mostly banks, from going under. So far, international efforts appear to be concentrated more on funds mobilization for corporate survival, and enhanced government ownership and/or control of hitherto purely private or privatized entities. There is also a clamour for increased regulatory oversight over corporate governance and policies. Some countries, such as United Kingdom have complemented these with some monetary policy measures. For example, interest rate in the United Kingdom now stands at about half of one percent (0.05%), akin to what happened in the USA in early 2002.

The response so far in developing countries seems slightly different from the global trend. For example, there is a strong feeling in several quarters that there is as yet no felt need for corporate bail-out packages by the government. The banking industry in many countries though weak, has not slipped into crisis yet. There is the belief that the problem with the capital markets is also different from what obtained in the developed countries. Therefore, truncating unethical business behavior and mopping up corporate governance lapses are preferred institutional approaches, towards bailing out affected corporate entities.

Some countries, like Nigeria have taken steps to ensure the soundness of the financial system. The Central Bank of Nigeria (CBN) further assured that the banks were strong enough and would not require any bail-out assistance from the government. This has helped in sustaining confidence in the nation's banking system. The CBN has also taken concrete steps towards improving liquidity within the banking system, as well as reducing the cost of loanable funds. To this end, it reduced the cash reserve requirement from 4% to 2%, while reducing liquidity ratio from 40% to 30% and recently to 25%. It also reduced the monetary policy rate initially from 10.25% to 9.75%, and then to 8%. These are in addition to new measures towards ensuring better utilization of foreign exchange resources, and restructuring the equity-related facilities, especially margin loans of banks, among others.

Without doubt, the international community has much to learn from this crisis. First of all, it has debunked the concept of best practices in national economic governance within the developed economies, which developing countries are often encouraged to adopt. Secondly, the economic downturn has shown the universality of regulatory failure, although to varying degrees, across different parts of the world. Thirdly, it shows the fallacy inherent in almost exclusive focus on financial derivatives, such as consumer credit, as the most important tool for propelling economic growth, rather than the core economic fundamentals. The value of any financial derivative cannot be higher than the value of its underlying primary instrument or economic activity, especially the real sector.

Fourthly, the crisis has exposed the dangers inherent in unguided and wholesale deregulation and/or liberalization of the national economy. It has shown that excessive market freedom focused only on market accumulation can breed devastating greed and economic collapse. It has therefore underscored the desirability of a strong national government that can take proactive steps in curbing the excesses of the market, and negative consequences of market failure.

Finally, the wild-fire nature of the spread of the impact of the meltdown highlights the erosion of the concept of risk diversification induced by the rapid spate of globalization. By this, the world economy as a whole, will either rise or fall, at the same time. Whereas, ideally, there should be differential performance, whereby the collapse of the economy in one part of the world should be compensated for by booms in other parts of the world. This should be the advantage inherent in the diversity of resources across different regions of the world, which is being neutralized by globalization, more so to the detriment of developing parts of the world.

The above imply the falsity inherent in the imposition of uniform procedures and policy frameworks, such as stereotype economic reform packages for all countries and regions of the world. Rather, beyond generally accepted good economic governance benchmarks, each nation should be free to design and implement its own national development programmes and policies. This home-grown felt need should form the basis for interaction with the international economic community.

ALTERNATIVES FOR NIGERIA

In many developing countries, discretionary fiscal policy has been used as a tool for mitigating the severity of economic slowdown. However, in some of the countries, institutional weakness, limited role of automatic stabilizers and limited access to financing for expansion can lead to mistimed or ineffectual fiscal measures. Thus, before initiating a fiscal response policy makers in Nigeria should:

a) Carefully assess the country's exposure to economic instability in other countries to avoid an unnecessary or excessive fiscal response. This can be done by evaluating the country's dependence on trade, foreign investment and remittances.
b) Monetary policy options should also be considered. Policy makers need to coordinate monetary and fiscal interventions. In Nigeria, the Central Bank's policy interest rates are still high and inflation is high, suggesting that there may be no room for traditional easing measures. This is because relaxing monetary policy entails risks, including downward pressure on exchange rates and the loss of anti-inflationary credibility.
c) Fiscal expansions need to be sustainably financed otherwise stimulus measures can backfire and lead to higher inflation, if fiscal deficits are monetized, or a debt crisis if there is extensive borrowing. Fiscal policy can only succeed in a country with a strong fiscal position and large reserve stocks.
d) Fiscal policy responses to the crisis should either be reversible or likely to yield long-term productivity gains. This is crucial to ensure that long-run fiscal and debt sustainability is not jeopardized by a countercyclical spending increase. Projects that act as automatic stabilizers are one way to achieve this. Another way of reducing the risk of unsustainable public debt accumulation is to increase spending in areas with reasonable expectations of long-term growth benefits.
e) Fiscal expansion must be timely but not rushed. To minimize the potential for waste and fraud, policy makers should not rush into new and untried public spending projects. They should first consider expanding existing and well-functioning programs and financing pre-appraised and "shovel ready" new projects.
f) Policy makers should understand that the success of a fiscal expansion depends greatly on how it is delivered. Nigeria with a large informal sector, tax cuts and social insurance transfers will not suffice as they will fail to reach many of the poorest households and firms thereby increasing inequality and social tension.It is pertinent to note that for Nigeria, expansionary fiscal policy has not been an effective tool for responding to economic downturns in the past. This, however, does not mean that fiscal policy can play no role in mitigating the effects of the current crisis. Instead, it implies that countercyclical fiscal measures should take into account the lessons from past experience to provide successful short-term relief without undermining long-term development.

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