EFFECTS OF GLOBAL FINANCIAL CRISES IN NIGERIA

IHE NDUBUISI
Department of Accountancy,
Imo State University
Owerri, Imo State
Nigeria

And

ILECHUKWU AMOBI DAMIAN
Department of Accountancy,
Imo State University
Owerr, Imo State
Nigeria

ABSTRACT

The global financial system has witnessed rapid growth and substantial structural changes in the past few years leading to globalization of financial market. This growth and integration has accentuated the rapid flow of capital across borders as well as magnified the contagious effects of financial crisis with wide implications. Consequently, this paper shall examine the concept of financial crisis, causes and impact of financial crisis, as well as bailout options. Ordinary least square method of analysis was adopted. Conclusions were drawn and recommendation proffered.

Introduction

In the last few months of the year, 2008, the world witnessed the worst global crisis in decades. The global financial system around which modern free market economy and capitalism is built is crashing like a pack of cards. Authorities, local and international are confused at the spate of the meltdown in major stocks. This phenomenon became inexplicable as no near solution is on the table. What remains unknown are its duration and severity for different nations. In Nigeria, it is difficult to state with any degree of accuracy and certainty the impending impact of the crisis on Nigeria (Monday vanguard, 20, Oct, 2008) as the financial crisis takes turns in nations for their impacts.

The present financial crisis which had its origin in East Asia was triggered by the devaluation of their currency (the Baht) in 1997, which prompted attack on East Asia currencies and stocks. Within the same period, the value of national currencies in the region experienced large deterioration ranging between 50 percent for Indonesia and 55 per cent for South Korea. In Indonesia, the crisis threatened the economy and eroded the gain in living standards accumulated over the last 30 years. According to Torbat (2008), the banking system was weakened considerably and there is fear that the country may default on its external debt obligations. Nigeria has recently devalued her currency as officials claim that it is an effort to respond to the global crisis which affected revenue due to the crash in oil prices and has instituted a standing economic crises management committee to checkmate the effect of the world global crisis on Nigerian nation.

CONCEPT OF GLOBAL FINACIAL CRISIS

Some people have explained global financial crisis in a number of ways. Some say it is a historical imperative that must take its full course before correcting itself. As put forward by Greespan (2008), the former head of the US reserve system; it is an event that occurs once in 100 years. Many others associate the financial crisis with law of jungle capitalism or casino capitalism that pervades the global financial system (Forsu and Magnus, 2006; Essien and Onwioduokit, 1999). This implies a system where capitalism no longer invests in means of production and job creation, but instead is attracted to invest in stocks and shares in totally unfiltered manner. Here, money is used to chase money artificially to a mass stupendous profit, line the pockets with billions of dollars without commensurate work or productivity. Onyekakeya (2008) classifies it as a high stake gambling. It could flourish for a long time during which time gamblers lose sight of a possible downturn. Thus, in the event of unpredicted crash like what we are currently witnessing, the recorded huge profit could be wiped out in one flash.

This form of capitalism is currently destroying the world economy. Whereas, the West has the capacity to absorb the shock, the developing countries such as Nigeria are particularly imperiled because of lack of solid productive base and widespread poverty. Many new investors entered the stock market with borrowed money. Stock prices rose steadily as inflated market demand outpaced increases in the value of real assets of these businesses as well as their profits. Investors eventually realize that a large imbalance existed between stock prices and real assets available to back them up, including profit and decided to sell. According to Mordi (2010), millions of investors lost their savings in the crash, and many found themselves deeply in debt because they could not repay the money they had borrowed to buy stocks. The present case poses a different dimension which involves bank-run and credit crunch, stock market crash and bubble, currency crisis, capital flight and sovereign default and economic recession and depression. Furthermore, the situation has caused the collapse of major credible and reliable investment in both the private and public sectors of the Nigerian economy and beyond.

CAUSES AND CONSEQUENCES OF FINANCIAL CRISIS

Strategic complementarily and self-fulfilling prophecy:

It is often observed that successful investment requires each investor in a financial market to guess what other investors will do. George Soros has called this need to guess the intension of others 'reflexivity'. Similarly, John Maynard Keynes compared financial market to a beauty contest game in which each participant tries to predict which model other participants will consider most beautiful.

TRANSMISSION CHANNEL OF THE GLOBAL FINANCIAL CRISES TO THE ECONOMY

The economy of Nigeria is one economy known to be driven by oil and gas. This accounts for the reason, why fiscal policies and measures are anchored on the budgetary estimates in the fiscal year. The oil and gas sector also accounts for about 60% of annual revenue, income and foreign exchange. The upswings in the oil prices increased our foreign exchange reserves to a high of US $60 billion in 2010 (Igbatayo 2011). The over reliance on oil for all budgetary plans is enough to cause a` leakage in the economy since agriculture was abandoned. The capital market which is a financial market for long term loans had attracted local and international investors in the past but with the upsurge in the global financial crises, capital flight was observed (Rachdi and Saidi, 2011).

IMPACT OF FINANCIAL CRISIS ON NIGERIAN ECONOMY

Economists are worried that Nigeria might be more seriously affected in the web of global crisis than officials do admit, Utomi (2008). But with the turn of events shown by the continued crash in the stock market prices, officials wake-up to acclaim the need to checkmate the impact of the impending global crisis and has responded in a number of ways which include lastly setting up an economic team to standby and monitor the impact and report where necessary. According to Ihe (2014), a number of factors on which the global financial crisis situation may have direct or indirect impact are as follows:

i) Increasing political –socio-environmental and religious crisis
ii) Foreign Portfolio investment withdrawals and withholding in order to service financial problems at home, as well as prospects of reduced foreign direct investment (FDI) are abound to affect investors' confidence and the economic health of Nigeria. This in particular is an area where public –private partnership (PPP) of big tickets items – power plants, rail, housing and roads are being encouraged.
iii) Weak link between the banking system and international financial markets
iv) The Sub-prime problem is forcing Nigerian investors who borrow from banks for investment in stock exchange to incur huge losses of money parallel to the concept of sub-prime mortgage problem abroad is the rife phenomenon of marginal borrowing/lending in Nigeria, whereby investors borrow money from banks to invest in other financial instruments (particularly IPO of other banks) with the hope of making profit all around.
v) Continued fiscal instability and decline in both prices and oil production with ethnic tensions in the Niger-Delta as well as in innovative energy resources (wind, solar, fuels) in developed countries, have continued to raise loss of confidence in Nigeria's economy.
vi) Lop-sidedness of the Buhari led government in infrastructural provision and marginalization of some sections of the country.
vii) The global financial crisis has also hit Nigeria in her product export essentially – Cocoa export. According to Oladujoye (2008), Global crisis has crippled business, almost everything is at standstill. Nigeria has the capacity to process about 100,000 tonnes of Cocoa per year, grinding roughly 25% of National output but currently, Nigeria's eight functional plants were operating at around 60% capacity due to poor infrastructure, high cost, multiple taxes coupled with economic meltdown which has cut the grinder's capacity to less than 20% since there are no demands for processed products in Europe and the domestic consumption has not helped matters to make for the bill in exports.
viii) Although government officials ab initio admitted that the global financial crisis shall not significantly impact on the nation but the spreading impacts have recently made the federal Government to proclaim naira devaluation to N174:$1. Soludo (2008) acknowledged the devaluation of naira to make –up for short fall in revenue resulting from oil price crash as such declining oil price could put pressure on the foreign reserve

and exchange rate and by extension on the financial sector. The mix of weakening oil prices, weakening fiscal balance and trade balance is not good for the economy, especially because of the inherent weakness in the economy. So the moment oil prices start falling, it is natural to use the significant accumulated foreign reserves to stabilize the naira. But this is not the case; the government rather opted to devalue the naira.

ix) Infrastructural development: the global financial crisis has affected Nigeria in a number of ways – it has limited the quantum of government spending on infrastructure in 2009. With the meltdown, oil prices continue to fall thereby denying the expected revenue to the government and forcing it to cut spending on development projects. The only way to cushion the effect is for heavy taxation on the citizenry.

x) In 2008, before the impact on the global financial options, the nation started to notice food crisis especially in staple food price. This forced the Federal government bailout-plan to ease the problem by doling out over 40 billion. This is further bailed out by various state governments which supported the programme. The consequences is that before Dec. 2008, prices of this food items came down as low as N7, 500 as against N13,000 when the year started.

BAILOUT OPTIONS TO FINANCIAL CRISIS

Onafowoka (2008) observes that the financial crisis ravaging the global economy is naturally a serious cause for concern to investors and that the situation calls for calm, calculated and proactive response by the economic managers of the countries. The developing economies are the worst hit. By trying to model their economies along the path of Casino capitalism, without solid productive base which the big economies already had, the developing economy would risk being thrown asunder if the current situation persists (Utomi, 2018). For instance, without first creating a solid productive base whereby the citizenry could afford to live above the poverty line, many countries in the developing world have toed the part of the West in privatizing state enterprises, deregulating their currencies to float against the dollar and apply other painful measures to cut down debts (like subsidy removal) on essential services (Ajibade, 2008). When policies that were thought would turn around the economies failed, these countries would face worst conditions and the result is mass poverty.

Around the world, measures were applied to mitigate the impact of the meltdown. Example, US Government assigned $700 billion bailout funds to boost the economy that contracted 0.3 percent annualized rate in the 3 quarters as consumer spending declined at fastest rate in 28 years (Adewale, 2008). The bank of Japan released $ 25 billion to maintain liquidity of Japan's financial market. The bank of England on its own offered its market members 20 billion pounds out of a demand of 60 billion. In the same vein, Russian Federation injected 350 billion rubles to maintain liquidity in the Russian market. While all these measures fail to provide the needed solutions as stocks dipped, authorities and analysts in different countries thought of what next to do deal with the baffling situation.

With the global financial meltdown, and subsequent drop in crude oil prices, economy operators in Nigeria, said the crisis could shortly affect the government's spending and project execution. The issue portends grave consequences for the country, since she largely depends on oil for sustenance. Also the Federal Government relies on oil benchmark to fix its budgets. However, according to Ajibabe (2008), the challenges could be overcome through prudent fiscal policies.

METHODOLOGY

In this study, ordinary least square method of analysis was adopted. This is because OLS) is a widely used statistical technique to study trends and investigate relationship among variables and as such extensively in regression analysis and estimation. Ordinary least square method is specified by an equation with certain parameters to be referred to as observed data. Such data could be used for financial analysis or forecasting price trend which will also eliminate human bias. Therefore, the importance of its application is in data fitting.

Furthermore, the best fit in least square minimizes the sum of the squared residuals. Such residual is the difference between the observed value and the fitted value provided by the model. Since the model shall contain x parameters, there will also be y gradient equation, which will recognize the minimum of the sum of squares found by setting the gradient to zero. The gradient equations apply to all least square problems. Therefore, a regression model is linear when the model is comprised of linear combination of parameters.

MODEL SPECIFICATION

Consists of data pairs (X_1 Y_1) = 1…..n
X_1 is the independent variable
$Y_1$is the dependent variable

These values are obtained by observations. The model function will take the form of f(X_1 B).

It is important to mention that when using OLS, a number of assumptions are made, which are stated as follows:

i. The error term has constant variance. This could be true if the observation of the error term is drawn from identical distributions.
ii. Under certain conditions, the OLS estimator has a normal asymptotic distribution when properly normalized and centered. Generally, the larger sample size is, the more combinations of values of X and Y that we have observed, the more accurately we can describe the relationship between X and Y.

ANALYSIS AND RESULT

The equation for the regression model is given below as:

$$Y = a + b + E$$

Where

X = Independent variable (Total expenditure)
Y = Dependent variable (Economic growth)
a = The intercept
b = Partial regression coefficient
e = Error term

Table 1: Regression Output

Variable	Coefficient	Standard Error	T. statistics	Prob.
TTLXP	8.328623	0.275067	30.25833	0.0000
C	-978628.8		-1.874429	0.0756
R-squared	0.978623	Mean dependent var		10298509
Adjusted R-squared	0.977554	S.D-Dependent var		11446513
S.E of regression	1714927	Akaike info Criterion		31.63415
Sam squared resid	5.88E+13	Schwarz criterion		31. 73333
Log likelihood	-345.9756	f-statistic		915.5665
Durbin – Watson sat	1.320575	Prob (F-statistice)		0.000000

Source: E-view version 7.0

Interpretation From the analysis above;

a= 978628.7614; b = 8.32066788

Therefore, the linear regression equation obtained from the data is:

Economic Growth = 8.32066788 TTLXP – 978628.7614. Thus, the predicted values can be obtained when the value are substituted for total expenditure for the period under study and within the data range of economic growth of which GDP at current basic was applied in this study as proxy for economic growth.

The test result above indicates that there is a strong positive linear relationship between the dependent variable total expenditure, since R = 0.989253546 which is close to 1. Coefficient of determination R^2 is 0.97862278 indicates that 97.9 of the variance in the dependent variable y can be obtained by variations in the independent variable. This indicates that the model is a good fit.

In testing for significance of R = 0.98925346 from the F distribution table, the critical value obtained at a = 0.05 d.f.N. = 1, d. f. d = 20 is 4.35. Since F.cal is 915.56665157 is greater than the value 4.35 while the P. value = 0.000 which is less than the level of significance, a = 0.05, we therefore reject the null hypothesis which states that there is no significant relationship between total expenditure and economic growth and summarize as follows: there is a significant relationship between the independent variable and the dependent variable.

Conclusion

Global financial systems have witnessed rapid growth and substantial structural changes leading to globalization of financial markets. No wonder the effects of the financial crisis badly affected every facet of activities in both developed and developing nations. Nigeria has started to have her bouts of the problem with government setting up economic team to address the problem whenever the need arises. What cannot be easily assessed is the dimension it will reach and to estimate it with every level of accuracy and uncertainty.

Recommendations

1. With the fear of financial crisis, what is important now for Nigeria to do is significant financial restructuring on the local economy. With these leverages in play, economic planners and politicians must sit down and formulate a comprehensive plan to protect our long term economic development goal.

2. Urgent measures need to be put in place to prevent the backlash of global credit crunch. According to Ajibade (2008), the government is soliciting support from various stakeholders – CBN, SEC, NCE, BANKS and the ministry of finance to work to reduce the impact of the crisis.
3. The government should encourage Foreign Portfolio Investment by ensuring that there is public Private Partnership (PPP) where the foreign investors are encouraged through a partnership to invest in major sectors of the economy - rail, power, road and housing. These of course, will stimulate the economy and make it more vibrant and consequently, increase the living standards of the citizenry.
4. There is need to deepen the economy by reinvigorating the real sector of the economy as well as revitalizing the service sector.

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