An SBm Intel Report

ENERGY REVOLUTION AND ECONOMIC DISRUPTION

ABOUT
SBM Intel

Founded in 2012, SBM INTELLIGENCE, an arm of SB Morgen, is an organisation devoted to the collection and analysis of information.

We offer comprehensive analysis for, and support to governments, businesses and NGOs. SBM Intelligence runs a Nigeria-wide network of contacts and associates.

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Commodities and the trade therein have had a great impact on geopolitics throughout history, and energy (and petroleum in particular) has been at the core of numerous conflicts. As nations move away from one source of energy to another, the potential for disruption to economies cannot be overstated, especially for nations who are dependent on the supply of energy sources as their main means of earning money. In this regard, the fast approaching energy revolution in Europe and Asia has the potential to completely upend economies from Africa to the Middle East and beyond unless their governments take urgent steps to diversify their economic bases away from petroleum.

When European traders first began interacting with West Africans, the commodity of interest was slaves for use in plantations in the New World (essentially, human energy). Several slave empires, the Oyo Empire, Dahomey and the Aro Confederacy rose to prominence in West Africa as a result. However, the Indus trial Revolution, coupled with the rise of the Abolitionist Movement led to a rapid decline in the slave trade. Slavery was abolished by the British and the Royal Navy was tasked with patrolling the Atlantic and the seizure of slave-carrying vessels bound for the last remaining major slave market: the United States of America, where the agrarian south remained dependent on slave labour as the pri mary driver of production, while the north more rapidly industrialised and moved to coal as the primary source of energy.

This would eventually lead to the American Civil War as the south, lacking the industrial might of the north, and spurred on by the slave-owning elite who were unable or unwilling to innovate, fought to keep the institution of slavery alive even as the world rapidly changed around it. The south lost the war and slavery was abolished in the United States. With this, the Transatlantic Slave Trade was finally finished.

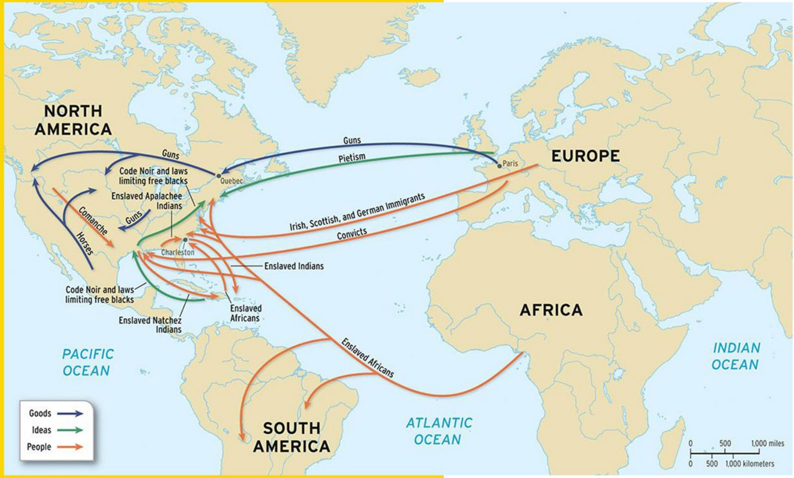


Figure: For centuries, slaves was the main commodity exported from Africa. Image – Oxford University Press

The complete disappearance of their commodities market had huge economic repercussions for the slave-trading kingdoms. Oyo suffered a fiscal crisis, and some of its subjects began to rebel. By 1835, key parts of Oyo had fallen to the Fulani Empire established by Usman Dan Fodio – and much of the rest of the 19th century was spent on infighting, leaving the once mighty empire greatly weakened.

However, it was coal, and not petroleum, that drove the Industrial Revolution. The leading industrial powers in the 19th century had an abundance of coal, so there was little need to fight for access to coal resources and until oil palm assumed critical importance in industry, the power structures in this part of the world were largely left alone. Early industrialists in Manchester, Liverpool, Newcastle and other booming factory towns in Britain discovered that palm kernel oil was a great machine lubricant and feedstock for soap manufacturing. British traders were initially content with sourcing palm products from local traders in the Niger Delta, and this facilitated the rise of powerful trading houses in the Niger Delta (Jaja of Opobo led one of those houses). When the Benin Empire, weakened by the loss of income from the collapse of the slave trade, tried to assert its sovereignty over the oil palm trade, the British discovered that they were no longer content with merely buying palm oil, but desired to control its source. They made the Niger Delta a protectorate of the British Crown which led to the invasion and sacking of the Benin Empire, which would eventually be absorbed into the British Colony known as Nigeria.

By the end of the 19th century, it had become clear that crude oil would displace coal as the key energy resource of the 20th Century, and by 1910, the Royal Navy switched its main power source from coal to petroleum to power its ships, and by the beginning of the Second World War, all combat operations were driven by the supply of petroleum.

British geologists soon established that large crude oil deposits were likely to be found in the Middle East. This knowledge largely drove British policy in the Middle East, and guided British actions during the drafting of the Sykes-Picot Agreement.

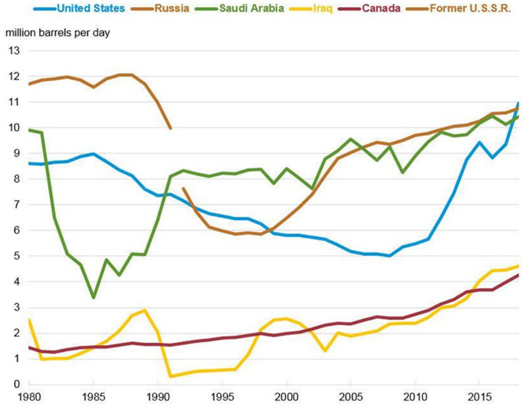
During the inter-war years, the Americans realised that they also had to get involved in the Middle East or cede the strategic advantage to the British, or worse, the Soviets. The Soviets had been the first to recognise Abdulaziz Ibn Saud as King of the Hijaz and the Sultan of Nejd in February 1926, and were well on their way to becoming an important strategic partner of the House of Al Saud until Stalin executed his Middle East Envoy, Karim Khamimov in 1938. The execution outraged King Abdulaziz who considered Khamimov a personal friend, and he subsequently rejected all future Soviet envoys to his Kingdom. This break in relations was fully exploited by the US, and in 1945, on his way back home from the Yalta Conference, Franklin Roosevelt met with Ibn Saud and initiated a strategic relationship between the US and Saudi Arabia.

Crude oil rapidly became crucial to industrial activity throughout the world, and a major driver of global economic activity. Nations with significant petroleum deposits sought control over the resource, leading to conflicts with multinational oil companies, many of whom had been granted rights to petroleum in the colonial-era. In 1953, one of these conflicts prompted a US-organised coup d'etat which ousted Mohammad Mosaddegh, the Prime Minister of Iran, and his replacement with the Western-friendly Shah, an act which still colours relations between Iran and the US today.

To take control of the price of their commodity, the nations in which the petroleum was found created OPEC, and began to flex their economic muscle. In response to wars with the newly created state of Israel, Arab members of OPEC imposed an oil embargo on the United States which led to long queues for petrol in the United States. Speed limits were introduced as a means of economising petrol consumption.

The embargo would lead the US to seek out alternative suppliers of crude oil, and this led to elevated interest in Nigeria, which quickly became one of the top suppliers of crude oil to the US. Nigeria's strategic importance to the US economy was such that the Pentagon even explored the possibility of seizing the Niger Delta and its crude oil and gas resources in the event of a severe supply disruption. The embargo also led US policymakers to begin looking at means to reduce US dependence on foreign oil and a greater focus on domestic crude oil deposits.

By the start of the 1980s, a combination of a drive towards energy efficiency, new discoveries in regions like the North Sea and the winding down of the post-Civil War economic boom here resulted in a commodities bust and a fiscal crisis that tipped Nigeria's economy into recession. What followed was almost two decades of low crude oil prices, till an agreement was reached in the late 1990s between OPEC and other key producers like Norway and Russia to cut production.



Top 5 oil producing countries, 1980 to 2018. Nigeria never featured. Image source – EIA

About the same time, researchers working for American billionaire George Mitchell were perfecting fracking, a technique of extracting crude oil and natural gas from the impervious rock layer (shale) in petroleum formations. By the late 2000s, it became clear that shale was a major challenge to OPEC, so OPEC responded by flooding the market to drive shale producers off the market. This ultimately failed, as shale producers innovated out of this problem and OPEC's "fragile five" (Angola, Iran, Libya, Nigeria and Venezuela) could no longer absorb the pain of low oil prices.

The Shale Revolution does not only have an economic impact; it also has a geopolitical impact. The Middle East and Nigeria used to be critical to America's energy security. They no longer are. 15 years ago, the US used to be the top destination for Nigeria's crude oil exports, today they barely buy anything from Nigeria, and India has replaced the US as Nigeria's top energy importer.

There is more trouble down the line. Because of a combination of shale oil and drilling friendly policies by the Trump White House, the US has displaced Saudi Arabia as the world's largest oil producer, and now accounts for 19% of global output. America's current daily output of 15 million barrels per day is just 7 million shy of the combined output of Saudi Arabia and Russia, which are second and third respectively, and by 2025, the IEA estimates that US crude oil production will almost equal Saudi and Russian production combined. In simpler language, the Americans will totally dominate the crude oil market. Added to that, there has been a flurry over conventional crude oil discoveries in places like South Africa, Guyana, Ghana and Mozambique. Guyana will move from producing zero barrels of crude/day today to 750,000 barrels of crude/day by 2025.

Another potentially massive Shale Oil play, the "Vica Muerta" in Argentina is likely to be developed in the next decade.

IMPLICATIONS FOR NIGERIA

To understand the implications for Nigeria, we need to understand how our relationships with key economic partners like US, China, Europe and India will change.

As the US has most of the other commodities Nigeria produces and Nigerians cannot afford most American produced goods, there won't be much basis for significant economic ties between the United States of America and Nigeria. American multinational oil and gas companies will continue to operate in Nigeria, but their presence here will not be considered as strategic as it was in the past.

The result will be that counterterrorism, international development and geopolitical competition with China will subsequently drive US – Nigeria relations. However, the Trump Administration's interest in counterterrorism is waning, as the focus of Western populists is no longer terrorism, but migration, and migr tion from Africa is largely seen as Europe's problem, not America's.

International development is definitely not the focus of the Trump Administration, but competition with China is. It is difficult to determine how far the US is prepared to go in its competition with China, in what arenas it plans to compete, or how much it is willing to invest. Given President Trump's strident "America First" rhetoric, and distaste for foreign aid programmes, it is unlikely that the US will see Nigeria as an important destination for the few dollars this administration deigns to dole out

European engagement with Nigeria is likelier to be more focused on a single issue; migration, than economics. Recent visits from top European diplomats and heads of state to the African continent have focused on the goal of discouraging migrants. As the US makes the transition from net crude oil importer to exporter, Europe is working hard to adopt alternative energy vehicles. Europe is also in a state of flux, with enough problems like Brexit, the rise of right wing nationalism, and a potential Eurozone crisis induced by a stagnant economy, to keep it occupied for at least a decade.

India and China are now two of Nigeria's most important and dynamic trading partners. India for exports and China for imports, and there is sufficient room for growth in these relationships.

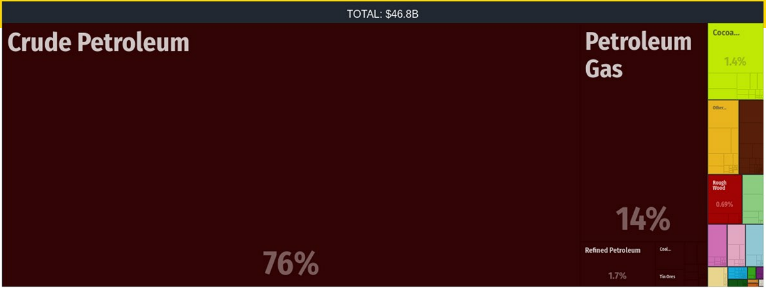


Figure: Nigerian exports 2017. Image source: Observatory of Economic Complexity

In a competitive energy market, Nigeria cannot merely afford to sell its petroleum, and leave it at that. Other players like the Saudis are working hard to lock themselves in the Indian market, and while the visit of Saudi Arabia's crown prince, Muhammad bin Salman to India in February this year was of critical importance, Nigeria did not seem to notice, and appears to lack a strategy to take advantage of vulnerabilities in the Gulf to sell itself to an Asia that is heavily dependent on Gulf petroleum supplies.

Climate change concerns are also poised to severely disrupt the petroleum-based economies of the world as activists push for more focus on renewable energy sources. The Green Party in Germany recently secured major electoral victories based on its campaign as the party of responsible climate stewardship.

Climate change is an issue that dominates amongst millennials, and these are the people rising in economic prominence. European and American automakers are now investing heavily in the development of mass-produced electric cars. China, driven by air pollution concerns, is also making large investments in renewable energy.

Nigeria's elite has grown rich on trade in a single commodity, but despite oft-stated rhetoric on diversification, the federal government of Nigeria remains hopelessly addicted to crude oil revenues, and rather than innovate or truly revolutionise its economic base, the political elite only seems capable of focusing on areas in which some small amounts are already demonstrably available and then increasing taxes in those areas. It would be safe to say therefore, that Nigeria's political elite is quite incapable of adjusting to a major disruption in the market for crude oil such as a sudden breakthrough in renewable energy production. What this means is that Nige ria has a fiscal crisis and an internal political architecture that is not optimised to generate enough revenue to make up for the shortfall in exports of that sole commodity.

Indeed, the collapse in crude oil prices spurred by shale oil drove the country into a sudden recession, and led to a massive spike in borrowing. The debt profile of Nigeria has doubled in the past four years and there is no apparent end in sight. Meanwhile, there are no major infrastructure or economic investments to show for all the borrowed sums, meaning the debts will be that much harder to repay.

We saw earlier that the switch in emphasis from human- to machine-based means of production disrupted economies based on the supply of the humans, and unable to innovate around the problem, those empires eventually fell. However, while the slave trade lasted for hundreds of years, the petroleum economy has only truly been around for the last 60 or so. Crude oil has always been a finite resource, and even absent the environmental and climate concerns driving the current push away from petroleum, all oil-producing countries would have eventually run out of oil and been forced to find new ways to survive. Some nations will survive the post-oil economy in much better shape than others, and as things currently stand, Nigeria cannot count itself in the former category.