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THE EFFECTS OF COVID-19 ON OIL-PRODUCING ECONOMIES: A CONSIDERATION OF NIGERIAN AND SAUDI ARABIAN VAT INCREASES

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ABSTRACT. The COVID-19 pandemic is a multi-faceted crisis with global impact. Its impact on many economies, including those dependant on oil producing and exporting, may compel such governments to make far-reaching policy decisions. In this context, we briefly consider the economic considerations on two major global oil producers, Nigeria and Saudi Arabia, as they also struggle to come to grips with their own broader economic reforms – announced before and during the pandemic. Specifically, under consideration is the increase in both countries' VAT rates at (perhaps) inopportune times. We argue that the burden of the VAT increase on businesses fighting for survival amidst outfall of the COVID-19 crisis will be counter-productive in attaining economic reform objectives.

Key terms: COVID-19 economic impact, oil dependence, Nigeria, Saudi Arabia, value added tax

JEL Classification Codes: G01, H21, H61

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Introduction

Labelled as a black swan event and likened to the economic scene of World War II, the 2020 COVID-19 pandemic has had a detrimental effect on global healthcare systems with a ripple effect on many aspects of society (Nicola et al. 2020). The SARS-Cov-2 virus was initially identified in the Chinese city of Wuhan (in the Hubei province) during December 2019 and spread rapidly across the world (McKibbin & Fernando 2020). On 30 January 2020, the World Health Organization (WHO) declared COVID-19 a public health emergency of international concern and six weeks later the outbreak was classified as a pandemic (Yezli & Khan 2020). Policy-makers in many countries were under pressure to respond to the coronavirus outbreak. As a result, many governments made quick policy decisions that had far-reaching effects on their respective economies, with many countries plunged into a recession (Ozili & Arun 2020). The resultant economic impact thereof is being felt across multiple sectors and countries (Fernandes 2020), with oil-dependent countries also severely impacted by a resultant significant drop in the oil price (Baldwin & Weder di Mauro 2020; Smith 2020). Two such oil-dependent countries are Nigeria and the Kingdom of Saudi Arabia (hereafter Saudi Arabia).

Nigeria, a country located on the vulnerable African continent, recorded its first COVID-19 case on the 27th February 2020 (Farayibi & Asongu 2020). Prior to the COVID-19 pandemic, Nigeria was already facing a significant shrinkage of its fiscal space as the government relies disproportionately on the oil sector for its revenue (Ejiogu, et al. 2020), with oil and gas revenue accounting for more than 60% of the country's gross domestic product (GDP) growth (Idris & Oruonye 2020). Similar to many resource-dependent countries, Nigeria faced the brunt of the fluctuations in the price of crude oil – which accounts for about 70% of its GDP and 65% of total government revenue (Farayibi & Asongu 2020).

Findings revealed that the pandemic had a twin shock effect on the Nigerian oil-dependent economy, namely global and domestic economic shocks as well as subsequent oil price shocks – affecting the economy through the supply, demand and financial channels (Farayibi & Asongu 2020). Furthermore, Nigeria is projected to account for 30% of the world's poor by 2030 without taking the impact of COVID-19 into account (Ejiogu et al. 2020). In response to COVID-19, the Nigerian government introduced an amendment to the 2020 budget in May 2020 aimed at re-prioritizing expenditure to ensure that funds are directed to areas in most need. Although the value added tax (VAT) rate in Nigeria is 7.5% (raised from 5% on February 2020), the COVID-19 Intervention Fund represents 4.7% of total expenditure in the amended budget which provided a 'modest' stimulus to the economy (Ejiogu et al. 2020).

Saudi Arabia is a country located in the Middle East and is also considered an oil-reliant economy (Nurunnabi 2017; Faudot 2019; Moshashai et al. 2020). Oil contributes more than 90% of its export earnings and 42% of its GDP (Violi 2017). With the aim of diversifying the economy, Deputy Crown Prince Mohammed bin Salman Al Saud announced a reform plan (Saudi Vision 2030) together with a detailed National Transformation Plan (NTP) during April 2016 (Thompson 2017; Saudi Vision 2030 2018; Faudot 2019). The aim hereof is the creation of high value-added industries, specifically in the context of a robust private sector, to counter Saudi Arabia's economic dependence on oil (Faudot 2019; Rostan & Rostan 2020). The first case of COVID-19 was reported in Saudi Arabia on March 2nd, 2020 (Algaissi et al. 2020; Yezli & Khan 2020), resulting in a number of extreme restrictions on social and religious gatherings, social movement, businesses and travel in an attempt to curb the spread of the virus (Algaissi et al. 2020). Notwithstanding, according to Rostan & Rostan (2020), the COVID-19 pandemic has 'brutally hurt' Saudi Arabia's economy due to the collapse in the global oil demand, combined with an oversupply of the commodity. Saudi Arabia announced a slew of austerity measures to cope with the fiscal impact of the pandemic and oil price collapse (AMEinfo 2020; Gulf Business 2020), including a significant raising of the VAT rate.

The advent of COVID-19 has arguably caused the biggest demand shock for crude oil in its history – below USD 30 per barrel – as of a considerable decline in the transportation activities due to travel restrictions and lockdown, measures have adversely decreased the oil demand. Hence oil-exporting nations such as Nigeria and Saudi Arabia recorded huge losses (Ejiogu et al. 2020). As such, oil revenue and aggregate output growth rate in those countries are expected to shrink in the fiscal year 2020 due to oil slump (Idris & Oruonye 2020).

Research note objective and layout

In this research note, we reflect on the effect of COVID-19 on the Nigerian and Saudi Arabian economies, both being major oil producers that are to a large extent oil-dependent economies, considering the economic reforms announced before and amidst the pandemic. The rest of the paper is structured as follows: the next section discusses the oil price shock followed by economic situation pre and during COVD-19 in Nigeria and Saudi Arabia, in the end a concluding discussion.

Oil price shock

Early in 2020, the oil price fell due to the price war between Russia and Saudi Arabia (Ozili & Arun 2020). During a meeting of the Organisation of Petroleum Exporting Countries (OPEC) in Vienna on 6 March 2020, a refusal by Russia to reduce its oil production triggered Saudi Arabia to retaliate with extraordinary discounts to buyers and a threat to pump more crude (Nicola et al. 2020), resulting in Saudi Arabia increasing its March 2020 oil provisions by 25% over February 2020, and taking its oil production to unprecedented levels, causing the steepest one-day price crash seen in nearly 30 years. On March 23rd, 2020, the price of Brent crude oil dropped by 24% from $34 per barrel to $25.70 per barrel, negatively affecting most other oil dependant economies (Nicola et al. 2020) (see Figure 1). When Saudi Arabia later supplied excess oil to the world, the market was flooded with too much oil, exceeding demand during the COVID-19 pandemic, and subsequently keeping the oil price very low (Ozili & Arun 2020). The oil prices will likely remain under pressure as long as OPEC and Russia are locked in a price war, which may cause prices to rise at a (less than ideal) pace in the future, and lower oil demand and stalling potential investments. All these will have lasting economic consequences for commodity exporters.

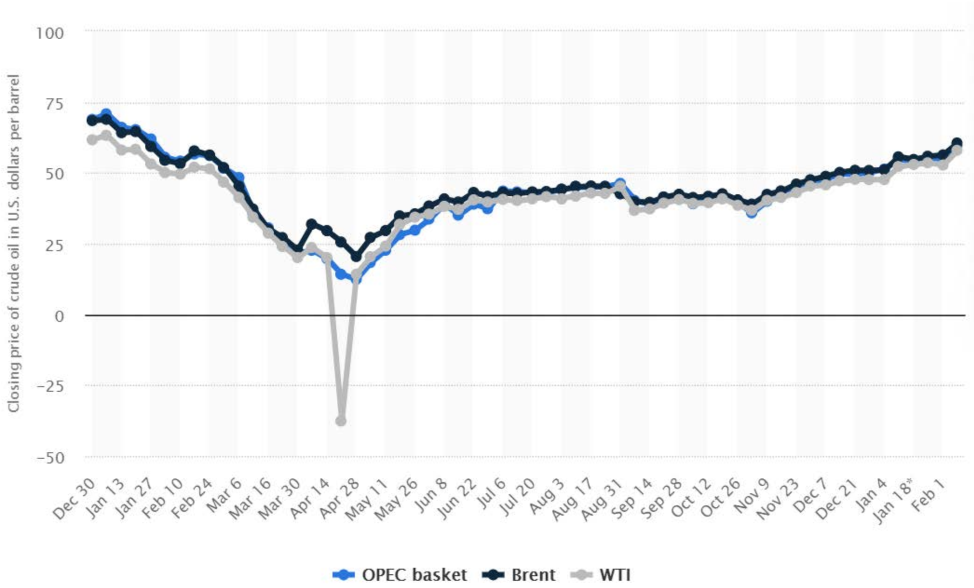

Figure 1. Crude oil price trends (USD per barrel)
Source (Statista)

The COVID-19 pandemic worsened the situation through the reduction in the demand for oil (Ozili & Arun 2020). As illustrated above, the oil price has plummeted since the start of the pandemic in January 2020 and intensified across most of Europe and North America. Additionally, the COVID-19 pandemic meant slower manufacturing and less travel, which contributed to lower oil prices. This is further demonstrated by the absence of an agreement between Saudi Arabia and Russia, who have different budgetary needs, fiscal deficits and market outlooks. While Saudi Arabia hopes to keep oil prices high, Russia is seeking a larger share of global oil markets, hence the price war (Kingsly & Henri 2020).

Although a worldwide slowdown in COVID-19 related illnesses and deaths have caused some stabilisation of oil prices, there is still much uncertainty (Nicola et al*.* 2020). The good news, however, is that a recovery in manufacturing activity should increase demand for oil over the medium term (Kingsly & Henri 2020).

Nigerian economic considerations

Prior to the COVID-19 pandemic, Nigeria was already facing significant shrinkage of its fiscal space (Ejiogu et al. 2020). Like many resource-dependent developing countries, Nigeria has faced the brunt of the fluctuations in the price of crude oil (Farayibi & Asongu 2020). In addition to the fact that Nigeria depends so much on foreign sources of financing of its current deficits (Idris & Oruonye 2020).

During the pandemic, Nigeria was severely affected because of it being an *import-dependent* economy – primarily from China. Since much local and international travels were suspended, sustained reduction in the demand for automotive and aviation fuel was experienced (Ozili & Arun 2020). This pandemic proved as a critical economic shock for Nigerians on all macroeconomic indicators as it introduced a barrier between the market forces and stakeholders – possibly resulting in an extended financial crisis for the country (Idris & Oruonye 2020).

Ozili and Arun (2020) summarises (on going) economic effects witnessed during COVID-19 on Nigeria as:

- The pandemic affected borrowers' capacity to service loans, which subsequently affected Nigerian banks.
- Oil demand shocks which was reflected in the sharp decline in oil price.
- Supply chain shocks as many Nigerian importers shut down their factories and closed their borders particularly to China.
- Stock market plunged when investors pulled out their investments – market investors lost over NGN2.3 trillion (US$5.9bn).

Saudi Arabian economic considerations

Saudi Arabia is considered the world's most 'oil-rich' country, owning about 16% of the global proven petroleum reserves, and is the largest exporter of petroleum (Nurunnabi 2017). The country is also a key role player in the OPEC (Stenslie 2018). Low oil prices between 2014 and 2017 have negatively affected the country's economy (Rostan & Rostan 2020), with government debt increasing from 1.6% of GDP in 2014 to an estimated 22.8% of GDP in 2019 (SAMA, 2020). Although its deficit dropped below $500 billion in 2017, it rose again to over $500 billion in July 2018 (Faudot 2019; Moshashai et al. 2020). In an effort to address the budget deficit, economic reforms were announced with the unveiling of the *Saudi Vision 2030* reform plan, supplemented by the NTP (Moshashai et al. 2020; Rostan & Rostan 2020). This economic blueprint aimed to diversify the state's oil-dependent revenue base and decrease the budget shortage. The country, however, is facing challenges to implement these reforms, especially in its efforts to diversify the economy away from oil income and promoting a robust private sector (Moshashai et al. 2020). In an effort to boost the state coffers, in 2018 the Saudi Arabian government introduced a 5% VAT which the International Monetary Fund (IMF) estimate would increase governmental revenues with about 1.5% of the GDP (Moshashai et al. 2020).

In the midst of the pandemic, Saudi Arabia's revenues fell by 45% in the second quarter of 2020, while total revenues recorded a decline of 49% and a staggering $29 billion budget deficit was recorded for the second quarter of 2020 (Barbuscia 2020). According to the Saudi Press Agency (2020), this caused the Saudi Finance Ministry to announce several interventions as a result of the COVID-19 pandemic, to counter three major economic shocks that have significantly affected state revenues and expenses, causing the government to intervene. These shocks are:

- The decline in the demand for oil and the consequent steep decline in governmental oil revenues;
- the reduction or suspension of economic activities due to precautionary measures taken to protect citizens against the spread of the pandemic; and
- the cost of governmental interventions of healthcare measures in prevention, or treatment, of Saudi citizens and residents.

Taxes as a way to counter COVID-19 effects

From the above it is obvious that the COVID-19 pandemic had substantial impact on key global oil producers. The question is how such impacts will be handled. In consideration of the above-mentioned, Rostan & Rostan (2020) is of the opinion that in addition to the direct impact of the COVID-19 pandemic on the economy, the governments' response thereto will result in a secondary impact on such economies. Tax is considered an important tool for countries to achieve their set objectives, and efficient tax systems are important for policy-makers (Alhussain 2020). VAT is classified as an indirect tax, which is collected throughout a product/service's life-cycle, i.e. from the initial raw material purchase to the sale of the final product (Alhussain 2020).

As mentioned, VAT was first introduced in Saudi Arabia during 2017 and subsequently implemented in January 2018 at a rate of 5% (Moshashai et al*.* 2020; Alhussain 2020), which was similar to Nigeria's rate of 5% (Trading economics, n.d.). At that time these rates were amongst the lowest in the world, compared to Australia at 10%, Italy at 22% and India at 28% (Alhussain 2020). Nonetheless, VAT is also often considered as *regressive* in nature since it has a greater potential impact on lower-income groups than on higher income groups.

In a seemingly counter-intuitive move, Saudi Arabia increased its VAT rate threefold from 5% to 15% starting 1 July 2020 (Saudi Press Agency 2020). Nigeria, on the other hand, also increased it VAT rate in 2020, albeit by a substantially smaller increase, from 5% to 7.5% (Trading economics n.d.). According to AMEinfo (2020), the significant rate increase and one of the fiscal measures taken by the Saudi Arabian government to mitigate the adverse effects of the COVID-19 pandemic and other macro-economic developments on public finance. Although the government's intention may be to address the effects of COVID-19, it will lead to firms reconsidering their structures and transaction flows to minimise the effect of thereof (Gulf Business 2020; AMEinfo 2020).

Contrary to the route taken by Saudi Arabia (and to a smaller extend by Nigeria), Laffitte et al*.* (2020) propose the setting of a *minimum* effective tax rate, as a way to tackle COVID-19, related economic concerns. Similarly, Baldwin & Tomiura (2020) assert that reducing taxes may increase the resiliency of firms in affected sectors, especially in avoiding debt and credit forbearance. These actions would also help to ease the pressure on firms facing an abrupt falloff in demand.

The VAT increase will impose an additional burden on firms and will directly incur elevated expenses due to the rate increase, and indirect expenses to comply with the new regulations (Deloitte 2020). In addition, in the instance of Saudi Arabia, Deloitte (2020) also warns against an increased level of scrutiny from the General Authority of Zakat and Tax

(GAZT), especially as VAT will become an important additional source of governmental revenue. (Note: Zakat is explained as a religious obligation paid by Muslims as a portion to the poor (Nadzri et al. 2012)).

In order to somewhat pre-empt the effects of the VAT increase, firms should be encouraged to set new strategies and implement plans to absorb the dramatic changes imposed due to COVID-19. Such strategies and plans include (AMEinfo 2020; Deloitte 2020):

- The update of existing supplier contracts to ensure a continuous supply of products/services;
- calculation and consideration of additional finance cost to fund the cash flow due to timing differences between payments and recovery of VAT;
- the updating of pricing of goods/services, including adjustments to marketing material to reflect the new prices; and
- reconsidering transaction flows with the aim of minimising the impact of the VAT rate increase.

Concluding comments

The COVID-19 pandemic remains a multi-faceted crisis and requires governments to make decisions regarding health, monetary and fiscal policies. Both Nigeria and Saudi Arabia are facing economic crises due to the steep decline in governmental revenues and a dramatic increase in governmental expenditures. It requires the state to make difficult decisions to fund the increasing budget deficits.

This global pandemic occurred amidst efforts to diversify the Saudi Arabian economy away from its dependence on oil by, amongst others, including creating and strengthening private sector businesses. On the other hand, Nigerian government, in response to COVID-19, introduced an amendment to the 2020 budget in May 2020 aimed at re-prioritizing expenditure to ensure that funds are directed to areas in most need. Whereas one of the measures announced by Saudi Arabia to bolster state revenues, was the tripling of the VAT rate. Although the 15% VAT rate may be more in line with most countries, we argue that although this might increase governmental revenues in the short term, the sudden impact thereof could restrict private sector growth over the longer term.

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