



**MANAGING RESOURCE REVENUES
FOR SUSTAINABLE DEVELOPMENT**

PRECEPT POLICY BRIEF

The Nigeria Natural Resource Charter (NNRC) commissioned this Policy Brief in its efforts to synthesize key recommendations necessary for policy action using its 2017 Benchmarking Exercise Report (BER). The NNRC periodically assesses petroleum sector governance in Nigeria against the Natural Resource Charter (NRC); a set of principles intended for use by governments, societies and the international community to determine how best to manage natural resource wealth for the benefit of current and future generations of citizens. Although this Policy Brief focuses solely on petroleum resource governance, it should be noted that this Policy Brief is adaptable for management of all other natural resources within Nigeria.

ACKNOWLEDGEMENT

This Precept Policy Brief was developed in partnership with the Centre for the Study of the Economies of Africa (CSEA). CSEA was responsible for updating precepts 5, 6, 7 and 8 from the NNRC's 2014 BER into its 2017 BER.

ABOUT THE BENCHMARKING EXERCISE REPORT

The Nigeria Natural Resource Charter implements the Natural Resource Charter in Nigeria. The Natural Resource Charter does not prescribe specific approaches to enhancing resource management but instead identifies 12 broad 'precepts', which cover the main decisions required to transform assets under the ground into development above ground.

ABOUT THE NIGERIA NATURAL RESOURCE CHARTER

The NNRC's Benchmarking Exercise Report assesses Nigeria's performance against 12 pre-requisites; 'precepts' determined as necessary to effectively manage Nigeria's petroleum resource wealth. A traffic light system is used to measure performance against the precepts; red to indicate 'poor', amber 'intermediate' and green; 'good'. The 2017 BER is the third in the series of benchmarking exercise reports produced by the NNRC; carried out to provide an assessment of governance of Nigeria's petroleum wealth. The first two exercises were conducted and published in 2012 and 2014 respectively. Updated BER's identify crucial changes that have taken place in petroleum resource governance since the last benchmarking exercise was conducted.

Specifically, this Precept Policy Brief covers three precepts; which scored 'amber', proposing principles the Nigerian government must imbibe to enhance their management of Nigeria's petroleum resources:

Project 4: Taxation and other company payments:

Tax regimes and contractual terms should enable the government to realize the full value of its resources consistent with attracting necessary investment, and should be robust to changing circumstances.



Project 7: Investing for growth:

The government should invest revenues to achieve optimal and equitable outcomes, for current and future generations.

Project 8: Stabilizing expenditure:

The government should smooth domestic spending of revenues to account for revenue volatility.



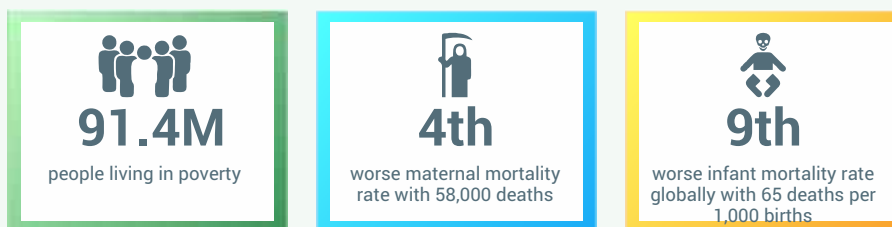
INTRODUCTION

In most business schools and development economics classes around the world, Nigeria is used as a textbook case of "resource curse". With more than USD 1 trillion earned from oil revenue since inception, the country is still ranked high in major underdevelopment indicators such as poverty, infant and maternal mortality among others. In 2018, the country has 91.4m people living in poverty, 4th worst maternal mortality rate with 58,000 deaths and 9th worst infant mortality rate globally with 65 deaths per 1,000 births. A comparative analysis of resource-rich countries, however, indicates that development outcomes hinge not strongly on the resource endowment per se, but crucially on effective management and governance of the resource. This is a major conclusion of the most recent assessment; 2017 Benchmarking Exercise Report (BER) assessing Nigeria's oil and gas resource management strategies conducted by the Nigeria Natural Resource Charter (NNRC). The 12 precepts of the Natural Resource Charter provides insights into the revenue management strategies adopted in Nigeria using oil and gas resource revenues from 2015 to 2017. In particular, precept 4, 7 and 8 touched on the weak fiscal regime, the linkages between revenue and development, and concerns around stabilizing expenditure. This brief provides actionable policy recommendations that can enhance the better management of resource revenues for development, especially in line with the key policy gaps identified in the 2017 BER.

QUICK FACT

with more than
\$1 Trillion

earned from oil revenue the country is still ranked high in major underdevelopment indicators such as:



PRECEPT 4: Improving Resource Revenues



Resource extraction can be a significant source of revenues for a government. But for this to happen, the government must balance obtaining a share of the value of the resource with terms attractive enough for capable companies to invest. Thus, **Precept 4: Taxation and Other Company Payments** posits *'tax regimes and contractual terms should enable the government realize the full value of its resources consistent with attracting necessary investment, and should be robust to changing circumstances.'*

QUICK FACT



It is estimated that Nigeria has lost about
\$18 billion
due to obsolete oil and gas law

The present fiscal regime for sharing revenues from joint venture arrangements between the government and oil companies is archaic, complex and opaque, thereby limiting the revenues accrued to the government. Low returns from investments minimize the level of interventions that the government can undertake to improve the lives of Nigerians. It is estimated that Nigeria has lost about USD18 billion due to obsolete oil and gas law. One example of such law is the the Deep Offshore and Production Sharing Act 1993. A major section of the Act gives incentives for deep off shore drilling to oil companies such that those drilling beyond 1000 meters paid 0% royalty until such as time as the price of crude went beyond \$20. While the \$20 benchmark has been crossed since 1993, the federal government has failed to activate this clause resulting in substantial loss of revenue. The 2017 BER finds that the Nigerian government's take from Production Sharing Contracts (PSCs) remains the lowest in the world and deep-water oil royalties remain at zero percent. The needed revisions to the extant law which is due for many years has not happened due to vested interest and influence of important stakeholders in the oil and gas sector that are benefiting from the present regime. Also, outdated contracts and expired Memorandums of Understanding (MOU)'s are still in force resulting in under assessments, under-payment and invariably loss of revenues to the government. The 2017 BER also found weak accountability and transparency with regard to licensing disclosures for oil facilities and inefficient use of tax incentive. Specifically, in the 2017 Revenue Governance Index, Nigeria scored 17 out of 100 placing it 77 out of 89 countries in the assessment of licensing. Again, lack of transparency could fuel corruption and diversion of resources. According to NEITI an additional N435 billion may also have been lost due to abuse of the tax waivers by about 6 other oil companies. Overall, government is making less revenue from oil and gas sector because of the prevailing ineffective fiscal regime and opacity which allows for corruption.

Recommendation

- Seek quick passage of the Petroleum Industry Fiscal Bill, which will enhance the effectiveness of oil and gas laws in responding to changing global and local dynamics. Strengthen the role of Nigerian Extractive Industry Transparency Initiative (NEITI) and by extension civil society organizations in improving the transparency of oil licence award processes. Transparency in production and financial management has already improved with effort of NEITI and various civil societies.
- Develop the capacity of statistical agency in the collection of data on various value chain of oil and gas sector, including licensing and making it publicly available for scrutiny.

QUICK
FACT



42%

of government expenditure has no direct impact on the citizen.

Source: BudgIt

PRECEPT 7:
Balancing Savings and Consumption



If managed well, the revenues from resource extraction can finance growth in the non-resource economy and improve standards of living. If managed poorly, the government can squander revenues and subject the economy to economic shocks, leading to wasteful spending, poorer public and private sector investment choices, over-borrowing, debt crises and ultimately poorer human development. Thus, **precept 7 suggests that 'the government invest revenues to achieve optimal and equitable outcomes, for future and current generations'** if the benefits of resource extraction are to be maximized.

The NRC suggests that revenues from resource extraction can finance growth in non-resource economy and improve standards of living. It further suggests that if managed poorly, the government can squander revenues and subject the economy to economic shocks, leading to wasteful spending, poorer public and private sector investment choices, over-borrowing, debt crises and ultimately poorer human development. Therefore, the optimal way to utilize the opportunities from resource endowment is deploy the resource revenues for present needs without compromising the needs of the future generation. In addition, natural resources are non-renewable resources and saving revenue from extraction will ensure that society effectively transit to a sustainable revenue source and eventually diversify away from oil. The 2017 BER found that Nigeria tended towards excessive consumption. Since 2012, less than 20% of the total government expenditure has gone to capital expenditure. Even a significant part of the allocation for capital expenditure is part of MDAs administrative expenses such as for new buildings, cars, computers among others. Analysis of 2018 budget by BudgIt shows that 42% has no direct impact on the citizen.

Also, of the USD180 billion that has accrued into the Excess Crude-oil Account (ECA), a fiscal buffer established in 2004, less than USD2 billion remains as at 2018. The major weakness of the ECA is the lack of appropriate legal backing especially at the sub-national level. Specifically, it is more of a political arrangement with no legal framework guiding its operations and withdrawals. This structure allows for indiscriminate withdrawals subject to political exigencies. For example,

the federal government in 2018 withdrew from the ECA USD1 billion for security expenditure without approval of the National Assembly.

The Nigerian Sovereign Wealth Fund (SWF) while created on more solid legal standing, is poorly capitalized. As at May, 2018, the fund had USD2billion in capital, this represents about USD10.5 per person. Comparatively, Norway, Kuwait and Botswana have USD 185000, USD148000 and USD14400 per person in their respective sovereign wealth funds. With their robust savings, these countries are better positioned to absolve oil price shocks, develop critical infrastructure and develop their human capital.

Recommendations

- Implementing a more stringent rule on deposit into the Nigerian SWF, especially establishing a stronger link between funding going into ECA and capital into Nigerian SWF.
- State governments, especially the oil producing states, should consider establishing their respective SWF.
- Another mechanism to improving saving is by increasing capital spending, which invariably benefits both present and future generations

PRECEPT 8:

Using Strong Macroeconomic Policy to respond to Oil Price Volatility



Resource revenues are particularly volatile. When governments decide their level of spending based on these volatile revenues, the consequences for economic growth and poverty reduction can be dire. Thus, the Natural Resource Charter's Precept 8 sets a benchmark for **'governments to smoothen their domestic spending of revenues to account for revenue volatility.'**

Nigeria can improve the effects of oil price volatility by simply learning the lessons history has taught. The NNRC's Benchmarking Exercise Reports have shown that the oil and gas market is characterized by a boom and bust cycle. This is buttressed by Figure 1 which shows oil price fluctuations between 2010 and 2017. Since 2014, oil price has shown more volatility largely due to the combined effect of global geo-politics and new technology in shale oil and renewable energy. The implications of this trend for oil dependent countries are multifaceted. For instance, oil price volatility implies revenue volatility which could affect budget implementation as is especially the case for the Nigerian government which relies on the oil and gas sector for around 70% of its resource revenues. As shown in Figure 1, government revenues have dropped by about

**QUICK
FACT**

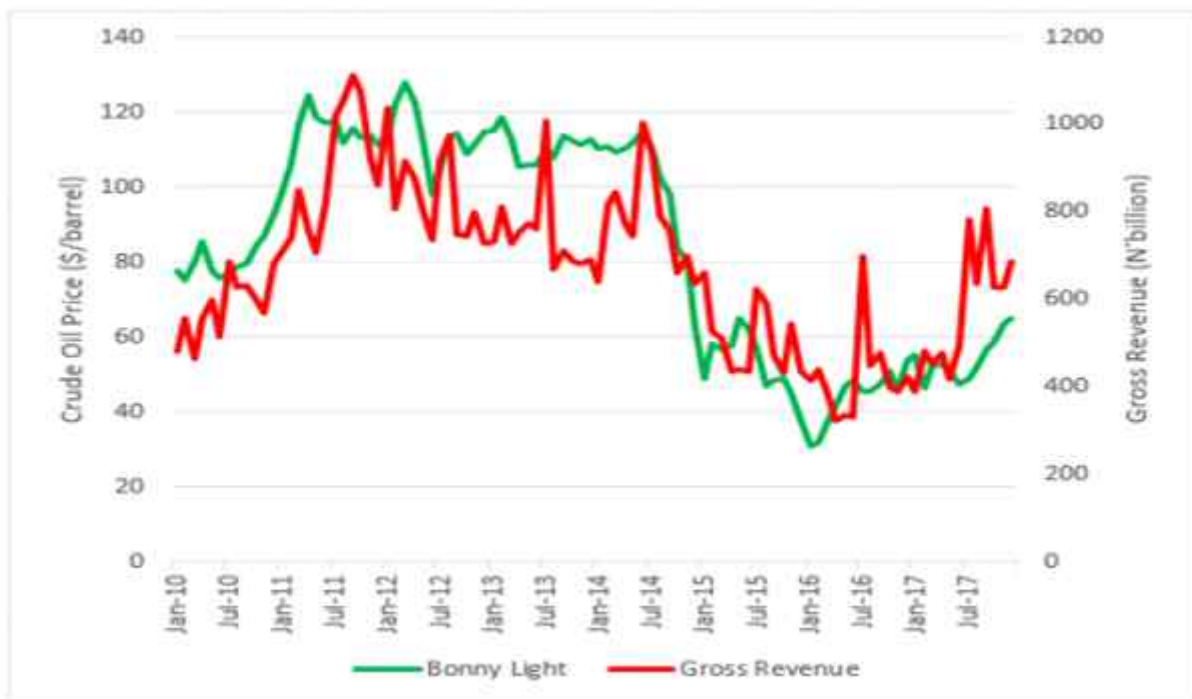


In 2017, government was only able to implement **59.08%** of the approved budget estimate due to revenue shortfalls.

Source: Budget

37% since 2014. The Nigerian government has tried to stabilize expenditure through deficit financing. However, the 2017 BER found that only the federal government has been able to utilize this tool to mitigate budget volatility, as majority of the state governments entered into fiscal distress and had to be bailed out by federal government.

Figure 1: Gross Government Revenue and Crude Oil Prices



Source: OPEC, 2018 & Central Bank Statistical Bulletin, 2018.

Poor budget credibility and implementation is another negative effect resulting from overreliance on oil in Nigeria. In 2017, government was only able to implement 59.08% of the approved budget estimate due to revenue shortfalls. Going by past trend, the budget implementation and credibility challenges might continue given the persistent oil price volatility and production constraint due to capacity issue in oil exploration and unrest and illegal bunkering in the Niger-Delta region.

The 2017 BER observed weak capacity to manage inflationary pressures due to oil volatility and absence of effective measures by government to efficiently manage foreign direct investment inflows to the extractive sector. Particularly, while monetary policy has responded well to mitigate inflationary pressure, fiscal policy, on the other hand, has worsened it. The subsidy

regime was phased out in 2016, but has now been reintroduced in an opaque process; re-branded 'under-recovery' without parliamentary checks to curtail abuses.

Macroeconomic policy is essential in responding to the challenges facing the oil sector in general and government expenditure volatility in particular. First, the earlier issue raised regarding the importance of saving is equally relevant here. It is vital for fiscal policy to be more counter-cyclical, which means more saving in the period of oil price boom, while drawing on the saving in the period of oil bust. In addition to this, there are other important macroeconomic considerations that can be looked into:

Recommendations

- Reforms are required to the Fiscal Responsibility Act (FRA) to ensure greater fiscal compliance, especially at the sub-national levels. Enhancing the capacity of state through improving capacity for tax administration and more importantly improving their revenue base will be crucial.
- State governments in Nigeria should also consider establishing their own stabilization savings mechanisms such as SWF will ensure their resilience to revenue shocks.
- Government should do more to stabilize exchange rate. The relative calm in forex market at present represents a positive development, but more is needed in order to close the present multiple exchange windows. Also, Central Bank of Nigeria (CBN)'s regular intervention in the forex market through dollar injection might be unsustainable with another shock to oil prices. Therefore, in the long-run, diversifying the foreign reserve portfolio through expansion of export base will be required.
- A sustainable debt policy is needed to avoid future fiscal crisis. Debt financing no doubt can help in smoothing out revenue volatility, but there is a limit to this. It is would be more appropriate with effective counter-cyclical fiscal policy in place and coordination with the monetary authority to ensure inflation is effectively controlled.

