# STABILIZING NIGERIA'S VOLATILE ECONOMY

## Necessity of a Constitutional Savings and Stabilization Mechanism

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# Executive Summary

Despite being the largest producer and exporter of petroleum in Africa and one of the ten largest producers in the world, Nigeria has failed to transform decades of oil earnings into sustainable development.

In the period spanning 1970 to 2014, Nigeria wasted five oil booms – earning a conservative estimate of a trillion dollars in oil revenue but making no significant savings. These earnings have also not translated to lasting or productive capital through human development, infrastructure and institution building. Nigeria's failure to effectively manage revenue earned from oil and gas has delayed the country's transition from a developing economy to an advanced one.

The fiscal linkage between the petroleum sector and the Nigerian economy is pivotal. Petroleum is the largest contributor to Nigerian government revenue at all levels – Federal, State and Local – and is therefore a major influence on the capacity of government to deliver its socio-economic responsibilities to citizens. Oil is also the country's major source of foreign exchange. As a result, the management of oil revenues is a key determining factor of the exchange rate and general performance of other sectors of the economy.

The volatility and unpredictability of oil prices over the years has made oil revenues difficult to manage. Sharp swings in prices distort the economic growth of oil revenue dependent economies, with ripple effects on budget deficits and fiscal planning.

Over the past three decades, the Nigerian government has made several attempts to stabilize the economy for a long-term growth trajectory through various policies and programmes. These attempts were plagued by consistent legal and governance issues, lack of transparency, lack of consistency and poor management of resources. The country has failed to manage risks associated with the robust endowment of natural resources and continued to repeat the same mistakes with severe consequences for both the country and its citizens.

This report reviews the performance of Nigeria's oil-based fiscal policies, examines case studies of countries with successful stabilization policies and proposes policy approaches for establishing an effective savings and stabilization mechanism for Nigeria.

# The Nigerian Economy and Revenue Profile

## Structure of Nigeria's Economy

Nigeria is richly endowed with a variety of mineral resources that include coal, iron, tin, columbite, zinc and crude oil. However, despite the abundance of these mineral resources, attention has predominately focused on the exploitation of crude oil. At independence, agriculture was the mainstay of the economy, making significant contributions to government revenue, foreign exchange, GDP and employment. Following the rise in crude oil production and prices in the 1970s, Nigeria reaped enormous wealth by producing over 2 million barrels per day.

The massive increase in oil revenue resulted in unprecedented and unplanned wealth, resulting in an economy solely dependent on oil revenue while relegating agriculture to the background. Crude oil now accounts for approximately 95% of Nigeria's gross earnings. This shift has led to structural distortions that have affected Nigeria's economic growth and development prospects.

Table 1 shows the percentage of oil contribution to government revenue, export and GDP.

*Table 1: Structure of Revenue, Percentage Contribution to Export and GDP (1970-2017)*

| Revenue | 1970 | 1980 | 1990 | 2000 | 2010 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|
| **Oil** | 26.3% | 81.1% | 73.3% | 83.5% | 94.3% | 95.2% | 94.2% | 95.4% |
| **Non-Oil** | 73.7% | 18.9% | 26.7% | 16.5% | 5.7% | 4.8% | 5.8% | 4.6% |
| Export | | | | | | | | |
| **Oil** | 57.6% | 96.1% | 97% | 98.4% | 96.7% | 97.3% | 95.2% | 96.4% |
| **Non-Oil** | 42.4% | 3.9% | 3.3% | 1.6% | 2.3% | 2.7% | 4.8% | 3.6% |
| GDP | | | | | | | | |
| **Oil** | 6.7% | 32.5% | 35.4% | 30.7% | 15.4% | 9.6% | 8.5% | 6.7% |
| **Non-Oil** | 93.3% | 67.5% | 64.6% | 69.3% | 84.5% | 90.4% | 91.5% | 93.3% |

Oil contributes over 90% of total government revenue and export. However, its relative share to GDP is on the decline. Markedly, oil revenue as a share of total revenue increased to 95.4 % in 2017, while total export of oil rose to 96.4%. Conversely, its contribution to GDP has been significantly low.

Between 1961 and 2014, illustrated in Table 2, Nigeria produced 32.5 billion barrels of crude oil (almost equivalent to today's reserves), earning as much as N118.5 trillion. At the current production-reserve ratio, reserves will last for little more than another 40 years (NNPC, 2017).

*Table 2 - Crude Oil Production and Revenue (1961-2014) - NNPC, NBS 2017*

| Year | Crude Oil Production (Billion Barrels) | Revenue from Production (N'Trillion) |
|---|---|---|
| **1961-1970** | 1.13 | 0.001 |
| **1971-1980** | 7.26 | 0.061 |

| | | |
|---|---|---|
| **1981-1990** | 5.27H | 0.347 |
| **1991-2000** | 7.39 | 5.539 |
| **2001-2010** | 8.40 | 58.152 |
| **2011-2014** | 3.27 | 54. 400 |
| **Total** | **32.70** | **118.499** |

The fiscal dependence of government on oil revenues is shown in Figure 1. Between 1993 and 2015, federal, state and local governments received N67.06 trillion, N19.15 trillion and N15.3 trillion respectively, largely from oil revenue. We can only imagine the developmental impacts of these revenues on Nigerians if they had been utilised efficiently.

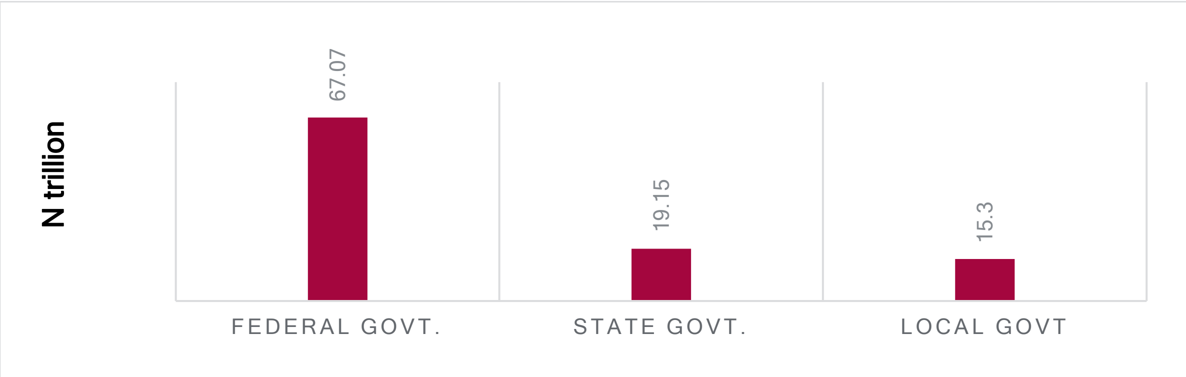


*Figure 1 - Revenue Allocation from Oil Wealth (1993-2015)- CBN Statistical Bulletin (2015)*

## Dynamics of Government Revenue and Expenditure

Government revenue, as demonstrated in Figure 2, has moved in the same direction as the price of oil over the years. Oil price volatility has therefore directly impacted government revenue. However, comparing recurrent and capital expenditures with federal revenue from 1990 to 2016 shows that while there is some variation in the short run, over a longer term recurrent and capital expenditure closely follow revenue.

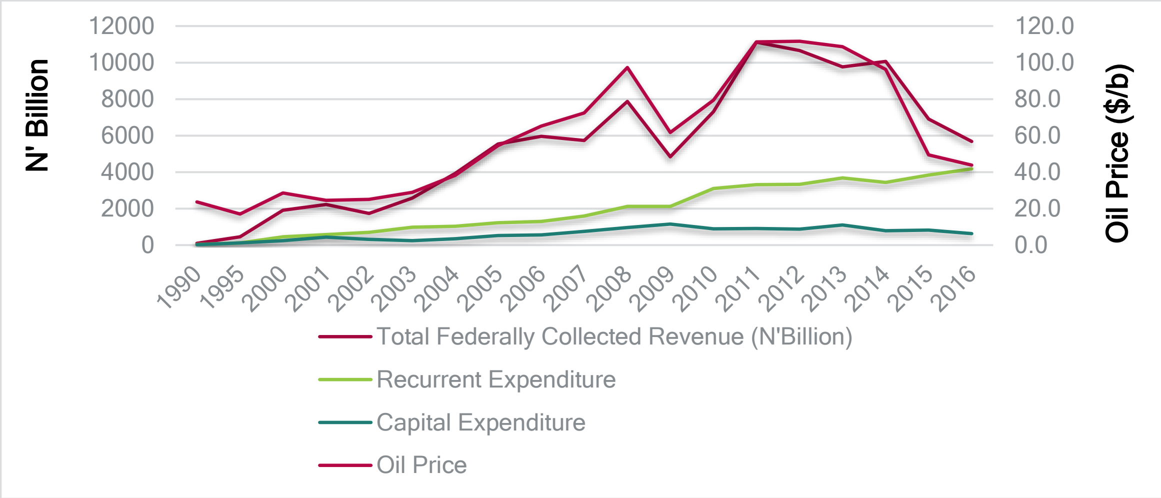


*Figure 2 - Oil Price, Government Revenue and Expenditure (1990-2016)*

## FAAC Revenue Allocation

Revenue allocations by FAAC to the three tiers of government has resulted in the economy becoming over reliant on oil at the expense of economic diversification, import dependence and the ability to generate internal revenue. Figures 3 and 4 show FAAC allocations to different levels of government and state IGR respectively. Dispite this vast revenue, most states are still burdened by outstanding salaries owed to workers and huge debts to contractors.

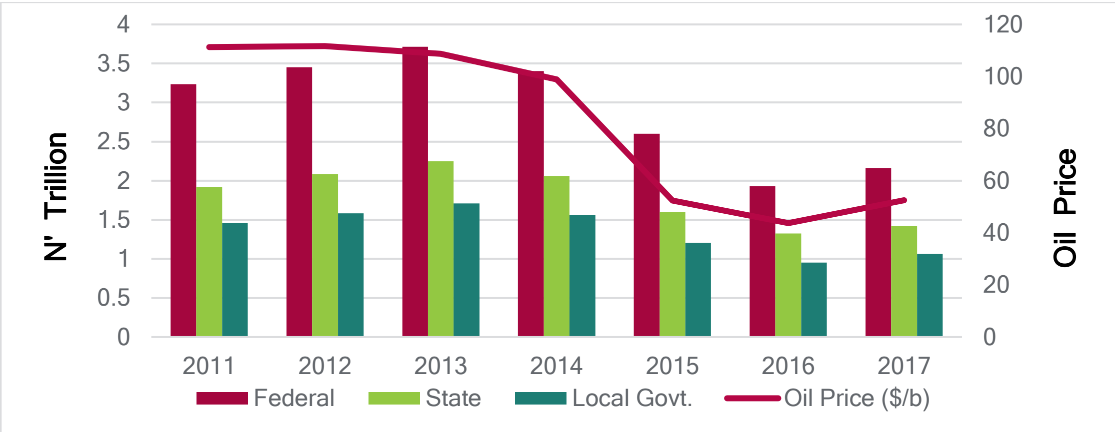


*Figure 3 - Oil Price and FAAC Statutory Allocation (2011-2017) - NBS 2017*

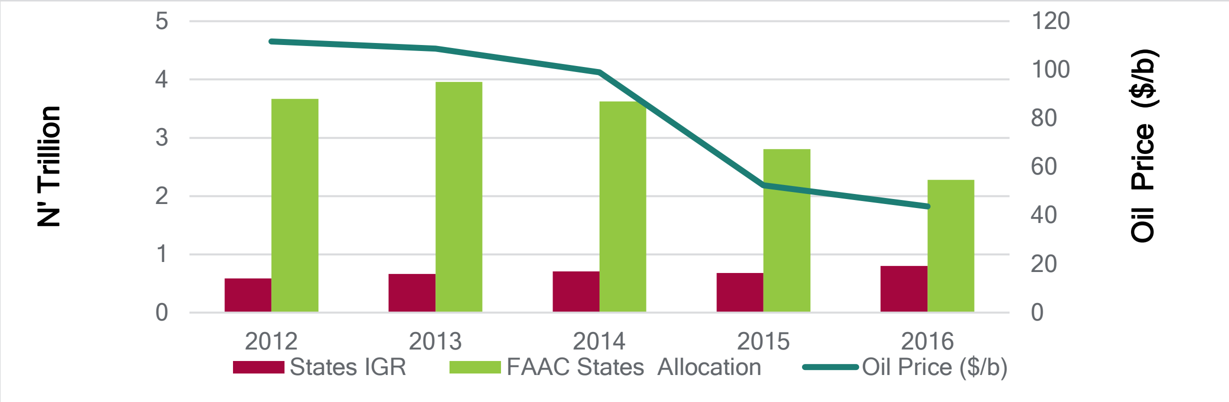


*Figure 4 - Oil Price, States IGR and FAAC Allocation to States - NBS 2017*

Low oil price has increased the debt burden of states, leading to state governments placing even more pressure on the Excess Crude Account and draw downs of balances in stabilization funds.

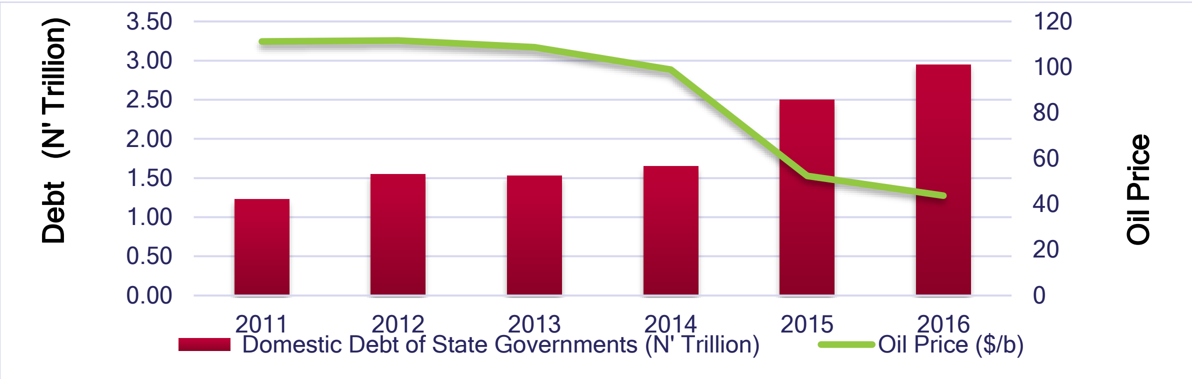


*Figure 5 - Oil Price and Domestic Debt of State Governments (2011-2016) - NBS 2017*

## Crude Oil Production and Prices: Trends and Impacts

Over the years, crude oil production has grown to a maximum of 2.5 million barrels per day, making Nigeria Africa's largest oil producer and 10th in the world (NNPC 2017). This increase in production has, however, been dictated by the dynamics of oil price, global economic fluctuations and activities in the Niger Delta region. In 1986, oil production dropped by 42% and rose again in 1990. Figure 6 presents the dynamics of oil production and prices.

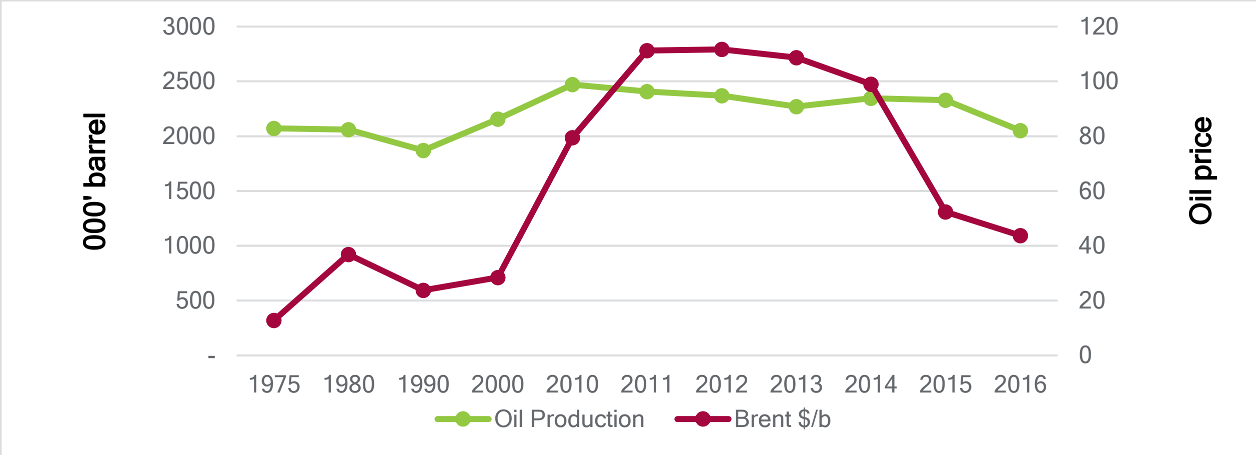


*Figure 6 - Trend in Crude oil production and Prices (1975-2016) - NNPC, OPEC Bulletin, 2017*

Sharp swings in oil prices have a profound impact on global economies and geopolitics. Oil price plunges can severely distort economic growth, especially for oil revenue dependent economies, with ripple effects on budget deficits and fiscal planning. Oil price volatility has continued to generate debate among policy makers, investors, governments and researchers. Aliyu (2009) posits that oil price volatility can enhance growth, Cerralo (2005) argues that it can impede growth. Nonetheless, for oil exporting countries, an increase in oil price increases fiscal revenue through export earnings. Conversely, for oil importing countries, an increase in oil price decreases fiscal revenues and increases budget deficits. Therefore, the net impact of oil price volatility depends on whether a country is oil importing or exporting.

The Nigerian economy aptly fits as both an oil exporting and an oil importing country because Nigeria exports crude oil and imports refined petroleum products. This implies that oil price volatility, whatever the nature (either an increase or decrease), can benefit and hurt the Nigerian economy at the same time. Figure 7 shows estimates of volatility for oil production and prices, revealing that volatility in oil price is generally greater than volatility in oil production.

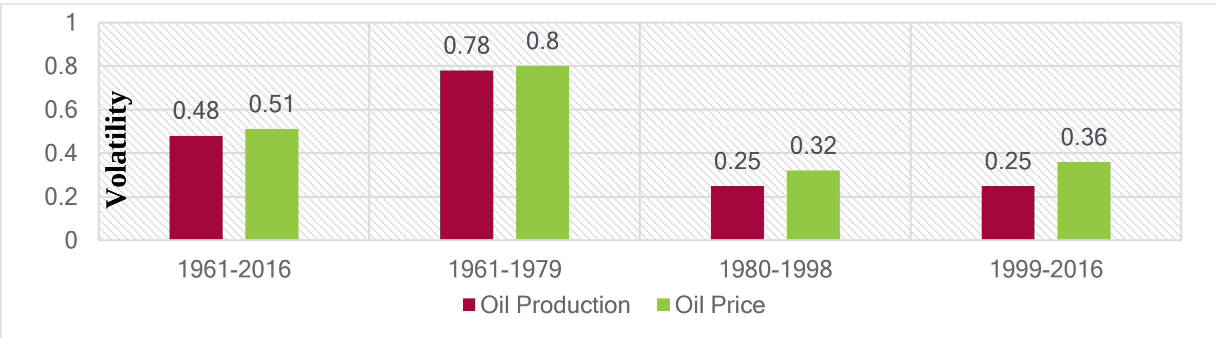


*Figure 7 - Volatility of Oil Production and Prices - OPEC Bulletin, 2017*

# Implications of Crude Oil Price Volatility on Key Macroeconomic Variables

Nigeria is consistenly exposed to shocks in revenue and macroeconomic performance due to over reliance on oil proceeds. With an increasing ratio of oil revenue to total revenue, any major volatility in oil price triggers macroeconomic shocks in the economy, creating uncertainty in government fiscal behaviour.

Recognizing the potential of oil prices to be volatile and to ensure stability in domestic expenditure, the government in 2004 enacted the Expenditure-Smoothing Policy and the Oil Price Fiscal Rule Policy (OPFR). These efforts were aimed at lowering the effects of revenue volatility on public expenditure. However, as observed in the Nigeria Natural Resource Charter Report (NNRC) 2014, the OPFR struggles with implementation and effectiveness.

Against this backdrop, studies including Adeniyi (2011), Omojolaibi (2013), and Babatunde, Adenikinju and Adenikinju (2013) have investigated the impact of oil price volatility on macroeconomic variables and revenue in Nigeria. Their consensus is that oil price changes have a direct significant relationship with various macroeconomic variables and government revenue. It is therefore pertinent to analyze the trend in oil price and macroeconomic dynamics in Nigeria. Figure 8 presents an oil price and GDP growth nexus; Figure 9 highlights the link between oil price and exchange rates; Figure 10 depicts oil price and the behavior of interest rates; Figure 11 shows the oil price - unemployment nexus; Figure12 shows the link between oil price and inflation, and Figure 13 illustrates oil price and foreign reserve dynamics. In general, oil price volatility impacts each of the macroeconomic variables, though the effects are more amplified in particular variables for various reasons.

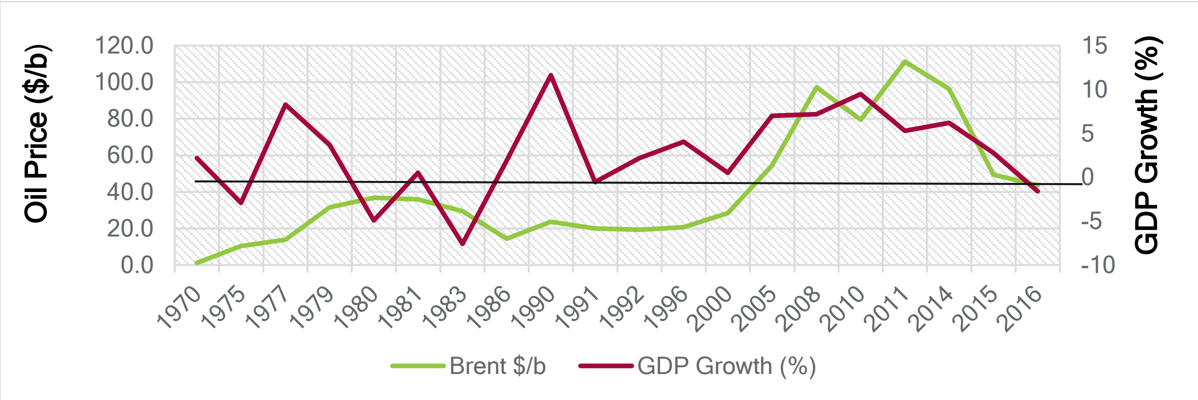


*Figure 8 - Oil Price and GDP Growth (1970-2016) - NBS 2017*

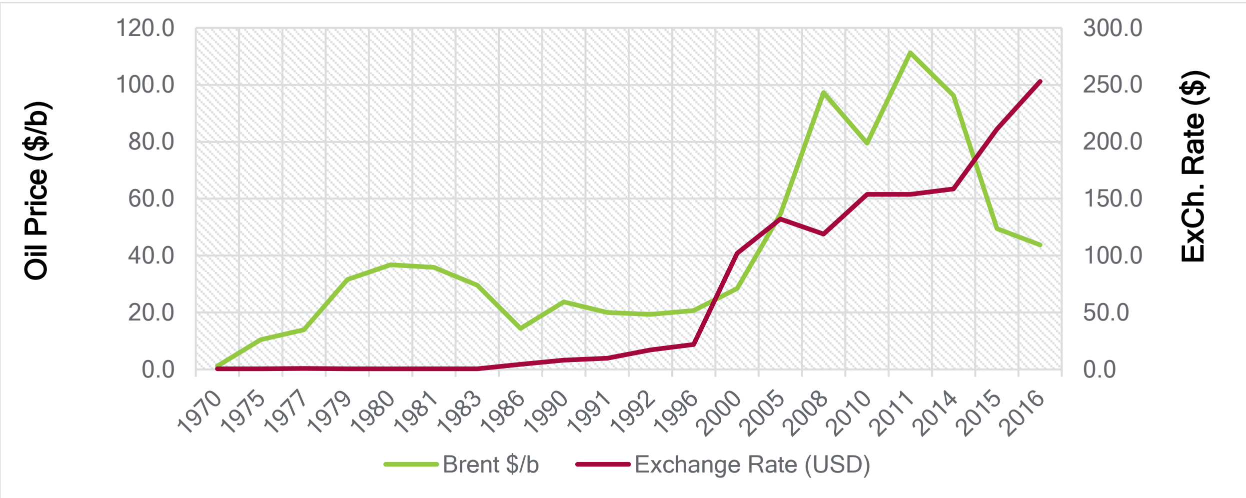


*Figure 9 - Oil Price and Exchange Rates (1970-2016) - NBS 2017*

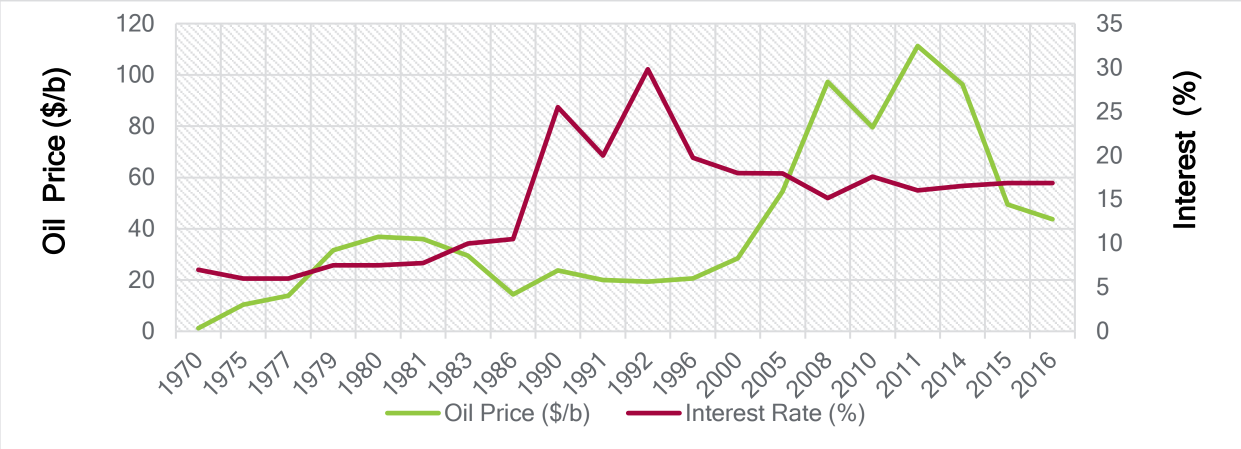


*Figure 10 - Oil Price and Interest Rates (1970-2016) - NBS 2017*

Oil price affects interest rates through monetary mechanisms. Activities of CBN Monetary Policy Committees have helped to significantly weaken the impact of oil price volatiliy on interest rates.

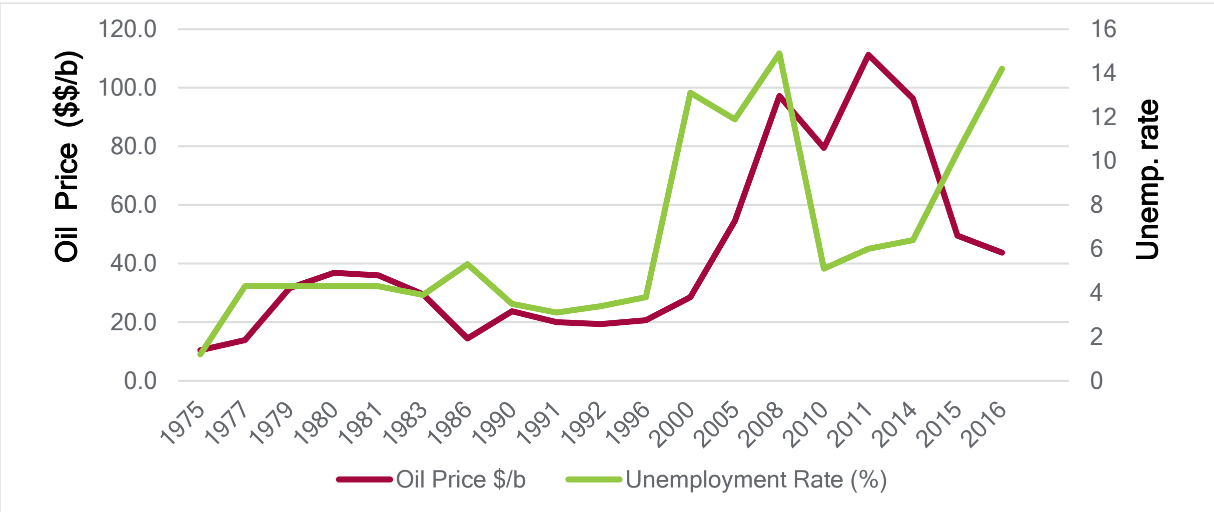


*Figure 11 - Oil Price and Unemployment (1975-2016) - NBS 2017*

As shown in Figure11, oil price and unemployment show similar trends until 2009. The 2008 crash in oil price from $93.7/b to $61.7/b in 2009 resulted in an increase in the unemployment rate from 14.9% in 2008 to 19.7% in 2009. This was also evident when oil prices crashed from $96.3/b in 2014 to $49.5/b in 2015, and unemployment increased from 6.4% in 2014 to 10.4% in 2015.

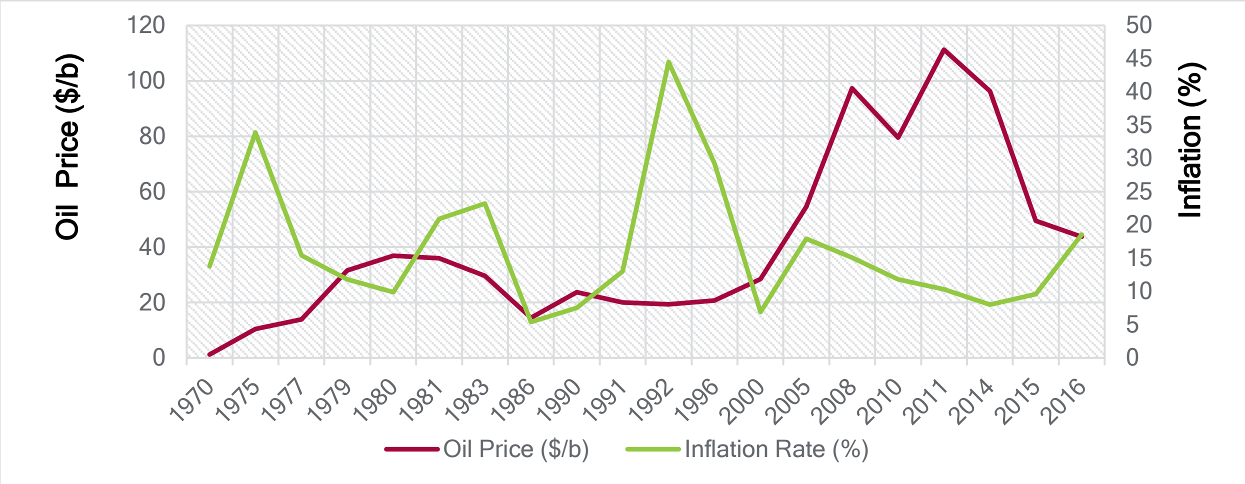


*Figure 12 - Oil Price and Inflation - NBS 2017*

Inflation in Nigeria has, over time, responded counter-cyclically to changes in oil price. As observed in Figure 12, prior to 1986, oil price and inflation moved in the same direction. However, the movement of oil price and inflation became negative from 1987.

As illustrated in Figure13 below, foreign reserves have been procyclical with oil price movement over the years.

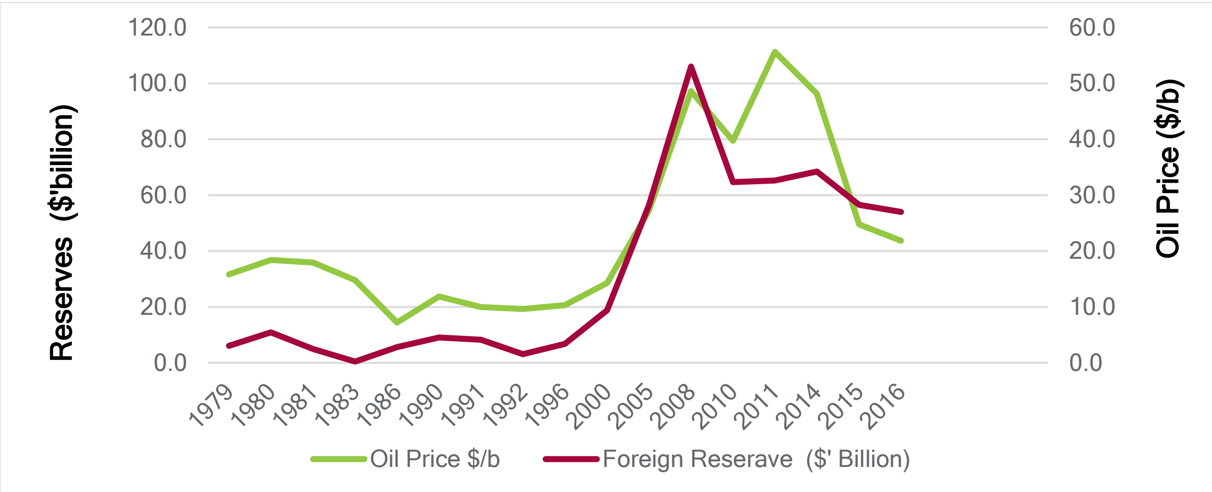


*Figure 13 - Oil Price and Foreign Reserves (1979-2016) - NBS 2017*

## Implications of Crude Oil Price Volatility on Key Human Development Indicators

Adenikinju (2017) noted that energy resource ownership alone does not necessarily translate into higher indicators of human development. This is evident in the Nigerian economy as there is no link between the country's energy resource endowment and the economic welfare of its citizens. Despite the oil sector being the mainstay of Nigeria's economy, oil wealth has not translated into increased welfare for Nigerians, illustrated by the very low indices of human development (Figure 14 below).

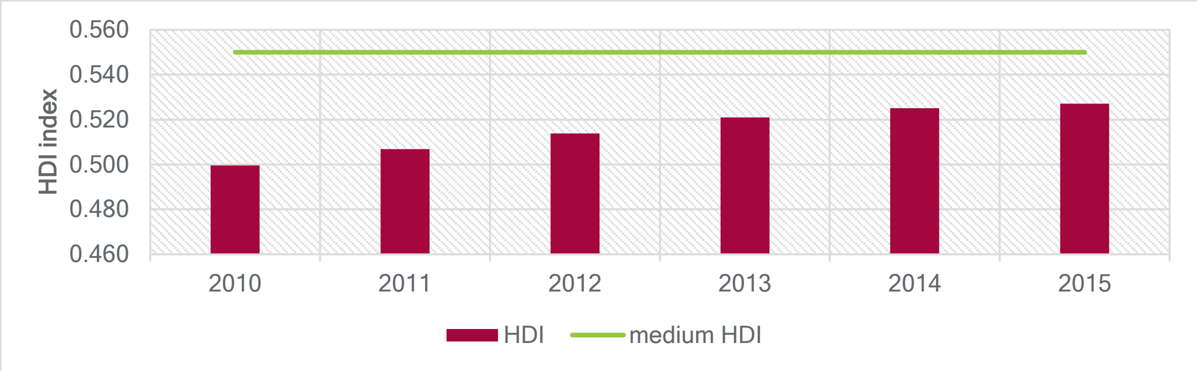


*Figure 14 - Human Development Index for Nigeria (2010-2015) - World Bank 2018*

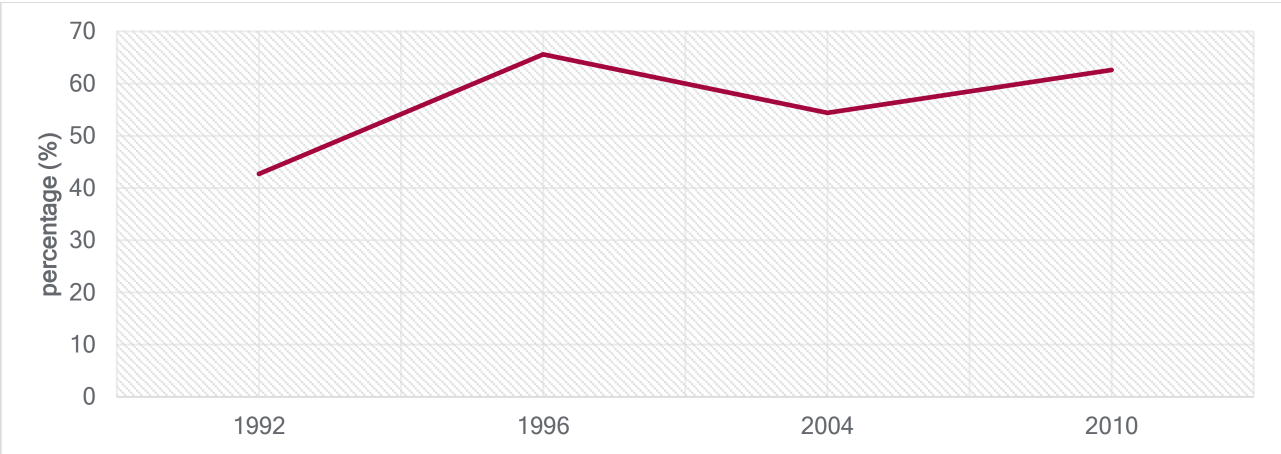


*Figure 15 - Poverty Rate in Nigeria (%) - NBS 2017*

The vast majority of Nigerians live below the poverty line. But as the economy continued to witness growth and revenue from oil, Nigerians below the poverty line increased from 42.7% in 1992 to as much as 65.6% of the population in 2010; while the price of oil increased from $19.3 in 1992 to $79.5 in 2010. This implies that oil revenue has not contributed to poverty reduction.

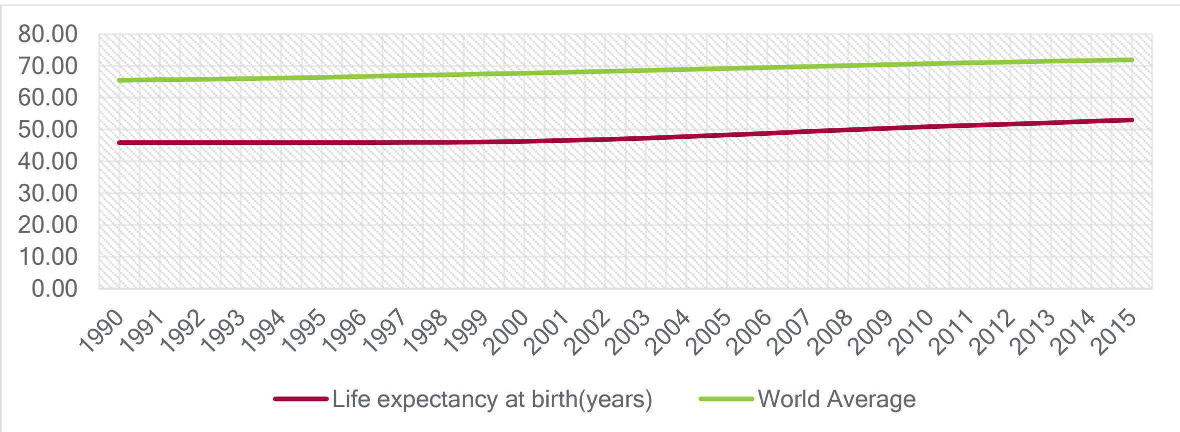


*Figure 16 - Life Expectancy in Nigeria and the World Average - NBS, World Bank 2017*

In 2015, the gap between average global life expectancy and Nigeria's life expectancy stands at about 19 years. This suggests that though numerous resources and revenue accrued to Nigeria over the years, Nigerians are still likely to die at a younger age compared to the majority of their counterparts born on the same day in other countries.

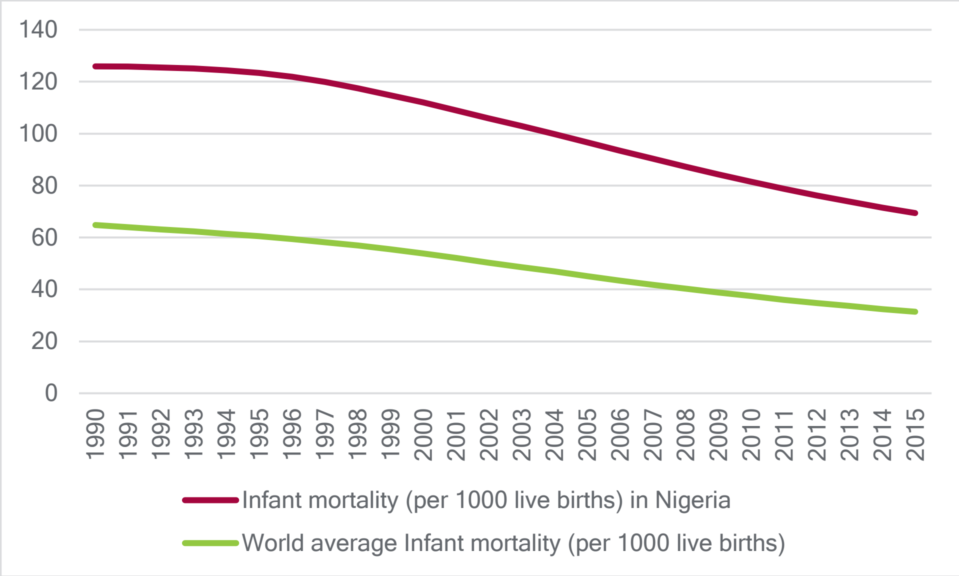


*Figure 17 - Infant Mortality Rate (Per 1000 live births) in Nigeria and the World*

The chart above illustrates that since 1994, the infant mortality rate (per 1000) in Nigeria has dropped consistently. However, the Nigerian infant mortality rate (per 1000) is still high compared to the world average. In 2015, the world average infant mortality rate (per 1000) was 31.4, while Nigeria's infant mortality rate (per 1000) was 69.4.

## Nigeria's Misery Index

The misery index, otherwise known as the economic discomfort index (EDI), measures the degree to which an economy is plagued by the "twin evils" of inflation and unemployment. A higher score in the misery index reflects the extent to which an economy is miserable. The misery index is also associated with a broad measure of the quality of life and the macroeconomic performance of an economy.

Given that the misery index threshold of a healthy economy is in the range of 6 to 7, the Nigerian economy has continued to perform miserably, with an average misery index of 30 (1970 to 2016). Between 1984 and 1995, the Nigerian economy featured an average misery index of 53. In 1995, the misery index was an incredible 74. In 2016, the misery index was as high as 36.8. Figure18 presents the misery index in Nigeria from 1970 to 2016.

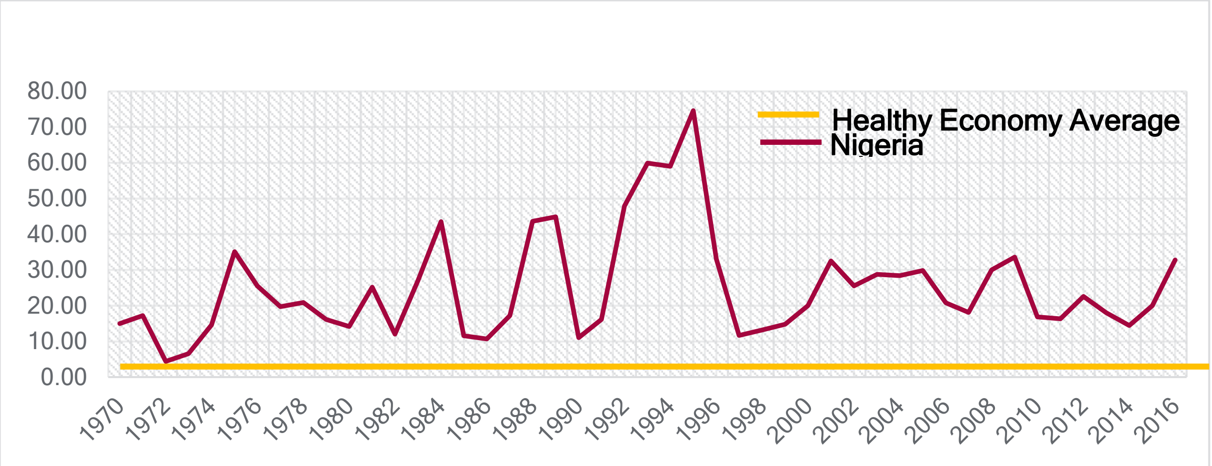


*Figure 18 - Nigeria's Misery Index - NBS World Bank 2017*

## Misery Index and Oil Price Nexus

The misery index in Nigeria has over time responded counter-cyclically to volatility in oil prices. As observed in Figures 18 and 19, the misery index falls when the price of oil increases and it rises when oil prices decrease. Positive oil price shocks lead to a reduction in the misery index, while the reverse is the case for negative oil price shocks.

In 1992, when the price of oil dropped by 15% the misery index shot up by 25%, and rose again by 26% in 1995. In 2009, oil prices fell by 36% and the misery index rose again by 10%. In the same vein, the misery index shot up by 42% when the price of oil crashed by 48% in 2015. This suggests an increase in inflation, unemployment and poverty whenever there is a negative oil price shock to the Nigerian economy.

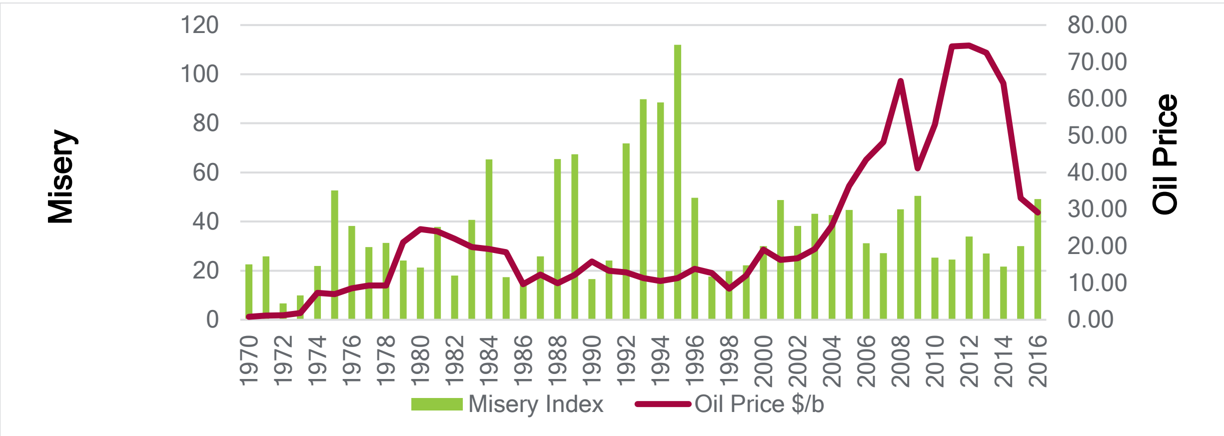


*Figure 19 - Oil Price and Misery Index (1970-2016) - NBS, OPEC 2017*

*Table 3 - Resource Ownership and Nigeria's Comparative Global Ranking*

| Energy Resource ownership | Global ranking | Indicators of Institutional, Socio-Economic Welfare | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Energy | Global ranking | Economic Factors | Global ranking | Social factors | Global ranking | Governance | Global ranking |
| Oil production | 10th | Oil consumption per capita | 99th | GDP (US$ PPP) | 30th | Infant mortality rates | 10th | Competition index | 124th |
| Oil reserves | 10th | Natural gas consumption per capita | 98th | GDP per capita (US$PPP) | 180th | Children under age of 5 years and undernourished | 26th | Corruption perception index | 136th |
| Oil exports | 5th | Electricity consumption | 68th | GDP growth rate | 36th | Physician density | 130th | Index of Economic Freedom | 115th |
| Natural gas reserves | 9th | Electricity consumption per capita | 186th | Population living below poverty line | 180th | Hospital bed density | 176th | | |
| Natural gas production | 28th | | | Unemployment rate | 32th | Life expectancy at birth | 210th | | |
| Electricity production | 67th | | | Investment-GDP | 112th | Literacy rate | 188th | | |
| | | | | Inflation rate | 24th | Health Expenditure | 126th | | |
| | | | | Industry production growth rate | 154th | Railways (KM) | 51st | | |
| | | | | Foreign exchange reserves | 43rd | | | | |

Source: CIA 2016 (cited in www.indexmundi.com/g/r.aspx visited 3.48pm Saturday 11th of March, 2017)

Note: 1/ ranking is based on 242 countries globally for most of the indicators

# A Review of Nigeria's Oil Based Fiscal Policies

## Introduction

A study of Nigeria's oil boom in the 1970s shows that as oil exports increased, the agricultural sector was de-emphasized. Increased oil revenues led to an increase in government expenditure, including wage rates, exchange rates and a more than 250% increase in military expenditure. Nigeria's budget deficit has continued to increase from 1975.

In 1981, the global price of oil began to decline, falling 20% by the end of 1982. Instead of adjusting to this loss of revenue by cutting spending, the civilian government turned to borrowing. By 1991, Nigeria's external debt had increased from $1 billion in 1970, to $33 billion in 1991 (Abuka et al 2007).

Beyond poor management, the oil boom gave Nigeria an acute case of *Dutch Disease*, a term coined to describe negative impacts of the Netherlands' natural gas discoveries. As petrodollars poured into Nigeria, the naira appreciated nearly 30% between 1973 and 1974, reaching a high of N0.55 per $1 in 1980. Inflation spiked, increasing from 5% in 1973 to 34% in 1975. The combination of high inflation and naira appreciation affected the competitiveness of Nigeria's non-oil exports in global markets and led to a decrease in production – a hallmark of the Dutch disease.

In response to rising inflation, government threw open the borders to flood the market with cheap imports. Unable to compete at home or abroad, the Nigerian manufacturing and agricultural sectors contracted. Population began to outpace agricultural output by 2% per year, and the country began importing staple foods. (Duggan, 2009)

The economic malaise inflicted on Nigeria by the oil boom and bust of the 1970s laid the foundation for subsequent crises of public finance. Nigeria continued to grapple with risks associated with a rich endowment of natural resources and repeatedly made the same mistakes.

The Obasanjo administration's economic reforms of 2003-2007 represented the first attempt to break the pattern through innovation of a "savings mechanism" known as the Excess Crude Account (ECA) into which extra revenue from oil was warehoused for "rainy day expenditures". The ECA proved so successful that at the end of that administration in 2007, it had accumulated $17 billion USD, despite paying the Paris Club $12.4bn in exchange for the remainder of its $30bn official debts being written off. However, the tempo of the accumulation of savings was not sustained by successive administrations.

The situation has continued to worsen despite six years of record high oil prices which could have built up foreign reserves to as much as $100 billion dollars, including an ECA level of at least $40 billion.

*"The depletion of the Excess Crude Account to about $2.5 billion has made the country more vulnerable than it was in the past and put the economy of the country at great risk."*

Ngozi Okonjo-Iweala
Former Minister of Finance
(2014 World Economic Forum)

# Rationale for Stabilization Policies

## *Definition*

A stabilization policy is a set of macroeconomic management strategies embarked upon by governments and Central Banks of nations to smoothen business cycles, maintain economic growth, ensure stable price levels and keep unemployment to a minimum. According to Keynesian theory, it is the regulation of an economy's total spending to required levels in an attempt to avoid unemployment or inflation. In other words, it is a set of defined strategies employed to correct factors that threaten to undermine the financial wellbeing of a business or an economy. It can also refer to a set of policies aimed at stabilizing specific economic crises, such as sovereign debt defaults or exchange rate and stock market crashes, to prevent a paralyzing business cycle crisis.

Stabilization policies are most often demand management strategies where either fiscal or/and monetary policies are implemented to regulate economic activities. In both situations, they are essentially discretionary in nature and help to control fluctuations through various mechanisms designed to increase demand to counter high levels of unemployment or suppress demand in response to rising inflation.

Due to the shocks on economic variables experienced as a result of oil price volatility, most oil-rich countries have been able to establish a stabilization fund or mechanism to mitigate volatility that:

- Insulates the budget and the economy against commodity (usually oil) price swings.
- Serves as savings for future generations.
- Serves as development funds to promote industrial policies with the aim of promoting economic growth.
- Servers as Contingent Pension Reserve Fund that provides (from sources other than individual pension contributions) for contingent unspecified pension liabilities on the government's balance sheet.

## Key Indicators for a Successful Stabilization Programme

Stabilization programmes are policies formulated to make the growth process smoother, stabilize price levels, lower the rate of unemployment and ensure equilibrium in the balance of payment position to achieve steady growth in GDP. The success of any policy is measured vis-à-vis target variables and the degree to which stated objectives are achieved or the extent to which targeted problems are solved.

Indicators of a successful performance of Sovereign Wealth Funds include the size of funds and capacity of the fund to perform basic “stabilization” functions. This is determined by comparing the value of assets to a country’s annual budget, GDP and per-capita savings. Institutional and governance factors such as fiscal rules and approving authority for withdrawals of funds from the SWF also determine the performance of fund.

A successful Stabilization Fund is determined by the following indicators:

a) The Savings Rule: How assets are transferred to the Fund.
b) The Spending Rule: How assets are withdrawn from the Fund.
c) The Investment Strategy: How assets should be invested (medium or long- term).
d) Governance and Implementation: Defined roles and responsibilities for effective management.

## Stabilization Programmes in Nigeria

Over the past three decades, the Nigerian government has made numerous attempts to stabilize the economy on a long-run growth trajectory through various policies and programmes. Contested legal and governance issues, lack of consistency and continuity and poor management of resources have plagued these attempts.

### *Nigeria Before Stabilization Policies (1971-1988)*

Dominant stabilization measures put in place during this period featured demand management strategies. These included the use of fiscal and monetary policies to regulate economic activities. Fiscal policies focused on government expenditure and taxes while monetary policy focused on money supply, interest rates and exchange rates. These instruments were used to determine the level of economic activities. The oil price rise in the early 1970s triggered an increase in government revenue and expenditure, however, the oil price decline in the early 1980s, resulted in revenue decline; thereby increasing unemployment and inflation rates. GDP growth plummeted.

### *The 0.5% Stabilization Policy (1989-2003)*

The fund was backed by the Allocation of Revenue Act 1990 (Federation Account). The 0.5% allocation from the Federation Account to the Fund was meant to augment allocation to “any state of the Federation which suffers absolute decline in its revenue arising from factors outside its control”. It is estimated that at least $13 billion has accrued to the fund between 1989 (when the fund was first operated) and 1994. According to the NEITI Occasional Paper Series, Issue 2, July 2017, reports released in 2013 showed that while N109.7 billion was transferred into the account for the period between 2007 and 2011, a sum of N152.4 billion was withdrawn from the account during the same period. Figure 3.1 shows that while the rise in oil price boosted government revenue, Government expenditure did not rise to meet the increase in revenue. This accounts for the growth of the Fund during this era.

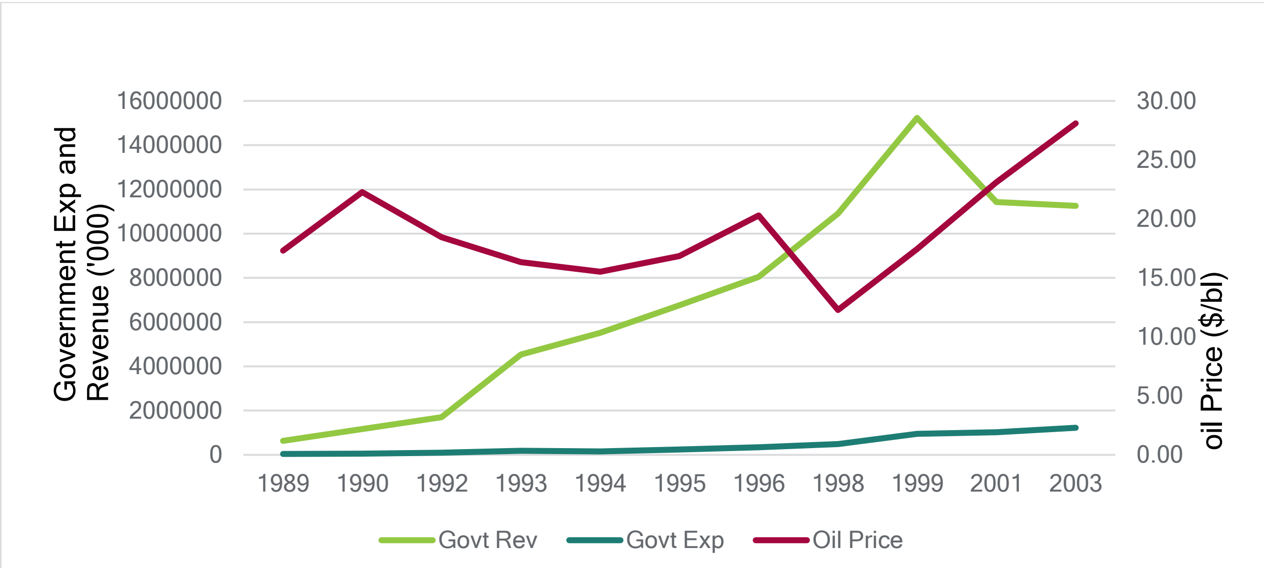


*Figure 20 - Oil Price, Government Expenditure and Revenue (1989-2003) - NBS, CBN*

## *The Excess Crude Account (2004- 2011)*

The Excess Crude Account was established in 2004 to generate revenue to meet future budget shortfalls, provide dedicated funding for infrastructure development and maintain savings for future generations. The Nigerian government account holds savings of oil revenues that are greater than budget benchmark prices to reduce government expenditure vulnerability to oil prices. The ECA has been criticized by state governors who deem it in contradiction with the1999 constitution and demand a 'sharing' of the monies among the three levels of government. This would, however, leave no safeguard against future price shocks or resources for strategic long-term investment (Gillies, 2011:2).

Surging crude oil prices led to the Excess Crude Account increasing almost fourfold, from $5.1 billion in 2005 to over $20 billion by November 2008, accounting for more than one-third of Nigeria's external reserves at that time. By June 2010, the account had fallen to less than $4 billion due to budget deficits at all levels of government in Nigeria and the steep drop in oil prices (NEITI Occasional Paper Series, Issue 2, July 2017).

A study by National Economic Council in 2015 revealed that while $201.2 billion accrued to the ECA between 2005 and 2015, the amount withdrawn from the account was $204.7 billion, indicating a deficit balance. Unfortunately, withdrawals from the ECA did not have a serious impact on reducing unemployment as it increased from 13.4% in 2004 to 19.7% in 2009. GDP growth shrank from 10.4% in 2004 to 5.30% in 2011 and inflation soared from 15% in 2004 to 18.5% in 2016. The ECA was, however, available to pay off the Paris Club debt and mitigated the 2008/2009 financial crises when oil revenue reduced drastically due to drastic decline in oil prices.

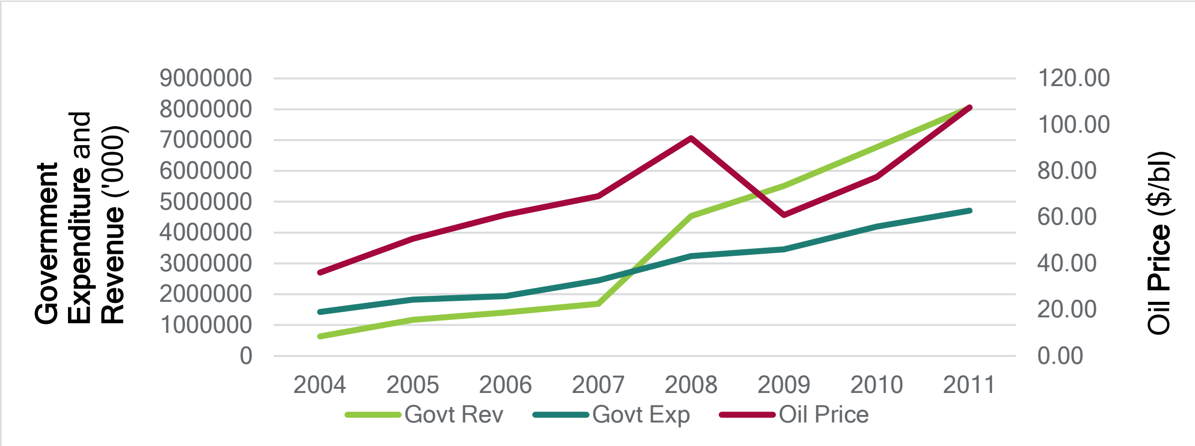


*Figure 21 - Oil Price, Government expenditure and Revenue (2004-2011) - NBS, CBN*

### The Sovereign Wealth Fund (2011- Date)

In a bid to remedy legal issues related to the ECA, the Federal Government established the Sovereign Wealth Fund (SWF) in Nigeria. Government decisions with regard to SWFs under their control affect the interests of four key groups: governments regulating their SWFs, citizens of those countries, domestic and international financial market participants as well as governments and citizens in countries where funds are invested (Truman, 2010:1).

According to the Central Bank, the Nigerian Sovereign Wealth Fund was created to address disputes from state governors and legislators over legalities of the ECA. Fund components include the Future Generation Fund, the Stabilisation Fund and the Infrastructural Fund. It is important to note that the ECA is still in operation even while the NSIA is in existence.

The NSIA Act 2011 mandated the Fund to receive and manage a diversified portfolio of medium and long-term investment revenue in preparation for the eventual depletion of Nigeria's oil resources. The Act seeks to build a savings base for Nigerian citizens, contribute to the development of Nigeria's infrastructure and provide stabilization support in times of economic stress. The initial funding of US$1 billion was comprised of proportional contributions from Federal, State, Local Government and Area Councils in accordance with the formula for allocating Federation revenues (NEITI Occasional Paper Series, Issue 2, July 2017).

Subsequent funding is derived from Federation Account residual funds transferred to the Authority in a manner specified in the Act. Nevertheless, the continued existence of the ECA has impeded SWF funding and impacted its effectiveness. Despite the existence of both funds, Nigeria experienced declining economic growth in 2015 and a subsequent recession through the 2nd quarter of 2017 as the funds were not sufficient to serve as buffers for the economy during the oil price crash.

## Management of the Funds

Management of the NSIA meets international standards, scoring 9 out of 10 on the global Sovereign Wealth Institute's transparency index; the highest of any African SWF. The NSIA Act (2011) is a significant improvement on the ECA and 0.5% Stabilization Fund which were established without specific governance, transparency or accountability requirements. The NSI Act (2011) includes the following governance and accountability features:

- Extensive corporate governance and management provisions in line with global principles, best practices and international financial reporting standards.
- Requirements for professionalism and technical expertise of management and members of the NSIA board.
- Clearly defined reporting requirements and accountability relationships between management, the Board, and Council.
- Regular reporting to the NSIA Council, National Economic Council, National Assembly, state houses of assembly and the general public.

*Table 4 - NSIA Savings and Earnings - NEITI Occasional Paper Series, Issue 2, July 2017*

| Year | Savings (US$ billion) | Earnings (N million) |
|---|---|---|
| **2012** | 1,000 | 0 |
| **2013** | 0 | 505 |
| **2014** | 0 | 15,800 |
| **2015** | 250 | 26,300 |
| **2016** | 0 | 149,830 |
| **2017** | 250 | - |
| **Total** | 1,500 | 192,430 |

The table above shows accruals to the SWF, indicating that cumulative deposits of $1.5billion remain intact. An additional N192billion has been earned by NSIA investments since 2012. This substantial 30% plus increase establishes the potential of the SWF.

## Bill to Establish Excess Revenue Fund Account

Members of the National Assembly (NASS) individually and collectively consider the Excess Crude Account (ECA) an affront to the constitutional powers of the Legislature as per section 81 of the 1999 Constitution. Lawmakers have refused to acknowledge the existence of “any Excess Crude Account", describing it as an illegality and constitutional breach. Each session of the eight Assemblies elected since 1999 have featured hearings in some form into management of the ECA by the Federal and 36 State Governments.

When the Federal Government tabled notification of its intention to spend $1 Billion USD on an anti-terrorism war, the 8th National Assembly of the Senate and House of Representatives decided to take legislative action.

In February 2018, a bill seeking to amend Section 5, of the Allocation of Revenue (Federation Account) Act, 2004, included a new Section 5(a) to establish the Excess Revenue Fund Account (ERFA). What lawmakers envisaged was that all revenues or other monies raised or received by the Federation above revenue targets set for funding the budget in a fiscal year will accrue to the ERFA and be subject to their appropriation process.

It stipulates that no monies shall be withdrawn from the Account except to meet expenditure that is authorized and or prescribed by the National Assembly pursuant to Section 81 of the Constitution. Any expenditure from the proposed account shall be in accordance with Section 2 and 3 of the Principal Act; provided that the Federation Account Committee shall prescribe the manner of distributing such monies to the Consolidated Revenue Fund for the purpose of the bill and Sovereign Wealth Fund. The Bill passed second reading in the House of Representatives.

The House of Representatives seeks to use the ERFA as a tool for conferring legitimacy to the ECA while simultaneously asserting their legislative influence. It is unclear how an Act with equivalent status to the Fiscal Responsibility Act would have the constitutionality, legality and legitimacy that the ECA has lacked in the last fifteen years.

To assess the effectiveness of the proposed ERFA, it is important to ask three key questions.

1. **Will the ERFA be Binding on States and Local Governments?**

The status of the ERFA, if eventually passed into law by both houses of the National Assembly and signed into law by the President, would still not have superior status to the Fiscal Responsibility Act. To the extent that provisions of the proposed act will not be binding on States and Local governments in the distribution of excess revenue, it falls short of the objective of a consensus-based Stabilization Fund for Savings by the federating units.

Even if the ERFA was politically negotiated and accorded legitimacy by the Federal, State and Local governments as well as the three arms of Government, without a constitutional amendment the outcome would be no better for citizens than what is obtainable with the ECA.

2. **Is the ERFA Constitutional?**

The Revenue Mobilisation Allocation and Fiscal Commission (RMAFC) in its recent public reaction stated, “The national assembly has no power to dictate how excess revenue is to be spent.”

The Commission further asserted that the “constitution is very clear on how the money accrued from Excess Revenue would come, who owns it and how it should be spent. So, the National Assembly cannot dictate the management of these funds when it cannot decide for state and local governments.”

Section 162(1) of the 1999 constitution provides that: “The Federation shall maintain a special account to be called “the Federation Account” into which shall be paid all revenues collected by the Government of the Federation, except the proceeds from the personal income tax of the personnel of the armed forces of the Federation, the Nigeria Police Force, the Ministry or department of government charged with responsibility for Foreign Affairs and the residents of the Federal Capital Territory, Abuja."

Subsection (2) also provides that: "The President, upon the receipt of advice from the Revenue Mobilization Allocation and Fiscal Commission, shall table before the National Assembly proposals for revenue allocation from the Federation Account, and in determining the formula, the National Assembly shall take into account, the allocation principles especially those of population, equality of States, internal revenue generation, land mass, terrain as well as population density."

3. **How did the National Assembly miss the opportunity to include the required alteration to the relevant sections in the recently concluded constitutional amendment process?**

It would be interesting to know what the legislative incentives or disincentives were that led to the omission of any discussion of the Excess Revenue Fund Account as part of the previous constitutional amendment process. The push for a stand-alone bill instead of taking advantage of the window of opportunity for constitutional amendment could be interpreted as self-serving on the part of the Legislators since the bill merely transfers appropriations from the ECA from the Executive to the Legislature.

# The Impact of Stabilization Policies in Nigeria and Selected Countries

## Introduction

The changing dynamics of commodity prices have necessitated the need for governments to establish stabilization funds as buffers during periods of economic downturn. Against this backdrop, natural resource rich countries including Norway, Saudi Arabia and Algeria have designed savings and stabilization mechanisms that shield their economies from the vagaries of volatile commodity prices. Nigeria's ECA and SWF were established to ensure that excess crude oil revenues are available in times of fiscal difficulty.

## Comparative Analysis

### *Levels of Compliance to Indicators of a Successful Stabilization Programme*

#### *Norway*

- **Current Fund Status:** Established in 1990, the fund has accumulated $1.032 billion to date.
- **Savings Rule:** 100% of oil revenue accrues to the fund.
- **Investment Rule:** Funds are invested in near cash assets. Norway owns 2% of all listed shares in Europe and 1% globally. 60% of the funds are in equities and 40% in fixed income and real estate. Investments are predominately outside the country for diversification of risks.
- **Withdrawal Rule:** Budgetary rule stipulates that drawdown must not exceed 4% per annum which is equal to the rate of return, ensuring that capital remains intact.
- **Structural Strengths:** Model for most nations. Robust fiscal structures employing competitive, transparent and successful asset management strategies.
- **Structural Weaknesses:** None evident.
- **Control:** Independent, though not constitutionally guaranteed. Protected as a separate unit within the central bank, overseen by the finance ministry and monitored by parliament. Frugal and transparent, information regarding every investment is available online.

#### *Saudi Arabia*

- **Current Fund Status:** Established in 1971, the fund has accumulated $514 billion to date.
- **Investment Rule:** Funds are invested in both domestic and foreign assets. Standardized rules, procedures and guidelines are being developed to govern investment decisions focused on building a diversified portfolio that will achieve attractive, risk-adjusted returns over time.
- **Structural Strengths:** Given extraordinary oil reserves, there is no foreseen impact resulting from declining production levels. Accumulated approximately $800bn (end of 2014) in foreign assets through ad hoc savings during previous boom periods.
- **Structural Weaknesses:** Lack of a rule-based framework for savings, stabilization and spending of oil revenues.
- **Control:** Overseen by Saudi Arabia's Council of Economy and Development to ensure transparency and achieve best practices.

### *Algeria*

- Established in 2000, the fund has accumulated $7.6 billion to date.
- **Savings Rule:** Deposits are made to the fund based on a conservative reference oil price of $19/barrel.

### *Nigeria*

- **Current Fund Status:** Established in 2011, the fund has accumulated $1.5 billion to date.
- **Savings Rule:** Oil revenue in excess of budget price and volume benchmarks should be transferred to the NSIA. The law prescribes that 60% of the fund be equally allocated to: (1) Future Generations Fund (2) Nigeria Infrastructure Fund and (3) Stabilization Fund. 40% is to be allocated at the discretion of the board of the NSIA.
- **Investment Rule:** Short term assets which are easily monetized for budget augmentation. Up to 10% is invested in “social infrastructure” tagged as “development projects”. Funds are currently invested in agriculture, healthcare, motorways, power and real estate.
- **Withdrawal Rule:** Up to 60% of profits available yearly for distribution to the three tiers of government. Assets and capital from the Stabilization Fund is available for financing any shortfall in the budget arising from declining oil prices below the budget benchmark.
- **Structural Strengths:** Robust governance and accountability framework for fund management.
- **Structural Weaknesses:** Lack of a constitutional provision for savings, stabilization and spending of oil revenues. Saving and withdrawal rules are not precise, giving room for manipulation.
- **Control:** Withdrawals must be approved by the NSIA Council comprising Nigeria’s president, five cabinet members, state governors and twelve others representing the private sector, academia, youth and civil society.

## Welfare Indicators

Most Sovereign Wealth Funds established by oil rich countries are used to support welfare targets including reduction in unemployment, inflation, increase in per capita income and improved general well-being of the citizenry. An analysis of the impact of oil price fluctuations on welfare variables in Nigeria is compared with Norway, Saudi Arabia and Algeria below.

### *Per Capita Income*

There is a direct correlation between per capita income and the welfare of individuals in any country. Figure 22 presents a comparative analysis of the per capita national income for selected oil-rich countries. Norway has the highest per capita income followed by Saudi Arabia. Nigeria ranks lowest.

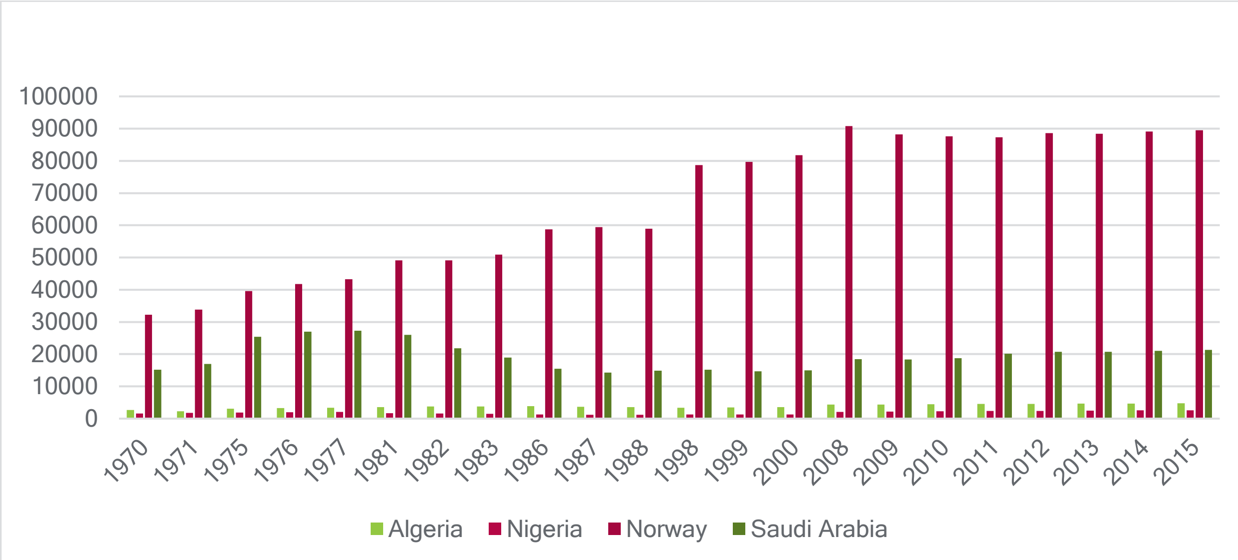


*Figure 22 - Comparative GDP Capita (1970-2015) - NBS, World Development Indicators*

## *Primary School Enrollment*

Poverty and low per capita incomes are factors that affect primary school enrollment. Nigeria ranks highest, followed by Algeria. Norway has the lowest percentage of out of school children among the four oil-producing countries under review (Figure 23). The high number of children out of school in Nigeria reflects government's inability to deploy expenditure to address human development needs.

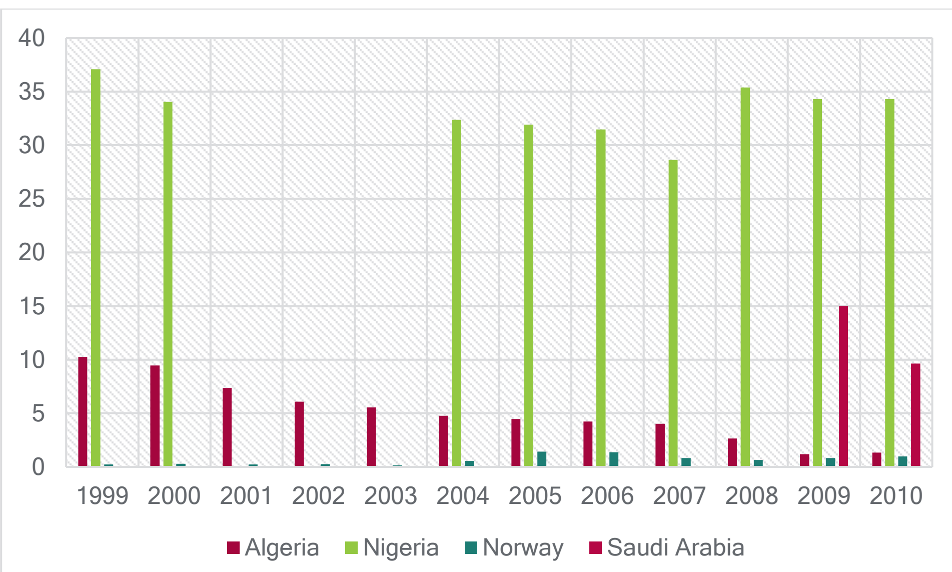


*Figure 23 - Children out of school (% of primary school age) - World Development Indicators*

## *Electricity Consumption and Access to Electricity*

Electricity consumption is proportional to the level of income of an individual as well as the national income of a nation. A high-income economy results in high electricity consumption and access. The same principle applies to electricity generation, transmission and distribution. Most poor and rural Nigerians are not connected to the national grid and do not have access to electricity.

As demonstrated in Figure 24 below, less than 50% of Nigerians have access to electricity, Algeria and Saudi Arabia have over 80% access, while Norway has 100% access. Successive Nigerian governments have been unable to provide reliable access to electricity. The existing infrastructure cannot generate, transmit and effectively supply power to the percentage of the population connected to the national grid.

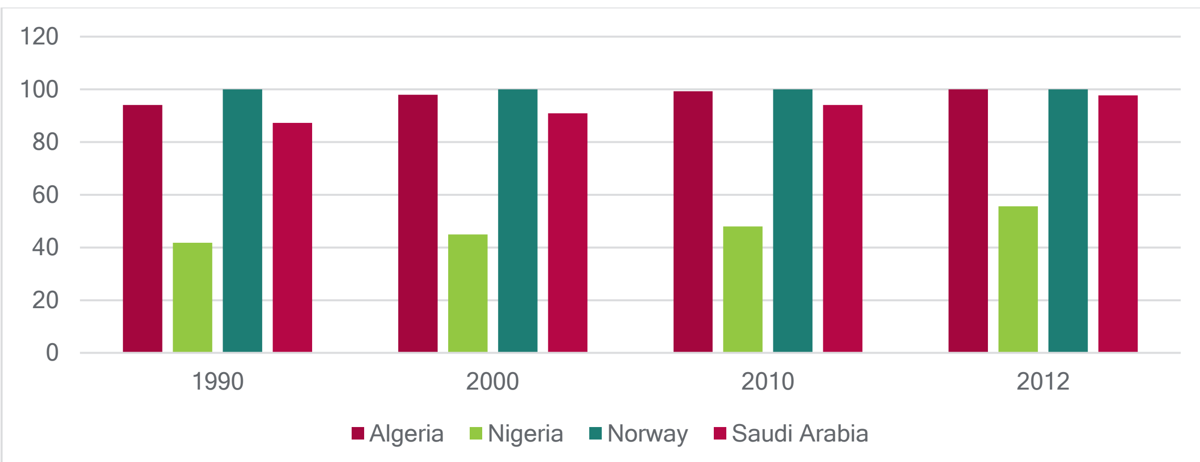


*Figure 24 - Access to Electricity % of Population - World Development Indicators*

## *Comparative Mortality Rate*

Child mortality in Nigeria is among the highest in the world as a result of staggering levels of poverty. Nigeria records 100-210 deaths per 1000 births for children under five years due to preventable diseases including Malaria, Pneumonia, Diarrhea and Measles. Figure 25 below shows that Nigeria accounts for a disproportionate  number infant deaths among the four countries in review, followed by Algeria.

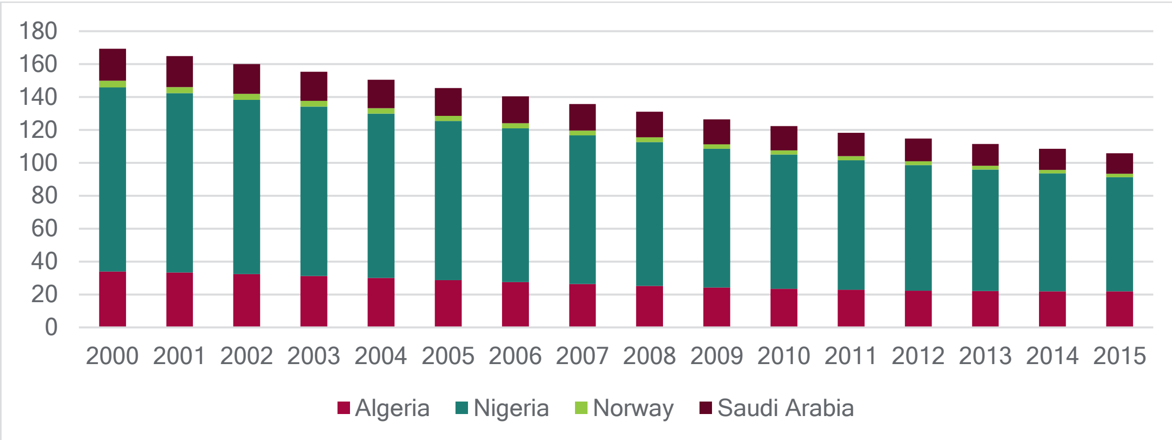


*Figure 25 - Mortality Rate, infant (per 1,000 live births) - World Development IndicatorsComparative Life Expectancy*

A country's per capita income is an indicator of the quality of food, health care, and living conditions of their citizens, factors that determine the life expectancy of an average individual. Norway ranks highest among the countries under consideration with a life expectancy of 78 years while Nigeria ranks lowest with a life expectancy of 48 years.

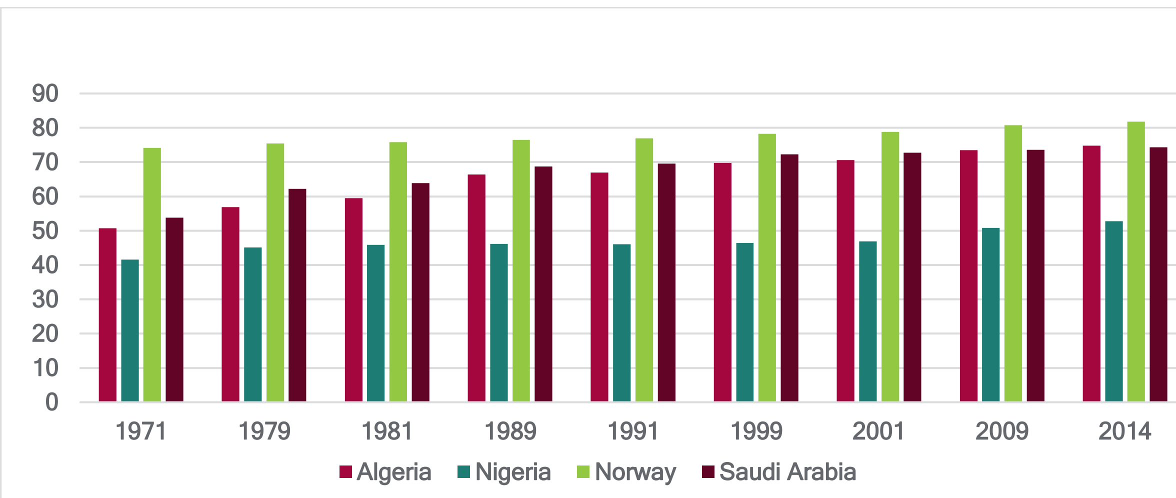


*Figure 26 - Life Expectancy (Years) - World Development Indicators*

## Human Development Index

The Human Development Index is a summary measure of average achievements in key dimensions of human development. These dimensions include life expectancy, quality of education and per capita income. Norway maintains the highest ranking of .09 and Nigeria the lowest with an average ranking of .05. (Figure 27).

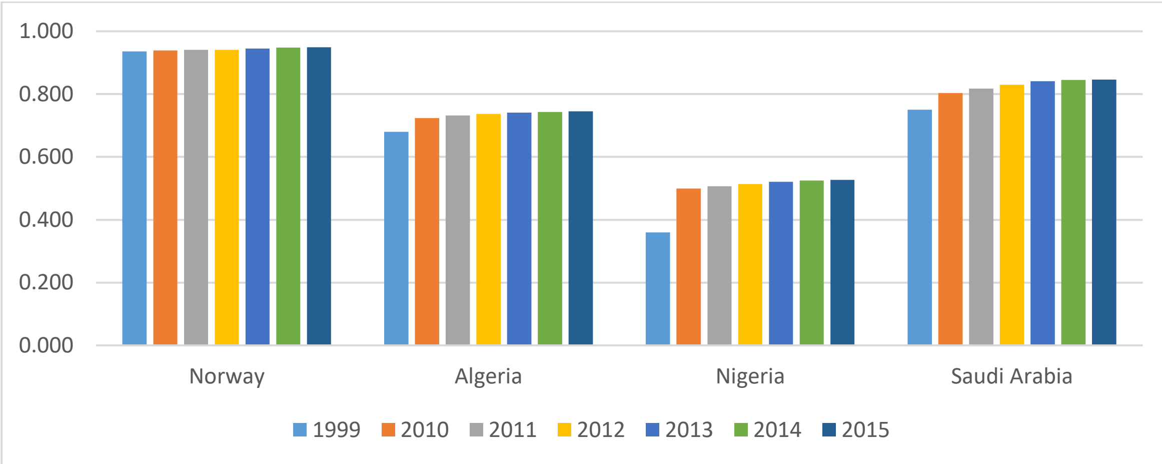


*Figure 27 - Human Development Index - World Development Indicators*

## *Comparative Inflation Rate*

The stability of price levels is an important indicator of a healthy economy. Increasing inflation decreases purchasing power, makes investments less desirable and creates uncertainty for the future. Figure 28 shows that Nigeria has had the worst inflationary experience of the oil producing countries under review.

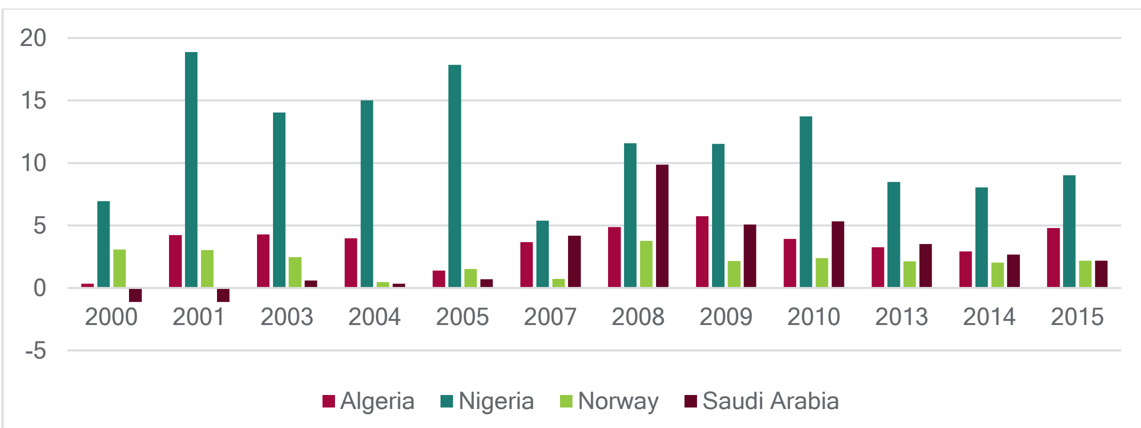


*Figure 28 - Comparative Inflation rate (%) - World Development Indicators*

## Control of Corruption

Corruption in a society undermines the effectiveness of government spending on public goods. Stablisation funds can have little or no impact on the welfare of citizens in a country with rampant corruption. The Transparency International Corruption Perception Index ranks Nigeria 148 out of 180 countries.

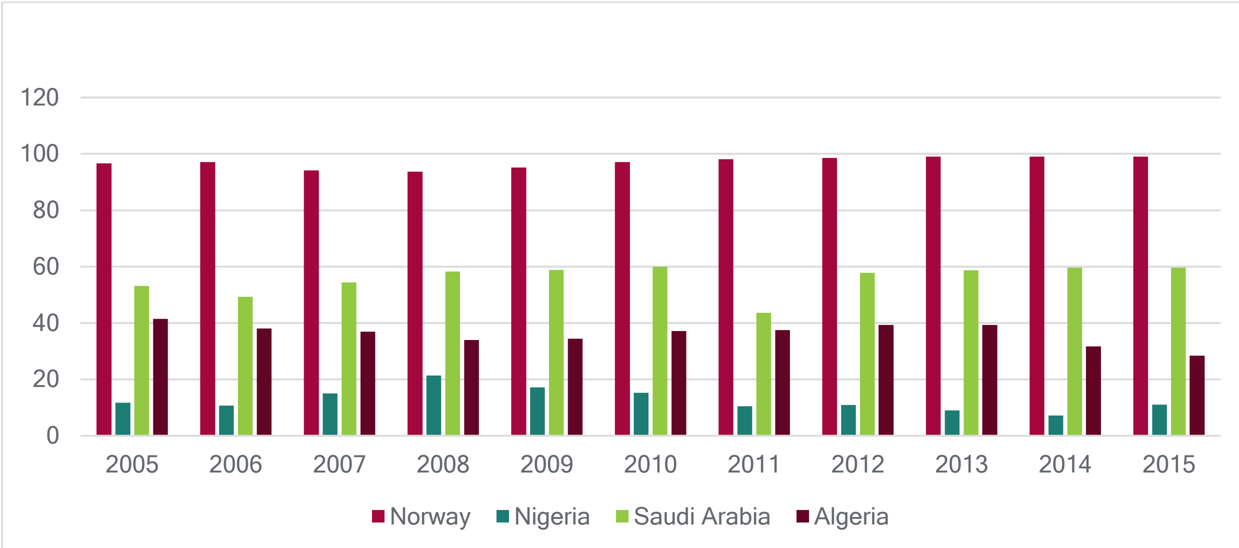


*Figure 29 - Corruption Control (Percentile Rank) - World Development Indicators*

# Policy Recommendations for Improved Management of Nigeria's Oil Revenue

## Challenges to Implementing an Effective Savings and Stabilization Mechanism

### *Political*

The transactional nature of Nigeria's politics undermines the effectiveness of a savings mechanism. Clientelism – the exchange of goods and services for political support – is the dominant culture. The political class remains under persistent pressure to satisfy an overwhelming demand for patronage in order to maintain power.

### *Corruption*

The prevalence of corruption in Nigeria's public institutions erodes confidence in government's ability to manage any kind of stabilization policy. Rampant greed, bribery and nepotism have destroyed the public's faith in governance. Compounding this challenge is a history of inept leadership that has weakened institutions and created a sense of fatalism. As a result, citizens prefer initiatives that deliver immediate gains rather than longer term benefits that are likely to be captured by the elite.

### *Cultural*

At the household level, the experience of the Structural Adjustment Programme in the 1980s hollowed out Nigeria's traditional savings culture due to the havoc wreaked by inflation, exchange rate instability and general uncertainty. Since then, the domestic gross savings rate has continued to decline. A savings and stabilization mechanism is more likely to be sustained in Nigeria if the culture of savings is restored.

### *Constitutional*

Provisions of the Nigerian constitution for management of Federation revenues make no allowance for implementing a savings and stabilization scheme – rendering policy efforts vulnerable to legal action.

## Policy Options for Establishing Fiscal Rules in Nigeria

### *Maintain the Status Quo*

If steps are not taken to address uncoordinated fiscal measures by the Federal and State Governments, the capacity to respond to economic shocks will be limited. Human development indicators will worsen. Nigeria will continue to experience boom and bust cycles, inflation and exchange rates will rise, unemployment will increase, and we will be discussing the same issues; having learned nothing and changed nothing in Nigeria's approach to oil wealth management.

### *Constitutional Amendment and Reform Driven by the Political Class*

In this option, the reform process is initiated by the Executive Arms of the Federal Government and the Thirty-Six States of the Federation and implemented by National and State Houses of Assembly.

National and State Houses of Assembly will need to pass legislation to empower automatic funding of the NSIA by inserting relevant clauses into the Nigerian Constitution. Sections 162(1), (2) & (10) of the 1999 Constitution which prescribe modes of sharing Federation revenue do not make provision for a savings mechanism and will therefore require amendment.

This option, though desirable in the short term, will not address the political, cultural and behavioral impediments to sustaining a savings and stabilization mechanism. Any progress in policy implementation could be quickly and easily reversed.

### *Cultural and Constitutional Reform Driven by National Economic Debates*

This approach will involve a series of citizen-led, national economic governance debates initiated by civil society, to drive cultural and constitutional reform and the adoption of effective legal, institutional and policy frameworks for Nigeria.

These national economic debates should address political, cultural and institutional impediments to responsible fiscal management in Nigeria. Additionally debates should address knowledge asymmetries that foster transactional governance in order to create an organic demand for sustainable development policies.

## Proposed Approach to a Constitutional Amendment

The culture of debates that can result in consensus-building and conflict resolution is yet to become a significant feature of Nigeria's democracy. Political leaders tasked with the responsibility of decision-making are most often driven by political expediency. Opportunities for lasting governance reforms are wasted in playing to the public gallery.

Economic debate has largely focused on distribution mechanisms rather than a deliberative process to mobilize consensus leading to the establishment of prudent oil revenue management rules and systems. An inclusive dialogue on national strategies to utilize and conserve natural resources has never been formalized, despite the numerous political conferences convened to discuss matters of the long-term viability of the Nigerian State.

One factor that is common to all the countries that have recorded remarkable positive outcomes from natural resources is the deliberate orchestration of consensus on critical details of natural resource governance to ensure the political legitimacy of applicable processes, rules and institutions.

The strategy for orchestrating a multi-staged, citizen-driven "National Debate on Economic Governance" should incorporate the following steps:

- Organization of a series of preliminary debates incorporating evidence-based advocacy and nationwide engagement of citizens. These debates will create platforms to educate and empower citizens with knowledge to make improved governance choices. Complex economic and public finance issues should be sufficiently simplified so that the average Nigerian can understand and develop opinions about possible solutions.

  The citizen-led nature of multi-layered debates would foster the emergence of some of the critical "nation formations" of shared values, purpose and identity, cognizant of the diversity Nigeria's citizens.

- The citizens collective created by preliminary debates may then leverage its public following to influence the Federal Government, National Economic Council and State Houses of Assembly to initiate a National Debate. The reason that these governing blocks might welcome such a debate is that the unity of purpose generated around the topic would create political risks for anyone considered to be acting contrary to the interests of the general public. The nature of this debate would lend itself to "solving the problems of Nigerians" and not another round of elite squabble over oil rents.

- Following debates, it is envisaged that a measure of consensus would have been reached on management strategies for natural resource revenues. The political consensus should facilitate the necessary reforms necessary to establish a new set of rules to guide fiscal relationships, revenue and public expenditure management; options for reforming the structure of governance; a diversification strategy that encourages regional competition and productivity; new social contract with tools of social accountability.

- Specific issues requiring consensus would include:
  - Strategy for management of external shocks
  - Reform proposals for Fiscal Federalism
  - Public financial management reform.
  - Reform of Revenue Sharing Formula
  - Revenue Management, Savings and Stabilization System: A constitutional backing for the Fiscal Responsibility Act and the NSIA

*Ghana for example, copied the 1970s approach of Botswana and designed an elaborate bottom-up consultation process. The goals of the consultation were:*
*a) To ensure that the eventual rules and guidelines of the petroleum revenue management meet the aspirations of the people and, to the extent possible.*
*b) Ensure that there is broad consensus on the most fundamental elements of what would eventually become the law.*
*The citizens of Ghana tailored their consultative process to focus on the comprehensive elements of a well-governed resource management. This consultative process that allowed the Ghanaian citizens to give their voice to a range of questions to serve as a model process that Nigeria should adopt as a game-changer for oil revenue management.*

- Economic diversification agenda
- Human capital development strategy

- Resolutions from citizen-led dialogues would include an agreement for a nationwide referendum on issues that require constitutional amendment.

- The final stage of the "National Debates on Economic Governance" would be the implementation of a nationwide referendum proposing key clauses that entrench good economic governance practices for all Nigerians.

## Building Public and Political Legitimacy for a New Fiscal Orientation

The current economic situation requires a political consensus for short and medium-term savings. It is feasible to adjust expenditure if authorities can gather sufficient political and social support. This is likely to be a challenge because required adjustments will likely result in significant devaluation of the Naira or down-sizing of the public sector at all levels. Actions necessary to prevent Nigeria's fiscal crisis from growing worse is likely to have extensive political consequences.

It is important to trigger effective public dialogue to build political buy-in for the comprehensive reform of public financial management at a minimum, or a full scale constitutional dialogue that pioneers a referendum on issues in Nigeria. Nigeria might borrow from the Ghanaian model in which input from citizens led to the more technocratic design of laws and policies that safeguard natural resource revenues. To that effect, it is recommended that civil society groups including ORTI, NEITI, Natural Resource Governance Institute and BudgIT NG commit additional resources to disseminate simplified information on the state of oil revenue management for public consumption.

## Conclusion

The implementation of an effective and sustainable savings and stabilization mechanism in Nigeria will have enormous political costs as it requires significant adjustment in expenditure which could result in the devaluation of the Naira and down-sizing of the public sector at all levels. Government will only consider it a viable option if they are convinced that the policy direction enjoys sufficient political and social support.

Political consensus to promote savings in the short and medium term is therefore needed if Nigeria is to reform its natural resource governance.

A series of national economic debates, if properly orchestrated, can facilitate political buy-in for comprehensive reform of public financial management at a minimum or a full scale constitutional change that pioneers new approaches to governance to ensure a prosperous and inclusive future for Nigerians.