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Political economy of oil resources management in Nigeria: Lessons from other countries

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Political Economy of Oil Resources Management in Nigeria: Lessons from Other Countries

Perekunah B. Eregha & Ekundayo P. Mesagan

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Abstract

The study focuses on the political economy of oil resources management in Nigeria with the sole purpose of showcasing how far the country has gone in effectively managing its crude oil proceeds. It presents a brief history on the excess crude account as well as the sovereign wealth fund in Nigeria and then presents the models of excess oil resource management of some other countries. This is to enable Nigeria to draw some lessons and then take steps that guarantees the sustenance of growth and development.

Keywords: Crude Oil; Political Economy; Sovereign Wealth Fund; Excess Crude Account; Growth; Nigeria.

JEL Classification: D72, D73, D78, Q34, Q43

1. Introduction

The quest to develop the Nigerian economy from crude oil proceeds has not achieved the desired results due to several challenges plaguing the oil sector. Since the discovery of crude oil in Nigeria, the country is still hindered by financial and economic challenges due to the mismanagement of crude oil proceeds accruing to the country. In fact, the country is ranked among the most corrupt countries in the world due to the activities of public office holders who consistently syphoned crude oil proceeds. Consequent on this, efforts to diversify the economy has remained largely a mirage. During the periods of huge oil earnings when a

barrel of crude oil was sold for over 100 US dollars, the country failed to make provision for the macroeconomic shocks that unexpected oil price movements could cause (Eregha and Mesagan, 2017).

Despite the recommendation of the international agencies for a sovereign wealth fund which is a state-owned investment fund, where earnings from excess crude could be pooled for future use (Tsani, 2013; Mehrpouya, 2015; Isola *et al.,* 2017; Charles *et al.,* 2018; Mesagan *et al.,* 2019), the failed in this regard. Nigeria, as a country, was unable to build its sovereign wealth fund to a point where it could provide the needed stabilization it requires against shocks from international crude oil price fluctuations. The experiences of other oil producing countries, such as Norway and Kuwait, have shown that the sovereign wealth fund can serve as a catalyst for economic stability in providing the needed economic cushioning when crude oil price crashes internationally. Lack of political will in effectively managing crude oil wealth in Nigeria has placed serious limitation on the country's effort to diversify its productive base, thereby inhibiting its quest to move from being a mono-product to a multi-product economy (Eregha *et al.,* 2015; Mesagan, 2015). The huge Petro-dollars earned by the country on daily basis, in the recent past, has made Nigeria to consistently run on budget deficit. In fact, the country is listed among the major oil producing countries that run on budget deficits all the time (Isola and Mesagan, 2014; Ufuoma& Omoruyi, 2014; Emodi & Boo, 2015; Omojolaibi *et al.,* 2016; Mesagan and Dauda, 2016).

Moreover, disagreement between the government, oil marketers and organised labour over fuel subsidy is another issue negatively affecting the country. It is an on-going debate whether fuel subsidy regime should come to an end or not, owing to the country's loss of revenue from the fall in crude oil prices. In a response to this, the Federal government of

Nigeria recently reviewed upward the pump price of Premium Motor Spirit (PMS) from ₦86.50 to a ceiling of ₦145 and this did not go down well with the major faction of the Nigeria Labour Congress (NLC) which down-tool for few days before it was eventually called-off. It is in this light that this present study attempts to investigate the political economy of crude oil management in Nigeria by taking a clue from the experiences of other oil resource abundant countries, which have been able to surmount both the resource curse and Dutch disease syndromes by diversifying their economies.

To this end, this is a policy paper that sets out to review how Nigeria has managed its crude oil proceeds since oil discovery, with a view to analyse the behaviour of the Nigeria's macro-economy and oil revenue up to date. It also undertakes a critical review of oil resources management models adopted so far and present models from other resource abundant economies to draw lessons that can assist the country in instituting an appropriate oil resource management model for economic diversification.

2. Review of Role of Institutions in Oil Resource Management

Empirical studies have suggested that a very important factor in resource management and economic development is strong institutions and good governance (Acemoglu, Johnson, & Robinson, 2001; Rodrik, Subramanian, & Trebbi, 2004; Ahmadov, Mammadov, &Aslanli, 2013; Eregha & Mesagan, 2016). This is because when institutions are weak, good governance will be lacking and effective management of resources -both natural and human- becomes a mirage. More insightful studies of Mehlum, Karl, & Ragnar (2006), and Azhgaliyeva (2014) explained in detail the decisive role that institutional quality and governance play in ensuring effective resource management for economic development. According Mehlum *et al* (2006), even when institutional settings are entirely persistent and did not affect oil and gas discovery, institutional quality are still very decisive. Bulte,Richard,

& Robert (2005), Stevens &Dietsche (2008), Beland &Tiagi (2009), Perry & Olivera (2009), and Wizarat (2013) affirmed in their studies that good governance and strong institutions can enable resource-endowed nations turn resource curse into resource blessing. The studies confirmed that economic growth and natural resources have positive interactions and spillovers between them. They however, agreed that corruption, poor governance and rent seeking are observed in countries with weak institutions that can trigger conflict. The notion that poor governance and deteriorating institutions cause problems in resource rich countries is also supported by Kolstad & Soreide (2009).

Having established the important role of good governance and institutions in resource rich nations, studies in economic literature have gone further to compare the performance of resource abundant countries that are mono-product like Nigeria with that of export-diversified countries. For instance, Mehlum *et al* (2006), Brunnschweiler & Bulte (2008), Wizarat (2013), as well as, Mesagan and Bello (2018) found that resource abundant countries have lower long run rates of growth than countries with a more diversified export structure. It thus follows that poor management of oil proceeds caused by weak institutions have negative effect on the export performance and economic growth of resource rich nations. Studies in the line of thought that weak institutions prevent resource abundant countries to diversify their export structure include Sachs & Warner (1995), Kronenberg (2004), Collier & Hoeffler (2009) and Eregha & Mesagan (2016). The argument is that when the proceed from a natural resource, is mismanaged, it reduces the amount of resources available in diversifying the export base of the economy, cripples export performance, and lowers long run growth. Apart from these studies, others such as Tsani (2013) investigated the role of institutional quality, governance and resource funds in resource-abundant economies. The study which was driven by the controversial debate on the inability of resource funds in addressing the resource curse,

observed that resource funds are veritable tools for improving governance and for addressing the institutional deterioration in resource-endowed nations.

From the foregoing, it is important to stress that several of the studies that have been reviewed in this study have solely beamed searchlight on the role of quality institutions in the management of natural resource proceeds. To mention a few, studies like Rodrik *et al* (2004) and Ahmadov *et al* (2013),only traced the discourse of effective resource management to institutional quality while Mehlum *et al* (2006) and Azhgaliyeva (2014) focused on the role of institution in promoting economic development through resource abundance. In addition, studies like Beland & Tiagi (2009), Perry & Olivera (2009), andWizarat (2013),only investigated how resource-endowed nations can turn resource curse into resource blessing via the institution channel, while Sachs & Warner (1995), Kronenberg (2004), as well as, Collier & Hoeffler (2009), linked countries' ability to diversify their export structure to the strength of their prevailing institutions. It is obvious that these studies have focused more on natural resource abundance and not solely on oil resource, in which Nigeria is well endowed. Other studies have been mostly empirical, but this is a policy paper to address a pertinent issue currently affecting the Nigerian economy. In addition, the management of resource wealth has not been given considerable attention in the literature, and this is very important, especially in a country like Nigeria. Hence, the need to fill this noticeable gap by examining the political economy of managing oil proceeds in an oil resource abundant economy like Nigeria.

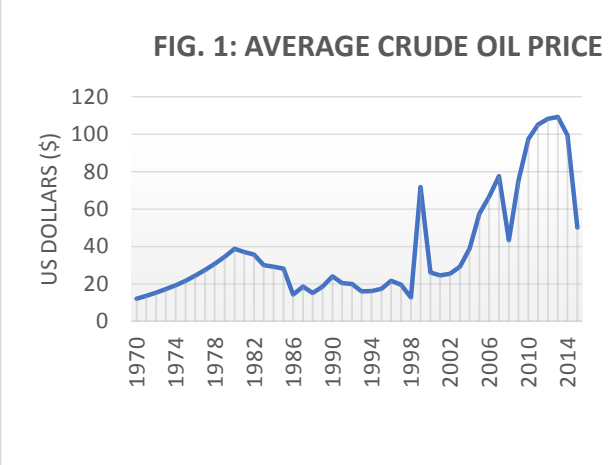
3. Research Methodology

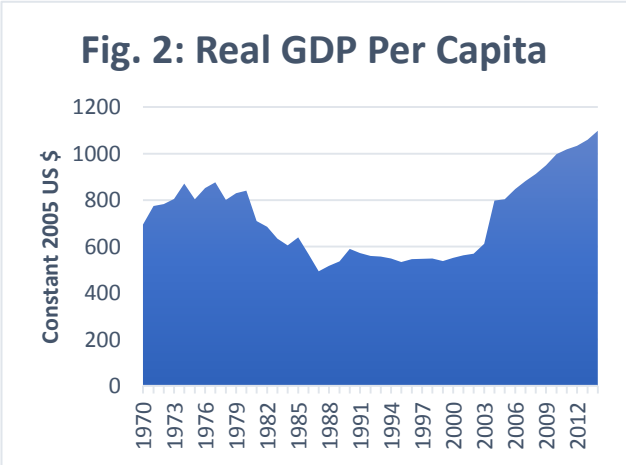
To assess the political economy of oil resource management in Nigeria, this study employs strictly descriptive and exploratory research approach. The advantage of using the descriptive

methodology is hinged on the fact that it makes it possible to analyse the trend of various indicators and paint a clearer picture. Furthermore, the study's quest to analyse the situation in other oil-producing countries with a view recommend appropriate policies for Nigeria in effectively managing its crude oil proceeds informs the use of the exploratory research approach. Hence, to examine the efficiency of oil resource management in Nigeria, the study uses graphs and average annual performance of key economic indicators like the real gross domestic product, crude oil price, exchange rate, inflation rate, and crude oil benchmark prices. The study also relates the trend of crude oil production to a social indicator like the poverty rate to add some social dimension to the discussion.

4. Oil Proceeds and the Nigerian Macroeconomic Indicators

In section 2, it is evident that proper management of oil resources can provide impetus for stimulating the long run growth of an economy and can also serve as a catalyst to diversifying the export base of a nation.

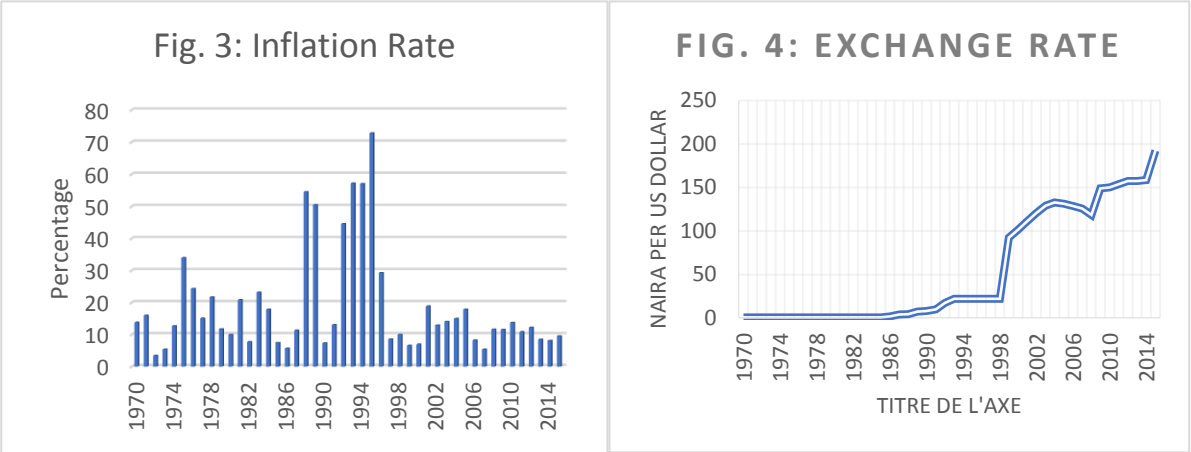




Source: Authors Computation from WDI (2017)

In figures 1 and 2, it is evident that the main driver of Nigeria's growth is crude oil export. Between 1970 and 2014, crude oil price has been highly volatile, and its effect can be seen very clearly in terms of the performance of the economy as GDP growth rate took a big deep between the early 1980s as oil price fluctuates. Especially, between early 1980s and early 1990s, when

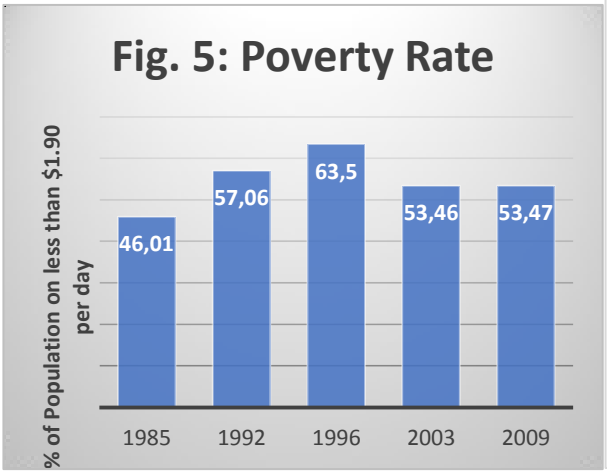
crude oil earnings for the country revolved around the $20 US mark, GDP per capita in Nigeria was also very low revolving below $600 US dollar mark. However, between the early 2000s and lately 2014, before the late downward trend up to date, the GDP per capita in Nigeria has received a boost moving close to as high as around $1000 US dollar mark. This implies that the Nigerian economy has been solely dependent on happenings in the international crude oil price and if not well managed, it exposed the economy to serious external shocks.

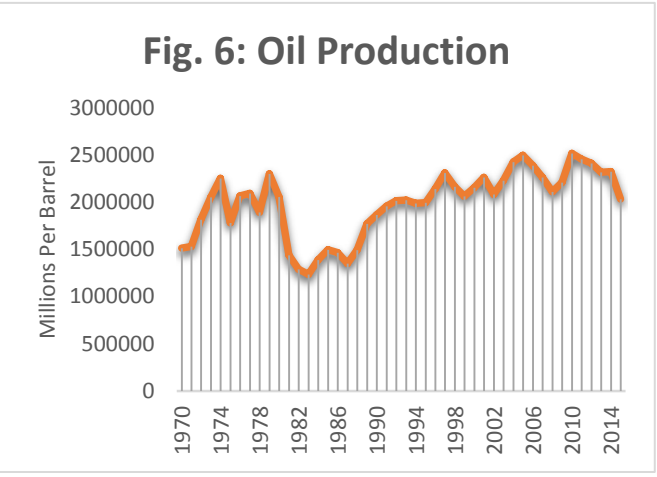


Source: Authors Computation from WDI (2017)

In the same vein, inflation rate in Nigeria as seen in figure 3 was somewhat high in the late 1980s up to the early 1990s, however, efforts on the part of government to maintain a single inflation digit has seen the country improved significantly while being able to keep inflation below the 10% rate between mid-1990s to early 2000. Despite the occasional surge in inflation rate between 2001 and 2005, Nigeria has been able to maintain a single digit inflation rate on the average up to 2014 before the latest fall in the international crude oil price. A striking feature of exchange rate was noticed in figure 4 as the trend of exchange rate shows that the naira to dollar exchange rate has continued to rise significantly since the early 1990s up to date. The post 2014 trend, which is the period of the current international shock in crude oil price, has seen the naira exchanging for over ₦300 to one US dollar at some point. This also has some implication for the inflation rate presented in figure 3 as the inflation rate in 2016 has now gone extremely beyond 15% in the first quarter of the year.

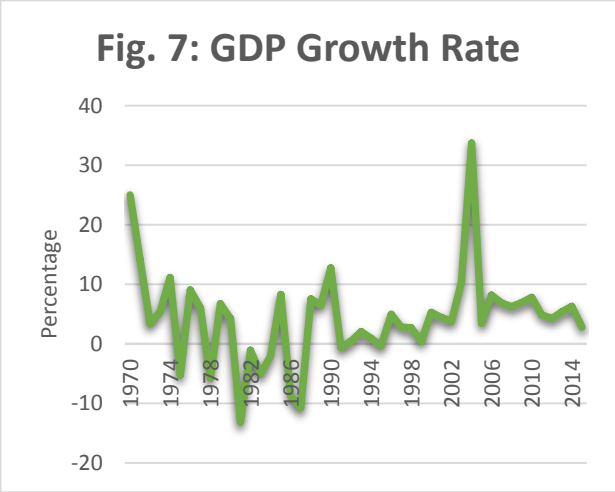
This can be attributed to the inability of the economy to effectively manage the shock it is exposed to from the ongoing international crude oil crises.

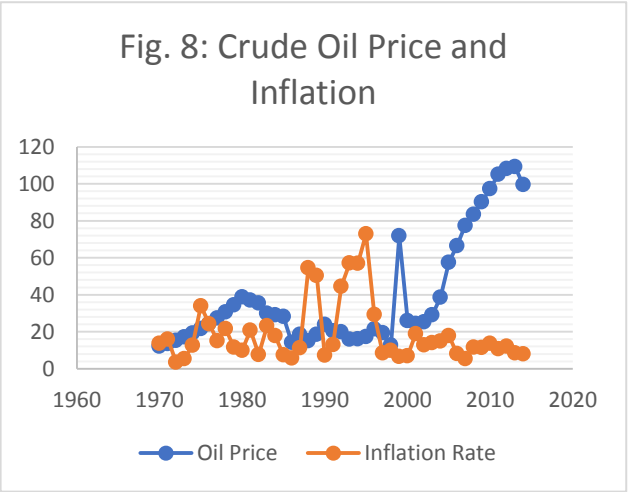




Source: Authors Computation from WDI (2017)

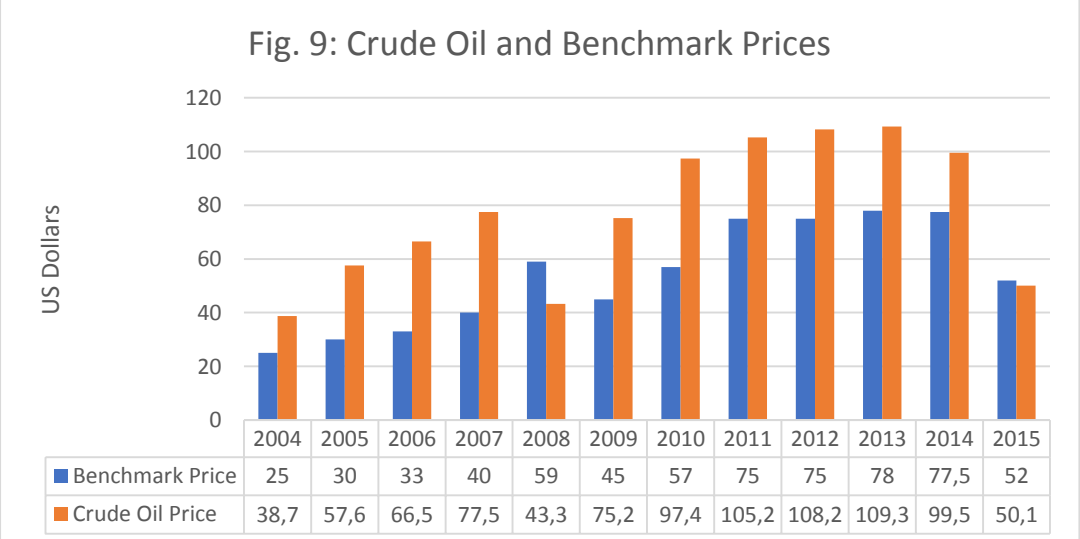
Despite the huge oil earnings that Nigeria has garnered in the past, most of the citizenry are still very poor. In figure 6, between 1990 up to 2014, Nigeria has maintained a little above 2 million barrels of crude oil export per day. However, the poverty level of the citizens, as presented in figure 5, remains very pathetic. Presented in terms of the proportion of population living on a less than $1.90 per day, about 46% and 57% people were poor in 1985 and 1992 respectively. This rose to about 63.5% in 1996 before stagnating at about 53.46% and 53.47% respectively in 2003 and 2009. It thus shows that efforts by the Federal government to effectively manage the excess crude to galvanise investment and secure a better future for the citizens have not yielded any benefit due to corruption and mismanagement of funds.





Source: World Development Indicators (2015)

In figure 7, the growth rate of GDP in Nigeria has remained fairly stable at an average of 6% per annum with the exception of few years in the early 1970s and lately. In fact, GDP growth in the country, which was pegged at about 6.3% in 2014, slumped to about 2.8% in 2015 due to the recent oil price fall. According to the global forecast, the country's GDP growth in the first quarter of 2016 was -0.5%. This is not a good indicator for an economy if the current trend is not halted. In figure 8, crude oil price lately has shown some positive relationship with inflation rate as noticed in the economy between 2015 and 2016.This is caused by the rise in importation bills, and it has negative implications on the import dependent economy.



	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Benchmark Price	25	30	33	40	59	45	57	75	75	78	77,5	52
Crude Oil Price	38,7	57,6	66,5	77,5	43,3	75,2	97,4	105,2	108,2	109,3	99,5	50,1

Source: Authors' Computation from Federal Ministry of Finance

Figure 9 indicates that Nigeria's crude oil earnings outweighed the benchmark price of crude oil between 2004 and 2015. The country recorded excess oil earnings, which are expected to be kept in the excess crude account (ECA) and used for safe guarding the economy against any international shock. It is only in 2008 during the global economic melt-down when crude oil price fell sharply that the country's benchmark surpassed the oil price, and then the ECA was used to bail the economy back to recovery. However, the Sovereign wealth fund, which replaced the ECA in 2011, is not able to protect the country against economic shock it currently witnesses. Poor management of oil proceeds and corruption have caused the inability of the country to save in periods of bountifulness.

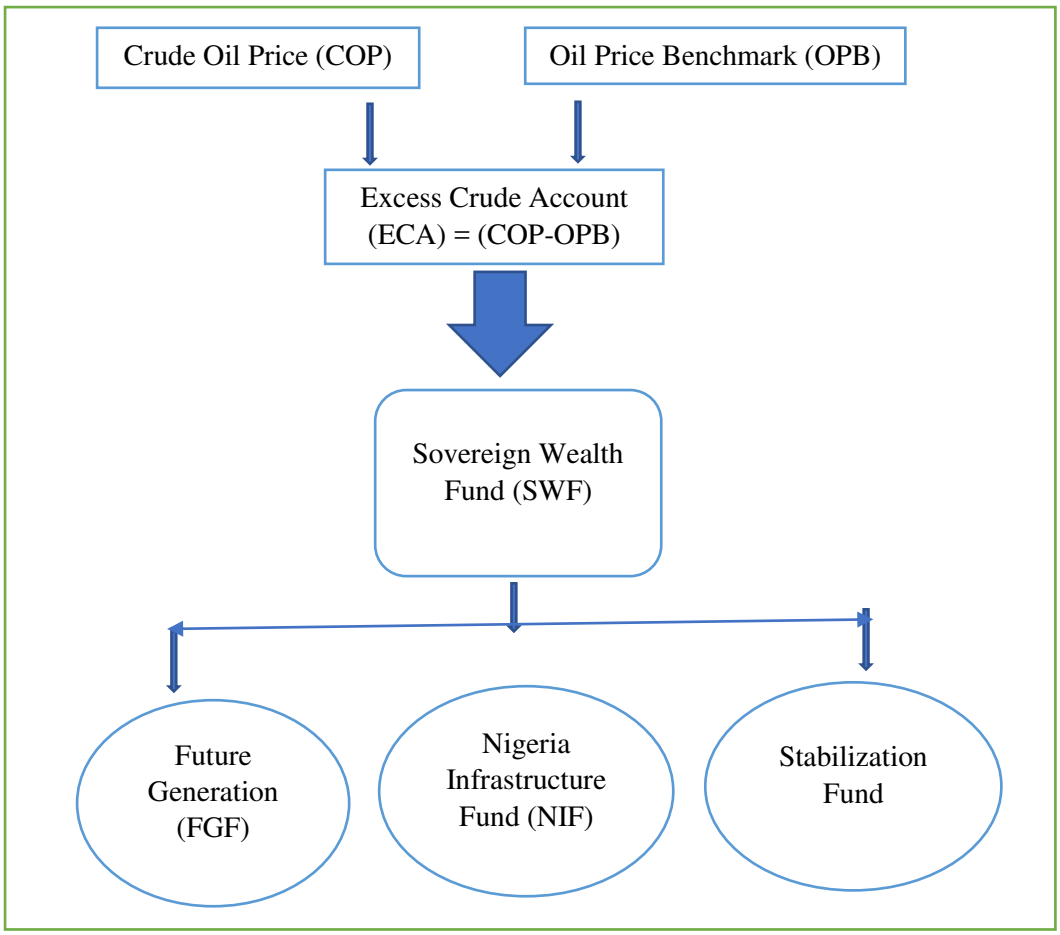
5. Nigeria's Management of Crude Oil Proceeds: The Sovereign Wealth Fund

To manage excess crude oil earnings in Nigeria, the Excess Crude Account (ECA) was created in 2004. It was meant for saving crude oil earnings more than crude oil benchmark price. It was meant to protect planned budgets against deficits that are due to international oil price volatility and prevents the country's economy from external shocks. Between 2005 and 2008, the ECA grew by almost 400% from $5.1 billion to about $20 billion respectively owing to the surging rise in the international crude oil prices. However, by June 2010, its value declined to about $4 billion due to a fall in crude oil prices internationally and budget deficits were recorded across the nation. This led to the approval of the Sovereign Wealth Fund (SWF) by the country's National Economic Council in 2010 to replace the ECA. The Excess Crude Account on its own was very good, as it assisted the country to boost its external reserves. It also provided impetus for stabilising the economy during the global financial meltdown of 2008 and 2009. It however suffered a great setback as the National Assembly and subnational governments in the country saw the ECA as a creation of the

Federal executive. They, therefore, challenged its existence as it was not contained in the country's constitution (CBN, 2012).

To address the shortcoming of the ECA, the Sovereign Wealth Fund was established by the Nigeria Sovereign Investment Authority (NSIA) Act in 2011. Through this Act, the SWF was charged with receiving, managing and investing the revenues of Federal, State and Local government in a diversified portfolio of medium term and long term. This is to prepare for the eventual depletion of the country's oil resources. The Fund is also to provide stability for the economy during economic shocks, facilitates the building of infrastructures and provides a saving base for Nigerians. To this end, the Federal, State and Local government councils contributed an initial $1 billion, according to the federal allocation formula of the Federation Account, and it is to be managed by the NSIA. Subsequent funding is expected to come from Residual Funds from the Federation Account NSIA in a mode specified in the Act, so long as the derivation portion of the revenue allocation formula is not included as part of the funding. After receiving revenue into the Federation Account every month, the NSIA is funded from all amounts of residual funds above the budgetary smoothing amount. It thus means that every other revenue that accrues to all levels of government, apart from the excess crude, is also made available to fund. Moreover, only revenues earned from the sales of crude oil at the benchmarked price of the Federal budget for a particular year is shared among all the federating units (CBN, 2012). Every other revenue, minus deductions specified, is transferred to the NSIA for investment in the Funds. The Authority can also be funded by the returns on investment it made. To execute its operations, the NSIA has three operations, which include Future Generation Fund (FGF), Nigeria Infrastructure Fund (NIF) and Stabilisation Fund as shown in figure 12.

Figure 12: Diagram of ECA and SWF



Source: Adapted from CBN, 2012.

6. Lessons from other Oil Producing Countries

6.1 The Norwegian Experience

The experience of Norway shows that its Sovereign Wealth Fund is managed by the Government Pension Fund Authority (GPFA). The Fund keeps the excess wealth generated by the Norwegian petroleum earnings. Based on 2008 valuation, the fund was the second largest in the world and the largest in Europe. It is among the most transparent sovereign wealth fund in the whole world. The GPFA is not a pension fund actually because it derives its financial strength from oil earnings and not pensioners. The GPFA was established after oil was discovered in Norway around the North Sea in 1969 by the Norwegian act of parliament known as Government Petroleum Fund Act. The first transfer to the fund was

made in 1996, and as it is today, the Fund has an investment amount up to the tune of $873 billion as at 2015 (SWFI[1], 2015). Its main objective is to facilitate government savings that is necessary to meet the rapid increase in public pension expenditures and to support a long-term management of oil proceeds. It invests in international real estate up to the tune of 5%, fixed income and equities but not in private equities. The activities of the Fund have enabled the country to generate significant financial assets in the Government Pension Fund. The Fund is expected to invest 60% into equities and 40% into fixed income instruments. This is expected to cover two geographical regions with Norwegian region taking about 85% and the Nordic region, excluding Iceland, taking about 15% (CBN, 2012).

6.2 The Chinese Experience

In China, Sovereign Wealth Fund is given to three fund managers to manage. The Fund managers include the China Investment Corporation, National Social Security Fund and Hong Kong Monetary Authority Investment Portfolio. The Sovereign wealth is well managed to the extent that the total value of its portfolio of assets amounts to about $746.7 billion in 2015 (SWFI, 2015; Mesagan *et al.,* 2018). The main aim of the Chinese Fund is to ensure the maximisation of profits at an acceptable level of risk. It was also designed to improve the corporate strategy governance of important financial institutions owned by the government. The Fund participates in indirect equity holdings through various investment funds and makes use of external money managers. Part of the SWF in China is used for bailing out certain government enterprises when it is necessary and provided some economic stability in the process. It is also invested in international assets in Asia, Australia, Africa and North America. The fund has some asset allocation in some developed and emerging economies, real estate, infrastructure, corporate debt, sovereign debt and hedge funds (CBN, 2012).

[1] Sovereign Wealth Fund Institute Ranking, 2015. (Available at http://www.swfinstitute.org/fund-rankings).

6.3 The Kuwait's Experience

Kuwait has the oldest SWF in the world as it was founded in 1953. To bring this Fund to top speed, the Kuwait Investment Authority (KIA) was established in 1982 to take over the role of managing all the assets of Kuwait's government. The funds manage by KIA is of two folds, namely: The Future Generations Fund (FGF) and the General Reserve Fund (GRF). The General Reserve Fund serves as the main treasurer for the government as it receives all government's revenues from oil and gas and other sources and it also pays out all national expenditures. The GRF holds all national assets, including that of the Kuwait Petroleum Corporation and Kuwait's participation in multilateral organizations like the Arab Fund, the IMF and the World Bank. The FGF, on the other hand, was established in 1976 through a transfer of 50% of the GRF's assets and its early function was to invest in external assets outside Kuwait. By the Kuwait's law, 10% of government revenues are to be transferred to the FGF annually. The KIA can also manage other funds that the Ministry of Finance entrusted to it (CBN, 2012). Currently, Kuwait's sovereign wealth is over $592billion in 2015 (SWFI, 2015).

6.4 The United Arab Emirates' Experience

Unlike the earlier SWFs discussed, the United Arab Emirate (UAE) has its sovereign wealth fund managed by different fund managers that include Abu Dhabi Investment Authority, International Petroleum Investment Company, Investment Corporation of Dubai and Mubadala Development Company, among others. The quest for the effective management of excess proceeds from oil exports necessitated the establishment of the different authorities. They are to set up manage and invest funds on behalf of the government of different Emirates in UAE, as well as, guarantee and stabilise the future welfare of the Emirates (CBN, 2012).

Currently, the total sovereign wealth fund for the country is around $773 billion in 2015 (SWFI, 2015).

7. Conclusion

Sequel to the discussion in this paper, it is important to note that Nigeria still has a long way to go in a quest to effectively maintain a sovereign wealth fund that can compare with those of the other performing oil-rich nations. Experience so far has shown that the country is very weak in maintaining very strong fiscal rules that can galvanise proper management of oil proceeds for diversification. A well-managed sovereign wealth fund would have been able to assist the country in diversifying its export base and serve as a buffer against oil price volatility. To this end, corruption must be reduced to the barest minimum for the country to be able to get out of the current economic quagmire. Also, every stake holder must be ready to make sacrifices to ensure that the little that is left over from the crumbs can be put together to make the sovereign wealth fund more effective. Sacrifices are also needed to make the SWF to achieve its purpose of boosting the investment base of the nation and make funds available for economic diversification. This will make it possible to bring the economy back on the path of growth and development.

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