Oil and Gas Resources in the Federal Republic of Nigeria

Wumi Iledare\textsuperscript{1} and Rotimi Suberu\textsuperscript{2}

1. Overview

Nigeria, with an estimated population of 140 million, ranks among the top 10 nations in proved oil and natural gas reserves. Of Nigeria’s current 36 constituent states, only nine are classified as oil and gas producers. The nine states are located in the three southern geopolitical zones—Southwest, South-South (Niger Delta), and the Southeast. The six producing states in the South-South geopolitical zone—Delta, Bayelsa, Rivers, Akwa Ibom, Cross River, and Edo—accounted for 91.5 percent of the gross oil production in 2008. In the late 1990s, the majority of oil and gas production was from onshore and shallow water fields. But, as militant disturbances and insecurity of employees increased, suspension and outright abandonment of oil and gas operations in the western part of the Niger Delta region became inevitable.

As of January 1, 2009, the estimated crude oil and natural gas reserves are, respectively, 36.2 billion barrels and 182.4 trillion cubic feet (tcf). Crude oil production has expanded, growing from its initial daily output of about 5,100 barrels in 1956 to as high as 2.5 million barrels per day in the late 1970s and in 2004 and 2005 (OPEC Bulletin, 2008). Continual investments and economic and policy incentives have been instituted by the federal government in an attempt to increase Nigeria’s proved oil reserves to 40.0 billion barrels and expand production capacity to 3.0 to 4.0 million barrels per day by 2010 from its current 2.5 million barrels per day. At current extraction levels, Nigeria has a production equivalence of about 30 years in comparison to the global aggregate average of 45 years.

As in many other developing-world federations with “twentieth-century constitutions” and large regionally concentrated hydrocarbons, multi-ethnic Nigeria has entrusted the ownership, regulation and redistribution of its oil and gas wealth in the federal government (Watts 2008: 98). At the same time, the country’s fiscal federalism architecture constitutionally and statutorily guarantees the devolution of considerable amounts of centrally collected oil and gas revenues to the federation’s state and local governments.

2. Federal System and constitutional provisions

The expansion of the petroleum industry from the seventies produced fundamental changes in the structural configuration and fiscal architecture of the Nigerian federation. The federal system has evolved through five key moments since it was first instituted, under British colonial rule in 1954, to hold together Nigeria’s fissiparous society, including two historic regions (North and South), three major ethnic groups (Hausa-Fulani, Yoruba, and Ibo), hundreds of ethnic minorities, and almost equal number of Muslims and Christians.

\textsuperscript{1} Omowumi O. Iledare is a Professor of Petroleum Economics and Policy Research, and the Director of Energy Information and Data Division of the Center for Energy Studies. He is also an Adjunct Professor of Petroleum Economics at the Craft & Hawkins Department of Petroleum Engineering in Louisiana State University.

\textsuperscript{2} Rotimi Suberu is a Faculty member at Nigeria’s University of Ibadan since 1986.
The post-independence First Nigerian Republic (1960-66) combined a Westminster-style parliamentary system with an awkward federal structure of three (later four) large, but unequal, regions, each of which was dominated by a major ethnic group and controlled by a party based on that group.

This was succeeded by military rule from 1966 to 1979, during which the soldiers broke the four regions into 12 and later 19 smaller states in a largely successful bid to undermine the Ibo-led Eastern Region’s war of secession and to consolidate Nigeria’s post-civil war unity.

Civilian rule was restored in the Second Republic (1979-83), which incorporated the basic features of the military’s integrationist political engineering, including the 19-state federal structure, the replacement of the parliamentary system with a strong executive presidential system, the formal prohibition of sectional parties, and the massive shift of fiscal and legislative powers from the states to the central government.

The military re-imposed their rule from 1984 to 1999 and during that period the number of states grew from 19 to 36.

Since 1999, the country has seen the political disengagement of the military and witnessed the longest era of uninterrupted civilian rule in the federation’s history. Under the political dominance of the Peoples Democratic Party (PDP), this period has seen both a historic inter-civilian transition from the presidency of Olusegun Obasanjo to that of Umaru Yar’Adua as well as the implementation of modest socioeconomic reforms and the reassertion of states’ rights in reaction to years of predation and over-centralization under military rule.

3. Ownership and jurisdiction

The current 1999 Nigerian Constitution, section 44 (3) affirms the Federal Government’s proprietorship and ‘control of all minerals, mineral oils and natural gas in, under or upon any land in Nigeria, its territorial waters, and exclusive economic zone.’ All such minerals, oils and gas shall ‘vest in the Government of the Federation and shall be managed in such manner as may be prescribed by the National Assembly.’ Accordingly, the Constitution places under the Federal Government’s list of exclusive legislative powers all matters relevant to the regulation and management of the petroleum industry. These include export duties, incorporation and regulation of corporate bodies, mines and minerals (including oil fields, oil mining, geological surveys and natural gas) and taxation of incomes, profits, and capital gains.

Federal Government ownership of Nigeria’s mineral wealth is further reinforced by several statutory laws and regulations. The most important of these decrees or acts include the Petroleum Act (which was first promulgated in 1969), Petroleum Profits Act (1959), Nigeria Liquefied Natural Gas (LNG) Act (1990, 1993), Land Use Act (1976), Oil Pipelines Act (1978), and the Oil in Navigable Waters Act (1979).

The Petroleum Act, for instance, confirms the Federal Government’s proprietary rights over Nigeria’s petroleum assets and gives the Federal Ministry of Petroleum Resources the authority to issue licenses (to Nigerian citizens or companies incorporated in Nigeria) to undertake activities relating to oil prospecting, exploration, drilling, production, storage, refining or transportation.

The Petroleum Profits Act specifies the applicable tax rates on the chargeable or net profits of companies engaged in petroleum operations.

The Land Use Act provides “for an extraordinary level of government control over land use and transfer” (Human Rights Watch 1999: 68). The Act had two fundamental implications: (i) it made land ultimately a matter of national, rather than sub-national jurisdiction, effectively enabling the central government to control and acquire land anywhere in the federation, thereby constraining the formal powers of the governors to regulate land use in their respective states; (ii) it brought land under government, rather than private or customary (communal) ownership, which meant that land legally or customarily occupied before
the Act could be revoked and acquired by the government “for mining or oil pipeline purposes with compensation restricted to the value of unexhausted improvements at the date of revocation”.

Although ownership and control of all onshore and offshore mineral resources is constitutionally and statutorily vested in the Nigerian federal government, the federation has historically included arrangements for the compensation of oil-bearing units through the payments of portions of centrally collected mineral revenues to those units on a derivation or unit-of-origin basis. However, whereas the constitutional framework of the First Republic had explicitly made both onshore and offshore petroleum resources subject to the derivation rule, a 1970 military decree limited the application of the derivation principle to revenues from onshore resources only, while the post-military constitutions since 1979 (including the current 1999 Constitution) have been silent on the issue. In response to demands by the Niger Delta states for the application of the derivation rule to offshore oil the federal government crafted a political deal that culminated in the enactment by the National Assembly of the “Allocation of Revenue (Abolition of Dichotomy in the Application of the Principle of Derivation) Act of 2004.” This provided that an area of “two hundred meter water depth Isobaths contiguous” to the littoral states would be deemed to belong to those states for the purpose of the derivation principle. The Act, however, provoked another round of litigation as it was challenged at the Supreme Court by 22 non-oil producing states. The Supreme Court ruled that the Abolition Act was consistent with the extensive revenue sharing powers of the National Assembly. This underscored the Court’s willingness to abandon a rigid adherence to the constitutional principle of federal ownership of natural resources for the larger goals of inter-regional accommodation and conflict mitigation in the Niger Delta.

4. Petroleum revenue arrangements in context of the federal fiscal regime

Oil and gas revenues

Over the years, the Nigerian oil and gas sector has dominated merchandise exports. Oil revenue from exports grew from $718 million to $9.4 billion from 1970 to 1978 but declined dramatically from a high of $25 billion in 1980 to $4.7 billion in 1986 as a result of the crude oil price collapse. The vulnerability of the economy to oil price instability has also been costly in terms of revenue fluctuation, income distortions, and fiscal indiscipline. In 2008 total oil export receipts for Nigeria were about $75 billion dollars, which represents about 98.8 percent of total exports for the year. Yet, the oil and gas sector’s share of GDP in Nigeria declined from a high of about 47.7 percent in 2000 to just 25 percent in 2005 and 22 percent in 2006. A recent World Bank estimate shows that the contribution of the oil sector to GDP is still low at 28.4 percent.

Centre-State fiscal transfers

The 1999 Constitution, Section 162, sets out the basic guidelines for the intergovernmental sharing of the major centrally collected revenues. It provides for the payment of the revenues into a Federation Account, which is to be allocated, according to an act of the National Assembly based on the recommendation of the Revenue Mobilization Allocation and Fiscal Commission-RMAFC. Any such act, according to the Constitution, “shall take into account the allocation principles of population, equality of states, internal revenue generation, land mass, terrain as well as population density, [while] the principle of derivation shall be constantly reflected in any approved formula as being not less than thirteen percent of the revenue accruing to the Federation Account from any natural resources.” Derivation revenues are set aside before eligible remaining revenues are distributed from the Federation Account.

Currently, revenues in the Federation Account are distributed in the proportions of 48.50 percent to the central government, 26.72 percent to states, 20.60 percent to localities, and 4.18 percent to centrally controlled special funds. The Federation Account revenues devolved to the sub-national governments.
are shared among the states and among the localities on the basis of the following indices and percentage weights: equality (equal shares to each state or locality) 40 percent; population 30 percent; social development needs 10 percent; land mass and terrain 10 percent; and internal revenue generation effort 10 percent. This is aside from the derivation rule, which allocates 13% of natural resource revenues exclusively on a derivation or constituent unit-of-origin basis. These constitutional and statutory provisions notwithstanding, federal revenue sharing has remained one of the most intractable and controversial issues in Nigeria.

Particularly, the derivation principle has been the most contentious issue in Nigeria’s fiscal federalism, creating gross disparities in per capita federal revenue transfers between oil-producing and non-oil-producing units, while failing to contain militant resource sub-nationalism in the Niger Delta. Despite the entrenchment of the minimum 13 percent derivation rule in the 1999 Constitution, however, intensive agitation for the expansion of the rule to between 25 and 50 percent persists in the Niger Delta states. Yet, the distribution of gross revenue allocation shows that the nine oil-producing states in Nigeria received over fifty percent of the total federal revenue transfers to the states in 2008 even though they accounted for 22.3 percent of the population.

The inequality in national revenue distribution amongst the states is evident in the steep disparities in per capita allocation between oil producing and non-oil producing states. Total revenue per capita allocated to oil producing states, on average, was N35, 955 in 2008. In comparison, the per capita allocation to non-oil producing states was N10, 249. A state like Rivers, which accounts for 36.9 percent of oil production and 3.7 percent of the population of the federation, received 14.9 percent of total allocation to the 36 states in 2008 with a per capita allocation of N64, 213. Bayelsa, with about 2 percent of the population, received 6.8 percent of transfers in 2008, with a per capita allocation of N89, 282. In comparison, each of the 27 non-oil producing states in Nigeria garnered, on average, less than two percent of the transfers in 2008, even though they collectively accounted for 77.7 percent of the population.

5. Macroeconomic challenges

While Nigeria has earned billions of dollars exporting oil and natural gas, the industry has not generated the type of multiplier effects necessary to facilitate sustainable national development and economic growth. The petroleum economy has made the federation more like a unitary state than a federation in a fiscal sense. Expanded access to oil revenues has increased the financial dependency of the constituent states and localities (which derive 90% of their finances from federal revenue transfers), accentuated the disparities in central revenue transfers to them, and led to an underdevelopment both of alternative sources of sub-national revenues (partly because the fiscal effort criterion in the allocation formula is not worth much) and of effective budget formulation, accounting, recording, and reporting systems (owing to the easy availability of shared revenues). In addition, the poor quality of public financial management at the sub-national level, where approximately half of national public spending takes place, intensify macro-economic challenges.

The oil legacy has also imposed significant costs on the Nigerian economy through petroleum and energy price distortions, corruption and inefficiencies, and fiscal instability due mostly to crude oil price volatility. The subsidization of domestic petroleum prices increased from N278.9 billion in 2006 to N633.2 billion in 2008. Phasing out subsidies, although an unpopular reform, would be necessary to reduce the cost to the national economy especially with rising share of imports in domestic petroleum products supply.

Since 2004, the federal government has spearheaded a political agreement between all tiers of government to implement an oil-price based fiscal rule. In response to significant fiscal instability, the rule adopted an approach that is based on relative conservative estimates of the oil price for each budget with “excess revenues” being saved for stabilization. The oil price rule “broke the link between public spending and oil prices and created an oil-savings cushion [the Excess Crude Account] of $18 billion…as well as foreign
reserves that peaked in September 2008 at $62 billion”. The benefits of this rule became evident with the sudden decline in global crude oil prices from a high of $147 in July 2008 to about $45 in December 2008; the federal government had based its budget on an oil price of $45 and was able to draw monies from the excess crude fund to stabilize spending during the downturn. Yet, the current stabilization regime also does not seem to have a truly integrated structure in terms of federal, state and local spending; the states seem to have taken a bigger hit during the downturn than did the federal government.

6. Environmental and social issues

Nigeria’s centralized petroleum industry governance framework leaves the oil-bearing communities with no constitutional or statutory rights, voice, or even consent on oil and gas industry projects in their communities.

Nigeria gas flaring rates is among the highest worldwide. Oil spillage or leakage, arising from the non-replacement of corroded, high-pressure oil pipelines, but also from the activities of oil thieves, vandals or saboteurs, have often occurred. There have been a few instances of badly designed or poorly maintained oil facilities, and weak government investment in critical infrastructure improvements. All these factors have combined to endanger the rich and unique, but fragile, ecosystem of the Niger Delta (Africa’s largest wetland).

Although petroleum industry operators are statutorily required to observe the highest international environmental safety standards in their activities, the limited technical capacity of the federal regulatory agencies (Department of Petroleum Resources, National Environmental Standards and Regulations Enforcement Agency, and National Oil Spill Detection and Response Agency), and the shallow rule of law context, have meant that such requirements are weakly enforced or respected.

High levels of poverty, unemployment, socio-economic inequality, dysfunctional social services, and infrastructure underdevelopment in the Niger Delta compound the environmental neglect and degradation of the region. Although poverty is less extreme in the Niger Delta than in Northern Nigeria, the divisions between rich and poor are more obvious in the Delta, and declines in Human Development Index have been steeper for the Niger Delta states than the rest of the federation.

The capital intensive nature of the oil industry means that levels of unemployment and underemployment are higher in the core states of the Niger Delta than in any other region in Nigeria. In addition, the high earnings of some oil industry workers lead to localized price distortions, driving up prices and constraining the purchasing power of ordinary people. Federal and local government mitigating measures have been scarce, marginally effective, non-transparent, and generally poorly coordinated.

7. Conclusions

The expansion of the oil and gas industry in Nigeria since the 1970s has produced fundamental changes in the structural configuration and fiscal architecture of the Federation. Nigeria has transformed from the diversified, agro-based economy that it was in the sixties to the mono-resource, petroleum based economy that it has become. This transformation has made the Federation more of a unitary state than a federation in a fiscal sense and expansion in access to oil revenue has increased the financial dependency of the constituent states and localities, and disparities in the amount of statutory revenue allocations to them. The oil legacy has also imposed significant costs to the national economy in Nigeria through petroleum and energy price distortions, fraudulent practices, inefficiencies, and fiscal instability.

The oil-based funding of constituent states and local governments by constitutionally and statutorily guaranteed central financial transfers have been a powerful inducement to fraudulent practices at the sub-national level. This is because these governments are neither responsible to the central government nor accountable to their constituents for the use of the transfers. In recent years, the central government has
subjected its own fiscal operations to the rule of fiscal responsibility in accordance with the Fiscal Responsibility Act of 2007 (CBN, 2008). The Act, which is designed to institutionalize budgetary transparency and accountability as well as effective management of the public sector, has helped the federal government to minimize undue leakages in the economy.

The monumental lack of financial transparency and accountability that afflicts Nigeria persists despite various measures implemented since 1999 to promote fiscal accountability and efficiency. Such measures include the establishment of the Independent Corrupt Practices Commission (ICPC), Economic and Financial Crimes Commission (EFCC), the NEITI Act, Excess Crude Oil Account, Fiscal Responsibility Act (FRA), Public Procurement Act (PPA), and Electoral Reform Committee (ERC). Ultimately, the prospects for promoting transparency and accountability in oil and gas governance in the Nigerian Federation depend crucially on the restructuring or reinvigoration of these currently weakly designed or poorly implemented reform measures. A major weakness, however, of recent reform measures is that they have been dependent not only for their establishment, but also their operational effectiveness (including appointment and funding decisions), on the very political class whose abuses and excesses the reforms are designed to contain.

Abating fraudulent practices and corruption in the petroleum sector and the economy as a whole requires full adherence to transparency and good governance principles in the NEITI Act of 2007. Reforms to put an end to the ill-considered and politicized intra-tier revenue allocation formula and put more emphasis on conditional grants are worth considering for promoting accountability and good governance. Sound fiscal policy framework for managing the nation’s mineral wealth—oil-based budget rule, excess oil savings and mandated infrastructural dedicated spending among others—is necessary. The PIB 2009 represents an ambitious attempt to expunge fraud and inefficiency out of the structure, governance, and fiscal framework of the oil and gas sector.

Ultimately, lack of transparency and accountability has consequences that include among others, public discontent over the pace of national development despite the earning potential from the oil sector; greed and power struggle among competing elites to control oil revenue sometimes leading to instability of government; public protest over domestic fuel shortages and related inefficiencies; inequitable distribution of petroleum wealth, which often exacerbates public fraud and corruption; and ineffectiveness of national laws, unenforceable contracts, and weak regulatory regimes, all of which produce an inefficient business environment. Credible oversight institutions with autonomy to detect, investigate, report and punish fraudulent practices, and a truly credible and competitive electoral environment with incentives for politicians to deliver public goods and services are proven ingredients of good governance. International cooperation in prohibiting and policing public officials’ illicit offshore assets acquisition would also go a long way to improve transparency and accountability in the governance of the Nigerian petroleum sector and economy.

---

1 This Framework Paper was prepared for the Conference on Oil and Gas in Federal Systems, and summarizes the findings of a more detailed paper on “Oil and Gas in the Federal Republic of Nigeria”. The Framework Paper is not for citation without authors’ permission. The full version of the paper is available on the Conference’s webpage at http://go.worldbank.org/J42LOWNS80.

The findings, interpretations, and conclusions expressed herein are those of the authors and do not necessarily reflect the views of the International Bank for Reconstruction and Development or the World Bank or of the Forum of Federations and their affiliated organizations, or those of the executive directors of the World Bank or the governments they represent. The World Bank and the Forum of Federations do not guarantee the accuracy of the data included in this work.
Nigeria

![Nigeria Map]

Courtesy of the Forum of Federations

### Political and Economic Indicators

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>DATA</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>US$319.572 billion PPP (2008)</td>
</tr>
<tr>
<td>GDP per capita</td>
<td>US$2,162.054 PPP (2008)</td>
</tr>
<tr>
<td>Number, type and % of population of constituent units</td>
<td>36 states: Lagos 6.5%, Kano 6.5%, Kaduna 4.4%, Katsina 4.2%, Oyo 3.9%, Rivers 3.8%, Jigawa 3.2%, Benue 3.1%, Anambra 3.1%, Bauchi 3.2%, Delta 2.9%, Borno 2.8%, Imo 2.8%, Akwa Ibom 2.7%, Sokoto 2.7%, Niger 2.7%, Abia 2.6%, Ogun 2.6%, Osun 2.4%, Adamawa 2.4%, Enugu 2.4%, Plateau 2.4%, Kogi 2.4%, Edo 2.4%, Kebbi 2.3%, Zamfara 2.3%, Ondo 2.2%, Cross River 2.1%, Ekiti 2.0%, Taraba 1.7%, Kwara 1.7%, Gombe 1.7%, Yobe 1.6%, Nassarawa 1.3%, Bayelsa 1.1%, Ebonyi 1.1%, Abuja Federal Capital Territory 0.4%</td>
</tr>
<tr>
<td>Total population</td>
<td>~149 million</td>
</tr>
<tr>
<td>Area</td>
<td>923,768 km²</td>
</tr>
<tr>
<td>Currency and exchange rate</td>
<td>Nigerian Naira (NGN)153.660 = $1 US Dollar, floating rate</td>
</tr>
<tr>
<td>Political system – federal</td>
<td>Federal Republic</td>
</tr>
<tr>
<td>Political Party Regime</td>
<td>Peoples Democratic Party dominant party but with some states under opposition parties</td>
</tr>
<tr>
<td>Distribution of powers/Ownership of petroleum resources</td>
<td>The Federal Government has exclusive powers and proprietary rights over all regulation and management of the petroleum industry. These include export duties, incorporation and regulation of corporate bodies, activities relating to oil prospecting, exploration, drilling, production, storage, refining or transportation, and taxation of incomes, profits, and capital gains. As established with the Petroleum Act. The Abolition Act allocates “two hundred meter water depth Isobaths contiguous” to the littoral states, deemed to belong to those states for the purpose of the derivation principle.</td>
</tr>
</tbody>
</table>