

The Case for a Robust Oil Savings Fund for Nigeria



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Major Highlights



To overcome commodity price volatility and depletion of non-renewable resources, countries dependent on revenues from natural resources are usually advised to save for the rainy day and for the future generation.



Nigeria has about three decades of experience in implementing different oil revenue funds. However, attempts at oil revenue savings have been plagued by contested legal frameworks, governance issues and inadequate political will.



Nigeria has one of lowest natural resource revenue savings in the world. The balance in the three funds (0.5% stabilization fund, ECA and NSIA) is less than \$3.9 billion, not enough to fund 20% of 2017's federal budget.



Nigeria's \$1.5 billion sovereign wealth fund is one of the lowest in the world, has one of the worst ratio to annual budget (10%), and one of the lowest SWF per capital (\$8), better only than war-torn Iraq and crisis-hit Venezuela, but not by much.



In contrast, Norway, a country of 5.2 million people (2.8% of Nigeria's 186million people) has a sovereign wealth fund worth \$922 billion (which is 23,641% of the \$3.9 billion balance in Nigeria's three oil revenue funds)



Between 2005 and 2015, \$201.2 billion accrued to ECA but \$204.7 billion was withdrawn from the ECA during same period, indicating that withdrawal was 102% of deposit.



It is clear therefore that Nigeria has no prudent and robust oil revenue savings scheme that can tie it over expected volatility of oil prices and the eventual depletion of its oil reserves in 38 years; neither does it have a strong mechanism for promoting inter-generational equity.

FG and the states should seek speedy resolution at the Supreme Court of the case on the constitutionality of remittances to the ECA and the NSIA;

Initiate amendment of Section 162 of the 1999 Constitution (as amended), drawing on the political consensus that led to the creation of the ECA and the NSIA.



Section 1: Introduction



\$200bn to \$2bn

When oil prices began to tumble from June 2014, Nigeria had just \$2 billion in the ECA, despite having remitted a total of about \$200 billion in excess crude proceeds into the account between 2004 and 2014

Despite current efforts to pull Nigeria out of recession, the economy remains vulnerable to one of the conditions that created the problem in the first place: lack of adequate and prudently managed savings in a period of plenty. Nigeria did not save enough oil revenues to sustain economic activities when oil prices began to tank in June 2014. Also problematic is the level of consumption relative to non-oil exports. Nigeria typically responds to high oil prices with equally high, but manifestly unsustainable, level of consumption.¹ The absence of sufficient savings left Nigeria severely exposed when the price of oil, Nigeria's main source of government revenues and foreign exchange, started to plunge in 2014. It was a sad turn, but not totally unpredicted.

Countries that depend on revenues from natural resources to finance their budgets are characteristically prone to the boom-and-bust cycle. One major way in which resource-rich countries have sought to insulate themselves from such volatility is by setting up stabilisation funds. The objective is to set aside money, especially during periods of high prices, which would be used to "smoothen" expenditure when prices fall. This insulates the economy from the effects of price volatility, ensuring the country would not necessarily go bust when price falls. Stabilisation funds also protect these countries against the Dutch Disease, which itself is a consequence of how countries choose to spend natural resource revenue.²

Nigeria established the Excess Crude Account (ECA) in 2004 based on a fiscal rule where crude oil earnings in excess of a budgeted price and production volume are transferred into the account. However, very little savings was accumulated during a period of consistently high prices, as the basic fiscal rules were not observed. When oil prices began to tumble from June 2014, Nigeria had just \$2 billion in the ECA, despite having remitted over \$200 billion in excess crude proceeds into the account between 2004 and 2014.

In addition to price volatility, Nigeria also faces the prospect of depleting oil reserves. Nigeria's proven oil reserves as at 2015 was 37 billion barrels.³ At current level of production, the reserves are projected to last for 40 years, counting from two years ago. Meanwhile, in the last forty years of production at less than current levels, Nigeria extracted about 31 billion barrels of its oil reserves. From 1980 to 2015, Nigeria exported crude oil worth about \$1.09 trillion.⁴ As at June 2017, there was less than \$3.9 billion dollars in all of the country's oil revenue funds. This is only enough to finance 16% of the current (2017) budget of N7.44 trillion.



16% of 2017 budget
of N7.44 trillion

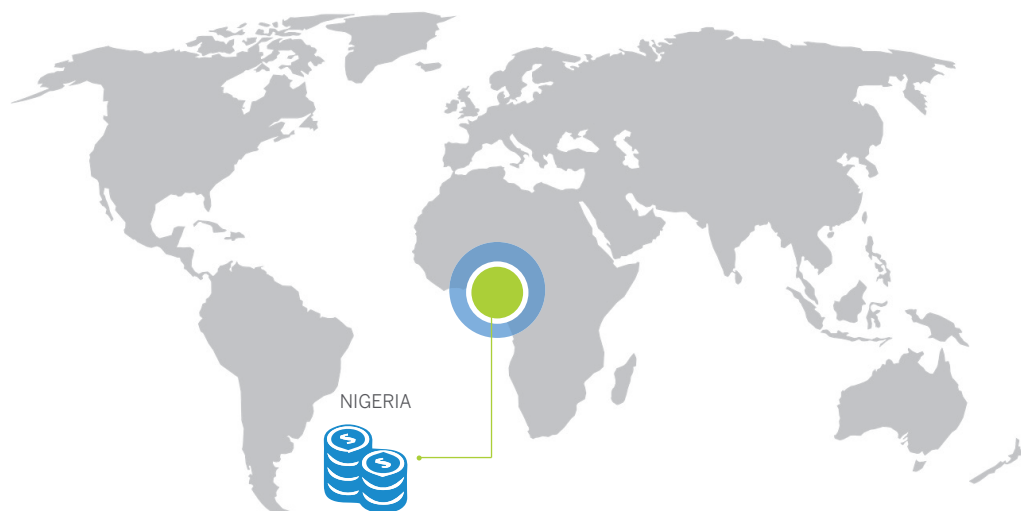
¹ Nigeria Macroeconomic Risk Management: Issues and Options. World Bank Report 1983

² "Dutch Disease" is a term first used by The Economist in 1977 to describe the Dutch economy, where influx of foreign currency from discovery of large gas reserves made imports cheaper and Dutch exports more expensive and less competitive, leading to the crowding out of the productive sector.

³ OPEC Annual Statistical Bulletin 2015

⁴ WTO Statistical Database: <http://stat.wto.org/CountryProfile/WSDBCountryPFHome.aspx?Language=E>

Given this scenario, it can hardly be said that Nigeria currently has a serious future generation's policy in the management of its oil revenue. Yet a review of more than fifty sovereign wealth funds around the world shows that almost all of them were established with an overriding future generations' objective. The prospect of a looming depletion of Nigeria's oil resource raises the urgency of the need for accelerated savings for the benefit of future generations.



The subject of a future generations' fund is particularly crucial in designing stabilisation funds that are both viable and insulated from the political and domestic spending pressures that have plagued a fair number of stabilisation funds around the world. So, beyond serving a mandatory purpose of saving revenue from a non-renewable resource for the future, the structure of a future generation fund is necessary to mitigate most of the problems that have made it difficult for Nigeria to implement a successful savings and stabilisation policy.

Most countries that established one or more oil revenue funds have accumulated huge savings in their stabilisation accounts. On the other hand, Nigeria's ECA has been dogged by questions about its constitutionality, which have hindered regular remittances into the account. But the ECA also faces governance issues bordering on transparency and failure to adhere to the fiscal rules guiding the operation of the ECA. In the end, distrust by subnational governments about the management of the fund coupled with lack of political will has prevented the government from effectively implementing its savings and stabilisation policy.

The establishment of a sovereign wealth fund (SWF) by the government in 2012 was intended to address the governance issues associated with the ECA. While the SWF is a vast improvement over the ECA, it has inherited the same constitutional hurdle that dogged the ECA. Until recently when \$500 million was paid into the SWF, little savings had been made beyond the \$1 billion seed capital transferred from the ECA in 2012. Litigation between the federal and state governments over the constitutionality of the ECA and the SWF has lingered at the Supreme Court.



While there are obvious institutional challenges with the operation of the ECA, the greatest impediment was the clear lack of political will to save in times of bumper earnings. Bearing in mind that oil prices continue to respond, mostly without warning, to a myriad of market and non-market events, and that another shock is always inevitable, Nigeria's economy will remain vulnerable to these conditions even beyond the current recession.

The federal and states governments should therefore pursue a speedy resolution of the issues at the Supreme Court to determine the legal status of the ECA and the SWF. Thereafter, the political actors should, among other interventions, proceed with necessary haste to effect amendment to Section 162 of the 1999 Constitution.

Section 2: Stabilisation Policymaking by Resource-Rich Countries

Resource-rich countries traditionally face challenges arising from revenue volatility, the Dutch Disease, the resource curse syndrome and depleting stock of natural resources. The degree of vulnerability for any of these countries depends on the extent to which the country relies on natural resource revenues to fund its budget.

Simple demand and supply dynamics are major determinants but even seemingly non-economic factors like geopolitical tensions, instability within countries, armed conflicts, global energy policy and technological innovation can create sudden price movements.



Some countries have tried to mitigate volatility by attempting to collectively regulate production quotas. The formation of the Organisation of Petroleum Exporting Countries (OPEC) in 1960 was a major attempt “to secure fair and stable prices for petroleum producers”. However, more than five decades of OPEC policy has done little to tame the market and shield the economies of member countries from the turmoil caused by price shocks. The size of the volatility and the extent of potential damage to the oil economy are better understood in the frequency and pattern they have occurred. Figures from 1970 to the present show very dramatic price movements. Prices have either suddenly doubled/ tripled (1974, 1980, 1986, 1990, 2003, 2007, 2010 and 2017) or halved/ have fallen to just a third of their values (1991, 1998, 2001, 2008, 2014 and 2016), within a few months. Other sharp increases or declines have occurred in various magnitudes, reinforcing the inherent nature of a notoriously unpredictable market.

The threat of volatility and, hence, the probability of sudden and sustained price shocks is significantly increased by the variety of potential triggers. A major shock can result from any one of a myriad of economic and political factors in any one of the producing or importing countries. Simple demand and supply dynamics are major determinants but even seemingly non-economic factors like geopolitical tensions, instability within countries, armed conflicts, global energy policy and technological innovation can create sudden price movements.

Happening within a single budget cycle as shown above, these sudden swings make any meaningful fiscal adjustments within the planned period

Empirical evidence shows that countries endowed with natural resources tend to be associated with negative governance and development indices.

virtually impossible without existing safeguards. The tragedy of the oil price swing is that both ‘positive’ and negative changes have the potential to cause cyclical or structural damages to the economy. A sudden plunge in price undermines a country’s purchasing power, constrains its capacity to spend at budgeted levels and reverses growth. It may seal the fate of nation states.⁵

However, the boom-and-bust cycle is not necessarily an automatic consequence of price volatility. The negative effect of high oil prices on exporting countries has traditionally been associated with countries disposed to pro-cyclical fiscal policies.⁶ Windfall spending in countries with these policies has been associated with worsening fiscal accounts and public sector corruption in resource-dependent countries.⁷

Empirical evidence shows that countries endowed with natural resources tend to be associated with negative governance and development indices.⁸ However, the curse of natural resources does not lie in the resources themselves but in the way countries choose to allocate natural resource revenues. Studies have found that because natural resource revenues are largely economic rents, they tend to be mismanaged especially in emerging economies with weak accountability structures. In the end, rather than facilitate prosperity and progress, they tend to fuel corruption and stagnation. Countries with pro-cyclical spending policies, that is countries whose spending patterns simply follow the volume of natural resource revenue, are more likely to be victims of resource curse.

On its part, the Dutch Disease stems from the manner in which natural revenues enter the economy. Revenues from natural resources have the potential to harm the domestic economy when substantial foreign exchange earned from these resources makes imports cheaper relative to the country’s non-oil exports. This fuels consumption of cheap imports, which ultimately crowds out the local manufacturing sector. This creates a double whammy: dependence on a single product for foreign earnings and dependence on imports to meet domestic household and industrial needs. Given all of the above, resource-rich countries are advised to save and invest rather than spend a substantial portion of natural resource revenue.

2.1 The Curse of Natural Resources in Nigeria

All resource-rich countries experience commodity price volatility. All are faced with the prospect of a future when the resource would have been completely depleted. However, not all experience the boom-and-bust cycle, the Dutch Disease or are ill-prepared for life after resource endowment. Volatility and resource depletion are inevitable, but the curse of natural resources is a result of the choices that resource-rich countries make. Ezekwesili⁹ identified two notable exceptions to the resource curse



Norway and Botswana have “bucked the trend” of the Dutch Disease and resource curse owing to the “deliberate policy objectives that guided resource management

⁵See “The Soviet Collapse: Grain and Oil” by Yegor Gaida, former Russia Prime Minister.

⁶Nigeria Macroeconomic Risk Management: Issues and Options. World Bank Report 1983.

⁷Bagattini (2011): Political Economy of Stabilisation Funds: Measuring Success in Resource-dependent Countries.

⁸See Michlael Ross (1999) “The Political Economy of Resource Curse; and Global Witness (1999) report on Angola.

⁹Obiageli Ezekwesili (2016), “Safeguarding and Smoothing Fiscal Adjustments in Nigeria: Policy Options”.

syndrome – Norway and Botswana. Both countries have “bucked the trend” of the Dutch Disease and resource curse owing to the “deliberate policy objectives that guided resource management”.

On the other hand, Nigeria seems to have borne the full brunt of the negative consequences of natural resource endowment. A fair amount of the resource curse literature lists Nigeria as one of the countries afflicted with the malaise.¹⁰ Some have singled out the country as a notorious example of pro-cyclical fiscal policy, resource curse and the Dutch Disease respectively. Pro-cyclical spending policy has undermined long-term planning. Thus oil revenue has not been used to drive the country’s long-term development goals. Because oil windfalls have always been available for spending, these windfalls have always created the illusion of prosperity and abundance. Hence oil earnings have tended to finance consumption (of finished goods) rather than of productive assets. The crowding out of local manufacturing has only increased the pressure on foreign exchange earned from oil. When prices fall, reduced revenue is insufficient to sustain consumption levels leading to high, unsustainable borrowing to finance deficits. Overtime, high oil prices have created structural problems caused by revenue volatility. With the exception of 2008/09 when Nigeria had significant savings in the ECA, drastic decline in oil prices has always resulted in debt and economic contraction.



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2.2 Depleting Stock of Mineral Resources

Although volatility, pro-cyclical spending, resource curse and the Dutch Disease tend to dominate the discourse on stabilisation funds in recent times, the concept of “inter-generational equity” arising from the non-renewable nature of mineral resources has influenced economic policymaking in resource-rich countries long before volatility became a staple of the stabilisation discourse. Right from the moment that mineral discovery is made, some countries established stabilisation or Sovereign Wealth Funds (SWFs) to save and invest revenues from mineral resources for the benefit of future generations. This paper reviewed 40 natural resource funds listed by the International Monetary Fund (IMF) and found that at least 85% of the funds that were established before 1990 expressly specified a long-term, future generations purpose. In 2015, over 65% of the funds exist partly or wholly for the same purpose.¹¹

2.3 The Role of Stabilisation Funds

Stabilisation funds are generally set up by resource-rich countries to smoothen revenue across budget cycles. They also refer to the savings made by these countries in anticipation of a future era when countries’ mineral deposits would have been completely used up. Over thirty of such funds currently exist around the world. More than twenty of the funds have been established within the last twenty years by developing countries. These

¹⁰ See Cylfason (2001), “Lessons from the Dutch Disease: Causes Treatment and Cures”; Mehlum et al (2001), “Institutions and the Resource Curse”; Bidina et al (2006), “Nigeria: Dutch Disease or Debt Overhang?”

¹¹ IMF, October 2015 Fiscal Monitor

funds have been established under different nomenclatures, depending on the intended purpose of the fund.¹² Typically, stabilisation funds are established to achieve three broad objectives, which are listed below:



2.3.1 Smoothing Revenue

Stabilisation funds enable resource-dependent countries smoothen revenue by saving money from high commodity prices to be used during periods of low prices. The nomenclature reinforces the role of these funds as a tool designed to insulate resource-dependent countries from the destabilising effects of price volatility. The pervasive use of stabilisation funds among resource-rich countries is evidence of growing acceptance of price volatility as a constant reality of the market, with the attendant fiscal problems it creates for these economies.



2.3.2 Savings Fund

Portions of mineral resource revenues that are excluded from the national budget and held as part of a country's reserve also serve a very important function for resource-dependent countries. These reserve funds can greatly enhance a country's capital balances. Economies with healthy reserves typically attract greater investors' confidence and attract significant flow of foreign capital into the economy. Reserves have also been useful for providing critical infrastructure, for social interventions and even during major national emergencies.



2.3.3 Investment Funds

Sovereign Wealth Funds (SWFs) have become an important tool used by resource-rich countries to address the challenge of depleting mineral resources. Although Sovereign Wealth Funds are not exclusive to minerals exporting countries, they are largely associated with earnings from mineral resources. The first recorded SWF, the Texas Permanent School Fund, more than a century and half ago was based on oil.¹³ Out of a list of 78 sovereign funds compiled by the Sovereign Wealth Fund Institute, more than two-thirds are oil, gas or mineral based. In terms of assets size, oil and gas alone accounts for more than half of the over \$7 trillion SWF assets worldwide. Evidently, both the history and prevalence of SWFs attest to importance of saving current revenue for future generation

¹² In this paper "Stabilisation Fund" is used to refer to all mineral resource-based funds established for smoothening/reserve and for investment (Sovereign Wealth) funds.

¹³ Sovereign Wealth Fund Institute, <http://www.swfinstitute.org/sovereign-wealth-fund-rankings/>.

Section 3.0: Comparative Analyses and Case Studies

This section looks at the stabilisation and sovereign wealth funds of six countries which bear some economic, political or demographic similarities with Nigeria. A brief analysis of each case is carried out on the basis of history, size, operational characteristics and performance. At least one empirical study showed that three of the countries experience reduced expenditure volatility after establishment of stabilisation fund.¹⁴

3.1 Norway

Norway established the Petroleum Fund of Norway, which later became the Government Pension Fund Global (GPFG), in 1990 through an act of parliament. Regarded as “the best practice in stabilisation funds”¹⁵ the fund is managed by Norway’s Central Bank on behalf of the Norwegian people. Norway’s entire oil revenue is transferred into the GPFG except the portion that is used to finance the budget deficit. The country’s annual budget itself is based on non-oil revenue. The fiscal rule prescribes that withdrawal from the fund to finance the annual budget shall not exceed 4% of the fund, which is equivalent to the estimated return on the fund. The fund is invested abroad “to avoid overheating the Norwegian economy and to shield it from the effects of price fluctuations”.¹⁶ From a modest ‘seed capital’ of less than \$310 million in 1996, total asset value of the fund currently stands at \$922 billion.¹⁷ This figure is twice the total amount of money transferred into the fund since it was established. This means that the fund has yielded returns equal to the value of savings that has been made. An EITI report in 2015 showed that earnings from Norway’s SWF in 2013 was double the total revenue from oil in the same year, even with very high oil prices.¹⁸ In 2016, returns on the fund was more than triple the total revenue from oil.¹⁹ In the same year, the GPFG earned about \$30 billion in third quarter alone.

3.2 Chile

The Economic and Social Stabilisation Fund (ESSF) of Chile was established in 2007 with the passage of the Fiscal Responsibility Law (2006).²⁰ This law replaced the existing Structural (fiscal) Balance Rule which sought to align government expenditure with long-term projection of average copper price rather than the cyclical fluctuations of copper prices.²¹ The law, which also created a Pension Reserve Fund, guarantees annual transfers, first into the



1996

\$310 million

2017

\$922 billion



2007

\$2.58 billion

2017

\$14.7 billion

¹⁴ See Crain & Devlin (2003).

¹⁵ Gustavo Y. Bagattini (2011). The Political Economy of Stabilisation Funds: Measuring their Success in Resource-Dependent Countries. IDS Working Paper 356.

¹⁶ <https://www.nbim.no/en/the-fund/about-the-fund/>

¹⁷ Data as at April 2017 published by The Sovereign Wealth Fund Institute. <http://www.swfinstitute.org/sovereign-wealth-fund-rankings/>

¹⁸ <https://eiti.org/news/norway-revenue-from-oil-fund-now-exceeds-revenue-from-oil>

¹⁹ <http://www.norskpetsroleum.no/en/economy/governments-revenues/>

²⁰ <http://www.swfinstitute.org/fund/chile.php>

²¹ See International Forum of Sovereign Wealth Funds <http://www.ifswf.org/member-profiles/fiscal-responsibility-funds>

pension fund of an amount equivalent to a minimum of 0.2% (whether there is budget surplus or not) of previous year's GDP, and up to a maximum of 0.5% if the budget surplus exceeds 0.2%. Secondly, any surplus above 0.5% and up to 1% of GDP is paid to the Central Bank as capital contributions to the bank. Surpluses above 1% of GDP are then remitted to the ESSF. Hence fiscal savings from Chile's stabilisation fund consist of three components - savings in the Pension Fund, transfers to the Central Bank reserves, and savings in the ESSF. The law sets strict limits to the application of the funds, limiting annual withdrawal only up to the returns on the funds for the first ten years, and subsequently only up to a certain percentage of previous expenditures. As for the ESSF, the fund can be used to finance structural (non-copper) budget deficit and to service debt. Earnings from the PRF and ESSF are considered structural income included in the fiscal budget.²²

The Minister of Finance appoints the central bank, acting strictly in accordance with the rules, to manage the funds on behalf of the Chilean people. The minister renders monthly and quarterly reports to the parliament, and is assisted by a committee of professionals on the economy and finance.²³ Through prudent management of the fund and strict adherence to the rules, the funds have grown from an initial capital injection of \$2.58 billion to about \$14.7 billion.²⁴

3.3 Angola

Angola's stabilisation fund package consists essentially of four components: the SWF of Fundo Soberano de Angola (FSDEA), the Strategic Financial Oil Reserve Account for Infrastructure Fund, the Oil Price Differential Account, and the Revenues Account for Bonus from Oil Concessions.

The government set up the Fundo Soberano de Angola (FSDEA) in 2012. The aim of the fund is "to promote growth, prosperity and social and economic development" through the generation of wealth for the present and future generations.²⁵ The fund is also designed to safeguard the economy of Angola against future adverse economic conditions. The Angolan president set up a special commission for the establishment of a SWF in 2008. The law establishing the fund was passed by parliament in 2011. Thereafter, the fund was set up with an initial capital of \$5 billion, corresponding to the revenue generated from sale of 36.5 million barrels (or 100,000 barrels/day) of crude oil in 2010.²⁶ The fund's investment portfolio is highly diversified across different assets and industries locally and internationally.

Apart from the initial investment, the FSDEA receives funds equivalent to the prevailing market value of 100,000 barrels of crude oil per day. However, only half of this amount is remitted directly into the FSDEA.²⁷ The other half is retained in the Oil Reserve Account for Infrastructure and thereafter



Total assets value of the Fund currently stands at

\$4.6 billion. IMF put the total value of the other three funds at approximately half of Angola's international reserves.

²² Sovereign Wealth Funds Annual Report 2008 by Chile's Ministry of Finance.

²³ International Forum of SWFs

²⁴ Sovereign Wealth Fund Institute data as at April 2017.

²⁵ Fundo Soberano de Angola, <http://www.fundosoberano.ao/about-fsdea/>

²⁶ "Angola's New Sovereign Wealth Fund", Banker Africa, Issue 4, July 2013. <http://www.cpifinancial.net/flipbooks>

²⁷ IMF Country Report on Angola No. 14/275, September 2014.

transferred to the FSDEA if not utilised by the end of the financial year. The FSDEA devotes 7.5% of its endowment to social projects in education, health care, clean water, energy and income generation. While the FSDEA is not, strictly speaking, a stabilisation fund, the rules however stipulate that up to 20% of its liquid assets should be available at all times to be used in periods of natural disasters/emergency and in the event of severe economic distress. Withdrawal from the funds is made at the request of the finance minister in accordance with the applicable law.²⁸ The FSDEA is therefore both a savings and development fund.

The FSEA is governed by an administrative, advisory and audit boards, all appointed by the president. Periodic reports are submitted to parliament for review and presented to the public.

Total assets value of the Fund currently stands at \$4.6 billion. IMF put the total value of the other three funds at approximately half of Angola's international reserves.²⁹ A review of the FSDEA's annual reports show that the above balance exclude the amount used to develop basic infrastructure including energy and water resources as part of the Strategic Oil Financial Reserve for Basic Infrastructure. It also excludes 7.5% due to the fund that is retained for social investment as well as \$45.7 million set aside as reserves.



Total assets value of the Pula Fund currently stands at

\$5.7 billion

3.4 Botswana

Botswana operates two separate funds for the purposes of stabilisation and savings respectively. These are the Revenue Stabilisation Fund and the Pula Fund. The Pula Fund, a long-term investment fund, was established in 1994. However, the legal framework of the fund was promulgated in 1996 with the Bank of Botswana Act. The aim is to preserve part of the revenue from diamond exports for the benefit of future generations.³⁰ The Pula Fund consists of the government investment account and the excess reserve account. There is also a more liquid foreign reserve account at the central bank.³¹ The Fund could also serve short-term objectives of stabilisation. Both long-term and short-term objectives are determined by the Central Bank in consultation with the Ministry of Finance and Development Planning.³² All of the funds assets are invested abroad to shield the economy from macroeconomic instability. The Fund management is subject to parliamentary oversight through submission of annual reports to the National Assembly.

The law did not specify numerical triggers or limits to the amount of funds that should be remitted to or withdrawn from the fund at any time. Government's and the central bank's fiscal and monetary policy choices that give rise to surpluses or deficits determine the amounts that can be saved or withdrawn from the fund in any given year. Total assets value of the Pula Fund currently stands at \$5.7 billion.

²⁸ Angola, Presidential Decree, No. 48/11

²⁹ IMF 2014; Also IMF Country Report No. 17/39 (Article IV Consultation), February 2017.

³⁰ The Pula Fund: Bank of Botswana. <http://www.bankofbotswana.bw/content/2009103013033-pula-fund>.

³¹ IMF Country Report 16/103 (2015 Article IV Consultation), April 2016.

³² "Case Study: Botswana's Management of the Pula Fund. Bank of Botswana, <http://www.bankofbotswana.bw>

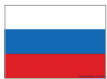
The Stabilisation Fund was established earlier in 1972 to smoothen expenditure and avoid sharp fiscal adjustments. However, due to the fact that Botswana had consistently recorded budget surpluses over the years, the account had been drawn down as loans to statutory corporations and local authorities.³³



KIA has a total asset of
\$592 billion

3.5 Kuwait

The Kuwait Investment Authority was created in 1953 and later backed by law of the National Assembly in 1982. It is charged with managing the country's reserve fund and the future generations' fund. The authority consists of a Board, which appoints the management and is itself answerable to the Council of Ministers. Allocation to the authority is made from the annual budget of the government. The law allocates 10% of the country's general revenues every year to the fund for the use of future generations. The profits from the investments are also paid into the fund. The law prohibits any withdrawal from the fund. The KIA has a total asset of \$592 billion.



The value of Russia's
two SWFs is
\$89.9 billion

3.6 Russia

Russia started saving surplus oil revenue in 2002 in a financial reserve fund.³⁴ The accumulated funds were transferred into the Oil Stabilisation Fund (OSF) in 2004. By the end of 2007, the OSF had \$157 billion. In 2008, Russia formally created its SWF comprising the Reserve Fund (RF) and the National Wealth Fund (NWF). The sum of \$66.8 billion was transferred into the two funds. The balance of the OSF was held in Russia Federation's reserves. The RF aims to maintain budget balance and "contribute to stability of Russian Federation economic development" while the NWF has a longer-term objective of supporting the pension system. Every year, a portion of oil revenue corresponding to 3.7% of GDP is set aside to fund the budget. The rest is transferred to the RF. The size of the RF is capped at 10% of GDP forecast for the Russian Federation. Whenever the RF reaches this threshold, the rest is transferred to the NWF. Funds can be withdrawn from the RF to balance the budget and pay debt with the approval of the Russian Federal Assembly as part of the federal budget process. The value of Russia's two SWFs is \$89.9 billion.³⁵

3.7 Comparative Evaluation of Sovereign Wealth Funds

The size of Sovereign Wealth Funds (SWFs) is the most common measure of performance. However, SWFs are also measured by the capacity of the fund to perform a basic "stabilization" function. This is determined by comparing the value of the assets to the country's annual budget. Other measures are the relation to a country's Gross Domestic Product and the per-capita savings. Institutional and governance factors like the fiscal rules and



³³ Bank of Botswana Annual Report 2012. <http://www.bankofbotswana.bw/assets>

³⁴ Merlevede et al (2009). Russia From Boom to Bust and Back: Oil Price, Dutch Disease and Stabilisation Fund

³⁵ Figures, as at May 01, 2017, provided by the Russian Ministry of Finance.

TABLE 1: COMPARATIVE ASSESSMENT OF SWFs

Country	Purpose	Year est.	Seed capital (\$bil)	Size (\$bil)	% of Budget (2017)	Pop (mil)	Fiscal rule (savings)	Fiscal rule (withdrawal)	Approving authority
Norway	Stabilisation, Savings	1990	0.31	922.1	3,720	5.2	100% of oil revenue	4% of fund value	Automatic trigger
Chile	Stabilisation, Pension	2007	2.58	24.1	39.8	18.1	Between 0.2% to more than 1% of GDP	Not more than fund's profits	Automatic trigger
Angola	Savings, Development	2012	5.0	4.6	10.4	25.8	100,000 oil bpd	7.5% for social projects; up to 20% of liquid assets available for emergency	President
Botswana	Stabilisation, Savings	1994	NA	5.7	101.8	2.3	Budget surplus based on fiscal/monetary policy	Budget deficit based on fiscal/monetary policy	Automatic trigger
Russia	Stabilisation, Saving	2008	66.8	89.9	32.1	143.4	All revenue after 3.7% of GDP is deducted	Determined yearly through though budget process	Russia Federal Assembly
Kuwait	Stabilisation, Savings	1953	0.7 [*]	592	910.8	4.0	10% of government's revenue	No withdrawal of both capital and profits	Not applicable
Nigeria	Stabilisation, Savings, Development	2012	1.0	1.5	6.2	186.9	Difference between budget and actual oil revenue	Up to 100% of stabilisation component and 60% of SWF profit	National Economic Council

Sources: SWF Institute (fund size); countries' ministries of finance (budget); UN Department for Economic and Social Affairs (population); extant legislation for respective funds (fiscal rules).

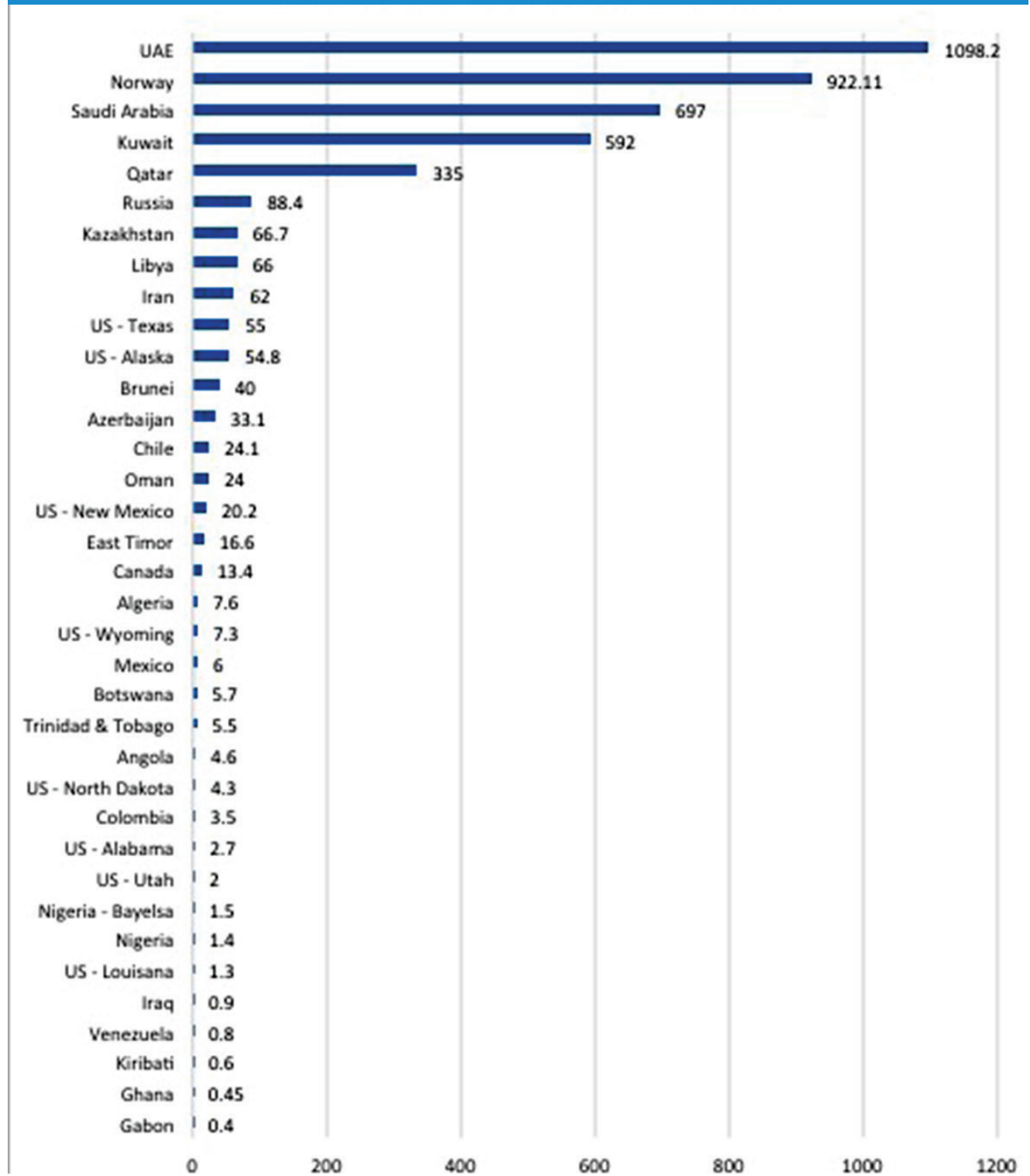


Among these countries, Nigeria currently has the worst SWF to annual budget ratio. The current value of Nigeria's SWF cannot finance one-tenth of current annual budget. Norway has 37 budget years' worth of SWF while Kuwait's is at least nine years

approving authority for withdrawals of funds from the SWF also determine the performance of the fund.

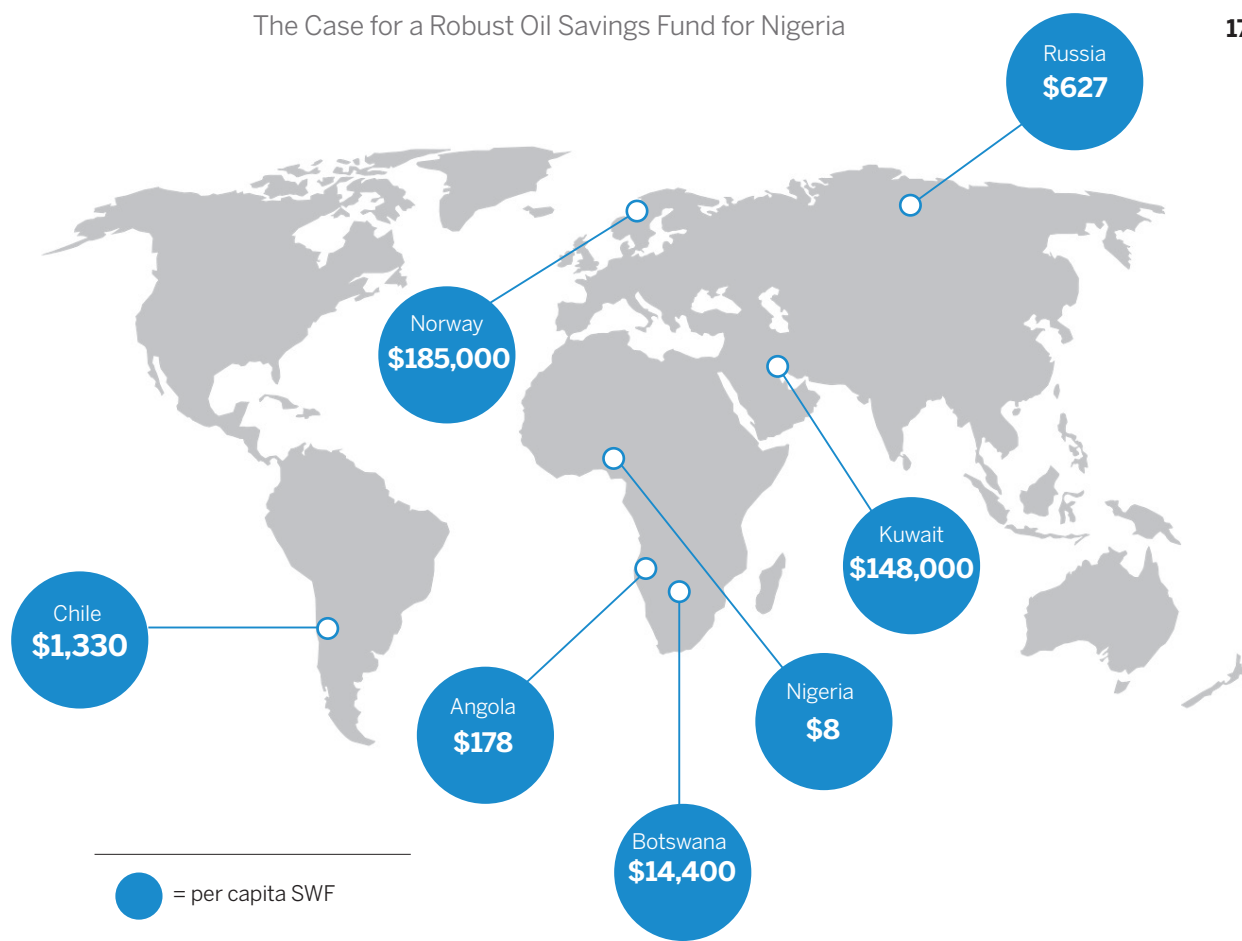
Table 1 shows comparison in terms of size, purpose, fiscal rule, and approving authority for funds withdrawals. Comparing the size of a country's sovereign wealth fund with the annual budget would show the potential effectiveness of a given SWF, i.e. extent to which a country is protected against volatility or can survive in the event of total depletion of its natural resource. This ratio varies from 3,720% to 6.2%. Among these countries, Nigeria currently has the worst SWF to annual budget ratio. The current value of Nigeria's SWF cannot finance one-tenth of current annual budget. Norway has 37 budget years' worth of SWF while Kuwait's is at least

Figure 1: Major Sovereign Wealth Funds



(Source: Sovereign Wealth Institute and others)

* This is the earliest quoted figure available for the Kuwait fund as at 1965: See Sovereign Wealth Funds: The New Intersection of Money and Politics by Christopher Balding.



Nigeria's indices fall considerably behind the other countries in its capacity to provide for future generations.

nine years. Botswana's SWF can finance the entire country's budget while Russia has enough for about a third of its budget.

The effectiveness of a Sovereign Wealth Fund is also measured against a country's population in the way in which the fund is designed to cater for future generations. Section 31 of Nigeria's NSIA Act (2011) for instance stipulates that the optimal size of the Future Generations Fund and the Infrastructure Fund should be reviewed periodically as dictated by "demographics and growth projections". However, Nigeria's indices fall considerably behind the other countries in its capacity to provide for future generations. Angola's has a per capita SWF of \$178, followed by Russia with a per capita SWF of \$627. Next is Chile's \$1,330 and then Botswana's with per capita savings of \$14,400. Kuwait and Norway lead the pack, having saved \$148,000 and \$185,000 for every one of their citizens respectively. In dramatic contrast, Nigeria's per capita SWF saving is \$8.

Out of these case studies, Russia presents a useful case for analysis given its demographic and political similarities with Nigeria, and given the size of its Sovereign Wealth Fund relative to its oil and gas resources. In 2003, about the time both countries began making significant savings from oil revenue, Russia's population was greater than Nigeria's by about 12 million. Russia, like Nigeria, was heavily indebted to the Paris Club. Three years after Russia started saving in the first Oil Stabilisation Fund, it used part of the savings to offset its entire \$22 billion indebtedness to the Paris Club, about the same

time that Nigeria paid \$12 billion to its creditors to get a debt reprieve of \$18 billion.

Russia has had significant challenges with saving oil revenue as a federal system and as a country with comparable governance indices. A recent review of Russia's Reserve Fund (RF) and the National Wealth Fund (NWF) identified several governance issues with withdrawals from the funds. Russia has no doubt its fair share of challenges with operating its fund in a federal system of government, where there have been "intense domestic pressure" for the government to spend the savings in the SWF. Still, Russia's \$89.9 billion SWF is about sixty times the size of Nigeria's SWF. Russia's oil production may be five times that of Nigeria, but its annual budget expenditure is more than ten times Nigeria's.

Like Russia, Nigeria has faced challenges of saving revenues in a federal structure, but the two countries are by no means the only ones with this experience. At least eleven countries on the list of the Sovereign Wealth Institute's SWF ranking are federal states. All but one of these countries are constitutional democracies, dispelling the notion that only autocracies or monarchies can successfully maintain a Sovereign Wealth Fund. Among these countries, only war-torn Iraq and crisis-hit Venezuela perform worse than Nigeria, but not by much.

Yegor Gaidar, Russia's former prime minister, observed that the country learnt its lessons from its experience following the crash in oil prices in 1985. He traced the collapse of the Soviet Union partly to the economic crises brought on by the sheer size of the price crash. The former premier concludes that contemporary Russia has learnt useful lessons and has become shrewder with more prudent fiscal management and the accumulation of significant oil savings. Recent (2016) IMF Article IV reports provide an insight into the management of oil revenue by both countries. According to the report, Russia's low debt and moderate financing needs, coupled with NWF liquid assets alone, equivalent to 5% of GDP, was more than sufficient to finance its deficit. By contrast, Nigeria's fiscal deficit was worsened by higher than budgeted (mostly recurrent) spending, even though "revenue underperformed by 50%".

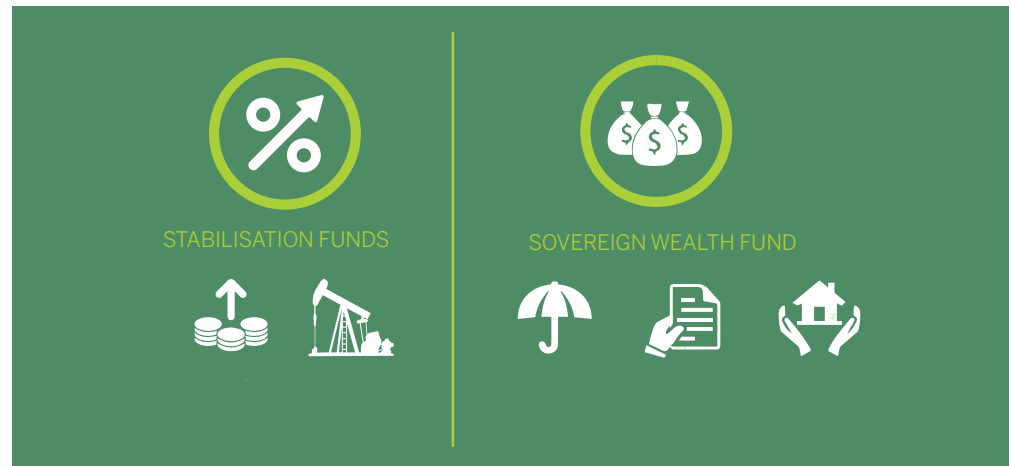


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Instructively, Russia has tended to maintain a more modest expectation of oil price levels than Nigeria. In 2005, Russia's spending plans was based on predicted oil price of \$20/barrel. The same year, Nigeria planned for a \$30 oil price. The following year, Russia's projected barrel price was \$27 while Nigeria's was \$35. This year, Russia expects average oil prices at \$40. Nigeria's parliament approved benchmark of \$44.5. This shows that while other countries have adopted a more pragmatic approach to volatility, Nigeria has largely been driven by the illusion of continuous oil windfall. The country can hardly achieve meaningful savings given this mindset.

Section 4.0: The Management of Nigeria's Stabilisation Funds

The excess withdrawal was offset partly by loan repayments and partly by the amount in the account before 2007.



Nigeria currently operates two separate oil stabilisation funds (the “0.5% Stabilisation Fund” and Excess Crude Account) and three “ring-fenced” funds under the Sovereign Wealth Fund (Future Generations’ Fund, Nigeria Infrastructure Fund and Stabilisation Fund).

4.1 0.5% Stabilisation Fund

The fund was established to save oil windfall revenues and was later backed by the Allocation of Revenue (Federation Account, etc.) Act 1990. The law allocates 0.5% of the Federation Account to the fund to be used to augment allocation to “any state of the Federation which suffers absolute decline in its revenue arising from factors outside its control”. The IMF estimates that at least \$13 billion accrued to the fund between 1989 (when the fund was first operated) and 1994.³⁶ The NEITI Fiscal Allocation and Statutory Disbursement Audit report released in 2013 showed that while N109.7 billion was transferred into the account for the period between 2007 and 2011, sum of N152.4 billion was withdrawn from the account. The excess withdrawal was offset partly by loan repayments and partly by the amount in the account before 2007. The result was that the opening balance which stood at N41 billion in January 2007 was further depleted to N36.1 billion by December 2011. As at May 31, 2017, the account had a sum of N29.02 billion.

³⁶ Nigeria: Background papers and Statistical Appendix. IMF 1996.

**\$2.3 billion**Total credit balance in the
ECA as at May 2017

4.2 Excess Crude Account

The Excess Crude Account (ECA) was established in 2004 as part of the economic reforms of the President Olusegun Obasanjo administration. The government had adopted an Oil Price-based Fiscal Rule (OPFR) as part of the National Economic Empowerment and Development Strategy (NEEDS) approved by the Federal Government following “nationwide consultations and debates” among stakeholders.³⁷ The objective was to “create a predictable macroeconomic environment” and to encourage government savings. Government was expected to ensure that the budget benchmark price is consistently below projected international oil prices. Attempt was made to legalise and institutionalise the ECA in the Fiscal Responsibility Act 2007. The law stipulates that revenue in excess of a pre-determined commodity price should be saved in a Consolidated Revenue Fund at the Central Bank, and to be invested by the Bank in consultation with the Minister of Finance, State Commissioners of Finance and local government treasurers.³⁸ Specifically, the law states that government cannot spend the money “unless the reference commodity price falls below the pre-determined level for a period of three consecutive months.” Total credit balance in the ECA as at May 2017 was \$2.3 billion.³⁹

4.3 Sovereign Wealth Fund

In 2010, the National Economic Council approved the creation of a Sovereign Wealth Fund for Nigeria. In 2011, the government established the Nigeria Sovereign Investment Authority (NSIA) through an act of the National Assembly to “prepare for the eventual depletion of Nigeria’s hydrocarbon resources”.⁴⁰ The law aims to build a savings base, develop infrastructure and provide stabilisation in times of economic stress. Thereafter, three distinct (ring-fenced) funds were created, namely: (1) Future Generations’ Fund (2) Nigeria Infrastructure Fund and (3) Stabilisation Fund. Oil revenue in excess of the budget price and volume benchmarks was to be transferred to the NSIA. The law prescribed that 60% of the fund should be allocated equally to the three funds, while 40% is to be allocated at the discretion of the board of the NSIA. Consequently, the board has allocated 40% each to the future generations and the infrastructure funds, while Stabilisation Fund has 20%. Savings in the future generations and infrastructure funds are to be made until the amounts in each fund reach a certain percentage of GDP. The threshold is to be reviewed every two years by the NSIA, giving consideration to population and growth projections.

The “Stabilisation Fund” component of the SWF is invested in short-term assets that are easily monetised for possible budget augmentation. Up to 10% of the Infrastructure Fund is invested in “social infrastructure” tagged as “development projects”. The funds are currently invested in agriculture, healthcare, motorways, power and real estate. The projects include the presidential initiative to deliver locally produced fertiliser at affordable price.

³⁷ See National Economic Empowerment and Development Strategy Document (NEEDS) 2004.

³⁸ See Section 35 of the Fiscal Responsibility Act 2007.

³⁹ Monthly Federation Account Allocation Committee Report

⁴⁰ See Nigeria Sovereign Investment Authority (Establishment, ETC) ACT 2011.

It aims to deliver 100 million metric tonnes of fertiliser in 2017, resulting in potential budgetary savings from fertiliser subsidies, foreign exchange savings and job creation. Other projects are the \$200 million Agriculture Fund Investment, the Family Homes Fund, and the Second Niger Bridge (2NB).

While up to 60% of profits from the SWF is available every year for distribution to the three tiers of government, the entire “Stabilisation Fund” component (assets and capital) of the SWF is available for financing any shortfall in the budget arising from oil price falling below the budget benchmark price. Assessment for budget stabilisation needs is carried out quarterly, and funds are released at the end of each quarter, if stabilisation is required for that quarter. This disbursement of 60% profits to the three tiers of government (through the federation account) must be approved by the NSIA Council comprising Nigeria’s president, five cabinet members, state governors and twelve others representing the private sector, the academia, the youth and civil society. Disbursement from the “Stabilisation Fund” is made on the direction of the Minister for Finance, subject to the existence of a pre-determined stabilisation trigger. From a seed capital of \$1 billion in 2012, total capital is currently \$1.5 billion.⁴¹



Year	Savings (\$million)
2012	1,000
2013	0
2014	0
2015	250
2016	0
2017	250

Year	Earnings (Nmillion)
2012/13	505
2014	15,800
2015	26,300
2016	149,830
Total	192,430

Source: NSIA's annual reports; www.nsia.gov.ng

4.4 Performance of the NSIA

The NSIA is a comprehensive legislation with extensive corporate governance and management provisions in line with global principles and best practices.

The NSIA Act (2011) is a significant improvement on the legislations for the ECA and the 0.5% Stabilisation Fund in terms of comprehensiveness, transparency and accountability. While the ECA and the 0.5% fund were established each by a single clause in broader (fiscal) legislations, with no specific governance, transparency or accountability requirements, the NSIA is a comprehensive legislation with extensive corporate governance and management provisions in line with global principles and best practices. The law emphasises professionalism and technical expertise of both management and members of the NSIA board. There are clearly defined reporting requirements and accountability relationships between management, the Board, and Council. The NSIA presents annual reports to the NSIA Council, the National Economic Council, the National Assembly and states’ houses of assembly. The annual reports and quarterly reports are presented to the

⁴¹ See Sovereign Wealth Fund Institute Data, <http://www.swfinstitute.org/sovereign-wealth-fund-rankings/>

9/10

NSIA - the highest score for any African SWF and second joint highest globally.

public through publication in national newspapers. NSIA accounts are being audited by PriceWaterhouseCoopers in line with international financial reporting standards.

In terms of transparency, the NSIA has scored 9 out of ten on the global Sovereign Wealth Institute's transparency index, the highest score for any African SWF and second joint highest globally.

After the first (seed) capital, the government transferred \$500 million to the SWF between November 2015 and March 2017, bringing total current savings to \$1.5 billion. While these savings are significantly below projected transfers to the SWF,⁴² it has however not been depleted unlike the ECA and the 0.5% Stabilisation Fund. Since its establishment, NSIA investments generated net incomes of N505 million in its first 15 months, N15.8 billion in 2014, N26.3 billion in 2015 and N149.83 billion in 2016. This progressive and substantial increases show the revenue potential of the SWF.

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4.5 The Intentions, Objectives and Implementation of Nigeria's Stabilisation Policy

Evidently, Nigeria has a fairly longstanding history of stabilisation policymaking. The 0.5% Stabilisation Fund was established almost three decades ago. Remarkably, all of the three oil revenue funds that were created since 1989 are still active in 2017. All these accounts are still being funded, wholly or partly, according to the rules that established them.

The stated objectives of Nigeria's stabilisation policymaking have been to smoothen revenue and to save for the future generation. However, evidence shows that the cumulative savings so far is negligible compared with the volume of oil revenue earned. It is also nowhere near the level of savings required to absorb the effect of the next price shock or sustain the country in the not-too-distant post-oil era. Between 1989 when the first stabilisation fund was established and 2015, Nigeria exported about \$980 billion worth of crude oil.⁴³ However, total savings in the infrastructure, future generations, first and second stabilisation funds, and the ECA amounted to \$3.9 billion.⁴⁴

⁴² NSIA Act 2011

⁴³ World Trade Organisation Statistical Database

⁴⁴ Broken down as follows: \$2.32bn in ECA, \$1.5bn in NSIA and \$95m in the 0.5% stabilization fund

This is just 0.39% of total crude oil exports for the period, 0.8% of GDP as at 2015 or 16% of Nigeria's current budget.

The failure of Nigeria to record meaningful savings from oil revenues despite establishing several accounts for that purpose, and in spite of consistently high oil prices especially in the ten years up to 2014, is traceable as much to a failure to comply with the rules guiding the stabilisation funds as well as to deficiencies in the rules.

Table 4 depicts the performance of the Excess Crude Account in relation to the operation of the Oil Price-based Fiscal Rule (OPFR).

Table 4: ECA Benchmarks and Actuals

Year	Budget Benchmark Price (\$/barrel)	Average yearly crude oil Prices (\$/barrel)	Budget Crude Oil Production (mbpd)	Actual Production (mbpd)
2005	30	50.59	2.71	2.5
2006	35	61	2.5	2.38
2007	40	69.04	2.5	2.2
2008	59	94.1	2.45	2.1
2009	45	60.86	2.2	2.13
2010	67	77.38	2.35	2.45
2011	75	107.46	2.3	2.37
2012	72	109.45	2.48	2.33
2013	79	105.87	2.53	2.19
2014	77.5	96.29	2.38	2.18
2015	53	49.49	2.27	2.12

Total savings in the infrastructure, future generations, first and second stabilisation funds, and the ECA amounted to \$3.9 billion.

Source: Report of the NEC Committee on the ECA for January 2005 to June 2015

⁴⁵ Obiageli Ezekwesili (2016), "Safeguarding and Smoothing Fiscal Adjustments in Nigeria: Policy Options"

FIG 1: Budgeted and Actual Crude Oil Prices (\$) barrel

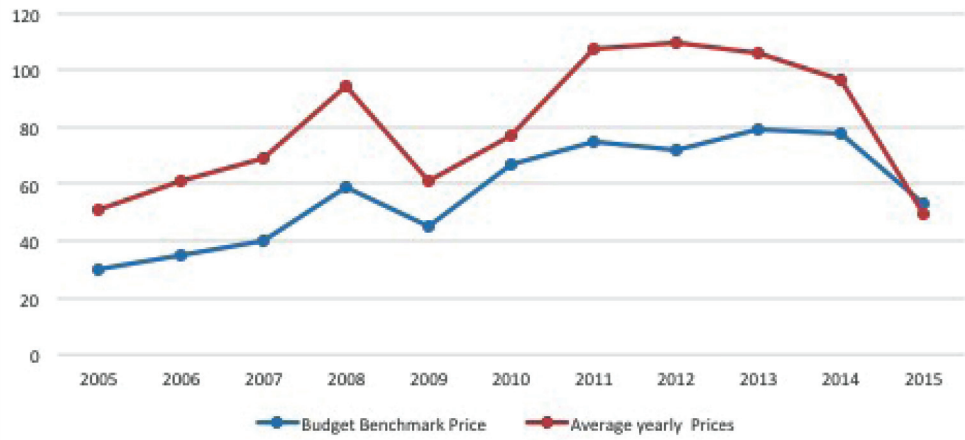


FIG 2: Budgeted and Actual Crude Production (Million barrels per day)

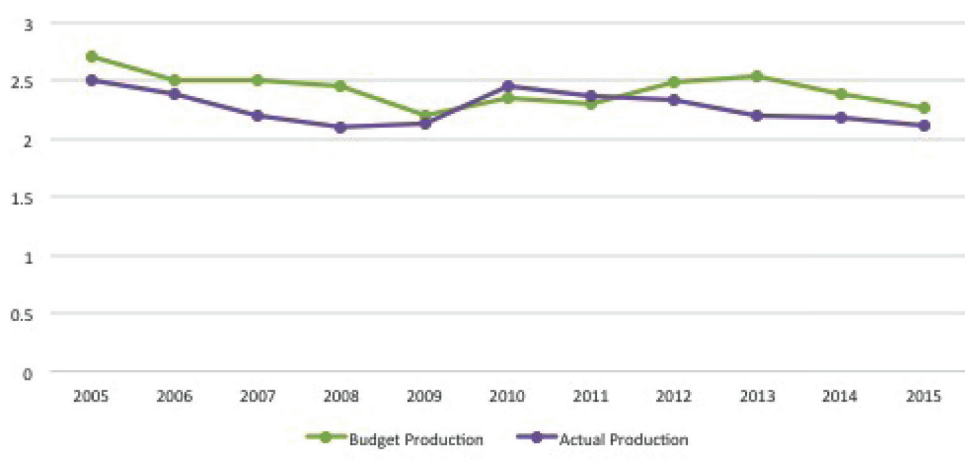
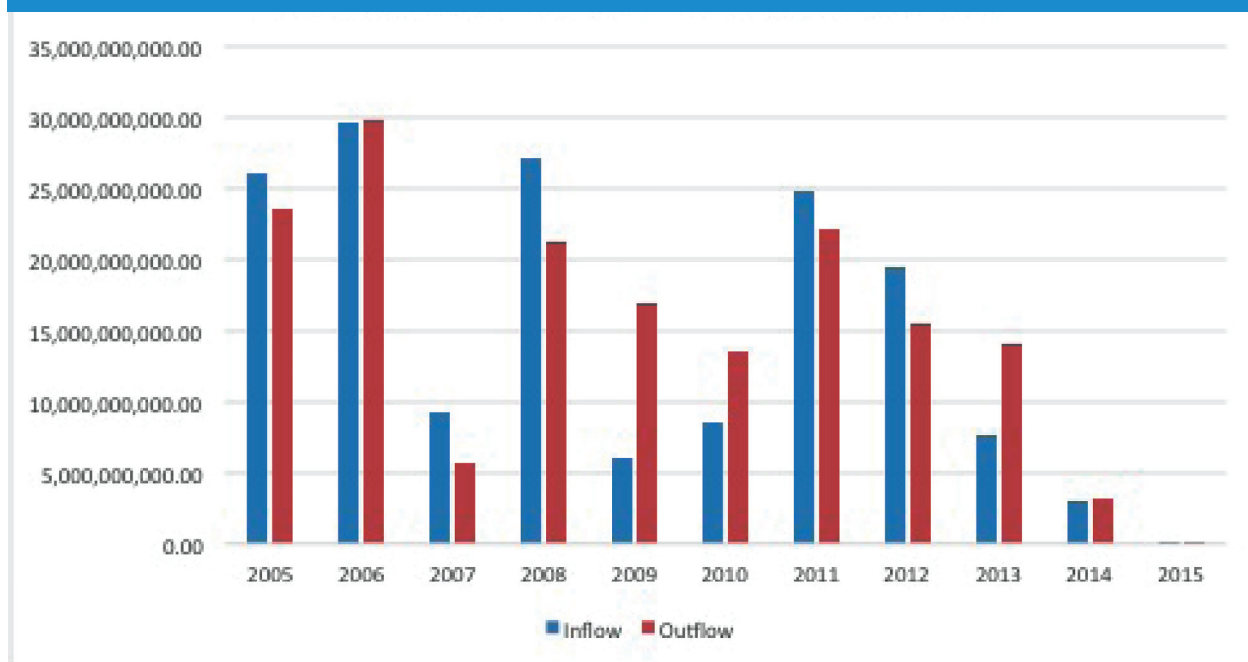


Table 5 : Inflows and Outflows to ECA from Export Sales (\$)

	Inflow	Outflow	Net Transfers
2005	26,064,510,832.72	23,487,954,919.57	2,576,555,913.15
2006	29,614,809,449.80	29,799,214,045.58	-184,404,595.78
2007	9,272,022,127.89	5,641,515,025.65	3,630,507,102.24
2008	27,172,721,576.50	21,295,282,389.27	5,877,439,187.23
2009	6,062,491,906.54	16,978,385,122.29	-10,915,893,215.75
2010	8,530,670,444.43	13,512,145,590.65	-4,981,475,146.22
2011	24,777,730,043.58	22,161,827,466.99	2,615,902,576.59
2012	19,505,221,193.67	15,423,187,037.76	4,082,034,155.91
2013	7,736,816,198.19	14,103,886,235.52	-6,367,070,037.33
2014	3,026,262,171.81	3,274,266,648.51	-248,004,476.70
2015	236,916,438.85	93,600,088.14	143,316,350.71

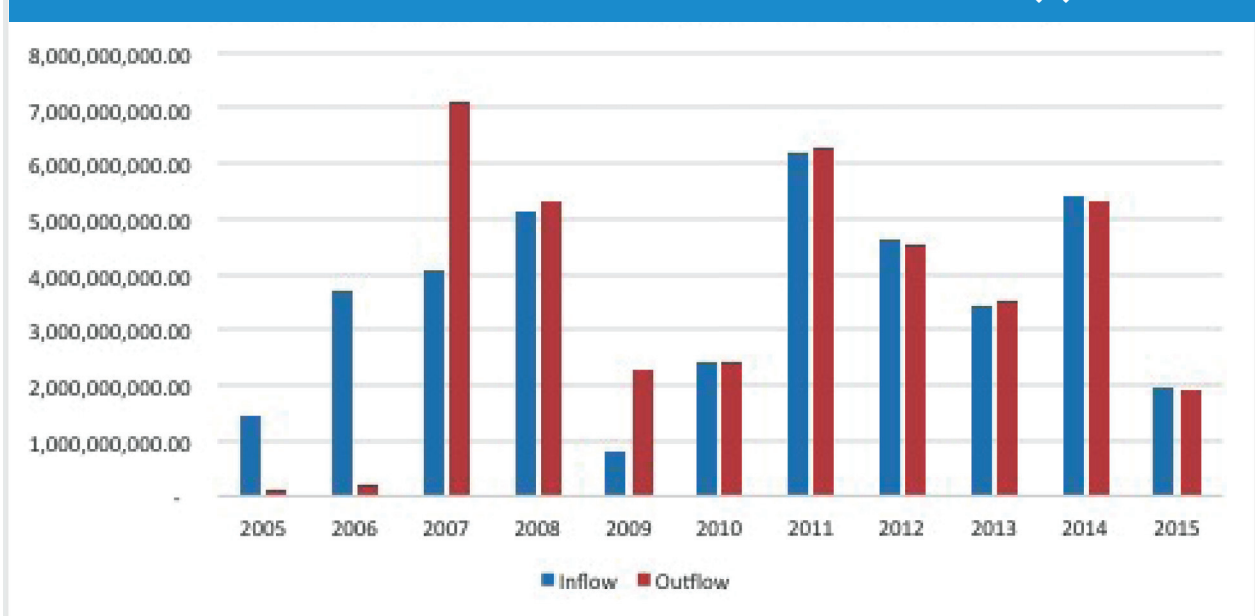
FIG 3: Inflows and Outflows to ECA from Exports (\$)

Source: Report of the NEC Committee on the ECA for January 2005 to June 2015

Table 6: Inflows and Outflows to ECA from Domestic Sales (\$)

	Inflow	Outflow	Net Transfers
2005	1,458,249,093.02	98,359,656.76	1,359,889,436.27
2006	3,718,976,745.45	194,363,025.02	3,524,613,720.43
2007	4,068,448,659.01	7,117,135,845.43	-3,048,687,186.41
2008	5,139,903,669.88	5,316,539,454.49	-176,635,784.61
2009	780,568,891.72	2,290,083,162.80	-1,509,514,271.08
2010	2,420,899,655.60	2,393,455,835.15	27,443,820.45
2011	6,175,130,264.62	6,274,139,420.20	-99,009,155.58
2012	4,626,094,543.82	4,534,792,012.09	91,302,531.73
2013	3,425,496,939.90	3,516,735,279.01	-91,238,339.11
2014	5,399,201,170.80	5,317,490,516.66	81,710,654.14
2015	1,947,064,654.36	1,906,525,955.85	40,538,698.51

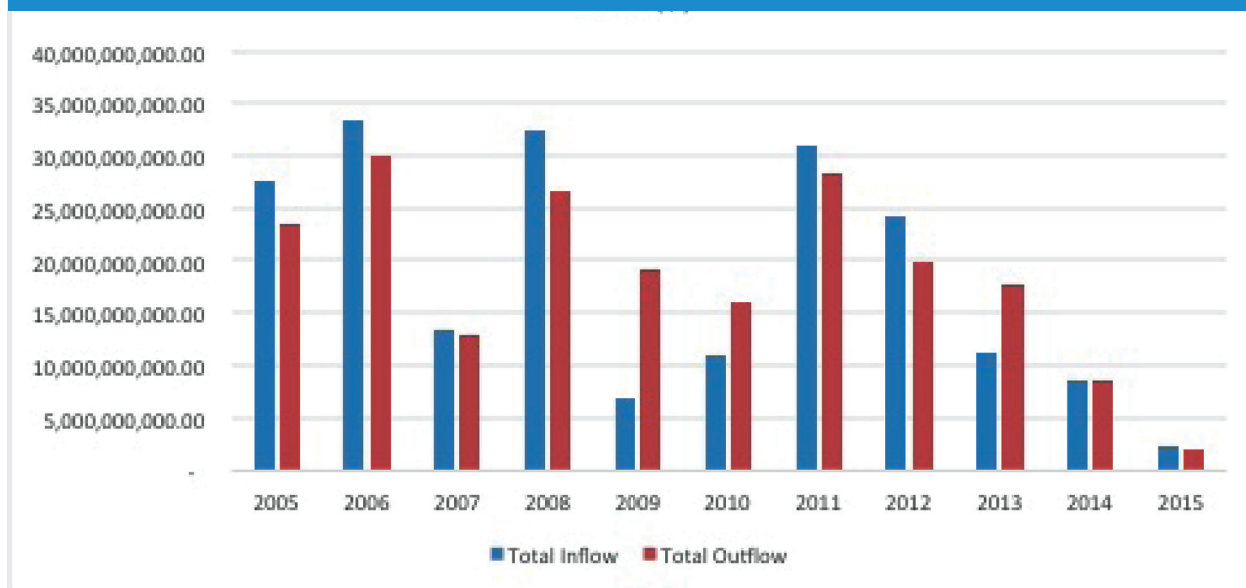
FIG 4: Inflows and Outflows to ECA from Domestic Sales (\$)



Source: Report of the NEC Committee on the ECA for January 2005 to June 2015

Table 7: Total Flows to the Excess Crude Account from Export and Domestic Sales (\$)

	Total Inflow	Total Outflow	Net Transfers
2005	27,522,759,925.74	23,586,314,576.33	3,936,445,349.42
2006	33,333,786,195.25	29,993,577,070.60	3,340,209,124.65
2007	13,340,470,786.90	12,758,650,871.08	581,819,915.83
2008	32,312,625,246.38	26,611,821,843.76	5,700,803,402.62
2009	6,843,060,798.26	19,268,468,285.09	-12,425,407,486.83
2010	10,951,570,100.03	15,905,601,425.80	-4,954,031,325.77
2011	30,952,860,308.20	28,435,966,887.19	2,516,893,421.01
2012	24,131,315,737.49	19,957,979,049.85	4,173,336,687.64
2013	11,162,313,138.09	17,620,621,514.53	-6,458,308,376.44
2014	8,425,463,342.61	8,591,757,165.17	-166,293,822.56
2015	2,183,981,093.21	2,000,126,043.99	183,855,049.22

FIG 5: Total Inflows and Outflows to ECA from Export and Domestic Sales (\$)

Source: Report of the NEC Committee on the ECA for January 2005 to June 2015

\$201.2 billion

Amount accrued to the ECA
between 2005 and 2015



\$204.7 billion

Amount withdrawn from the
account for sundry reasons,
indicating that the amount
that was withdrawn from the
account exceeded the amount
that was transferred into the
account for the period.

The OPFR meant that savings were supposed to be made whenever actual volume and/or price exceeded budgeted levels, and in proportion to the size of variation. However, the table shows that except for 2005, savings consistently fell short of the level of the price/volume variation, or did not even happen at all as required by the fiscal rule. Throughout the period covered, the slight negative variations in actual production volume were more than compensated by the fact that actual prices of oil were significantly higher than the benchmark prices. In fact, both price and production volumes exceeded the budget projections in both 2010 and 2011. Yet, the country recorded negative savings in 2010, which is one of the five years that recorded negative net savings. One key statistics more or less summarises the general pattern of performance of the ECA. An extensive study conducted on the ECA by the National Economic Council in 2015 showed that while \$201.2 billion accrued to the ECA between 2005 and 2015, \$204.7 billion was withdrawn from the account for sundry reasons, indicating that the amount that was withdrawn from the account exceeded the amount that was transferred into the account for the period. Or put another way, withdrawals were 102% of deposits. The implication was that the ECA which had an opening balance of \$5.9 billion in January 2005 dropped to \$2.1 billion by December 2015.

This was the state of affairs when oil prices suddenly plunged to less than half of their values in 2014/15. An economy that had swallowed up the entire \$58 billion⁴⁵ that the country earned from oil in the previous year (2013) was evidently not equipped to withstand the shock of significantly reduced revenue, with just \$2 billion in the stabilization account. As a result, the economy contracted, the country accumulated more debt and used up most of its foreign exchange reserves. Ezekwesili traced the lingering “crisis in Nigeria’s public finance” to “the economic malaise that oil boom and bust inflicted on Nigeria in the 1970s. She attributed this to the fact that the country has “failed to understand how to manage the risks associated with rich endowment of natural resources” and has kept repeating the same mistake resulting in “severe consequences for both country and citizens”⁴⁶.

⁴⁵ NEITI Audit Report 2013

⁴⁶ Obiageli Ezekwesili (2016), “Safeguarding and Smoothing Fiscal Adjustments in Nigeria: Policy Options”

Section 5.0: Challenges to Effective Operation of Nigeria's Oil Revenue Funds

The operation of the various oil revenue funds set up by Nigeria's government has faced governance, legal and political challenges. These are discussed in reference to evidence contained in this paper as well as previous studies carried out on the stabilisation funds.

5.1 Governance

The governance issues identified by this paper center around three main areas: authority for disbursement of funds, savings and stabilisation trigger, and application of funds.

(i) Authority for Disbursement (Accountability and transparency issues)

The relevant laws prescribed the condition for disbursement of the 0.5% Stabilisation Fund and the ECA, but did not specify how the funds should be withdrawn and allocated. This falls short of what is generally regarded as good practice in the management of stabilisation funds for the purpose of transparency and accountability.⁴⁷ In practice, the pitfalls inherent in this arrangement became glaring in a recent report by the National Economic Council Committee on the ECA, where it noted that the President of Nigeria, the Federation Accounts Allocation Committee (FAAC) and the CBN were listed at various times as approving authorities for withdrawals from the ECA. In one case, "resolutions of the Houses of Assembly of the States" was listed as the approving authority. On the other hand, the Sovereign Wealth Fund clearly vests the authority for approvals in the NSIA Council.

Another report also identified "limited disclosures on the details of transaction in the ECA", which is a major transparency issues with the operation of the ECA.⁴⁸

(ii) Effectiveness of the Savings and Stabilisation Trigger

Table 4 above showed that, over time, funds have been withdrawn from the ECA and shared by the three tiers of government, even when the fiscal conditions for stabilisation did not exist i.e. when there was no need in the economy for stabilisation. NEITI's 2007 to 2011 FASD audit found that withdrawal from the ECA peaked in 2011, the same year that Nigeria recorded the highest revenues in excess of the budget. This runs counter to the logic of "stabilisation" and reinforces the same pro-cyclical fiscal practice that stabilisation funds were designed in the first place to mitigate. In the case of the SWF, the savings trigger has apparently failed to apply, considering the current size of the funds. The total capital, which was \$1



Funds have been withdrawn from the ECA and shared by the three tiers of government, even when the fiscal conditions for stabilisation did not exist i.e. when there was no need in the economy for stabilisation

⁴⁷ See Principles 4 & 5 of the Santiago Principles

⁴⁸ Ezekwesili (2016).



The IMF notes that funds accruing to the 0.5% Stabilisation Fund from the 1990/91 oil windfall were mainly spent on supplementary and extra-budgetary items, and distributed to states on ad-hoc basis

billion when the fund was established in 2012 has only increased by \$500 million in spite of the fact that oil revenue target was substantially exceeded in the first two years, and in the subsequent three years.

(iii) Application of Funds

The main principle underpinning fiscal “stabilisation” is that the fund would be used to smoothen expenditure within the budget limits. This principle is enshrined in the rules establishing Nigeria’s stabilisation funds. In practice however, the funds have largely been used to fund non-budget expenditure. The IMF notes that funds accruing to the 0.5% Stabilisation Fund from the 1990/91 oil windfall were mainly spent on supplementary and extra-budgetary items, and distributed to states on ad-hoc basis.⁴⁹ Similarly, a 2013 NEITI audit of the 0.5% Stabilisation Fund concluded that “the Fund was accessed mainly for loan purposes not related to the stabilisation trigger”. As for the ECA, a National Economic Council review of the fund classified most of the withdrawals, especially from the domestic excess crude account, as “unusual items”.

Table 8: “Unusual” withdrawals from the domestic Excess Crude Account (2005-2015)

Item	Amount (N)
Loan to ALGON	6,685,516,168.21
Loan to 32 States to pay London Club Debt refund	28,700,000,000.00
Funding of Niger Delta Power Plants	12,688,395,721.65
Petroleum Equalization Management Board	24,164,184,589.44
Funding of NIPP	46,870,265.14
Subsidy (PPPRA & Oil Marketers)	3,453,953,843,595.37
SURE-P Payment	400,397,749,680.75
Total	3,926,636,560,020.56

Source: Report of the NEC Committee on the ECA for January 2005 to June 2015

The table lists withdrawals from the ECA which violated the operating principles of the ECA. Collectively, the items in this category constitute about 67% of total outflow (N5.85 trillion), indicating that the “unusual” withdrawals were significantly more than double the withdrawals that were properly made. While N5.82 trillion was transferred into the account as

⁴⁹ See IMF 1996.

excess revenue, N5.85 trillion was withdrawn. This meant that in 11 years (2005-2015), there was almost no net addition to the domestic ECA (credit balance in the ECA was less than 0.5% of total inflows). In seven out of the eleven years (2005, 2006, 2007, 2009, 2010, 2013 and 2015) these “unusual” withdrawals represented the entire outflow (100%) from the domestic ECA.

Another review⁵⁰ of the ECA (domestic) showed that disbursements by the Federation Account Allocation Committee (FAAC), which can be classified as the only ‘proper’ disbursements since FAAC is the body statutorily empowered to distribute federation revenue, accounted for less than 25% of total disbursements, and about half of the expenditure on a single item (subsidy payments) on the ‘unusual withdrawals’ list.⁵¹

5.2 Operational Issues

Several operational issues were associated with the handling of the ECA. There was lack of consistency in the records kept by the office of the Accountant-General, in addition to the fact that data entry was prone to errors, resulting in over 60% of “income” into the ECA being “reversed”.⁵²

5.3 Constitutional Challenge

Legal challenges to the operation of the ECA and the SWF stem from the provisions of Nigeria’s constitution, precisely Section 162(1) of the 1999 Constitution (as amended), which states 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”. Hence, the other tiers of government, specifically the state governments, have continuously questioned the constitutionality of the ECA. The governors of the 36 states of the federation went to the Supreme Court in 2008 seeking to nullify the ECA. Attempts to ‘legitimise’ the ECA led to negotiations, between the federal government and the state governors, both using the instrument of the National Economic Council, a constitutional instrument of which both parties are members. Consequently, the Council approved the establishment of the Sovereign Wealth Investment Authority (SWIA) in 2010. However, the governors went back to court following the federal government’s decision to transfer additional \$2 billion⁵³ from the ECA to the SWF. Attempts to settle out-of-court failed and the governors returned to court the in 2012. The case has lingered and the Supreme Court again asked the parties in late 2015 to settle out-of-court. The protracted legal tussle has impeded further capitalisation of the NSIA.



The governors of the 36 states of the federation went to the Supreme Court in 2008 seeking to nullify the ECA.

5.4 Developmental Challenges

Nigeria’s low development indices present a real and present challenge to the argument to save revenue from oil, which is the country’s main source of sustenance. With huge infrastructure deficit and pressing human

⁵⁰ Ezekwesili (2016).

⁵¹ Ibid.

⁵² Ibid.

⁵³ This amount is yet to be transferred because of the litigation

development obligations, it is difficult to ignore the argument that available resources should be allocated to these pressing needs. For instance, the governors have opposed the operation of the ECA as a “rainy day fund” as they believed that it was already raining at the time.⁵⁴ The arguments become even more difficult to ignore in a period of recession where increased spending appear to be the most appropriate remedy. However, the real challenge lies in the fundamental trade-off between current economic needs and the welfare of future generations. This, ultimately, is a political decision that has not been made in the context of Nigeria’s exploitation of its non-renewable resources.

5.5 Structural Challenge

This challenge stems from the mechanism of fiscal federalism and the problem of practising centralised savings in a regime of decentralised expenditure. Nigeria’s stabilisation system is tied to a fiscal rule executed through the Federal Government’s budget. But the states’ budgets are not based on these parameters, nor are the state parameters uniform across the 36 states of the federation.

5.6 Trust Issues

At the political actors’ level, there is some evidence that lingering distrust of the Federal Government’s operation of the ECA has contributed to the governors’ continued opposition to the ECA and the SWF. At the Supreme Court, the governors have pointed to cases of “arbitrary withdrawals” from the ECA as a major impediment to an out-of-court settlement with the federal government.

5.7 Conceptual Problems

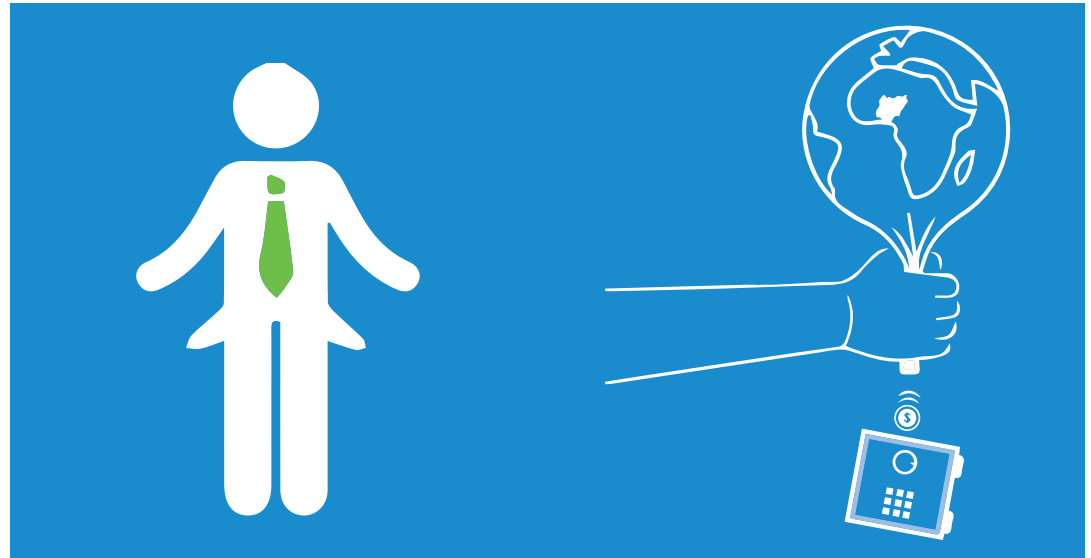
There is a way in which the perception of the ECA and the 0.5% Stabilisation Fund as largely a “smoothing” mechanism may have contributed to the rapid depletion of the funds. These funds were conceived from the beginning as tools for implementing the annual budget or implementing government programmes. The NEITI FASD audit found, for instance, that the 0.5% Stabilisation Fund became “a pool for funding various expenditures”. The way in which ECA was conceived as a “fiscal” rule also fuelled the propensity to deploy the money in the fund to finance government spending decisions.



Problem of practising centralised savings in a regime of decentralised expenditure

⁵⁴ Okonjo Iweala (2012). “Reforming the Unreformable: Lessons from Nigeria”, The MIT Press.

Section 6.0: Options for a Successful Savings and Stabilisation Practice for Nigeria



Nigeria's experience with management of stabilisation funds provides the basis for recommendations on the design and implementation of a more effective savings and stabilisation fund. The recommendations are also in line with widely-adopted frameworks and best practices on the structure and operation of stabilisation funds.

6.1 Legal Framework (Constitutional Amendment)

A “sound” legal principle is generally prescribed for effective operation of sovereign wealth funds.⁵⁵ The law is expected to prescribe clearly the structure, operations and relationship of the SWF with other state institutions. Evidence presented in this paper shows that all five oil revenue funds operated by Nigeria are backed by acts of parliament. The laws for the 0.5% Stabilisation Fund and the Fiscal Responsibility Act are found to be defective in failing to specify the authority for withdrawal of funds from the accounts. The SWIA Act, on the other hand, addressed most of the principles the GAPP principles.⁵⁶

However, the critical factor with all five funds is that their establishment and operations are supposedly in contravention of Section 162 of Nigeria's constitution, which is the sovereign law of the land. Proponents of the current stabilisation funds have argued that the funds in the ECA and SWF are jointly owned by the same constitutionally recognized beneficiaries of the Federation Account; that funds in these accounts are held on behalf of the

The laws for the 0.5% Stabilisation Fund and the Fiscal Responsibility Act are found to be defective in failing to specify the authority for withdrawal of funds from the accounts

⁵⁵ Generally Principles and Practices (GAPP) or “Santiago Principles” endorsed by the 31 members of the International Forum of Sovereign Wealth Funds including Nigeria.

⁵⁶ Ibid



The different oil revenue funds should be consolidated and the legal framework harmonised. Specifically, the 0.5% Stabilisation Funds and the ECA should be merged with the NSIA.

beneficiaries of the Federation Account; and that the constitution empowers the National Assembly to prescribe the “terms” and “manner” to distribute revenue in the Federation Account to the beneficiaries.

So far, the federal government has challenged the jurisdiction of the Supreme Court to adjudicate the matter. This paper recommends that:

a) All parties should allow, and in fact seek, a speedy resolution of the matter in court, since previous attempts to settle out-of-court have been unsuccessful. Continued litigation has frustrated sufficient remittances to the SWF in spite of the provisions of the NSIA Act.

b) Initiate amendment to Section 162 of the constitution to accommodate the welfare of future generations. The constitutional path appears, on the face of it, as the most challenging, given the chain of processes involved, and given that the principal actors in that process appear to be in disagreement on the ECA or the SWF. However, as Ezekwesili argues that constitutional option is necessary to ensure that the “rules are not subject to political fluidity”.

⁵⁷ Fortunately, the main political actors at the national and sub-national levels were involved in the processes that led to the establishment of the ECA and the SWF. Once the same consensus is achieved at the constitutional amendment level, there would be no more legal barriers to the proper operation of the stabilisation fund. However, the negotiations need to be complemented with appropriate guarantees for transparent and accountable governance of the funds to reassure stakeholders especially at the sub-national level.

6.2 Consolidate Existing Funds into the NSIA

Following constitutional resolution of the issue, the different oil revenue funds should be consolidated and the legal framework harmonised. Specifically, the 0.5% Stabilisation Funds and the ECA should be merged with the NSIA. Overtime, the multiplicity of funds with different rules has led to uncoordinated and widespread extra-budgetary spending. Apart from depleting the savings in each fund, such unrestricted spending defeats the purpose for which the funds were set up in the first place - to shield the economy from revenue volatility.

6.3 Improve Transparency and Accountability of NSIA

It is observed that the NSIA currently publishes its reports as required by the NSIA Act. However, the NSIA should put in place mechanisms to facilitate request for information not contained in its reports, and to promptly provide information requested by members of the public. The SWF belongs to Nigerians, as such the authority should be accountable to

⁵⁷ Ezekwesili (2016).



Oil Price-based Fiscal Rule makes savings possible only when oil prices rise above the budget benchmark.

not just the statutory organs of government. Similarly, the NSIA Council should ensure grassroots representation by including representatives from the Local Government Areas in the Council. Presently, the third tier of government, which statutorily owns 20% of the funds in the SWF, is not represented in the NSIA Council. Lastly, future amendments to the Act should delete amorphous provisions that are potentially open to abuse, like Section 3(d), which states that the NSIA “shall carry out such other matters as may be related to the above objects”.

6.4 Guarantee Savings Irrespective of Price

The Oil Price-based Fiscal Rule makes savings possible only when oil prices rise above the budget benchmark. While this fulfils the “smoothing” objective of the fund, it does not guarantee that future generations will get a fair share of current revenue. Some countries have successfully resolved this dilemma by adopting savings policies which guarantee savings at all price levels. Angola, for instance, pegs savings as the equivalent of 100,000 barrels of oil daily; Chile pegs savings as a percentage of GDP; Norway simply transfers all oil revenues to the fund, and then proceeds to disburse only the amount needed to finance any deficit in the budget, which itself is based on non-oil revenue.

6.5 Ensure Regular Financial Incentives for Funds’ Beneficiaries

As the size of sovereign wealth investment increases, the rules should ensure that regular dividend pay-outs are made to the three tiers of government, to compensate for their ‘sacrifice’. This will provide practical incentive for sub-national governments to continue to support investment in the funds. Overtime, at significant levels of investment, earnings from these funds become sufficient to finance government expenditures (current profit on Norway’s Sovereign Wealth Investments is more than twice the oil revenue), and may constitute the bulk of the ‘non-oil’ revenue of government.

6.6 Set Limits on Withdrawals for Budget Stabilisation

Despite its vastly improved provisions, the NSIA rules still do not set any limit on the amount that can be withdrawn to augment the budget. The rules state only that the amount to be withdrawn shall be “equal to the difference” between the benchmark and actual revenues. This means that the amount in the “Stabilisation Fund” can be entirely withdrawn for augmentation, leaving nothing for future stabilisation purposes. Besides (and for practical purposes) funds in the Stabilisation Fund at any given time may be less than the “difference” between projected and actual revenue, hence the law, as it stands, cannot practically be implemented in such circumstance.

6.7 Aim Ultimately to Delink Government Expenditure from Oil Revenue

The first objective of stabilisation is to delink government budgets from oil revenue. In this way, price volatility would have little or no effect on the economy (because the volume of economic activities does not depend on the size of oil revenue). At the moment, with oil revenue accounting for about 85% of total government budget, any shock in oil price would inevitably have severe effects on the economy. For starters, government should review the budgeting and stabilisation parameter which is based on crude oil prices. This reform will both ensure that government will save a portion of oil revenue whether prices rise or fall, and also ensure that price volatility will not necessarily produce the usual boom-to-bust cycle for the economy.



Countries are generally advised to adopt prudent fiscal policies, otherwise stabilisation funds will have no benefits in the long run

6.8 Implement Complementary Macroeconomic Policies

The literature theorizes, and Nigeria's experience has proven, that the existence of a stabilisation fund does not in itself guarantee the economic health of resource-rich countries. Countries are generally advised to adopt prudent fiscal policies, otherwise stabilisation funds will have no benefits in the long run. For instance, a country may have a credit balance in its stabilisation fund but then resort to borrowing heavily to finance huge budget deficits. Thus the country would be compounding the debt burden for future generations and in the meantime paying interests at a rate that is higher than the rate of returns on invested funds. In addition, budget deficits should be within the limits that can be financed with the funds available for stabilisation at any given time.

Section 7.0: Conclusion



Fortunately, this paper found a promising history of acceptance, by the political actors, of the need for a stabilisation fund, and the political approach required to set it up.

Nigeria, like all resource-endowed countries, faces the constant reality of price volatility and the real prospect of depleting stock of its oil resources. These countries have turned to stabilization funds as a means of shielding the economy from the destabilising impact of unpredictable oil prices and to save part of mineral revenues in preparation for when the stock of mineral resources would have been used up. However, after almost two decades of operating several funds, there is not enough in these funds to finance even 20% of one year's budget if prices suddenly fall by 50%, much less to cater for the next generation. Yet, Nigeria's remaining oil reserves are projected to last less than forty years more. In the meantime, the crude oil market remains characteristically unpredictable – any number of events can occur, including old (new) producers entering (re-entering) the market, causing supply to rise and prices to crash. The management of Nigeria's stabilisation policy has been plagued by two critical challenges: a contested legal foundation and insufficient political will. Okonjo-Iweala, Nigeria's former Minister of Finance, wrote about “zero political will” to save during a period of record-high oil prices. In reality, these conclusions suggest that one (lack of political will) may have fuelled the other (contested legality of the funds).

Fortunately, this paper found a promising history of acceptance, by the political actors, of the need for a stabilisation fund, and the political approach required to set it up. Starting with the ECA, the federal government had actively sought the buy-in of other stakeholders prior to establishing the funds. This is a very important first step. Secondly, legislation, albeit limited, has been achieved on all the funds that have been set up. While some experts have argued that the constitutional provision



Nigeria does not have fifty years left to prepare for life after oil revenue.

that empowers the National Assembly to determine the “terms” and “manner” of distribution of the country’s revenue among the three tiers of government is sufficient backing for the SWF, this paper recommends that there should be speedy resolution of the matter currently before the Supreme Court. Thereafter, the political actors should proceed with necessary haste to effect amendment to Section 162 of the 1999 Constitution.

But an effective stabilisation policy will only be achieved if the establishment of a savings and stabilisation fund is complemented with prudent fiscal regime that seeks to delink government expenditure from oil revenue, using only part of the earnings from oil to finance the annual budget. Also important will be the institution of right-headed and competently implemented macro-economic governance. Achieving these recommendations will address the short and long-term pitfalls of resource endowment. But these measures have to be implemented as soon as possible because, even though the country has lost fifty years’ worth of savings from its oil revenue, Nigeria does not have fifty years left to prepare for life after oil revenue.



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