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ISSUE BRIEF

# Nigeria's Oil Revenue Crunch

## Falling Prices and Increased Competition Strain the Economy and Stability

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Nigeria's March 2015 presidential election, in which Muhammadu Buhari defeated incumbent Goodluck Jonathan, was hailed as an African milestone. It was the first time in Nigeria's turbulent history that a democratically elected president peacefully surrendered power to an elected opposition leader. The historic nature of the election has created high expectations for Buhari, who was elected on promises to root out corruption, subdue a radical Islamist insurgency that has infested parts of Nigeria's northern territory, and maintain the fragile peace in the troubled southern Niger Delta region that produces Nigeria's oil—all while revitalizing the struggling economy of Africa's largest and most populous nation.

Nigeria's security challenges are daunting, but it is the rapid fall of world oil prices since July 2014 that most threatens to undermine progress. The price of crude oil has been roughly halved, gutting government revenues. The growth in Nigeria's real gross domestic product (GDP) for the 2015-16 fiscal year is expected to drop to its lowest level in fifteen years.[1] Recession in 2016 is a real possibility—a striking turn of events for a nation whose annual GDP growth rates have averaged 6 percent since 2005.[2]

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1 Daniel Magnowski and Chris Kay, "Nigeria Can Avoid Recession by Spending, Vice President Says," *Bloomberg*, October 20, 2015, http://www.bloomberg.com/news/articles/2015-10-20/nigeria-to-raise-spending-to-revive-economy-vice-president-says.

2 Trading Economics, "Nigeria GDP Annual Growth Rate 2005-2015," http://www.tradingeconomics.com/nigeria/gdp-growth-annual.

After taking office, President Buhari was slow to announce cabinet picks and begin articulating a clear economic strategy for the country. Strapped for cash, the government has tightened fiscal and monetary policy through actions that are worsening growth prospects for some critical non-oil sectors. Now that ministers are settling down to work, many will be watching Nigeria's next steps in managing the oil sector, which will continue to be impacted by fluctuations in the global oil market, and by the surging production of shale oil in the United States.

Nigeria's declining revenues may impact US security goals in the region. Nigeria is the linchpin of West Africa—instability there could negatively affect the entire region. A public revenue crisis could further complicate the Nigerian government's ongoing campaign against the insurgent group Boko Haram and the government's efforts to maintain stability in the restive oil-producing Niger Delta. Understanding the implications of current oil market dynamics for Nigeria is therefore especially important for US policymakers.

## Snapshot of Global Oil Market Dynamics, in a Nutshell

Historically, the revenue from Nigeria's oil sector has underwritten roughly two-thirds of government spending, and has provided 90 percent of the country's export income. Since the first quarter of 2014, however, Nigeria's oil revenue has plummeted by roughly one-third, from 1.3 trillion to 839 billion naira (US$6.6 billion to $4.3 billion).[3] Crude-oil production also fell 7 percent, from 2.21 million barrels per day (bpd) in the second quarter of 2014 to 2.05 million bpd in the second quarter of 2015.[4]

Even before the 2014 price shock hit, global demand for Nigerian crude had been weakening. Since at least 2012, more Nigerian cargoes have been late finding buyers. This means larger volumes of crude have been sitting in storage without a buyer, sometimes for months. Nigeria has continued to sell roughly 1 million barrels of crude oil per day, but has struggled to achieve a robust price. In 2015, in an effort to move more oil, the state-owned Nigerian National Petroleum Corporation (NNPC), which sells Nigeria's share of production on behalf of the nation, cut selling prices to the lowest point in a decade or more. Brent crude—the benchmark against which Nigerian oil is priced—is now traded at between $36 and $44 a barrel. By comparison, the price per barrel was commonly $100 or higher from 2011 to 2014.

Of the major oil suppliers to the United States, Nigeria has suffered the most.

Rising US shale oil production is one major cause of lower global oil prices, and of the weakening demand for Nigerian oil. The United States was the top destination for Nigerian oil for most of the early 2000s. Imports peaked at 1.3 million bpd (around 9 percent of total US oil imports) in 2006; that year, nearly half of NNPC exports went to North American buyers. But between 2010 and 2014, average daily imports of Nigerian oil to the United States fell by almost 96 percent, to about 58,000 bpd.[5] The cause of this import slump is clear. During the same period, fast-tracked development of US shale oil—also called "light tight oil" (LTO)—had added around 4 million bpd of domestically sourced crude to the US energy mix.

Of the major oil suppliers to the United States, Nigeria has suffered the most. The LTO that is drawn from American fields is similar in quality to Nigerian light sweet crude, competitively priced, and generally cheaper to transport to the East Coast refineries that process light sweet barrels. Recently, in response to market pressures, some US LTO and light sweet crude refiners have reconfigured their facilities to process heavier, cheaper crudes from the likes of Saudi Arabia or Kuwait. Looking outside the United States, a glut of light sweet crude in the Atlantic market, volatile refining margins, and the return of more Libyan light sweet crude to the market have also curbed global demand for Nigerian oil.[6]

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3 The Economist Intelligence Unit, *Country Report: Nigeria*, October 2015. Currency conversions from naira to US dollar were made using rates from December 15, 2015 (196.47 naira/$1). For more updated conversions, see Central Bank of Nigeria, "CBN Exchange Rates," http://www.cenbank.org/rates/ExchRateByCurrency.asp.

4 The Economist Intelligence Unit, *Country Report: Nigeria*, November 2015, p. 31.

5 US Energy Information Administration, "US Imports by Country of Origin," http://www.eia.gov/dnav/pet/pet_move_impcus_a2_nus_epc0_im0_mbblpd_a.htm.

6 Aaron Sayne, Alexandra Gillies, and Christina Katsouris, *Inside NNPC Oil Sales* (Washington: Natural Resource Governance Institute, 2015), http://www.resourcegovernance.org/sites/default/files/NRGI_InsideNNPCOilSales_CompleteReport.pdf.

## The Impact of US Shale Oil on Nigeria's Bottom Line

Thus far, lower American demand has not forced Nigeria to scale back production because Europe and Asia have mopped up most of the Nigerian oil that the United States no longer buys. Europe imported more than 900,000 bpd (or 45 percent of total Nigerian crude exports) in 2014, up from 450,000 bpd in 2010.[7] In Latin America, Brazil's Petrobras has remained a reliable second-tier buyer, and Shell recently started shipping Nigerian oil to Venezuela and Colombia for mixing with local heavy crude.[8]

Future gains in the production of US LTO will not necessarily come at Nigeria's expense. Rather, the interplay of several variables—none of them easy to predict in the long term—will determine the extent to which US shale oil crowds Nigerian crude out of the US market, and how strong the demand for Nigerian crude remains elsewhere.

Most obviously, price will affect buying decisions. Refiners look for crudes that will give them the best profits, and this can change quickly. If prices keep falling, Chinese refineries—which usually prefer heavier, cheaper Angolan crude for making diesel—could start purchasing more than their usual one or two Nigerian cargoes per month.[9] Nigerian exports to India, which reached a record 776,000 bpd in May 2015, can also rise and fall by several million barrels per month, depending on projected profits.[10]

Many other factors will shape the future demand for Nigerian crude, both in the United States and abroad: freight rates; crude-oil storage economics; trading in related futures markets; seasonal demand for certain fuels, especially gasoline; global and national oil-stock levels; and the pace of exports from light sweet producers such as the North Sea, Libya, and Azerbaijan. These factors can offset the impact of higher US shale production. Even though US LTO production rose incrementally during the second and third quarters of 2015, a mix of favorable transport costs, futures market spreads, and low prices convinced some East Coast refiners to once again start importing about 80,000 bpd of Nigerian crude, instead of railing in more LTO from US production sites.[11]

Another wild card for future Nigerian oil demand is the US decision to lift its forty-year-old ban on oil exports. The move has drawn some dire predictions from Western pundits and the Nigerian press, yet little serious analysis is available regarding how US exports might displace the Nigerian barrels currently going to Europe or Asia. Analysts propose widely varying baseline-production scenarios for LTO, depending on price and reserve quality.[12] At the moment, the low global prices for light sweet crude are curbing production and will make it uneconomical for some US producers to start exporting their oil in the near term. But as prices rebound and more US barrels do start entering the world market, they could compete with Nigerian exports. This, in turn, could add further stress to the country's political economy—if the same interplay of market factors just discussed (prices, transport costs, and crude-storage availability) favored US sellers, or if US exporters moved early to lock in preferential long-term supply deals with overseas refiners who are currently buying Nigerian oil. Shale exports could also further depress Nigerian prices by adding to the glut of light sweet crude in the Atlantic market, but that is also not inevitable.

## The Cost of Corruption

Even assuming that future US LTO production and exports pose a threat to its oil sales going forward, Nigeria's biggest challenges are at home. First among these is NNPC's destructive dominance of the oil sector. The corporation's approach to selling Nigeria's oil suffers from significant corruption, and fails to maximize gains for the nation—as does its business model generally.

7 US Energy Information Administration, "Nigeria Country Brief: Analysis," http://www.eia.gov/beta/international/analysis.cfm?iso=NGA; European Commission, "Registration of Crude Oil Imports and Deliveries in the European Union (EU27)," https://ec.europa.eu/energy/en/statistics/eu-crude-oil-imports.

8 Christina Katsouris and Tim France, "West African Loadings Face Sudden Resistance," *Energy Intelligence Briefing*, October 16, 2015, http://www.energyintel.com/pages/login.aspx?fid=art&DocId=903222.

9 John van Schaik and Freddie Yap, "Market Forces: Finding Asia's Sweet Spot," *Energy Compass*, August 21, 2015, http://www.energyintel.com/pages/login.aspx?fid=art&DocId=896664.

10 John van Schaik, "Market Forces: India's Strong Demand Hand," *Energy Compass*, July 31, 2015, http://www.energyintel.com/pages/login.aspx?fid=art&DocId=892730.

11 "Crude Oil Market: Attention Moving from Light, Sweet to Medium, Sour," *Oil Market Intelligence*, October 15, 2015, http://www.energyintel.com/pages/login.aspx?fid=art&DocId=901994.

12 US Energy Information Administration, *Annual Energy Outlook 2015* (Washington: US EIA, 2015), https://www.eia.gov/pressroom/presentations/sieminski_05042015.pdf; Oxford Institute for Energy Studies, *US Shale Oil Dynamics in a Low Price Environment* (Oxford, England: Oxford Institute for Energy Studies, 2015), http://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/07/Executive-Summary-US-Shale-Oil-Dynamics-in-a-Low-Price-Environment.pdf.


Muhammadu Buhari (center) on the campaign trail in January, where brooms symbolized Buhari's promise to sweep out corrupt politicians. *Photo credit:* Heinrich-Böll-Stiftung/Flickr.

After nearly forty years, the corporation has failed to develop its own commercial or operational capacities, and has not promoted the growth of the sector through external investment. Its problems are widely acknowledged, yet past governments have consistently punted on implementing any meaningful reforms, reflecting how deeply NNPC is embedded in the power and patronage structures of Nigerian politics.[13]

Under President Goodluck Jonathan, NNPC entered into many questionable, costly deals and withheld billions of dollars from oil-sales proceeds each year, with little convincing commercial justification or public accounting. Early in 2014, the then-Governor of Nigeria's central bank, Lamido Sanusi II, warned that N4 trillion ($20 billion) in NNPC oil-sale revenues had vanished.[14] Multiple probes and an audit by PricewaterhouseCoopers failed to fully explain how the funds were used. Worryingly, during the price boom of 2011-2014, treasury receipts from oil sales actually fell by a magnitude of several billion dollars per year.[15]

The high oil prices of the 2000s allowed NNPC to muddle through and mask much of its operational dysfunction. But as prices have sunk, and as corruption and waste have accelerated, NNPC has been increasingly unable to bankroll its under-profitable, debt-ridden operations (including its refining and fuel-supply businesses). The crisis precipitated by lower oil prices could, in combination with the change of government in Abuja, create an unprecedented opportunity to take on some of the institutional and political shortcomings that keep the Nigerian public from earning full and fair value for its oil.

13 Sayne et al., *Inside NNPC Oil Sales*, op. cit.

14 Ibid.

15 Ibid.

## Compounding Problems in the Domestic Economy

Falling oil revenues have placed heavy pressure on Nigeria's external and fiscal accounts. Crude oil sales are the country's biggest source of income, generating 61 percent of total government revenues in 2013.[16] Necessarily then, the drop in oil prices has reduced public revenue receipts. Government revenue was only N1.49 trillion ($7.6 billion) in the second quarter of 2015, little more than half the revenue generated in either the third or second quarter of 2014, and was also affected by falling non-oil revenues over the same period.[17] The break-even fiscal oil price for 2015 was estimated to be as high as $122 per barrel, more than double the current per-barrel price of oil.[18] The 2016 budget will benchmark crude at $38 per barrel.

The difficult fiscal situation has been compounded by a broader slowdown. Lower investor confidence, stagnating government expenditure, exchange-rate volatility, and significant inflation have hindered—though by no means staunched—progress in some non-oil sectors that have contributed greatly to Nigeria's GDP growth over the past decade. Nigeria's national statistical agency reported that real GDP growth fell to 2.57 percent in the second quarter of 2015, down from 3.86 percent in the first quarter.[19]

In recent months, public spending on federal capital projects has either stalled or been funded through rising, though still manageable, national debt. The government is now using the majority of its revenue to pay for the running of bureaucracy and for servicing debts. In June 2015, 91.1 percent of federal revenue was spent on recurring expenditures.[20] Furthermore, twenty-seven of thirty-six states have relied on a multibillion-naira bailout from Abuja to avoid paying salaries in arrears.[21] Recurrent expenditures have consumed all federal oil revenues, and some civil servants have not been paid in months.[22] A presidential transition committee has estimated arrears to government contractors at N800 billion ($4 billion) and salary arrears at N500 billion ($2.5 billion).[23] Meanwhile, the Central Bank of Nigeria (CBN) has spent billions of dollars to safeguard the naira. With two controlled devaluations, the currency has lost more than one-quarter of its value in a year.[24]

Despite the unprecedented oil price boom of 2011 to mid-2014, Nigeria does not have adequate fiscal buffers to weather the downturn in oil receipts.

Despite the unprecedented oil price boom of 2011 to mid-2014, Nigeria does not have adequate fiscal buffers to weather the downturn in oil receipts. Heavy spending and corruption under Jonathan's administration has depleted the country's savings. Throughout that period, Nigeria's consolidated fiscal balance ran deeper into deficit.

An official response to these cross-cutting challenges has been slow to emerge. Buhari's delay in articulating an economic policy has been questioned, inside and outside of Nigeria. Low oil prices have succeeded in spurring discussion of possible domestic resource-mobilization reforms, including improving tax administration, reviewing the value-added tax rate, and monitoring oil

16 "What's Happening to Nigeria's Rubber?", *New Telegraph*, June 20, 2014, http://newtelegraphonline.com/whats-happening-to-nigerias-rubber.

17 The Economist Intelligence Unit*, Country Report*: *Nigeria*, November 2015, p. 31. Third quarter 2014 revenue was N2.78 trillion ($14.1 billion) and second quarter 2014 revenue was N2.61 trillion ($13.3 billion).

18 Oliver Masetti, "Nigeria: Shale Boom and Lower Oil Prices Present Challenges," *Deutsche Bank Markets Research*, November 10, 2014.

19 Bassey Udo, "Nigeria's Economy Records 2.57% Growth in 2nd Quarter of 2015, Says NBS," *Premium Times*, August 26, 2015, http://www.premiumtimesng.com/news/top-news/189026-nigerias-economy-records-2-57-growth-in-2nd-quarter-of-2015-says-nbs.html.

20 The Economist Intelligence Unit*, Country Report*: *Nigeria*, November 2015, p. 31.

21 Emma Ujah and Victor Ahiuma-Young, "Ebonyi, Ekiti, Imo, Ogun, Oyo Get FG's Bail-Out Funds," *Vanguard*, September 18, 2015, http://www.vanguardngr.com/2015/09/ebonyi-ekiti-imo-ogun-oyo-get-fgs-bail-out-funds.

22 For an overview of key statistics, see BudgIT, "Falling Oil Prices: An Opportunity for Reforms," December 2014, http://www.yourbudgit.com/wp-content/uploads/2014/12/FALLING-OIL-PRICE_BudgIT_Nigeria.pdf.

23 All Progressives Congress Nigeria, *Second Interim Report of the APC Transition Committee 2015*, p. 32.

24 Central Bank of Nigeria, "Exchange Rate Data by Currency," http://www.cenbank.org/rates/ExchRateByCurrency.asp.

theft and illegal mining.[25] But any attempt to restrict large expenditures, such as energy subsidies (which account for 20 to 40 percent of government spending) or the public-sector wage bill, will likely face significant opposition from the public and unions.[26] Effective January 1, 2016, the government set the regulated price of gasoline at N86 ($0.43) per liter, higher than current combined costs of importing, transporting, and retailing in Nigeria. While this price will be revisited in March, there will be no gasoline subsidy in the first quarter of 2016. The new cabinet thus faces stark tradeoffs that have implications for social stability, security, and future growth prospects in the country.

Thus far, the government has not done much to cut or redirect spending. The last parliament cut the 2015 federal budget by only 3 percent. In October, Vice President Yemi Osinbajo announced plans to increase spending through a N5 trillion ($25 billion) energy-sector fund.[27] In addition to financial support from both local and international partners, Nigeria's sovereign wealth fund and domestic pension funds would help pay for the energy fund.[28] The proposed 2016 budget is 15 percent larger than the 2015 budget, coming in at N6 trillion ($31 billion). Much of the increase will be put to capital projects and will likely need to be covered by additional borrowing on international markets.

Meanwhile, on the monetary side, the CBN has instituted capital controls in an attempt to stabilize the naira. In March 2015, the CBN imposed foreign-exchange controls and fixed the exchange rate to N198-199 per US dollar.[29] Unable to stop the naira's slide, the CBN has since restricted access to foreign currency and banned a long list of imports, to the dismay of many local companies.[30] Furthermore, the CBN has maintained a benchmark interest rate at a record high of 13 percent amid concerns of rising inflation.[31] Critics of the policy, including former CBN Governor Lamido Sanusi II, argue that these actions are exacerbating the economic downturn by depleting foreign reserves and weakening imports.[32] Sanusi claims the country is in danger of a long-term economic slump if the CBN does not change tactics. In September 2015, JPMorgan Chase announced the removal of Nigeria from its index of emerging-market government bonds due, in part, to the currency controls.[33]

## The Impact of Resource Constraints on Security

Despite N4.63 trillion ($24 billion) in defense spending over the past five years, large pockets of insecurity remain in Nigeria—particularly in the underdeveloped northeast regions of the country, which have suffered since 2009 from the expansion of Boko Haram, the Nigerian terrorist group that in early 2015 pledged allegiance to the Islamic State of Iraq and al-Sham (ISIS), although the impact of that move is unclear in open source intelligence.[34] Longstanding instability in the southern, oil-producing regions of the Niger Delta has been quieted by amnesty payments to various rebel groups, but the possible expiration of these payments at the end of 2015 may trigger new violence.

**Boko Haram.** In terms of its counterterrorism efforts, Nigeria's economic downturn could not have come at a worse time. Buhari's efforts to wipe out Boko Haram have been complicated by constrained resources. And Boko Haram has shown few signs of slowing down. Just days before Buhari's electoral victory, the group pledged allegiance to ISIS, and continued fighting and ongoing

25 Bassey Udo, "Nigeria's Oil Revenue Drops Further, as N389.9 Bn Is Shared," *Premium Times*, October 29, 2015, http://www.premiumtimesng.com/news/top-news/192339-%E2%80%8B%E2%80%8Bnigerias-oil-revenue-drops-further-as-%E2%80%8Bn3%E2%80%8B89-9-bn%E2%80%8B-is-shared%E2%80%8B.html.

26 The Economist Intelligence Unit, *Country Report*: *Nigeria*, November 2015, p. 5.

27 Magnowski and Kay, "Nigeria Can Avoid Recession," op. cit.

28 "Nigeria Planning $25 Bln Infrastructure Fund—Official," *Reuters*, October 29, 2015, http://uk.reuters.com/article/nigeria-infrastructure-idUKL8N12T5X520151029.

29 "Nigeria Tightens Controls on Foreign Exchange," *BBC News,* June 24, 2015, http://www.bbc.com/news/business-33258942.

30 Paul Wallace, "Nigeria's Emefiele Stands Firm on Foreign Exchange Controls," *Bloomberg*, July 8, 2015, http://www.bloomberg.com/news/articles/2015-07-08/nigeria-s-emfiele-stands-firm-on-foreign-exchange-trade-controls.

31 Paul Wallace and Emele Onu, "Sanusi Says Nigeria Central Bank 'In Denial' with Naira Policies," *Bloomberg*, October 23, 2015, http://www.bloomberg.com/news/articles/2015-10-23/sanusi-says-nigeria-central-bank-in-denial-with-naira-policies.

32 Xola Potelwa, "IMF Says Africa Must Enable Weak Currencies to Absorb Shocks," *Bloomberg*, October 27, 2015, http://www.bloomberg.com/news/articles/2015-10-27/africa-must-allow-currencies-to-fall-to-absorb-shocks-imf-says.

33 Paul Wallace, "Nigeria's Biggest Economy Defying Currency Critics Chokes Growth," *Bloomberg*, October 30, 2015, http://www.bloomberg.com/news/articles/2015-10-30/africa-s-biggest-economy-defying-currency-critics-chokes-growth.

34 Joshua Olufemi, "Nigeria Spends N4.62 Trillion on National Security in 5 Years, Yet Widespread Insecurity Remains," *Premium Times*, June 18, 2015, http://www.premiumtimesng.com/news/headlines/185285-nigeria-spends-n4-62-trillion-on-national-security-in-5-years-yet-widespread-insecurity-remains.html.

terror attacks have killed 1,600 people since June 2015.[35] In fact, new analysis by the Institute for Economics and Peace recently concluded that Boko Haram is the "most deadly terrorist group in the world," with nearly six hundred more deaths attributed to it than to ISIS.[36] Bomb blasts in northern Nigeria attributed to Boko Haram—many of them suicide bombings—have been occurring with greater frequency.

Longstanding neglect of the military has allowed Boko Haram to grow and spiral out of control. In an attempt to fight the insurgency more effectively, Buhari replaced the heads of the army, navy, and air force; restructured the military; and shifted the military's headquarters north, to Maiduguri.[37] Regional coordination has also improved, through the establishment of a Joint Multinational Task Force with contributions from Nigeria, Cameroon, Chad, Niger, and Benin.[38] While the task force has been moderately successful in dislodging Boko Haram from its northern Nigerian strongholds, the gains have been limited and fragile. Loss of territory has prompted Boko Haram to return to its historic reliance on asymmetric, "hit-and-run" attacks, particularly suicide bombings that result in death, destruction, and widespread fear in the region.

Buhari's efforts to wipe out Boko Haram have been complicated by constrained resources. And Boko Haram has shown few signs of slowing down.

**The Niger Delta.** The economic downturn has added tension to a complex and longstanding unrest in the heart of Nigeria's oil industry. For years militants angry over the region's impoverishment, environmental damage, and perceived unfair treatment by the government have attacked oil pipelines and kidnapped expatriates working for international oil companies (IOCs). Industry-wide data on oil theft is unavailable, and reports of theft are often unreliable or manipulated for political gain, but illegal oil bunkering is roughly estimated to cost Nigeria hundreds of billions of naira per year.[39]

Goodluck Jonathan's administration managed to limit social instability in the Niger Delta by buying off the most determined militant leaders, and by offering monthly stipends and education services to thirty thousand former militant foot soldiers through an amnesty program.[40] The program established a new normal in the region and brought some predictability to the sector by diminishing kidnappings. But uncertainty over whether the amnesty payments will continue after their scheduled expiration in December 2015 is now mixing with political fears of exclusion in a government led by northerners.[41]

While Buhari has stated he will keep the "better aspects" of the amnesty deal after the current program expires at the end of 2015, there are fears among politicians that he will cut funding to the region and launch a partisan crackdown on corruption.[42] Special Advisor on Media Femi Adesina has reported that President Buhari would sustain the program only after thorough examination.[43]

There is evidence that, despite spending approximately N197 billion ($1 billion) between 2009 and 2011, attempts to reintegrate former militants into society have not

35 Amnesty International, "Nigeria: Boko Haram: Bombing Campaign Sees Civilian Deaths Spiral," September 23, 2015, https://www.amnesty.org/en/documents/afr44/2498/2015/en/. Data are through mid-September 2015.

36 Institute for Economics and Peace, *Global Terrorism Index 2015*, November 2015, http://static.visionofhumanity.org/sites/default/files/2015%20Global%20Terrorism%20Index%20Report_0_0.pdf.

37 Ludovica Iaccino, "Nigeria: President Buhari Moves Army to Maiduguri until Boko Haram Fight Is Over," *International Business Times*, June 9, 2015, http://www.ibtimes.co.uk/nigeria-president-buhari-moves-army-maiduguri-until-boko-haram-fight-over-1505193.

38 Ole Tangen Jr., "Multinational Force Announced as Boko Haram Attacks Continue," *Associated Press/Agence France-Presse*, July 31, 2015, http://www.msn.com/en-ca/news/other/multinational-force-announced-as-boko-haram-attacks-continue/ar-BBlgIcv.

39 "The Cauldron Boils Again," *Africa Confidential*, November 6, 2015, http://www.africa-confidential.com/article/id/11303/The_cauldron_boils_again.

40 Ibid.

41 Buhari hails from the region most affected by Boko Haram, while his predecessor was born in the Niger Delta.

42 "After the Amnesty, More Amnesty," *Africa Confidential*, July 25, 2014, http://www.africa-confidential.com/article/id/5714/After_the_amnesty%2c_more_amnesty.

43 "Amnesty Without End?", *Nation*, October 14, 2015, http://thenationonlineng.net/amnesty-without-end/.

Welders work on the prefabrication stage of the Egina Project oil field near Port Harcourt. *Photo credit*: Cristiano Zingale/Creative Commons.

succeeded as planned.[44] A report released in March 2015 stated that only 151 of 15,451 training-program graduates were employed.[45] Critics argue that the high stipend, which is far more than the legal minimum wage of N18,000 ($92), has actually discouraged former militants from seeking formal employment.[46] Adding to concerns are reports that the leaders of demobilization camps have been stealing half of the militants' monthly stipends of N65,000 ($331).[47] Both issues bring into question the sustainability of the program as currently executed, as it requires large budgetary allocations without necessarily delivering outcomes.

Dire predictions of violence in the event of Buhari's election failed to play out, and concerns about increased instability in the wake of reforms to the amnesty program may also be overblown. But the Delta's governors, nearly all of whom are loyal to the ousted ruling party, may do little to ease tensions. This could lead to a new rise in kidnappings and oil theft, which could further dampen investor appetite for Nigerian oil.

The drop in government revenues caused by falling oil prices will hamstring efforts to address these sources of insecurity, and may necessitate cuts to public benefits, increasing the risk of public unrest.

Underinvestment and misallocation of resources within the security sector have rendered Nigeria more vulnerable to instability than during prior periods in its history. Despite a population of approximately 181 million people, Nigeria has a relatively small standing army, of between

44 Nigeria Stability and Reconciliation Programme, *Policy Brief: The Niger Delta Amnesty: Lessons Four Years On* (Abuja: NSRP, 2014), http://www.nsrp-nigeria.org/wp-content/uploads/2014/11/E189-NSRP-Policy-Brief-ND-Amnesty-4-Yrs-On_FINAL_web.pdf.

45 International Crisis Group, *Curbing Violence in Nigeria (III): Revisiting the Niger Delta* (Brussels: ICG, September 29, 2015), p. 3, http://www.crisisgroup.org/~/media/Files/africa/west-africa/nigeria/231-curbing-violence-in-nigeria-iii-re-visiting-the-niger-delta.pdf.

46 "Amnesty Without End?", *Nation*, op. cit.

47 "After the Amnesty, More Amnesty," *Africa Confidential*, op. cit.

90,000 and 130,000.[48] Even that range is misleading in terms of military fighting capability, as it also includes nurses, administration, military police, and others who are not deployed in combat, as well as an estimated three thousand troops serving in United Nations (UN) peacekeeping missions. Security institutions are also hollowed out by the privatization of public security. Military and police commanders, for example, hire out their men to private companies and residences willing to pay about N295,000 ($1,500) per month for police units as protection against crime. According to a retired Deputy Inspector General, one-third of the country's total police force is outsourced as private security providers.[49] As a result, the country is severely undermanned in terms of managing the Boko Haram conflict and potential instability in the Niger Delta.

Nigeria's military lacks the funding and training it needs to tackle the myriad and complex security threats it faces. This is mostly due to corruption, which has been rampant in the military since the 2000s. In the last year, the government has often failed to pay the N20,000 ($102) monthly salaries of low-level soldiers, due to financial mismanagement and declines in government revenue.[50] It is unclear whether funds earmarked for particular programs reach their intended recipients, as the Ministry of Defense and related bodies, such as the army and the National Security Advisor's office, do not make their spending public.[51] Soldiers and external analysts have also reported vast shortages in equipment—particularly weapons and ammunition—leading to low morale and large-scale mutinies. Many units in Nigeria's military barely qualify as part of a modern conventional army, much less one which has to undertake counterinsurgency operations such as those required for the fight against Boko Haram. For example, at Nigerian staff colleges, military officers are incentivized to take courses that lead to the UN Department of Peacekeeping certification, rather than tactical courses—resulting in security forces geared toward peacekeeping rather than warfighting.[52] As such, Nigeria's military is better prepared to monitor ceasefires in other countries than it is to defeat armed threats at home. Reforms in how the defense sector is funded and managed will be keys to success in addressing the threats emanating out of the Niger Delta and from Boko Haram—though the impact of shrinking revenues on the government's ability to make meaningful reforms remains to be seen.

But Buhari's fight against corruption has started to address some issues in the defense sector. In November 2015, Jonathan's National Security Advisor Sambo Dasuki was arrested for purportedly awarding phantom contracts for military equipment.[53] While these early actions provide a welcome look into the inefficient workings of the security apparatus, deep reforms will require strong execution and new levels of oversight.

## Recommendations

Falling oil prices have aggravated Nigeria's pressing economic and security challenges. But Buhari's election has generated domestic and international goodwill. Fast tracking the following key reforms could help leverage this political capital into sustained economic growth and enhanced well-being for Nigeria's citizens.

### Reform of the Oil and Gas Sector

The Buhari administration has not articulated a comprehensive reform plan, but appears determined to improve performance in the oil and gas sectors. Understandably, the government has thus far focused on new appointments, stopgap spending, and cost-control measures. Buhari has centralized control of the oil and gas sectors by naming himself Petroleum Minister, and by asking NNPC Group Managing Director, Emmanuel Ibe Kachikwu, to serve as his deputy. Since his appointment in August, Kachikwu has gotten off to a fast start, with a raft of big-ticket policy announcements and agenda

48 Central Intelligence Agency, *The World Factbook: Nigeria*, https://www.cia.gov/library/publications/the-world-factbook/geos/ni.html; Aryn Baker, "Nigeria's Military Quails When Faced With Boko Haram," *Time*, February 10, 2015, http://time.com/3702849/nigerias-army-boko-haram/http://time.com/3702849/nigerias-army-boko-haram/; Ibrahim Abdul'Aziz and Dulue Mbachu, "Nigerian Troops Say Corruption Saps Will to Fight Islamists," *Bloomberg*, July 16, 2014, http://www.bloomberg.com/news/articles/2014-07-15/nigerian-troops-say-corruption-saps-will-to-confront-islamists.

49 "Rent-a-Cop: Private Security in Nigeria," *Economist*, October 17, 2015, http://www.economist.com/news/middle-east-and-africa/21674811-private-security-hollowing-out-nigerias-security-forces-rent-cop.

50 Kevin Sieff, "The Nigerian Military Is So Broken, Its Soldiers Are Refusing to Fight," *Washington Post*, May 10, 2015, https://www.washingtonpost.com/world/africa/the-nigerian-military-is-so-broken-its-soldiers-are-refusing-to-fight/2015/05/06/d56fabac-dcae-11e4-b6d7-b9bc8acf16f7_story.html.

51 Abdul'Aziz and Mbachu, "Nigerian Troops Say Corruption Saps Will to Fight Islamists," op. cit.

52 Baker, "Nigeria's Military Quails," op. cit.

53 "Nigeria's Dasuki 'Stole $2bn' from Anti-Boko Haram Fight," *BBC News,* November 18, 2015, http://www.bbc.com/news/world-africa-34855695.

items. The coming six to twelve months will determine how many of these initiatives bear fruit.

To weather the ongoing oil-revenue crisis, and respond to the shifting market for Nigerian crude, the Buhari government should do the following:

**Fundamentally change how NNPC is structured and governed.** The success of the government's reform ambitions, measured in terms of additional dollars saved and earned, may turn largely on how much officials are willing to attack the rampant political interference, corruption, and waste in NNPC. The President has had harsh words for the corporation, and seems to have strong, state-centric ideas about how to run it. In August, Kachikwu announced reshuffles, forced retirements that pruned top management staff from 122 to 83, and simplified the management structure. Most subsidiaries also received new heads.

After years of secretive, unaccountable management, NNPC and its subsidiaries will need to submit to a comprehensive performance audit, with physical, financial, process, and value-for-money components.[54] Kachikwu has already promised to order the first financial audit since 2010, along with a five-year "value-for-money review." Beyond audit functions, other corporate-governance reforms are needed—above all, in the areas of subsidiary management and reporting, board restructuring and transparency. Kachikwu's recent decision to publish detailed monthly financial and operational reports was a positive step in this direction.[55]

To further reduce revenue losses, the government needs to place limits on NNPC's ability to discretionarily withhold oil-sale proceeds, including from the leaky 445,000 bpd "domestic crude allocation," which is supposed to feed the corporation's refineries.[56] Establishing and applying performance benchmarks for NNPC operations would also be prudent. Finally, the Buhari government should develop and implement a full commercialization plan for NNPC. The plan should take on the many hard questions about privatization, corporate governance, and finance of operations that earlier governments ducked, and which have reached crisis levels.[57] Both the President and Kachikwu have promised to "restructure" NNPC, though neither has spelled out how the necessary transitions would happen.

**Decide on a fate for the Petroleum Industry bill.** Also unknown at this point is the degree to which the Buhari government will attempt to use the long-delayed Petroleum Industry bill as a primary vehicle for reforming the sector. For at least eight years, nonpassage of the bill has deferred needed institutional overhauls and, possibly, nearly a trillion naira (tens of billions of dollars) in deepwater investments. Voices in the new administration have touted the idea of breaking the several-hundred-page bill into parts in order to speed passage, but this alone is no guaranteed win. The failure to pass the bill under Jonathan was arguably less due to its length than to the fact that the most influential stakeholders needed to support it—the President, Petroleum Minister, IOCs, and National Assembly leadership—were either indifferent or actively working behind the scenes to defeat it. Past drafts of the bill also said almost nothing meaningful about key reform areas—NNPC restructuring and oversight, especially.[58] Implementation would take years, stretching well beyond Buhari's tenure, and could generate large-scale confusion and rent-seeking opportunities. Simply amending existing laws could probably bring about many of the needed statutory changes.

**Complement structural reforms with greater official accountability.** To send stronger signals that public oil revenues cannot be wasted or diverted with impunity, the new government needs to rebuild the collapsed accountability infrastructure around the sector. This includes empowering heretofore weak oversight institutions, such as the Auditor General of the Federation and Economic and Financial Crimes Commission, and reassuring their heads that they have mandates to ask hard questions (especially of NNPC).

In parallel, the administration will need to sanction past malfeasance, using both law enforcement and lesser measures, such as firings or demotions. Buhari ran for president on a strong antigraft platform. Much of his

54 Sayne et al., *Inside NNPC Oil Sales*, op. cit.

55 For the earliest example, see Nigerian National Petroleum Corporation, *Monthly Financial and Operations Report*, August 2015, http://www.nnpcgroup.com/Portals/0/Monthly%20Financial%20and%20Operations%20Data/NNPC%20Monthly%20Financial%20and%20Operations%20Report%20August%202015.pdf.

56 For more on the problems with the domestic allocation, see Sayne et al., *Inside NNPC Oil Sales*, op. cit.

57 For more analysis of the changes needed, see Aaron Sayne, Paasha Mahdavi, Patrick R. P. Heller, and Johannes Schreuder, *The Petroleum Industry Bill and the Future of NNPC* (New York: Revenue Watch Institute, 2012), http://www.resourcegovernance.org/sites/default/files/rwi_bp_nnpc_synth_rev2.pdf.

58 Ibid.

government's focus thus far, at least publicly, has been on recovering looted funds from jurisdictions like the United States, United Kingdom, and Switzerland, rather than on taking legal action in Nigeria. Although cross-border work is in the early stages, the recent arrests of former Petroleum Minister Diezani Alison-Madueke and others in London suggest the possibility for an era of unprecedented international cooperation. The President may have some targets in mind, especially high-profile figures from the last administration. However, his government should resist anticorruption measures that look personal or driven by vendettas, in order to avoid destabilizing effects in national politics and security.

**Develop new markets for Nigerian oil.** As the US market for Nigerian oil withered, NNPC under Jonathan focused on selling oil to well-connected middlemen, mostly via short-term deals with little-known "briefcase companies." Rather than undertaking any new marketing of its own, the corporation has relied on private commodities traders and the trading divisions of IOCs to find new buyers. For years, Nigeria has been the only major world oil producer (i.e., with output of more than 1 million bpd) "not experiencing full-scale conflict that sells almost all of its crude to middlemen, rather than end-users."[59] This is not a risk-averse, sustainable strategy for the future, especially since Europe and India have limited longer-term growth potential as destinations for Nigerian oil exports.[60]

In the near term, NNPC should explore the option of signing longer-term contracts with overseas refineries, especially those in the transatlantic region, Europe, and Southeast Asia that already routinely buy Nigerian crude from IOCs and traders. A round of new oil sale contracts signed with IOCs and foreign refiners at year's end could be a step in the right direction, if the terms are fair to Nigeria. Further out, the government should force NNPC to set up a high-capacity, full-service trading department or subsidiary with the management structure and incentives to sell Nigeria's oil with greater freedom from patronage demands, and less reliance on private traders. The country also needs to sell off NNPC's irredeemably corrupted downstream infrastructure, including the refineries, and ease the barriers to greater domestic refining of crude oil. In many ways, the most obvious future growth market for Nigerian crude is at home.

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**Gradually improve the terms and oversight of commercial arrangements with private-sector players.** In August, Kachikwu took the promising step of canceling several poorly structured, leaky contracts. These included three offshore oil-processing agreements with Nigerian trading companies that together consumed one-fifth of Nigeria's oil allotment, as well as some opaque deals to transport oil to NNPC's refineries by ship.[61] All eyes should now be on the terms of the contracts that replace these. Once the worst deals are fully wound down, the government needs to recoup the losses it has incurred through contractor underperformance or misconduct. In early September, NNPC said it had started to recover more than N2 trillion ($10 billion) in excess IOC tax deductions and funds owed under past contracts. No updates have followed.

On a more ambitious level, the government could move to shorten the woefully slow contracting cycle for major oil projects, and explore Kachikwu's recent promise to renegotiate the fiscal terms in existing law and contracts with upstream operators—particularly the production-sharing contracts signed under military rule in the 1990s. Both of these steps are bound to meet heavy resistance, particularly in a time of low oil prices. Nigeria also desperately needs stronger cost-control rules and processes—above all, at the Federal Inland Revenue Service and National Petroleum Investment Management Services—to curb excessive company cost recovery and tax avoidance. Arguments over fiscals become more academic if sophisticated, powerful IOCs can use their operating budgets and tax returns to claw back whatever they lose upfront. At the very least, the new government should review, and possibly revoke, some discretionary tax waivers, especially the "pioneer status" grants given to some indigenous upstream companies that cost the country more than a hundred billion naira (billions of dollars) annually.

59 Sayne et al., *Inside NNPC Oil Sales*, op. cit.

60 Eklavya Gupte, "A Tale of Two Crudes: Nigeria and Angola," *Platts*, May 25, 2015, http://blogs.platts.com/2015/05/25/two-crudes-nigeria-angola.

61 For more on the problems with these deals, see Sayne et al., *Inside NNPC Oil Sales*, pp. A19-A20 and B1-B49, op. cit.

### Larger Reform of Nigeria's Economy

The era of outsized oil revenue is over. In order to offset the recessionary pressures of depressed oil prices and changing trade patterns for crude, Nigeria must attack corruption and economic inefficiencies, while also prioritizing diversification efforts to ensure that non-oil sectors will be the source of an increasing share of future economic growth. The Nigerian government should do the following:

**Initiate high-level coordination of efforts to promote non-oil export sectors, including agricultural products.** Nigeria has tremendous agricultural potential, but continues to be a net importer of food.[62] By boosting local production, Nigeria can save valuable foreign exchange and create much-needed jobs. Cocoa, for example, is one of Nigeria's largest export commodities. Rising global cocoa prices and increased domestic investment in the sector have led to a projected doubling of production from 2012-15. Much of Nigerian cocoa's recent surge is due to government seed and training programs, rehabilitation of farms, and international certification.[63] Agricultural Minister Audu Ogbeh has announced plans to plant more than two million cocoa trees in order to boost progress in the sector.[64] The government should apply a similarly coordinated approach to other sectors, including cassava and dairy. Minister Ogbeh has noted the need and the opportunity: "We import milk into this country to a tone of 1.3 billion dollars a year, some of it not very good; why can't we produce milk if Uganda and Kenya are doing it?"[65] Mobile and e-wallet technologies, like those deployed under former Agriculture Minister Akinwumi Adesina, can support smart subsidies across agricultural sectors, and prevent the siphoning off of billions meant to support farmers' productivity.

**Unlock growth through banking the "unbanked" and by energizing Nigeria's underperforming financial sector.** Less than one-third of Nigerians have bank accounts; addressing this issue can bolster growth and create jobs.[66] If the insurance industry could increase its value from N300 billion ($1.5 billion) to N1 trillion ($5.1 billion) over the next three years, it is projected that jobs would increase from thirty thousand to more than one hundred thousand.[67]

Government involvement in financial matters is crucial to creating a mortgage market, encouraging credit-card use, and establishing a regulatory environment in which banks are incentivized to lend to small and medium-sized enterprises. Nigeria's pilot mortgage program was created in 2013 to address housing shortages and make mortgage loans longer term and more affordable.[68] Given the incredible demand initially demonstrated, the new government should scale up this program. Finally, the Buhari government should reevaluate the heavy regulatory approach to mobile money, in order to free the economy from the burdens of being overly dependent on cash. Although N815.7 billion ($4.2 billion) has already been transferred to mobile accounts, no single mobile-money platform has become a standard or has reached scale, as has happened in Kenya.[69]

**Enhance the efforts of the Economic Community of West African States (ECOWAS) to reduce transit times between countries, lower the cost of doing business across borders, and increase overall intraregional trade.** ECOWAS's intraregional trade has remained low, representing only 12 percent of the region's total trade, and Nigeria plays the dominant role in the region, constituting 65 percent of ECOWAS GDP.[70] Since regional trade can spur economic growth, ECOWAS should look to the East African Community's successes through the

62 Obinna Chima, "Nigeria's N630bn Annual Food Import Bill Worries Emefiele," *This Day Live*, September 18, 2015, http://www.thisdaylive.com/articles/nigeria-s-n630bn-annual-food-import-bill-worries-emefiele/220572.

63 Chijioke Ohuocha, "Nigeria Nurtures Its Once-Unloved Cocoa Industry as Prices Flourish," *Reuters*, September 5, 2014, http://www.reuters.com/article/2014/09/05/us-nigeria-cocoa-idUSKBN0H00BU20140905#M05hzHJgJZbFuqtT.97.

64 Alexis Akwagyiram and Felix Onuah, "Nigeria Hopes to Reach Rice Mill Deal With China by Year-End," *Reuters*, November 20, 2015, http://uk.reuters.com/article/nigeria-farming-idUKL8N13E5A020151120.

65 "Audu Ogbeh, Lokpobiri Resume as Agric Ministers, Vow to Maximise Potential," *This Day Live,* November 12, 2015, http://www.thisdaylive.com/articles/audu-ogbeh-lokpobiri-resume-as-agric-ministers-vow-to-maximise-potential/225365.

66 "Reflections on Nigeria's Banking Reforms," *This Day Live*, November 1, 2015, http://www.thisdaylive.com/articles/reflections-on-nigeria-s-banking-reforms-1-/224294.

67 Atlantic Council, "Transcript: Conversation With Nigerian Finance Minister Ngozi Okonjo-Iweala," December 22, 2014, http://www.atlanticcouncil.org/news/transcripts/transcript-conversation-with-nigerian-finance-minister-ngozi-okonjo-iweala.

68 Palash Ghosh, "Nigeria Sets Up Government Mortgage Firm to Help Solve Massive Housing Shortage," *International Business Times*, January 18, 2014, http://www.ibtimes.com/nigeria-sets-government-mortgage-firm-help-solve-massive-housing-shortage-1543690.

69 "Nigeria's Mobile Money Transfer Scheme Hits N815.47blln," *Naija247*, http://naija247news.com/2015/10/nigerias-mobile-money-transfer-scheme-hits-n815-47blln.

70 Regional Strategic Analysis and Knowledge Support System, "Nigeria: Overview," http://www.resakss.org/region/monitoring-progress/nigeria.

Northern Corridor Integration Projects[71] as a model. Easy access to neighboring markets will help better position Nigeria as an export hub for the subregion, and attract investment in non-oil sectors. Given Nigeria's clout, Buhari can make significant progress by demonstrating political will at the presidential level.

**Continue reforms in the power sector, attract outside energy investment, and carefully manage energy subsidies.** Only half of Nigeria's population has access to electricity, and the areas with access are plagued by costly inefficiencies, including privately owned generators, that drive up the price of doing business.[72] Past attempts to reform the power sector have fallen short, and amid falling oil prices, Nigeria can no longer afford poorly implemented energy initiatives. Buhari should form an international brain trust for the power sector—with members from the private sector, financial community, World Bank, and local producers—that meets quarterly in order to address obstacles in a systematic way.

Nigeria can no longer afford poorly implemented energy initiatives.

## Conclusion

Nigeria's stability depends upon the government's ability to achieve sustainable economic growth, create robust investor confidence, and build stronger institutional capacity to deliver critical services to the rapidly expanding population.

The country is unlikely to recapture the high oil revenues of the past decade, and now needs to do everything possible to maximize remaining revenues by cutting corruption and increasing efficiency in the oil sector. Most importantly, though, Nigeria must rapidly improve growth in the non-oil sectors that have so far kept the economy out of recession. These sectors are the unsung heroes of Nigeria's economic story.

Nigeria's security threats—Boko Haram, instability in the Niger Delta, and potential unrest stemming from cuts in social services—will make this economic renaissance harder. Buhari is under tremendous pressure to make Nigeria safer for its citizens, meaning that he will have to prioritize reforming Nigeria's military and security services. The military will require fundamental changes in doctrine and training, as well as appropriate equipment and adequate logistical and other support. The task will be neither easy nor quick, and the fiscal constraints will make it even more of a challenge. Consequently, Nigeria will need to work with its international partners on a strategy that prioritizes investments in the areas that are most critical to defending the population against Boko Haram and other armed groups—preventing those groups from gaining any additional ground, with an eye to rolling back their gains completely—while simultaneously developing a sustainable program to systematically build capabilities. For their part, Nigeria's international partners need to appreciate the vulnerable geopolitical and economic position of the West African country at this moment in its history and would do well to avoid any steps that might add further stress to an already delicate balance.

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71 By targeting inefficiencies, Northern Corridor efforts reduced cargo travel times from Mombasa, Kenya, to Kampala, Uganda, from eighteen days to four days, and between Mombasa and Kigali, Rwanda, from twenty-one days to five days. See Aubrey Hruby, "China's Slowdown: An Opportunity for Africa to Address Longstanding Economic Inefficiencies," *Financial Times*, October 26, 2015, http://blogs.ft.com/beyond-brics/2015/10/26/chinas-slowdown-an-opportunity-for-africa-to-address-longstanding-economic-inefficiencies.

72 William Wallis, "Nigeria Ramps Up Power Reform," Financial Times, February 10, 2014, http://www.ft.com/intl/cms/s/0/61f86e50-9274-11e3-8018-00144feab7de.html#axzz3uPkBGRwx.

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