



NIGERIA

SELECTED ISSUES

March 13, 2019

Approved By
African Department

Prepared by Monique Newiak, Liam O'Sullivan (all AFR); Ozlem Aydin Sakrak, Pasquale di Benedetta, Jay Purcell (all LEG); Ayman Alfi (MCM); Amr Hosny, Vivian Malta (all SPR); and Stephen Younger (Commitment to Equity Institute). Ms. Canales, Ms. Liu and Ms. Ibrahim provided excellent assistance for the preparation of this report.

CONTENTS

GOVERNANCE IN NIGERIA: FOCUS ON THE OIL SECTOR AND AML/CFT	5
A. Introduction	5
B. Governance of the State-Owned Enterprise Sector	6
C. Governance of the Petroleum Sector and the NNPC	7
D. Using AML/CFT Tools in and beyond the SOE Sector	13
E. Conclusion and Key Policy Recommendations	21
BOX	
1. Selected Challenges in PIGB	14
TABLES	
1. Elements of an Effective Ownership Policy	7
2. Required Revisions to the Legal Framework to Increase Transparency of Revenues	9
3. Steps to Increase the Transparency of Petroleum Revenue	10
4. Towards Good Practice in Budget Allocation and Documentation	10
5. Strengthening the OAuGF and National Assembly's Oversight Functions	12
6. Strengthening the Role of the Ministry of Finance	12
7. Steps to Strengthen the Transparency of Beneficial Ownership	16
8. Steps to Strengthen Scrutiny of PEPs	17
9. Improving Asset Declaration by Public Officials	18
10. Strengthening AML/CFT Supervision of FIs, BDCs	19
11. Maintaining Momentum Generated by the NFIU Act	20
12. Advancing the Effective Prosecution and Timely Conclusion of Corruption-Related Cases	20
References	22

FUEL SUBSIDIES-LATEST INCREASE AND IMPLICATIONS OF A CHANGE IN THE REGULATED GASOLINE PRICE _____ **23**

FIGURES

1. Selected Emerging and Developing Countries: Average Gasoline Price, 2016 vs. Latest 2018 _____	<u>23</u>
2. Decomposing the Cost of One Liter of PMS _____	<u>24</u>
3. Petrol Expenditure by Income Percentile _____	<u>25</u>
4. Fares and other Transport Expenditures by Income Percentile _____	<u>25</u>
5. Distributional and Poverty Impact from a Regulatory Fuel Price Increase _____	<u>25</u>
References _____	<u>28</u>

ASSESSING THE COST-RISK OF INCREASING NIGERIA'S EXTERNAL DEBT _____ **29**

A. Background _____	<u>29</u>
B. Macroeconomic Assumptions _____	<u>32</u>
C. Methodology _____	<u>32</u>
D. Results of the Analysis _____	<u>34</u>
E. Conclusions _____	<u>39</u>

FIGURES

1. Cost-Risk Representation of Different Borrowing Strategies, 2022 _____	<u>36</u>
2. Cost-Risk Representation of Different Borrowing Strategies, 2028 _____	<u>36</u>
3. Measures of External Debt Vulnerability 2022 _____	<u>38</u>
4. Measures of External Debt Vulnerability 2028 _____	<u>38</u>

TABLES

1. Cost-Risk Indicators under Different Debt Management Strategies (2022) _____	<u>34</u>
2. Cost-Risk Indicators under Different Debt Management Strategies (2028) _____	<u>35</u>

ANNEX

I. Data Requirements and Assumptions _____	<u>40</u>
References _____	<u>42</u>

ASSET MANAGEMENT CORPORATION OF NIGERIA (AMCON) _____ **43**

A. Background _____	<u>43</u>
B. Current Challenges and Implications for the Real Economy _____	<u>44</u>
C. Recommendations _____	<u>45</u>

FIGURE

1. AMCON's Sectoral Linkages _____	<u>45</u>
References _____	<u>48</u>

HUMAN CAPITAL AND GENDER EQUALITY	49
A. Introduction	49
B. Status Quo	50
C. Macroeconomic Gains from Equality of Opportunity	54
D. Government Initiatives	57
E. Policy Recommendations	59
FIGURES	
1. GDP per Capita (PPP) and Human Capital Index	50
2. GDP per Capita (PPP) and Public Health Expenditure	50
3. Health Indicators	51
4. Education Outcomes	53
5. Inequality in Access to Education	54
6. Impact from Different Education Scenarios	56
References	61
MACRO-STRUCTURAL OBSTACLES TO FIRM PERFORMANCE: EVIDENCE FROM 2,640 FIRMS IN NIGERIA	62
A. Introduction	62
B. An Initial Look at the Data	63
C. Empirical Methodology and Results	67
D. Conclusion and Policy Implications	73
FIGURES	
1. Surveyed Firms are Distributed over Different Cities	64
2. Surveyed Firms are Distributed over Different Sectors	64
3. Most Surveyed Firms are Small	64
4. Most Surveyed Firms are Sole Ownership	64
5. Most Firms Sell to National Markets; Larger Firms Have Bigger Export Shares	64
6. Most Firms are Domestically Owned; Larger Firms Report More Foreign Ownership	64
7. Firms, on Average, are 16 Years Old	65
8. Technical Skills are the Most Important	65
9. Skills is Typically not a Constraint in Hiring Women	65
10. Performance Varied Across Firm Sizes	66
11. Access to Finance is the Top Obstacle to Firm Operations	66
12. Especially in Smaller Firms	66
13. Most Firms Did Not Spend on Research and Development Recently	67
14. Better Firm Performance With More Export Diversification	67
15. Half of the Sample only Recently Improved Production Methods	67
16. Especially in Large Firms	67
17. Ease of Doing Business	73

TABLES

1. Determinants of Access to Finance: Ordered and Binary Logit/Probit _____	69
2. Determinants of Export Diversification: Binary Logit/Probit _____	70
3. Endogenous Treatment Regression: Firm Performance _____	72
References _____	75

GOVERNANCE IN NIGERIA: FOCUS ON THE OIL SECTOR AND AML/CFT¹

Accountability, governance, and transparency in the state-owned enterprise (SOE) sector facilitate the efficient use of public resources and help to monitor fiscal risks. Reducing leakages in the petroleum sector is especially macroeconomically critical, given Nigeria's current fiscal and external dependence on oil revenue. Against this background, this paper provides an overview of developments, recent reforms, and challenges, and outlines policy recommendations for stronger governance and corruption prevention, detection, and resolution, including through anti-money laundering and combating the financing of terrorism measures that are useful beyond the petroleum sector.

A. Introduction

1. Issues of transparency and corruption rank high among the concerns of Nigeria's population and have a substantive impact on macroeconomic outcomes in the country, particularly in the petroleum sector.

- According to a recent survey by Nigeria's National Bureau of Statistics, one out of three respondents that had contact with a public official reported having paid a bribe, and respondents identified corruption as one of the three most pressing issues affecting Nigeria (NBS 2017). Indeed, estimates suggest that the macroeconomic costs of corruption are large: lowering corruption to the levels of other peer countries could boost growth by ½ to 1½ percentage points annually, increase public investment efficiency, and increase the tax-revenue to GDP ratio by 1½ percentage points (IMF 2018).
- With oil currently accounting for 57 percent of total government revenues and 94 percent of exports, reducing leakages in the petroleum sector is key to fiscal sustainability and external stability.

2. The government has initiated several reforms that signal its commitment to addressing these concerns.

- **The National Anti-Corruption Strategy (NACS) for 2017–20** identifies priorities at the national level, including improving asset recovery and management, the adjudication of corruption cases by the court system, investigation and prosecution, and coordination and collaboration among competent authorities.
- **Strengthening the anti-corruption infrastructure.** Key institutions have been bolstered, with additional resources provided to the Economic and Financial Crimes Commission (EFCC), and the

¹ Prepared by Ozlem Aydin Sakrak, Pasquale di Benedetta, Jay Purcell (all LEG), and Monique Newiak (AFR).

passage of the Nigerian Financial Intelligence Unit (NFIU) 2018 Act, which provides the NFIU with operational independence, in line with the Financial Action Task Force's recommendations.

- The National Assembly has passed amendments to the ***Companies and Allied Matters Act*** (CAMA, 1990), in part to ensure the transparency of ultimate or “beneficial” ownership (BO) of legal entities and arrangements, which may be abused to conceal or launder the proceeds of corruption and other crimes.
- The ***publishing of the monthly financial and operational reports of the Nigerian National Petroleum Corporation*** (NNPC) is a good step toward enhancing the transparency and integrity of the oil sector. The 2019 Extractive Industries Transparency Initiative (EITI) report found that Nigeria has fully addressed corrective actions from its first validation and made satisfactory progress overall with implementing the EITI standard. The Petroleum Industry Governance Bill (PIGB), approved by the National Assembly, could be an important step towards improving institutional arrangements and oversight in the oil sector.
- The ***whistle-blower policy*** and the ***open government initiative*** are also welcome steps towards improving governance.

3. This paper discusses further concrete steps to improve the governance of SOEs and of the oil sector, given their importance to fiscal transparency and sustainability.²To this end, it details the strengths and weaknesses of Nigeria's SOE governance framework, notes critical pending and future reforms, and highlights the unique potential of anti-money laundering and combating the financing of terrorism (AML/CFT) tools to support anti-corruption efforts in and beyond the SOE sector. It points to a number of important reforms, including with respect to the building of institutions, that would improve transparency and reduce incentives for corruption, thus strengthening corruption prevention. It further argues that when prevention fails, the infrastructure for public-private cooperation in the detection of corrupt acts must not. And where corrupt acts are indeed detected, Nigeria's criminal justice system must function to counteract impunity.

B. Governance of the State-Owned Enterprise Sector

4. The current ownership arrangements for Federal Government enterprises (FGOs) follow a dual decentralized model that has become more complex. The state is both the provider of the product or service and the regulator and supervisor of the performance, resulting in an inherent potential conflict. The association of the FGOE with public policy increases the chances that enterprise assets are misused to avoid going through the budget appropriation process or for narrowly political purposes. Ownership functions are fragmented among the Ministry of Finance (MoF), the office of the Accountant General, sector ministries and the Bureau of Public Enterprises.

² The broader anti-corruption strategy should include also efforts to strengthen governance and thereby reduce vulnerabilities to corruption across a range of key state functions, including tax administration, procurement, market regulation, FX policies, and financial sector oversight, as discussed in the accompanying staff report.

5. Quantifying the fiscal risks stemming from the SOE portfolio is increasingly challenging. The definition of an FGOE is not consistent across several Acts. There is no standard reporting policy and no aggregated annual report on the financial performance of the overall FGOE sector. A lack of standardized accounting policies complicates quantifying the ‘operating surplus’ of each FGOE. Obtaining a true picture of the FGOEs’ performance or financial situation enabling the authorities to react on time and to be selective in their intervention is therefore difficult.

6. In view of these weaknesses, the central government has decided to strengthen its oversight of the FGOE sector. Performance contracts are being designed to ensure surplus revenue targets are realistic and adhered to. The review of FGOE portfolio to ensure proper classification and separate an SOE from a departmental agency as well as calls for publishing regular quarterly financial statements are also ongoing.

7. One key priority—in line with international practices—is to gradually centralize existing fiscal oversight arrangements and enhance ownership arrangements. Efforts to improve financial and fiscal discipline—as currently planned by the authorities—should be integrated with a broader public financial management reform agenda. A cohesive ownership vision would redesign and streamline the division of regulatory, oversight, policy, and ownership roles and responsibilities. Best-practice examples suggest a central role for the Ministry of Finance in monitoring SOE performance (Table 1).

Table 1. Nigeria: Elements of an Effective Ownership Policy

- Create a monitoring fiscal oversight unit within Ministry of Finance
- Line ministries should only perform core ownership functions such as voting shares, overseeing board members, and monitoring SOE performance
- Develop safeguards against political interference in commercial decision-making.
- Provide SOEs greater autonomy from line ministries by empowering SOE boards to take on greater responsibilities
- Develop/strengthen SOE corporate governance tools and guidelines
- Develop a system to monitor and benchmark the performance of ministries as owners

8. The current FGOE institutional features are present in the petroleum industry. The institutional fragmentation and overlaps of roles and responsibilities pave the way to strengthen operational efficiencies, management, and accountability. This has a direct impact on the operations of NNPC, which remains the largest source of income for the Federal Government.

C. Governance of the Petroleum Sector and the NNPC

9. Several agencies are tasked to oversee the petroleum industry in Nigeria, with blurred regulatory, policy, and ownership roles. The Ministry of Petroleum Resources (MPR) is responsible for oversight of the overall sector, including all its agencies, and for policy making. The Department of Petroleum Resources (DPR) exercises regulatory powers on behalf of the MPR, and licensing and monitoring powers for oil, gas, and downstream petroleum products. The Petroleum Products Pricing Regulatory Agency regulates petroleum products prices. The Petroleum Technology Development Fund is in charge of training. The Petroleum Equalization Fund is responsible for the equalization of pricing of petroleum products countrywide. NNPC is the national oil company.

10. These overlapping roles pose governance challenges. The Minister of Petroleum, in charge of overseeing the sector and NNPC, is also the chairman of NNPC. The DPR is legally founded in the Act that constitutes NNPC, which calls for an inspectorate Directorate within NNPC. An inadequate budget, limited human resources, and conflicting objectives limit the operational effectiveness of DPR. The Auditor General does not have a direct mandate to audit NNPC. There is no central role for the Ministry of Finance in the current set up.

11. The management of NNPC is a direct consequence of its incorporating Act, with the current board structure creating a number of challenges. The 1977 NNPC Act empowers NNPC to engage in oil and gas related activities. Two key aspects influence the way NNPC operates: (i) the Act does not assign a commercial mandate to NNPC, and (ii) the Act allows NNPC to be an agent of the Federation without defying the commercial aspects of this agency contract. The governance of NNPC faces several challenges: appointment, evaluation, and remuneration policies do not appear to be in place, and the power to make appointments of key board members and CEO remains concentrated in the hands of the President of the Federation. As a result of these governance weaknesses, oversight roles and executive responsibilities run the risk of facing political interference in NNPC's decision making processes.

12. NNPC's corporate structure and internal audit and control functions are under transformation. NNPC is a federally owned entity, with 12 subsidiaries incorporated as joint stock companies as per the Company and Allied Matters Act. To be more efficient on the core businesses, NNPC is attempting to become a de facto corporate group by creating four autonomous business units (Upstream, Downstream, Gas and Power, and Refineries) with corresponding subsidiaries. It also aims to move from a compliance-based audit to a risk-based audit and control approach. Needs assessments were completed in 2017, and the overall internal governance architecture has been drafted to promote better board oversight, communication channels, and reporting mechanisms. Policies to support the internal audit and control function have been developed. When fully implemented, this revamp could help NNPC adapt to new challenges (including the transformation to a corporate entity as per CAMA provisions), and better fit within the parameters of a profit-oriented mandate. It would also be important for NNPC to envision an approach to integrating sustainability, including environmental and social considerations, into NNPC operations, with clear indicators that are measurable and monitorable, and feed disclosure reporting.

Fiscal Discipline of NNPC

13. Limited fiscal oversight and a fragmented institutional set up impacts revenue collection. NNPC engages in major fiscal arrangements in the oil sector on behalf of the Federal Government of Nigeria, which mainly consist of Joint Ventures (JVs) and Production Sharing Contracts (PSCs). As reported in 2015 NEITI reports, revenues are often lost or under-collected due to discretionary decision-making in the award of oil blocks, unpaid signature bonuses after a license is awarded or renewed, unpaid royalties, and significant crude oil theft.³ For example, in 2015, NEITI

³ The extractive Industries Transparency Initiative (EITI) provides international standards for the good governance of oil, gas and mineral resources along the value chain of the sector. NEITI is the Nigerian chapter of EITI.

estimates that NNPC owes \$ 9.8 billion to the Federal Government, mainly due to deductions from gross oil revenues and opacity in the new JV cash call arrangements. The involvement of various agencies (NNPC, DPR, and Federal Inland Revenue Service) in collecting revenues adds to the lack of clarity.

14. Legal ambiguities generate uncertainty on NNPC revenue transfers. The Constitution requires that all NNPC revenue proceeds be paid to the Federation Account but the NNPC Act states that the NNPC shall maintain a fund from which NNPC can defray all expenses. NNPC thus makes prior deductions out of its gross income with no need to recourse to appropriation by the National Assembly. The Fiscal Responsibility Act mandates NNPC to remit one-fifth of its operating surplus to the Consolidated Revenue Fund of the Federal Government but neither defines “operating surplus” nor provides a limit to deductions (generally related to landing and transportation costs for imported petrol, crude losses, product losses, and pipeline management and repairs). NEITI and Audit General’s Reports have consistently highlighted concerns of transparency and accountability as deductions have increased over the years. Making revenues more transparent requires revisions to the legal framework (Table 2).

Table 2. Nigeria: Required Revisions to the Legal Framework to Increase Transparency of Revenues

- Strengthen information sharing and coordination among collecting agencies to compare payments
- Establish a clear mandate to fund NNPC operations (define the surplus, the possibility to make deductions and limits to defray operating costs)
- Reconcile provisions of the NNPC Act concerning revenue withholdings in light of constitutional requirements.

15. The new funding mechanism for cash calls has helped to reduce arrears accumulation, which had been a recurrent problem in the past.⁴ Before 2017, gross proceeds were transferred immediately to the Federation Account, and monthly cash calls were paid to JV partners through a budget appropriation process. This set up allowed the Federal Government (FG) to better oversee revenue distribution. However, discrepancies between NNPC approved amounts and FG budget allocations coupled with budgetary process delays contributed then to the accumulation of significant arrears (US\$ 5.1 billion 2011-2015; US\$ 1.2 billion in 2016). To prevent arrears accumulations, NNPC has begun to first pay cash call obligations and then remit net revenues to the Federation Account in January 2017, decreasing accumulations of cash call arrears but raising concerns about the constitutionality and transparency of deductions in the annual reports of the Office of the Auditor General (OAuGF).

16. The publication of contracts is necessary to reduce fiscal risks. Petroleum contracts (sales contracts, service contracts, PSCs, and JVs) that have a significant impact on public finances are kept fully confidential which can facilitate abuse in the negotiation process, prevent public scrutiny, and

⁴ NNPC participates in the JVs arrangements with international or domestic oil companies for upstream operations in which the Nigerian government is a majority share equity investor. This usually entitles NNPC to receive a production share equal to its ownership stake (petroleum revenue). In return, NNPC pays cash liabilities that are its share of the operating and capital expenses associated with its JV activities (cash call payments).

represent fiscal risk (Table 3). With attention to confidentiality of commercially sensitive data, and in line with international transparency standards, it is important that contracts be fully disclosed.

17. Budget allocation and actual expenditures of NNPC differ significantly, and NNPC's participation in the appropriation process seems limited. Nigeria's budget process is governed by the Constitution, the Finance (Control & Management) Act and the Fiscal Responsibility Act. They require NNPC (along with other FGOEs) to submit, as part of the appropriation bill process, its revenue and expenditure estimates to the Budget Office, which submits it to the National Assembly for approval. However, amounts approved by the NNPC do not often match Federal Government budget allocations. In fact, the Ministry of Finance is in charge of revenue forecasting and scenario modeling but is constrained in its technical and sector expertise as well as by limited data access. NNPC's budget is not published, nor identified in the federal government's budget. There is also no information on the operational surplus of NNPC, while non-appropriated spending is increasing due to NNPC's first deductions, calling for significant changes (Table 4).

Transparency of NNPC

18. The legal framework for fiscal transparency has been significantly enhanced with the issuance of the FRA. The FRA requires that fiscal and financial affairs be conducted in a transparent manner and that SOEs (including NNPC) provide full and timely disclosure and wide publication of all transactions and decisions involving public revenues and expenditures and the implications for their finances. On the company side, the NNPC Act provides that the corporation shall prepare and submit to the National Council of Ministers, in each financial year, a report on the activities of the Corporation, which includes a copy of the audited accounts of the Corporation for that year and the auditors' report.

19. NEITI has played a pivotal role in improving financial disclosure standards in the oil industry. Incorporated as a Government Agency in 2007 (to protect its role from political interference), Nigeria is one of the few countries to have legislated the EITI with the 2007 EITI Act.⁵ The Act gives Nigeria's EITI a mandate to develop a framework for transparency and accountability

Table 3. Nigeria: Steps to Increase the Transparency of Petroleum Revenue

- Establish a clear decision-making process on revenue inflows and outflows in the framework: clarify procedures for payment and withdrawal from certain accounts, and which agency should make the determination
- NNPC's JVs arrangements should be fully disclosed, including clear information on gross revenues received and of transfers made beyond those to the Federation Account
- Grant relevant Government stakeholders (Ministry of Finance; Accountant General) full oversight of Government cash flows across cash call bank accounts

Table 4. Nigeria: Towards Good Practice in Budget Allocation and Documentation

- Introduce better systems of information sharing, and disclosure of fiscal risks
- Include in the budget documentation forecasts of credible and transparent resource revenues
- Ensure that all NNPC revenues and expenditures are fully integrated in the budget process
- Place strict limits on extra-budgetary spending to achieve a more realistic incorporation of NNPC's budget into Federal government budget
- Publish JV contracts

⁵ Extractive Industries Transparency Initiative (EITI) provides international standards for the good governance of oil, gas and mineral resources along the value chain of the sector.

in the reporting and disclosure of all extractive industry companies' revenue due to or paid to the Federal Government and enables EITI to conduct financial, physical and process audits of Nigeria's oil and gas industry. As a result of NEITI's efforts, NNPC now publishes monthly financial and operation reports and monthly petroleum statistics and annual statistical bulletins. Of note, in February 2019, the Board of EITI agreed that Nigeria reached 'satisfactory' progress in implementing the EITI standards as the first Anglophone African country.⁶

20. Despite recent reforms, improving auditing and data reconciliation is essential for proper monitoring of NNPC's financial situation. NNPC is self-reporting and its figures cannot be verified or challenged by other government bodies, complicating the validation of information. There are concerns about the accuracy of revenue statements and room for enhancing the level of disclosure, including on what NNPC ultimately considers as net revenue. As highlighted by NEITI, there is significant scope to improve the regularity of NNPC disclosures (for example, NNPC Financial and Operational Reports are available only until November 2018, while the last Annual Statistical report and petroleum statistic were published in 2017 and 2016 respectively) and to subject them to analysis. For instance, NEITI noted that its auditors under the EITI framework have not independently verified the information and data from NNPC monthly reports. Further, there are data discrepancies between the NNPC, Audit General, Central Bank of Nigeria, and Accountant General. Finally, the Fiscal Responsibility Act requires NNPC to prepare and publish audited accounts but there is no published audit report to date.

21. Strengthening transparency is needed to ensure that Nigeria receives maximum benefits from the oil and gas sector. The IMF's Fiscal Transparency Code requires that resource corporations report on project-level fiscal payments to and from the government, which should be reconciled with government receipts in line with international standards, with no major unexplained reconciliation error. In line with good practices, it is important for the NNPC to disclose all revenue transfers and remittances to the Federation Account by providing complete and timely information that ensure accountability of its receipts and expenditure. In addition, NNPC could consider further enhancing and integrating its transparency practices by reporting on environmental, social, and governance considerations. The recently adopted Sustainability Disclosure Guidelines by the Nigeria Stock Exchange could provide useful guidance in this respect.⁷

Oversight of NNPC

22. The Constitution does not give the Auditor-General a direct mandate to audit NNPC. It establishes the appointment of the Auditor-General to audit public accounts and offices of the Federation. It explicitly excludes the accounts of government statutory corporations from the scope

⁶ The EITI Board confirmed Nigeria's efforts to use the EITI as a crucial diagnostic of oil and gas industry oversight to support reforms of state participation, license management and off-budget revenues. While discrepancies between rules and practice in the governance of the extractive industries persist, the Board considered that the latest EITI disclosures adequately reflected practical challenges in the mining, oil and gas sectors.

⁷ The guidelines are to primarily provide the value proposition for sustainability in the Nigerian context. It also articulates a step by step approach to integrating sustainability into organizations, indicators that should be considered when providing annual disclosures, and timelines for such disclosures.

of the Auditor General's mandate but grants the Auditor-General power (not defined) to conduct periodic checks aimed at (i) verifying that budget appropriations are spent in accordance with the Ministry of Finance's instructions and (ii) investigating expenditure patterns of the government including inflows and outflows of NNPC revenues to the Federation Account.

23. The role of the Auditor-General can be strengthened (Table 5). The Office of the Auditor

General (OAuGF) is resource-constrained, as it requires greater financial and operational independence to strengthen the overall quality of its audit function (Table 5). According to the law, the Auditor General is the only physical person in the OAuGF that can be considered civil servant. The rest of the

Table 5. Nigeria: Strengthening the OAuGF and National Assembly's Oversight Functions

- **Enact a law that will provide OAuGF with:**
 - financial and operational tool when conducting audit over public accounts.
 - petroleum sector expertise
 - better tools to improve stakeholders' engagements, in particular with the National Assembly

office instead depends on a British Ordinance that was never converted into Nigerian law, de facto eliminating a legal basis to grant civil servant status for OAuGF employees, which has affected the regularity of their salaries and the allocation of an operational budget to conduct audits and to do capacity building (in the last two years, a total of \$300 was allocated by the Accountant General to the OAuGF for training purposes). In addition, the relationship between the OAuGF and the Committees of the National Assembly and other external stakeholders needs to be strengthened to enhance the usefulness of the Auditor General Report as an effective instrument for legislative oversight over the NNPC's operations.⁸

24. The fiscal oversight role of the Ministry of Finance should be strengthened (Table 6).

The Finance (Control and Management) Act gives the Minister of Finance powers to supervise and control the expenditure and finances of the Federation and all matters related to the financial affairs of the Federation which are not by law assigned to any other Minister. Despite these general powers, the Ministry's fiscal oversight function over NNPC should be strengthened and enhanced. The Petroleum Unit, which was established in the Ministry with a mandate to provide sector revenue forecasting and support to the Federal Inland Revenue's audit functions, needs to be enhanced through additional training on the sector, appropriate staffing (total of 6 people) and greater resources. The oversight unit should be responsible for oversight of, among other things, planning and budgeting

Table 6. Nigeria: Strengthening the Role of the Ministry of Finance

- Legally provide the Ministry of Finance with powers to exercise fiscal oversight of NNPC, covering a comprehensive range of fiscal risks
- Establish reporting systems to allow the MoF to regularly oversee monitor and assess NNPC operations.
- Foster close collaboration with other revenue collecting agencies and oversight/auditing institutions (information sharing, financial assessment, joint audits and technical assistance)

⁸ Standing Committees have been set up in both the Senate and House of Representatives to oversee Nigeria's oil and gas industry, such as Committees on Petroleum Resources (downstream and upstream) and Public Accounts Committee.

arrangements, in year and end-of-year reporting requirements, dividend policy, and financial assistance from the Government, including guarantees and quasi-fiscal activities.

25. An effective sanctions and enforcement regime would also help. This may include giving to the Auditor General and the Ministry of Finance the legal powers to enforce sanctions for individuals and institutions for the non-remittance of revenues to the Federation Account, failure to disclose information required by the laws, and non-compliance with requirements related to process, expenditure, and mismanagement of public assets.

The PIGB Act

26. Recognizing the above challenges, the government has tried to push for the approval of the Petroleum Industry Bill (PIB)—a key element of its Economic Recovery and Growth Plan—to improve institutional weaknesses. The PIB aims at redesigning the overall institutional architecture of the oil industry in a bill of four acts. The first act—the Petroleum Industry Governance Bill (PIGB)—aims at: clarifying separation of ownership, policy making, and regulatory roles and responsibilities among the agencies; establishing a commercially oriented focus for petroleum entities; promoting transparency and accountability in the administration of the petroleum resources; and creating a conducive business environment. Following a number of versions over the past decade, the PIGB had been approved by parliament in 2018 and is now awaiting final presidential approval.

D. Using AML/CFT Tools in and beyond the SOE Sector

27. Further strengthening Nigeria’s AML/CFT regime will bolster critical aspects of the anti-corruption effort in and beyond the FGOE sector, including by diminishing the underlying financial incentives. The proceeds of corruption must almost always be laundered, i.e., made to appear legitimate to be spent, transferred, or invested. As such, the AML/CFT tools for identifying, tracing, and confiscating ill-gotten gains play a dual role: helping to detect, investigate, and sanction corrupt practices that have already occurred while also diminishing the incentive to engage in such practices in the future.

28. The Nigeria AML/CFT National Strategy 2018-2020, adopted in June 2018, reflects the government’s high-level commitment to strengthening the AML/CFT regime. The Strategy recognizes a strong AML/CFT regime as key to the country’s socio-economic and political development and includes the review and enactment of AML/CFT legislation, as necessary; the issuance of related guidelines and regulations; awareness-raising for the private sector; the provision of adequate resources, e.g., funding and staffing, in the public sector; and enhanced stakeholder collaboration.

Box 1. Selected Challenges in PIGB

Implementation of the PIGB would represent a clear break from past practices by restructuring institutional arrangements and calling for greater transparency. Its effectiveness will be strengthened by ensuring the following selected challenges are addressed:

- **Coordination:** The PIGB gives responsibilities for rents and royalties to the Nigerian Petroleum Regulatory Commission, for PSCs to the Petroleum Asset Management Company (PAMC), and of other contracts by NNPC (especially JV) to the National Petroleum Company (NPC). Coordination between these different parts of the new fiscal regime is critical and may require adequate information flows among these institutions, assistance in audit processes, and sharing expertise.
- **Monitoring and oversight:** Additional safeguards are required to subject new institutions to effective government oversight, whilst continuing to operate independently of political interference. The PIGB's objective is to improve clarity of the roles and responsibilities of sector agencies. According to PIGB, the NPC and PAMC will be subject to Companies and Allied Matters Act and the Securities and Exchange Commission's Codes of Corporate Governance. This will enhance the corporate governance but there is no single oversight unit that can monitor these entities.
- **The role of the Ministry of Finance:** The MoF's role in monitoring key financial information in relation to NPC and PAMC and assessing fiscal risks arising from their activities is not provided under the PIGB. This is particularly important given that NPC would be entitled to retain revenue from its operations to cover its expenses, debt liabilities, and cash call obligations in the JVs. The PIGB also excludes the new NPC from the provisions of the Fiscal Responsibility Act 2007 and the Public Procurement Act 2007. This creates additional fiscal risks as NPC is excluded from budgetary planning, borrowing limitations, conditions for guarantees by the federal government, public procurement provisions and fiscal transparency requirements
- **Formalize Appointment, Remuneration, and Evaluation Policies:** The PIGB remains silent on transparency and formalization of the appointment process, evaluation, and remuneration of the members of the Commission and of the board of directors of NNPC and AMC

29. Several of the AML/CFT reforms discussed in the following sections would have a direct impact on promoting and ensuring good governance in the SOE sector. Greater visibility into the beneficial ownership (BO) of legal entities (i.e., companies) and arrangements (i.e., trusts), along with the strengthened implementation of existing measures designed to enhance scrutiny of the finances of politically exposed persons (PEPs)⁹ – whether via transaction monitoring or asset declaration – would advance the authorities' efforts to uncover acts of corruption, including those that involve SOEs; track the associated proceeds; and prevent those proceeds from being laundered and spent (see text table for illustrative examples).

⁹ The Financial Action Task Force (FATF), the global AML/CFT standard-setter, defines domestic and foreign PEPs as individuals who, "are or have been entrusted...with prominent public functions, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, [and] important political party officials."

Transparency of Beneficial Ownership

30. Ensuring the transparency of ultimate (or “beneficial”) ownership is critical to prevent, detect, and investigate the abuse of corporate vehicles to engage in corruption. Corrupt officials may form or use legal persons (e.g., companies) to obscure their part in a bribery or kick-back scheme; strike advantageous deals with themselves, their family, or their associates (see Text Table 1 below); or launder the associated proceeds. The risk of the abuse of corporate vehicles is particularly acute in the SOE sector, where large sums of state resources are regularly expended to procure equipment or obtain services and expertise from contractors, whether local or foreign.

Text Table 1. Examples of Acts of Corruption in the SOE Sector and AML/CFT Tools to Address Them	
Theft or Diversion of Funds from SOEs	Relevant AML/CFT Tools
<i>Cooking the Books:</i> An external accountant hired by an SOE discovers serious – and seemingly deliberate – discrepancies in the ledgers of the previous Chief Financial Officer (CFO).	<i>Suspicious Transaction Reports (STRs)</i> ¹⁰ : The accountant files an STR with the national financial intelligence unit (FIU), noting possible complicity within the SOE.
<i>Hiring Yourself:</i> A high-level SOE executive attempts to steer a lucrative contract to a previously unknown parts supplier that submitted a relatively unattractive bid.	<i>Transparency of Beneficial Ownership:</i> After consulting the official corporate registry, the contracting committee determines that the supplier is “beneficially” owned by the high-level executive.
<i>Receiving Kick-Backs from a Foreign Partner:</i> An SOE Metering Technician receives several wire transfers from a firm incorporated in a small country known as an offshore financial center.	<i>International AML/CFT Cooperation:</i> With help from the FIU, investigators obtain critical information from overseas counter-parts: the firm is a shell company with possible ties to the SOE’s foreign partner.
<i>Taking Bribes from a Local Contractor:</i> The Chief Executive Officer (CEO) of an SOE makes several large, all-cash deposits into her bank account. Her salary is paid in regular intervals by direct deposit.	<i>Enhanced Monitoring of PEPs:</i> As required by law, the bank monitors the PEP’s account closely, requests information on the funds’ origin, and suspends her account/submits an STR when there is no response.

¹⁰ STRs are confidential disclosures made by banks, other financial institutions, and designated non-financial businesses and professions (DNFBPs), such as accountants, lawyers, and notaries, to a national FIU, based on the suspicion that a client may be engaged in money laundering, terrorist financing, or related criminal activity. STRs are then analyzed by the FIU and, when appropriate, disseminated to law enforcement for possible investigation.

31. The passage of amendments to the Companies and Allied Matters Act (CAMA, Repeal and Re-enactment) Bill, 2018 represents a critical step forward, but they have yet to be enacted.

In view of the relevant Financial Action Task Force (FATF) recommendations, and Nigeria's commitments under the EITI and at the London Anti-Corruption Summit of 2016, the Government crafted amendments to the CAMA that would mandate the disclosure of beneficial interests in a company's shares and task the Corporate Affairs Commission (CAC) to compile and maintain the resultant information in the public domain. The Amendment ("Repeal and Re-enactment") Bill was passed by the Senate on May 18, 2018, and by the House of Representatives on January 17, 2019. Presidential approval is needed for its enactment.

Table 7. Nigeria: Steps to Strengthen the Transparency of Beneficial Ownership

- Enact the amendments to the CAMA, once they have received Presidential assent.
- Collect and compile BO information for all companies registered in Nigeria and ensure that it is regularly updated and verified.
- Amend the NFIU's STR template to include a field for BO information, when the object of the report is a legal person.

32. The lack of reliable BO information is a significant impediment to the full use of key AML/CFT tools to support Nigeria's anti-corruption framework (Table 7). Among the affected tools are the NFIU's analysis of STRs involving corporate entities and law enforcement's efforts to conduct financial investigations ("follow the money") in certain corruption cases. In the present environment, the authorities must request BO information from financial institutions (FIs), which are required to "identify and take reasonable steps to verify" the BOs of their legal person clients per the Central Bank of Nigeria (AML/CFT in Banks and Other Financial Institutions in Nigeria) Regulations, 2013. However, the authorities have found some FIs resistant to providing this information, while others are slow to do so, and still others provide information that is later determined to be inaccurate or incomplete.

Politically Exposed Persons and Asset Declaration

33. Applying special scrutiny to PEPs' financial dealings, including via asset declaration requirements, makes detection of corrupt acts and ML more likely. Such scrutiny also deters criminals from attempting to carry out corrupt acts in the first place.

34. In line with the FATF recommendations, Article 18 of the 2013 CBN regulations puts relevant requirements on FIs. These include to (i) obtain senior management approval before establishing (or continuing) business relationships with PEPs; (ii) conduct enhanced ongoing monitoring of those business relationships; (iii) render monthly returns on all PEP transactions to the CBN and the NFIU; and (iv) take reasonable measures to establish the source of wealth and of funds of PEP customers.

35. In practice, FIs struggle to identify their PEP clients (Table 8). To facilitate their compliance with the requirements noted above, banks, BDCs, and other FIs requested a list of qualifying Nigerian officials from the CBN. However, the preparation of such a list falls outside the CBN’s remit, is unlikely to prove a sufficiently

Table 8. Nigeria: Steps to Strengthen Scrutiny of PEPs

- Amend the NFIU’s STR template to include a field to indicate if the individual in question is a PEP. Such a field would provide context to the NFIU and enable it to prioritize more efficiently the analysis of STRs.
- Complete the NFIU’s strategic analysis of corruption. The NFIU already intends to increase its focus on strategic analysis; it should prioritize corruption.

comprehensive or dynamic solution and could foster private sector complacency. The Chartered Institute of Bankers of Nigeria (CIBN), Nigeria’s banking association, is therefore taking the welcome step of working with consultants to develop a proprietary account and transaction monitoring tool. A similar, but still nascent, effort on the part of the Association of Bureaux de Change Operators of Nigeria (ABCON) would also be welcome, especially as BDCs already appear to lag other Nigerian FIs in the implementation of their AML/CFT-related obligations.

36. In parallel, all “public officers” must declare their assets, but the completed forms are not available to the public. Per the Fifth Schedule to the Constitution, all “public officers”, whether at the local, state, or federal level, must declare their assets immediately after taking office, every four years thereafter, and again at the end of their terms/service. The Code of Conduct Bureau (CCB) is responsible for receiving and analyzing completed asset declaration forms, but must currently do so on a confidential basis, thereby limiting the potential for civil society organizations and members of the general public to identify, and bring the CCB’s attention to, assets that have not been declared—or that have not been declared accurately. Moreover, the current forms do not contain fields to capture certain highly relevant information, such as sources of income, beneficially owned assets, or personal property above a certain value.

37. The CCB receives few completed asset declaration forms and is in need of additional resources (Table 9).

The CCB has no list of declarants, i.e., specific individuals that it considers to be “public officers”, estimating only that they number between 4 and 4.5 million. Yet it received fewer than 17,000 completed asset declaration forms in 2018. Even this number of forms is difficult to process, as the CCB works with limited resources and on an almost exclusively manual/paper-driven basis with a relatively small number of staff (889) spread out among a national headquarters and 36 state-level offices. The CCB’s budget allocation declined from \$8.5M to \$8M in FY 2019.

AML/CFT Supervision

38. AML/CFT-specific supervision is critical to ensuring that financial institutions faithfully implement the full range of their AML/CFT-related obligations, including with respect to the transparency of BO, the identification of PEPs, the submission of (corruption-related) STRs, and the implementation of targeted financial

sanctions. Absent adequate AML/CFT supervision, private sector compliance levels tend to remain sub-par, whether owing to ignorance, incompetence, or the knowing facilitation of illicit activity.

39. The CBN’s AML/CFT (Administrative Sanctions) Regulations of 2018 addressed an important gap in its supervisory framework; the pilot program for risk-based supervision is welcome. The Regulations provide the CBN with an adequate legal basis to impose administrative sanctions and penalties for non-compliance with AML/CFT-related obligations, and include a detailed schedule laying out the specific sanctions and penalties to be imposed in response to identified violations. The CBN reports that it has begun to issue sanctions in accordance with the new regulations, but that the schedule will likely have to be updated on an ongoing basis, to ensure that the applicable penalties remain sufficiently dissuasive in the context of normal inflation. The pending commencement of a pilot program for risk-based supervision represents a substantial step toward increasing effectiveness. The risk-based approach (RBA) entails the classification of supervised entities by money laundering and terrorist financing (ML/TF) risk and the subsequent

Table 9. Nigeria: Improving Asset Declaration by Public Officials

- **Provide additional resources to the CCB** to enable it to (i) recruit, train, and retain staff; (ii) compile the names of (at least the high-risk) public officers required to declare assets; (iii) establish an IT infrastructure for the digitization of records and on-line submission of asset declaration forms; and (iv) proactively pursue cases involving non- or inaccurate declaration.
- Amend the legal framework and issue the National Assembly Guidelines necessary to enable and ensure the publication, on-line, of the list of declarations received from high-level federal and state officials, along with the declared assets and their values.¹
- Once the amendments noted above have been enacted and implemented, consider further amendments to establish criminal penalties for non- or inaccurate declaration, at least with respect to high-level federal and state officials.
- Update the asset declaration form to include fields for all sources of income, beneficially owned assets, and personal property above a certain value. This would help clarify unexplained wealth and reveal conflicts of interest.

¹ This would require the National Assembly to issue guidelines for the release of information per paragraph 3(c) of the Third Schedule to the Constitution; to amend sections 12, 14, and 15 of the Freedom of Information Act (2011); and, potentially, to amend both the Code of Conduct Bureau and Tribunal Act (1991) and the Official Secrets Act (1962) (so as to clarify the CCB’s custodial responsibilities with respect to completed asset declaration forms). In parallel, i.e., while working to enact these changes to the legal framework, the Government should encourage public declaration on a voluntary basis.

varying of the frequency, scope, and intensity of inspections in accordance with that classification. As such, it should enable the CBN to focus its limited resources more sharply.

40. However, limited human resources continue to pose a challenge (Table 10). The CBN incorporates AML/CFT-related components into its annual prudential inspections of each of Nigeria’s 34 primary mortgage banks. But the limited number of dedicated AML/CFT inspectors precludes regular AML/CFT inspections of those banks or of a sufficient sample of BDCs, which were labeled as “high-risk” in Nigeria’s 2016 National Risk Assessment. Only 2.3 percent of licensed BDCs received AML/CFT on-site inspections in 2018 (relative to 2.5 percent in 2017).

Table 10. Nigeria: Strengthening AML/CFT Supervision of FIs, BDCs

- Conduct thematic inspections of banks and BDCs to ensure the full and consistent implementation of their PEP-related obligations. A methodology based on the robust sampling of customer files would help determine the true extent to which Nigerian FIs are willing and able to identify their PEP clients and apply enhanced monitoring to their transactions.
- Progressively increase the number and severity of sanctions applied for violations of AML/CFT-related obligations to demonstrate the CBN’s resolve to achieve compliance. When violations of AML/CFT-related obligations are uncovered, the CBN should share the inspection reports with the NFIU.

Effectiveness of the Nigerian Financial Intelligence Unit (NFIU)

41. A critical component of every country’s AML/CFT regime is its FIU. It collects, analyzes, and disseminates STRs related to ML, TF, and the related, underlying (or “predicate”) offenses, such as fraud, bribery, the diversion of public funds, and other forms of corruption. The private sector is on the front lines of the fight against corruption, with FIs functioning as the primary conduit for attempts to transfer, store, or launder ill-gotten gains. FIUs therefore play an essential role in translating confidential, private sector-generated tips into criminal investigations and prosecutions. In 2018, for example, the NFIU disseminated 134 STRs to its former parent agency, the Economic and Financial Crimes Commission (EFCC); 88 involved possible corruption.

42. The passage of the NFIU Act in 2018 represents a major milestone. It assures the NFIU’s operational independence in line with the FATF recommendations, thus restoring the NFIU’s international network by enabling its reconnection to the secure information-sharing platform for the 159 FIUs that comprise the Egmont Group. Moreover, the Act gives the NFIU the power to conduct inspections of FIs and DNFBPs, thereby putting it in a position to help ensure that they submit – and maintain the confidentiality of – STRs in all cases of suspected corruption, regardless of the prominence of the affected customer or the size of his or her business. The NFIU has also benefited from the recent confirmation of a new director and the provision of its own line-item in the FG budget. The NFIU’s budget for the current fiscal year saw a substantial increase, with many resources already invested in the training of analysts.

43. The NFIU’s close collaboration with its domestic partners is already yielding results but would benefit from additional formalization (Table 11).

The NFIU’s domestic partners, including the EFCC and the closely related Independent Corrupt Practices and Other Related Offenses Commission (ICPC), report that it can be relied upon to provide timely and accurate information, whether held by the NFIU itself or by a foreign partner – and that, in the latter case, working with the NFIU to obtain information is generally more efficient than pursuing the same via mutual legal assistance channels. Still, to the extent that this collaboration is based at least partly on good faith and/or interpersonal connections, it will be important to formalize it to make it more sustainable over the long term.

Table 11. Nigeria: Maintaining Momentum Generated by the NFIU Act

- Issue an executive order requiring all domestic competent authorities to provide the NFIU with information as and when requested, to reduce the NFIU’s reliance on bilateral memoranda of understanding (MOUs) and *ad hoc* requests to obtain critical information from its domestic partners.
- Conclude an MOU between the NFIU and the EFCC to establish a template for the relationship between the newly autonomous NFIU and its former parent agency.

Vigorous Prosecution and Timely Conclusion of Corruption-Related Cases

44. The timely and effective administration of criminal justice, particularly in high-profile cases, is key to deterring future corruption.

Strengthening the application of the tools discussed above for detecting and investigating corruption will be in vain to the extent that the criminal justice system fosters a sense of impunity by failing to convict and sanction offenders in a timely manner, if ever.

Table 12. Nigeria: Advancing the Effective Prosecution and Timely Conclusion of Corruption-Related Cases

- Rebalance any new resources between the EFCC and the ICPC to enable both to pursue their core mandates with maximal coordination and minimal overlap. The Presidential Advisory Committee Against Corruption should continue to play a coordinating role, while maintaining a bird’s eye view of Nigeria’s entire anti-corruption architecture.
- Vigorously enforce the Administration of Criminal Justice Act (ACJA, 2015), which was designed, in part, to minimize the ability of defendants to achieve impunity through delay.
- Make greater use of information technology (IT) systems over time to begin to chip away at the daily delays caused by manual processes in the judiciary.

45. A recent budget increase for the EFCC and the confirmation of a new director for the ICPC – both critical law enforcement agencies – are welcome.

An infusion of resources allowed the EFCC to hire 1,200 additional staff in 2018, while opening 3 new “zonal offices”. It is now working to train recent recruits and build the skills of existing investigators. By contrast, the ICPC conducted its last recruitment in 2012; the new director, confirmed in December 2018, plans to work with both the Government and external development partners to address any resource gaps. Both agencies report that they conduct parallel financial investigations in corruption and other cases involving the generation of illicit proceeds.

46. But further efforts are needed to reduce procedural delays in the criminal justice system (Table 12). The EFCC and ICPC report that many of their prosecutions stretch on for years, as wealthy and sophisticated defendants leverage appeals and adjournments to delay their trials, often

in contravention of the law. Moreover, the retirement, promotion, or movement of judges among different assignments leaves some cases in limbo while forcing others to be retried, owing to persistently poor caseload management at all levels of the criminal justice system. Those rare corruption cases that manage to advance without undue disruption tend to advance slowly, as judges record the proceedings in longhand and motions are filed manually.

E. Conclusion and Key Policy Recommendations

47. The Nigerian authorities must accelerate their anti-corruption efforts to maintain momentum against both entrenched challenges and evolving threats. Despite the high-level commitment of the administration and the deep devotion of many public servants working in the SOE sector, as well as in the country's anti-corruption and AML institutions, the Nigerian government will need to accelerate and intensify its reforms in this area—as stated in its Economic Recovery and Growth Plan— if it is to have a durable impact on the incentive structures that underpin corruption in Nigeria. This paper has examined issues in two key areas of the anti-corruption effort—SOE governance, especially in the petroleum sector, and AML/CFT efforts.

48. Achieving critical improvements to SOE governance and AML/CFT efforts will require a combination of legislative action, institutional reform, and additional resources.

- **Legislative Action.** The authorities should prioritize the enactment and implementation of the PIGB and the CAMA (Repeal and Re-enactment) Bill of 2018. They should also consider legislative action to design an overall ownership policy for SOEs, improve fiscal and financial discipline with a broader public finance management reform, and enhance the transparency of public revenue flows and coordination among collecting institutions.
- **Institutional Reform.** The MOF should regain a central role in the oversight of fiscal risks while the Auditor General should have a legal basis to operate effectively; the CBN will need to fully implement the risk-based approach with respect to its AML/CFT supervision; and the judiciary will need to embrace both legal requirements and best practices related to its management of individual cases and system-wide caseloads.
- **Additional Resources.** The authorities should prioritize the allocation of any new or newly available resources to: (i) the Oversight and Oil and Gas Departments within the MOF; (ii) the Auditor General's staffing and operational and training budgets; (iii) the CCB; (iv) the ICPC; and (v) the judiciary, such that these are all able to carry out their core functions efficiently, leveraging technological solutions as available and appropriate.

References

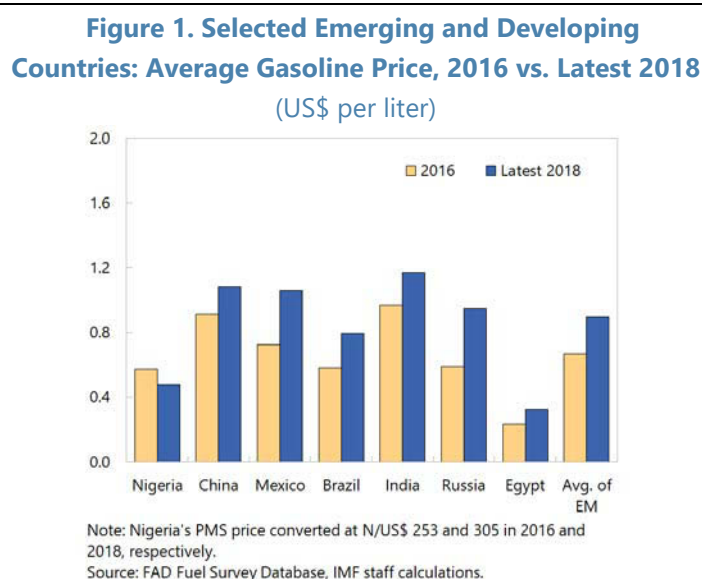
- Extractive Industries Transparency Initiative. 2019. "Nigeria Validation." Decision reference: 2019-20/BM-42. February 27, 2019.
- IMF. 2018. "Strengthening Transparency and Governance in Nigeria". Nigeria Selected Issues. IMF Country Report No. 18/64
- Nigeria Extractive Industry Transparency Initiative (NEITI). 2019. "Nigeria Validation". EITI Board Decision 2019-20/BM-42
- Nigeria Extractive Industry Transparency Initiative (NEITI). 2016. "2016 Oil and Gas Industry Audit Report"
- Nigeria Extractive Industry Transparency Initiative (NEITI). 2015. "2015 Oil and Gas Industry Audit Report"
- Office of the Auditor General for Federation of Nigeria (OAuGF). 2018. "Annual Report of the Auditor-General for the Federation on the Accounts of the Federation of Nigeria for the year ended 31st Dec. 2016"
- Office of the Auditor General for Federation of Nigeria (OAuGF). 2017. "Annual Report of the Auditor-General for the Federation on the Accounts of the Federation of Nigeria for the year ended 31st December 2015"
- United Nations Office on Drugs and Crime (UNODC). 2017. "Corruption in Nigeria. Bribery: Public Experience and Response." UNODC, Vienna, and National Bureau of Statistics

FUEL SUBSIDIES-LATEST INCREASE AND IMPLICATIONS OF A CHANGE IN THE REGULATED GASOLINE PRICE¹

The implicit cost of fuel subsidies is significant. Analysis based on Nigerian household data shows that a removal of the implicit subsidy (through an increase in the regulated price of Premium Motor Spirit, PMS) would reduce income inequality and, if combined with targeted transfers, could result in a decrease in the poverty gap while leaving significant fiscal space for other productive expenditures. To avoid a re-emergence of fuel subsidies, a deregulation of fuel pricing or the implementation of an independent and automatic fuel price-setting mechanism will be necessary. In the interim, the cost of currently below-cost recovery regulated prices should be explicitly stated in the budget.

1. Nigeria's regulated price for PMS is no longer cost-reflective and is lower than in most comparator countries.

In May 2016, faced with fuel shortages and severe external and fiscal pressures, the Nigerian government increased the regulated fuel price significantly (by 68 percent, to Naira 145 per liter)—making the level appropriate in the context of premium gasoline prices of just above US\$500 per ton at then prevailing oil prices of US\$45 to US\$50 per barrel and exchange rate of 197 Naira/US\$. Since then, the price of PMS has remained unchanged. Oil prices are now hovering above US\$60-65 per barrel, Rotterdam Platts prices increased, and the exchange rate has further depreciated in windows reflective of market rates, while fuel imports are still priced at 305 Naira/US\$. As a result, the regulatory fuel price cannot fully cover the cost of fuel importation and distribution. Oil companies in the downstream business have relied on their allocation of fuel imports by the national oil company (NNPC) for distribution. The cost incurred by the NNPC in absorbing below market costs results in lower net oil revenue transfers to the federal government and reduced transfers to state and local governments. In contrast, fuel prices in comparator countries have increased significantly, and are on average substantially higher than in Nigeria.



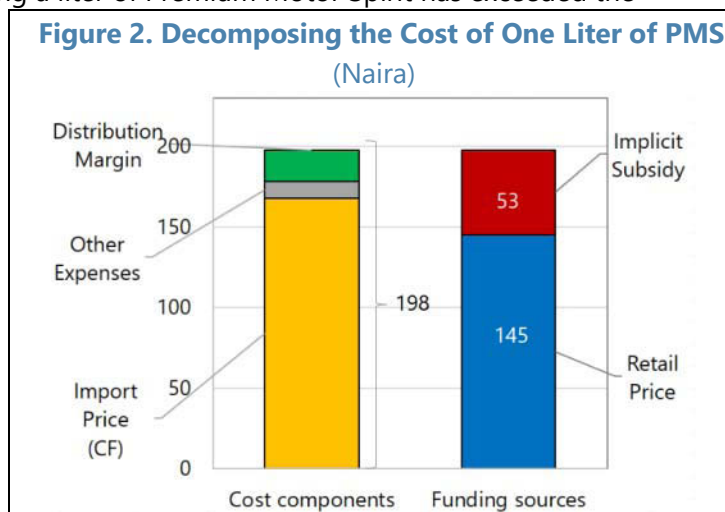
¹ Prepared by Monique Newiak (AFR) and Stephen Younger (Commitment to Equity Institute).

2. As a result, implicit subsidies have increased markedly; removing them would increase fiscal space.

In 2018, the cost of delivering a liter of Premium Motor Spirit has exceeded the

regulatory retail price of Naira 145 by some 40 percent. At this level of price under-recovery, and assuming consumption of about 37 million liters in Nigeria per day, the implicit cost to the budget could amount to 0.5 percent of GDP in 2018, compared to just 3 to 4 percent in tax revenues), and even 0.9 percent of GDP under publicly announced import numbers of 55 million liters per day that are used to build strategic reserves and are to a large extent diverted through

smuggling into neighboring countries. The exchange rate margin created through pricing fuel imports at N/US\$ 305 instead of the market rate (N/US\$ 360) creates an additional implicit subsidy that is not accounted for in the analysis but would add around 20 percent to the cost. A removal of subsidies would therefore imply increased fiscal space.



3. However, a price adjustment would reduce households' purchasing power, calling for an analysis of the impact by income groups, in particular for poorer households.

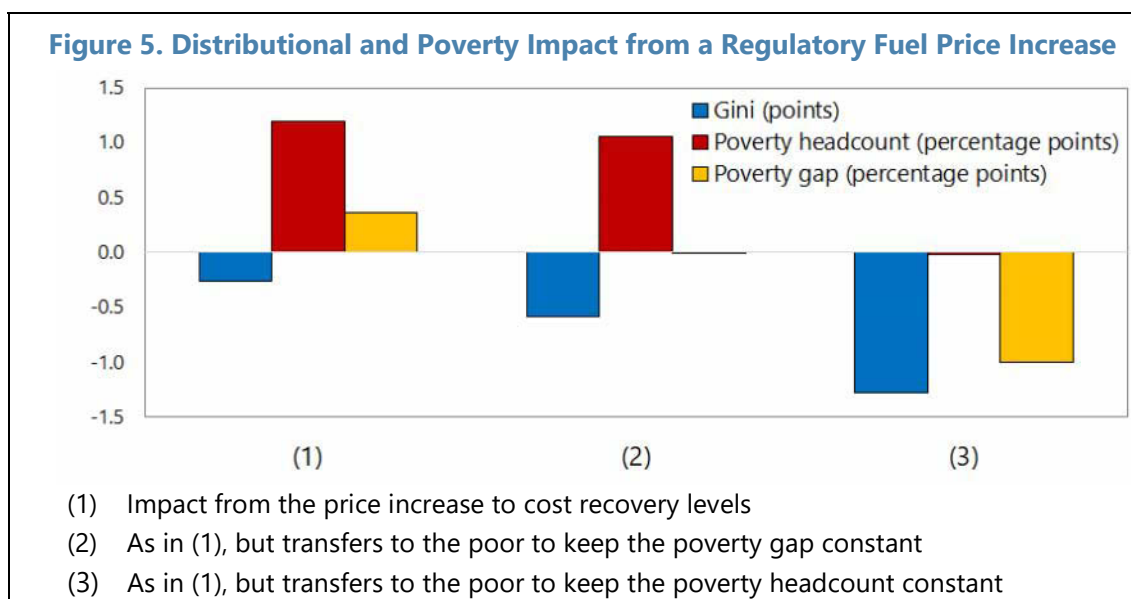
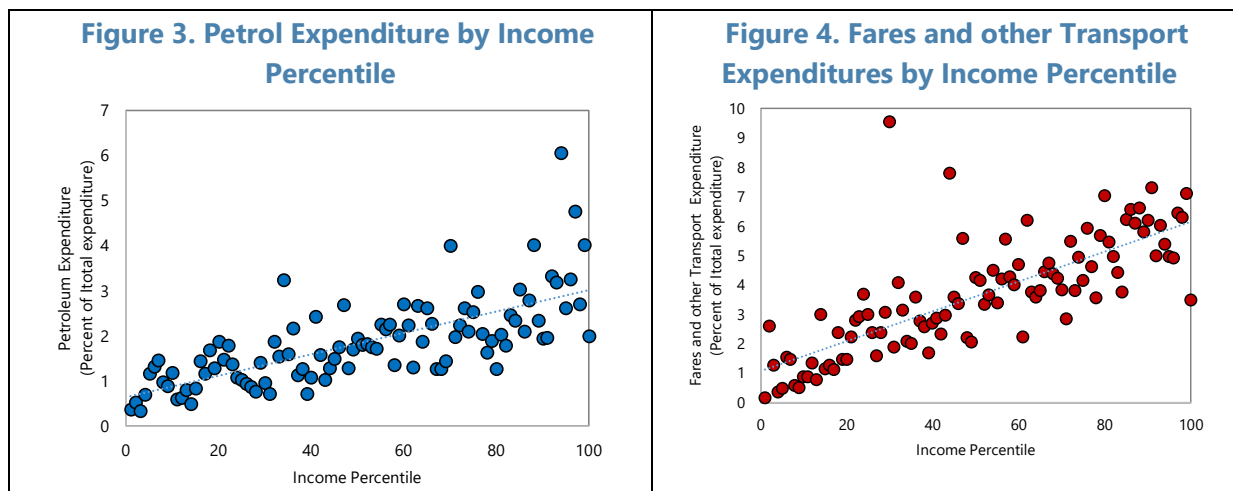
- With transport prices currently estimated at 6.5 percent of the consumption basket based on current CPI weights, the direct first-round impact on the overall price level in Nigeria of a 40 percent fuel price hike would be around a 2½ percentage points increase. The inflationary impact from this "one-off" increase would affect households with varying income levels differently.
- To estimate the distributional impact, incidence analysis is used to assess the implications of a 40 percent price increase (recovery of current costs) on households' budgets, based on the 2015/16 representative Nigeria General Household Survey that captures 5,000 households across all states. The approach assumes that demand for PMS is inelastic, implying that the direct impact on households' budgets is proportional to their consumption levels. It takes into account that a price increase results in an indirect impact on households' budgets by increasing the prices of other goods and services (such as transport and goods that require transport, see above).

4. The analysis shows that increasing retail prices would reduce income inequality but increase poverty levels.

- Richer households tend to spend a larger share of their income on petrol than poorer households (Figure 3). The same relationship holds for fares and other transport-related expenditures (Figure 4). Not surprisingly, a fuel price increase is therefore progressive, i.e. it

disproportionately reduces the disposable income of richer households, and thus decreases income inequality (here measured by the Gini coefficient) by 1/4 point.

- However, the negative impact on poor households' purchasing power results in increasing the poverty gap by 0.4 percentage points and the poverty headcount by 1.2 percentage points (Figure 5, part (1)).



5. The cost of measures to mitigate the adverse impact on the poor are relatively small and would amplify the reduction in income inequality from the price increase.

- To assess the cost of compensatory transfers to the poor, the analysis chooses households to benefit from transfers through proxy-means testing. The proxy-means test identifies poor households that should receive the transfer based on their predicted household expenditure

based on a range of indicators that may be easily verifiable in practice (state in which household resides, rural vs. urban location, ownership of a refrigerator, ownership of a car, electricity expenditures). A scenario that keeps the poverty gap (the mean shortfall of the total population from the poverty line) constant, would imply transfers with at a total cost of just Naira 63 billion, less than a tenth of potential savings through the price increase. Income inequality would decline further (by 0.6 point). However, even with the compensation, the poverty headcount would still increase by 1.1 percentage points (Figure 5, part (2)).

- To eliminate this increase in the poverty headcount based on the national poverty line, transfer packages would need to be scaled up further, to Naira 239 billion—still just about a third of potential gains of the reform at current prices and costs, excluding administrative cost of such transfers, see [IMF \(2018\)](#) for caveats around the design (including challenges to scale up administrative capacity in the short term). In such a scenario, the poverty gap would decrease even compared to the situation before the price increase, and income inequality would decline significantly (by 1.3 points, Figure 5, part (3)).
- Safety nets could be scaled up as part of a wider project to increase the National Social Safety Net ([World Bank 2018](#)).

6. The impact of an increase in PMS prices is thus expected to be overall positive if compensatory measures to protect vulnerable households are introduced. In addition, these effects do not take into account a number of other positive implications of the price increase in productive fiscal expenditures (e.g. infrastructure) that could have positive growth and distributional implications that would help compensate for adverse effects on demand from higher input costs, which are not taken into account in this analysis.

7. Fuel price reform requires increasing transparency, ensuring timely adjustment of prices to cover costs based on market conditions, and participation at the state level:

- **Transparency.** Independently from a price adjustment, the budget should communicate any foregone benefits of the implicit fuel subsidy transparently by including them as an explicit item into the budget and communicating domestic PMS consumption levels. In addition, if the government wishes to share costs across state and local governments, then these should be explicitly shown and implemented, possibly through a cost-sharing formula, rather than indirectly through lower net oil revenue transfers from NNPC to the government.
- **Price-setting mechanism.** To eliminate the subsidy in a sustainable manner, an increase in the regulated price should be accompanied by an implementation of an independent and automatic fuel price-setting mechanism. As part of the mechanism, regulated prices would be reviewed regularly to avoid the re-emergence of fuel subsidies. The pricing formula could include a best-practice smoothing mechanism to avoid disruptive adjustment in cases of large oil price shocks and volatility, while guaranteeing a pass-through of oil prices over the medium term (see, e.g., [Coady and others \(2012\)](#) for design and implications). For example, Chile's scheme consists of a two-part fuel tax, with one part indexed to inflation, and the other adjustable. A gradual

adjustment is also possible. For instance, India raised the price of diesel every month from Jan 2013 to Oct 2014, until the unit subsidy was eliminated, and then let it follow international price fluctuations.

- **Deregulation.** Alternatively, deregulating fuel prices to allow for market pricing would achieve a similar effect with less control on profit margins but savings in costs of regulation.
- **Communication.** Designing and implementing an effective public communication strategy will be critical to implement the fuel price reform.