

The Nigerian EITI: Aims & Objectives in the Quest for Transparency

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Protocol

1. **We are most gratified to see the enthusiastic turnout of the good people of the South-West Zone** to this road show, which has also taken us to the South-South and North-West geo-political zones. We are all stakeholders in the Nigerian enterprise, and it is critical that issues that affect its wellbeing, prosperity and image are treated as the collective responsibility of all of us.

2. **The ongoing reforms by the present Administration, (captured in the NEEDS document, 2004) represent are all-encompassing**—cover all facets of the economy and society: from macro-fiscal reforms to banking sector consolidation; from public sector reforms to structural reforms; and from public procurement reforms to the fight against corruption and drive for transparency. The work of the Nigerian Extractive

Industries Transparency Initiative (N-EITI) should therefore be seen as an integral part of the overall reform agenda. To that extent, it should be contextualized as a critical link in the chain of the reforms. Numerous international studies have demonstrated that reforms cannot succeed in delivering the intended results without a strong anti-corruption component; and transparency is at the core of the fight against corruption. To start with, it would be difficult and even immoral to ask the Nigerian public to make the sacrifice that reforms generally entail. It should be said here that corruption is not unique to Nigeria. The problem is that because of our weak institutions, corruption tends to manifest itself more blatantly, and the socio-economic damage is more far-reaching (see, for example, Wolfensohn, 2005).

3. For whatever reasons, the extractive industry (primarily oil and gas, but also solid minerals) has been associated with problems of governance across the world; you only need to look at the history of oil to see the struggles for its control. Look at Russia, Indonesia and the Middle East, and you will see how oil shaped the destinies of countries—for good and for ill. A major

characteristic of the commodity is the huge rent that is embedded in the price. The average cost of producing oil varies greatly: from about \$3 per barrel in parts of the Middle East to about \$6-8 in Nigeria, and up to \$15 per barrel in some of the harsher environments. The difference between the market price and production cost roughly approximates the rent per barrel. Thus, at today's crude oil price of about \$55 per barrel, it is obvious that there is a large room for amount of money to be fought over or shared. The struggle for this rent element, as between owners of the resource (e.g. host governments) and oil producing companies who are contractors with the technological know-how is at the core of the transparency issue. Oil companies are in business to maximize profits and will do all they can to reduce their tax obligations to Government, including by arguing for large incentive allowances, cost uplifts, tax exemptions, and charging as much of their costs against tax liabilities as possible.

4. In this kind of environment, where large sums of money are involved, public officials charged with responsibility for awarding contracts, giving approvals, calculating and collecting

taxes and royalties on behalf of Government suddenly find themselves exposed to the temptations of the sector. It takes a very disciplined person to hold the line, particularly if his remuneration is not very good. Even politicians are not far away from the action where oil is concerned. They want to get involved, especially when the contract is worth hundreds of millions of dollars.

5. The literature is full of examples of oil-related policy failures from different countries over the years: from Angola to Azerbaijan; from Gabon to Venezuela and, indeed from Nigeria, of the 1990s. Oil has always been a source of contention and a veritable avenue for rent-seeking behaviour. This is why oil producing countries that have benefited the most from their oil resources are those with strong institutions to check the propensity of the sector for sharp practices. Norway is often cited as an example of an oil-producing country that has managed its resources well and therefore gained a lot from it. In contrast, Nigeria and many developing countries are often cited as examples of countries that have suffered varying degrees of the "Dutch Disease", resulting from poor

macroeconomic management of oil revenue, as well as serious governance issues.

6. **The role of oil in the Nigerian economy cannot be overemphasized:** oil revenue accounts for 75-95% of revenue in all tiers of Government, 90-95% of foreign exchange earnings and about 33% of GDP. The problem with the oil sector, of course, is that it is an enclave sector and very capital intensive so its contribution to overall employment is not commensurate with its share of GDP or contribution to foreign exchange earnings. Since the seminal work of Hotelling (1931), the world has come to a realization that oil, as an exhaustible resource, needs to be managed carefully so as to ensure that it is used not only for the benefit of the present generation, but also the benefit of future generations. This implies that the government must limit current consumption to the permanent income from the total wealth. Under this approach, the discounted value of the oil reserves is estimated, with the per-period drawdown being limited to the permanent income flow from the total

wealth.¹ The appropriate policy target under this model is the accumulation of sufficient stock of financial assets such that the flow of income from those assets would cover the financing of the non-oil budget deficit after the exhaustion of the oil reserves or, indeed, during periods of prolonged decline in the oil price. This is the essence of a savings fund.

Establishment of, and Role of the Nigeria EITI

7. The urgency for the establishment of the N-EITI became very clear after a study by the World Bank that was commissioned by this Administration in 2000 revealed some disturbing findings. Among other things, it found lapses in four broad areas, namely, **crude oil output and disposal; funds inflows; funds outflow; and institutional effectiveness**. It therefore became imperative for the Administration to take decisive steps to institutionalize a system of regular independent audits of hydrocarbon reserves, financial flows and processes/practices in the Extractive Industry.

¹ The requirement that the value of the wealth be kept constant in per capita terms entails a more stringent fiscal policy, given the effect of a positive population growth. In lay terms, good oil management policy requires savings, for example, in the form of the excess crude oil revenue account currently operated by the Federal Government.

8. **The N-EITI was established under the umbrella of the *National Stakeholders Working Group (NSWG)*** as a permanent organ to oversee issues of transparency in the extractive industry. The global EITI project took off in 2003 as an initiative of the UK government although other international NGOs had also been pushing the same agenda. Nigeria became the first country to sign up to the EITI, demonstrating Government's commitment to shine the light of transparency on a sector that, for too long, was seen as opaque.

9. **Nigeria is a leader in the EITI field** not only because of its pioneer status, but due to the fact that it is implementing EITI++, i.e. going beyond the minimal requirements stipulated by EITI International. For a change, Nigeria is being cited as an example of international best practice because of our EITI work. Other countries are sending their people to learn from us.

10. **The philosophy of the NSWG/NEITI is based on the principle of inclusiveness**, with membership drawn from various segments of society in order to enhance its credibility. Mr. President, in February 2004, launched the NEITI and inaugurated a National Stakeholders Working Group with a

mandate to codify the Administration's transparency and accountability agenda in the Extractive Sector. The NSWG is made up of 28 individuals as follows: Civil Society (2), Media (1), National Assembly (2), States Assemblies (2) Indigenous and Multi-National oil companies (3) and the Organized Private Sector (4) and Federal Government represented by key agencies in the Extractive sector (14). Within this formation, the industry Trades Union is represented.

11. Towards realizing its objective, the NSWG has engaged the services of an international audit company, the Hart Group (made up of reputable Nigerian and British firms), after a thorough international tenders process—to execute an audit of all oil companies at three levels: a process audit, a financial audit and a physical audit. The audit will critically review and challenge, where appropriate, the annual accounts and tax filings of the oil companies. The same auditors would be in a position to prepare a credible annual statement, on both a disaggregated and aggregated basis, of all revenues received by the Government. It involves looking at the books of relevant Government agencies that have a role in collecting the sector's

revenue in the form of royalty, taxes, etc, as well as the CBN where the monies are deposited in Government accounts. In the end, standard templates would be developed, which would be the basis for a framework for future reporting.

12. In the context of Financial Audit, the NSWG would ensure regular public reporting of the payment and revenue data. The statements prepared by the independent auditors would be regularly and automatically published, on a timely basis, and in formats and through media easily accessed by the public, in Nigeria and internationally. To enhance accountability, statements on payments to, and revenues received by government, would be disaggregated, with payments going into the Federation Accounts separated into their federal, state and local components by applying existing constitutional sharing formulae and payments to agencies such as the NDDC clearly identified.

13. The auditors' report would compare payments made and revenues received and identify and, where they find any irregularities or discrepancies, they would comment as to what might have accounted for these.

14. **The Process Audit would concentrate on the process by which the affairs of the sector is handled** and whether this provides an adequate basis for protecting the interest of the federal government in matter concerning oil and gas. This is premised on the notion that unless there is a strong and transparent process in place, problems of crude oil and products theft and such other malpractices, which have implication for revenue, would continue to pose governance problems.

Specific Functions of the N-EITI

15. Aside from coordinating the day-to-day work of the Secretariat, the core focus of the N-EITI Secretariat is directed at realizing the mandate of the NSWG. The draft Bill presently before the National Assembly is clear about the objectives. Sections 2 (a), (b) & (c) respectively state the primary objectives of N-EITI as:

- "to ensure due process & transparency in the payments made by extractive industry (EI) companies"
- "to ensure accountability in the revenue receipts of the Federal Government from EI companies"

- "to eliminate all forms of corrupt practices in the determination, payments, receipts and posting of revenue accruing to the FG from EI companies".

16. For the purpose of realizing these objectives, Section 3 (a), (d), and (f) respectively, require the N-EITI:

- "to develop a framework for transparency in the reporting & disclosure by EI companies of revenue due to or paid to the FG"
- to request from EI companies, "...an accurate record of the cost of production & volume of sale of oil, gas, or other minerals extracted by the company..."
- "to ensure that all payments to the FG from EI companies, including taxes, royalties, dividend, bonuses, penalties, levies and such like, are duly made".

17. **Towards actualizing the above mandate, the N-EITI undertakes specific studies** in selected areas that have a bearing on the drive for transparency in the extractive industries. For example, the Technical Department (formerly the Oil and Gas Accounting Office in the office of the Minister of Finance) undertook a detailed research work on aspects of

the MOU relating to the payment of petroleum profits tax (PPT), which resulted in the recovery of over \$300 million for the national treasury. Before then, we had conducted a study on the "Time Value of Money", covering the sequencing of PPT payments to the Government. We are also currently completing a study on the disposal and financial accounting for equity crude oil that NNPC takes on behalf of the Government.

18. In order to position itself to play these roles effectively, the N-EITI requires expertise in:

- Petroleum engineering
- Petroleum economics
- Accounting,
- Financial analysis,
- Petroleum law, etc.

We have competence in some of these areas, and are targeting others in the wider public service on a secondment basis. A major problem we have found is the degree of asymmetry of knowledge between Government agencies and the international oil companies with whom they have to engage. The issue of oil revenue accounting is, in a sense, a struggle for the share of

the economic rent described earlier. It usually involves a 2-person zero-sum game where one person's gain is the loss of the other person. The currency in this game is information and knowledge. You require information and knowledge to be able to understand the technical issues in the sector and therefore ensure that your interests are fully protected. To position itself to adequately play its role, the N-EITI is taking steps to strengthen its own capacity and to provide training for staff of other agencies that have a role in oil and gas revenue administration.

19. A further area of interest is in expanding the scope of its work to the solid minerals sector. With the recent change in leadership of the Ministry for Solid Minerals Development, new focus has been brought to the sector, including a re-certification of licenses and leases. The operations of the sector are underpinned by a fiscal regime, just like the oil and gas industry. We will develop a framework for this as well with a view to mainstreaming the fiscal aspects of the sector.

20. We believe that information is useful only when it is shared, particularly to stakeholders. Since the Nigerian public

is the most important stakeholders, we will keep them engaged through regular publication of information, directly and through the NGO community. In this context, we have developed a Communications strategy designed to carry the message of the work of the NSWG/N-EITI to the Nigerian people. Aside from the Communications expert on the NSWG, the N-EITI Secretariat is developing a dedicated Communications Department to focus on this aspect of its work. Apart from publications, other channels of communications would be through Road shows such as this, as well through workshops and electronic media.

21. This battle is the responsibility of every Nigerian. No nation in history has ever succeeded in bringing about economic transformation or lifting its people from poverty without the patriotic involvement of its Civil Society. It is the patriotic responsibility of all of us to ensure that the oil and gas industry is rid of the present negative image that surrounds it.

Responsibility of Governments

22. We should not give the impression that the focus is only on oil companies. The other side of transparency in tax

payments to Government is a responsibility to give a proper accounting to the Nigerian public on how the money is spent. On the Federal Government side, several measures have been introduced to improve public expenditure management, centering on improved budget preparation and implementation procedures - (i) Fiscal Strategy Paper to enable Agencies make informed trade offs; (ii) Fiscal prudence underpinned by the adoption of a price-based fiscal rule, with excess crude oil revenue saved; (iii) Quarterly release of capital budgets to ensure that, as much as possible, agencies get their allocations; (iv) Institution of Cash Management Committee to match revenues & expenditures; (v) Introduction of performance indicators and improved Budget Monitoring (vi) Greater Accountability for the Budget, etc.

23. All of these efforts have paid off handsomely since 2004, as evidenced by the improved macroeconomic stability, the rise in the level of international reserves, and rising balance on the excess crude oil account. These have translated into positive reports on Nigeria by objective international sources (see IMF and World Bank reports, as well as the report by

Transparency International [TI]). TI in particular listed Nigeria as one of 21 countries that have improved significantly; its position improved from second most corrupt to 6th. The successful debt deal with the Paris Club was a direct outflow of the impressive implementation of the reform agenda.

24. The reforms are being underpinned through legislation.

The Fiscal Responsibility Bill, designed to enshrine fiscal prudence, transparent budgeting and increased accountability in our public affairs, are now being considered by the National Assembly. Similarly, the Procurement Bill, which will ensure that we adopt standard procedures of competitive bidding into our procurement systems, is now going through 2nd reading in National Assembly. Meanwhile, procurement guidelines have been developed, and a Procurement journal is now published regularly. There is also progress in some States, as Due Process and Procurement Reforms are being introduced in over 10. And, of course, the N-EITI Bill is also under consideration by the Legislature.

25. States have responsibility for improved governance and public expenditure management. Most corruption comes from poor

public procurement systems un-transparent tendering process, which sets the stage for contract inflation and poor quality work. In the end, it is the public that suffers. International research has long shown the global spread of corruption and the associated high cost (to society) (see among others, Mauro, 1997; Tanzi and Davoodi, 2000; Collier and Hoeffler, 2005; Jha, 2005). Specifically, Mauro (1997) found that *"...corruption discourages investment, limits economic growth, and alters the composition of Government spending, often to the detriment of future economic growth"*. Similarly, Tanzi and Davoodi (2000) have shown that high corruption is associated with high public investment, but the quality of that spending is usually low. They also found that *"...corruption reduces private capital investment by more than it increases public capital investment"*. Private investors tend to shy away from an environment with high corruption. States have a critical role in correcting this type of anomalies through a Due Process mechanism and better fiscal management. On the revenue side, they would need to focus on raising more non-oil revenue.

Closing Thoughts

26. There has been a paradigm shift in our approach to the management of public resources under the ongoing reform program, with a fierce thirst for accountability. The setting up of the N-EITI, and its work agenda to actualize the mandate of the NSWG are a decisive demonstration of the commitment of this Government to opening up the sector. The Federal Government has set the transparency agenda through the reform program, and it is up to the rest of the country to take up the challenge. The Administration is working with the Legislature to underpin the reforms through legislative instruments. It is the responsibility of Nigerians to utilize these laws and their moral authority, as the principal stakeholders in this enterprise, to ensure the successful entrenchment of transparency into the extractive industry sector, as well as in our way of life.

Thank you all!

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