Policy Brief

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Subnational Management of Resource Revenues in Nigeria

Nigeria is seen as a typical example of the so-called 'resource curse.' It is Africa's largest oil producer, but has struggled with poverty and weak institutions. The system of federalism in Nigeria has also thrown up an intriguing paradox of political decentralization with low subnational transparency; while states have fiscal autonomy, and states' spending constitutes around half of consolidated public spending, not much is known about how subnational governments manage natural resource revenues.

Addressing the 'resource curse' in resource-rich federations such as Nigeria requires a more prominent role for subnational governments, given their proximity to local communities, and the important fiscal and political role they play in the federal system.

Sound management of resource revenues in federal countries requires joint action by central and subnational governments.

This policy brief examines oil revenue management practices by subnational governments in Nigeria's oil-rich Niger Delta. The report identifies several issues in the management of oil revenues and state budgets, and sets out appropriate policy interventions.

Does political decentralization address the 'resource curse' in resource-rich, federal countries? The scholarship on the 'resource curse' in Nigeria has largely focused on the policies of the national government, although subnational governments are important actors in the country's federal system of governance. Nigeria's 36 subnational governments receive (oil) revenue transfers from the central government according to a constitutionally backed revenue sharing principle (Salami 2011). However, it is argued that subnational fiscal autonomy under a decentralized federal system has facilitated the mismanagement of natural resource revenues that could be used to address the biting poverty in local communities (Human Rights Watch 2007).

This policy brief examines how state governments in the oil-rich but restive Niger Delta region, which are currently entitled to the largest share of subnational oil revenue allocations, have utilized their oil revenues to address the development needs of local communities, based on an analysis of budgets in two states – Akwa Ibom and Bayelsa, from 2008 to 2012.

Akwa Ibom State

Akwa Ibom state is located along the eastern coastline of the Niger Delta, with a landmass of 6,900 square kilometres. The state has a population of 3.9 million, according to Nigeria's 2006 census, and is rich in natural resources, including hydrocarbons, solid minerals (such as limestone, aluminum and coal), and rich, fertile farmland. With an estimated GDP of US$11.8 billion, it is currently the leading oil producer in the Nigerian federation, and receives the highest statutory revenue allocations, or 9.4% of the total revenue allocated to the 36 states.

Akwa Ibom state has one of the highest adult literacy rates in Nigeria, at 89%, and reasonably high primary school completion rates of 96%. However, the unemployment rate of 27% is among the highest in the Niger Delta. 63% of the population is considered to be 'poor', with 53.6% living on US$1 a day (NBS, 2012).

A boom-bust fiscal cycle

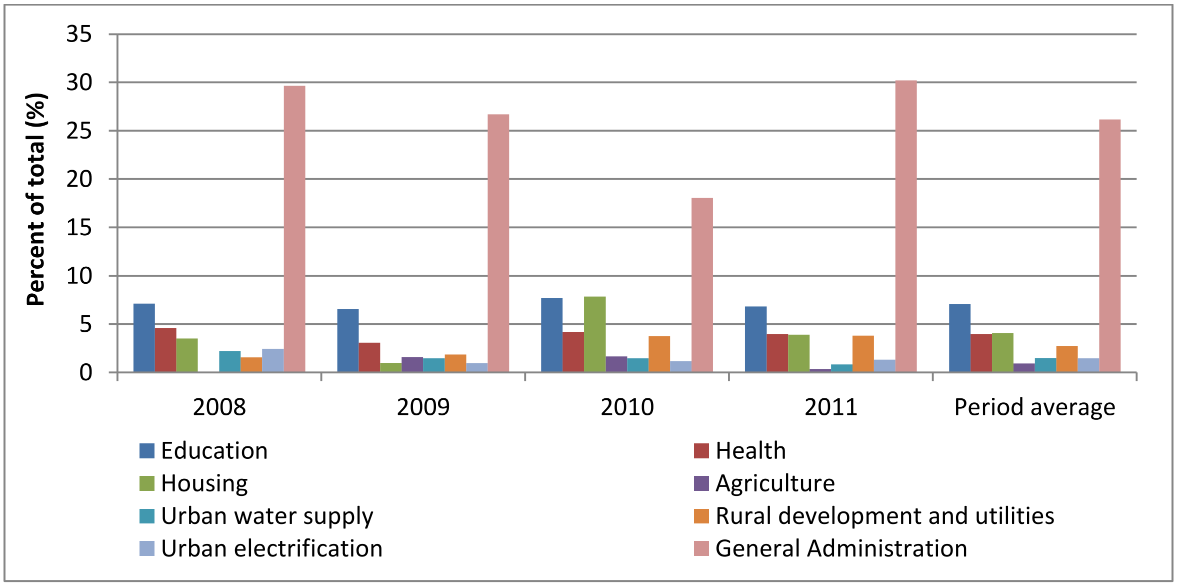
Looking at the state's budgets for 2008-2012, public expenditures have been volatile, mirroring trends in Nigeria's national budget arising from a procyclical fiscal policy. The scale of the sums involved is mind-numbing - in Naira terms, total public expenditure between 2008 and 2012 was N1.5 trillion, an average of N305 billion per year, or in US dollar terms, approximately US$9.8 billion in total. The dependence on statutory (oil) entitlements has fostered a neglect of non-oil revenue generation. Thus, between 2008 and 2012, less than 10% of budgeted revenue was generated from non-oil sources, and up to 90% of state revenues are funded from federal revenue transfers. Public revenues have largely tracked annual spending, in line with the volatility in statutory oil entitlements. However, rising expenditure is creating sizeable budget deficits which could be potentially destabilizing in the future. Volatile public expenditures undermine the state's ability to allocate resources to critical social sectors that can alleviate poverty and unemployment. Furthermore, extreme dependence on federal (oil) revenue transfers indicates a narrow revenue and economic base, and high vulnerability to external shocks.

Is public spending reaching the poor?

From 2008 to 2011, education, health and agriculture received approximately 7%, 4% and 4% of total capital expenditure respectively (*see Fig. 1 below*). Similarly urban water supply, rural development and urban electrification programmes were allocated, on average, less than 3% of total spending in the same period. The 'general administration' category, which appears to be an overhead cost better suited in the recurrent budget, accounted for a whopping 26% of average annual capital spending. The allocation to the enigmatic 'security votes' was 3% of total capital spending in 2011, greater than the allocation to agriculture, urban water supply and rural electrification. In addition, the government's own provision for the 'governor's office' was 7.95% of the total capital budget in 2011, which is slightly above the average share of education in total capital expenditure from 2008 to 2011.

The pattern of resource allocation indicates misplaced priorities for the state in the use of revenues. Resources could be put to better use by funding programs in pro-poor sectors that will create a favourable setting for inclusive, sustainable growth.

Figure 1: Akwa Ibom State – Capital expenditure on key social sectors (2008-2011)



Fluctuations in annual spending on core social sectors reflect the poor quality of budgeting. A critical review of budget performance in Akwa Ibom state by a leading Niger Delta civil society group showed a litany of problems - duplicated items in the state budget, vague expenditure classification, unfinished and abandoned capital projects, an arbitrary budgeting process that does not involve state citizens, and failure to release fiscal data and budget information to the public (NDCBP 2009, 2010, 2011).

Bayelsa State

Bayelsa state is located in the heart of the Niger Delta, with its southernmost tip bordering the Atlantic Ocean. Covering a landmass of around 11,000 square kilometres, the vegetation is an estuarine maze of mangrove swamps and narrow creeks that flow into larger rivers which empty their waters in the ocean. Major economic activities are fishing, farming, petty trading and artisanry. It has a small population of 1.78 million (based on Nigeria's 2006 census) with an estimated GDP of US$7.8 billion. It also receives substantial oil revenues; currently 5.7% of total revenues distributed between the states. Bayelsa has a relatively high adult literacy rate of 74.9%, and primary school completion rates of 97.1%, although 47.3% of the population lives on US$1 a day. However, the unemployment rate of 27.4% is very high, and absolute poverty of almost 60% is consistent with regional trends (NBS, 2012).

Bayelsa was among the first states in Nigeria to introduce in 2009, a Public Procurement Law and a Fiscal Responsibility Law. These reform measures were seemingly geared towards enhancing transparency in the fiscal activities of the state government. The most significant reform was the creation of the Bayelsa State Expenditure and Income Transparency Initiative (BEITI). The BEITI, the first and only of its kind in Nigeria, led to increased civil society engagement on fiscal transparency, and facilitated greater public access to the state's fiscal data. However, four years after its inception, the BEITI Law has still not been ratified by the state legislature, and the lack of political commitment by the state's executive leadership to the implementation of the BEITI has undermined its effectiveness. Critics cite the unwillingness of state officials to open up their books, excessive red tape and lack of political commitment as undermining the effectiveness of BEITI in the state (Weate 2012).

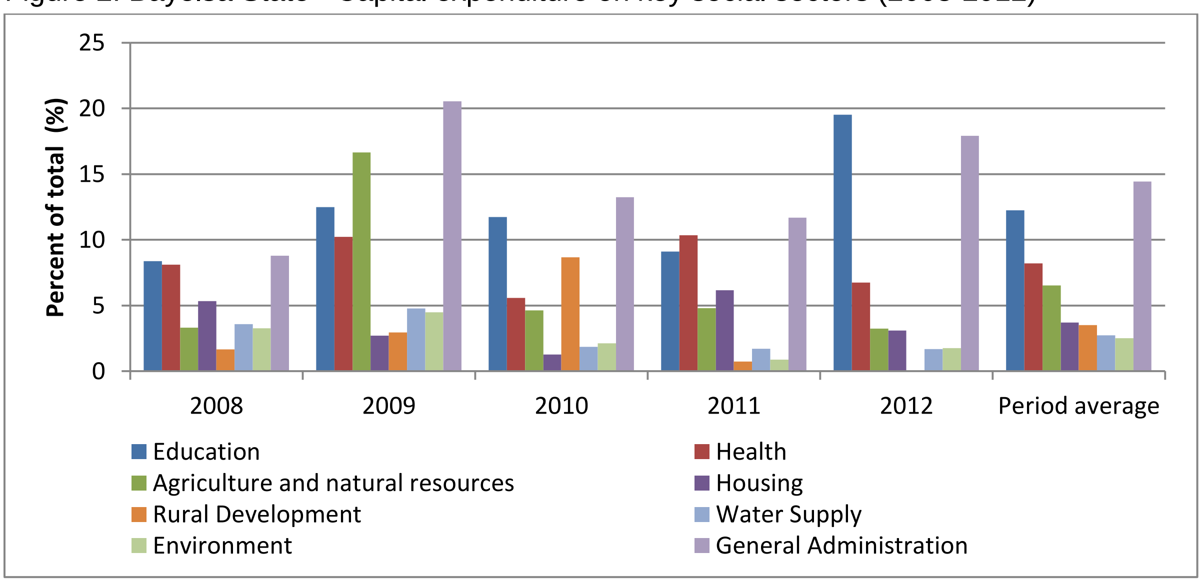
Volatility, again

Bayelsa's public expenditure has been significant since 2008. In Naira terms, a total of N476 billion (or US$ 5.8 billion) was spent in this period. Overall spending tracks revenue fluctuations on a year-to-year basis, again reflecting the oil-related volatility in states that are highly dependent on federal revenue transfers. Bayelsa state is also running considerable budget deficits. In 2008 and 2009, projected expenditures exceeded expected revenues by 33% and 22% respectively. Furthermore, the contribution of internally generated revenue (IGR) from non-oil sources to overall Bayelsa state revenues is very low. Aside from 2009, the share of IGR has remained below 5%. Again, volatile fiscal policy, and narrow revenue base raise serious policy challenges for the Bayelsa state government.

Following the money

In relative terms, education, health, agriculture and water received on average, about 12%, 8%, 6% and 3% respectively, of annual capital expenditure from 2008 to 2012 (in Fig. 2). Once again, 'general administration' was allocated an average 14% of the capital budget between 2008 and 2012, which is even greater than the allocations to education, healthcare, water and the environment. Furthermore, in 2012, the Bayelsa state government did not make any provision for rural development in its capital budget. The volatility in capital spending on the critical social areas is reflected in annual relative changes. For example, agricultural spending grew by almost 300% between 2008 and 2009, but sharply fell again, by 80% from 2009 to 2010.

Figure 2: Bayelsa State - Capital expenditure on key social sectors (2008-2012)



Civil society watchdogs have criticized the budget and fiscal performance of the Bayelsa government on many counts – the high dependence on statutory oil transfers, duplication and misclassification of expenditure categories, uncompleted and abandoned capital projects, and worryingly, a very poor budget execution track record (NDCBP 2009, 2010, 2011). As an illustration, in the first six months of 2011, the Bayelsa state government had spent only N3.5 billion out of the total planned capital expenditure of N70 billion (NDCBP 2011).

For a state that has adopted the right tools, including a raft of public transparency laws, and the BEITI, the evidence on its use of oil revenues shows that the rhetoric is very far from reality.

Findings

The case studies of Akwa Ibom and Bayelsa states show two similar contexts where the subnational government depends almost exclusively on federal statutory oil revenue transfers, which results in highly volatile public revenue and expenditure. Public spending is not directed at pro-poor social sectors that can generate growth and employment, the budgeting system is opaque, and actual budget implementation is very poor. When transparency reforms are introduced by the executive (such as the BEITI), there is no significant change in the quality and effectiveness of public spending. Furthermore, there are no effective mechanisms for ensuring fiscal discipline and political accountability in subnational jurisdictions. Managing huge inflows of natural resource rents is difficult for many developing countries. At the lower levels of government in a country that has been dogged by the so-called *paradox of plenty*, managing natural resource revenues is very challenging. Depending on the degree of political and fiscal autonomy, subnational governments play a vital role in the management of natural resource revenues within a federal structure.

Local context – the nature of socio-political institutions, technical capacity in managing public finances, and degree of political accountability, determines how resource revenues are managed by subnational governments in Nigeria. This suggests that the governance of natural resources in resource-rich federal countries is constrained by the degree of political decentralization. In general, due to the *local context*, political decentralization in federal countries may not result in good governance of natural resource revenues, but create more localized opportunities for revenue mismanagement.

Policy suggestions

In order to improve the management of resource revenues within Nigeria's federal system, it is imperative to strengthen the framework for subnational resource revenue management, fiscal discipline and political accountability. Economic, political and constitutional reforms, complemented by donor interventions, should target the following areas:

Building state capacity: Subnational governments require technical support for the management of public finances, in order to improve the effectiveness and impact of social spending on pro-poor sectors.

Reducing volatile revenues and spending: Fiscal policy can be delinked from volatility in federal oil revenue transfers by establishing stabilization or investment funds that can also set aside oil revenues for future use. Fiscal volatility can also be tackled by making conditional grants to subnational governments for the provision of public services.

Incentivizing fiscal discipline: Subnational oil revenue assignments should include 'lump-sum' rewards for fiscal transparency, backed by binding constitutional pacts on macroeconomic and fiscal policy convergence, and basic service delivery standards between the federal and subnational governments.

Improving civic oversight: Better funding by the donor community of innovative grassroots civil society transparency initiatives (e.g. using the Internet and social media), that can create awareness within local communities on the accountability of public officers in managing oil revenues.

Political accountability: Accountability can be improved through credible election of political leaders that are committed to the rule of law and fighting corruption. Strengthening anti-corruption agencies such as the Economic and Financial Crimes Commission (EFCC), and the role of an effective legislature and judiciary in ensuring accountability in the use of oil revenues.

This Policy Brief is based on a research project by the author titled: *Political Decentralization and Natural Resource Governance in Nigeria*, for the NSI's 2012 Helleiner Fellowship Program. The full report is available at www.nsi-ins.ca.

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