Economic and Financial Review

Volume 42 | Number 4 Article 11

12-2004

Funding of oil sector activities in Nigeria

G. Nzekwu
World Bank Office, Abuja

Follow this and additional works at: https://dc.cbn.gov.ng/efr

Part of the Economics Commons

Recommended Citation
Nzekwu, G. (2004). Funding of oil sector activities in Nigeria. Economic and Financial Review. 42(4), 107-125.

This Article is brought to you for free and open access by CBN Institutional Repository. It has been accepted for inclusion in Economic and Financial Review by an authorized editor of CBN Institutional Repository. For more information, please contact dc@cbn.gov.ng.

FUNDING OF OIL SECTOR ACTIVITIES IN NIGERIA

Greg-Tai Nzekwu*

Thank you for inviting me to this year's CBN Executive Policy Seminar. I also appreciate and congratulate the organizers on the theme "Current Economic Reforms in Nigeria: The Case of Deregulation of the Downstream Petroleum Sub-Sector". The theme is very timely especially the development agenda of the Government under the NEEDS is that of reducing poverty, target development to those that need it and ameliorate the hardship of the people in the midst of plenty. I am sure that in the course of this seminar, a lot of issues have been placed on the front burner for the key policy and decision makers to handle, especially as the Central Bank is very critical in designing the direction the economy should swing to from time to time.

Introduction

Oil is of special importance to Nigeria. As a result of the discovery of oil in Nigeria and the critical impact Nigeria's oil has on the world economy, the country is not just seen as a third world country. The founding of oil, including natural gas in Nigeria shows that Nigeria is blessed indeed in absolute terms. Oil is a major resource endowment and accounts for very high percentage of the GDP, government revenue and foreign exchange earnings. Oil is viewed as a commodity of strategic importance, and one of the commanding heights of the economy. Nigeria is currently the seventh largest oil producer in the world. Its oil reserves represent 6 percent of the world's total outside the Middle East. With 4 per cent of total global production, the country is the fifth-largest oil producer within OPEC. Nigeria is well located relative to the world

Mr.Greg-Tai Nzekwu *is a Senior Economist in the World Bank Office, Abuja. The views expressed in this paper are those of the author and do not represent those of the World Bank or World Bank policy.*

markets and so attracts buyers from the major world economies. A demonstration of the importance of Nigeria's oil to the world economy could be seen in the recent threat of violence in the Niger Delta which raised price per barrel to very unprecedented levels in the international market and influencing economic policies in the developed world.

Nigeria's proven oil reserves are estimated at 34 billion barrels and at current levels of production, these reserves would last about 30 years. The government's objective is to increase its proven oil reserves to 40 billion barrels by 2010. Total oil production in 2003/04 remained fairly stable at around 2.33 million bpd (plus 150,000 bpd of condensate)[2], 80 percent of which was exported with the remainder (about 450,000 bpd) allocated to the national oil parastatal Nigerian National Petroleum Corporation (NNPC) for domestic processing in its four domestic refineries[3]. Oil production capacity, currently about 2.5 million bpd, is expected to reach 3 million bpd in 2005 and 4 million bpd by 2010. Much of this reserve increase will come from new deepwater concessions awarded in the 1990's under Production Sharing Contracts (PSCs), which are gradually coming on stream in 2004. About 97 per cent of current production is from the Joint Venture (JV) fields.

How Higher Prices of Nigeria's Oil Affect the Global Economy

Oil prices remain an important determinant of global economic performance. Overall, an oil-price increase leads to a transfer of income from importing to exporting countries through a shift in the terms of trade. The magnitude of the direct effect of a given price increase depends on the share of the cost of oil in national income, the degree of dependence on imported oil and the ability of end-users to reduce their consumption and switch away from oil. Naturally, the bigger the oil price increase and the longer higher prices are sustained, the bigger the macroeconomic impact. For Nigeria as a net oil-exporting country, a price increase directly increases real national income

[2] This was in excess of its OPEC quota of 2.018 million bpd.

[3] Due to the poor condition and low capacity utilization of these refineries, only about 28 percent of the domestic allocation was actually processed in Nigeria in 2003, with the remainder exported unprocessed by NNPC

through higher export earnings.

Higher oil price also leads to inflation, increased input costs, reduced non-oil demand and lower investment in net oil-importing countries. An oil price increase also changes the balance of trade between countries and exchange rates. Net oil-importing countries normally experience deterioration in their balance of payments, putting down pressure on exchange rates. As a result, imports become more expensive and exports less valuable, leading to a drop in real national income. An oil-producing country should experience a boost to economic growth as a result of higher oil prices; however, this impact is yet to be seen in the Nigerian economy.

Role of Oil in the Economy

Oil is central to the Nigerian economy. Oil is a commodity of strategic importance and developments in the sector are critical in determining macroeconomic performance and fundamentals. Nigeria's petroleum sector contributes about 35 percent of GDP, 70 percent of government revenues and 95 percent of export revenues. Government revenues from crude oil sales are largely determined by international oil prices, Nigeria's OPEC quota and the structure of contracts. In 2002, Nigeria's total public revenues were around US$16.7 billion, of which, about US$13 billion (77%[4]) derived from oil and gas in the form of NNPC's equity share, petroleum profit tax, royalties and other payments.[5] This was much higher than during most of the 1990s, due mainly to higher international oil prices witnessed since 1999. This degree of oil dependence is much higher than in several other oil producing and exporting countries (Table 1.1). This dependence has deepened over time while other countries have succeeded in diversifying and reducing the weight of oil in their economies economic activities[6]. This and the fact that unlike other oil dependent economies Nigeria has not built a large enough buffer of external reserves[7], show clearly that Nigeria is extremely vulnerable to an adverse oil price shock.

[4] *Figure includes revenues from oil and gas sales*

[5] *IMF*

[6] *Most Banks for example rely heavily on government deposits.*

[7] *Despite some recent improvements, external reserves stand at about $7.5 billion or 4 months of import cover at end 2003.*

TABLE 1.1: RELATIVE PETROLEUM DEPENDENCE FOR SELECTED OIL PRODUCING COUNTRIES

Country	% GDP	% Government Revenues	% Exports
Nigeria	40	70	95
Norway	10	15	50
Indonesia	10	25	80
Algeria	30	65	80
Venezuela	28	55	70
México	2	30	6

Source: (Mcpherson, 2001)

Nigerian oil producing capacity is rising rapidly, due to the development of the deepwater offshore fields. The prospects for enhanced oil production and revenue depend on how increases in oil production capacity and the constraints imposed by OPEC quotas are managed[8]. Projections of oil prices and petroleum revenue growth over the medium term vary; nonetheless, most projections assume oil prices over the medium term will exceed the long run average of $40-$60 range. A major assumption in these projections is binding OPEC quotas leading to production being constrained below capacity. The World Economic Outlook projections for oil prices for 2005 are to average above $50 per barrel. Projections for the medium term (2005-2009) show oil prices in the region of $45-$60, which would generate on average a total of $38 billion in petroleum revenues per annum, representing 45-48 per cent of GDP[9], which would be shared in accordance with the contractual arrangements, whether JV or PSC.[10]

Despite the significance of the oil sector to the economy, there are oil sector-related issues that have arisen over the years. These issues include: commercial efficiency;

[8] *Over the past year, Nigeria has been producing in excess of its OPEC quota.*

[9] *IMF Article IV consultations (2003)*

[10] *A description of the different fiscal regimes is provided in the next chapter*

non-commercial objectives; governance; cash requirements; and conflict of interest. A recent management audit of the Nigerian National Petroleum Corporation (NNPC) estimated losses at between US$800 million and US$1 billion annually. These losses are due mostly to inefficiencies in both the upstream and downstream operations. Upstream operations attract a lot of attention because of the sheer volume of revenues generated at that level, frequent losses appear to be concentrated downstream. The low levels of commercial efficiency in the oil sector, especially downstream could be traced to lack of competition. Non-commercial objectives could be social, economic or political. These include: *job creation* – oil is a capital, not labor-intensive industry, yet most governments look to the oil sector to provide employment *(many of those employed have very low productivity, either because they are not needed, or because they have not had the necessary training or education),* presumably on the presumption that the operators in the sector can afford to do this; *low capacity* – the oil sector is expected to develop local technical, commercial and managerial capacity, but is often not well equipped to take on this role because of the limited operational experience (upstream) or because of the constrained ability to operate commercially; *social infrastructure* – operators in the oil sector are asked to fund or directly support local schools, hospitals and related community services which can be expensive and may well be outside its core competency; *regional development* such as local roads, bridges, airports, telecommunications and water; *income redistribution and transfers* – requires that the petroleum products are sold at local prices that are below market levels; *state borrowing* – operators may be asked to raise finance for government for non-oil activities. These non-commercial obligations drain the cash flow needed for re-investment and distract management attention from its proper business.

Oil Sector Activities

The oil sector is a complex one. In Nigeria, the critical oil sector operations take place in the Niger Delta basin, a region that remains one of the most prolific in the world. Oil exploration in Nigeria is done onshore and offshore with oil exploration firms investing heavily in both the shallow and deep sea waters. Oil sector activities are in two distinct spheres. These are: Upstream Activities and Downstream Activities.

Upstream Oil Activities – upstream activities cover exploration and production of crude onshore and offshore in deep waters. It involves major foreign oil exploration firms with high investment potentials. Financing oil sector activities is closely linked to the matter of national sovereignty over natural resources and energy security. Financial constraints play critical role in the upstream oil activities. In the past few years, the Nigerian government has been increasingly hard-pressed to meet financial obligations to joint-venture partners, due to the need to spread limited hard currency revenue to all sectors of the national economy. Also, adherence to international treaties and allowing foreign access to a country's strategic energy sector tend to raise the sensitive issue of partial ceding of state sovereignty. Unlike the major privately owned international oil companies that can mobilize large cash resources, the amount of earnings national oil companies can retain for investment purposes will necessarily be a derivative of the broader needs of national budgets. Financing new projects could become a problem where the national debt is already high and national considerations discourage or preclude private or foreign investment.

Downstream Activities

The downstream operations cover all activities following the delivery of crude oil to processing plants. The activities include refining and conversion to petrochemical products, transportation, marketing of the finished products and other related auxiliary services. The downstream sector of the Nigerian oil industry shows a sharp contrast with the upstream sector. While the upstream is regarded as successful (characterized by high productivity, asset regeneration and replenishment), the downstream sector is characterized by such aberrations as supply shortages, price shocks, product adulteration, smuggling, pipeline vandalization an poor state of operating assets. The reason for the disparity is that while the upstream petroleum industry is largely private sector driven, the downstream sector have government as the dominant player. The result is seen in asset wastage, decline in productivity, and obsolete technology. The Nigerian oil industry is in the opposite direction from the rest of the world.

There are three major players in the downstream sector, namely NNPC, the major marketers, and independent marketers. The NNPC plays major role in the downstream sector of the oil industry as it owns and operates the four refineries in the economy (with installed capacity of 445,000 b/d). The NNPC also owns and operates depots and a network of over 5,000 kilometres of pipelines for evacuation and distribution of petroleum products in the country. The major marketers that dominate the marketing of petroleum products in the country include Mobil Oil Nigeria Plc, Oando Plc (formerly Unipetrol Nigeria Plc), Conoil Plc (formerly National oil and Chemical Marketing Plc.), Texaco Nigeria Plc, Total Nigeria Plc, African Petroleum Plc, Agip Nigeria Plc (acquired by Unipetrol in 2002), and Elf Nigeria Limited. However, Government and Nigerian investors have bought into these companies, thereby altering the ownership structure. The independent marketers owe the origin to petroleum products shortages of the 1970s, partly attributed to lack of sufficient investments by the major oil marketing companies in petroleum retailing outlets especially in the rural and more distant areas. Independent marketers are gradually increasing their market share at the expense of the majors, and their share of the products market is expected to rise even more dramatically.

Determining Funds for Oil Sector Activities

Oil sector activities and projects require large capital, but there is a growing reluctance among oil companies to use their balance sheets to fund new oil projects. As a result, many private sector sponsors are pursuing project financing. However, successful project financing depends in large part on the strength of the contractual commitments of the various project participants. These, taken together, ensure lenders that there will be a reliable source of cash flow for repayment of the debt. Among the most important commitments are the contractual undertakings of the host government or governments. In a typical oil sector concession agreement, the government grants to the project entity the right to develop the project in exchange for a stream of payments or payments-in-kind.

The general funding mechanism of the oil sector available to host governments at the national and international levels tends to focus on some concerns. One of these is the domestic risk reduction mechanisms. As practice demonstrates, there are various measures that the host governments may adopt in order to boost the investors' confidence in the country's investment climate and so lower the political and regulatory risks. Some of these measures include:

- Protection of the private property institution is the primary concern of every investor. The prohibition of unjust expropriation without prompt and adequate compensation should be outlined at the highest legislation level.

- The level at which the foreign investment access into the national oil sector is governed can also indicate the level of regulation stability in the country. In cases where such authority is vested in a single ministry, the minister may influence the guidelines for the utilities on his own decision.

- A major indicator of the investment climate and the transparency of the business environment is the factual level of proclaimed policy measures implementation.

- Another important point in providing a healthy investment environment is setting up regulatory authorities independent of the government structure, which would not be directly influenced by the state in carrying out their functions. The regulators should have the necessary expertise, and be independent of both the government, the industry, as well as, the pressure of the public opinion.

- Also, the investor would seek a reliable and independent judiciary system to turn to in order to ensure its property and the enforceability of contracts.

- Some other approach not related directly to regulation is the support of competition in the industry allowing market forces to dictate most of the rules to the industry and with that allows government to resign from the position of the sole decision-maker. Also, promote widespread private ownership of the oil sector stocks, as this creates a larger constituency in favour of maintaining stable regulatory policies.

Other concerns of investors include:

- Unhindered income flow – as the investor needs assurance that the project's profits will not be undermined by excessive taxation or the local exchange rate, and that they may be freely taken out of the country.

- Stability and predictability of the host country's investment climate, and the reliability of the state mechanisms.

- Transparency of the business environments and institutional governance – FDI regulation principles should not only be proclaimed in the host country's legislation, but also be supported by the implementation practice.

- Guarantees against obsolescent bargaining by the host governments, in the view of specificity of energy projects and the exposure of energy investment.

- Guarantees of a level playing field vis-à-vis the incumbent market participants and the domestic investors.

The government may also have some concerns that directly impact on the investors in the sector. These concerns include:

- Protection of the national economy and the interests of the local population. No investment project should be implemented to the detriment of the socio-economic development of the country;

- Raising the revenue for the state budget. Energy ventures are ideal for imposing high rent obligations and taxation schemes, due to the size of profits and the long life-spans of projects, clearly bringing substantial revenues to the investors;

- Provision of energy services to the population and ensuring the security of domestic energy supply;

- Development of the energy sector, which is often the driving factor for a country's overall economic performance;

- Protection of the strategic sectors of the economy, which ensure the state's economic standing and political well-being; and

- Addressing the market externalities associated with the energy sector, e.g. public goods considerations, and environmental concerns.

The interests of both sides demonstrate a clear need for protection against obsolescent bargaining: investors require protection against the misuse of the host governments' sovereign powers resulting in open or creeping expropriation; while the states call for performance guarantees by the investor, especially in the cases of exclusivity of the investor's status.

Sources of Finance for the Oil Sector

The complexity of the oil sector requires that protection be provided through the use of various instruments offered to both the government and the investor by the international investment practice. These vary from general guidelines adopted by reputable international institutions, and credit ratings to adherence to legally-binding international treaties with strong enforcement mechanisms. However, there are some general investment-fostering mechanisms available to host governments at the national and international levels that impact on the oil sector.

Identifiable sources of funds for oil sector activities include: (i) investors' equity; (ii) export credits; (iii) multilateral agencies; (iv) government grants and other bilateral arrangements; (v) supplier credits; and (vi) commercial banks. Each of these will be discussed very briefly.

Equity: For a given project to attract external funds, it is customary to have significant investors funds. Such funds serve as a hedge to mitigate the risk to lenders by ensuring adequate debt service coverage. Substantial portion if not all of investors' funds typically expected to be disbursed before any is made on any other debt.

Joint Ventures: Joint Venture operations are a very important source of funding oil sector operations in Nigeria. Joint Ventures between the Government and viable private entities make credit more attractive to a lender if one party has a strong credit standing on its own. In the oil sector, JVs involve essentially major privately owned international oil companies that can mobilize large cash resources. There are seven petroleum joint ventures (Shell, Mobil, Chevron, Agip, Elf, Pan Ocean, and Texaco). These JVs target the upstream oil sector activities. In each of these JVs, the Government through the NNPC holds 60 percent equity interest (except the Shell Joint Venture, where Government has a 55 percent interest). The Joint Operating Agreement (JOA) governing the joint ventures specify that each partner should fund the partnership's operations in proportion to its equity interest. In 2003, the seven JVs submitted budget proposals of US$9,466,000 million for their work programs. NNPC's share of this budget was about 57 per cent or US$4,600,950 million. Over the years, the JVs agreement has experienced under-funding due to inability of Government to meet its own quota interest.

One may add that there has been some misconception about Joint Venture Agreements which assume that the Government or NNPC must own shares in the affected oil companies. These Joint Ventures are not incorporated and therefore are not legal entities in which shares can be owned. The arrangement consists of two types of agreements: the Participation Agreement which allows the state through the Participation Agreement to acquire a right to the title in the concession specified. The Government therefore acquires shares in the production of crude oil and natural gas from the concession in proportion to the Government interest as specified in the Participation Agreement. Since the oil company participating in the Venture is liable to pay petroleum profits tax, the benefit derived by Government in the arrangement is threefold, consisting of the right to participate in the management of the concession and thereby obtaining pertinent experience and training; the right to benefit from the production of the concessions and the income derived from taxation. The major disadvantage of the arrangement is the huge capital front end investments cost which Government is obliged to invest in the venture. Such cost has sometimes become a heavy financial burden to the Government. A second type of arrangement is the Operating Agreement. This specifies the appointment of the multinational oil company as the Operator of the Venture and specifies the rights, powers, responsibility and the obligations of the Operator. It also establishes an Operating Committee consisting of representatives of the Government and the oil company, specifies the funding obligations, powers and the circumstances under which the parties can embark on sole risk operation, among others.

In order to mitigate some of the shortcomings of Government, especially meeting its portion of the funding in a joint venture, the Production Sharing Contract (PSC) approach was introduced. The PSC requires operating companies to bear the sole risk for oil prospecting and exploitation. The PSC agreement is concluded between the national oil company (NNPC) and the foreign oil company who is employed as a contractor to conduct the petroleum operations on behalf of the national oil company. The contractor is therefore the operator working under the supervision of the national oil company. The contractor provides all the funds for the operations as well as all the technical expertise, and therefore bears all the financial risk of the arrangement. Profit for successful finds is shared according to an arrangement that allows the operating company to recover fully its costs. All the crude oil discovered in the contract area is usually allocated in pre-determined proportions to cover the recovery of operation costs, taxes and royalty before the profit oil is allocated again in pre-determined proportions. PSCs allow for the optimal exploitation of natural resources.

Other options for funding the oil sector include Project Finance (backed up by international banks). There is also the NNPC carry by the JV companies in exchange for cost oil and profit oil. Project finance and to a lesser extent carry arrangement require certain guarantees and commitments from NNPC to the financiers and risk takers. The Upstream industry has so far invested about US$130 million in ongoing alternative funding.

Bilateral Agreements – Bilateral Investment Treaties (BITs) play quite a significant role in the international protection of foreign investment. BITs impose obligations towards treatment of foreign investors directly on states, and allow private companies to enforce such rights by direct, treaty-based arbitral litigation against governments. According to UNCTAD, by the end of 1999 the total of BITs has reached 1,857. These BITs were between developed countries and developing countries with a view to introducing additional investment protection guarantees and at the same time a means of attracting foreign investments.

Other instruments include (a) Escrow Accounts – this is often utilized as a safeguard mechanism set up to mitigate commercial risk and provide additional security for the investors. Its purpose is to insulate export revenues and disburse to lenders the hard currency revenues generated by the project. Escrow Accounts are designed to receive the investment capital and the revenues from the project. The account is controlled by an independent escrow agent who acts on the basis of an escrow contract. The agent releases the funds upon presentation of the documents specified in the contract, confirming that the party has met its contractual obligations. (b) Credit Rating Agencies – these are firms that receive payment for publishing an evaluation of the creditworthiness of their clients. These ratings apply to a variety of entities, including states, governments, and corporations. Investors use credit ratings as indications of the likelihood of getting their money back in accordance with the terms on which they invest. Different credit rating agencies have different grading systems. However, credit rating agencies have no direct impact on international investment support.

Multilateral Agencies: Another major source of funding for oil sector activities is the World Bank and its specialized agencies. As Walde notes, "the World Bank has become the most significant international economic development institution, far beyond the influence of the UN (including the UNDP) or the EU, both in terms of funding volume, but also in terms of leadership in terms of ideas, policies and programme orientation." The World Bank Group includes – International Bank for Reconstruction and Development (IBRD) which engages in virtually all economic, social, financial and environmental issues relating to the current notion of development. The International

Finance Corporation (IFC) is the arm of the World Bank which deals with the private sector investment in developing countries. Besides providing loans to its clients, it also may engage in equity and quasi-equity financing. The IFC also provides advice and technical assistance to businesses and governments. The International Development Association (IDA) provides assistance to the poorest of the developing countries. The IDA credits are loans with very long maturity periods (20, 35 or 40 years with a 10-year grace period on repayment of principal). With no interest charge, IDA credits only carry a small service charge of 0.75 percent on disbursements. The Bank Group also includes the International Centre for Settlement of Investment Disputes (ICSID). It is devoted to facilitating investment dispute resolution between governments and foreign investors. The Multilateral Investment Guarantee Agency (MIGA) has as its main goal, the promotion of foreign direct investment into emerging economies by offering guarantees against political risk to investors and lenders, as well as by providing technical assistance and legal services.

The World Bank Group plays its role through the issue of guidelines on the treatment of foreign direct investment. The guidelines are suggested standard of governmental behaviour towards foreign investors. These guidelines do the following:

- Create an overall legal framework which would embody the essential legal principles so as to promote FDI;
- Cover 4 main aspects of investor/state relationship;
- Main concern is private foreign investment as well as general principles;
- Encourage the state to support foreign investment into their economies;
- To facilitate investment and avoid preventable complications;
- Deals with issues of investment treatment – protection and security of the investors' person, property rights and interests; granting of permits, import

and export licenses and the authorization to employ, and the issuance of the necessary entry and stay visas to their foreign personnel; other legal matters relevant to the treatment of foreign investors;

- Guidelines encourage the states to recognize the importance of investors' employment policies in line with local conditions;

- Ability to transfer abroad funds and salaries of personnel, profits, the amounts required for servicing debts and other contractual obligations as well as proceeds from the investments' liquidation or sales; and

- Guidelines urge the states to promote the necessary measures in order to prevent corrupt business practices and to implement accountability and transparency in dealings with foreign investors.

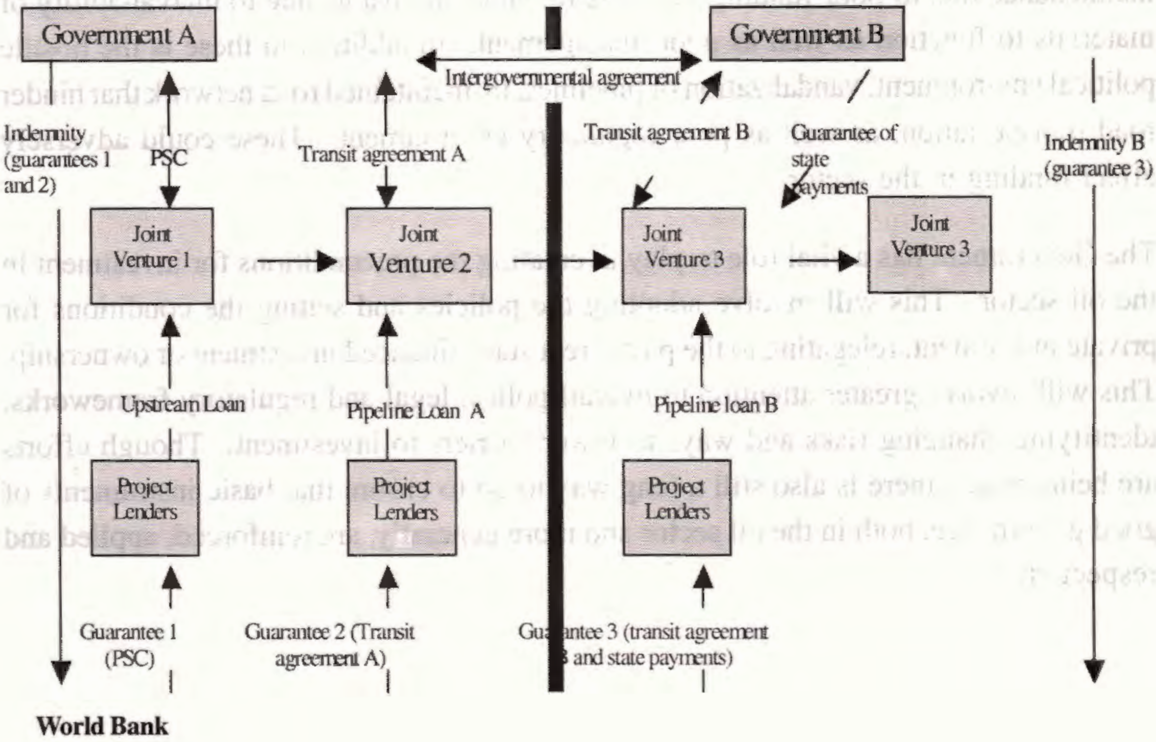
World Bank Guarantees: When it comes to supporting investments in the oil sector and other energy projects, the World Bank may play several roles. World Bank guarantees are a powerful instrument to mitigation of various government performance related risks. Because of its relationship with the governments, the World Bank may afford to cover some of the risks that the private lenders may not be ready to assume. The Bank guarantees ensures the payments to lenders in the case of a government's failure to meet its obligations to a private or public project. The government in whose territory the project is located provides the World Bank with a counter-guarantee, under which the country is obligated to repay the bank if the guarantee is called and paid out. If the country fails to do so, the World Bank may freeze all its financial operations in that country. The World Bank's participation results in additional stability for the investment projects. As Sinclair notes, "guaranteed debt is often arranged at lower costs and longer maturities than would otherwise be possible; the pass-through of these savings to the government can be an important part of the Bank's value added to the project."

There are two types of Guarantees. These are – Partial Risk Guarantees (PRG) and Partial Credit Guarantees (PCG). PRGs (i) cover specific obligations of the government to a private project; (ii) cover such risks as – contractual payment obligations, changes in law, expropriation and nationalization, licenses, approvals and consents; (iii) does not increase a government's obligation to a private project; (iv) help to attract and secure commercial financing for projects, especially in the oil sector; and (v) PRG may allow long-term private financing on softer terms, while assuring government's input into public-private partnerships.

The PCGs (a) cover private lenders against all risks during a specified period of the financing term of debt for a public investment; (b) extend project maturity by guaranteeing later cash flows; (c) improves the market terms for specific project financing; and (d) mostly used to secure privately funded public projects, improving their financial viability.

The figure below describes a typical structure of an oil project supported by the World Bank Guarantee. An upstream project (joint venture 1) is located in country A, a pipeline is constructed (joint ventures 2 and 3) to bring the oil products to country B, where they are to be purchased by the government owned offtakers. In this scheme, there are four obligation points that may require securing from the lenders' point of view: on the side of country A – the production sharing agreement (or other subsoil extraction agreement), and the transit agreement A; on the side of country B – the transit agreement B, and the state payment obligations. Each of the two governments indemnifies the World Bank regarding their respective obligations; the World Bank provides three separate guarantees to project lenders for each of the three separate projects, therefore each guarantee supports an individual link (joint ventures 1, 2 and 3) within the overall oil project chain.

Typical Structure of Oil Project Supported By the World Bank Guarantees



Conclusion

The oil sector is becoming very active especially with developments in the international political scene. Nigeria is well endowed with oil and gas still to be explored. Oil is central to the economy and accounts for a significant proportion of the GDP as well as foreign exchange earnings. However, despite the strategic importance of the sector, developments are very fragmented. Upstream activities are effective and efficient because it is private sector driven and could attract the required foreign direct investment either through Joint Venture Operations, or other alternate funding approaches attractive both to the investors and the government. However, it should be noted that despite the critical nature of the oil sector to the national economy, budgetary contribution is inadequate. Government contributions to Joint Venture Operations are not met and this creates wide gap. Worse are the downstream operations where none of the refineries is operating beyond 40 percent. All the refineries experience irregular maintenance due to poor funding, shutting down of the plants due to unavailability of materials to function as well as poor management. In addition to these is the hostile political environment, vandalization of pipelines, ill-maintained road network that hinder road transportation, as well as poor regulatory environment. These could adversely affect funding in the sector.

The Government has a vital role to play in creating the preconditions for investment in the oil sector. This will involve adopting the policies and setting the conditions for private investment, relegating to the past direct state-financed investment or ownership. This will involve greater attention to overall policy, legal and regulatory frameworks, identifying changing risks and ways to lower barriers to investment. Though efforts are being made, there is also still a long way to go to ensure that basic instruments of good governance, both in the oil sector and more generally, are reinforced, applied and respected.

REFERENCES

PL Consulting, Nigerian Oil and Gas Industry, 2003 Outlook.

Fawibe, O. (Ed), Challenges of Energy Investment in Nigeria, The Proceedings of the International Energy Investment Seminar, April 1994.

S. Sinclair, World Bank Guarantees for Oil and Gas Projects Note No. 157, p.7 (the World Bank Group, November 1998).

D. Kerwer, Managing Global Risk: The Role of Credit Rating Agencies in the Governance of Financial Markets.

T.W. Walde, International Energy Law: Concepts, Context and Players.