

**The political economy of oil in Nigeria:  
How oil's impact on rent distribution has  
contributed to Nigeria's sub-optimal economic  
performance**

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## **Abstract**

Nigeria is an oil-rich country, and one of the largest oil producers in the world, however, its economic and developmental statistics have consistently ranked among the worst in the world. This paradox is widely believed to be a result of the natural resource curse.

The natural resource curse is a phenomenon attributed to the inverse relationship between economic growth rates and the natural resource abundance of countries, and several notions have been put forward as to the mechanism through which the curse arises. These notions are generally categorised as either market-based explanations or political economy-based explanations. However, market-based explanations rely on assumptions that often do not apply in developing countries such as Nigeria. Consequently, the literature has come to increasingly focus on political economy explanations, two of the most prominent of which are rent seeking, and domestic conflict and political instability.

Therefore, this paper seeks to identify some the drivers of the curse in Nigeria by particularly assessing the influence that rent seeking and domestic conflict and political instability may have had on Nigeria's economic experience. Since much of the resource curse literature is based on quantitative analysis, this paper aims to extend the literature using a qualitative approach, which involves the process tracing of major events in Nigeria. This approach is motivated by the fact that qualitative analysis is better suited to the task of identifying crucial insights concerning underlying dynamics of a specific country. Furthermore, this paper uses the limited access order (LAO) framework to guide its analysis. This framework is useful given that it involves the analysis of rent distribution as a means of curbing violence. Therefore, overall, this paper focuses on deciphering how oil's impact on the nation's economic rent distribution contributes to Nigeria's economic performance.

Rent distribution, which largely occurs through patronage and corruption in Nigeria, is analysed through two different dimensions: (i) Formal rent distribution, which is institutionalised, and which mainly involves examining oil influenced changes to the

revenue allocation formula and (ii) less formal rent distribution, which primarily involves examining discretionary and covert rent distribution in the oil industry.

Based on the analysis, this paper concludes that oil's impact on rent distribution contributes to Nigeria's substandard growth in two ways; directly and indirectly. Regarding the first dimension, the effect is indirect, as oil's impact on formal rent distribution becomes a driver of conflict, which in turn adversely affects the economy's growth performance. However, regarding the second dimension, the effect is more direct, because oil's impact on discretionary rent distribution leads to massive economic waste, which contributes to the suboptimal growth of Nigeria's economy.

Overall, with the lack of good institutions that can limit the power of the federal government, and effectively enforce checks and balances in the oil sector, Nigeria's experience of conflict and economic underperformance will remain perpetual in nature.

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# Contents

Plagiarism declaration

Abstract

Acknowledgements

<b>1. Introduction</b> .....	1
<b>2. Resource curse mechanisms</b> .....	6
2.1 Rent-seeking.....	6
2.2 Domestic conflict and political instability.....	10
2.3 Discussion.....	12
<b>3. Introduction to the LAO Framework</b> .....	16
<b>4. Nigeria’s political landscape and its background</b> .....	22
4.1 Introduction to Nigerian elites.....	22
4.2 Development of political tensions.....	25
<b>5. The oil sector</b> .....	32
5.1 Industry Structure.....	32
5.2 Main players in the industry.....	38
<b>6. The political economy of revenue allocation</b> .....	44
6.1 Inception of the revenue allocation issue.....	44
6.2 Changes to revenue allocation.....	45
6.2.1 Changes without oil influence.....	46
6.2.2 Oil-influenced changes and related conflicts.....	47
6.2.2.1 First reduction in state derivation and coups 1 & 2.....	47
6.2.2.2 First round of state creation and civil war.....	49
6.2.2.3 Further reduction in state derivation and coup 3.....	51
6.2.2.4 The “Islamisation” of Nigeria and a failed coup.....	54
6.2.2.5 Further reduction in state derivation and more state creation.....	54
6.2.2.6 Dwindling oil rents, monopolisation of the Presidency and coup 4.....	56
6.2.2.7 Professionalism of the military leader and coup 5.....	57
6.2.2.8 More state creation, monopolisation of the head of state office and crisis..	58
6.2.2.9 Permanent return to civil rule and relative peace.....	60

<b>7. Patronage and corruption in the oil sector</b> .....	61
7.1 The oil sector as a source of rents and its channels of patronage and corruption.....	63
7.1.1 Patronage and corruption at the employment level.....	64
7.1.2 Patronage and corruption at the operations level.....	64
7.1.2.1 Upstream Sector.....	65
7.1.2.1.1 Awarding of licenses.....	65
7.1.2.2 Downstream Sector.....	66
7.1.2.2.1 Awarding of oil service contracts.....	66
7.1.2.2.2 Awarding of term/lifting contracts.....	67
7.1.2.2.3 Awarding of import permits.....	72
<b>8. Conclusion</b> .....	75
<b>9. References</b> .....	77

## List of Figures

<b>Figure 1</b> Nigerian production by operator.....	42
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## List of Tables

<b>Table 1</b> Onshore royalty rate.....	36
<b>Table 2</b> Offshore royalty rates for different water depths.....	36
<b>Table 3</b> Onshore royalty rates for different production levels.....	37
<b>Table 4</b> Offshore royalty rates for different production levels.....	37
<b>Table 5</b> Deep offshore royalty rates for different water depths.....	38
<b>Table 6</b> Revenue allocation formula changes.....	46
<b>Table 7</b> Timeline of state creation.....	50

# 1. Introduction

Nigeria is Africa's top oil producer, with proven crude oil reserves of over 37 billion barrels, and rankings of 12<sup>th</sup> and 6<sup>th</sup> among the world's largest producers and exporters, respectively (Energy Information Administration [EIA], 2015). Nigeria's rate of oil production has also increased from a meagre 5 100 barrels per day in 1958 when production began, to approximately 2.4 million barrels per day today (Nigerian National Petroleum Corporation, 2015). Furthermore, by 2014, Nigeria's government's oil revenues were ₦6 793 billion, having hiked over the past three decades from ₦11 billion in 1985 to ₦324 billion in 1995 and further to ₦4 762 billion in 2005 (86%) (Central Bank of Nigeria, 2015). Thus, the oil sector is extremely significant to the Nigerian economy and it dominates in its contribution to exports and government revenues, accounting for 95% and 70%, respectively (Corrales et al., 2015).

However, Nigeria's economic performance and pace of development have been slower than expected. It has continuously had one of the lowest rankings in the world in terms of its GDP per capita, which was in fact worse between 1981 and 2004 than it was in 1970. Furthermore, by 2005, the extent of the nation's poor economic performance was so severe, with an external debt of \$36 billion, that it received some international assistance through debt relief worth \$18 billion (Center for Global Development [CGD], n.d). By 2015, GDP growth was 6.3% and GDP per capita was approximately current US \$3 184.62. However, 62% of the Nigerian population lives below the poverty line of PPP US\$1.25 per day, and the intensity of the poverty is extreme, indicated by a poverty gap of 33.7. Furthermore, by 2012, only 55.6% of the population had access to electricity. There is also a major issue of inequality, as is evident from its Gini coefficient of 43 in 2009, whereby the lowest 20% of income earners represented 5.4% of the total income in Nigeria, while the highest 20% accounted for 49% of total income (World Bank [WB], 2015). Moreover, Nigeria suffers from an unemployment rate of 23.9 %, which is more than double Sub-Saharan Africa's average unemployment rate of 11.9 % (United Nations Development Report [United Nations Development Programme [UNDP], 2015).

Furthermore, the economy has failed to diversify and therefore is extremely dependent on

its oil (Heritage Foundation, 2016). Concerning the human capital of its population, health and education statistics are less than optimal. Life expectancy at birth in the country remains low, having increased from 45.6 in 1980 only to 52.8 in 2014, and the adult literacy rate was last measured as 51.1% in 2008 (UNDP, 2015). In addition, corruption is pervasive, and Nigeria is amongst the most corrupt countries in the world. It ranks 39<sup>th</sup> in the world with a Corruption Perception Index score of 27 (where a score of 0 means highly corrupt and a score of 100 means “very clean” i.e. not corrupt) which is in stark contrast to Denmark’s score of 92 as the least corrupt country in the world. Even Nigeria’s judiciary system is not completely independent, as it faces regular political interference, and inadequate funding, which make it susceptible to corruption (Heritage Foundation, 2016). Overall, the economic performance of Nigeria has left much to be desired. Thus, this begs the question as to what has been the cause of its overall suboptimal performance.

Sachs and Warner (1995), attribute this paradox, faced by many resource rich-countries, to a phenomenon called the resource curse, which is characterised by the suboptimal growth rates of resource-rich countries. Thus, the purpose of this paper is to highlight some of the underlying factors that have caused the symptoms of the curse in Nigeria.

There have been several notions put forward as to the cause of the inverse relationship between natural resource abundance and economic growth rates. Generally, the literature on the topic can be divided into two broad categories, one of which provides explanations for the inverse relationship that are market-based, while the other provides explanations that are political economy-based (Deacon and Rode, 2012). Among the most popular notions, which attempt to shed light on the mechanism through which the natural resource curse manifests itself, are the Dutch disease, which falls under the market-based explanations, as well as rent-seeking, and domestic conflict and political instability, which fall under the political economy explanations.

Sachs and Warner’s 1995 publication argues that the resource curse arises through the Dutch disease. However, market-based explanations, which typically attribute the curse

to some form of crowding out, whereby the natural resource boom redirects economic activities in a manner that is counter-productive, have been found to have many exceptions and a very limited applicability across all resource rich countries (Deacon and Rode, 2012). In particular, the Dutch disease has since been found to have a limited applicability in low-income countries. Therefore it is an unlikely driver of Nigeria's experience.

To elaborate, the Dutch disease is characterised by an economically harmful contraction of the manufacturing sector. Sachs and Warner's 1995 publication contends that when a nation has an abundance of natural resources, the natural resources sector rather than the manufacturing sectors comes to be the dominating focus of tradeables production. Consequently, factors of production (capital and labour) that would alternatively be used in manufacturing are drawn into the non-tradeables sector, because the demand for non-tradeable goods, and thus, wages in the non-tradeable sector increase as a result of higher incomes from the booming natural resource sector. Hence, the manufacturing sector shrinks while the non-tradeable sector expands. The contraction of the manufacturing sector also occurs when the excess demand in the non-tradeables sector causes the nation's currency to appreciate against other currencies. The appreciation causes the country's exports to be relatively more expensive for other countries. Thus, the non-resource tradeables sector, i.e. the manufacturing sector, becomes less competitive in the global market and experiences a decline in demand, which shrinks the sector (Usui, 1997). The manufacturing sector is assumed to have more positive externalities, such as learning by doing, than the resource sector, due to its backward and forward linkages to the rest of the economy. Thus, a shrinkage in the manufacturing sector is assumed to lead to, "a socially inefficient decline in growth" (Sachs and Warner, 1995).

However, the Dutch disease is based on the assumptions of, "full employment, the efficient use of production factors, and perfect elasticity of demand for tradeables" which are conditions that are not always present in low-income countries (Nkusu, 2004). For example, in low-income countries such as Nigeria, there isn't full employment so the country would be, "able to draw from its idle productive capacity to satisfy increased

demands for nontradeables” which would cause the Dutch disease to be avoided (Nkusu, 2004). Hence, the applicability of the Dutch disease in Nigeria and other low-income countries is limited.

Thus, due to the weaknesses of market-based explanations, more and more literature came focus on political economy explanations. This is because the latter are better suited to explain the varying experiences of resource abundant countries, as they attribute the variance in experiences to differences in interactions between resource extraction and political systems in different countries (Deacon and Rode, 2012).

Hence, since the notions of rent-seeking and domestic conflict and political instability are more widely applicable than the Dutch disease, especially in low-income countries, this paper aims to assess their influence, as possible drivers of the resource curse, in Nigeria’s experience. Since much of the literature on this topic has attempted to explain the mechanism through which the resource curse manifests itself using quantitative analysis, this paper aims to extend the literature using a qualitative approach that involves the process tracing of major events in Nigeria. Furthermore, with the aid of the limited access order (LAO) framework, which is useful in that it calls for the analysis of rent distribution as a means of curbing violence, this paper particularly focuses on deciphering how oil’s impact on the nation’s economic rent distribution contributes to Nigeria’s economic performance.

Rent distribution, which largely occurs through patronage and corruption in Nigeria, is analysed through two different dimensions: i) formal rent distribution, which is institutionalised, and ii) less formal rent distribution, which is more discretionary and covert. Analysing formal rent distribution involves examining oil-influenced changes to the revenue allocation system, mainly through changes to the revenue allocation formula, as well as through some complementary changes to arrangements that affect the distribution of revenue. On the other hand, analysing less formal rent distribution involves mainly examining oil influenced revenue distribution through more discretionary and corrupt measures in the oil sector.

Based on the analysis of economic rent distribution across these two dimensions, this paper argues that oil's impact on rent distribution contributes to Nigeria's suboptimal growth in two ways; directly and indirectly. With regard to the first dimension, formal rent distribution; this effect is indirect, as oil's impact on rent distribution becomes a driver of conflict, which in turn negatively affects the economy and its growth performance. However, with regard to the second dimension, less formal rent distribution, the effect is more direct, because oil's impact on rent distribution, leads to massive economic waste, which contributes to the suboptimal growth of Nigeria's economy.

Thus, this paper proceeds as follows:

**Section 2** expands on the notions of rent-seeking and domestic conflict and political instability in relation to the resource curse.

**Section 3** provides an introduction to the LAO framework.

**Section 4** provides some background knowledge to Nigeria's current political landscape.

**Section 5** describes the structure and the makeup of the oil sector.

**Section 6** examines, at a national level, how oil has impacted rent distribution, specifically with regard to the revenue allocation system, as well as how it has affected conflict in relation to these changes. The discussion then progresses to an assessment of the economic impact of these changes.

**Section 7** zooms into the industry level and down to the organisational level as the discussion moves on to the second dimension of rent distribution; the less formal distribution of revenues, via covert patronage and corruption in the oil sector. A discussion on the economic consequences of such distribution then follows.

**Section 8** proceeds to conclude that overall, oil's impact on formal and less formal rent distribution has had a detrimental effect on the economy and therefore has contributed to Nigeria's suboptimal growth.

## **2. Resource curse mechanisms**

The literature on the natural resource curse is vast and diverse. As previously mentioned, apart from the formerly most popular idea that the resource curse arises through the Dutch disease, more possible mechanisms arose, among the most prominent of which are rent seeking, and domestic conflict and political instability. Thus, an expansion of these two notions follows below.

### **2.1 Rent seeking**

Rents are super profits at a level above that which a perfect market would produce, and Lane and Tornell (1996) present the issue of the resource curse, in relation to rent-seeking, in resource-rich economies as a problem of powerful groups being able to increase the extraction of transfers from the centre. This causes the economy to have a suboptimal growth rate, because when certain groups have the power to obtain fiscal transfers, “capital stocks are not truly private” (Lane and Tornell, 1996). Since, taxation finances these transfers, an increase in transfers to one group causes an increase in taxes for the whole economy, which, “in turn reduces the rate of return, investment and the growth rate” (Lane and Tornell, 1996). However, another path that leads from an increase in transfers to a decline in economic performance, according to Lane and Tornell (1999), is through the reallocation of capital to the informal sector where, though it cannot be taxed, it is also less productive. Hence, economic growth also declines.

Considering the fact that many developing countries that are rich in natural resources have weak institutions, which allow for the proliferation of powerful groups that strive to accumulate the nation’s resource rents through redistributive transfers, it is therefore not surprising that many of these countries have poorer economic growth rates.

However, with regard to understanding why these countries’ economic growth rates further deteriorate during resource booms, Lane and Tornell (1996) emphasise the voracity effect. This effect is, “a more than proportional increase in redistribution in

response to an increase in the raw rate of return” (Lane and Tornell, 1996). They highlight that resource windfalls typically intensify the redistributive activity in nations with three conditions. First, a weak government and weak institutions (e.g. the legal system and professional bureaucracy). Second, a prevalence of powerful rent-seeking groups (divided according to ethnicity, geographical/regional location or occupation) that are competing for rents. Third, an, “elasticity of inter-temporal substitution [that] is high enough” (Lane and Tornell, 1996).

To elaborate, the powerful groups referred to are defined as, “coalitions with power to extract transfers from the rest of society” (Lane and Tornell, 1996). They can include, among others, province-level governments that obtain allocation from the centre, powerful unions and industrial conglomerates that solicit protection, and patronage networks that acquire bribes from public works (Lane and Tornell, 1996). The competition among the groups, which is more severe in the presence of a resource windfall, usually appears as state officials lobbying for extra resources and private and public enterprises doing the same for bigger allocations. These actions result in public subsidies and other forms of transfers, such as public sector loans, construction projects and public sector wage increases growing more quickly than the rise in windfall income, when “inter-temporal elasticity of substitution is high” (Lane and Tornell, 1996). This, all in turn, lowers the effective rate of return on investment and as a consequence aggregate economic growth decreases.

Thus, although an increase in the raw rate of return, which is partially determined by the level of resource endowment and terms of trade, would be expected to be beneficial, it induces two effects; a direct positive effect and indirect negative effect, the magnitudes of which determine the overall effect. The direct effect, “increases the profitability of investment one to one”, and thus improves the growth rate, while the indirect appropriation effect causes each group to scramble to acquire a bigger share of national wealth by demanding more transfers (Lane and Tornell, 1996). In most cases, countries have multiple powerful groups that do not coordinate themselves, and a weak institutional environment that cannot countervail discretionary redistribution. Therefore,

most often, the latter effect dominates, through the voracity effect, which hence, creates an inverse relationship between the economic growth rate and the raw rate of return (Lane and Tornell, 1996).

Hodler (2006) in a slightly different light attributes the resource curse to the extent of the fractionalisation of groups engaged in the rent-seeking contest and the spill over effect it has on property rights. He puts forward the notion that the curse is related to contestation or fighting in rent seeking between rivalling groups, and argues that natural resources increase rivalry or fighting activities if there are multiple rival groups. The result is that fewer productive activities occur, and property rights become undermined. This, in turn, makes productive activities even less appealing, and thus leads to an aggregate reduction in production that exceeds the positive income effect of the windfall gains, if the number of rival groups is large enough. Hence, Hodler (2006) argues that in highly fractionalised countries i.e. countries with numerous rival groups, the curse arises. Moreover, he argues that the more fractionalised the country is, the more severe the symptoms of the curse are. In contrast, in countries with few rival groups, natural resources do not instigate fighting, and therefore, the positive effect prevails. In fact, focusing on ethnic fractionalisation, and the difference in economic experiences between the resource rich countries, Nigeria and Norway, Hodler's model predicts, "intensive fighting, weak property rights and lower per capita incomes for a such a fractionalised, oil rich country as Nigeria" (Hodler, 2006). In contrast, the ethnically homogenous country of Norway does not experience increased infighting with a windfall, according to the model, as Norway has, "neither class struggles nor other reasons for social fragmentation"(Hodler, 2006). Furthermore, based on historical evidence, Hodler (2006) concludes, that the predictions of his model are valid in the case of Nigeria and Norway.

Baland and Francois (2000) also explore the issue of rent seeking from a different angle, developing a model of rent seeking in which foregone entrepreneurship is the opportunity cost of rent seeking. Furthermore, they provide some criteria as to the conditions under which resource booms promote rent-seeking activities.

Choosing quota licenses as the form of rents to focus on, they argue that, “entrepreneurial activity, by creating new and better goods or services, destroys rents accruing to those holding licenses restricting trade in already existing goods or services” (Baland and Francois, 2000). Furthermore, they explain that, “a rent seeker holding the exclusive right to import a particular good under quota experiences a loss if domestic entrepreneurs compete to produce the same good” (Baland and Francois, 2000). Thus, unlike many other models, which only focus on how rent-seeking can crowd out entrepreneurship, in their model, entrepreneurship may also crowd out rent seeking depending on the initial makeup of the economy (Baland and Francois, 2000). In essence, the viewpoint of Baland and Francois (2000) is that the resource curse does not occur unconditionally, but that rather it results when a resource boom occurs in an economy where there is a significant amount of rent-seekers already dominating it. In such a case, the boom would pull more entrepreneurs out of entrepreneurship into rent seeking, and ultimately cause a decline in aggregate income (Baland and Francois, 2000).

The reason for this lies in the fact that entrepreneurs face a positive marginal cost of production. Thus, although both rent-seekers and entrepreneurs benefit from an increase in the size of the economy as a result of the boom, the rent seekers are able to capture their full benefits, while entrepreneurs can only partially capture the benefits that arise. The intuition behind this is that in a sector where a good is sold by rent seekers, whose rents derive from holding the right to sell the imported good, the amount sold i.e. the quota amount does not change. Therefore, the only response to a higher demand stemming from the resource boom is a higher price, which is a benefit that the rent seekers, holding import quotas, fully capture because consumers simply pay the higher price. On the other hand, entrepreneurs, who compete based on price, cannot increase their prices, and therefore react to the increased demand by increasing production. However, because producing and selling more units also causes costs to rise, they do not capture the full benefits. In fact, consumers capture some of the benefits as a result of increased supply (Baland and Francois, 2000). Thus, since returns to rent-seeking are relatively higher compared to the returns to entrepreneurship, entrepreneurs will become more inclined to partake in rent-seeking activities. This model is in line with the general

notion found in the literature on rent-seeking, that “an increase in rent-seekers thus lowers returns to both rent seeking and entrepreneurship, with possibly larger marginal effects on production” which lower economic growth (Baland and Francois, 2000).

Baland and Francois (2000) further provide some supporting evidence from the experiences of a sample of twelve countries. Although the sample is small, they argue that the experiences of Nigeria, Saudi Arabia and Trinidad indicate that oil booms led to their slower growth through increased rent seeking. Their conclusion is gathered from the fact that public consumption in GDP in these countries had increased while the share of manufacturing had decreased (Baland and Francois, 2000).

## **2.2 Domestic conflict and political instability**

Another school of thought is that the natural resources curse is caused by natural resources' impact on violent conflict and is motivated by the wide consensus that conflict is detrimental to growth and development. The pathway from conflict to the deterioration of an economy involves direct costs and indirect costs. These include a rise in the spread of diseases and mortality rates, a disruption to education, which can take decades to restore, a disruption to productivity, caused by damaged social and physical infrastructure, and the shrinkage of opportunities to trade, communication, and therefore profitability (Bannon and Collier, 2003). Hence, the investment climate becomes volatile, which increases capital flight, and lowers incomes due to the contraction of the manufacturing and tourism sectors, among other reasons, all of which hinder the growth rate (Bannon and Collier, 2003).

Collier and Hoeffler (1998) posit that war takes place when the difference between the gains from a victorious rebellion and the costs of rebellion is sufficiently large. When the incentive of a rebellion is to capture the state, then, “their capacity will be dependent upon the potential revenue of the government and hence the taxable base” (Collier and Hoeffler, 1998). Thus, this is where the natural resource sector comes in as it is part of the taxable base, and therefore affects revenues. They find that it is one the variables that

have a strong and significant influence on the probability and duration of civil wars. If the aim of rebellion is secession, on the other hand, the tax base of the state before secession does not determine the potential gains, which are dependent upon victory. However, if inhabitants of a region that is well endowed with natural resources, feel that their interests are underrepresented by the state, they may be motivated to secede, and their endowment may help put them in a well enough position to do so (Collier and Hoeffler, 1998). It is important to note, however, that it is common for rebels groups to be motivated by either or both of these objectives, meaning both potential gains may induce the same rebellion. For example, the civil war in Ethiopia consisted of the Tigrayan People's Liberation Front, and the Eritrean Liberation Front. Upon victory, the former captured the state, while the latter seceded from the state (Collier and Hoeffler, 1998).

In Collier and Hoeffler (1998) empirical analysis indicates that up to a certain level of resource abundance (a ratio of 0.27 of resource exports to GDP), natural resource endowments increase the risk and duration of war. They posit that this is due to the attraction of a lucrative resource base owing largely to resource abundance. However, at a very high level (a ratio higher than 0.27), natural resources seem to reduce the risk of war, which they interpret is due to the heightened financial capacity of the government and thus its defence capabilities, which reduce the likelihood of a victorious rebellion (Collier and Hoeffler, 1998). Furthermore, examining Africa, as a continent, Collier and Hoeffler (1998) find that on average it has a very low income and a resource abundance ratio of 0.17. Thus, Africa falls into the range in which natural resources have a negative influence, which explains why many African countries exhibit the resource curse.

Brunnschweiler and Bulte (2009) however, refute the above findings and argue that Collier and Hoeffler's results are flawed due to their use of a resource exports to GDP ratio, as a proxy for resource abundance when the ratio, in truth, measures resource dependence, which is endogenous with regards to conflict. Based on the use of a model, which instrumented for dependence, Brunnschweiler and Bulte (2009) instead argue that conflict increases a country's dependence on the extraction of resources. They explain

that this relationship can arise when investments in the non-natural resource sectors, such as manufacturing (which only thrives in stable politico-economic conditions), decline due to past, current or expected future conflict. In such a country, in response to the conflict, the economy's dependence on the resource sector would rise. This would likely be because the resource sector is less sensitive to tensions or violent conflicts that occur in the realm of other sectors of the country, since there are few linkages between the resource sector and the rest of the economy.

Furthermore, by using a stock variable that captures the discounted value of future resource rents, as a proxy for resource abundance, Brunnschweiler and Bulte's results indicate a significant and negative relationship between resource abundance and the outbreak of war. They posit that this negative relationship is most likely the outcome of a positive income effect, which, possibly through the sale of resources or an increase in access to credit (using the resources as collateral), provides governments with the means to, "invest or provide certain public goods that raise income" and deter conflict (Brunnschweiler and Bulte, 2009).

### **2.3 Discussion**

However, as mentioned before, over the years, there are several other notions that have been put forward as the cause of the inverse relationship between natural resource abundance and growth. Although the scope of this paper won't allow for the analysis of all of them in the context of Nigeria, it is noteworthy to mention that debt overhang and human capital are two other notions that may have some relevance to the Nigerian context as contributors to its economic performance, given that Nigeria once reached an economic state so dire that it was awarded debt relief, and it still suffers from low adult literacy rates today, which points to low human capital.

To briefly elaborate on the former, in Manzano and Rigobón (2007) it is argued that the resource curse is a flawed generalisation about countries that have abundant natural resources. Firstly, in contrast to much of the literature spurred by Sachs and Warner's analysis, which groups agriculture, minerals and fuels under one category as the natural

resources correlated with lower growth, Manzano and Rigobón find that after dividing resource exports into different categories, the supposed resource curse effect is only through non-agricultural exports, and mainly through minerals (Manzano and Rigobón, 2007). Secondly, they attribute the alleged inverse relationship to the issue of high indebtedness caused by credit constraints, rather than natural resources, per se (Manzano and Rigobón, 2007).

Their analysis finds that when a credit constraint variable is incorporated into the growth model, it appears as strongly significant and causes the non-agricultural resource abundance variable to become insignificant (Manzano and Rigobón, 2007). In essence, Manzano and Rigobón suggest that the unobserved culprit of resource rich countries' underperformance is linked to credit constraints. This is supported by a pattern which emerges from the data, according to which, "many of the countries with strongly negative growth and high resource abundance...also showed large increases in their debt-to-GDP ratio from 1975-85" (Manzano and Rigobón, 2007). This issue arose because between 1970 and 1980 commodities, such as oil, copper, coal and iron experienced a boom, increasing their prices dramatically, which prompted resource rich countries to use their resources as collateral for their investment projects. However, when these commodity prices plummeted during the 80s, the decline, "left many high-borrowing commodity-rich countries with unsustainable balance-of-payments and debt crises" as they could no longer borrow more money with their resources as collateral (Manzano and Rigobón, 2007). As a result, "devaluations and other contractionary measures" which were taken in an attempt to repay the debts and balance the current accounts, led to a slowdown of economic growth (Manzano and Rigobón, 2007). This notion is further supported by the fact, "that resources were positively associated with growth until the post-war period when Latin America, the region hardest hit by the debt crisis, drove a reversal sign" (Manzano and Rigobón, 2007). Thus, Manzano and Rigobón conclude that, "credit market imperfections- rather than problems associated with the presence of natural resources-are reasons for bad performance" (Manzano and Rigobón, 2007).

Regarding the latter explanation, relating to the level of human capital, Bravo-Ortega and Gregorio, "emphasise the interaction between natural resources and human capital and

their effects on levels of income and rates of economic growth” (Bravo-Ortega and Gregorio, 2007).

Considering the varying experiences of Scandinavian countries versus Latin American countries, they draw attention to the fact that, “during the late 19<sup>th</sup> and early 20<sup>th</sup> centuries, both groups of countries enjoyed similar levels of GDP per capita and...both were primarily exporters of natural resources” (Bravo-Ortega and Gregorio, 2007). However, by 1990, there was a significant divergence in their income levels. They further note that it is challenging to explain the faster growth performance of the Scandinavian resource rich countries compared to the generally poor performance of the Latin American resource rich countries, “without highlighting the educational gap that emerged between the two groups of countries over the period 1870-1910, and which remained large throughout the 20th century” (Bravo-Ortega and Gregorio, 2007).

Thus, the results of their investigation into the influence of human capital, reveal that, “when interactions with human capital are ignored, an increased abundance of natural resources reduces the rate of growth but increases income” (Bravo-Ortega and Gregorio, 2007). However, when an interaction variable between human capital and natural resources is added to regression analysis, “for levels of human capital over a very low threshold, the rate of growth also increases with the abundance of natural resources” (Bravo-Ortega and Gregorio, 2007). That is to say that, “human capital always offsets the negative effects of natural resources on economic growth, and this offsetting effect is increasing in the level of human capital” (Bravo-Ortega and Gregorio, 2007).

The intuition behind the effect that their model predicts is that the natural resources sector draws resources away from other economic sectors, such as the industrial sector, that would generate further economic growth through higher spillover effects into the rest of the economy and their ability, “to add human capital indefinitely” (Bravo-Ortega and Gregorio, 2007). However, the more developed a country becomes, its increased accumulation of human capital eliminates this effect. This is because, as with the Scandinavian countries, “a well educated labour-force...can [assist] in sectoral

restructuring as new industries [develop] in the process of natural resource exploitation”, as well as increase the country’s capacity, “to create and use innovations that would raise the productivity of the natural resources” (Bravo-Ortega and Gregorio, 2007). Hence, the negative impact of natural resources can be outweighed by an accumulation of human capital that is sufficiently high (Bravo-Ortega and Gregorio, 2007).

In general, several issues plague the literature both in terms of methods used for empirical analysis and assumptions used for models. Thus, there are many theories, and many of these theories are contested in some way or form. As touched on before, one of the most significant weaknesses relating to the empirical analysis of the resource curse has been the widespread use of the ratio of resource exports (agriculture, minerals and fuels) to GDP in cross-section analysis. The first issue concerns the statistical issues related to cross-section analysis, which comes with the risk of biased results due to unobserved country specific variables and endogeneity, (the latter of which, in this case, is caused by the use of total GDP, which includes the resource sector) in the ratio (Manzano and Rigobón, 2007). The second, is linked to the claim that the ratio is a measure of resource abundance; a practice that is common and almost standard in the literature. This claim has come to be criticised, as the ratio, is in fact, more of a proxy for resource dependence and furthermore, its value can be misleading as some countries, such as Singapore, re-export a substantial amount of their raw materials (Lederman and Maloney, 2007).

Nonetheless, regardless of whether this ratio is regarded as a proxy for resource abundance or dependence, it has essentially been accepted as a stylised fact that it is negatively correlated with growth (Lederman and Maloney, 2007). However, Lederman and Maloney (2007), challenge this longstanding assumption by revealing that this negative correlation fails to withstand changes in estimation techniques, small changes in sample, and different measures of resource abundance. They find that once various conditioning variables related to the accumulation of capital (both human and physical), terms of trade and macro stability are introduced; the effect of resource abundance on growth is changed. What they find instead, in cross section analysis, is that the resource exports/gdp ratio is shown to have no impact on growth. In a similar vein, when using

panel data analysis, the correlation is completely reversed, as the ratio in fact, appears to affect growth positively and significantly. Thus, based on their results they conclude that there is no resource curse (Lederman and Maloney, 2007).

Overall, though the literature is vast and diverse, it is not completely conclusive. Since countries differ in many respects, it seems more reasonable to accept that natural resources can have a positive or negative effect, depending on the country. Furthermore, for those countries that do seem to experience the resource curse, it is more likely due to a combination of reasons, rather than just one, and these combinations are most likely to vary across countries.

Finally, concerning the aims of this paper, and the fact that Nigeria seems to be plagued by the resource curse, it is precisely the abovementioned weaknesses of empirical analysis that provide further justification for the use of a qualitative case study approach. Moreover, cross-country empirical analyses generally only offer hypothetical explanations for an “average” country. Therefore, insights into the crucial dynamics of specific countries are usually left undetermined. Thus, a case study approach for Nigeria provides an opportunity to explore the underlying dynamics of the resource curse and further refine some stylised facts found in empirical research.

### **3. Introduction to the LAO framework**

This framework stems from an appreciation of the fact that all societies deal with the inherent problem of violence as individuals and organisations (groups of individuals which share similar objectives), actively utilise or threaten to adopt the use of violence to acquire wealth and resources (North et al., 2013). The use of this framework requires highlighting that over the course of human history, there have been three social orders which are, “ways of organising societies that are self-sustaining and internally consistent” that have handled the issue of violence in different ways (North et al., 2007). Hence, the problem of creating an incentive that would encourage individuals to refrain from violence drives the entire framework (North et al., 2007).

### *The 3 social orders*

The first social order characterised pre-recorded human history and is called the primitive social order, which comprised of hunter-gatherer societies. Comparatively, such societies were extremely violent (North et al., 2006).

The second social order that arose was the limited access order (LAO), which has dominated the past 10 000 years. Limited access order states can also be thought of as natural states because this social order seems to be the natural way that societies address the issue of violence (North et al., 2007). This social order solves the problem of violence by reducing and containing it using, “political manipulation of the economic system to generate rents by limiting entry to provide social stability and order” (North et al., 2006).

To elaborate, envision a society composed of numerous small self-organising groups. Members of each group trust others within their own group based on personal relationships, but distrust members of groups outside their own with which they have no such relations. Thus, to avoid continuous violent conflict, leaders of the self-organising groups, “agree to divide land, labour, capital and opportunities” among themselves and “agree to enforce each leader’s privileged access to their resources” (North et al., 2013). This coalition between the leaders is called the dominant coalition (North et al., 2013). Within their own groups, each leader then provides limited access to economic and political resources and activities in order to generate rents. This usually involves the leaders limiting access to trade, education, religion and warfare. However, it also involves them limiting access to forms of social organisation, and most importantly, to contract enforcement and property rights (North et al., 2007). Access to these is made available only to, “individuals and groups with sufficient access to violence that can, if they act unilaterally, create disorder” (North et al., 2007). These groups are known as elites, each of which is granted exclusive control over specific resources or activities, and who thereby enjoy the benefits of special privileges and the associated rents (North et al., 2006). Hence, the internal structure of the dominant coalition is composed of elites. Since violence would reduce these rents, the existence of rents allows credible commitments to be made among powerful elite groups within and between each leader’s group to

recognise and respect each other's rights to specific resources/activities (North et al., 2006). The commitments are deemed credible because the elites have an incentive to refrain from the use violence and instead to cooperate and support the dominant coalition (North et al., 2007). Thus, each leader manages to enforce the other leaders' privileged access to their agreed upon resources, and peace ensues.

Finally, a third social order arose during the last 300 years called the open access order (OAO). In this social order, competition in the political and the economic spheres, open access to organisations in these spheres, and the freedom to form such organisations, as well as institutions such as the rule of law, are used to sustain order and peace (North et al., 2007). This is achieved by having the state possess a monopoly over all organisations that exhibit a legitimate threat of violence, which thus, reduces the use of violence during competition in the political and economic spheres (North et al., 2006). The state also provides incentives for political officials to abide by constitutional rules (North et al., 2007). Consequently, opposing groups are left to compete on the basis of other factors such as price, quality or votes for example" (North et al., 2006).

Unlike in the case of LAOs, the stability of an OAO social order relies on competition as opposed to the creation of rents (North et al., 2006). In essence, LAOs, systematically create rents and differences between elites and non-elites, which therefore suppress sustainable development, while OAOs systematically create competition through entry and mobility, which cultivate long-term development (North et al., 2006).

With regards to growth, LAOs' economic performance is poorer than OAOs' essentially because economic exchange in LAOs is based on personal relationships. This means that recurrent interactions are required for exchange to take place, which therefore limits, "the range of exchanges of any one individual" (North et al., 2006). In turn, this limits productivity and thus, growth. Furthermore, because the dominant coalition's survival does not depend on non-elites, non-elites are not a credible threat to the state. For this reason, non-elites cannot rationally believe that their property rights will be protected even if the state makes such a promise. As a result, their investments in physical and

human capital are substantially lower than if their property rights were credible, and thus, their suboptimal investment places a limit on growth as well (North et al., 2006). The differences in growth performances also lie in how rents are created. In LAOs rents are created by reducing competition through limits to entry, to organisational forms and resources. On the other hand, in OAOs, Schumpeterian rents are created via technological and institutional innovations in a cycle of creative destruction (North et al., 2006). The cycle of creative destruction refers to the cycle in which entrepreneurs identify new ways of creating rents and form organisations to capture those rents (North et al., 2006). However, these rents are eroded over time as new firms enter and compete by implementing the same innovations. This then drives entrepreneurs to come up with even newer innovations, and thus this pushes the markets to more efficient outcomes. Essentially, in the long run in an OAO, competition becomes based less on price and more on innovative processes and products (North et al., 2006). Economic growth is constricted in LAOs by the fact that innovation is a driver of growth, and LAOs do not induce innovation.

Much of the policy advice from the World Bank and donor countries to developing countries have failed to produce the intended results because development tools based on the experiences of developed OAO countries are not appropriate in developing LAO countries where the social dynamics are different (North et al., 2007). Moreover, this framework acknowledges that there are two problems of development. The first problem consists of trying to raise GDP per capita, as an LAO, from approximately \$400-\$8 000 while the second problem consists of trying to kick-start the transition from an LAO to an OAO and increasing per capita income from roughly \$8 000 to \$35 000 (North et al., 2007). Hence, there is often a, “mismatch between the development problems they seek to address and the available tools”(Alapiki, 2005). In fact, quite often, the policies are actually in conflict with the social logic that preserves order and stability (North et al., 2007).

An appreciation of the extent of the mismatch is amplified when one considers the fact that though almost all developing countries, including Nigeria, are LAOs, even within

that category; countries showcase immense variations. This is because the LAO social order, “is a general strategy for organising society, not a specific set of political, economic, or religious institutions” (North et al., 2007). Their forms can range from authoritarian regimes to ones which hold elections, and can include failed states, such as the Central African Republic, as well as states with long-term stability such as Mexico (North et al., 2007). These disparities are due to differences in how they structure organisations in their economic, political, military and religious systems that make up social orders (North et al., 2006). In fact, LAOs can be roughly subdivided into three further categories along a spectrum; fragile, basic and mature LAOs. Progress along the spectrum from a fragile to a mature LAO, moves a state from being less developed to more developed, however, this advancement is not a guarantee, as it is common for LAOs to stagnate or regress in the opposite direction (North et al., 2007).

### ***The LAO spectrum***

In fragile LAOs, “the state can barely sustain itself in the face of internal and external violence” (North et al., 2007). In such LAOs, “each faction of the dominant coalition has direct access to violence” and the distribution of rents are in line with the level of military power of each faction (North et al., 2007). If a misalignment occurs between the distribution of rents and the potential of violence of these factions, factions demand more, or violence erupts as they battle each other for more.

On the other hand, Basic LAO states are well established with a stable organisational structure. However, “the only durable organisation is the state itself, and the elite rights and privileges are closely identified with it” (North et al., 2007). They also have a greater capability of reducing violent conflicts. This is because, firstly, not every member of the elite specialises in violence, though each member does have links to such individuals. Secondly, basic LAOs are mainly composed of public law institutions, which structure the state’s internal affairs, and its relations with the dominant coalition members. Thirdly, basic LAOs’ public institutions may also include those which resolve disputes within the dominant coalition and those that support the succession of leaders and elites; both of which are processes that could result in violence (North et al., 2007).

Lastly, mature LAO governments have durable institutional structures that can usually withstand changes in the composition and structure of the dominant coalition, and that support a wide range of organisations that are external to the government. However, the requirement of these organisations to be sanctioned by the state is the process through which the state maintains a limit on competition so that rent creation is sustained. Mature LAOs also have a body of public law, “which delineates the state’s offices and functions, and the relationship between the two, as well as provides for conflict resolution procedures (North et al., 2007). This public law is also, “embodied in a state organisation, such as a court or bureaucracy, that is capable of articulating and enforcing the public law” (North et al., 2007). Since this essentially provides for elite private organisations to punish the government if it violates a commitment, the government can make more credible commitments to, “a wider range of policies and institutions” (North et al., 2007).

Overall, the progression along the spectrum from a fragile to a mature LAO involves the state and economy experiencing increased levels of specialisation, division of labour, exchange, investment and economic growth. The level of an LAO’s capabilities in supporting the cooperation of groups of individuals with a common goal, which make up complex, sophisticated organisations is crucial to economic growth performance. Hence, as these abilities improve along the spectrum, so does economic growth (North et al., 2006). The progression also involves an increase in resilience against shocks. Nevertheless, as LAOs, it is always possible that such states will succumb to violence, though such outbreaks become more intermittent as progress is made along the spectrum (North et al., 2007).

### ***Analysing the resource curse through the LAO framework***

Thus, through the lens of this framework, in relation to the resource curse, this paper analyses how the resource curse has worked through rent-seeking and domestic conflict and political instability in Nigeria’s LAO setting, and how this has resulted in a poorer economic growth performance. This analysis essentially involves identifying the contending groups in Nigeria’s political landscape and deciphering how the distribution of Nigeria’s rents; most importantly oil rents, among their elites, has succeeded or failed at maintaining stability in the country, which thereby affects its economic performance.

## **4. Nigeria's political landscape and its background**

From the late colonial years to the postcolonial era, elites in Nigeria have struggled to come to an agreement about the distribution of power and rents. Particularly in the postcolonial era, this mainly involved a continuous wrestle for power across three dimensions: political, fiscal and territorial (Orji, 2008). This manifested in regular alterations being made to the corresponding arrangements; the distribution of government offices, the revenue allocation system and the creation of states, respectively (Orji, 2008). This struggle was exasperated by the extremely high stakes at hand; namely, the opportunity to control the massive oil rents, which would be at the disposal of the ruling elites. Thus, to this day a sustainable resolution is yet to be established.

### **4.1 Introduction to Nigerian elites**

To begin to understand Nigeria's current political landscape, a brief introduction to the main elite groups competing in present-day Nigeria's political arena is warranted. According to Dogan and Hidley (1998) elites are, "holders of strategic positions in powerful organisations and movements, including dissident ones who are able to affect national political outcomes regularly and significantly" (Dogan and Higley, 1998). Among these, are political elites, which are of particular importance, for the purpose of this paper. Political elites, "participate in or directly influence national political decision-making" and they are generally, "politicians who have a privileged access to the state" (Orji, 2008). However, at times they can also include, "traditional rulers, senior military officers, administrators, professionals, academics, and businessmen" (Orji, 2008).

At the most relevant disaggregated level, the main elite groups in competition in Nigeria include five ethno-regional elites. These are the North elites, the Yoruba elites, the Igbo elites, the Middle Belt elites and the Niger Delta elites (Orji, 2008).

The North elite group arose in the former Northern region of Nigeria and is composed of the aristocratic and ruling elites of the Hausa, Fulani, Kanuri and Nupe ethnic groups. The foundation of their cohesion is having Islam as a common religion (Orji, 2008).

The Yoruba elite group inhabits the territory previously known as the Western region and it is composed of various and quite distinct sub-ethnic groups such as the Oyo, Ife, Ekiti, Ondo, Ijesha and Ketu. Through their access to education during the colonial times, they produced most of the educated elite in Nigeria (Orji, 2008).

The Igbo elite formed out of the majority ethnic group, the Igbo, in the Eastern region. Similar to the Yorubas, they were created out of their exposure to Western education, as well as urban migration, and their cohesion was based on their existing kinship solidarity (Orji, 2008).

The Middle Belt Elite was formed out of the mobilisation of minority groups, in the North central area of Nigeria, across several ethnic and linguistic lines, in resistance against the Muslim Hausa-Fulani's domination over them (Orji, 2008).

The Niger Delta elite group arose from six South-South states: Akwa-Ibom, Bayelsa, Cross-River, Delta, Edo and Rivers. Although it is composed of multiple ethnicities and cultures, its formation was based on the common historical experiences of its members, such as their resistance against domination and marginalisation by the colonialists, and later the Igbo and Yoruba elites, as well as the postcolonial Nigerian state (Orji, 2008).

### ***Elite coalitions***

There are times when these different elite groups form coalitions with each other in pursuit of a common interest. Furthermore, the alliances that the different elite groups form, and the identities their members ascribe to, depend on the issue at hand.

There are two main alliance formations that have been prominent throughout Nigeria's political history. The first is one which occurs in such a way that a North-South

dichotomy arises. This involves an alliance of the North and the Middle Belt elites to form a Northern opposition to the Yoruba and Igbo coalition, which make up the Southern opposition. This form of identity arises mainly in the arena of the distribution of public office (Orji, 2008).

The second alliance formation that also commonly materialises pits the majority ethnic elites against the minority ethnic elites. Orji (2008) prefers to refer to this as a “dominant vs. marginal” elite battle, due to the fact the minority elites are usually in the position of inferiority in both numerical terms as well as socio-political terms (Orji, 2008). In this battle, the dominant elites consist of the North, Yoruba and Igbo elites coming together as a front against the marginal elites, which consist of the Middle Belt and the Niger Delta elites. This frictional relationship between the dominant and marginalised elites, usually plays out during debates over power sharing in the fiscal and territorial dimensions (Orji, 2008).

### ***Military elite***

Since the military elite held power for most of Nigeria’s history prior to 1999, and many of its former members still continue to exert political influence as civilian political elites today, some explanation of the politics of this elite group is also warranted.

### ***Military elite formation***

A colonialist, John Glover, initiated the formation of the Nigerian military in 1862 when he created the Glover Hausas, Nigeria’s first military entity, composed of eighteen northerners, to defend Lagos in the south. Followed by the establishment of two other military entities; the Royal Niger Company Constabulary in 1888 and the Oil Rivers Irregulars, composed mainly of Igbos in 1891, the collective unit of these three entities was termed the West African Frontier in 1914. This unit proceeded to undergo two name changes before it became the Royal Nigerian Army in 1960 (Dummar, 1989).

### *Military elite composition*

The initial recruitment of the Glover Hausas, which was demographically biased in favour of northerners, led to Hausa arising as the command language until the 1950s. Hence, this was the inception of the long lasting ethnic imbalance in the military, which exists to this day (Dummar, 1989). Furthermore by 1960, the northern elite was demanding a 50% representation in the officer corps, to mirror the relative size of its region, which was twice that of the two southern regions combined. However, today the provisioning of recruitment is such that each state gets an equal quota. Although it is not surprising that the proposition of the northern elites in 1960 flared ethnic tension within the military, because it would mean that the position of officer would be linked to ethnic origins, the latter recruitment formula based on equality of states also fuelled such tensions. This is because some ethnic groups are geographically spread across several states. Thus, more officers from these ethnic groups are recruited in comparison to other ethnic groups that only inhabit one state. In fact, the Northern elite to this day is still the dominant elite in the military (Ikpe, 2000).

### *Military inter-elite factions*

Factions within the military fall into two main dimensions. The first dimension relates to rivalry along the lines of northern vs. southern. This stems from the resentment among southern elites over the fact that, due to ethnicity-induced patronage, the office of Army Chief of Staff has been dominated by Northerners, and rarely ever been filled by a Southerner (Ikpe, 2000). The second dimension relates to rivalry based on personalities, along the lines of political rent seekers vs. professional army men (Dummar, 1989).

## **4.2 Development of political tensions**

To further understand the politics in Nigeria today, a delineation of the background to Nigeria's current political climate is required. This calls for a discussion on the amalgamation of the Nigerian territory, the emergence of the aforementioned elite groups due to the organisation of subnational territories within a national context, and the subsequent tensions and elite battles during the late colonial and early postcolonial years.

The formation of present-day Nigeria was initiated when the British government colonised Lagos in 1861, some parts of present-day Nigeria's southern areas in 1885, and some of present-day Nigeria's northern territories in 1896. This was followed by Southern Nigeria and Lagos merging to become one administrative entity in 1906, and finally Northern Nigeria and Southern Nigeria merging in 1914 to form a unitary state, making up the Nigerian territory of today (Uche and Uche, 2004).

It is important to note that the various areas, which came under British rule and which were eventually merged to form the state known as Nigeria today, had and still have extreme diversities between them. For instance, it is estimated that there are approximately 250 ethnolinguistic groups across the Nigerian territory. Furthermore, within the Nigerian territory there exist over 374 ethnic groups that differ quite substantially, with regard to their culture, religions, customs and traditional systems of social rule. In fact, many of these ethnic groups lived separately both politically and geographically before colonisation ("The Nigerian Political...", 2015). For example, regarding traditional political systems, generally in the Northern areas, power was concentrated in the hands of an Emir, which was the main authority, who ruled autocratically as an absolute monarch. On the other hand, in the Southern areas, power was more decentralised, with a constitutional monarchy form of rule in the more western southern areas and a democratic form of rule in the more eastern southern areas ("Pre-colonial traditional...", 2013). It is also noteworthy, that during this pre-colonial era, the elites of the Nigerian territories were, "traditional rulers, princes and chiefs, wealthy long distance traders and priests" (Bariledum and Serebe, 2013).

Due to these differences in traditional political systems, when the British colonised these territories, the North and South were ruled differently. Because the North had an Emir as the main authority, the colonial government ruled via indirect rule, using the Emir to carry out administration and governance through the centralised political structures that already existed before in the pre-colonial era (Omeje, 2006). However, due to the fact that the South, on the other hand, was less centralised and more diffused, the colonial authorities governed via direct rule using more authoritarian administrative methods

(Amuwo et al., 1998). This form of British governance; ruling the North and South as two distinct administrative entities, continued even after the amalgamation took place, meaning Nigeria was essentially only a unitary state on paper (Amuwo et al., 1998).

It is also worth noting that the amalgamation of Northern and Southern Nigeria to form a unitary state, in 1914, was orchestrated not as a result of the desire of local politicians in the respective regions, but for the administrative convenience of the colonial powers. Since Southern Nigeria, which at that point included Lagos, had greater economic wealth than Northern Nigeria, which was essentially funded by British taxpayers as it, “relied heavily on grants from the Imperial Government to function” the colonial government unified the two territories. This was in order to support Northern Nigeria with the surpluses of Southern Nigeria, thereby relieving British taxpayers of their burden (Uche and Uche, 2004).

On the whole, although the amalgamation of Northern and Southern Nigeria may have been reasonably justifiable, economically, for the British, it was not necessarily culturally practical, given the diversities mentioned above.

Furthermore, due to the differences in political rule, the interference of the British in the North varied from that in the South. This was most glaring in the sphere of religion, as missionary activities were prohibited in the North, but not the South. This resulted in the North, being left largely uninfluenced by Western culture, remaining predominantly Muslim, and unexposed to Western education (Omeje, 2006). However, with no restrictions on interference in the South, missionaries spread Christianity across the South and many in the South became exposed to western education. Thus, during the colonial era, a new elite class started to emerge in the South, which consisted of westernised Nigerians who had received western education (Amuwo et al., 1998).

Then, when Southern Nigeria was split along the Niger, in 1939, Nigeria was divided into three regions that were administered separately: North, East and West Nigeria. Each of these regions was dominated by an ethnic group: the Hausa/Fulani, Igbos and Yoruba,

respectively. Thus, three of the five main contending elite groups in the political arena of Nigeria today rose to prominence. These included the North elites, the Igbo elites and the Yoruba elites, and they each lived amongst a variety of ethnic minority groups, “that lived under perpetual fear and threats of domination by the majority groups” (Omeje, 2006). Some of these minority groups included the Niger Delta groups, who had become split between the East and West regions. Thus, the Niger Delta elite group, which had previously emerged due to mobilisation against the colonialists, resurged in its resistance against domination by the Igbo and Yoruba elites (Orji, 2008).

Years later, in 1953, Northern Nigeria representatives opposed a motion for independence that was moved by a Southern political leader. Three aspects of the situation at the time motivated this opposition. First, more people in Southern Nigeria had received Western education than in the North. Second, and as a result of the first, the South had a significant representation in the National Legislative Assembly and was more advanced politically than their Northern counterparts (Suberu et al, 2000). Third, Southern Nigeria was more economically prosperous than Northern Nigeria (Omeje, 2006). Thus, the Northern representatives opposed the push towards independence out of fear that due to their backwardness in the above-mentioned respects as well as their, “negligible representation in the bureaucracy” independence at that point would result in the South assuming power, to the detriment of the North’s interests. Hence, out of, “fear of Southern domination in a self-governing Nigeria” (Omeje, 2006, Amuwo et al., 1998). Northerners pushed to delay independence until their position had improved (Anele, 2013).

This opposition resulted in a political crisis, as riots took place, and the dissolution of the Nigeria state nearly occurred. In essence, the previous decades of separate and detached political development between the two parts of the country had formed a deep cleavage and lack of understanding between their inhabitants, which led to differences in their political viewpoints, mutual disdain and mutual suspicion (Amuwo et al., 1998).

Thus, to dissolve the political crisis, the creation of a federal constitution was initiated and the following year, the Lyttleton Constitution of 1954 was introduced, which officially made Nigeria a federation (Amuwo et al., 1998). Federalism describes a, “system of government where there is constitutional division of powers between two or more levels of government” (Ebienfa and Kumokuo, 2012). Hence, the different regions were given the authority to make laws for themselves and deal with matters that were not exclusively the responsibility of the legislative branch. This move, which allowed regions to have greater autonomy regarding their governance and fiscal management, seemed imperative for the stability of the nation (Uche and Uche, 2004).

The Lyttleton constitution also provided the North with the bulk of the seats available in the federal legislature by assigning 52% of them to the North (Anele, 2013). This assignment was a result of the British repealing the principle of North-South parity used in the formula for the allocation of seats in parliament and, in its place applying a population weighted principle (Nwozor, 2014).

Also during this period of decolonisation in the 1950s, a ‘Northernisation’ policy started being carried out in the North by new Muslim elites who aimed to create a, “United North as a powerful political block in the new political entity of Nigeria” (Suleiman, 2012). These elites set out to do this by, “exploiting religious symbolism and sentiments to promote their political interests” and painting Southerners as Christians who should be equated to infidels. They thereby encouraged, Muslims, which make up the majority of the Northern population, not to associate with such “unbelievers” (Amuwo et al., 1998). One of the main features of this policy was the replacement of Southerners holding civil service posts in the North, with Northerners that were members or supporters of the North’s leading political party, the Northern People’s Congress (NPC), which was dominated by the Hausa-Fulani. To gain the support of Non-Muslim Northerners, the elites also employed the slogan of “One North, One people” (Amuwo et al., 1998). However, the Middle Belt Northerners benefitted little from the “Northernisation” policy and in fact were discriminated against in the choice of replacements. In most cases, replacement positions were given to those from the Upper North region, affiliated with

the NPC, as opposed to those in the Lower North region i.e. the Middle Belt, and in fact, the highest civil servant positions were given to descendants of previous Emirs (Amuwo et al., 1998). Thus, the push towards “Northernisation” was perceived by the Non-Muslims in the Middle-Belt as the Hausa-Fulani political elites’ disguised mission to dominate them and impose Islamic rule over them and eventually the whole of Nigeria (Suleiman, 2012). Thus, the Middle Belt elites emerged and they have since fought to forge out their own space as legitimate contenders in the political arena.

Nonetheless, immediately prior to independence, the nationalist movement against the colonialists was an alliance between the North (Hausa-Fulani) elite, the Yoruba elite and the Igbo elites. However this alliance was fragile and by the time independence was gained in 1960, the nationalist movement had dissipated in terms of its unity due to tensions over ethnic agendas and loyalties. The push for independence had instead been reduced to a loosely ‘unified front’ of the northern, eastern and western elites, against a common enemy, which was the colonial government. However, as soon as the British were pushed out, this unity disintegrated as each leading nationalist, from the regions’ respective political parties (formed along ethnic lines), wanted to achieve power using the people of his ethnicity as a power base (Bariledum and Serebe, 2013).

This fallout among the ethno regional factions at independence also points to the categorisation of the political elites at that time as being “fundamentally disunited” (Dogan and Higley, 1998). This is a term that describes a variant of political elite groups in which distrust is rife between subgroups (i.e. the North, West and East elites), and the goal of gaining political power is viewed as a winner takes all game (Dogan and Higley, 1998). This leads to discord over the value of political institutions, and engagement in unfettered and regularly violent struggles for political power (Dogan and Higley, 1998). This is indeed descriptive of Nigeria’s political history, which has been bedevilled by regular bouts of conflict in the form of coups and a civil war, especially under military rule.

Ultimately, due to the North's majority representation in the legislature and the delayed independence date, which gave the North some time to build up an educated class, the North was put in a prime position to successfully snag political power at independence in 1960, which it did.

However, at independence in 1960, the North's power was not as head of state, but through its majority representation in the federal parliament. This was the case because at independence, none of the political parties in the race for the presidency had succeeded in winning majority votes. These parties included the Northern People's Congress (NPC) of the North, the National Council of Nigeria and the Cameroon (NCNC) of the East, and the Action Group (AG) of the West. Thus, a coalition government was formed out of the joining of NCNC and NPC members, with Nnamdi Azikiwe (Igbo) as the Governor-General and Abubaka Tafawa Balewa (Hausa) as Prime Minister. This government ruled until the first republic began in 1963, upon the election of Nnamdi Azikiwe as president, and Balewa, as prime minister, just as before ("Political history of...", n.d.).

During this first republic, friction between Azikiwe and Balewa mounted. This was because, despite a southerner being president, the northern-dominated federal government had the power to focus on issues of the North, and neglect the needs of the South. Hence, in this sense, the North continued to hold power from the date of independence ("The Nigerian political...", 2015).

Moreover, after the first republic the North held onto power as head of state and ruled via military autocrats and democrats until 1999 except for the periods between January-July 1966; 1976-1979, and August-November 1993 (Nwozor, 2014). In other words, the Northern elite replaced the withdrawing British colonialists as the dominant elites and ruled for 40 out of Nigeria's 53 years as an independent state (Nwozor, 2014).

Thus, as the culmination of all the issues and resultant tensions discussed above, Nigeria's post independence political history has been marred by interethnic rivalry and a vicious cycle of instability (Omeje, 2006).

## **5. The Oil Sector**

### **5.1 Industry Structure**

In terms of the structure of the industry, it can be divided into three broad sectors; the upstream, downstream and services sector. The upstream sector is highly significant in that it contributes over 90% to Nigeria's exports and approximately 70% of the Federal government's revenues. Activities that fall into this sector include the exploration and production of crude oil and gas, and income made by companies taking part in these activities is subject to Petroleum Profits Tax. The downstream sector is mainly characterised by the refining of crude oil and the distribution and marketing of petroleum products. The oil services sector is made of services that support the activities of the other sectors. Some of these include exploration and production support services, drilling services, refinery maintenance, banking services and even catering services, among others (KPMG, 2014).

#### ***Governing bodies***

There are essentially three main public bodies that govern the oil sector in Nigeria. These include the Nigerian National Petroleum Corporation (NNPC), which is the main government actor in this sector, the Ministry of Petroleum Resources, (formerly known as the Ministry of Energy) and the Department of Petroleum (Gillies, 2009).

The Federal Government of Nigeria participates in the industry via NNPC, which is a statutory corporation. NNPC's chief role is that of manager and regulator of the sector, via its subsidiary, the National Petroleum Investment Management Services, while its secondary role is that of one of the most important oil companies in this sector, with responsibilities in the upstream and downstream sectors (KPMG, 2014). These secondary responsibilities involve NNPC being an operator and service provider in the upstream and downstream sectors, as well as being a buyer and seller of crude oil and refined petroleum products (Thurber et al., 2010).

The Ministry of Petroleum Resources handles policy formulation, and manages all the sectors including the upstream, downstream and oil services sector, by directing agencies in their exploration and production activities (KPMG, 2014).

The role of the Department of Petroleum Resources is to ensure compliance with the rules that pertain to the award of oil licenses to companies that are involved in petroleum operations (KPMG, 2014).

Thus, the oil sector is essentially run by the heads of NNPC, the president (through his position as the minister) and his top advisors, who make up, “the inner circle of oil sector decision making” as well as the director of the Department of Petroleum Resources (Gillies, 2009).

### ***Operation licences***

There are three types of licenses that permit companies to operate in the upstream sector. These include the Oil Exploration License, the Oil Prospecting License and the Oil Mining License (Lawal, 2013). An Oil Exploration License permits a company to explore for oil, without granting it exclusive access to the area it is permitted to explore. An Oil Prospecting License awards the license holder with the exclusive right to explore for oil, carry it away and dispose of if the oil is discovered within the licensee’s operating area, which cannot exceed 2590 km<sup>2</sup> (Lawal, 2013). However, the holder of an Oil Prospecting License can only carry away and dispose of petroleum that it has discovered and won after meeting certain requirements. An Oil Mining License is conferred to a holder of an Oil Prospecting License that has fulfilled those conditions, which include a daily production rate of 10 000 barrels or more. This Oil Mining License grants exclusive rights to the holder to explore for, carry away and dispose of petroleum that it has discovered and won across an area of 1295km<sup>2</sup> (Lawal, 2013).

### *Operation arrangements*

Furthermore, there are several arrangements under which a company can operate in the upstream sector. This can be under a Joint Venture, Production Sharing Contract, Service Contract or Marginal Field Concession.

In a Joint Venture agreement, which is the standard arrangement between NNPC and international oil companies (IOCs), both parties jointly hold the concession, and each party's contribution towards operation costs and allocation of oil produced, matches their equity share in the Joint Venture (KPMG, 2014). Six Joint Venture companies account for approximately 62% of the oil produced in Nigeria. These include Mobil, the Shell Petroleum Development Company, Chevron, Total E&P (formerly Elf Petroleum), the Nigerian Agip Oil Company and Chevron- Pennington (Thurber et al., 2010).

Furthermore, each of these six has NNPC as the majority shareholder, with a stake in the company that generally ranges between 55 and 60 % (Thurber et al., 2010), making it one of the most important oil companies in the sector. However, this type of arrangement is being phased out due to difficulties that NNPC has in funding its share of costs (KPMG, 2014).

Under a Production Sharing Contract, NNPC holds the concession rights, and the private company (whether an IOC or indigenous company) takes on the role of contractor, by operating the oil block on behalf of NNPC and itself (KPMG, 2014). Since this company assumes the risk and costs related to the uncertainty of exploration and production respectively, if oil is indeed found and produced, this company is first allocated a share of the oil that will cover these costs. Then, since it is common for tax and royalties to be paid to the government in the form of oil as opposed to cash, their oil value equivalent is subtracted from the oil produced. Only thereafter, does the oil get split between NNPC and the private company in accordance with the percentages agreed upon in the Production Sharing Contract (Sayne et al., 2015). This type of contract is now the “preferred arrangement” for IOCs in both onshore and offshore areas (KPMG, 2014).

Under a Service Contract model, the contractor company assumes the risk and performs the exploration production activities on behalf of NNPC or the concession holder, either of which solely owns the concession. The contractor recovers its costs through revenue generated from the sale of the crude oil and is paid for its services periodically according to a formula agreed to in the contract. It is noteworthy, that the contractor is not entitled to any of the oil produced, but is first to have the option to buy crude from the concession holder (KPMG, 2014).

Marginal Field Contracts spurred out of the government's efforts to improve Nigerian Content in the industry, which involved the Federal Government's introduction of the Petroleum (Amendment) Act No.23 as well as the Marginal Field Operations (Fiscal Regime) (KPMG, 2014). The former gives the President the power to make IOCs concede their marginal fields for reallocation to indigenous concession holders, and the latter encourages indigenous companies to bid for these marginal fields. A marginal field is, "any field that has reserves booked and reported annually to the DPR and has remained unproduced for a period of over 10 years" (KPMG, 2014). A company that wins the bid earns the right to negotiate and enter into a Farm-Out Agreement with the existing Oil Mining Leaseholder for that piece of land. Only once the terms of the Farm-Out Agreement are settled does the successful bidder have the right to undertake exploration and production activities in that field (Ashurst, 2014).

### ***Government revenue sources***

Concerning government revenues from this sector, the bulk of it is generated from the sale of crude oil (Thurber et al., 2010). However, the government also collects its revenues from oil companies via royalties, collected through the Department of Petroleum Resources and Petroleum Profits Tax, which companies pay to the Federal Inland Revenue Service (Gillies, 2009).

With respect to the amount of royalty a company holding a concession is obligated to pay, the rate varies depending on the location and depth within which a company operates. The Petroleum Act (1969) stipulates rates shown in the Tables 1 and 2 below.

**Table 1: Onshore royalty rate**

<b>Drilling location</b>	<b>Royalty rate (%)</b>
On shore	20

Source: (Petroleum Act 1969)

**Table 2: Offshore royalty rates for different water depths**

<b>Water Depth (m)</b>	<b>Royalty rate (%)</b>
0 -100	18.5
101 - 200	16.5
201 - 500	12.5
501 – 800	8.0
801 - 1000	4.0
Exceeding 1000	0.0

Source: (Petroleum Act 1969)

However, the Petroleum Act (1969) as amended in 2003, also stipulates rates specifically applicable to Production Sharing Contracts, operating in the onshore and shallow offshore. This amendment provides for varying royalty rates depending on the production level, with the aim of enticing more companies to form such arrangements as opposed to Joint Ventures (KPMG, 2014).

**Table 3: Onshore royalty rates for different production levels**

<b>Production (bbl/d)</b>	<b>Royalty rate (%)</b>
Production below 2000	5
Production between 2 000 and 5 000	7.5
Production between 5 000 and 10 000	15
Production exceeding 10 000	20

Source: (Petroleum Act 1969)

**Table 4: Offshore royalty rates for different production levels**

<b>Production (bbl/d)</b>	<b>Royalty rate (%)</b>
<b>Up to 100m depth</b>	
Production below 5 000	2.5
Production between 5 000 and 10 000	7.5
Production between 10000 and 15 000	12.5
Production exceeding 15 000	18.5
<b>Between 100m and 200m depth</b>	
Production below 5 000	1.5
Production between 5 000 and 10 000	3.0
Production between 10000 and 15 000	5
Production between 15000 and 25 000	10
Production exceeding 25 000	16.67

Source: (Petroleum Act 1969)

Furthermore, companies in Deep Offshore and Inland Basin Production Sharing Contracts (DOIBPSC) are not subject to the fiscal regime described in the Petroleum Act,

but rather to the one specified in the DOIBPSC Decree (1999), which is shown in Table 5 below.

**Table 5: Deep offshore royalty rates for different water depths**

<b>Water Depth (m)</b>	<b>Royalty rate (%)</b>
From 201-500	12
From 501-800	8
From 801-1000	4
Exceeding 1000	0

Source: (Deep Offshore and Inland Basin Production Sharing Contract Decree 1999)

Turning to the Petroleum Profits Tax, under the Petroleum Profits Tax Act, companies in Joint Ventures are charged a 65.75% tax rate on their chargeable profit during their first five years of operation, while the company is still aiming to fully recover its pre-production costs. After this period, they face a tax rate of 85%. On the other hand, the Petroleum Profits Tax rate for Production Sharing Contract companies operating in the deep offshore (over 200 metres) and the inland basin is 50% of chargeable profits from the contract area (KPMG, 2014). In a service contract, however, only the holder of the concession is subject to the PPTA, while the contractor company is subject to the Companies Income Tax Act, which stipulates a tax rate of 30% (KPMG, 2014).

## **5.2 Main players in the industry**

One of the most striking features of the industry is its domination by International Oil Companies (IOCs). This domination began in the colonial era as far back as 1908, when the Nigerian oil industry was conceived by the entry of the first IOC, the Nigerian Bitumen Company, which started exploration activities in the west of Nigeria, and was subsequently followed by more IOCS, namely the Mineral Survey Company. After the amalgamation of the Northern and Southern Nigerian protectorates, in 1914, the Minerals

Oil No.17 was passed that same year, stipulating that only British firms could obtain oil exploration licenses in Nigeria, essentially granting them a monopoly over this activity (Omeje, 2006). The colonial government then proceeded to grant Shell D'Arcy with sole concessionary rights over Nigeria's entire territory in 1938. However, concessionary rights to the exploration and production of oil in Nigeria were eventually opened up to other firms in 1951. Due to this, as well as the imminence of Nigeria's independence, more oil companies entered and became players in these oil activities, including Mobil, Saffrap (known today as Elf) Texaco, Gulf (known today as Chevron), Agip and Esso. Furthermore, by the time Shell D'Arcy made the first commercially viable discovery of oil in the Niger Delta in 1956, it was functioning as the operator of the Shell-BP Petroleum Development Corporation of Nigeria Limited, a joint venture company it had formed with British petroleum (BP) (Omeje, 2006).

For a decade after production and exportation commenced in 1958, these IOCs, "basically controlled the entire equity, production, export, and marketing of Nigerian oil" (Omeje, 2006). In this period Gulf, Mobil and Texaco discovered the first offshore oil fields. Also, over this period, during which Nigeria gained independence in 1960, the government made no investment and had no equity stake in the sector, and thus benefitted solely from rents and royalties, meaning the bulk of oil revenues went to the IOCs. In fact, the level of the government's non-activity extended to its regulation and supervision of the industry, as these efforts were, "quite negligible" (Omeje, 2006).

Only in 1971 did the government become active in the oil sector, with the formation of the Nigerian National Oil Company (NNOC), which became The Nigerian National Petroleum Company (NNPC) in 1977, through which the government would participate in the oil sector. As the government was looking to join OPEC, the formation of NNOC, was in adherence with an OPEC resolution, which required member countries to have a 51% equity stake in foreign IOCs in their countries, as well as a more active involvement in all aspects of oil operations. However, it was also a consequence of the Nigerian Petroleum Decree No.51 of 1969, which, "vested the entire ownership and control of all petroleum in Nigeria with the state and/or its agency" (Omeje, 2006). Thus, in line with

its intent, the government introduced the Indigenisation of Foreign Enterprises Decree, which obliged all IOCs to form operating joint ventures with NNOC in 1973, a rule that was later expanded in 1977 to increase government equity participation (Omeje, 2006). By 1979, NNPC had a participation interest of approximately 57% in most of Nigeria's oil producing ventures, with an 80% stake, "in the former Shell-BP venture", thereby completely nationalising BP's share, and leaving Shell with just 20% (Omeje, 2006). Thus, the Nigerian government started earning profit revenues as well as rents and royalties from the oil sector. Furthermore, NNPC began undertaking a more active role in the downstream sector, by becoming involved in the refining and marketing of Nigeria's crude oil.

Nevertheless, "until 1992 the expatriate companies had a hundred per cent domination of the oil exploration and production businesses" (Omeje, 2006). Thereafter, due to domestic pressure, the government passed some licensing policies to promote the emergence of indigenous exploration and production in the sector. Thus, eventually, NNPC became involved in exploration as well. Initially, NNPC explored mainly with the aim of discovering oil for other companies that would produce it. However, in much more recent years, NNPC became involved in oil production through its subsidiaries, the Nigerian Petroleum Development Company and the National Petroleum Investment Management Services (Omeje, 2006).

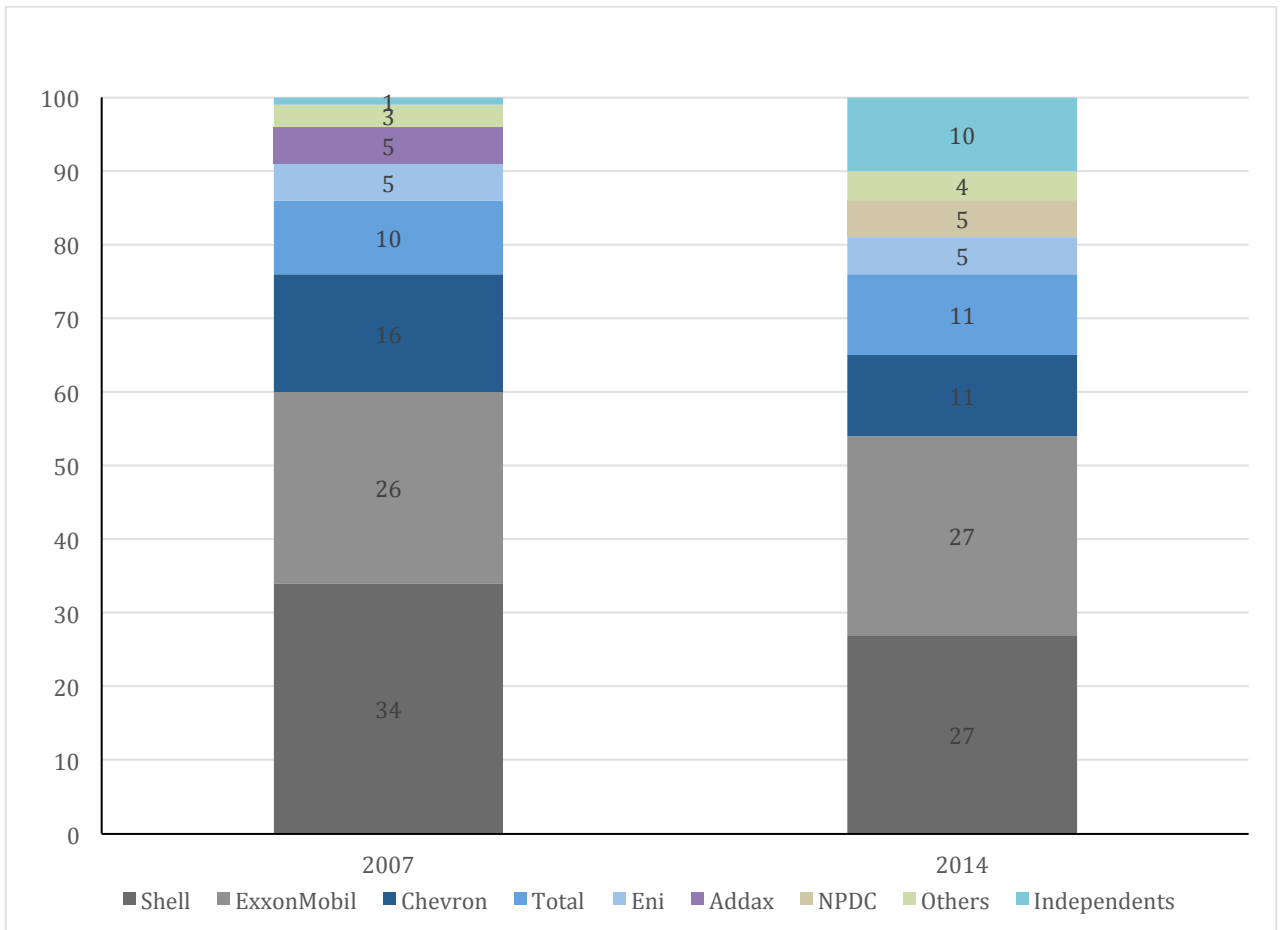
However, indigenous companies failed to make a significant mark in the industry, as by 1996, there were 38 of them, yet Nigeria's two largest indigenous oil companies, Amni International and Consolidated Oil, contributed only 0.7% to Nigeria's total oil production (Frynas, 2000). Furthermore, around that time, only a few of the indigenous oil companies were sufficiently equipped and self-financed (Frynas, 2000). Most of the rest of them formed joint ventures with foreign companies, in which the latter usually owned 40% of the equity, because they had the technical knowledge and financial resources that the indigenous companies lacked (Omeje, 2006). Interestingly, the emergence of indigenous oil companies increased the penetration of foreign oil companies in Nigeria. This was because their emergence provided the opportunity for

small foreign companies to enter the market through technical partnerships with the indigenous firms. Without their emergence, which presented a new market entry avenue, many of the small foreign companies may not have been able to viably enter the Nigerian oil exploration and production sectors (Frynas, 2000).

Ultimately, the diversification and indigenisation measures failed to diminish the dominance of the six IOCs (Shell, Mobil, Chevron Elf, Agip and Texaco), which together, made up for 97% of Nigeria's oil production (Frynas, 2000). In fact, indigenous producers, including NNPC subsidiaries, still only accounted for less than 2% of production by 2002 (Frynas, 2000). Since 2002, many Nigerian companies have entered the industry, which is a trend that was reinforced and incentivised in 2005 by the Nigerian Content Directives, and the Nigerian Oil and Gas Industry Content Development Act thereafter (KPMG, 2014). However, Shell continued to remain the largest oil producer in Nigeria, still accounting for a significant 50% of Nigeria's oil production by 2006 (Omeje, 2006).

Overall, to this day, IOCs have continued to dominate oil production in Nigeria. The extent of this domination is still quite extreme as currently, Nigeria's top four oil producers are all IOCs, which together dominate the market and account for 80% of oil production (Stratfor, 2015). However, Shell is no longer the sole the leading producer as in 2014 it was caught up to by ExxonMobil. In fact, the extent of Shell's domination has fallen to 27%; the market share that was matched by ExxonMobil in 2014 as can be seen in the Figure 1 below (Stratfor, 2015).

**Figure 1: Nigerian production by operator (%)**



Source: (Stratfor, 2015)

Furthermore, though today some indigenous companies such as Oando, Seplat and Amni Petroleum are gaining ground in the industry, indigenous oil companies only make up for a mere 6% of the market (Yeboah, 2014).

Even more interesting about the role of IOCs is the fact that the Nigerian government appears to have an alliance with these foreign companies. This is indicated by the several legislative actions the government has taken that have worked to increase the ease with which IOC's can perform oil activities in oil communities, to the detriment of the locals of the communities. These legislative actions, most significant of which are the Navigable Waters Act of 1968 and the Land Use Act of 1978, effectively reduced the

rights of the community members to receive compensation for accidental oil spills and the expropriation of their land for the purpose of oil activities, respectively.

Thus, through the disbursement of policy rents to the IOCs, which have translated into economic rents, the overall effect has been a reduction in rents that can be captured by the oil producing communities in association with the production of the oil. Instead, the oil companies and the state capture the rents through the great profits that oil production generates. Hence, these policies have led to the allocation of more oil-related wealth to oil companies than to community members.

These actions have been attributed by some academics, to an alliance between the state, ruling political elites and the multinational oil companies, which encourages the extraction of oil in order for oil wealth to be divided among these stakeholders (Obi, 2010). However, another set of academics view these legislative actions as primarily being driven by the pursuit of rents and the non-productive accumulation on the part of the state, which is dominated by, “an unstable coalition of ethnic majority elites who’s geographical homelands have little or no oil reserves” (Omeje, 2006). For this latter set of academics, the IOCs benefit because their interests happen to coincide in many instances with that of the state. This is because, the production of the rents that the state is in pursuit of is generated from oil production, which is mainly enacted and coordinated by foreign capital i.e. the IOCs. Hence, the IOCs naturally, secure huge profits as capitalist investors (Omeje, 2006). In other words, it appears as though, “the state bias in favour of oil companies, was ensured by the continuing reliance of the state and the business elite on foreign oil and gas investment” (Frynas, 2000). Moreover, “this bias rendered the state less receptive to the needs of village communities” (Frynas, 2000).

Nonetheless, the state’s bias towards the oil companies has an ethnic element to it as well. This is related to the fact that crude oil has predominantly and almost exclusively been located in rural areas on the land of ethnic minority groups in the South East of the country. Due to the numerical inferiority of these groups, which include the Ijaw, the Ikwerre, the Edo the Itsekiri, among many other small ethnic groups, they struggle to

exert political power (Frynas, 2000). In essence, because the dominant coalition's survival is not reliant on these non-elite minority ethnic groups, they are not viewed as the threat to the state and therefore have their needs overlooked.

## **6. The political economy of revenue allocation**

As previously mentioned, from the late colonial years to the postcolonial era, elites in Nigeria have struggled to come to an agreement about the distribution of power and rents. Particularly since the postcolonial era after the production of oil began, a continuous wrestle for access to oil rents has ensued. This has regularly manifested in alterations being made to the revenue allocation formula and the number of states in Nigeria. However, it has also manifested in other measures being taken that affect the access to or size of rents, and in turn, affect the distribution of revenues.

Thus, this section argues that with the rise in the dominance of oil in the Nigerian economy, alterations to the revenue allocation formula, particularly the aspects of it that relate to oil revenues, were undertaken to increase the ruling elites' access to oil rents. This led to the intensification of the "winner take all" fight for political rule among dominant elites, which in turn prompted conflicts, and even more tactics being undertaken to alter the distribution of revenues, such as the creation of states and other methods that affect access to rents and government offices. Overall, this resulted in numerous coups and a civil war, all of which contributed to the ultimately sub-optimal economic performance of Nigeria. Hence, oil's impact on formal rent distribution indirectly affects the economy through conflict and political instability.

### **6.1 Inception of the revenue allocation issue**

#### ***Revenue allocation***

The amalgamation of Northern and Southern Nigeria, was the first spark that ignited tensions concerning revenue allocation, as it induced the creation of a central account through which payments from regional governments' revenues would be collected, and

apportioned back to the regions according to an allocation formula (Nkowedi, 2001). Hence, the revenue allocation formula was the first arrangement conceived to deal with the distribution of revenues across Nigeria. Since then, revenue allocation has been a contentious issue in Nigeria; however, more so since oil started to influence the decisions made with regard to how revenue should be shared.

Due to the fact that Nigeria has adopted a federal system, the issue of revenue allocation is especially complex as it involves two components. The first component pertains to how revenue is distributed vertically between the federal government and various other tiers of government, including state and local governments (Ebienfa and Kumokuo, 2012). The second component relates to how revenue is shared horizontally across states and local governments, which varies based on several factors/principles (Ebienfa and Kumokuo, 2012). In Nigeria, the principles that have been considered in different combinations, in the sharing of the “national cake” have included: (i) Derivation (ii) Balanced development (iii) Basic Needs (iv) Population Derivation (v) Minimum responsibility of government, (vi) Equality of states (vii) Absorptive Capacity (viii) Landmass and Terrain (ix) Minimum material standards (x) Equality of access to development opportunities (xi) Social development factor (xii) Independent revenue/Tax effort (xiii) Fiscal Efficiency (xiv) Internal revenue generation effort (Lukpata, 2013).

Regarding the revenue allocation formula, this paper focuses on the principle of derivation in relation to mining rents and royalties, which has undergone the most changes with the ascendance of oil as the mainstay of the economy. Applying the principle of derivation involves the allocation of revenues based on their region or state of origin. For instance, a 100% application of the derivation principle for mining rents and royalties would mean that a region or state would receive a 100 % of the revenues that it contributed from its mining to the central account.

## **6.2 Changes to revenue allocation**

To reiterate, the main changes to revenue allocation in Nigeria occurred through changes in the application of the derivation principle to the revenue allocation formula, shown in

Table 6 below.

**Table 6: Revenue allocation formula changes**

Year	Derivation Principle (%)	Commission/committee Decree/Act
1946	100	Phillipson Commission
1951	100	Hicks-Phillipson Commission
1953	100	Chick Commission
1958	50	Raisman Commission
1964	50	Binns Commission
1970	45	Decree No.13 of 1970
1971	45 (of only onshore)	Decree No. 9 of 1971
1975	20	Decree No.6 of 1975
1979	0	Obasanjo regime
1982	1.5	Allocation of Revenue Act No.1 of 1982
1985-1989	1.5	4 different committees
1992	3	Oil Mineral Producing and Development Commission (OMPADEC)
1999 - now	13	1999 constitution

Sources: (Anyadike and Innocent, 2012); (Nkowedi, 2001); (Uche and Uche, 2004)

Thus, a discussion on the most significant changes to revenue allocation and the resulting episodes of violence follows.

### **6.2.1 Changes without oil influence**

Prior to independence, four revenue allocation commissions were set up. The first three were in response to constitutional developments, which, starting with the introduction of the Richards Constitution in 1946, became more and more influenced by the idea of Federalism. These first three revenue allocation commissions included the Phillipson commission (1946), Hicks-Phillipson commission (1951), and the Chick commission (1953) all of which applied the principle of derivation to mining rents and royalties. Hence, states of origin were entitled to 100% of these revenues (Uche and Uche, 2004).

It is important to note that around this time, agriculture was the mainstay of the economy, and, “the politics of revenue sharing [was] limited...because the regions were accorded the constitutional right to control the resources they produce” (Ebienfa and Kumokuo, 2012). In other words, each region was able to prosper from their agricultural resources, which was cocoa in the West, groundnut and coconut oil in the North and palm oil in East (Anyadike and Innocent, 2012). Tin and bauxite were also exploited in the Northern region, and because regions received 100 % of mining rents and royalties based on the principle of derivation at that time, only the North benefitted from this (Uche and Uche, 2004). Nonetheless, the West was the wealthiest of the regions, and though the East had the least of both agricultural and natural resources, its regional government took advantage of its endowments by raising revenues through various tax measures to meet the needs of the region (Ebienfa and Kumokuo, 2012).

Furthermore, at the point of the discovery of oil in the ethnic minority lands of Oloibiri in the Niger Delta, in 1956, Chick’s formula was in operation, meaning that the formula for revenue allocation was still based on a 100% allocation of mining rents to states of origin.

## **6.2.2 Oil-influenced changes and related conflicts**

### **6.2.2.1 First reduction in state derivation and coups 1&2**

However, in 1958, with political independence impending, the revenue allocation formula was due to go under review for the fourth time, and therefore, a fourth commission headed by Jeremy Raisman was set up to replace it. Since this was around the time that oil production commenced, the consideration of the potential magnitude of revenue yields from oil resulted in a fundamental change to the formula. This change was that mining rents and royalties would no longer solely belong to their regions of origin, as had formerly always been the case, but instead, would be shared (Uche and Uche, 2004). This fundamental change resulted from the Raisman commission’s recommendation that a Distributable Pools Account (DPA) should be formed from which, federally collectible revenues, which they proposed should begin to include mining rents and royalties, would be shared. The distribution formula for these revenues, stipulated by the committee, was that 50% should be allocated to regions of origin, 20% to the federal government, and

30% to all other regions (Uche and Uche, 2004). Essentially, during the creation of this formula, the Raisman commission deemphasised the principle of derivation, and replaced it what was viewed as an excellent index of fiscal need; the principle of population, as well as the principles of minimum responsibility of government and balanced development (Anyadike and Innocent, 2012).

The adoption of this report and its consequent change, marked the first oil influenced alteration to the revenue allocation system.

As revenue allocation based on the principle of derivation was deemphasised, other factors came to play a more prominent role in the decision making of how revenues would be distributed, and these included, population, balanced development of the federation, continuity and minimum responsibility of the government (Uche and Uche, 2004). Thus, regions began to shift their focus away from revenue generation to revenue allocation, which became apparent when most regions began using various techniques, such as the inflation of their population statistics, to try and increase the revenues that they derived from the DPA (Uche and Uche, 2004).

Subsequently, around the time that a fourth region, called the Mid-Western region was formed out of a segment of the Western region, in 1963 (Uche and Uche, 2004) oil had come to account for approximately 80% of the total revenues accruing to the federation. Furthermore, political tensions were mounting over the change in the application of the derivation principle to the formula, which the southern oil-producing states felt should be reverted to 100% (Nkowedi, 2001). There was also frustration over the incorporation of other principles, such as population and balanced development, into the horizontal formula, as they seemed to be simultaneously advantageous for the North and detrimental to oil-bearing regions' allocation of the revenues. This was an issue for the South, based on the fact that the North contributed the least to the central fund, while the South contributed the most.

However, the validity of the South's dissent is debatable by virtue of the fact that Nigeria is one nation, and furthermore, a more extreme prevalence of poverty existed and still

exists in the North, as compared to the South, due to lower education levels. As one nation it would seem justifiable for a government to distribute revenues from the oil, extracted within its boundary, across states partly on the basis of even development. Whether the application of the even development principle was for such genuine reasons or not, does not totally negate the fact even development is essential in fostering national unity, especially for a newly independent state, which Nigeria was at the time (Nkowed, 2001).

Nonetheless, adding to the agitation of the South, regarding the vertical formula, was the accumulation of a disproportionately high amount of the centrally collected revenues at the federal level, in the hands of the political powers, which since independence, had been dominated by the northerners (Nkowed, 2001). Thus, by 1965, “a political crisis generated between the regions and the ethnic struggle for political ascendancy at the centre was at the brink of total disintegration” (Nkowed, 2001).

Therefore, the military intervened by carrying out Nigeria’s first coup in January 1966, to re-establish order (Nkowed, 2001). This coup brought General Ironsi (Igbo) into power. In May that same year, his administration, in an attempt to consolidate control over the entire country, eradicated the federal structure of government, which it perceived to be the cause of problems, via Decree No. 34 of 1966, which thereby converted Nigeria into a unitary state, (Anyadike and Innocent, 2012). However, this only heightened ethnic groups’ fear of domination by other ethnic groups in a unitary state (Nkowed, 2001). Thus, Ironsi was killed in a counter coup two months later in July bringing Gowon (Middle Belt Christian) into power, who reverted Nigeria back to a federal state (Uche and Uche, 2004).

#### **6.2.2.2 First round of state creation and civil war**

Also, in 1966, the governor of the Eastern region, Lieutenant Colonel Ojukwu, who was the custodian of the majority of oil reserves in the Eastern region, threatened to secede. His motivation was the growing feeling of injustice expressed by Eastern inhabitants due to the derivation principle change and tensions with the federal government, which, even

with a Middle Belt head of state, remained dominated by Northerners, However, the federal government refused to allow it, considering the economic impact it would have on revenues for the rest of the federation (Uche and Uche, 2004).

Therefore, as a strategy to mollify tensions, in 1967, President Gowon, created more state and local jurisdictions, a method that proved to be popular among numerous Nigerian leaders that followed, which can be seen in Table 7 below.

**Table 7: Timeline of state creation**

Year	1967	1976	1987	1991	1996
No. of states	12	19	21	30	36
Head of state	Gowon	Obasanjo	Babangida	Babangida	Abacha

Source: (Frynas, 2000)

This form of power sharing, on the one hand, was used as an attempt to pacify the agitated Southern minorities by providing them with a level of autonomy and escape from domination by the Southern dominant ethnic groups (Orji, 2008). However, on the other hand, it was a means of undermining the strength of opposing coalitions (Thurber et al., 2010).

In this first case, by Military Decree No.15, Gowon created twelve states out of the existing four regions, three states of which were in the Eastern region. This was essentially a way of buying off factions of opposing coalitions, because, once a state or ethnic region is divided into more states, each new state is entitled to an equal amount from the federal government as a region that has remained intact as one state. Thus, the split up region or ethnic group collectively receives more from the federal account, if the ethnic group spans across several states (Ebienfa and Kumokuo, 2012).

To elaborate, particularly as a tactic to weaken the strength of the Igbo leaders who spearheaded the opposing coalition in the Eastern region, the government created two new states (Rivers State and South Eastern State) from the main oil producing areas, which belonged to minority ethnic groups in the former Eastern region, and made a third, landlocked and economically secluded state (East Central state) out of the area that belonged to the Igbos (Uche and Uche, 2004).

As a result, the minority ethnic groups received more money from the government. However, at the same time, because these proliferated states generally had no economic viability, they came to depend wholly on monthly allocations from the federal government (Thurber et al., 2010). Furthermore, this state creation round represented a weakening of the Igbo elites position among the dominant elites, because the Yoruba were assigned three states, and the North were assigned four states, while the Igbo only received one (Orji, 2008).

Hence, this initial creation of states and the ones to follow, shown in Table 7 above, in effect, led to the strengthening of the centre while the regions that were replaced by states, got weaker (Anyadike and Innocent, 2012). Furthermore, the opposing coalition was split into less powerful units, and the threat to central power from the dominant regional and ethnic political group was weakened (Thurber et al., 2010).

All in all, this move by Gowon was the last straw for the Igbo leaders, and therefore, Ojukwu declared the secession of the Eastern region as the independent Republic of Biafra, and the Biafra civil war broke out until 1970 (Uche and Uche, 2004).

### **6.2.2.3. Further reduction in state derivation and coup 3**

During the war, in 1968, Chief I O Dina led the sixth revenue allocation commission, which, motivated by the need to maintain national unity, recommended an expansion of the federal government's role and revenue base. Her commission was also especially significant in that it was the first commission to distinguish onshore oil from offshore oil. For oil revenues from onshore activities it was recommended that 15% should be allocated to the federal government, 10% to the states of derivation, 70% to a States Joint

Account (SJA) and 5% to a Special Grants Account (SGA). For offshore operations, the recommended allocation was 60% to the federal government, 30% to the SJA and 10% to the SGA (Uche and Uche, 2004).

This report, which would have been advantageous for the federal government, was rejected in 1969 by the meeting of Commissioners of Finance of the federation. This rejection was supposedly only possible because the Commissioners of Finance was dominated by civil politicians, due to the absence of former military political seat holders, who were aligned with the ruling coalition of the federal government, and who were at war (Uche and Uche, 2004). The difference in the decision that may have been made between military and civilian politicians possibly would have stemmed from the fact that civilian politicians adhere to constitutional rules more closely than their military counterparts do, as the latter rule more by force than by general civilian support.

Thus, from 1969 to 1974, the government used an interim allocation arrangement. However, in November 1969, the military government achieved a “win”, with regards to its control of resources, as the Petroleum Act of 1969 officially vested, “entire ownership and control of all petroleum in, under or upon any land in Nigeria in the state” (Ebienfa and Kumokuo, 2012).

After the defeat of Biafra ended the civil war, military officers were free to fill political positions (Uche and Uche, 2004). Therefore subsequently, as oil production increased in the early 1970s due to exploration and development success (Thurber et al., 2010) the most fundamental recommendations of the Dina report were put into effect by the 1971 Decree Number 9. The decree redirected rents and royalties from offshore oil mines from the states to the federal government (Uche and Uche, 2004). Thus, even more rents were squeezed from the minority ethnic groups to the benefit of the ruling elites.

Furthermore, when prices increased fourfold between 1973 and 1974 this led to a huge influx of revenues to a military government that was ill prepared to manage the funds efficiently. As opposed to making productive use of the revenues, taxes were scaled down while salaries and wages were scaled up. As a result, the government became

heavily dependent on oil, receiving 80% of its revenue from the oil sector, which also dominated exports with a share of 95% by 1974 (Thurber et al., 2010).

Although the government was already in a very lucrative position, especially during the windfall occurring at the time, the military government's hunger for more access to oil rents seemed insatiable. This was illustrated by its promulgation of the Constitution Decree Number 6 in 1975, according to which all revenues shared by the states, apart from the proportion of mining rents and royalties assigned to the states of origin (which was reduced to 20%) had to be channelled through the DPA. Thus, 80% of mining rents and royalties would now be shared through the DPA (Uche and Uche, 2004). Hence, non-oil producing states gained the most from this arrangement.

Soon after the proclamation of the decree, a third coup took place in 1975 replacing President Gowon with another military President, Murtala Mohammed (Hausa). This coup is speculated to have taken place due to the general dissent within the lower ranks of the military, most likely of Southerners. Their disapproval concerned the level of corruption in Gowon's regime, the perception that his government was "still punishing the Igbos" through his excessive changes to the formula, as well as his plans to postpone elections that were to occur the following year, which would have prolonged the situation (Dummar, 1989). The coup may likely have also been motivated by the desire of the Northern Muslim elites to have more direct access to the oil rents at the centre, because Gowon's corruption most likely mainly benefitted his Middle Belt elite group.

Nonetheless, the officers who led the coup chose a "ruling triumvirate" of Murtala Muhammed (Hausa) as head of state, Olunsegun Obasanjo (Yoruba) as the de facto vice president and T.Y Danjuma (Middle Belt) as Chief of Army Staff (Dummar, 1989). The integrative and more accommodative flavour of this decision represented a shift away from the winner takes all rivalry, and was arguably chosen based on lessons learnt about the tensions that led to the civil war (Orji, 2008). In effect, the new military government maintained the allegiance of the North, South and Middle Belt. Hence, it was

representative of an LAO in which the elites agree to cooperate in order to preserve rents, which would otherwise be reduced by conflict.

#### **6.2.2.4 The “Islamisation” of Nigeria and a failed coup**

Mohammed’s military administration was the first that intended to pass power on to civilians. Therefore, it initiated the drafting of a new constitution for the transition, which called for the appointment of a seventh Committee on revenue allocation, which would be chaired by Professor Aboyade in 1977 (Uche and Uche, 2004). However, early in 1976, Mohammed was assassinated in a failed coup. This assassination is believed to have been representative of the resistance of the Middle Belt elites and some Southern minorities to Mohammed’s alleged plans to implement Sharia law at the federal level. Such an act would have been akin to the Islamisation of Nigeria and would have solidified the rule of the Muslim elites (Omoruyi, 2001). Put differently, it appeared that the ruling triumvirate was being captured by the Muslim elites, which defeated the purpose of the triumvirate. This weakened the coalition as internal resistance mounted, because access to the nations massive rents would have been further limited to an even more exclusive elite group. This clearly would have been too small of a group, excluding too many who had sufficient access to violence and who could act unilaterally to create disorder; which is why the coup was attempted.

#### **6.2.2.5 Further reduction in state derivation and more state creation**

However, since the coup failed, Mohammed’s deputy, Obasanjo (Yoruba) became head of state, and continued to carry out Mohammed’s plan of transferring power to civilian rule (Uche and Uche, 2004).

Aboyade’s committee recommended that all federally collectible revenues should be paid to the federation account, with no exceptions. Furthermore, it was the first commission to consider local governments when determining vertical distribution, and the first commission that, “urged the abrogation of the principle of derivation” in the horizontal allocation of revenue (Nkowed, 2001). Instead, the commission recommended that revenue allocation decision should be based on, “Equality of access to development

opportunities, National Minimum Standards for National Integration, Absorptive Capacity, Independent Revenue and Tax effort and Fiscal Efficiency” (Uche and Uche, 2004). This report, however, was rejected by the Constituent Assembly for various reasons, amongst which included the fact that the recommended allocation was highly skewed to the advantage of the federal government (Nkowedi, 2001).

Nonetheless, in line with Ayobade’s recommendations, Obasanjo’s regime, essentially nullified the derivation principle, by ending the long-time practice of proposing a revenue allocation formula for every new constitution. Thus, with the promulgation of the new 1979 constitution, there was no revenue allocation formula (Nkowedi, 2001).

Furthermore, Obasanjo increased the number of states from twelve to nineteen in 1976. What is interesting about the creation of states at that point and thereafter is that up until the 1960s, the dominant elite groups were opposed to the idea of the creation of states because they feared that alterations to geographical boundaries would upset the equilibrium among the three dominant elite groups. Their logic was that if the regions were divided into smaller states to appease minority agitation, “new elites and parties would almost certainly emerge at the national level, since Nigerian politics has tended to develop along ethno-regional lines” and in that case, “the domains of the dominant groups would shrink seriously in size and importance” (Orji, 2008). However, after the first twelve states were created, dominant ethnic groups also began to agitate for more states by the 1970s. This is because they realised that by having more states, they would be allocated more revenues from the centre. Hence, each ethno-regional elite group embarked on campaign missions to increase their states (Orji, 2008).

The result of Obasanjo’s creation of states was that only a meagre seven of the nineteen states, existing by the end of the process, belonged to ethnic minorities, whereas six out of twelve of the states created in 1967 belonged to ethnic minorities. Furthermore, though the state creation exercise of 1967 had created six states in the North and six in the South, the 1976 exercise assigned ten states to the North and nine to South, abolishing the sense of federal equality/geopolitical balance that the former round had created.

These results were partly caused by the recognition of state creation as a form of, “devolution of central revenues” and the government’s subsequent commitment to making states, “as equal in population as possible...to ensure some per capita equity in the access of territorial communities to federal revenues” (Ojo and Adebayo, 2008). This commitment consequently allowed many requests for states to be rejected for no other reason other than a, “relatively limited population, which did not justify any reorganisation” (Ojo and Adebayo, 2008). Thus, in effect, numerically inferior ethnic groups were disadvantaged.

To clarify, conducive to the setting of an LAO, the use of population was essentially the ruling coalition’s way of limiting rent distribution and preserving a sizable amount of rents for the elites of the majority ethnic groups, whose positions were threatened by state creation in the first place. On the whole, the creation of states morphed into another scheme for the, “dissemination of central revenue derived mainly from the southern ethnic minority communities to predominantly ethnic majority populations” (Ojo and Adebayo, 2008).

#### **6.2.2.6 Dwindling oil rents, monopolisation of the Presidency, and coup 4**

With the shift to civilian rule upon the election of President Shehu Shagari (Fulani), in 1979, and a further jump in oil prices that year, corruption became rampant, as regulatory bodies struggled to implement and enforce checks and balances (Thurber et al., 2010).

Then, in 1980, a new revenue allocation committee, which was the first in a presidential system, was set up with Dr. Pius Okigbo as its head. It produced a report that was similar to Aboyade’s Report in its recognition and inclusion of local governments (Uche and Uche, 2004). However, its weakness was that it, “significantly raised the revenue of some states at the expense of others and, therefore, it negated the idea of balanced development in the country” (Anyadike and Innocent, 2012). Furthermore, the vertical allocation was such that the federal government would receive 58.5%, the state governments 31.5% and the local governments 10%.

The report was criticised, and the government faced some opposition regarding its adoption in 1981 on the grounds that it would have starved certain states relative to others, all while the federal government would have enjoyed a disproportionately large portion of the revenues (Amuwo et al., 1998). However, it was eventually adopted in 1982 through the promulgation of the Allocation of Revenue (Federation Account) Act number 1 of 1982. Thus, for the first time, local governments' allocation was put into effect (Uche and Uche, 2004).

Not long after the promulgation of the 1982 Act and the re-election of Shagari, the military succeeded in carrying out the country's fourth coup in 1983. This coup's most immediate trigger was the alleged fraudulent re-election of Shagari. However, its motivation was fuelled by the overall resentment towards the regime by the masses as a result of the dire economic state of the country, which was the culmination of corruption, a recession caused by declining oil prices, and endemic ethnic rivalry (Thurber et al., 2010). The result of the coup was Mohammadu Buhari (Fulani) becoming head of state.

#### **6.2.2.7 Professionalism of the military leader and coup 5**

However, Buhari's rule ended in 1985 with Nigeria's fifth coup, which brought General Ibrahim Babangida (Non-Hausa/Fulani Muslim Northerner) into power. Reasons for this coup were purportedly the result of personality-based opposition within the army. Buhari was a strict Muslim, and his attempts to apply Sharia law at the federal level led to the interpretation that his regime was another solely Northerner accommodating regime. Furthermore, his stern economic austerity measures, taken to strengthen the economy, also conflicted with the interests of rent-seeking elites in the military who found him too strict for their liking, as he restricted their access to oil rents as well. His overthrowing, represented the erosion of professionalism in the army and it appeared that, "officers that operated along the traditional military ethos were no longer welcome in the halls of power" (Dummar, 1989).

### **6.2.2.8 More state creation, monopolisation of the head of state office, and crisis**

After Babangida was brought into power, the arbitrary reviewing of revenue allocation formula continued, occurring four times in the period of 1985-1989 (Anyadike and Innocent, 2012). He furthermore, deposed all officers whom he believed were not loyal to him, or who were too professional for his liking, in order to entrench a system of patronage with loyal supporters (Ikpe, 2000).

Babangida also continued the practice of states' creation, which continued to be agitated for after 1976. Some of the main agitators had been Igbos, who were of the opinion that the Igbos were at, "a huge disadvantage in the competition for socioeconomic and political opportunities in the federation" (Suberu, 1991). Their view stemmed from the fact that the Igbos only controlled two of the nineteen existing states, which was low compared to the approximate five states each that the Hausa-Fulanis and Yorubas had. Thus, they argued that until a relatively equal balance was reached among the three dominant ethnic groups, instability in the country would persist (Suberu, 1991). In response, given the opportunity to popularise his rule, Babangida addressed the demands by creating more states. His first round of state creation involved the establishment of two more states in 1987, one in the North and one in the South. However, since this did not succeed in quelling the agitations for even more states, he proceeded to create nine more in 1991 to bring the total states in Nigeria to thirty (Ojo and Adebayo, 2008). This second round included two more Igbo states and the establishment of the capital of a third state, Delta state (carved from the former Midwestern region) in the state's Igbo dominated city, Asaba. The other six states catered to subgroups of Hausa/Fulani and Yoruba groups. However, Babangida's second round of state creation also failed to foster national integration as it overlooked the desires of minorities and exacerbated the geopolitical imbalance between the North and South by allocating five of the nine new states to the North so that ultimately Nigeria's 30-state structure consisted of sixteen states in the North and fourteen in the South (Ojo and Adebayo, 2008). As a consequence, "the exercise was greeted with violence, rampages and public demonstrations unsurpassed in the history of state creation in Nigeria" (Alapiki, 2005). For example in

the North-western zone, the rejection of the Zamfara people's request for their own state led to protests which were heightened by the fact that their neighbours, the Kebbi people, were allocated a state without having lobbied for one. Similarly, in Rivers state, in South-South Nigeria, demonstrators marched carrying placards protesting against the non-creation of an Abayelsa state that they had requested. They declared that its non-creation was, "an indication of the marginalisation and lack of sensitivity of the Federal government to the plight of the oil producing areas of Rivers State, whose vegetation ha[d] been ruined by oil pollution resulting from the exploration activities of oil companies" (Alapiki, 2005). In general, the groups that did not receive their requested new states perceived the rejection to be a result of, "high-level power plays and political manipulations of the elites of opposing ethnic groups" (Alapiki, 2005). Therefore, the main players in the decision-making process were targeted, and when they could not be identified, some of the federal government's facilities, property and assets were destroyed instead (Alapiki, 2005).

Babangida's political actions further prompted another political crisis when, in June of 1993, he annulled elections, after the release of preliminary results revealed that Chief Moshod Abiola (Yoruba) had won ("Nigeria profile...", 2015). The interpretation of this annulment was that it was a clear display of the, "North's perception of presidential birthright and intolerance towards other ethnic groups' aspirations to Nigerian leadership" (Nwozor, 2014). The uproar over this led to Babangida resigning as president and handing over of power to Ernest Shonekan (Yoruba) whom he appointed as an interim president. However, this civilian regime lasted for only two months, before Shonekan was overthrown in a 6<sup>th</sup> military coup, and replaced by General Sani Abacha (Non-Hausa/Fulani Muslim Northerner) in 1994.

It is important to note that since Babangida's annulment of the 1993 elections, state creation, alone, no longer worked to placate the perceived marginalisation and domination complaints of non-ruling elites (Amuwo et al., 1998). Therefore, an implicit agreement among elites arose whereby the offices of the President, Vice president, Senate President and Speaker of the House of Representatives would be rotated among six

geopolitical zones (North-West, North-Central, North-East, South-East, South-South, South-West) (Amuwo et al., 1998, Nwozor, 2014). In fact this, “new zoning remedy” became part of the standard agenda of socio-political reformers at the 1994 constitution conference (Amuwo et al., 1998).

### **6.2.2.9 Permanent return to civil rule and relative peace**

The return to military rule lasted until 1999, when power was transferred to President Obasanjo, this time as a civilian ruler. An oil-bearing state achievement that was made during this time, small, as it may be perceived, was an increase in the derivation principle to 13% as a result of the increasing agitation from the Niger Delta. This concession on the part of the federal government was agreed upon during the 1995 Constitutional Conference in preparation for civilian rule, enshrined in the 1999 constitution and put into effect in 2000 (Anyadike and Innocent, 2012).

Overall, since the return to civilian rule, more reviews of the revenue allocation formula have taken place. However, none have altered the derivation principle, which has remained at 13%. Furthermore, no more states have been created, an agreement among elites according to which the high offices in government are to be rotated between geopolitical zones has been made, and no more coups, nor civil wars have occurred.

Nonetheless, the alterations to revenue distribution made prior to 1999 have had a significant and negative impact on the economy. As oil’s share of total national revenue grew from an average below 25% in the 1960s to an average, thereafter, of more than 70% (Omeje, 2006), the government’s corresponding de-emphasis of the derivation principle, in conjunction with other changes and ethnic tensions, led to a series of violent and political conflict in the form of a civil war and various coups, as elites struggled for access to oil rents at the centre.

This political instability caused by conflict has had a negative effect on the economy. One of the major economic losses for Nigeria came from the disruption of oil production during the civil war, and to a lesser extent the coups d’états. In fact, according to the

World Bank development indicators, from the year that the first coup occurred, throughout most of the war, Nigeria's GDP growth rate was negative. It decreased from a growth rate of 4.88% in 1965 to -4.25% in 1966 when the first coup took place, worse still to 15.74% in 1967 when the civil war began, and to -1.25% in 1968 (WB, 2015).

The political instability has also contributed to depressing Nigeria's growth rate because political instability increases uncertainty in an economy with regards to policies, which is a deterrent for some foreign investors as well as a push factor for some local investors, who then opt to invest internationally.

Furthermore, the productivity of states reduced, as a shift in their focus occurred, which resulted in them being less focused on generating revenue and more preoccupied with trying to accumulate more revenues. This was made apparent by some of the tactics that some states employed, such as inflating their population statistics in order to be allocated more from the federal government (Uche and Uche, 2004).

Thus, all in all, the oil-influenced changes to formal rent distribution have indirectly contributed to Nigeria's sub-optimal growth rate through the conflicts they were a driver of.

## **7. Patronage and corruption in the oil sector**

Though a substantial amount of rents is distributed formally across the country, through means discussed in the previous section, that distribution, being public knowledge, is usually bound by some constitutional rules or at least by the desire of the ruling elite to attain some legitimacy in the view of the masses. Thus, for rent seekers, who have the insatiable desire to maximise their accumulation of rents, and for the ruling elite who aim to dispense rents to garner support and maintain stability, the covert system of patronage and corruption is another viable avenue through which revenues can be distributed, especially given the weak institutional environment in Nigeria. Thus, this section will analyse the less formal distribution of rents through covert patronage and corruption.

In Nigeria, this type of patronage takes place at different levels of society. In fact, even the executive branch of the government has a legacy of amassing huge amounts of rents through fraudulent measures. Two heads of state that are most notorious for having abused their positions to carry out such activities are Babangida and Abacha, who each stole billions of dollars while in office. Out of the \$120 billion that is estimated to have been looted from the treasury by various presidents, at least \$20 billion is purported to be traceable to Babangida. Furthermore, \$12.4 billion of what is linked to Babangida is alleged to have come from some of the billions of dollars of the revenues from the Gulf War-induced oil windfall in 1991, that were not deposited into the federation account (Ezeamalu, 2013b). Regarding Abacha's corruption, he allegedly embezzled billions of dollars from the Central Bank of Nigeria, which he diverted to personal foreign accounts; usually acquiring the funds under the guise that they were required for national security reasons ("How Abacha and...", 2014).

Outside the executive office, patronage also takes places at the federal level in other forms. For example, patronage is commonly extended through the appointment of certain state-level government officials as a way for the ruling coalition to garner support in that region. Similarly, at the state-level, patronage can take the form of the strategic appointment of administrators in local governments. However, it can also manifest itself in the delivery of certain developmental projects to local governments that support the same political party as the state's governor (Ibekwe, 2014).

However, since the oil sector has grown to be the sphere in which the most significant dispensation of patronage and corruption occurs, this section particularly focuses on these activities in the oil sector at the organisational level. Furthermore, it demonstrates that oil's impact on the distribution of rents via covert patronage and corruption at this level has had a direct and negative impact on Nigeria's economic performance.

## **7.1 The oil sector as a source of rents and its channels of patronage and corruption**

Due to the rise in oil's importance to Nigeria's economy, in 1971, the government started to acquire significant equity stakes in IOCs, all of which had previously been owned wholly by their international parent companies. This move was compounded by the creation of the Nigerian National Petroleum Corporation (NNPC) in 1971, which was specifically to increase the government's control in the sector (Lawal, 2013).

Today, state interference in most sectors of the economy has declined over time, which is a trend across the world. However, an opposite trend is apparent in Nigeria's oil sector, and in the resource sectors of many other hydrocarbon-rich countries, which use their nationally owned companies (NOCs) to maintain substantial control over their resource sectors, just as Nigeria's NOC, the NNPC does to this day (Thurber et al., 2010).

Given that underlying Nigerian politics is a continuous struggle for power and rents between the major ethnic groups, and that oil is Nigeria's biggest and most important source of rents, it is no wonder that the state has maintained a significant role in the sector from which rents can be distributed, and thus be used in an attempt to keep the LAO stable.

As the oil sector represents the ultimate pot of gold for politicians and elites given that it contributes the most to government revenues, it naturally incentivises rent seeking. Furthermore, as previously mentioned, in the context of Nigeria's weak institutional environment, this makes it a locus of corruption. Since many of the oil sectors activities, apart from the awarding of upstream licenses, fall within the sphere of NNPC's responsibilities, NNPC is at the epicentre of the vested interests of numerous actors in the oil industry. Thus, it has come to play a significant role as an, "instrument of patronage" (Thurber et al., 2010). Even outside the immediate sphere of these activities, by being one of the most powerful and unchecked actors in the industry, NNPC, is a leading distributor of patronage.

### **7.1.1 Patronage and corruption at the employment level**

Firstly, many of the top positions in the NNPC are filled by, “politically favoured individuals” (Thurber et al., 2010). This is made apparent by the fact that NNPC Board members are periodically rotated out and replaced, “often on a regional basis in line with the regional structure of Nigeria’s patronage network” and that, with every new president, the General Managing Director (GMD) of NNPC changes as well (Thurber et al). For example, when Obasanjo from the South was elected president, he appointed Jackson Gaius Obaseki from the South as NNPC’s GMD. In the same vein, when Umaru Musa Yar’udua from the North was elected president, he appointed Alhaji Yar’adua (no relation), from the North, and in fact from the same state as well. In most cases, “these changeovers are accompanied by promises of a full investigation of NNPC’s past dealings” (Thurber et al., 2010). However, such declarations are usually a ruse to disguise a shuffling of patronage networks in response to a new president (Thurber et al., 2010).

Furthermore, at the staff level, employment is also commonly found to be granted based on connections. However, the level of jobs at the staff level did decrease down to approximately 9 000 by 2007 from an excessive amount of 17 000 in 2003 (Thurber et al., 2010).

All in all, granting employment on the basis of patronage usually comes with a high risk of inefficiency as those hired for these purposes usually lack the required level of skills, and are motivated by the opportunity to accumulate rents rather than perform efficiently.

### **7.1.2 Patronage and corruption at the operations level**

Turning to the dispensation of patronage at the operations level, the main activities within the sector which carry the greatest opportunity for corruption and the delivery of patronage, include i) the awarding of licenses, ii) the awarding of oil service contracts iii) the awarding of oil export (lifting) contracts and iv) the awarding of import permits for the importation of refined products; all of which are “supported” by a structure of bureaucracy, bottlenecks, and inefficiencies (Gillies, 2009).

## **7.1.2.1 Upstream sector**

### **7.1.2.1.1 Awarding of licenses**

First, regarding the nucleus of the oil industry, which is the upstream sector, the awarding of licenses, which allow for the exploration and production of oil, is highly susceptible to corruption. This is because these awards are granted at the discretion of the Minister of Petroleum, who possesses full control over the allocation of such licenses. With no formal oversight mechanism to ensure the legitimacy of his decision-making, he is essentially free to perform the unchecked awarding of these licenses based on patronage. There has been evidence of corruption, especially during periods of military rule, during which oil blocks were granted to top military officers and their close connections (Gillies, 2009). Though in 1999, President Obasanjo's administration made efforts to improve the transparency and competitiveness of the process by making information about the available blocks, the selection criteria, and the bids received, publically accessible, subsequent investigations revealed that misconduct continued to occur.

A common form of corruption that occurs in this area of activities is the inconsistent application of qualification standards in bid rounds; to the benefit of particular companies. Furthermore, at times, rights of first refusal are granted to companies that promise to make power sector investments. However, often, many of those that receive such rights, lack the capacity to undertake such endeavours, and fail to deliver the promised investments (Gillies, 2009).

An example, which exemplifies the brazenness afforded by oil ministers in the past as a result of their discretionary powers, is when, in 1998, the then Minister of Petroleum, Dan Etete, awarded an Oil Prospecting License to Malibu Oil and Gas, a company in which he was the major shareholder. Hence, he effectively awarded it to himself (Global Witness, 2013).

### **7.1.2.2 Downstream Sector**

Further downstream in the sector, there is also ample opportunity for corruption. However; in this case, it is largely under the management of NNPC. NNPC has a complex bureaucracy and excessive red tape and therefore it is naturally replete with opportunities for discretionary favours at the many approval stages that plague all of its processes. Hence, “each approval stage represent [s] a transaction that can benefit a gatekeeper or his network of associates” (Thurber et al., 2010). Thus, due to the magnitude of corruption risks found within the sphere of NNPC’s activities, a more detailed discussion of NNPC activities will follow.

#### **7.1.2.2.1 Awarding of oil service contracts**

With regards to patronage, the area of contracting offers bountiful opportunities for benefits to be streamlined to those well connected with the NNPC employee associated with a given transaction (Thurber et al., 2010). For example, in the oil sector, it is common for numerous large-scale contracts to be awarded, largely to oil service companies, and in principle; it is the duty of the operator to award contracts. However, in Joint Ventures, NNPC approves contracts that are worth over US \$1 million, and in Production Sharing Contracts, the National Petroleum Investment Management Services (NAPIMSS) approves those over US\$250 000. These thresholds for the values of contracts, above which NNPC and its subsidiary, NAPIMS, intervene, are extremely low thresholds, considering the fact that the value of most contracts is usually above those values, and in the rest of the industry the thresholds are usually higher. Thus, the discretionary nature of the process, together with the extra rounds of approval created by these low thresholds increase the stages at which bribes can be made. This allows room for government officials, through NNPC and its subsidiary, to wield an excessive amount of control in the awarding of contract transactions. They can, therefore, exercise bias in favour of companies in which they have a financial stake, or companies of their allies; favours in return for which they receive political favours or an advantage in other business deals (Gillies, 2009).

An example of NNPC's patronage driven decisions made in the awarding of such contracts involves PPP Fluid Mechanics Limited (PPPFM) and Ocean Marine Securities (OMS). Reportedly, PPPFM was handpicked in a secret "bid" to receive a lucrative contract, which had not been advertised, to transport crude oil from drilling terminals to refineries by ship. The original owners at that time appeared to be fronts because eight months later, PPPFM was owned by Idahosa and Tunde, the latter of which is a, "longstanding ally" of former President, Goodluck Jonathan. OMS, also owned by Idahosa and Tunde, also received a contract, under the same suspicious conditions to provide security for the PPPFM ships transporting the crude oil. Nonetheless, the most inappropriate aspect of this deal was the fact that it involved the transportation of the oil via ship, which cost several times the cost of transporting the oil via NNPC's subsidiary, the Pipelines and Product Marketing Company's pipelines. NNPC's financial loss from this has been extremely substantial since the price it paid to transport crude via ship was ₦1 131.74 per barrel, (equivalent to \$5.68) whereas the price it could have paid to transport crude through PPMC's pipelines, would have been ₦5.97 (Ogala, 2015).

#### **7.1.2.2.2 Awarding of term/lifting contracts**

The awarding of contracts, which allow the export of crude oil, is also highly discretionary and the beneficiaries of these contracts, in particular, are given the opportunity to make extremely high profits through arbitrage. This is due to the fact that these transactions involve official prices, as opposed to prices determined by the market. Therefore, the gap between these prices offers opportunities for large profits and incentivises corruption (Thurber et al., 2010).

This brings the discussion to that of the most critical activity with regard to the risk of corruption: NNPC oil sales. NNPC sells almost half of the total amount of oil produced by Nigeria, with sales of approximately one million barrels of oil a day, making the biggest contribution, which was estimated to be \$41 billion in 2013, to government revenues (Sayne et al., 2015). The oil sold by NNPC can be divided into two main categories: oil that gets sold for export and oil that is sold to feed local refineries that serve the local market.

### *Crude oil sold for export*

Regarding the former, on behalf of the government, NNPCs Crude Oil Marketing Division (COMD) sells most of its share of crude oil production for export at an official selling price (OSP) which it sets monthly. These sales are mostly to international traders, but also to local trading companies, foreign refineries, NNPC oil trading companies, other countries and briefcase companies (Sayne et al., 2015). The proceeds of these transactions accrue to the Federation of Nigeria's account in the Central Bank of Nigeria (Thurber et al., 2010).

These export sale agreements are called term or lifting contracts ("lifting" referring to the act of "loading oil onto a ship at an export terminal") (Sayne et al., 2015) and holders of these contracts are allocated a set amount of oil from the government's share of oil that they can purchase and lift, which usually ranges between 10 000 and 60 000 barrels a day (Sayne et al., 2015).

The most simple transactions involve NNPC selling to a trader who sells to a buyer in the global market, which can include "another trader, or a refining or oil storage company" (Sayne et al., 2015).

*NNPC → trader → global market*

However, when NNPC sells to an intermediary with more limited capacities such a briefcase company, that company then, "re-sells to a trading house that has the financial and operational wherewithal to actually lift and sell the crude" to a buyer in the global market" (Sayne et al., 2015).

*NNPC → briefcase company → trader → global market*

As with the abuse of power in other areas, the lack of transparency in the award procedures creates opportunities for corruption and patronage. Evidence of this is that the advertised award criteria for term contracts, which include, among others, minimum requirements of turnover and local content such as labour, is not applied consistently.

This is undoubtedly to benefit politically connected individuals' companies, which by managing to attain a term contract, are placed in an extremely profitable position; more so if they are granted pricing terms that are especially favourable. As pointed out previously, such individuals profit from the difference between the OSP at which they buy crude oil and the higher World Price of crude oil, at which they sell it for when exporting (Thurber et al., 2010).

The risk for the delivery of patronage through these contracts is especially apparent when contracts are given to briefcase companies. These are small companies that generally resell the crude to more experienced intermediary trading companies with the financial and operational capacity to lift and sell crude oil on to end users such as refineries (Sayne et al., 2015). Evidence of this form of patronage is indicated by the fact that, in 2012, 50 term contracts were awarded, and of those that received these awards only around 12 – 20 of them were capable of financing the shipping and selling of their own cargoes (Sayne et al., 2015).

It is not clear that NNPC receives any commercial value from its dealings with briefcase companies. In fact, it is rather the briefcase companies that seem to benefit from these contracts, as, without much effort, they are able to capture margins from oil sales, which often fell within the range of \$0.25 - \$0.40 per barrel in 2013 (Katsouris and Sayne, 2013; Petroleum Revenue Special Task Force [PRSTF], 2012). They thereby diminish the estimated margins of, “\$100 000 - \$400 000” that should be accruing to NNPC per cargo made by traders” (PRSTF, 2012). Hence, the main purpose of such companies winning contracts seems to be the distribution of oil rents. This was more blatantly apparent before the 2000s, when generally, these companies had minimal capacities, often without offices or full-time staff. However, despite their limited capabilities, they still managed to enter into contracts with big traders who, “financed, lifted and sold whatever oil the briefcase compan[ies] got from NNPC, in exchange for a fixed per-barrel commissions” (Sayne et al., 2015). This meant the briefcase companies were guaranteed payment regardless of the sales performance of the trader. It is for these reasons that more and more briefcase companies came to be used as fronts by some

“politically exposed persons” (Sayne et al., 2015). To elaborate, it is common for briefcase companies to be owned by one or more private individuals who pose as a front for politicians in office and power brokers, with whom the briefcase company covertly splits its profit margins (Sayne et al., 2015). According to an expert in resource governance, briefcase entities proliferated under former President Goodluck Jonathan’s administration as a patronage system, and, “by 2014, Nigeria’s briefcase system was responsible for \$40 billion worth of oil contracts, using the Brent crude prices at the time” (African Network of Centers for Investigative Reporting [ANCIR], n.d.). Moreover, “a growing number appear[ed] to be businessmen and elites from the Niger Delta” (Katsouris and Sayne, 2013), which is no surprise given that Jonathan himself is a member of the Niger Delta elite, originating from the Bayelsa State in the South west area of Nigeria.

Some industry members support the award of contracts to these less experienced Nigerian Companies, on the basis that it would be good to, “boost home-grown trading skill and grown local content in the Nigerian crude trading business” (Sayne et al., 2015). However, this argument is moot in the many cases in which the briefcase company, neglects making efforts to enhance indigenisation or market growth, but instead focuses on channelling wealth from everyday civilians to elites (Sayne et al., 2015).

Another avenue through which potential term contract holders influence or guarantee their award of a contract is through bribes. In fact, some industry members have admitted that bribe payments remain an integral part of the business and that it is common for companies to bribe an official or someone who is well connected, politically (usually referred to as a sponsor), in exchange for being awarded an allocation of crude (Sayne et al., 2015). In these cases, the “sponsor” who can sometimes be a member of, “foreign, political elites, including government officials” is not necessarily a secret owner of the paying company (Sayne et al., 2015).

There is also the issue concerning the price at which NNPC sells oil to intermediaries. As mentioned, the profits that intermediaries make arise from the difference between the

OSP and world prices. By NNPC not selling directly to global buyers, it loses out on capturing the margin that intermediaries do. Sayne et al (2015) argue that this begs the question as to how and why NNPC prices crude oil at lower levels, and whether this is purposefully done to, “allow for payments to intermediaries or their hidden owners” (Sayne et al., 2015). According to the World Bank, during the Abacha administration, NNPC regularly lowered prices, which meant that middlemen could earn higher commissions. What is interesting, as Sayne et al (2015) note, is that, “buyers agree to cargoes NNPC offers them before knowing the price differential, suggesting they are fairly confident of obtaining wide enough margins” (Sayne et al, 2015). If not, they would likely not buy the cargo, if the payment for the “politically exposed person” could not be covered (Sayne et al., 2015). Although there is no proof to support this, given that Nigeria is an LAO, this may be plausible. The ruling coalition could be transferring these oil rents with the aim of dispersing rents to a wide enough web of elites, which would be viewed as necessary to keep the LAO stable.

Furthermore, for some term contract holders, their insatiable desire to accumulate rents drives them to perform more corrupt activities. For example, some of the term contract holders who sell to intermediaries, purposefully, “sell their cargoes at losses to intermediary companies (in which they have an ownership interest) that are located in offshore jurisdictions” (Sayne et al., 2015). This is done in order to be able to record a loss in their books and avoid income tax. However, they then re-sell the oil at a profit through their intermediaries, thereby, making super large profits.

### ***Crude oil sold for refined products***

Regarding the remaining share of the government’s crude oil, which was about 35% in 2013, this gets sold to NNPC’s subsidiary, the Pipeline and Products Marketing Company (PPMC) (Sayne et al., 2015). The amount sold to PPMC, is referred to as the “domestic crude allocation” and is supposed to be processed by Nigeria’s four state-owned refineries that should supply the domestic market (EIA, 2015). Essentially the purpose of the DCA is to provide fuel to the domestic market. The revenue generated through the sale of the petroleum products from the refineries is meant to be used to pay NNPC for

the crude that PPMC received, and subsequently paid to the government (Sayne et al., 2015). However, since these refineries operate at around 30% of their full capacity, and generally only meet at most 15% of the local demand (Thurber et al., 2010) about 75% of the domestic crude allocation is generally sold by NNPC for export, “to some of its term customers, on terms that are similar to regular export sales” (Sayne et al., 2015). Therefore, PPMC also pays NNPC for the crude with proceeds that it gets from the sales of crude for export (Sayne et al., 2015).

#### **7.1.2.2.3 Awarding of import permits**

Regarding how Nigeria attempts to serve its domestic demand for refined products, which its refineries fail to do, Nigeria has employed multiple means of obtaining and supplying fuel. The four methods that have been used involve:

- 1) NNPC refining crude oil at its local refineries and selling most of the fuel to private fuel marketing companies, with a smaller share being sold, through NNPC Retail Ltd., which is its network of retail filling stations (Sayne et al., 2015).
- 2) NNPC, through PPMC, importing via the open account import system, which is a mechanism in which refined products are imported and delivered to PPMC by traders in return for cash. PPMC then sells these products to fuel retailers, among other types of intermediary companies (Sayne et al., 2015).
- 3) The Petroleum Product Pricing and Regulatory Authority (PPPRA) granting import permits, without the involvement of NNPC, to private marketers who import petroleum products and sell them to a various wholesale and retail buyers (Sayne et al., 2015).
- 4) NNPC importing refined products through a cashless transaction, called a swap deal, which involves bartering some of the unrefined domestic crude oil allocation for petroleum products (Sayne et al., 2015). Note, after the open account system was phased out in 2011, due to PPMC’s inability to pay fuel importers, an increasing amount of this unrefined domestic crude allocation has been set aside for oil-for-product swap deals. In

fact, by 2011, 79 million barrels of crude, which was almost half of the DCA, and worth around \$9 billion, was allocated to swaps (Sayne et al., 2015).

Of these, the third and fourth methods are most relevant to the discussion of patronage and economic loss with regard to import permits.

Regarding PPPRA private marketers, past instances have shown that being granted such permits puts them in a prime position for corruption due to a lack of checks and balances. The corruption risk stems from the fact that these companies are entitled to subsidy payments from the Petroleum Support Fund (PSF), which reimburses them for the difference between the price at which they imported fuel and the subsidised price at which they are obligated to sell the fuel for in Nigeria (Sayne et al., 2015). This entitlement has incentivised some players to cheat the system. One way this has been achieved is by marketers obtaining petroleum products at subsidised prices from NNPC, and then forging documents, which present the fuel as imported petroleum products (Gillies, 2009). This allows them to make a claim to the PSF and benefit from a fraudulent subsidy payment. According to news reports, one of the culprits of this fraudulent activity is Ontario oil and gas, which was prosecuted for reportedly being the culprit of a ₦1.9 billion subsidy fraud (Ezeamalu, 2013a).

In terms of the swap deals, there are two types of swaps agreements, which NNPC enters into. One, referred to as a Crude-Oil-for-Refined-Product Exchange Agreement (RPEA), involves the trader receiving an allocation of crude, in return for which the trader takes on the responsibility of importing refined products that have an equivalent monetary value to the crude they received, “minus certain agreed fees and expenses, the value of which the trader keeps” (Sayne et al., 2015). The second type, known as an Offshore Processing Agreement (OPA), has terms whereby a refiner or trading company lifts a specific amount of crude, refines it abroad and returns the resultant products to NNPC, which should be in accordance with the expected yields of diesel, kerosene and gasoline outlined in the contract.

Similar to the case of other activities, the awarding of RPEAs and OPAs is opaque in nature, with a lack of oversight. Concerning the contract winners for these swaps deals, there is also evidence of patronage, as in the past some have lacked basic trading capabilities, such as being able to, “market their own crude and source their own products directly from refiners” (Sayne et al., 2015). For example, in the case of RPEAs being awarded to Aiteo and Ontari in 2011, these companies had had low profiles in the industry before being awarded their contracts that year, which in fact was a first time experience for both of them (Sayne et al., 2015). These discrepancies are indications that their contracts may have been awarded as an extension of patronage.

The main loss to NNPC of such practices arises when the contract terms agreed on are excessively favourable for the lifters. An example of this according to Sayne et al (2015) is in the OPA deals NNPC had with Aiteo and SIR-Sahara, whereby the favourable terms of three provisions in the two contracts, together, were estimated to have resulted in a loss to NNPC of \$381 million in one year. One of these provisions was in the refining fuel loss allowance. This allowance relates to the fact that when oil is refined, the amount of product that results is less than what was used, because of chemical conversion. In this case, although the average loss of refining is usually 8% for these companies, the contracts provided an allowance of 10.5%. Thus, according to Sayne et al (2015) NNPC lost out on an extra 70095MT of products that it could have received had it used the more realistic 8% allowance, and this resulted in a loss of \$70 211 896 in 2011.

On the whole, as part of an attempt to keep the LAO stable, various bodies in the oil sector, though predominantly the NNPC, by virtue of its inefficient, bureaucratic nature and incompetence as an oil company and regulator, administer patronage to elites from the upstream to the downstream sector. The economic impact of this is that much of the revenues that could be earned by the state and put to use productively get wasted in return for political favours, which bear no fruit to the nation. The subsidy fraud which reportedly cost Nigeria \$6.8 billion between 2009 and 2011 (“Factbox: Nigeria...”, 2012), as well as the revenues lost through extremely favourable terms in lifting contracts, service contracts and swap deals which benefit the contracts holders, among

other factors, have culminated in NNPC's failure to maximise long-term oil revenues, which in turn has undermined Nigeria's economic growth.

## **8. Conclusion**

Essentially, changes in rent distribution have had an effect on the economy in a number of different ways. With regard to formal rent distribution system, through the revenue allocation formula, state creation and other government actions, the effect has been indirect as it was predominantly channelled through conflict and political instability. In contrast, with regard to the less formal rent distribution through patronage and corruption at the organisational level in the oil industry, oil's impact on rent distribution has had more of a direct impact on the economy.

It appears that though agriculture was the mainstay of the economy prior to independence, as oil gained prominence in terms of its revenue generation, agriculture's role in the economy declined and the revenue allocation formula underwent increasingly drastic changes in order to allow the ruling elites and their close ties to have more access to oil revenues. In fact, what transpired was that, "with the ascendance of oil (found mainly in the homelands of the ethnic minorities) as the pivot of the nation's economy, the interest of derivation on the part of those who wield state power, faded, given that it would now promote the interests of minorities who do not hold state power" (Ebienfa and Kumokuo, 2012).

At the same time, as oil's role in the economy rose, the centralization of revenues at the federal centre increased. This, together with the proliferation of new states, left the resulting states unable to operate independently of the federal government, of which they eventually became mere appendages. Essentially, over the course of time, the revenue allocation formula and the number of states were altered in favour of the major ethnic groups in the federal government at the expense of the minority ethnic groups (Ebienfa and Kumokuo, 2012).

The result was that, a series of political crises occurred which resulted in a civil war and

numerous coups. While the war resulted from sentiments of exploitation, and marginalisation along ethnic lines, the numerous changes in governments, specifically the coups, were more of a result of rivalry within the predominantly northern military, than that of inter-regional civilian ethnic conflicts. This is because due to the centralisation of the bulk of Nigeria's revenues at the federal level, the state offered unfettered access to oil rents, which fuelled competition among different factions of the military for government posts and especially leadership (Omeje, 2006).

The ultimate impact on the economy is that economic growth has been stunted. This is in part due the fact that violent conflict interrupts oil production and productivity in the rest of the economy, but also because political instability deters investment as the notion of property rights is undermined, and uncertainty in the economy is high.

Furthermore, patronage in the oil sector results in the wasteful leakage of revenues from the state, away from nationally productive uses. Instead, the revenues get used unproductively to the benefit of a few well-connected rent seekers as opposed to the nation as a whole.

Overall, with the lack of an institutional architecture that limits the power of the federal government, and that effectively enforces checks and balances in the oil sector, Nigeria's experience of economic underperformance will remain perpetual in nature. Although steps in the right direction have been made with the maintenance of democratic civilian rule since 1999, and an improvement in the transparency of the oil sector, Nigeria has a long way to go before its institutional environment will be formidable against the manifestation of the resource curse.

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