FISCAL REGIMES OF OIL PRODUCTION IN NIGERIA

Eze A. Eze, PhD
Department of Economics,
Nnamdi Azikiwe University, Awka,, Anambra State, Nigeria
Email: ae.eze@unizik.edu.ng; +234 - 803 - 333 -1934.

ABSTRACT
This article used the analytical political economy method in the short survey of the nexus between fiscal policy and operations covering the different exploration and exploitation arrangements up to the Joint Venture Agreements (JVs) in the Nigerian oil industry including their tax regimes, how the challenges in the JV special purpose vehicles gave rise to the Production Sharing Contract (PSC) model, discussion of PSCs in some detail and the current tax regime governing them while a brief note was made of Service contracts. In the process, it was found that the opaque nature of the operation of the contracts calls for greater transparency to reduce the propensity to tax avoidance by the International Oil Companies (IOCs) and increase revenues to the government. Consequently, it was recommended that auditing of IOC operations (benchmarked against international best practices) should be more contemporaneous and cover profit and loss making operations instead of taking as long as three years to audit only profitable operations through which bloated costs of unprofitable operations are written off by the IOCs thereby sub - optimizing government revenue generation.
Key words: Fiscal policy, Joint Venture Agreement, Production Sharing Contract, Concession.

INTRODUCING FISCAL POLICY IN BRIEF

To Anyanwu and Oaikhenan (1995, p. 94), 'fiscal policy refers to the policy of the government with respect to the level of government expenditure on purchases of goods and services, and on transfers, tax structure and debt operations', in other words, government's three major macroeconomic activities are spending on goods and services (G), taxing (T) and borrowing (B). By fiscal policy, we refer to government actions affecting its receipts and expenditures which we ordinarily take as measured by the government's net receipts, its surplus or deficit' (Culberton,. in Jhingan (2003, p.981) takes us to the aims of fiscal policy when he defines it as 'changes in taxes and expenditures which aim at short run goals of full employment and price stability'.

As a purposive activity, fiscal policy is meant to increase economic growth rate, maintain domestic price stability, ensure exchange rate stability, reduce the rate of unemployment, work towards distributional equity, improve the human development indices of educational attainment, disease prevalence and poverty incidence, and currently, the attainment of the Sustainable Development Goals (SDGs) 2030. It is the instrumentality of budgetary policy-deficit, surplus or balanced- and compensatory (built in stabilizers and discretionary-changing taxes with government expenditure constant, changing government expenditure with taxes constant and variations in both expenditure and taxes simultaneously) fiscal policies that governments attempt to achieve

macroeconomic objectives. Essentially, the most concrete expression of fiscal policy is the government's annual budget and the development plans financed largely by crude oil exports revenues since the early 1970s.

OIL AND NIGERIA'S FISCAL POLICY

What comes to popular mind is that oil was first struck at Oloibiri in present day Bayelsa State in 1956 and in commercial quantity in 1958 when 1.876 million barrels was produced and 1.820 million barrels first exported. But records have it that as far back as 1928, oil was struck at Edda near Afikpo in the present Ebonyi State but was thought not to be in commercial quantity (Section 10, paragraph 208, 1928 Colonial Report No 1435 on Nigeria). Prior to the oil find, agricultural produce like palm oil, cocoa, groundnut and rubber were the main export goods and mainstay of the economy by contributing on average, over 80% of export revenues between 1960 and 1969. This structure was maintained till 1970 when the contribution of the oil sector was 57.6% and especially so by 1975 when it accounted for 92.6% averaging 97% up to 1995.(Anyanwu, Oyefusi, Oaikhenan, and Dimowo, 1997, p.59).

Table 2.1 below clarifies the juxtaposition of oil and non oil exports as sources of government revenue in Nigeria between 1960 and 1995 with 1970 as the turning point in favour of oil exports;

Table2. 1: OIL PRODUCTION AND EXPORTS IN NIGERIA; 1958 - 1995

Year	Prod (m)	Dom Consmp(m)	Oil Export(m)	Total Export Revenue(Nm)	Oil Export Revenue(Nm)	Share of oil exp. Rev (%)	Non oil Exp Rev(Nm)	Share of non oil Rev(%)
1958	1.876	-	1.820	-	-	-	-	-
1960	6.374	-	6.244	330.40	8.80	2.80	321.20	97.20
1965	99.36	-	96.99	536.80	136.20	25.40	400.60	74.60
1970	395.80	12.23	383.50	885.40	510.00	57.60	375.40	42.40
1975	660.15	32.51	627.64	4,925.50	4563.10	92.60	362.40	7.40
1980	753.40	134.86	656.26	14,077.00	13,523.00	96.10	554.60	3.90
1985	547.09	60.45	450.01	11,214.80	10,890.60	97.10	324.20	2.90
1990	660.56	112.31	548.25	109,886.1	106,626.8	97.0	3,259.30	3.0
1995	715.40	98.50	616.90	748,368.1	728,265.3	97.3	20,102.80	2.7

Sources:

Anyanwu, et al(1997, pp. 58-59)
Attamah,N.(2000, p.212). Petroleum Economics-Operations and Practices of the Oil Industry in Nigeria. Enugu, Marydan Publishers.

Non oil export's contribution fell from 97.2% in 1960 through 74.6% in 1965 to 42.4% in 1970 and plummeted to 2.7% in 1995. Conversely, oil exports' rose from 2.8% in 1960 through 25.4% in 1965 to 57.6% in 1970 and averaged over 96% from 1975 to 1995. The dominance of the oil sector in Nigeria's fiscal operations since 1970 has not changed notwithstanding the "economic diversification" objective contained in the Second National Development Plan (1970-1974). Even with the disruption of oil exploration and exploitation by the Niger Delta militants in the 1990s and the massive stealing of crude in the past two decades of the new millennium, 'oil exports accounted for over 76% of total exports in 2021 and in the previous year, was slightly lower at 75%' (https//www.statistica.com, retrieved 12/04/2024).
As the most dominant sector in Nigeria's fiscal operations, the strategic importance of oil exploration and exploitation to the economy cannot be over emphasized.

MODELS OF OIL EXPLORATION AND EXPLOITATION CONTRACTS

Since the emergence of 'the Seven Sisters', world oil market had been dominated by the International Oil Companies (IOCs) accounting for '76% of all Western World's oil production, 58% of total refining capacity and 66% of the tonnage of the tankers operating internationally'(Attamah,2000,pp.160–161). With the advantages of their multinational character, vertical integration, oligopolistic market structure, large size, substantial resources, research capability and technological superiority over competitors, skilled manpower, superior industry knowledge and worldwide market, they had the capacity to bargain on favourable terms with less developed exporting countries which host their activities.

From adopting the United States Gulf as the 'basing point' in pricing to incorporating the Persian Gulf as the second 'basing point' for pricing and calculation of transport costs for the Eastern hemisphere market (Attamah, 2000, p.161) and to book keeping operations for their concessions in host countries regarding exploration , production, transportation, refining and marketing, their general strategy involves 'tax avoidance' to the host countries and aggregate profit maximization by the use of transfer pricing accounting methods for the companies.

IOCS AND OPERATIONS MODELS IN NIGERIA

The Traditional or Licensing Model

Owing to the weaker bargaining position of Nigeria, the relationship between the IOCs and Nigeria pre independence was the traditional concession or licensing model (Onyi-Ogele,2016,p.137) in which the oil blocks were practically owned by the Concessionaire IOCs as governed by the Petroleum Profits Tax Act (PPTA) of 1959 which took retroactive effect from January 01, 1958(Adeyemi, p.6). Here, the IOCs 'received the exclusive right to explore, produce, market and transport (EPMT) oil and gas in return

for paying specified costs and taxes'(Onyi-Ogele,2016, p.137) and are characterized by large contract areas, long duration of between 40-75 years subject to renewal, extensive 'plenary rights' over ALL the minerals in the area and not just oil and gas, virtual assumption of sovereignty by the IOCs over the host country's natural resources, exclusion of the host government from ownership participation and operational control, minimal financial benefits to the host governments and royalties based on volume and not value of output, no income tax was levied till about 1950,no provision for concession renegotiation, concessions were blatant economic exploitation as the concession area became the private property of the IOCs which assumed the status of an enclave or government within a government(Onyi-Ogele, 2016, pp. 138).

Financial arrangements before 1971(Attamah, 2000, pp.14 - 29) between the IOCs and Nigeria stood on the PPTA of 1959 wherein the parties shared the companies' profits on 50% -50% basis; gross proceeds, which is the application of fair agreed 'realised price' on volume produced and exported, is the basis for calculating royalty and profit tax even as rentals and other minor taxes were calculated separately. Capital allowance or depreciations were accelerated as below;

a. Qualifying building expenditure like houses, offices and jetties at initial 20% and 10% annually for a total of 8 years.
b. Qualifying plant expenditure like machinery, flow station equipment, pipelines and vehicles at initial 40% and 20% annually for a total of 3 years.
c. Qualifying petroleum expenditure like exploration surveys and exploitation drilling at initial 25% and 15% annually for a total of 5 years.

Partial government involvement came with the Oil Pipeline Act of 1965 to regulate the provision of transport infrastructure for the export of crude oil. This was followed by Decree No 65 of 1966 which modified capital allowance in favour of the government by elongating the recovery period as below;

a. Qualifying building expenditure at initial 10% and annual 5% for a total of 18 years.
b. Qualifying plant expenditure at initial 20% and annual 10% for a total of 8 years.
c. Qualifying petroleum expenditure at initial 15% and annual 10% for a total of 8.5 years.

In all these, the government did more of regulation to provide the enabling environment for the OICs to operate and develop the industry even as the companies dictated both production levels and oversaw low levels of government stake in the industry. The government responded by introducing the Petroleum Profits Tax (Amendment) Decree No 1 of 1967 in which the government invoked the 'most favoured nation' clause in the agreements to get them set a 'posted price' for oil exports as was done in Libya and also in 'expensing' royalties instead of as tax offsets thereby receiving additional profits taxes in line with OPEC terms on companies operating in host countries. Then the Oil in Navigable Waters Decree of 1968 prescribed measures to combat oil pollution with increase in the volume of oil production and exports.

Thus the traditional or licensing model subsisted in Nigeria until 1971 even as the Petroleum Act 1969 which provided for the right of government participation in an OML

or OPL was not exercised until, on joining the OPEC in 1971, the country was encouraged to 'take a stake in the operations of oil companies operating within their respective countries' pursuant to the cartel's Resolution XVI, Article 90 of June 1968 (Adeyemi, p.7). Consequently, Nigeria adopted the Joint Venture route to participation through the Nigerian National Oil Corporation, later Nigerian National Petroleum Corporation(NNPC), to the tune of 58% with Shell and 60% with Mobil, Chevron, NAOC, Elf and Texaco by way of "Participation Agreements" that 'create a common law relationship of co ownership, co tenancy or concurrent ownership'(Olisa, in Adeyemi, p.7).

The Modern Concession or Leasing Model

It is important to note that there is the modern concession model or leases as in Oil Mining Lease (OML) and Oil Prospecting Lease (OPL) being granted to companies in Nigeria. However, their features are less onerous than the traditional model to wit: duration of 20 years, reduced area of not more than 1,298 square kilometers, right to one mineral but not plenary right to all minerals, increased financial obligations for rents, royalties and higher tax rates of between 55% to 90% while petroleum in situ remains the property of the host country (Onyi-Ogele,2016, p.138).This model was basically the relationship arrangement between the IOCs and Nigeria after joining OPEC in 1971.

JOINT VENTURE (JV) AGREEMENTS

Under this model, two or more parties agree to develop jointly held OML or OPLs jointly by contributing to the costs and sharing the benefits or costs in accord with predetermined equity holdings in the venture. Spurred by the Second National Development Plan (1970 – 1974) objective of effective participation in natural resources exploitation, option to acquire the 33.33% stake offered by Agip in 1962 and compliance with OPEC injunction for members to acquire 51% controlling interests in oil operations in their countries by 1982 (Attamah, 2000,p.31) the Joint Venture Department was established to ;

a. Oversee all operations and ensure continuous exploration activities.
b. Ensure optimum production levels
c. Ensure a fair return on investments
d. Promote the transfer of technology to Nigerians.

JVs can be incorporated as non-profit , incorporated profit making, incorporated in tax haven profit making or non incorporated option which Nigeria operates (Onyi-Ogele,2016,pp.139-140).

SERVICE CONTRACTS

In service contracts, the contractor has no title to the oil if and when produced but to payment in cash or kind for the investment in addition to agreed profit. Contract is for a single oil block. Exploration period is short to between two and five years while termination before an oil find results to forfeiture of all contract investments. An incentive to the contractor is the first option to purchase agreed quantity of oil produced (Attamah, 2000, p33).

Essentially, service contracts are of two types: in 'risk service', the contractor provides all the capital for exploration and production with investment recouped on agreed terms

while in 'pure service', the government bears all investment costs with the contractor paid stipulated fees for the services.(Onyi-Ogele,2016,pp145-146).

PRODUCTION SHARING CONTRACTS AND REVENUE NEXUS IN NIGERIA

The greatest challenge to the Nigerian government was meeting her Joint Venture 'cash calls' or counterpart funding for investment expenditure programmes as at when due in view of the volatility in oil prices, thus of government revenues together with burgeoning socio economic infrastructure obligations. An advantage of the PSC over the JV model which Nigeria operated up to 1993 was that contractors almost guarantee continuous provision of funds for exploration even after the first discovery of oil. Originating in Indonesia in 1960, the Production Sharing Contract (PSC) model made its debut under the Deep Offshore and Inland Basin Production Sharing Contract Decree No 9 of 1999, made retroactive with effect from January 01, 1993 and as amended in 2019. Under this model;

> The International Oil Company (IOC) is appointed by the Host Country (HC), directly or through its National Oil Company (NOC), as the exclusive 'contractor' (and not as a Concessionaire) to undertake petroleum operations in certain area during specific time periods; The IOC operates at its sole risk, its own expense, and under the control of the HC; If petroleum is produced, it belongs to the HC, with the exception of a share of production that can be taken in kind by the IOC for cost recovery and for profit sharing; The IOC is entitled to recover its eligible cost under the PSC from a portion of the production from the area subject to the contract; After cost recovery, the balance of the production is shared, based on a pre determined percentage split between the HC and the IOC; The net income of the IOC is taxable , unless the PSC provides otherwise; The title to the equipment and installations purchased by the contractor pass to the HC either immediately or over time, in accordance with the cost recovery schedules.(Duval, in Jibril and Fishim,2023, p. 2)

Essentially, the PSC divides the oil between the HC and the IOC by way of 'cost oil' for the contractor or IOC to recoup production cost; 'equity oil' to guarantee a return on investment by the IOC; 'tax oil' to defray tax and royalty obligations by the IOC and 'profit oil' that remains after cost, equity and tax is shared between the IOC and HC at a stipulated rate after which the IOC pays income tax on its share of profit oil. 'Royalty' in cash or kind in oil is guaranteed minimum revenue inflow to the HC from the IOC irrespective of the profitability of the enterprise and if treated as expense instead of tax deductible, will increase overall government revenue (Etomi, in Jibril and Fishim,2023, p. 3). Petroleum profits tax was at 50% flat rate of 'chargeable profit' and must be paid in US dollars with royalty oil and tax oil allocated to the NNPC, while profit oil is allocated according to the terms of the PSC (Section 10, Cap 13,LFN,2004) .Currently, Federal Inland Revenue Service Information Circular No 2022/20 of August 12, 2022 clarified that taxation of PSC operations under the Petroleum Industry Act 2021 consist of hydrocarbon tax of 15% and 30%, companies income tax of 30% and education tax of 2.5%. These are exclusive of other taxes, duties or levies imposed by

the Federal, State, Local Government or Area Council Authority (Section 3(2) Cap 13, LFN, 2004).

It is important to note that with all the theoretical and practical advantages PSC has over the JV model, (Quarterman, in Jibril and Fishim, p18) observed that;

> Nigeria's PSC system tempts the contractor to engage in creative accounting to show increased cost and avoid showing a profit. The state is cognizant of that temptation and must dig deep, which increases everyone's costs and the potential for disagreement between the contractor and the state. Since the state is not sharing in the losses of unsuccessful exploration efforts, the contractor's appetite for exploration may be suppressed. In the end, overall government receipts may be lower in such a scenario because it is impossible to design an inexpensive administrative process that either finds cost over runs or provides incentives for contractors to hold costs down. In all the models of the Nigerian PSC, the provisions on the audit of the accounting records of the contractor's operation are simply to the effect that NNPC has the right to inspect and audit the accounting records of the contractor. It is not used to determine the cost incurred in the petroleum operations before it is recovered. The audit provision in all the PSCs is basically the same.

In view of the above, it is doubtful that the Petroleum Industry Act (PIA), 2021 addressed all the lacunae and grey areas which the IOCs exploit to shortchange the government of revenue as they use creative accounting and transfer pricing for tax avoidance while maximizing their aggregate profit.

CONCLUSION AND RECOMMENDATIONS

The narrative above has shown how Nigeria moved from being a passive underdog in bargaining power in the traditional concession model of operations in the oil industry through OPEC's salutary jolt into taking controlling stakes and participating actively by way of Joint Ventures and transition to Production Sharing Contracts when providing JV cash calls became very challenging to government fiscal operations. Notwithstanding the cash flow benefits of PSC to government, the opaque nature of the operation of the contracts calls for greater transparency to reduce tax avoidance by the IOCs and increase revenues to the government.

Consequently, auditing of IOC operations (benchmarked against international best practices) should be more contemporaneous and cover profit and loss making operations instead of taking as long as three years to audit only profitable operations through which bloated costs of unprofitable operations are written off by the IOCs thereby suboptimising government revenue

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