



***Petroleum Fiscal Reform in Nigeria: Re-balancing
the government take and encouraging cost
reduction***

***Dr Tim Okon & Joe Nwakwue
Ministry of Petroleum Resources, Abuja***

February 27, 2018





Presentation Outline

- ❑ **Fiscal Policy Reform: Why Now?**

- ❑ **The Purposes of Fiscal Policy Reform**
 - ✓ **Aim and Objectives of the Policy reform**

 - ✓ **Reform Framework; Fiscal Rules of General Application**

- ❑ **Fiscal Policy Reform Objectives and Instruments**

- ❑ **Other Fiscal Policy Instruments/Actions**

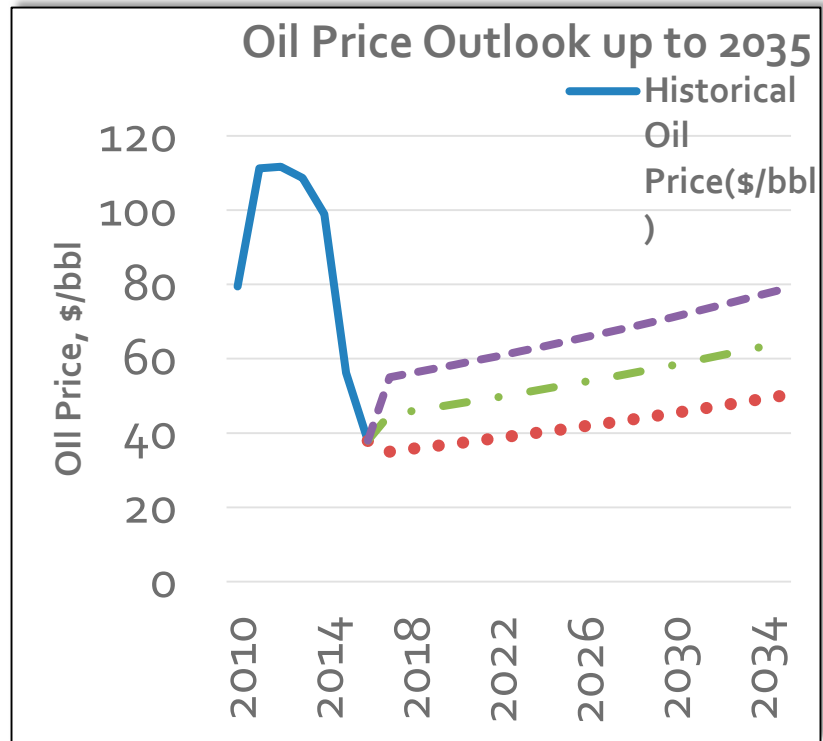
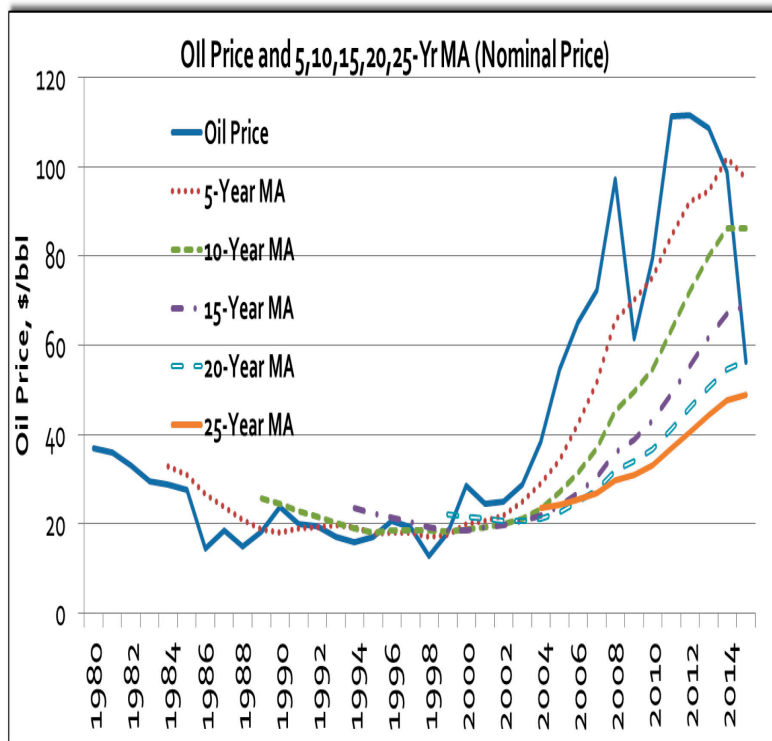
- ❑ **Forward-looking Analysis of Impact on Government Revenues**

Fiscal Policy Reform: Why Now?



Fiscal Policy Review is Necessary and Urgent!!!

- **Low Forecasted Long Term Oil prices**
 - \$35, \$45 and \$55 for low, most likely and high price assumptions



Source; MPR Fiscal Policy Team 2017

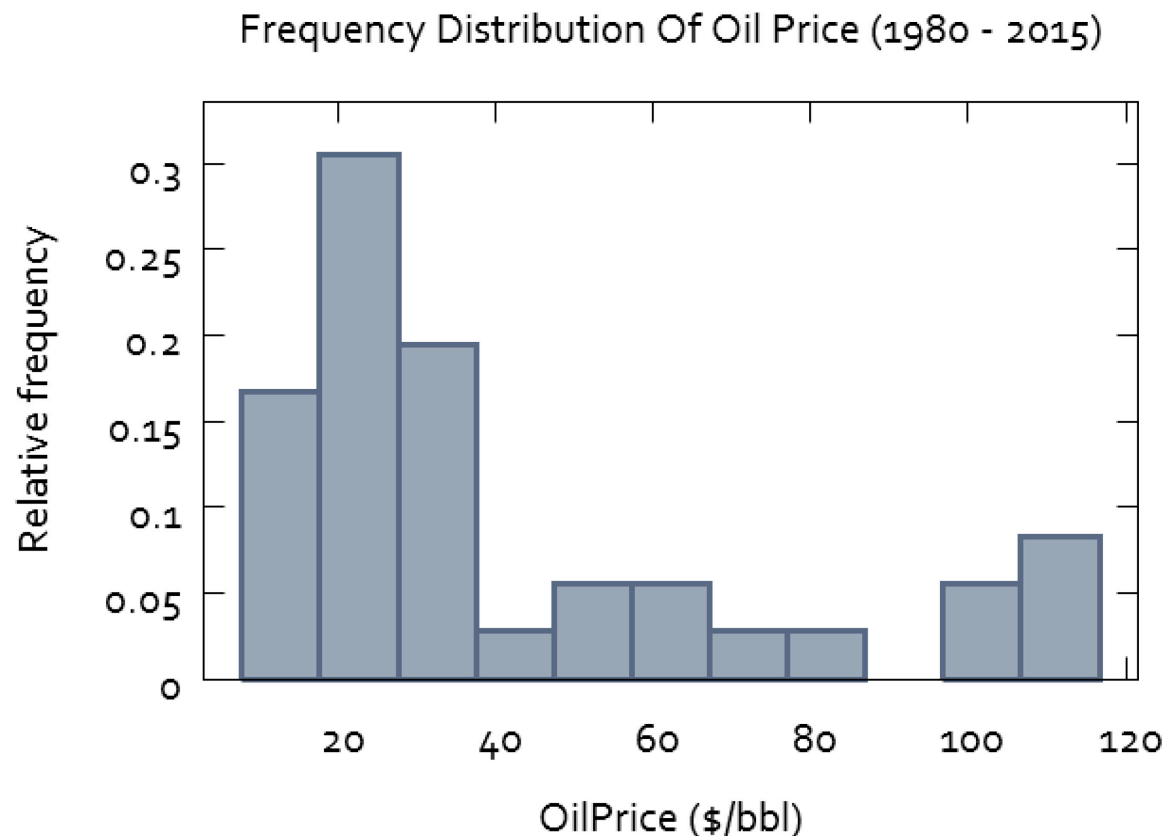
Fiscal Policy Reform: Why Now?



Fiscal Policy Review is Necessary and Urgent!!!

New Fiscal Rule to tackle commodity price volatility

- Oil Price exhibits Log-Normal Distribution
- ~67% of Oil Price is at most \$37.45/bbl
- Upper Quartile Oil Price \$57.25/bbl
- Mean Oil Price is \$41.76/bbl
- Trigger Price of \$50/bbl selected for Royalty by Price (windfall provision)
- Windfall trigger for savings into NSWF



OilPrice (\$/bbl)

Source: NNPC CP&S

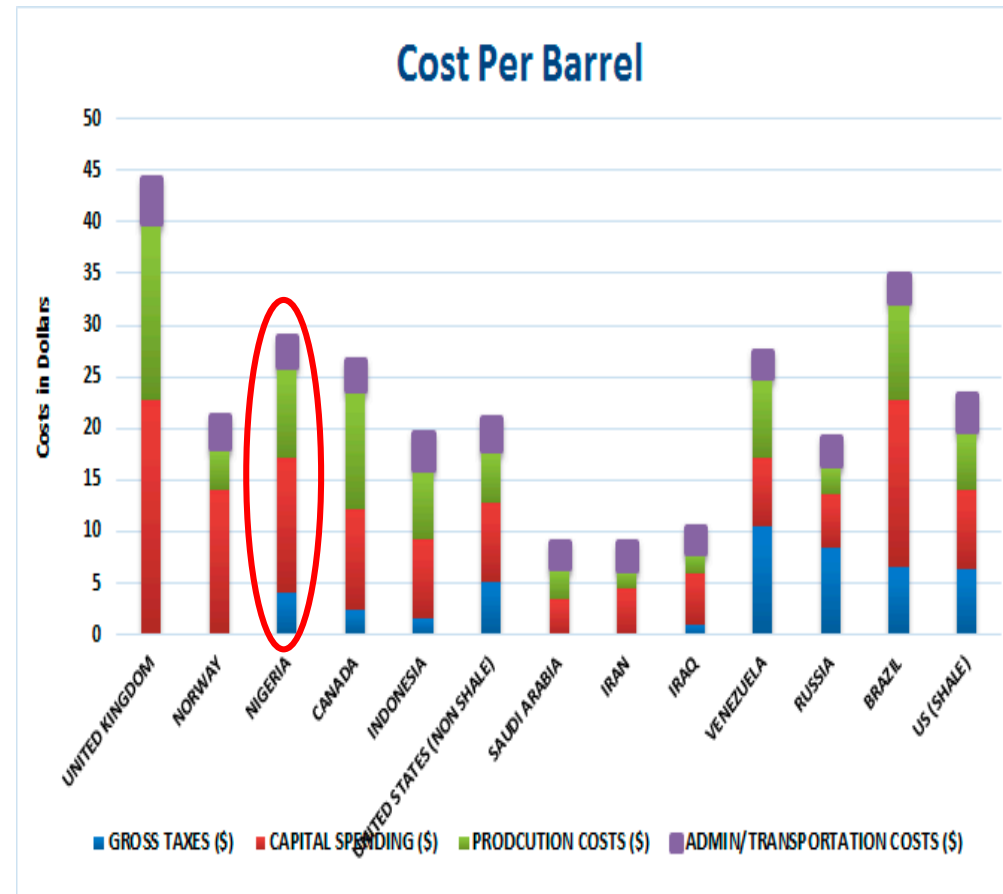
Fiscal Policy Reform: Why Now?



Fiscal Policy Review is Necessary and Urgent!!!

Escalating Unit Production Cost

- Nigeria has become a very high production cost environment
 - ✓ \$29 is exceedingly high for comparable terrain
 - ✓ Nigeria is presently more expensive than US Shale and Heavy oil in Canada
- High cost behavior driven more by fiscal system abuse and difficult operating environment
- No evidence of cost curtailment with decline in oil prices
- Savings index and government take has been severely erodes
- Current cost regulatory framework is ineffective



Source: Data from Rystad Energy March 2016

Fiscal Policy Reform: Why Now?

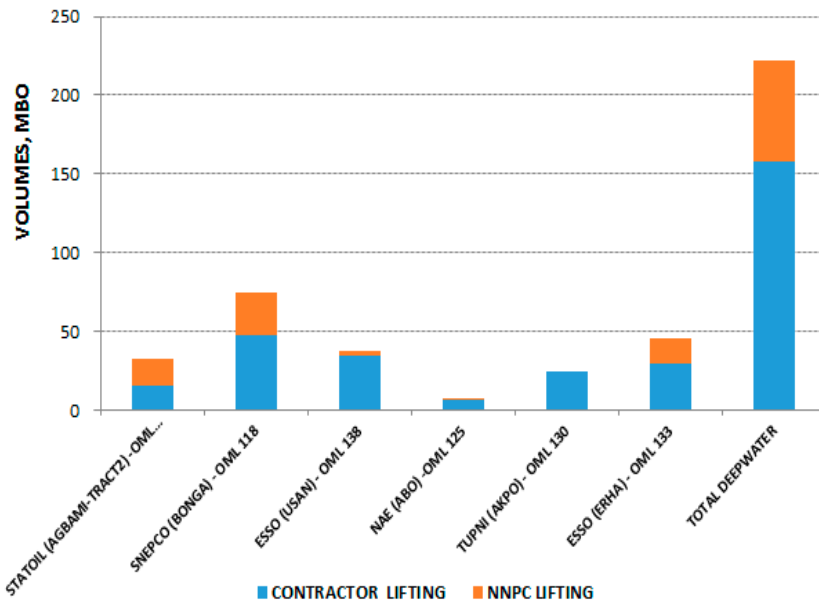


Fiscal Policy Review is Necessary and Urgent!!!

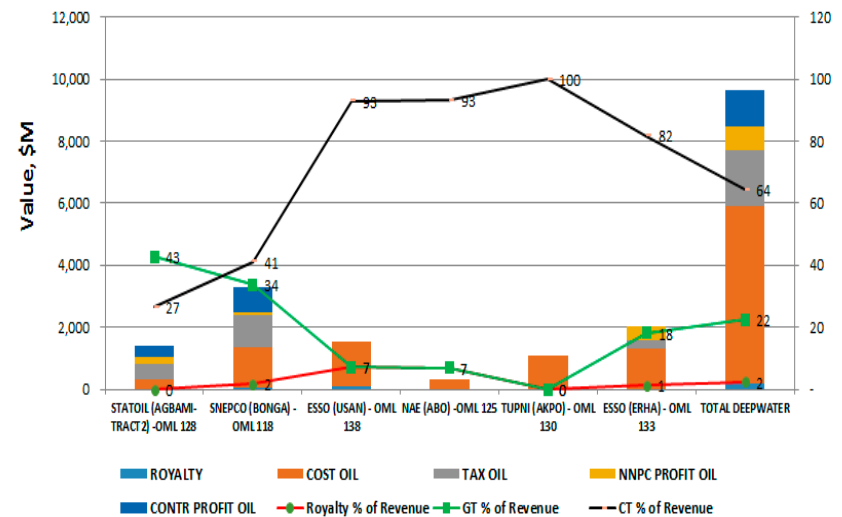
Escalating Unit Production Cost

- Unacceptably high Deepwater costs; Zero or miserly Government Take
- 2016; \$209M in royalties, \$5.7B cost oil, \$1.7b Tax Oil, \$800M Concessionaire profit, \$1.2b Contractor Profit, \$8.8b Revenues

2016 DEEPWATER CRUDE ENTITLEMENT LIFTINGS



2016 NIGERIAN DEEPWATER EARNING SPLIT



Source: Data NNPC COMD July 2017

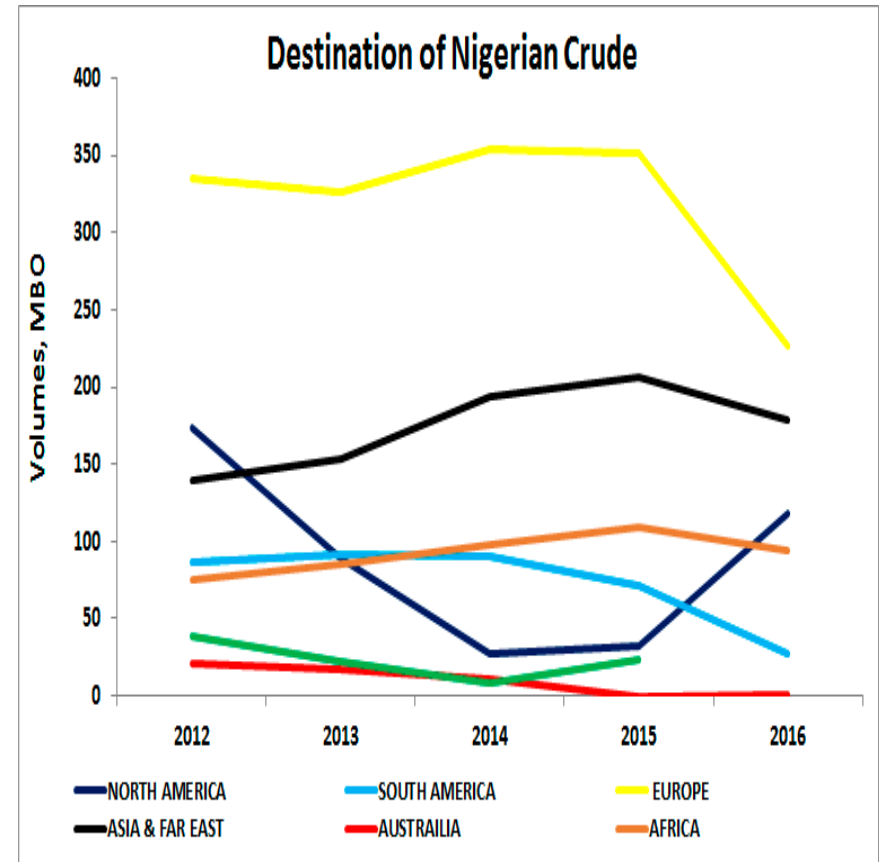
Fiscal Policy Reform: Why Now?



Fiscal Policy Review is Necessary and Urgent!!!

Technology/Market Disruption/New Discoveries

- US Shale Oil has meant severe decline in US oil imports from Nigeria
 - ✓ Increasing market uncertainty
- Significant distortion to our “traditional market”
 - ✓ Increasing sales to Asia and Far East
 - ✓ Geographically disadvantaged, Unstable supply
 - ✓ Netback pricing
- New discoveries (Ghana, Mozambique, Uganda, Kenya, Tanzania, Cote D’Ivoire) also mean increased competition for markets



Source; NNPC COMD

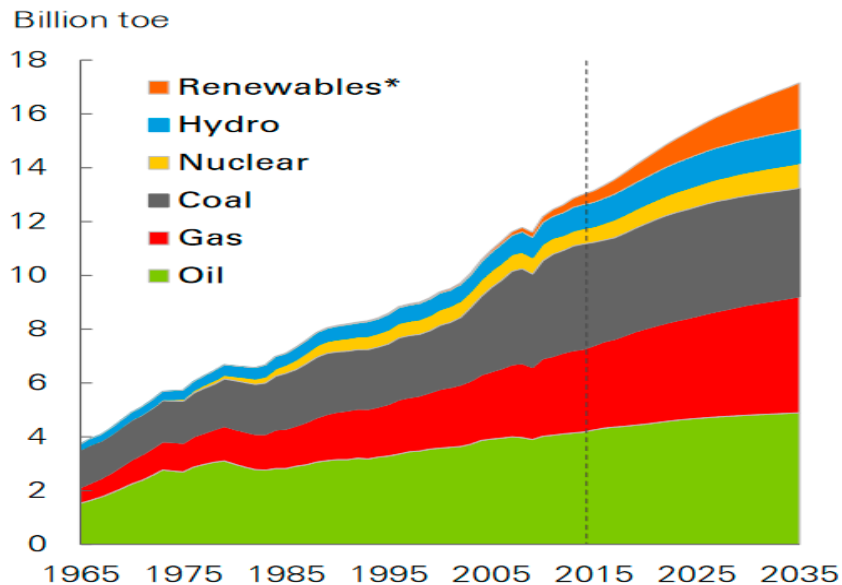
Fiscal Policy Reform: Why Now?



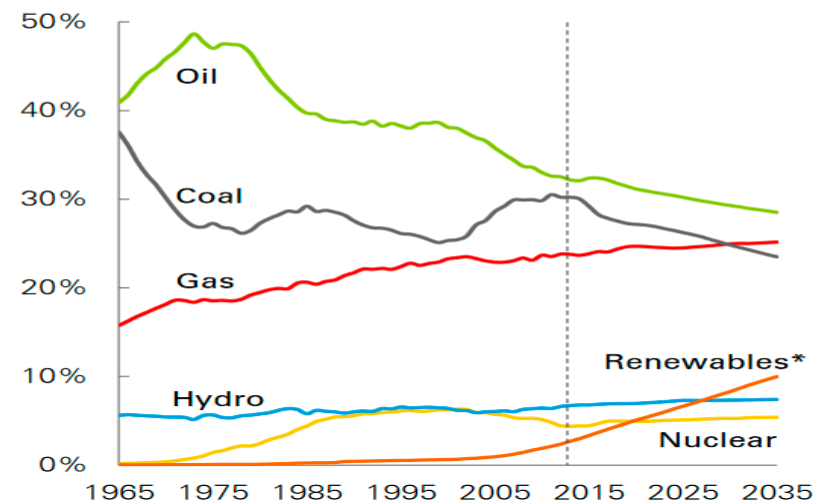
Fiscal Policy Review is Urgent!!!

- End of the Oil age; Shifting focus to Gas (Fiscal Policy focus on enabling gas)
- Forecasted growth in Overall Energy demand; Growth in Gas and Renewables. Diminishing demand for oil use.
- Declining switching costs
- Significant growth in Renewables forecasted and based on increasing demand for emission free transportation fuels e.g electric cars
- Clear and robust fiscal provisions for gas to underpin gas based

Primary energy consumption by fuel



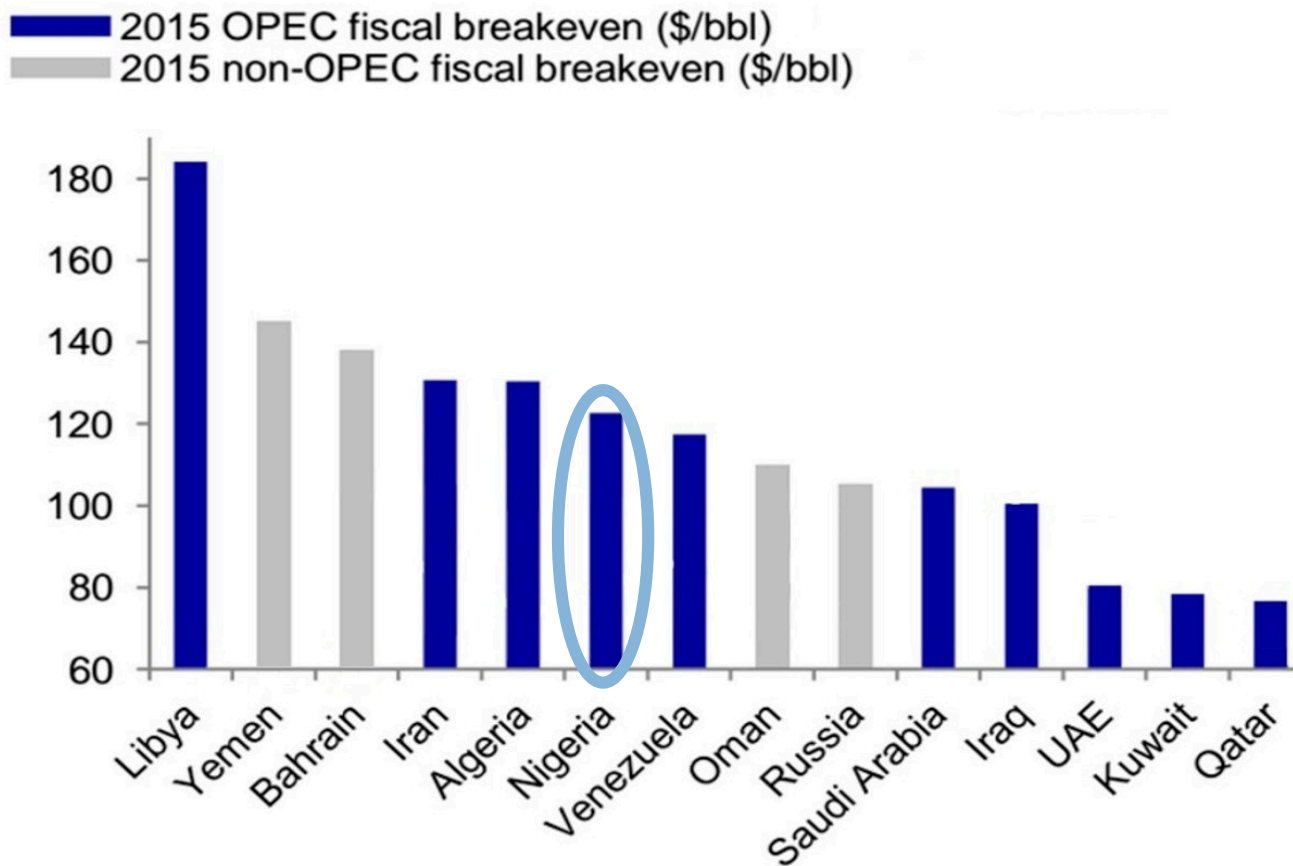
Shares of primary energy



2017 BP Energy Outlook

Fiscal Policy Reform: Why Now?

High Fiscal Breakeven Oil Price Exposes Nigeria's Vulnerability to Oil Price Volatility



Source: MPR Fiscal Policy Team 2016



The Purposes of Fiscal Policy

Aims & Objectives of Fiscal Policy Reform

- 1. The purpose of any sustainable fiscal policy is to maximize economic returns to the state while offering a risk balanced return to the investor.**
- 2. Fiscal policy must achieve competitive supply, balance the market, drive cost efficiency, and achieve competitive demand for sustainability.**
- 3. The role of the state is critical i.e. the state must not compel or Monopolize commerce rather, it should regulate it.**
- 4. The Oil and Gas sector must distinctly provide for upstream, midstream and downstream sub- sector. These elements of the value chain must be clearly demarcated to allow for broader participation of different players.**
- 5. Price volatility makes it imperative that the fiscal stance embedded in any fiscal policy must be right pricing or pricing that incentivizes supply and not scarcity.**
- 6. In the light of the price path of hydrocarbons, market based tools are preferred over command and control mandates.**
- 7. Fiscal policy must enhance economic value not through cross-subsidization, but right pricing of the commodity to reflect markets.**
- 8. The competitiveness of competing fuels must be preserved in any sustainable fiscal policy for the energy sector.**



The Purposes of Fiscal Policy

Aims & Objectives of the Policy Document

- The aim of the fiscal policy document is to produce a National Petroleum Fiscal Policy that will serve the socio-economic needs of all stakeholders in the petroleum industry and provide for best practice governance in the fiscal management of revenues.
- This document seeks to:
 - ✓ Establish the context within which the National Petroleum Fiscal Policy is developed and implemented
 - ✓ Set out the fiscal framework for a modern petroleum fiscal regime using fiscal rules of general application in Nigeria
 - ✓ Describe the strategic approach that would be used to achieve the policy objectives



Framework for Fiscal Policy Reform

Fiscal Rules of General Application

- ❑ **Fiscal Rules of General Application (FRGA) is the framework through which the interests of the state and that of the investor are codified. This is best articulated with respect to Resource-Rich Developing Countries (RRDC). FRGA are based on clarity and transparency which require that:**
 - ✓ **Rules are established by law and contracts are published**
 - ✓ **Laws are consistent with the nation's jurisprudence**
 - ✓ **Laws and contracts minimize discretion**
 - ✓ **Government revenue streams should occur during all production phases**
 - ✓ **And should increase with a larger share of revenues as profitability increases**
 - ✓ **Progressive fiscal systems that arise from FRGAs should be based on:**
 - **Royalty (Early Revenues);**
 - **Regular Corporate Income Tax (CITA)**
 - **Tax on Rent (Hydrocarbon Tax)**
 - ✓ **Simplify administration of Resource tax**



Fiscal Policy Reform Objectives & Tools

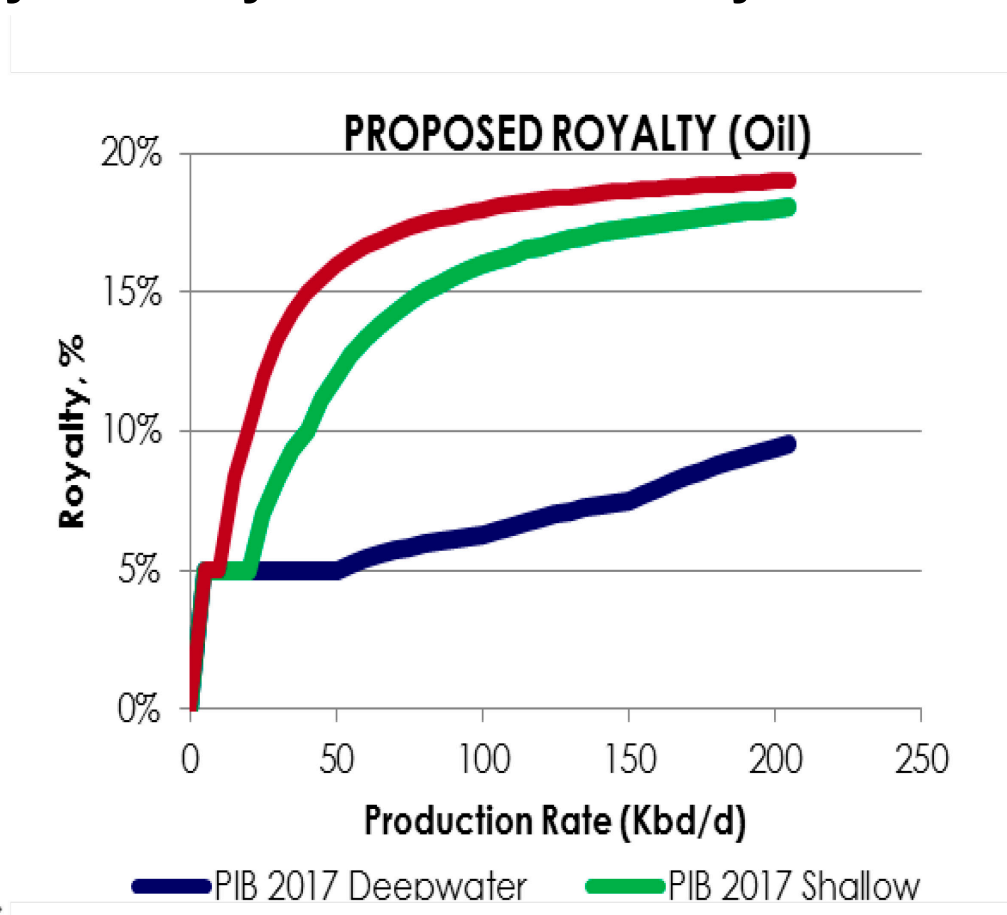
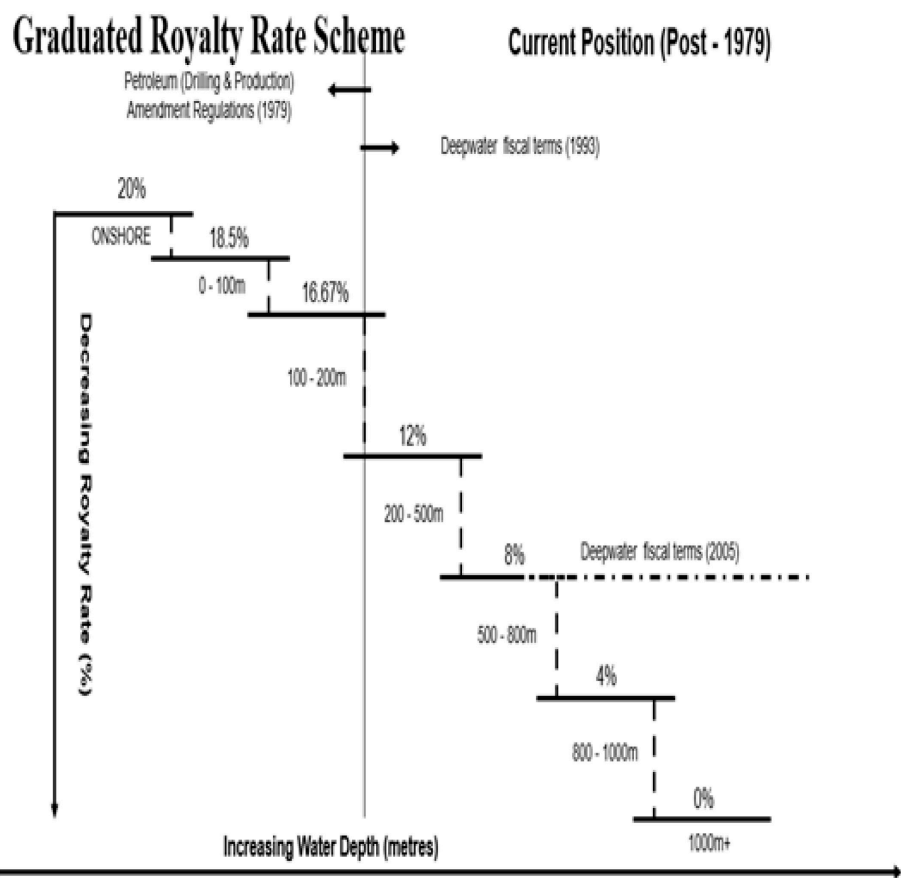
Fiscal Objective	Preferred Instruments
Rent Capture/Progressivity	Progressive taxes or production shares, ideally rate of return-based. Service fees.
Fiscal Neutrality / broad-based development	Profits-based taxes. No cross subsidy from oil to gas and vice-versa
Robustness/adaptability	Progressive taxes or production shares, ideally rate of return-based.
Early, dependable revenue	Royalties. Setting minimum percentage of profit oil, i.e., limiting annual share devoted to cost recovery
Limited risk exposure	Royalties
International competitiveness/ Balance of Objectives	Impact of overall mix of instruments is critical
Simplicity/Transparency	Royalty. Taxes or shares linked to easily observed indicators/Fiscal Rules that are published
Cost Curtailment	Cost Recovery Limits, Production Allowances instead of ITA, Lower Tax Rates



Fiscal Policy Objectives & Fiscal Tools

Rent Capture through Royalty by Volume - Oil

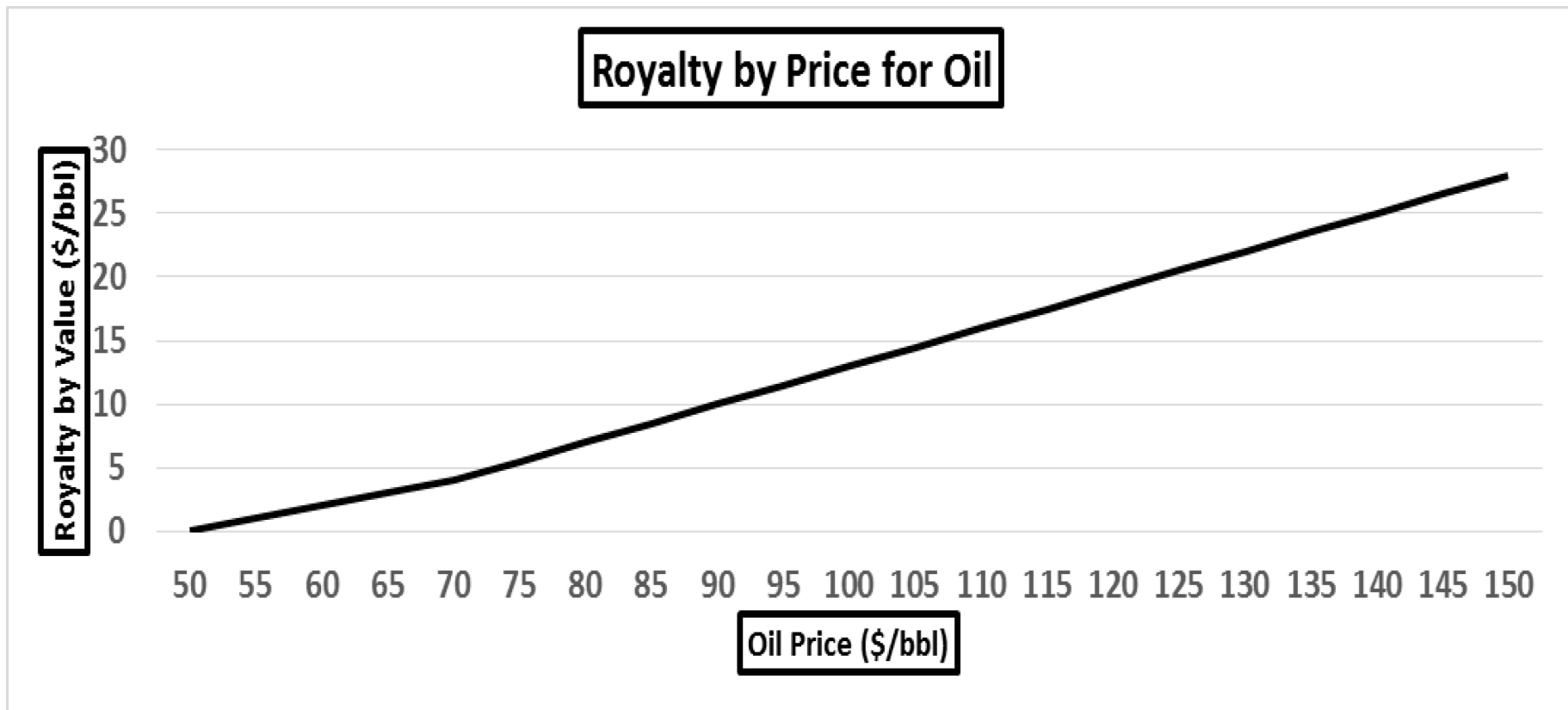
- Economic Rent in the new fiscal policy is enhanced through an optimized combination of Royalty Rates by Production and By Price.





Fiscal Policy Objectives & Fiscal Tools

Rent Capture through Royalty by Price - Oil



Royalty by price is 20% of additional revenue above a threshold oil price of \$50

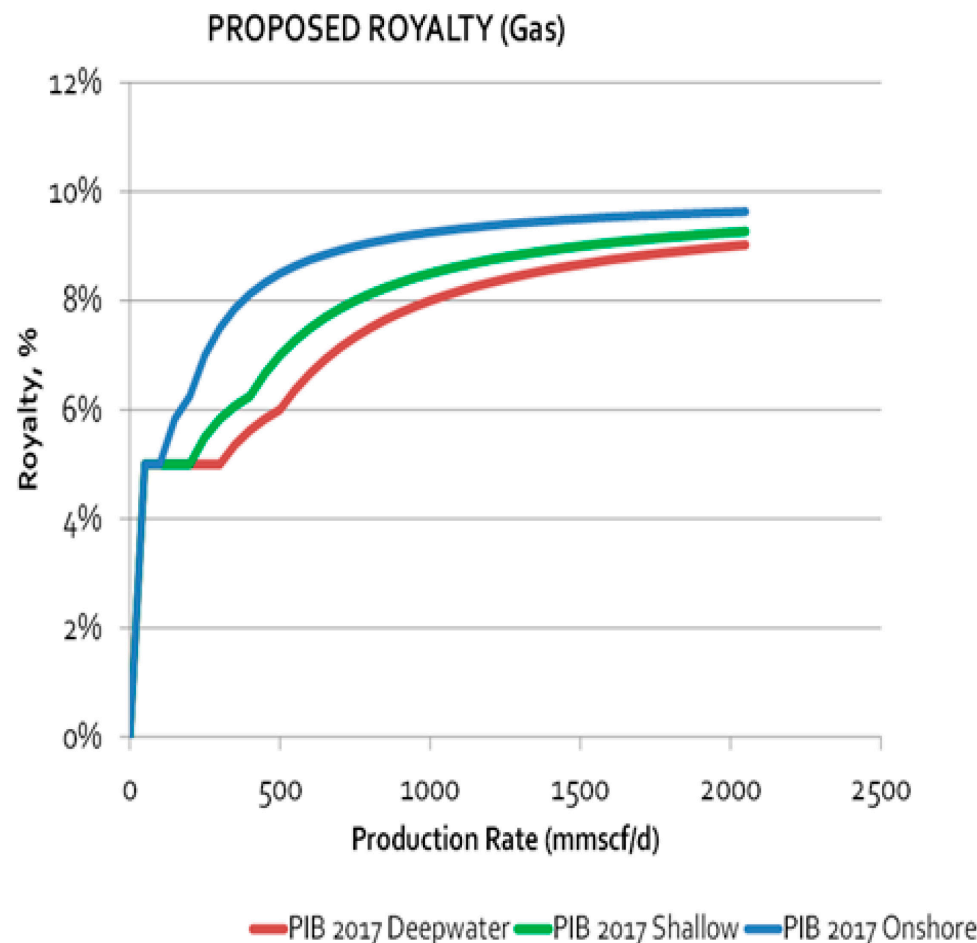


Fiscal Policy Objectives & Fiscal Tools

Rent Capture through Royalty by Volume - Gas

Gas Royalty Rates Based on Daily Production

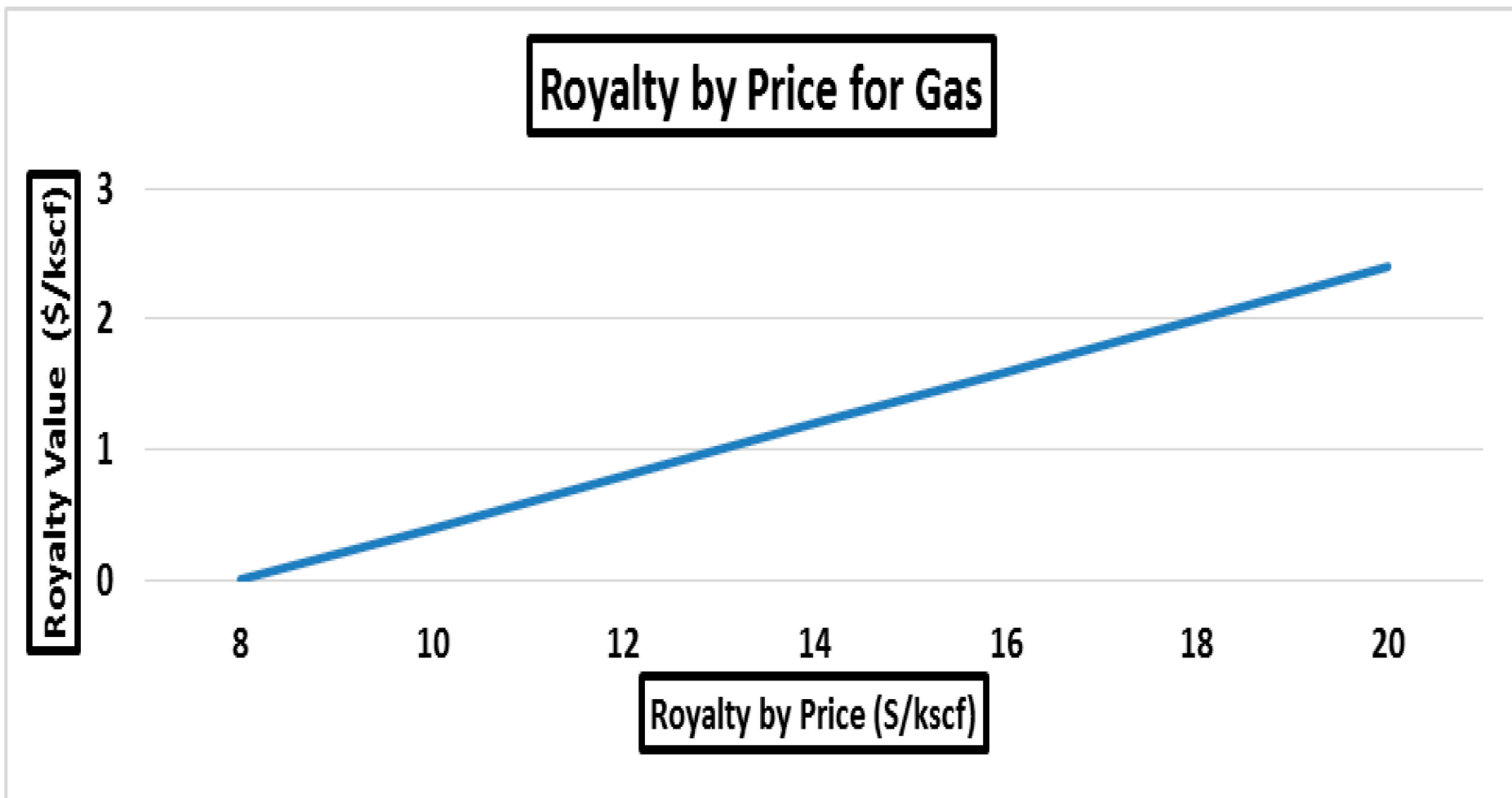
Gas Royalty Rate/PML	5%	7.5%	10%
Onshore (mmscfd)	0-100	>100<=200	>200
Shallow Water (mmscfd)	0-200	>200<=400	>400
Deep Water & Frontier (mmscfd)	0-300	>300<=500	>500





Fiscal Policy Objectives & Fiscal Tools

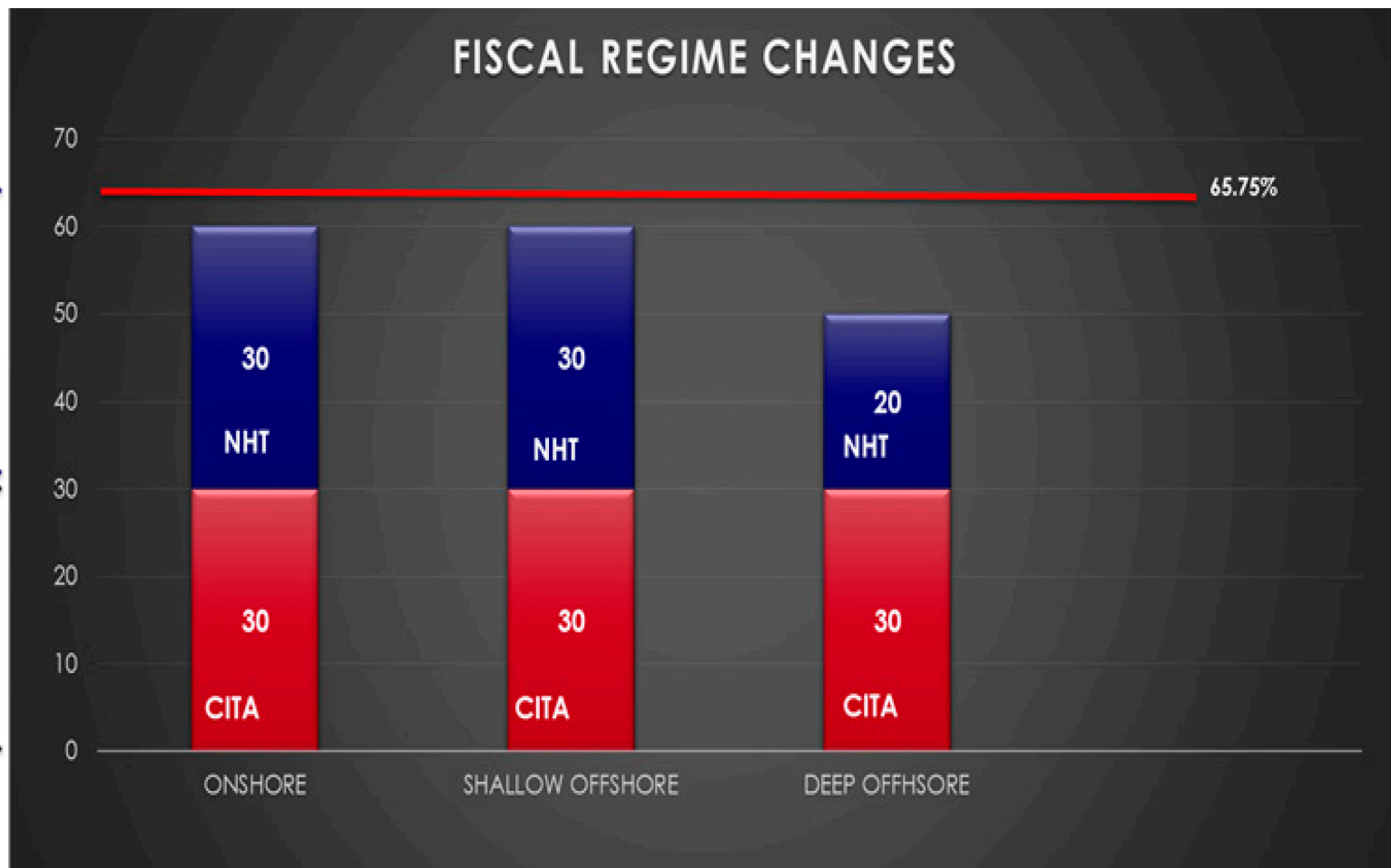
Rent Capture through Royalty by Price - Gas





Fiscal Policy Objectives & Fiscal Tools

Rent Capture through Tax - Oil



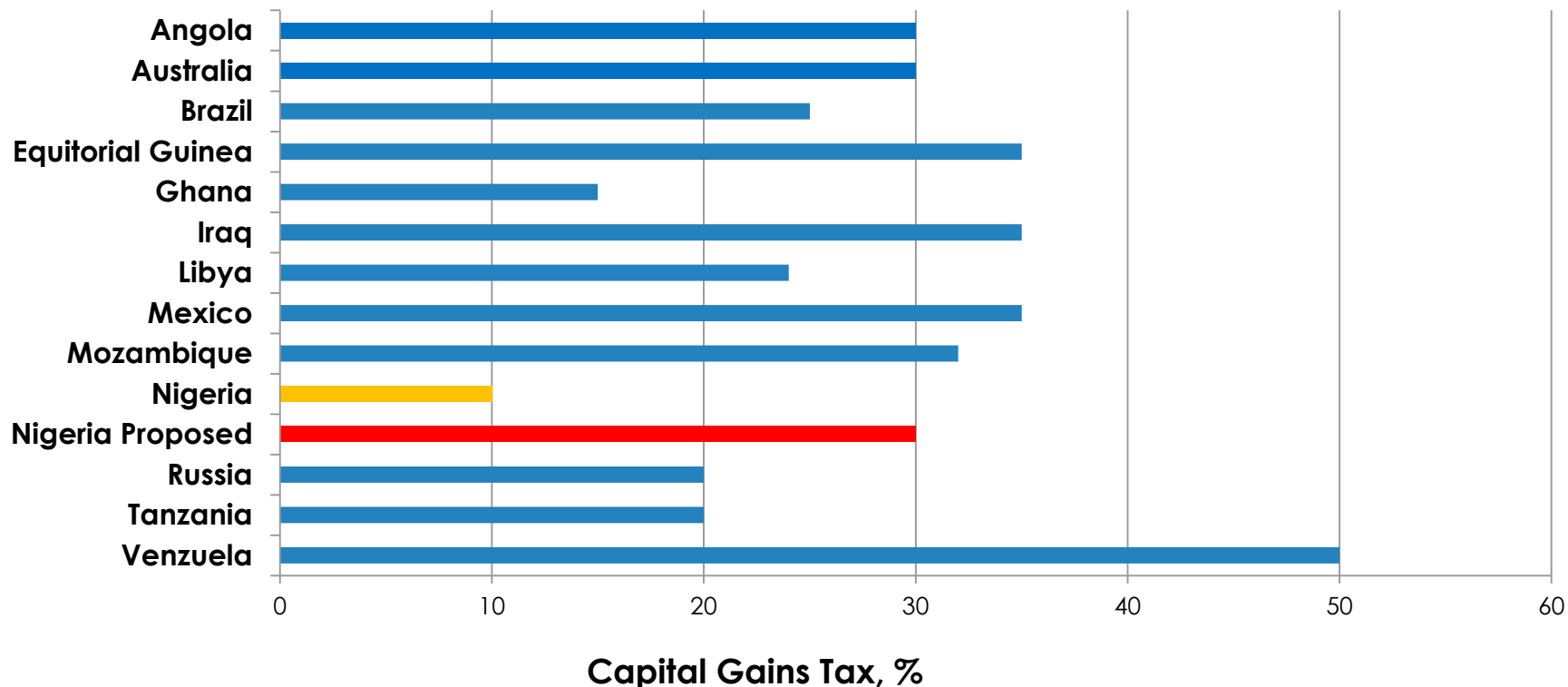
Fiscal Policy Objectives & Fiscal Tools



Rent Capture through Tax – Increase in Capital Gains Tax to 30%

- Removal of special incentive accorded the oil sector with respect to capital gains tax, to stem market distortion

Comparison of Capital Gains Tax

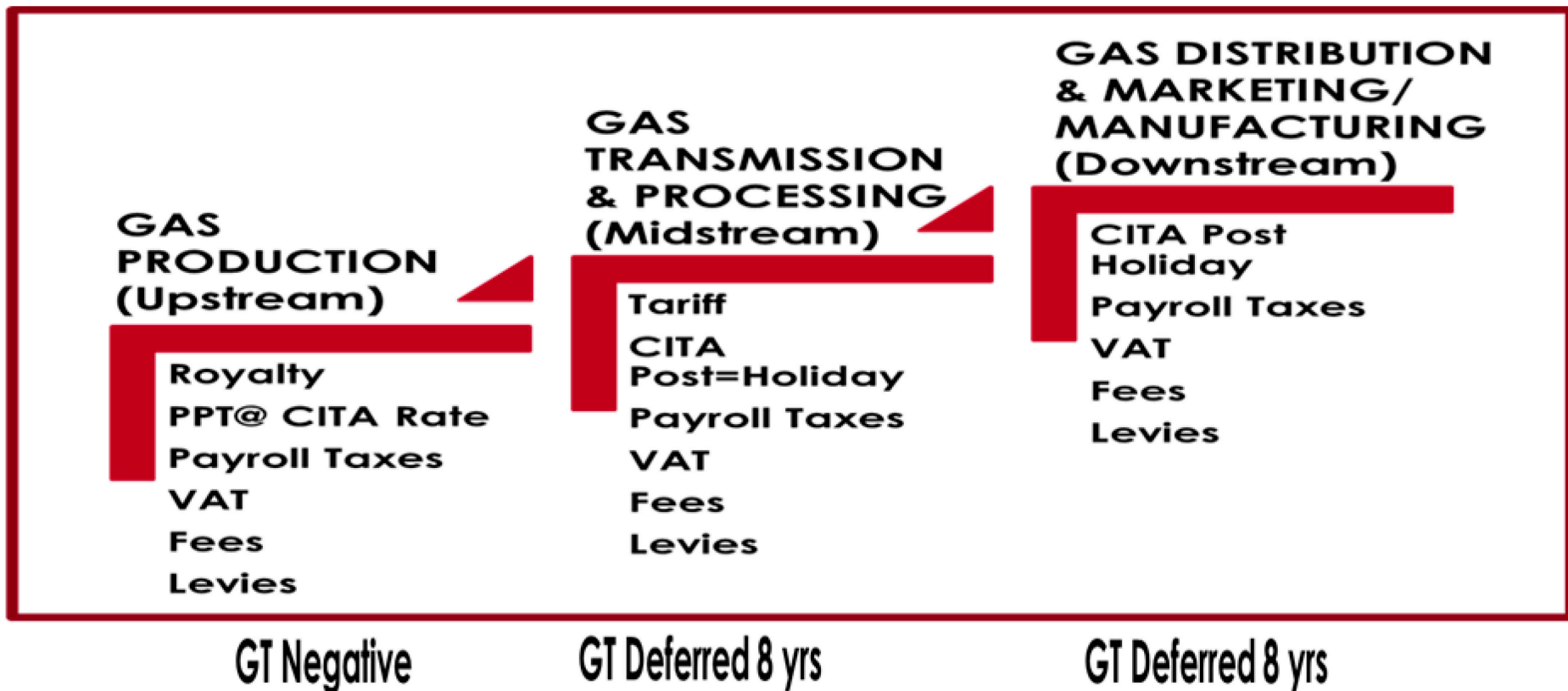




Fiscal Policy Objectives & Fiscal Tools

Fiscal Neutrality – Associated Gas Framework Agreement (AGFA) Abolished

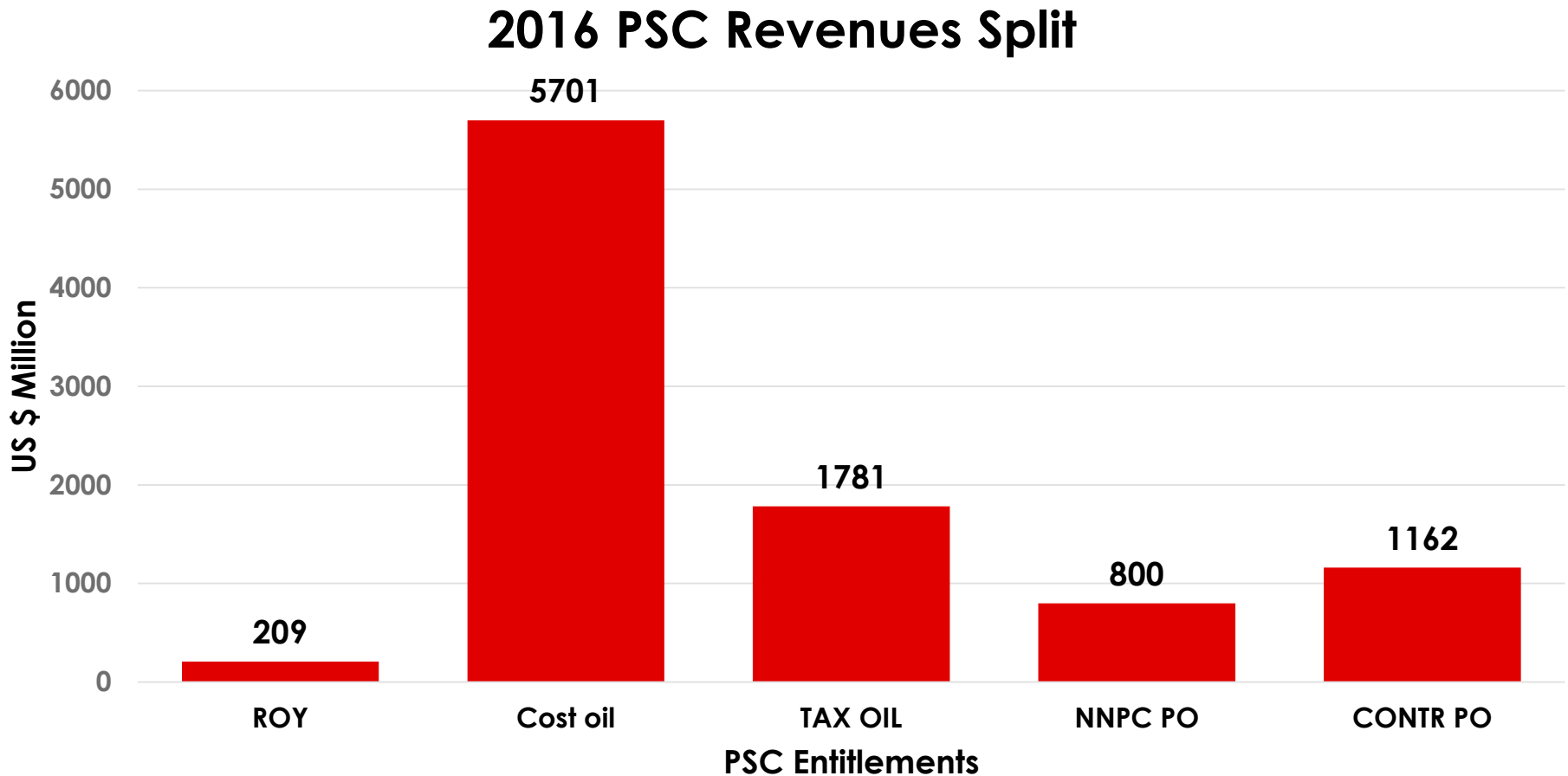
- ❑ Non-Consolidation of Midstream/Downstream with Upstream Income



Fiscal Policy Objectives & Fiscal Tools



Early Dependable Revenues – The Need for Significant Royalty Collection

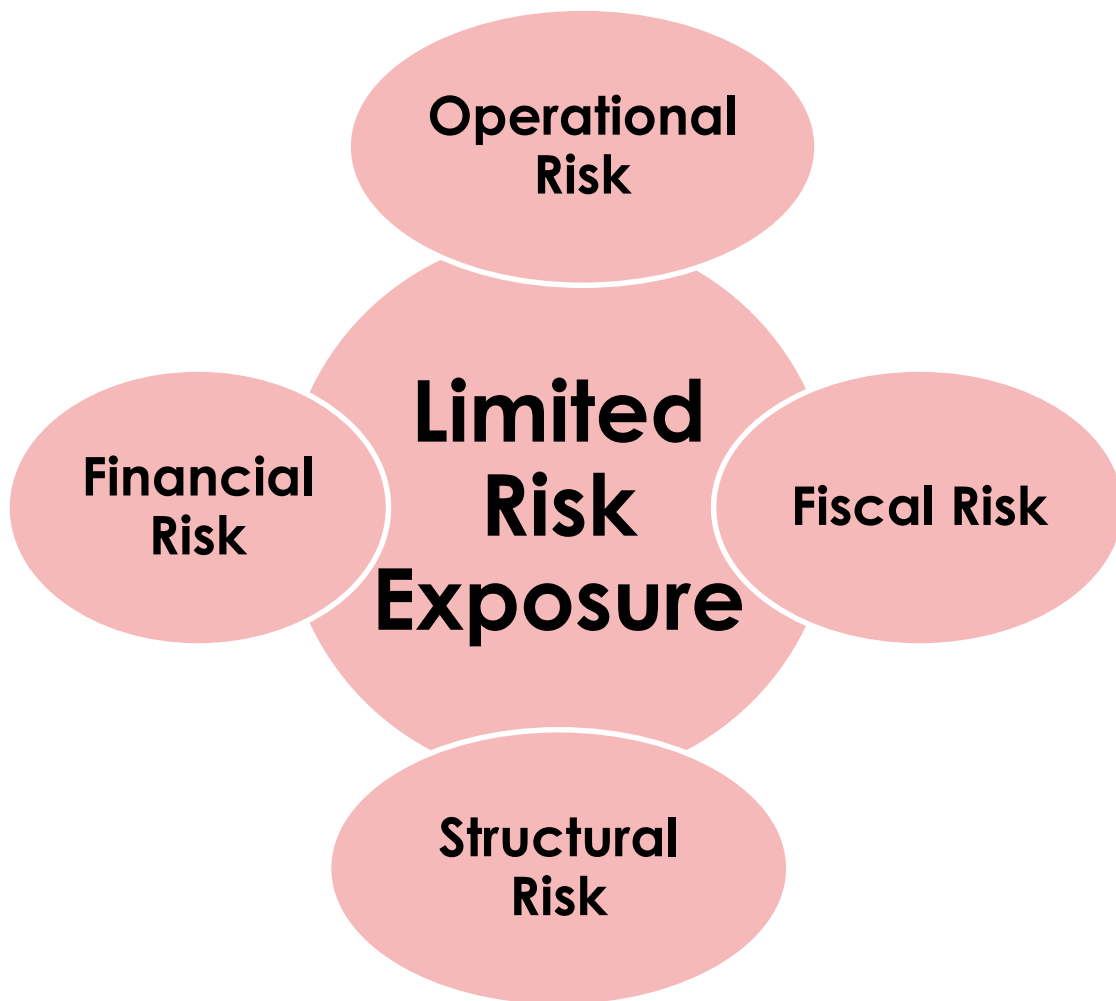




Fiscal Policy Objectives & Fiscal Tools

Limited Risk Exposure

- ❑ The Role of the State is to maximize value for itself by not undertaking risks beyond its competence.
- ❑ The state must not compel or monopolize commerce, but can regulate it.
- ❑ State participation must *'create value'* and not *'destroy value'*.



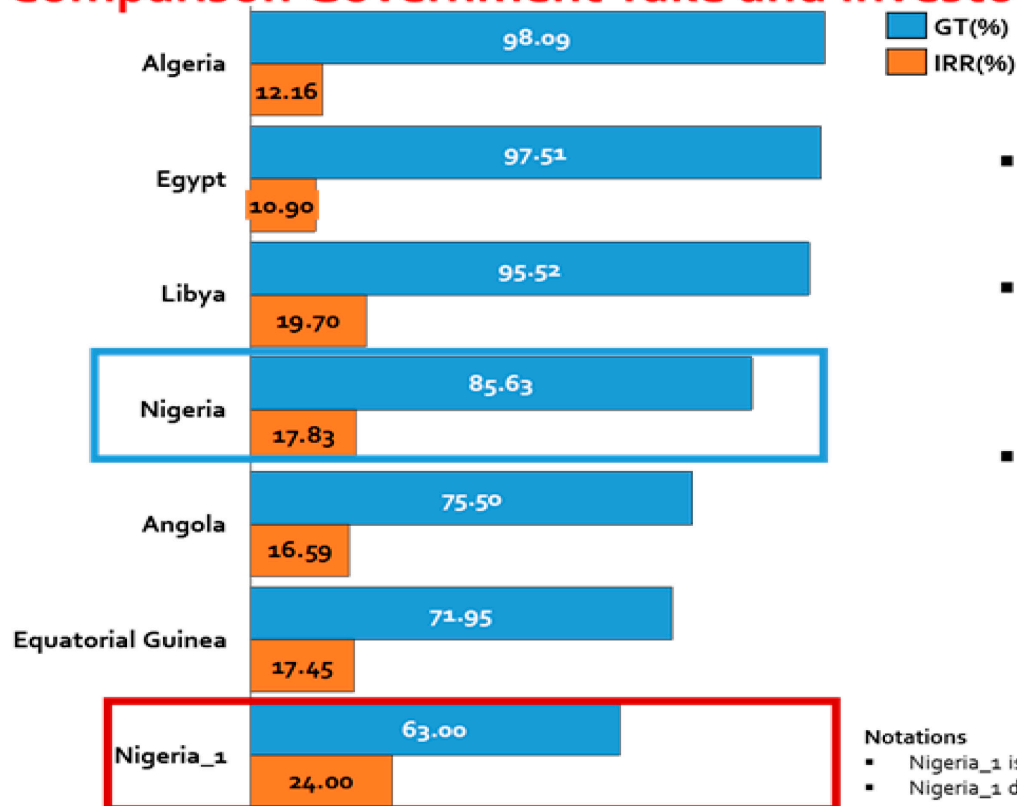


Fiscal Policy Objectives & Fiscal Tools

International Competitiveness

Competitive Analysis Of Proposed PIB 2016 Fiscal Terms:

Comparison Government Take and Investor IRR



- Comparison of Government Take (%) and Investor IRR (%) for top oil producing countries in Africa
- Note that in terms of ranking, Nigeria, under the current fiscal system, still ranks 4th out of 6 in **Govt. Take (Blue Rectangle)**
- The new proposals (Nigeria_1) is estimated to deliver a **Government Take that will see Nigeria with the least GT (Red Rectangle) while simultaneously delivering robust Investor Returns**

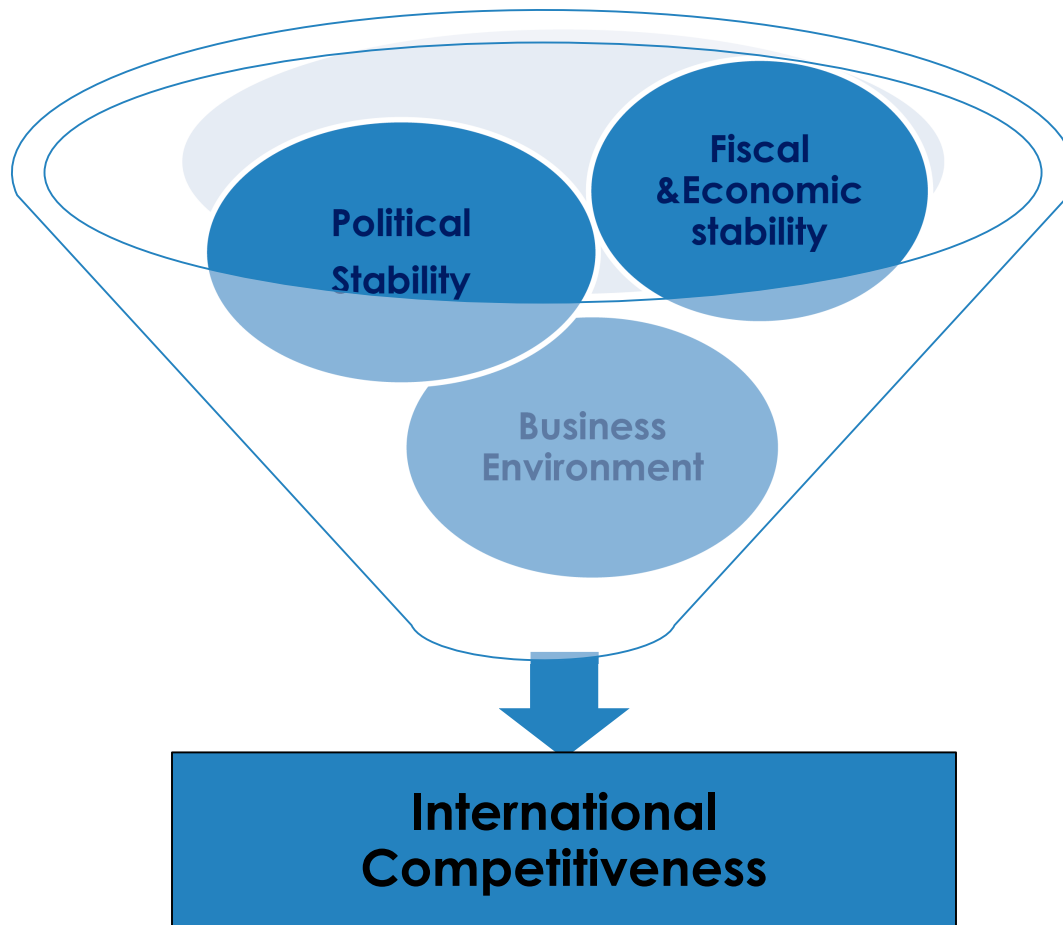
Notations

- Nigeria_1 is the fiscal system under consideration as proposed
- Nigeria_1 delivers a GT on average of 63% with Investor Returns of 24%



Fiscal Policy Objectives & Fiscal Tools

International Competitiveness

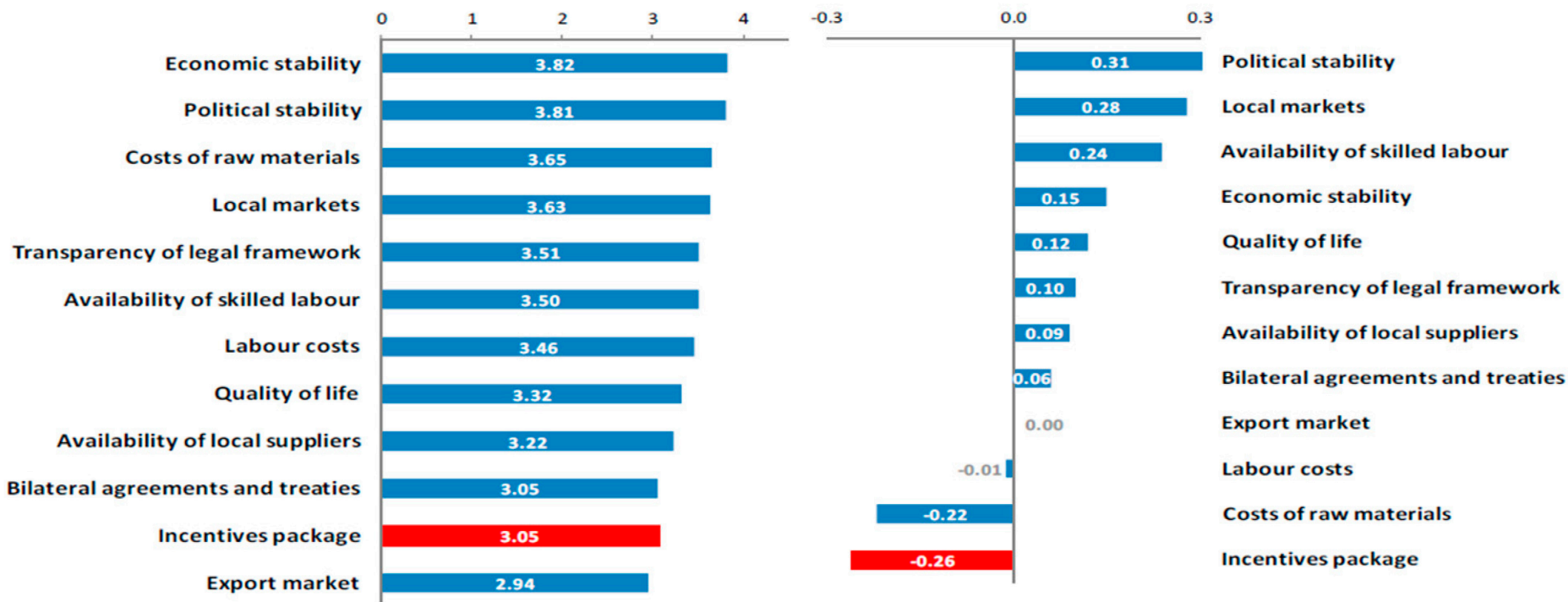




Fiscal Policy Objectives & Fiscal Tools

International Competitiveness – Non-Fiscal Factors

**Figure 2. Relative Importance of Tax Incentive Packages in Investor Location Survey 2010
(Left: Relative Rank; Right: Change in Rank since 2007)**



Source: UNIDO (2011)



Fiscal Policy Objectives & Fiscal Tools

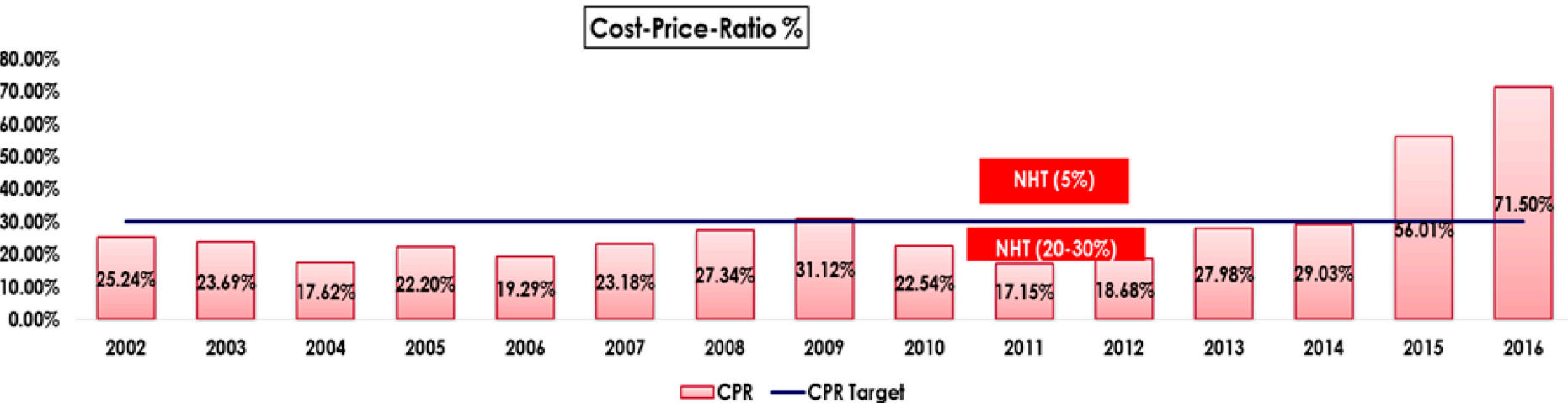
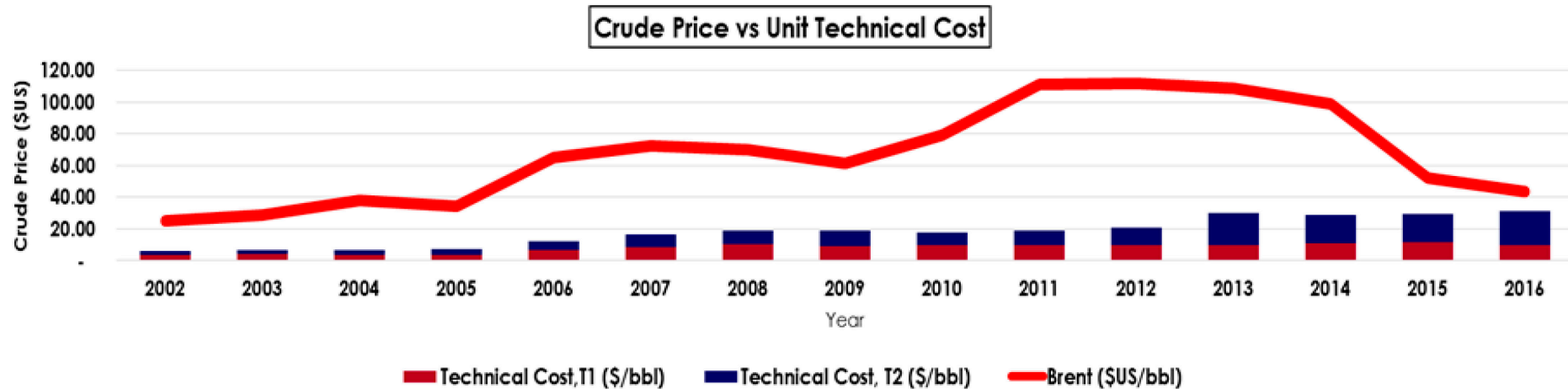
Simplicity & Transparency

- ❑ **The proposed fiscal law adopts financial reporting guidelines set out by the IMF as follows:**
 - ✓ **Natural Resources should be governed by a comprehensive legal framework and fiscal regime, with open and transparent procedures for granting rights for their extraction, and clear rules for governing resource revenue generation and collection.**
 - ✓ **Governments and resource companies should provide comprehensive, timely, and reliable reports on holdings of natural resource rights, on extraction and trading activities, and on collections and payments of resource revenue.**
 - ✓ **Budget documentation should provide a clear statement of the government's resource revenue management objectives, and report on the allocation of resource revenues for public spending and saving.**
 - ✓ **Governments should disclose, analyze and manage social, environmental and operational risks associated with natural resource exploitation.**



Fiscal Policy Objectives & Fiscal Tools

Cost Curtailment (Tax Inversion Penalty to Address Out of Control Costs)

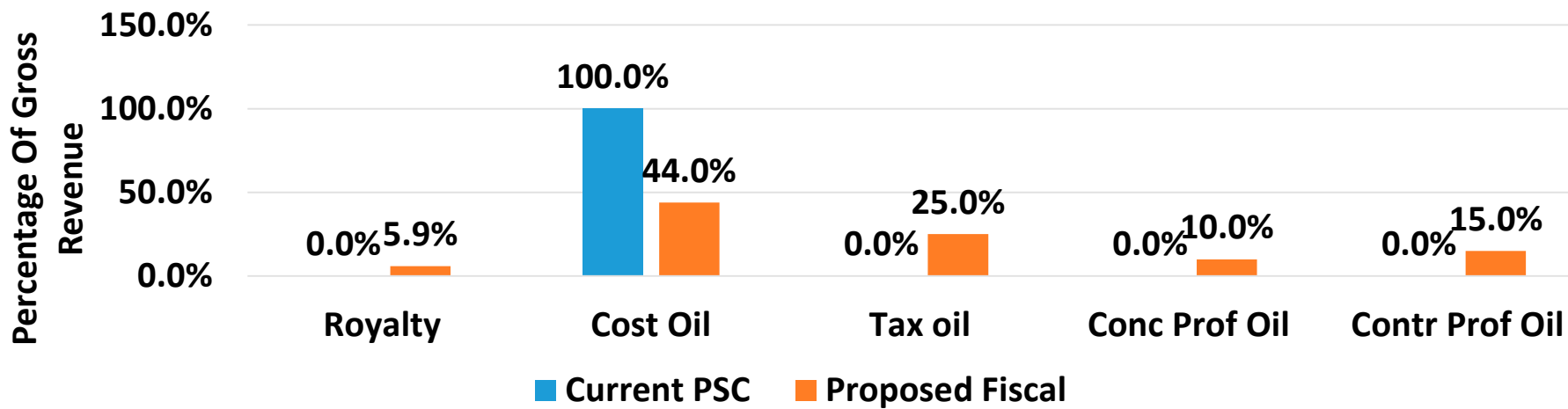




Fiscal Policy Objectives & Fiscal Tools

Cost Curtailment – C-P-R would address Fiscal Incentives Abuse

XX Field OML YY Allocation Of Proceeds



- XX is an excellent example of what the Fiscal system should never do, i.e. create a mechanism for 0% Government take.
- Cost Oil in 2016 in XX Field consumed 100% Oil revenue. Under the proposed Fiscal solution the tax inversion penalty and CPR Fiscal rule will reduce cost oil to 44% of revenue and tax Oil will increase from 0% to 25% of revenue.
- Government take that was 0% will become 30.9%.



Impact Assessment Gas

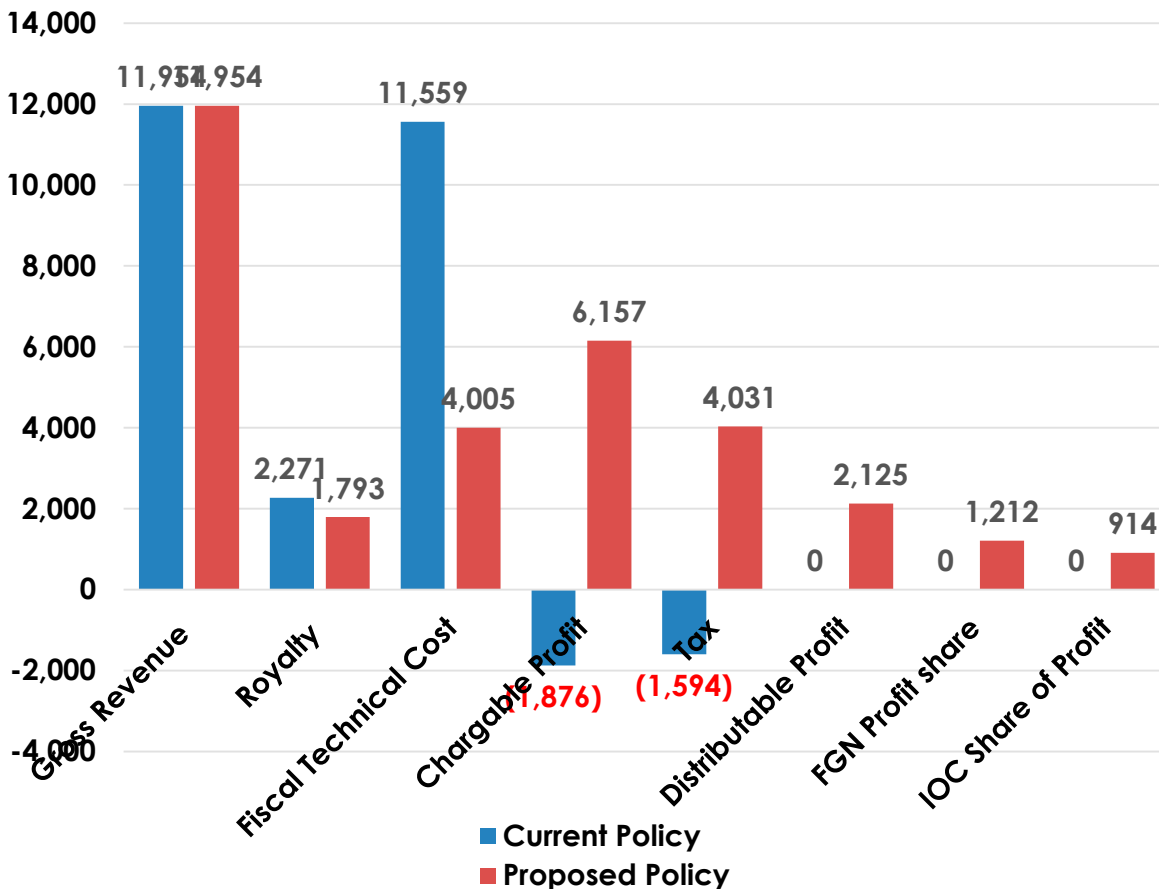
- ❑ **Current production would continue to yield similar investor returns based on Export Parity Pricing.**
 - ✓ **Proposed Fiscals for gas effectively mirrors current terms for existing production.**
 - ✓ **Royalty 5% - Tax 30% (No NHT)**
 - ✓ **New Production requires breakeven price of over \$2/kcf because of the abolition of AGFA.**
 - **AGFA impact estimated at \$3 billion - \$4 billion on current and future production.**
 - **However net benefit to Government is higher revenues due to non-consolidation with Oil income.**
 - ✓ **Delivered Gas price through a midstream facility to end user would vary but within the fuel oil switching Cost of \$5/kcf.**



Impact Assessment

Impact of Fiscal Policy on JV Economics (2016)

Impact of Fiscal Policy on JV Economics



Based on analysis of actual gross revenues for the JV, the impact of fiscal policy on 2016 returns show the following:

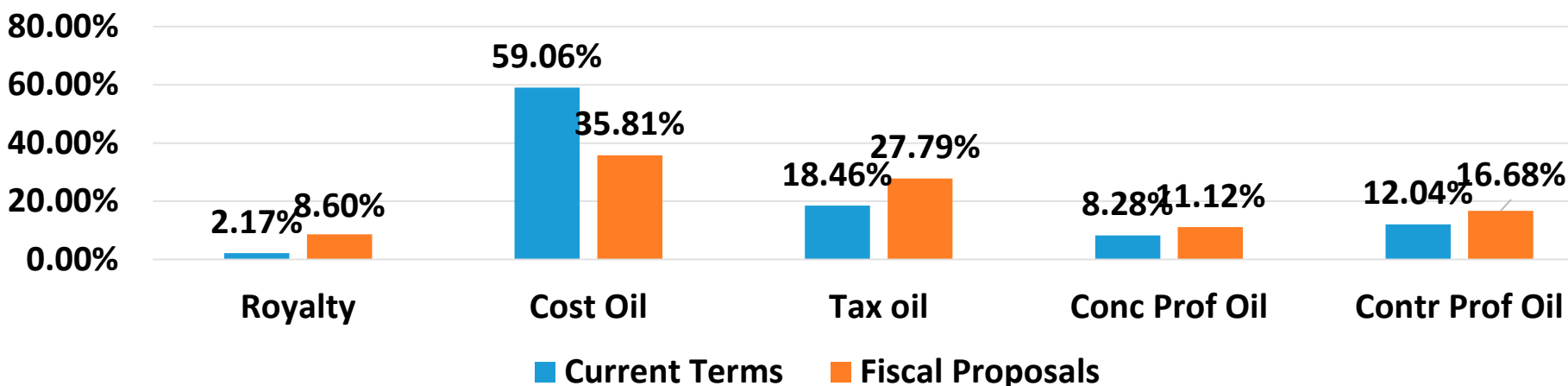
- 1) New fiscal policy would have delivered lower royalty of \$1.79 billion versus actual of \$2.27 billion.
- 2) The effect of C-P-R would have resulted in a positive tax of \$4 billion versus the negative tax of \$1.37 billion.
- 3) In other words, government take would have increased from \$2.2 billion to \$5.8 billion.
- 4) The graph shows that in 2016, the JV was not profitable for its owners due to the high cost of \$33/bbl.



Impact Assessment

Impact of New Fiscal Policy on 2016 Deep offshore economics

IMPACT OF NEW FISCAL POLICY ON 2016 DEEP OFFSHORE



- Total Deepwater production in 2016 was slightly over 605kbpd for which the average royalty rate was only 2.17%. The new fiscal policy would increase royalty to 8.6%, better managed cost from a high of 59.06% of revenues to 35.8%.
- Tax Oil would now be 27.8% of gross revenues and NNPC profit oil would go up to 11.12%.
- State take (Royalty + Tax + NNPC profit) 47.51% versus 28.91%.
- Government-take (Royalty + Tax) 36.39% versus 20.63%. (see next slide)



Impact Assessment

Impact of New Fiscal Policy on 2016 Deep offshore Economics

\$US Billion	Current Terms	Fiscal Proposal	Increase/Decrease
Royalty	0.21	0.83	0.62
Fiscal Cost Oil	5.70	3.46	(2.24)
Tax oil	1.78	2.68	0.90
Conc Prof Oil	0.80	1.07	0.27
Contr Prof Oil	1.16	1.61	0.45
Incremental State Take			1.80

- Proposed Fiscal for the Deep Offshore will deliver about \$2Billion extra income for the government at a reference price of \$45 per barrel and 605kbpd production.



Conclusion

- **The imperatives for reform of Nigerian oil and gas fiscal terms are glaring**
 - ✓ Potential for zero Government take
 - ✓ High tax rate leading to low savings index and Goldplating
 - ✓ In-effective cost regulation
 - ✓ Complexity in administration
- **Reform was anchored on 8 broad fiscal objectives and delivered via the Fiscal Rules of General Application (FRGA)**
- **Cost competitiveness is central to fiscal competitiveness and robust fiscal solution using the Cost-Price-Ratio has been developed**
- **Proposed terms are fair and balances risks and rewards**