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Common Cause Different Approaches:

China and Norway in Nigeria

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Table of Contents

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Acronyms and abbreviations

ADB	Asian Development Bank
AFRICOM	US Africa Command
AU	African Union
BBL	Barrels
CASS	Chinese Academy of Social Sciences
CASS	Centre for Advanced Social Science
CNOOC	Chinese National Offshore Oil Corporation
CSR	Corporate Social Responsibility
DAC	Development Assistance Committee
DPR	Departement for Petroleum Resources
ECON	Econ Pöyry
ECOWAS	Economic Community of West African States
EFCO	Economic and Financial Crimes Commission
EITI	Extractive Industries Transparency Initiative
EUCOM	European Command
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GGESS	Gulf of Guinea Energy Security Strategy
GWOT	Global War on Terrorism
ICPC	Independent Corrupt Practices Commission
IOC	International Oil Company
IPP	Independent Power Producer
IRR	Internal rate of return
IWAAS	Institute for Western Asian and African Studies
kWh	Kilowatt Hours
LG	Local government
LGA	Local Government Areas
MEND	Movement for the Emancipation of the Niger Delta
mmbl	Million barrels
MoU	Memorandum of Understanding
MW	Megawatt
NAFDAC	Nigeria's National Agency for Food and Drugs Administration and Control
NDDC	Niger Delta Development Commission
NDEBUMOG	Niger Delta Budget Monitoring Group
NDVF	Niger Delta Volunteer Force
NEEDS	National Economic Empowerment and Development Strategy
NEITI	Nigerian Extractive Industries Transparency Initiative
NGO	Non Governmental Organisation
NIIA	Nigerian Institute of International Affairs
NLC	Nigeria Labour Congress
NNPC	Nigerian National Petroleum Corporation
NPV	Net present value
OECD	Organisation for Economic Co-operation and Development
OML	Oil Mining License
OMPADEC	Oil Mineral Petroleum Development Agency Commission
OPL	Oil Prospecting License
PDP	Peoples Democratic Party
PPA	Power Purchase Agreement
R/P	Reserves to production ratio
Sinopec	China Petroleum and Chemical Corporation
SON	Standards Organisation of Nigeria
SPDC	Shell Petroleum Development Company

UN	United Nations
UNDP	United Nations Development Programme
USD	United States Dollar
WHO	World Health Organisation

Executive Summary

The purpose of this report is to present Chinese and Norwegian government and company perspectives on risks associated with operating in Nigeria, with a focus on the petroleum sector. It also seeks to identify joint strategies to mitigate such risk by promoting sustainable economic and social development in the host country. It concludes with joint recommendations to the Nigerian, Norwegian and Chinese governments on facilitating cooperation in this regard, based on comparative advantage. In addition, it provides a Nigerian perspective on perceived risks to the host country associated with the Chinese and Norwegian presence.

The project, which is a pilot, has the additional underlying goal of promoting cooperation and mutual understanding between researchers from China and Norway in an area where companies from both countries are active – while also learning from the perspective of researchers from the host-country. It brings together researchers from the Nigerian Institute of International Affairs (NIIA), the Chinese Academy of Social Sciences (CASS) and Econ Pöyry (Econ). Each institution has been responsible for particular sections of the report, as indicated by the initials of the relevant institution in parentheses after each section/chapter heading.

The hypothesis underlying the risk approach of this study is that it is important for foreign oil companies to understand the nature of operational risks in the host country, so that they are able to adjust their working habits to ensure the continued profitability of their operations. It is also important for the host country to understand the strategic considerations that drive the foreign operators' activities in critical sectors, in order to better work with them, but also to properly monitor and control such investment and protect the country's sovereignty and national interest.

Nigeria - background

Nigeria has experienced uneven economic development since independence in 1960. Despite having the largest petroleum production of any African country and income from the petroleum sector of USD 350 billion between 1965 and 2000, inflation adjusted GDP per capita was flat during the period and the number of people living on USD 1 per day increased significantly. The stifled economic development exacerbated tensions in this heterogeneous country, fuelling local conflicts, most visibly in the Niger Delta.

The transition to civilian rule in 1999 ushered in a period of gradual economic reform in Nigeria, and improved governance has been given particular priority.

Historically, the major Western oil companies have dominated petroleum extraction in Nigeria in joint-venture partnerships with the Nigerian National Petroleum Corporation (NNPC). But in recent years, state-owned Asian oil companies, particularly Chinese, have acquired many exploration licenses, offering infrastructure investments in exchange for access to acreage in deals often agreed at a government level.

China and Norway in Nigeria

Neither China nor Norway has historically been among Nigeria's most important commercial partners, and neither country has offered significant amounts of bilateral assistance. But this is changing as Chinese engagement with many African countries expands, particularly with resource-rich countries such as Nigeria.

The Norwegian bilateral assistance to Nigeria of approximately USD 4 million in 2006 was focussed on the petroleum sector. The assistance programme is small relative to what Norway offers some other African countries, considering the size of the population in Nigeria and the importance of the country for poverty alleviation in Africa.

The Norwegian commercial engagement, focussed on the petroleum sector, is more significant, but majority state-owned StatoilHydro (which merged in 2007) is a relatively minor player in the petroleum sector in Nigeria and will be responsible for less than 2 per cent of the total estimated petroleum production in the country in 2008, compared with Shell’s share of more than 30 per cent.

Chinese bilateral assistance to Nigeria as defined by the OECD Development Assistance Committee (DAC) is limited, but it provides significant concessional finance for investments in infrastructure, granted as export credits to Chinese companies. Trade between China and Nigeria is also expanding rapidly, and in 2006 China was Nigeria’s third largest trading partner.

The three main Chinese state-owned oil companies, CNPC, Sinopec and CNOOC, are all present in Nigeria. However, the companies are relative late-comers and together can be expected to account for 3-4 per cent of Nigeria’s oil production in 2008. Unless the Chinese state-owned oil companies make further large acquisitions similar to Block OML 130, which CNOOC purchased for USD 2.3 billion in 2006, it will take many years before the companies play a very significant role in the petroleum sector.

While Norway officially keeps a strict separation between bilateral assistance to the petroleum sector and the commercial interests of StatoilHydro, the Chinese official policy is to link soft loans for infrastructure development to acreage access for Chinese companies (as well as to long-term oil supply agreements).

Risk perception

Chinese and Norwegian officials share some perceptions regarding the main risks of operating in Nigeria. These include the integrity of the civil service system and consistent application of laws and regulations. The weak ability of the government apparatus to execute projects is seen as a particular risk, since it effectively hampers public service provision, fuelling resentment and conflict in local communities, particularly in the Niger Delta where most of the oil is produced.

Another important common risk highlighted by Norwegian and Chinese public officials is the weak infrastructure stock in Nigeria, including power, roads and rail. This holds back economic development and makes it more challenging for foreign companies to operate.

While the Norwegian and Chinese companies also noted these risks, they placed more emphasis on risks that affect their operations more directly. These include the security situation in the Niger Delta, stringent local-content requirements, the propensity of the government to introduce unilateral amendments to contracts, and very cumbersome approval processes for importing goods.

From the Nigerian side, the main perceived risks are associated with the rapid expansion of the Chinese presence in the country. Important issues of concern include increased tensions in the region resulting from heightened geopolitical competition over Nigeria's natural resources; the inflow of Chinese goods of "inferior quality" with little or no local Nigerian input and which undercut the market for local products; the large net migration from China; and Chinese companies' perceived weak respect for human rights and propensity to bribe Nigerian officials to obtain contracts.

Recommendations: Risk mitigation

This section summarises the three institutes' joint recommendations to the Norwegian and Chinese authorities on promoting risk mitigation, with a focus on promoting sustainable economic and social development in the host country, based on perceived Chinese and Norwegian comparative advantages.

Both Chinese and Norwegian engagement can be beneficial for Nigeria. Each country has specific core competences on which Nigeria should seek to capitalise. However, such presence is only likely to be beneficial for Nigeria if all external parties comply with best international practise when operating in the country.

Lack of public funds *per se* is not the main cause of underdevelopment in Nigeria. The challenge is rather to spend available public funds more wisely, i.e., where they have the greatest developmental impact. Improved governance is essential for accomplishing this and for accelerating economic development in the country.

The Nigerian Extractive Industries Transparency Initiative (NEITI) is important for enhancing transparency in the oil sector and related government institutions. Norwegian and Chinese companies operating in Nigeria are obliged by Nigerian law to comply with the NEITI reporting standards. **The Norwegian and Chinese governments should encourage the implementation of the NEITI, first through ensuring compliance by their companies, and also through provision of necessary technical assistance to the Nigerian government.**

One of the greatest governance challenges Nigeria needs to overcome is at the state and local level. **More international support should be provided to increase transparency and oversight over local-level funds and enhancing the capacity of state and local governments to plan and execute projects**. This is likely to have a positive impact on the stability of volatile regions like the Niger Delta.

The Western model of infrastructure development, with a heavy focus on attracting private capital, does not seem to work well in countries like Nigeria. **The Chinese approach of providing concessional loans for infrastructure development, including roads and railways, has effectively boosted infrastructure spending and accelerated economic growth**. Based on Norwegian and other Western experience with development assistance in the 1960s and '70s, **however, it is important to ensure that capacity exists also to maintain the infrastructure that is being built. It is also important that concessional loans do not undermine the promotion of transparency and good governance.**

Norway has core competence in transparent development and management of petroleum resources and revenues from the petroleum sector. With limited resources set aside for assistance to Nigeria, the **Norwegian development assistance is likely to have the greatest impact if it is concentrated even more in the petroleum sector.** The development of this sector, including revenue management, is crucial for the overall development in Nigeria.

One area of possible cooperation between Chinese, Norwegian and Nigerian companies is local content in the petroleum sector. Both Chinese and Norwegian companies have to comply with increasingly stringent local-content requirements in Nigeria. Mutual exchange of experiences, perhaps within the existing Norwegian local-content project in Nigeria, could be beneficial for all parties.

In hosting outsiders on its territory, the Nigerian Government should display confidence in taking the lead role in setting terms and conditions that strike a balance between the needs of foreign companies and those of Nigeria**..**

The trilateral institutional cooperation mechanism that facilitated the present project has proven innovative and useful. If sustained, it is likely to enhance long-term mutual understanding and cooperation among the three countries involved. **To maintain the momentum of this cooperation, it is recommended to embark on a follow-up project, specifically on Nigeria's expectations and agenda for engaging China and Norway in the petroleum sector. An extension of the process to another African country is also recommended.**

1 Introduction

The purpose of this report is to present Chinese and Norwegian government and company perspectives on risks associated with operating in Nigeria and to identify effective strategies to mitigate such risk, with a focus on the petroleum sector. In addition, a Nigerian perspective is provided on the risks for the country associated with the Chinese and Norwegian presence.

The hypothesis underlying the risk approach of this study is that it is important for Chinese and Norwegian entities to understand the nature of operational risks in Nigeria in order for them to properly adjust their habits to ensure the continued profitability of their operations in Nigeria's oil sector. It is equally important for Nigeria to understand the strategic intentions that drive the foreign operators' activities in the country's critical sectors in order to properly monitor and control them, and to protect the country's sovereignty and national interest.

In addition to identifying how risks are perceived by different stakeholders, the report summarises Chinese, Norwegian and Nigerian approaches to mitigating the respective risks. The report concludes by outlining areas of possible cooperation between Chinese, Nigerian and Norwegian government and company entities to mitigate risk in order to facilitate both business and economic development.

This project is a pilot. Part of the purpose is facilitate cooperation between researchers from the Nigerian Institute of International Affairs, the Chinese Academy of Social Sciences and Econ Pöyry on this topic. Each institution has written sections in the report providing the perspectives to their government and corporate entities.

A case study of the Niger Delta is included in the report to outline some of the current developmental challenges faced by Nigeria in more detail. The Niger Delta has been selected because it is the main petroleum province in Nigeria and is plagued by unrest and underdevelopment.

The report concludes by setting out areas where cooperation could be strengthened between Chinese, Norwegian and Nigerian entities.

In order to get a broad a range of perspectives, the three research institutions involved undertook comprehensive interviews with industry, government institutions, donor organisations and NGOs working in Nigeria. Information obtained through the interviews, together with an extensive literature review, forms the basis for the analysis and conclusions in the report.

Three academic institutions were commissioned by the Norwegian Ministry of Foreign Affairs[1] to undertake the work: Econ Pöyry (ECON), the Chinese Academy of Social Sciences (CASS) and the Nigerian Institute of International Affairs (NIIA).

The goal of the study is to encourage Chinese and Norwegian policy makers to assess the risks associated with their operations in Nigeria's oil sector and take necessary strategic actions to protect their interests in the country, particularly by ensuring that the

1 Including the Norwegian Agency for Development Cooperation and the Norwegian Embassy in Beijing.

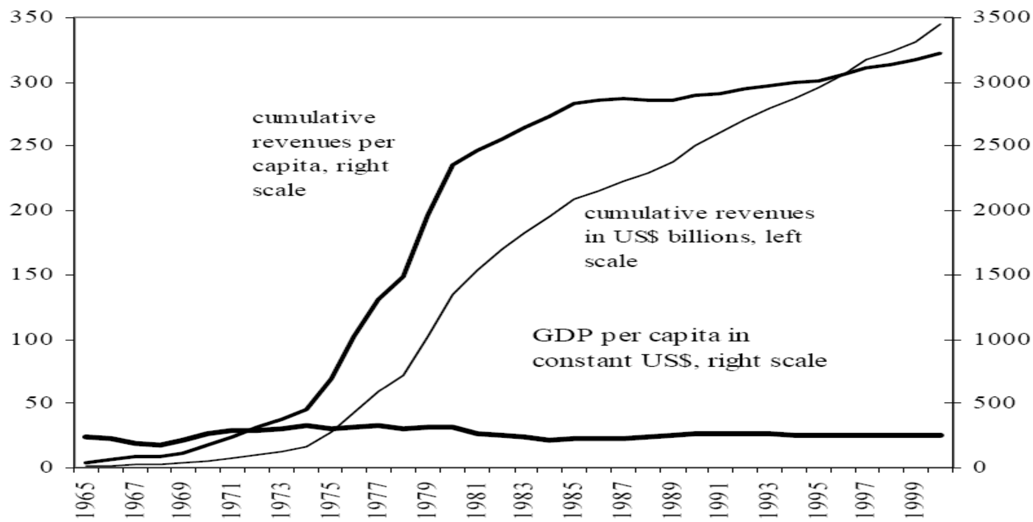
Nigerian people also benefit from such operations. Another goal is to help facilitate dialogue between Norwegian and Chinese policy makers to promote cooperation between Norwegian and Chinese companies in third countries, especially in Africa.

2 Background

Since its independence in 1960, Nigeria has experienced uneven economic development. At independence, the country was agrarian, a large commodities exporter and richer on a per-capita basis than both China and India. Oil became an increasingly important part of the economy from the mid 1960s, and the importance of petroleum to Nigeria's income grew further after the oil crises of the early 1970s.

Despite accumulated revenues from the oil sector of more than USD 350 billion in the period 1965-2000, inflation-adjusted GDP per capita fell from the late 1970s until the late 1990s (see figure 1) and was back at the 1965 level in 2000.[2] The population living on less than USD 1 per day increased from 36 per cent in 1970 to 70 per cent in 2000 as the gap between rich and poor increased.

Figure 2.1 Oil revenues and GDP development Nigeria 1965 – 2000



Source: Sala-i-Martin and Subramanian, 2003

Indonesia, a populous, oil-rich country with a similar GDP per capita to that of Nigeria in 1965, almost quadrupled its GDP per capita in the same period[3].

Nigeria failed to convert the significant income from the petroleum sector into economic development as the elites competed to control windfall gains rather than use those gains to bring about development in the country.[4]

The return to civilian rule in 1999 ushered in a period of gradual economic reform in Nigeria. A comprehensive reform strategy was developed by the Obasanjo administration and published in 2004. The National Economic Empowerment and Development Strategy (NEEDS), sets out the government's developmental priorities in four areas: a) an improved macroeconomic framework, b) empowering people through better education, c) promotion of the private sector, and d) improved governance.

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2 See Sala-i-Martin & Subramanian (2003).

3 See Nigeria: Selected issues and statistical appendix IMF 2005.

4 See Bevan, David L., Paul Collier and Jan Willem Gunning, 'Growth and equity in Nigeria and Indonesia".

Of the four main priority areas set out in the NEEDS strategy, the Nigerian government has made the fastest progress in creating a better macroeconomic framework. The country experienced relatively rapid economic growth in the period 2000-7 averaging 5.5 per cent per annum. Particularly encouraging is the sharp recovery in industrial and agricultural production outside the oil sector in the period 2004-7, which grew much faster than oil related GDP. Inflation, at less than 10 per cent per annum in 2007, appears to be under control, and Nigeria has accumulated significant foreign exchange reserves (USD 50 billion by the end of 2007, according to the World Bank), which will help reduce macroeconomic imbalances caused by fluctuations in petroleum prices.

The government has taken measures to strengthen education, but the effects of relevant reforms will most likely be evident only in the medium-to-long term. Although the secondary school enrolment level, at 27 per cent in 2005,[5] is not impressive by international standards, there are also pockets of world-class educational excellence in Nigeria and a human capital base adequate for accelerating the development of the country.

The Nigerian government has also started a process of deregulating the economy and making it easier for private-sector businesses to operate. According to the World Bank's Doing Business survey, Nigeria ranked 108th in ease of doing business in 2008 out of 178 countries surveyed[6]. Businesses complain particularly about the cumbersome processes of obtaining licenses and difficulties of operating within the letter of the law.

Infrastructure is especially inadequate and hampers economic growth. Nigerians consumed, on average, 157 kWh of electricity per capita in 2004, a decrease on a per-capita basis of 1,9 per cent since 1990.

The Nigerian government has made attempts to improve the efficiency and effective-ness of the decision-making process and the execution capacity of public institutions.

There are three legislative pieces underpinning the drive for better governance, all approved in the latter stages of the Obasanjo administration.

- *Fiscal responsibility Bill: Designed to ensure that expenditure matches the expected income from the sector in the long run.*
- *Public Procurement Bill: To ensure transparency in the award of public contracts.*
- *Nigerian Extractive Industries Transparency Initiative Bill: Designed to ensure transparency in transfer of resources from the extractive industry to government and in the use of public funds.*

Despite the drive for improved governance in Nigeria, significant challenges remain. According to a compilation of governance indicators[7], Nigeria still scores in the lowest 20 per cent of the world's countries on regulatory quality and government effectiveness and in the lowest 10 per cent on rule of law and control of corruption. These indicators

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5 See UN Development Report 2007/8 Statistical annex table 12.

6 See www.doingbusiness.org for details.

7 See www.govindicators.org for details.

improved only marginally between 1996 and 2006 despite a political commitment to reform.

The government is struggling to implement its plans because of weaknesses in the civil service structure. Moreover, many plans are created and projects implemented without noticeable improvements on the ground. One example is in the electricity sector, where the Nigerian government has invested 500 billion Naira (approximately USD 4 billion) since 1999 without measurable increases in availability of electricity to the grid.[8] This and many other apparently failed executions have contributed to the fact that Nigeria is still a desperately poor country with more than 70 per cent of the population living on less than 1 USD a day in 2006[9]. This is the highest share of poor people in any country in the world, according to UNDP.

The stunted economic development in Nigeria has exacerbated ethnic tensions in a heterogeneous country and has fuelled local conflicts. The Niger Delta, the centre of onshore petroleum production in Nigeria, has been particularly affected. The conflict is partly fuelled by dissatisfaction with the level of service provision to the local communities where the petroleum is produced. (See case study on the Niger Delta conflict for more information on this issue.)

2.1 Bilateral Engagement with Nigeria

Neither China nor Norway historically has been among Nigeria's most important commercial partners and neither country has offered significant amounts of bilateral assistance. However, this is changing in the case of China, as Chinese engagement with many African countries expands, particularly with resource-rich countries like Nigeria. Norway has also indicated that it wants to increase its engagement with Western Africa[10].

2.1.1 Nigerian-Chinese Bilateral relations

Sino-Nigerian diplomatic relations were first established in 1971. Since then, there have been regular official visits, most recently by Chinese President Hu to Nigeria in April 2006. This visit included a speech by the Chinese President in the Nigerian parliament in which he outlined the idea of establishing "a new type of Strategic Sino-African partnership". Also in 2006, Nigerian President Obasanjo participated in the "Sino-African Summit" in Beijing and held direct talks with President Hu. A memorandum establishing a bilateral strategic partnership was signed in January 2006.

Nigeria is one of China's most important African trade partners. The country has been China's second largest African export market for many years and exports have increased almost thirty fold over the last 14 years, from USD 99m in 1994 to USD 2.9bn in 2007. In 2004, the volume of China's exports to Nigeria constituted 12.5 per cent of China's total export to Africa. Meanwhile, China has become a major importer of Nigerian goods and services, especially crude oil, and in 2007 ranked as Nigeria's third largest trading partner after the US and EU.

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8 Comments by the Head of the Nigerian Energy Commission in discussions with Econ 29.11.07.

9 See UNDP Human Development Report 2007-8.

10 http://www.norway-un.org/NorwegianStatements/SecurityCouncil/20060810_sr_peaceconsolidation.htm

The Nigerian government has put much effort into cultivating good relations with China in a drive for economic reform and Foreign Direct Investment (FDI). This effort has seemingly had the desired effect, as several Chinese companies in construction, telecommunications, oil and gas, pharmaceuticals, etc., have invested billions of Naira in Nigeria. The volume of Chinese investment in Nigeria increased from USD 46 million in 2004 to USD 68 million in 2006 excluding investments in the petroleum sector. By the end of 2006, China's accumulated investments in Nigeria were USD 216 million, and Nigeria was the fourth most important destination for Chinese investments in Africa after Sudan, Zambia and Algeria. Industries where Chinese companies have invested in Nigeria include oil, ports, home electric appliances, and textiles. Today, there are more than 300 Chinese enterprises in Nigeria, both state- and privately-owned. The majority are small business and trading industries. Only 30 enterprises are involved in manufacturing.

President Obasanjo has described China's investment drive in Nigeria positively as part of the overall reform of the national economy and as a means to benefit from China's experience as an emerging economic power. However, there is also local skepticism regarding the benefits of the increased amounts of cheap Chinese goods on the streets of the major cities of Lagos and Abuja. The main concerns regard quality and the difficulty for Nigerian suppliers to match the low Chinese prices.

While Western countries focus on "software" such as capacity building, China puts more investment in "hardware" such as roads, railways and other tangible infrastructure that bring direct and visible benefit to the host country. The China Export-Import Bank, founded in 1994, has played an important role in providing financial support for such infrastructure projects. By September 2006, there were 259 projects financed by the Chinese Ex-im Bank in 36 African countries, 79 per cent of which were committed to infrastructure development, such as railways (Benguela and Port Sudan), dams (Merowe in Sudan; Bui in Ghana; and Mphanda Nkuwa in Zambia), thermal power plants (Nigeria and Sudan), oil facilities (Nigeria), and copper mines (Congo and Zambia).[11]. Most of these loans were issued as buyers credit with low interest (2 per cent) to Chinese companies and are not classified as bilateral assistance by OECD DAC[12].

Grant-based Chinese bilateral assistance agreed during the first Beijing China-Africa Summit in late 2006, is limited and includes one malaria prevention and treatment centre and two trade and economic cooperation zones and agricultural assistance.

2.1.2 Nigerian-Norwegian Bilateral Relations

Bilateral cooperation between Norway and Nigeria historically has been limited. Although diplomatic relations were established after Nigeria's independence in 1960, Norwegian development assistance to Africa has focused on the Eastern and Southern parts of the continent, with only limited funds provided to Western Africa. Norway spent approximately USD 3.4 million on bilateral development cooperation with Nigeria in 2006. This is less than 0,1 per cent of the overall Norwegian assistance budget of approximately USD 3.5 billion. Sudan, the largest recipient of Norwegian bilateral assistance in Africa, received approximately USD 124 million the same year.

[11] http://www.wilsoncenter.org/index.cfm?fuseaction=events.event_summary&event_id=224956

[12] Is China actually helping improve debt sustainability in Africa OECD July 2007.

The bilateral development cooperation was restarted after the transition to civilian rule in Nigeria in 1999. A Memorandum of Understanding (MoU) between the Norwegian and Nigerian governments was signed in 2000 focusing on development assistance to improve the management of the petroleum sector. This MoU was renewed in 2005, and the Norwegian government has signalled that it wishes to strengthen cooperation with Nigeria.

The Norwegian petroleum industry is dominated by the Norwegian state, which regulates the sector through the Ministry of Energy and Petroleum and the Norwegian Petroleum Directorate and is the majority owner (67 per cent) of oil company StatoilHydro, the largest company in Scandinavia in terms of market capitalization. The Norwegian Petroleum Directorate is the main implementing partner of Norwegian petroleum-related assistance. For outsiders, it has at times been difficult to distinguish between the assistance-related and commercial interests of the Norwegian State, especially in countries where Norway has a petroleum assistance programme and where StatoilHydro operates.[13] However, the Norwegian official policy is that there is a strict separation between bilateral assistance and commercial interests and that Norwegian assistance should not be aimed at furthering Norwegian commercial interests.

2.1.3 Commercial engagement in the petroleum sector in Nigeria

Foreign investors have been attracted to the Nigerian petroleum sector since the 1930s. The main allure has been the largest petroleum reserves in Africa, located mostly in the Niger Delta and offshore, as well as the large role offered to international petroleum companies in the sector compared to, for instance, many countries in the Middle East. But the risks have also been significant, and Nigeria is regarded as one of the most challenging places to operate in the world by the petroleum industry.[14]

Nearly all of Nigeria's oil production is carried out through Joint Venture operations between the Nigerian National Petroleum Corporation (NNPC) and multinational corporations. The biggest Joint Venture operation is run by Shell Petroleum, which accounts for almost 50 per cent of Nigerian petroleum extraction[15]. Other important international companies in the sector are ExxonMobil, Chevron and Total. The tax take for the government is significant. For example, at current oil prices of around USD 60+ per bbl, the Nigerian government receives more than 95 per cent of the profit from Shell’s oil production.[16]

Chinese and Norwegian oil companies play comparatively minor roles in the sector, although the Chinese presence has grown more rapidly in recent years.

2.1.4 Chinese Involvement in the Petroleum Sector

In terms of resource cooperation, China’s Africa policy, published in January 2006, states that

[13] Norway's mission to save poorer nations from 'oil curse' fails to win wide praise” Financial Times 12 May 2006.

[14] See Gazprom plans Africa gas grab Financial Times 05.01.08.

[15] Please see http://www.petroinfonigeria.com/shell.html for details.

[16] See Shell Annual report 2006 page 11 for information.

> *"the Chinese government encourages and supports competent Chinese enterprises to cooperate with African nations in various ways on the basis of the principle of mutual benefit and common development, to develop and exploit rationally their resources, with a view to helping African countries to translate their advantages in resources to competitive strength, and realize sustainable development in their own countries and the Continent as a whole."*[17]

In practice, the enterprises encouraged to conduct resource cooperation are predominantly large-scale, state-owned ones.

Following the "going out strategy" initiated by the Chinese government in the 1990s, the three main state-owned Chinese oil companies – China National Petroleum Corporation (CNPC), China National Offshore Oil Corporation (CNOOC), and China National Petrochemical Corporation (Sinopec) – have been investing actively overseas and playing a fundamental role in Chinese acquisitions in Africa. The reason is partly to pursue their ambition of becoming international oil companies (IOCs) and partly to secure China's oil imports at source. Though still minimal and in their early stages, Chinese oil companies' efforts have paid off and have generated some concern from Western oil companies.

Chinese petroleum investments in Africa are often combined with large infrastructure investments in the the relevant countries, initiated after bilateral negotiations between Chinese and African governments and regarded as an important component of Sino-African resource cooperation. Oil exploitation deals are therefore often associated with a package of infrastructure contracts. For example, in May 2006, immediately after President Hu Jintao's visit to Nigeria, China committed USD 4 billion to repair the Kaduna Refining and Petrochemicals Company and undertake other investment projects, such as building a hydropower plant in Mambila, Plateau State. In return for this, the CNPC was permitted to exercise the "right of first refusal" on four oil blocs. China also promised to invest USD 1 billion to help repair Nigeria's old railway lines and install new rolling stock and equipment. Later the same year, a Chinese conglomerate, the Guangdong Xinguang International Group, was awarded the contract to build a fast rail system linking Nigeria's biggest city, Lagos, to the political capital, Abuja.

Oil cooperation between China and Nigeria started in 1996, following the strategy of the Nigerian National Petroleum Corporation (NNPC) to diversify its international partnerships. Three of the four Chinese oil companies are present in Nigeria – CNPC, CNOOC and SINOPEC. However, China is still a relative newcomer to the Nigerian petroleum sector and is in the process of defining itself as an actor within Nigerian society. So far, Chinese experience and investment in Nigeria are relatively modest compared to those of other countries in Africa. The table below provides a brief overview of the activities of the Chinese oil companies in Nigeria.

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[17] China's African Policy, http://www.fmprc.gov.cn/eng/zxxx/t230615.htm/

Table 2.1 Chinese Interests in the Nigerian Petroleum Industry

Company	Block*	Operator	Production	Share %	Reserves P 50	Location
CNPC	OPL 298, OPL 471 OPL 721 OPL 732	CNPC				Niger Delt Deep offshore Lake Chad
CNOOC	OPL 229	CNOOC				Deep offshore
CNOOC	OML 130 Akpo	Total	Start 2008	45%	600 mmbl	Deep offshore
Sinopec	OML 64 OML 66	NNPC/ Sinopec	unknown		Discoveries but not yet appraised	Niger Delta

* Excluding the awards in the disputed 2007 licensing round which not yet has been approved by the incoming administration.

Currently, the Chinese state-owned oil companies do not have any producing assets in Nigeria, although this will change when the Total-operated Akpo field (OML 130), in which CNOOC has a 45 per cent stake, comes into operation in late 2008. Sinopec made discoveries in block OML 64-66 in the Niger Delta, but it is uncertain when it will be possible to start the production of these resources, due to the security situation in the area. Both CNPC and Sinopec are affected by the security situation in the Niger Delta, which has hindered their ability to develop their businesses in Nigeria, since several of their exploration and mining licenses are located in this area.

It is also worth noting that some of the exploration licenses awarded to the Chinese state-owned oil companies are located in areas that are not regarded as very prospective by most international oil companies, e.g., the Lake Chad region.

In sum, although the Chinese state-owned oil companies have made an aggressive push into Nigeria over the last 3 years, their impact is still minor and likely to remain so unless substantial discoveries are made in some of the exploration blocks that they have been awarded or they acquire producing assets, such as CNOOC did with the purchase of OML 130 in 2005. Production from the Akpo field is expected to be 225,000 bbl/day and with a 45 per cent share, CNOOC may end up controlling 3-4 per cent of the total Nigerian production in 2009, based on an expected total Nigerian output then of 2.5 million bbl/day.

2.1.5 Norwegian Involvement in the Petroleum Sector

StatoilHydro first launched activities in Nigeria in 1992 (at that time as Statoil) in a joint partnership with BP and has focused on utilising its offshore competence. Today, Statoil Hydro is partner in two Chevron-operated exploration blocks, OML128 and OML129, and in two Petrobras-operated exploration blocks, OPL315 and OPL324. StatoilHydro has been a relatively hesitant investor in Nigeria to date and took few new commercial initiatives in the period 2003-7. After 15 years in the country, the company has yet to produce any oil from any of the ventures in which it participates. The Chevron-operated Agbami field, where StatoilHydro has a 18.25 per cent share, will come online in 2008, and the company is expected to receive 40,000 bbl/d of equity oil at plateau stage. According to Helge Håland, the Managing Director in StatoilHydro Nigeria, the company is about to increase its commercial involvement in the country[18].

[18] Comments provided in interview in Lagos 23.11.07.

Table 2.2 StatoilHydro Interests in the Nigerian Petroleum Industry

Company	Block*	Operator	Production	Share %	Reserves P 50	Location
StatoilHydro	OML 128	Chevron	2008	18,25%	1000 mmbl	Deep offshore
	OML 129	StatoilHydro	?	53,85%	Gas/ condensate	
StatoilHydro	OPL 315 OPL 324	Petrobras	Exploration	45% 25%		Deep offshore

StatoilHydro plays a relatively minor role in the petroleum sector in Nigeria, and its production is not expected to exceed 2 per cent of the total estimated 2008 production in Nigeria of 2.5 million bbl per day. The main asset is the Agbami field, but the company has also made gas and condensate discoveries in block 129. It will take up to ten years to develop commercial discoveries offshore (it took StatoilHydro 16 years from starting operations in Nigeria until it produced its first petroleum). The only realistic option for boosting production in the short term would be to acquire assets.

2.2 Acquiring Exploration Licenses

The Nigerian government changed its approach to issuing exploration licensing in the petroleum round of 2005. Although the licensing round was hailed as the most transparent to date, with international advisors overseeing the tendering process, many of the licenses had already been awarded to state-owned Asian oil companies after bilateral negotiations prior to the launch of the tender. The licenses were awarded on a “first right of refusal” basis where a number of Asian state-owned companies (Taiwanese and Korean) got the opportunity to match the highest bid in the tender round. The state owned oil companies from the Peoples Republic of China became active in the tender round in 2006.

The Nigerian government wanted to link upstream and downstream investments to facilitate a broader-based development of the sector and reduce the severe downstream bottlenecks that had accumulated over the previous decades. Although Nigeria has refinery capacity in excess of 440,000 bbl/d, the country imported all refined petroleum products during certain periods of 2007, due to technical problems with the refineries and sabotage of the oil pipelines feeding them. In September 2007, Nigerian refineries produced only about 60,000 bbl/ of refined products per day[19], or about 13 per cent of capacity. The low utilization rate illustrates the very significant challenges facing the sector. The Nigerian government has invested more than USD 1 billion to upgrade the four state-owned refineries since 1999, while the refinery utilization rate has fallen sharply in the same period.

The international oil companies have historically been reluctant to get involved in the downstream business in Nigeria. One of the main reasons is that the refinery business has been a low-margin business all over the world for the last 20 years. What makes the Nigerian refinery business particularly unattractive from a commercial point of view is the low regulated retail prices for gasoline in the country (1 litre cost approximately US 65 Cents in November 2007, or only a little higher than the international price of crude).

[19] See monthly statistics NNPC September 2007.

This together with partly dilapidated assets, significant overstaffing and strong labour unions, has made it difficult to attract foreign investment to upgrade the sector.

As part of the oil exploration round in 2006, CNPC committed itself to invest USD 2 billion in the Kaduna refinery and was awarded four exploration licenses as part of the deal. The Chinese government played an important role as facilitator for the transaction. The agreement was closed during President Hu Jingtao's visit to Nigeria in April 2006. However, the bidding process initiated by the Bureau of Public Enterprises in Nigeria for the refinery to set the first right of refusal price for CNPC revealed that CNPC regarded the refinery assets in Nigeria as unattractive. The company raised a number of concerns about the quality of the assets[20] and the bid they submitted in May 2007 was below the reserve price set by BPE. After an unsuccessful privatisation process, the Kaduna refinery reverted back to NNPC in July 2007, most likely guaranteeing continued sub-optimal utilisation of the assets.

Investment in the power sector (which may be considered another "downstream" activity if produced gas is used) is equally unattractive from a commercial point of view unless a company can secure a power purchase agreement (PPA) from the government, e.g., backed by income from petroleum production. The electricity sector in Nigeria is plagued by low end-user tariffs and very high commercial and technical losses. To invest in generation assets without a government guarantee is at present not commercial. Reforming the electricity sector is politically difficult. As long as the service provision is poor, it is difficult to increase tariffs to make the sector financially sustainable. But without increasing tariffs, investing in the sector is not commercial, and the private sector almost certainly will not enter.

The Nigerian Electricity Regulatory Commission is taking measures to address some of the challenges of attracting investment to the power sector through the introduction of a new tariff methodology, which may improve the viability of commercial investments in the sector.[21]

Some international oil companies like Agip have invested in gas-fired power generation (480 MW) feeding the grid. If Agip isn't paid for the electricity provided to the public grid, NNPC will step in and guarantee the payment[22]. However the majority of the 20 IPP license holders were forced to contract with illiquid distribution companies after the unbundling of the National Electricity Power Authority. As long as these distribution entities are unable to collect adequate funds from end users, they will not be able to pay for the generated electricity they purchase, making it unprofitable to invest in generation assets.

The challenges in the downstream sectors in Nigeria illustrate the challenges that both the Nigerian and Chinese governments face when seeking to link upstream and downstream investments. The Nigerian government seeks investments without creating the conditions required for an investment to be profitable. The consequence is that the government ends up with a huge subsidy bill, which increases the risk of non-payment by the government. The Agip deal is an example of this. The World Bank estimates that the cost of funding the IPP contracts will outstrip the total revenues of the electricity

[20] Please see Privatisation of refineries BPE's nightmare http://afcham.ru/en/news/18/

[21] Please see Energy Tariff – Implication for IPP presentation NERC 27 Novembe 2007.

[22] Please see http://www.gasandoil.com/goc/company/cna13553.htm for details.

sector in 2008[23]. The alternative is that the investment fails. The Chinese government is providing loans to facilitate Chinese investment in the power sector, but this is effectively encouraging investments into a sector where it is impossible to make a profit. A number of Chinese state-owned companies that were encouraged to make investments, quickly found that the investments did not make commercial sense and tried to back out of the deals, e.g., in the case of the flawed tender process for the Kaduna refinery.

[23] See World Bank Appraisal Document Energy Programme Nigeria May 2005.

3 Risk Perceptions

Nigeria has over the last decades attracted limited amounts of foreign investment outside the extractive sector, despite being the most populous country in Africa with a significant home market[24]. The main reason has been that the risks associated with investments have been regarded as high, while the returns perceived as uncertain. A weak human capital base, poor infrastructure, significant political uncertainty, and a closed trade account have also limited the inflows.

In the petroleum industry, it has been significantly easier to lure investments. Although the management of the income from the petroleum sector by most standards has been poor, this has been compensated to some extent (from a company viewpoint) by a significant resource potential, a large role allocated to international oil companies and a relatively lenient tax regime.

The overall FDI inflow increased from USD 1,310 million in 2000 to USD 5,445 million in 2006, an increase from 2.4 per cent of GDP to 4.6 per cent. The investment into the petroleum sector was the main driver for the increase, with particularly large investments in 2004-5 driven by Asian state-owned oil companies' push into the sector. These large investments resulted in a substantial shift in the ownership of the FDI stock in Nigeria with non-Western countries (principally Chinese), increasing their share from 11.7 per cent in 2000 to 31.3 per cent in 2005[25]. Foreign direct investments in the non-extractive industries increased only modestly over the same period, mainly in transport and communications and business services, and the component of the extractive industries in FDI also increased.

Although the non petroleum-related economy contributed to most of the GDP growth in Nigeria in the period 2000-2006, foreign direct investments increasingly are concentrated in the extractive industries, partly due to the massive investment programmes offshore and CNOOC's purchase of block 130 for USD 2.3 billion USD in 2006.

3.1 The Norwegian Perspective (ECON)

The risk perception of the Norwegian authorities differs somewhat from that of the corporate sector as represented by StatoilHydro.

Norwegian officials highlighted the following main risks when asked to give their view of the risks in Nigeria and in the petroleum sector in particular.

Security risks in the Niger Delta: It is difficult to get an accurate overview of the situation in the Niger Delta, due to the security situation, which prevented Norwegian officials from travelling there. However, they felt that the security situation in the Delta was a major deterrent for commercial and bilateral assistance to the area.

Corruption: Many of the ex-governors at the state level are being investigated for corruption, and public office generally seems to have been used for personal enrichment

[24] More than 60% of foreign direct investment was in the extractive industry in Nigeria in the period 1970-2002.

[25] Please see Nigerian Central Bank Statistical Bulletin nr 16 for details.

in Nigeria. This highlights the perception that the integrity of the state apparatus is a major challenge facing foreign entities operating in Nigeria.

Weak ability of the state to execute projects: One of the main challenges Nigeria is facing is the weak ability of the government to execute projects and thereby bring about change. One example of this is that the deadline for stopping gas flaring was postponed from 2008 to 2010 partly because the Nigerian government had not set aside adequate funds to finance their share of the cost. Likewise, the inability of the state to monitor the production of petroleum properly results in lost revenues for the state coffers.

Centralised administration: It is often difficult to get decisions approved due to the highly centralised nature of the Nigerian administrative system. This hampers the flexibility and speed by which government decisions are taken.

Ongoing restructuring of the petroleum administration and fiscal framework: The Nigerian government has a very ambitious reform programme with ongoing restructuring of the petroleum administration, including a breakup of the Nigerian National Petroleum Company (NNPC) and changes to the fiscal terms taking place regularly. It is uncertain whether the government has the capacity to implement all of the changes effectively at the same time.

Table 3.1 *Risk perception of StatoilHydro Nigeria*

Political risk	Operational risk
Government institutional stability	Security
Stability of legal system	Health hazards
Geo strategic situation	Safety impact
Regional situation	Environmental impact
Sanctions	Taxes
Human rights	Enforceability of contracts
Social development	Corruption/crime
Economic stability	Regulations
	Infrastructure
	Factor costs

Source: Meeting StatoilHydro Lagos, 30 November 2007

StatoilHydro has a formalised approach to risk assessment. Risks of particular concern for StatoilHydro are the following:

Contracting risks: The concern that the government will change existing Production Sharing Contracts unilaterally as they have signalled they intend to do.

Local content requirements: Pressure to pre-qualify Nigerian sub-contractors for work they may not be not fully qualified to undertake creates operational risks for StatoilHydro.

Import regulations to Nigeria: Cumbersome and complicated procedures for imports of goods to Nigeria increases operational risks for StatoilHydro.

The overall security situation in the Niger delta: There is a risk that the volatile situation may spill over into StatoilHydro's offshore operations.

3.2 The Chinese Perspective (CASS)

To facilitate comparisons between the relatively comprehensive and macroeconomic risk perception of Chinese officials and the microeconomic perspective of Chinese firms, it is useful to use a division of different risks along the categories below.

3.2.1 Political risk

Nigeria is a multi-ethnic and multi-confessional country with a long history of military rule. The huge gap between rich and poor, the widespread poverty that is intensified by the unequal distribution of oil revenues between the government, oil companies and local communities, and the widespread corruption of the political system are seen by both Chinese firms and officials as the root causes of political, economic and social uncertainty in the country. The main political risks that spring from these are the following:

Political violence and international disputes: political violence often emanates from power struggles within the political class. Since the whole Nigerian national identity is still in the definition process, most rural people still feel more closely linked with their tribe or ethnic group rather than the country of Nigeria. The struggle for political position is still present along ethnic and religious lines. At the moment, there are over 30 political parties in Nigeria, almost all of which, to some extent, are associated with a particular ethnic group. Before, during and after elections, the number of occasions of political violence usually increases.

Policy continuity of Nigerian government: When the Nigerian government changes after elections, this change is often followed by reviews of pre-existing business contracts. This causes uncertainty regarding the integrity of Nigerian Government contracts, considered a major risk by Chinese companies. A typical case of such a change was a major railway reconstruction contract in Lagos where the government had signed a contract with a Chinese contractor in 1998, only to put the contract on hold after the election in 1999, pending a review of all contracts entered into by the previous government. The costs to the contractor of such reviews have been considerable.

Weak execution capacity in the Nigerian government: Corruption and the Nigerian government's weak ability to execute projects in a relatively efficient way have constituted another challenge for both Chinese authorities and Chinese firms. Much paperwork is required to initiate business in Nigeria, and very few government initiatives result in actual projects.

3.2.2 Economic risk

Nigerians' Perceptions of and attitude towards FDI from China: Even though the Nigerian government has encouraged FDI into Nigeria, the Nigerian people, in general, seem focused on the negative side of FDI and threats posed by the entrance of foreign companies. There are different attitudes towards Chinese involvement in the country. Some Nigerians regard China as a fast developed country, want to learn from the successful Chinese development strategy and hope that China will contribute more aid and investment. However, another part of the Nigerian population regards China as a poor developing country that does not have the capability to improve local conditions in Nigeria. At the moment, the issuing of Nigerian visas for Chinese businessmen is quite strict and such visas are difficult to obtain.

The quality of Nigeria's infrastructure needs further improvement: A particular challenge facing Chinese companies active in Nigeria is the poor quality of infrastructure. For example, poor electricity supply infrastructure results in frequent power cuts (although Nigeria has more than 6000 MW of installed power generation, only 3000 MW is working), and bad roads make transportation of goods expensive and time consuming.

Fraud and exchange rate risk: As the Nigerian economy has developed strongly in recent years, so has the business of fraud. The so-called "419 men" (named after the section of the Nigerian penal code covering fraud schemes) often collude with banks to cause financial loss for individuals and corporations. Lack of transparency in the issuing of oil exploitation licences and official corrupt behaviour at the federal, state and local level in the process of contract bidding, implementation and monitoring, also increase the risk of fraud for involved companies.

In recent years, even though the naira exchange rate has been relatively stable against the dollar, the public sector and current account balances have been showing troublesome deficits, representing respectively a negative 45 per cent and 36 per cent of non-oil GDP in 2007. This reflects an insufficiently diversified economic fabric, in which macroeconomic volatility and exchange rate risks are high.

Relations with trade unions and local communities: Another challenge that Chinese oil companies are facing is how to deal with the strong Nigerian trade unions and develop a good, harmonious relationship with local communities in terms of environmental protection and labour rights issues. The Chinese companies are usually unfamiliar with these and lack relevant experiences from corporate activities at home. Inappropriate handling of labour disputes with local trade unions and local communities are seen to easily cause strikes, demonstrations on the street, kidnappings or other attacks. NLC is the biggest trade union in Nigeria and has 4 million members. It successfully called a national strike before and finally won during the negotiating with the government.

3.2.3 Other risks

Militant groups and kidnapping in the Niger Delta: Rooted in underdevelopment and economic backwardness, the militant groups in the Niger Delta have transformed anger about unequal distribution of oil wealth and local environmental deterioration into extortion, kidnapping and attacks on foreign and local oil engineers and workers. These militant groups are often well-equipped and supported by local people. The main demands of these groups are governmental compensation for environmental damages and the release of prisoners. Chinese workers have been attacked several times in Nigeria, and for Chinese overseas workers security has become a new project issue. In addition, the security situation in Lagos is deteriorating. According to a report by This Day (Lagos) in early 2007, about thirty Chinese industries have moved their companies and factories in Ogun State, apparently frightened by the complexity of the procedure of setting up businesses in Lagos, the poor state of security there, the serious problem of multiple taxation and problems with gangs of street urchins ("Area boys").

Negative publicity about Chinese government and companies: China's recent global oil and gas expansion has received significant negative media coverage as well as criticism from some western scholars and officials. "Non-interference in other countries' domestic issues" and "no-string-attached aid" are two long-standing Chinese foreign policies which have been under heavy fire from the West in recent years. The western critique is based on the presumption that these principles “have empowered” those “rogue states” or human rights-abusing governments to secure their regime and therefore have prevented democracy and governance in Africa from moving forward. Such criticism is not only aimed at Chinese government development packages and state bank loans, but at Chinese state oil firms’ massive investments in other sectors (“oil-for-infrastructure-swaps”). It also points the finger at Chinese companies for lack of transparency, low bidding prices and lack of emphasis on environmental protection.

3.3 The Nigerian Perspective (NIIA)

3.3.1 CHINA

Observing China’s presence in Africa today would reveal tendencies similar to those of western powers that used to be characterised as “imperialist”.

First, while China was the largest oil-exporter in Asia, it became a net importer of oil in 1993. It is projected that by 2045, China will depend on imported oil for 4.5 per cent of its energy needs. With its 2006 GDP growth of 10.7 per cent, *China is determined to get, by all means, the resources it would need to sustain its soaring economy, and is taking its quest to lock down sources of oil and other critical raw materials across the globe*. Following the September 11, 2001 attacks and the subsequent upheavals throughout the Middle East, China has turned toward Africa, another major oil producing region. China has adopted an “aid-for-oil-strategy” that has resulted in increasing supplies of oil from African countries.

Second, *the need to find resources is now the driving force of Chinese foreign policy*. Beijing now encourages its state-controlled companies to seek out exploration and supply contracts with countries that produce oil, gas and other critical resources, while aggressively courting the governments of these countries with diplomacy, trade deals, debt cancellations, and aid packages. The strategy appears to be working, as China is known to have gained access to key resources around the globe, including gold in Bolivia, coal in the Philippines, copper in Chile, natural gas in Australia, and, of course, oil from Africa. To date, China has oil partnerships in Nigeria, Chad, Sudan, Angola and Gabon, and is exploring a potential collaboration in Kenya.

Third, *what characterises the current relationship between China and Africa is, essentially, trade and economic activity*. Behind the US and France, and ahead of Britain, China is today Africa’s third most-important trading partner. Sino-African trade grew by 700 per cent during the 1990s; and between 2002 and 2003, it doubled to USD 18.5 billion, and nearly doubled again to USD 32.17 billion in 2006. Most of the growth was due to increased Chinese imports of oil from Sudan and other African nations.

Fourth, *China is building its relationship with Africa through integrated packages of aid that lead to business opportunities and market share for Chinese companies*. For example, in Angola which currently exports 25 per cent of its oil production to China, Beijing has secured a major stake in future oil production, with a USD 2 billion package of loans and aid that includes funds for Chinese companies to build railroads, schools, roads, hospitals, bridges, and offices; lay a fiber-optic network; and train Angolan telecommunications workers. In other words, China is following a very traditional path established by Europe, Japan and the US to offer countries comprehensive and profitable trade deals combined with “aid”.

Fifth, *there seems to be a link between China's interest in oil and arms sales*. Selling arms to African countries helps China cement relationships with African leaders and helps offset the costs of buying oil from them. Beijing sees Africa as a growth market for its military hardware. Beijing exerts strong central control over its arms exports, which it uses as a foreign policy tool. By sending military trainers to African countries where it is actively involved in oil exploration activity, China gains important African allies in the United Nations (Sudan, Zimbabwe) for its political goals, including preventing Taiwan's independence and diverting attention from its own poor human rights record.

Sixth, China sells weapons worth billions of dollars to several African countries. The countries include: Sudan, Equatorial Guinea, Ethiopia, Eritrea, Burundi, Tanzania and Zimbabwe. Experts say any military air presence exercised by the government in Sudan, including the helicopter gun ships reportedly used to terrorise civilians in Darfur, comes from China.

Particular Risks Perceived by Nigeria

The new presence of China constitutes a grave national security risk for Nigeria, in view of the aggressively pre-emptive military measures being taken by the US and its Western allies to secure oil supply sources around the Gulf of Guinea area. Examples of crude military displays around that area in recent times include: The US African High Command (AFRICOM), the Gulf of Guinea Energy Security Strategy (GGESS), and the European Command's (EUCOM's) sixth fleet.

In other words, Nigerians are concerned that China's new presence is likely to provoke a new wave of "inter-imperialist" rivalries in Nigeria (and Africa) akin to the old East-West rivalries over spheres of interest in Africa. And when the elephants fight, it is the Nigerian grass that suffers. The last thing Africa needs today is to be made a new battleground in an economic and political war between outside powers for access to mineral resources.

Nigeria is concerned that China will behave towards Nigeria like a typical superpower, a concept that was defined in 1974 by then Vice Premier, Deng Xiaoping, at a special session of the UN General Assembly as "an imperialist country which everywhere subjects other countries to its aggression, interference, control, subversion or plunder and strives for world hegemony… if capitalism is restored in a big socialist country, it will inevitably become a superpower…"

China's total exports in 2006 were almost USD 1 trillion; its external reserves in 2006 were also over USD 1 trillion. Described by many today as the next superpower bound to lead the world in the 21st century, China is capable of committing several billions of dollars to projects in Nigeria's very sensitive and strategic sectors, such as energy, railway, power, etc.

Nigerians are conscious of the fact that the profit motive is the driving force of all capitalist enterprises everywhere. They do not, therefore, perceive China and Norway as altruistic players in Nigeria's (and Africa's) oil sector or any other sector. In other words, Nigerians do not accept the idea that foreign entities are in Nigeria to develop Nigeria. And Nigerians are concerned that the foreign entities will tend to exploit Nigeria's weak governance institutions in pursuing their own strategic and profit interests, thereby jeopardizing Nigeria's already fragile platform for development.

There are also concerns about the habit of Chinese companies dumping cheap goods produced by cheap labour in China on the Nigerian market, thus destroying the nascent industries in Nigeria, a country where enterprises are already operating under severe difficulties, including lack of basic and supportive infrastructure, that makes their products uncompetitive even within Nigeria. The collapse of Nigeria's textile industry has been blamed on the influx of cheaply-produced alternatives from China. While Chinese imports may provide affordable consumer goods, the risk is that they can also undercut domestic production.

A related concern is the dumping of inferior quality and substandard goods on the Nigerian market by Chinese companies. Complaints by the Standard Organisation of Nigeria (SON) about this are similar to those raised by the European Commission with regard to Chinese products in Europe, even though safety and health matters have received greater attention in the European and American markets. One recalls here the withdrawal from the market of some 19.5 billion toys (worth USD 20 billion) from China not long ago.

In addition, Nigeria's National Agency for Food and Drugs Administration and Control (NAFDAC) has traced to China (and India) several companies responsible for manufacturing and exporting substandard and expired drugs into the Nigerian market. Since such drugs are not released into the Chinese domestic market, it seems clear that the regulatory body in China has not been rigorous in ensuring that China's exports conform with World Health Organisation (WHO) standards. Here we recall the recent case of collusion and large-scale bribe-taking established against the head of China's food and drugs standard and safety regulatory agency, who, as a result, was executed.

Nigerians are also concerned about the large presence of Chinese men and women in retail trade and petty commercial activities in Nigeria. Also, the attention of both state and Federal authorities has been drawn to the springing up of several illegal so-called "China Towns" where smuggled goods are sold by Chinese people.

Nigerians are concerned that Chinese firms underbid local firms and do not hire Nigerians. Chinese investment in infrastructure is faulted for its extensive use of Chinese labour and materials, a practice which undermines the potential economic benefits and goodwill that could have come from such investments.

It has been observed that China's business practices, particularly its willingness to pay bribes and attach no conditions to aid-money, would tend to undermine local efforts to increase transparency and good governance.

Nigerians are also concerned about China's human rights policy and notoriety for human rights abuses. China's international human rights policy falls within its notion of "non-interference in domestic affairs" of other nations, a policy which maintains that attempts by foreign nations to discuss democracy and human rights violate the rights of a sovereign country. It must be noted here that the Nigerian concern about China's human rights record does not suggest that China is unique in cutting deals with bad governments and in providing them arms. On the contrary, Nigerians are aware that the US, for example, is highly selective about morality,e.g., by supporting major human rights violators such as Pakistan, Egypt, and Saudi Arabia, because of US strategic interests.

4 Risk Mitigation

This section outlines the risk mitigation approaches taken by Norwegian and Chinese government bodies and corporate entities, as well as a description of Nigeria's expectations of foreigners in this regard.

4.1 The Norwegian Perspective (ECON)

The limited Norwegian bilateral assistance in Nigeria focuses on improving the capacity of the Nigerian state to govern more effectively and efficiency. A key principal in all recipient countries is that development assistance should be demand-driven and that the local authorities should define their own needs and formulate the request for assistance.

The focus of Norwegian support has been on the petroleum sector. Key institutions, such as the Nigerian Department of Petroleum Resources, have been identified and assistance provided to them to improve the way they operate. Another key area of support has been to improve the local-content policy in Nigeria in order to facilitate a greater share for local industry in the development of local petroleum resources. The Norwegian government has also signalled that it would like to extend further support to the Nigerian Extractive Industries Transparency Initiative (NEITI), which focuses on improving the transparency in resource revenue transfers and use from the oil sector.

The Norwegian government does not provide assistance to infrastructure investments in Nigeria. Norway's view of western assistance to Africa in the 1960s and 1970s was that donors often financed construction of publicly-owned physical infrastructure only to see it crumble after a few years because of limited local capacity to maintain and manage the assets. This insight gradually shifted development assistance in the direction of capacity and competence building. The assumption has been that it possible to facilitate sustainable development only by enabling the civil service to govern wisely.

However, this approach has also come under scrutiny in recent years[26] because lack of infrastructure, such as stable power provision, decent roads and clean water, has hampered the economic development in many African countries, and the private sector has shown limited interest in infrastructure investments. There is a clear understanding that more investments are required and there is an ongoing search for a better model for attracting the investments. But the actual level of investment has still been too limited to meet the rapidly growing demands in many developing countries.

StatoilHydro, has taken a range of actions to mitigate its risks in Nigeria. Although all StatoilHydro operations in Nigeria are offshore, the company has initiated a community development project in Akassa in the Niger Delta as part of its "license to operate". The area was selected because it is the most likely to be affected by any eventual oil spill from StatoilHydro's operations offshore the Niger Delta.

[26] Please see Implementing the World Bank Group Infrastructure Action Plan 2003.

StatoilHydro's Akassa project in the Niger Delta

The Akassa project was initiated in 1988 by British Petroleum and Statoil, with the aim of providing sustainable livelihoods to a community of 180,000 people in the Akassa area in the Niger Delta.

The NGO Pro Natura International is the implementing partner in the project, and the oil companies provide the funding. The Akassa community designs and develops its own development projects. The idea is for the implementing partner to gradually withdraw its support as the community becomes more adept at managing its own affairs and the resources it receives from the local government, the donor organisations and the petroleum companies.

The project was awarded a runner-up prize for CSR projects at the 2005 World Petroleum Congress for small-company CSR projects.

But some argue that these CSR projects are really just a substitute for weak government, that it should not be the responsibility of oil companies to take on a larger social role, and that the local governments in the Delta states should be more effective in converting the very substantial funds they receive from the Central Government in Abuja into development projects so that there would be less need for the oil companies to provide public services. Shell, which spends approximately USD 160 million on CSR projects Nigeria, admits that the projects probably don't contribute much to the overall development in the over 1000 communities where oil production takes place[27].

4.2 The Chinese Perspective (CASS)

Encourage the current endeavours of the Nigerian government to improve governing efficiency and maintain political and social stability. Even though China has not signed the EITI at the moment, China is glad to see that NEITI has performed well so far in tackling the issue of corruption and the misuse of the money generated from the oil industry. As for the new initiatives the Nigerian government has taken in the Niger Delta region, China would like to see their smooth implementation and a stabilization of the situation there. In fact, China has contributed through providing equipment to the Nigerian Navy some two years ago. International players also could support Nigeria in developing an early warning and response database and mechanism in conjunction with relevant security offices. The Chinese government is also supporting Nigerian-led efforts to tackle the structural causes of conflict.

In terms of the border disputes between Nigeria and other African countries, the only possible mitigation effort is negotiations. All the stakeholders, such as relevant governments, African regional organizations like ECOWAS, as well as the UN and the African Union (AU), could play joint roles to bring the parties together to sign a final peace and border treaty.

Strengthen the mutual understanding through exchange of visits and human resources training. The sceptical Nigerian perception of, and attitude towards, FDI

[27] Comment by Olav Ljones Director of Communications in Shell Africa in interview in Lagos November 2007.

from China and the two extreme views about China mentioned earlier are all generated from lack of knowledge about the modern China. In fact, rich China and poor China are just two sides of one coin. Even though China's whole GDP and foreign exchange reserves rank among the highest in the world, the per-capita GDP is still low and 20 million people live under the poverty line. China's experience of attracting as much FDI as possible at an early stage of "reform and opening-up" could serve as a reference for Nigeria.

Help build infrastructure and training expertise, support Nigerian economic and social development. The combination of the Chinese and Norwegian approaches – "hardware" and "software" – could greatly improve the investment climate in Nigeria. The Chinese ability to integrate oil and gas investment with general development loans and infrastructure investment has proved especially popular and has generated practical results in most African countries. According to the data provided to the authors by Chinese economic and commercial counsellor in Nigeria, China has dispatched 524 agricultural experts to assist Nigerian farmers to increase productivity in the agricultural sector, and a further 150 Nigerian officials and technicians are under training in China currently to help develop the human capital base.

Improve risk awareness and equip employees with knowledge about the local situation. Better risk awareness would help considerably in handling such things as fraud and kidnapping more appropriately. After the kidnapping of employees, CNPC invited the Control Risks Group based in London to evaluate risks and to draw from international experiences. And back home in China, we would also strongly suggested that the Chinese oil companies arrange training courses for their employees to include analysis of local risks, as well as basic communication skills and local language training, before being dispatched abroad.

Strengthen the awareness of Corporate Social Responsibility and establish harmonious relationships with local communities. Fundamentally speaking, one of the main driving forces for Chinese oil companies "going-out" is to catch up with international standards and become international oil companies (IOCs). As one leading Chinese energy expert pointed out, China's low oil reserve-to-production ratio (R/P ratio) has forced the Chinese NOCs to explore new energy resources both at home and abroad. With their strategy of "going-out" and gradually embracing international management techniques and re-allocating their assets worldwide, they will also gradually gain a better understanding of international rules and practices. With the introduction of the concept of "Corporate Social Responsibility" into China, plus oil companies' own first-hand experience working in host countries, the Chinese NOCs have fully realized the importance of their dedication to the local communities and host country's development when implementing their business plan. In order to achieve sustainable development and a longer-term base, contributions to local social and economic development and harmonization with local culture and social behaviour are core operating procedures that the Chinese NOCs must enhance. This is also the key to enhancing safety in the Niger Delta region.

Strengthen the bilateral relations in an all-round way. Good bilateral relations can help mitigate risks to a great extent. In addition, a strong confidence in bilateral relations could lower the level of existing risks. Benefiting from the historical friendship between China and Africa, China's strong confidence in African countries' political stability and economic development in the future, as well as China's sufficient courage to take the necessary risks, the Chinese oil companies have been awarded a range of licences in various African countries in recent years. For example, CNOOC announced the acquisition of a 45 per cent stake in an offshore Nigerian oilfield, Akpo, for USD 2.3 billion in January 2006 after the Indian state oil company, Oil and Natural Gas Corporation, had given up the deal it had previously signed with the Nigerian side. It was said that Indian government overruled the deal due to fears of the political and legal risks associated with the oil field. Furthermore, the national energy policy priorities of the home country can empower the mental preparation and risk-taking capability to bear those risks by both officials and by the NOCs.

Greater and closer international cooperation is badly needed. Dealing with the international image risk, two-way-street understanding and cooperation between China and the West is a must. First, in order to coordinate the contradiction of different approaches, norms of behaviour and even principles between China and the West, each side should understand the other's presence in Africa from a historical perspective. China respects the West's legitimate interests in Africa. At the same time, the West should understand the uniquely Chinese pattern of Sino-African cooperation by looking at it from the perspective of historic development and results. In fact, if all relevant parties focus on promoting development and stability in Africa instead of on their different value and modes of development, they could find many meeting points for their interests in Africa.

Second, there is a need for coordination and cooperation between the Chinese oil companies and the Western multinational oil companies. With deep involvement in Africa, the Chinese oil companies also need to become more transparent in terms of strategy and tactics. At the moment, whether in technical know how and experiences or financial resources, the Chinese oil companies are not significant competitors of the Western multinational oil companies. But the Chinese companies also enjoy some advantages that the Western companies don't have, such as willingness to take risks, strict discipline, government support, and its workers' capacity for hard work, as well as the low cost for personnel expenditure. So there is plenty of room for further cooperation.

4.3 Nigeria's Expectations from Outsiders (NIIA)

4.3.1 China

Nigerians have significant expectations from the increased Chinese involvement in Nigeria.

- First, Nigerians expect genuine South-South cooperation that is based on equality and mutual respect and does not replicate existing unjust and exploitative North-South relations.

Second, Nigerians would encourage deeper Nigeria-China relations under South-South cooperation with the hope of learning the "secrets" of China's success. Many African countries believe that the "Beijing Model" or "China Model" would offer a better choice than the "Washington Consensus". How Beijing liberated itself from the Washington Consensus is an important lesson that Nigeria wishes to learn.

- Third, Nigeria would expect, through South-South relations with China, to overcome its marginalisation in international affairs. Nigeria is still marginalised despite several decades of close relations with the West. Diversifying its relations would help overcome this marginalisation. And China is expected to provide that avenue.

- Fourth, Nigeria expects to benefit from, and share in, the economic opportunities stemming from China's rapid growth. These opportunities would include not just better business access, but cooperation in information and communication technology, space science, etc.

On the whole, there are encouraging elements of the Sino-African South-South relationship that could be crafted from the spirit of the Africa-China summit held in Beijing in 2006. And Nigeria expects genuine and honest efforts to concretise them.

For example: China's 2006 African Policy Paper underlined its intention to develop a new type of strategic partnership with Africa on the basis of "Friendship, Peace, Cooperation and Development."

The major features of this strategic partnership are contained in President Hu Jintao's five-point proposal:

- Strengthening mutual trust and political equality;
- Expanding economic win-win cooperation;
- Expanding cultural exchange;
- Cooperating on security issues [on the basis of equality]; and
- Coordinating closely in international affairs.

While all of these sound good on paper, the challenge is to operationalise these initiatives now.

4.3.2 Norway

The operations of Norwegian firms in Nigeria's oil sector have not attracted the criticisms and misgivings experienced by many others.

The primary risk perception associated with them would therefore be that arising from their profit-orientation, as already mentioned in the case of China. But the Norwegians have been forthright in confessing that their intentions are not altruistic.

At a government level, a well-established cooperation programme between Norway and Nigeria has existed since 2000, based on a memorandum of Understanding (MOU).

Nigerian-Norwegian petroleum cooperation takes place on a number of levels. First, at the governmental level of petroleum directorates, there is cooperation on capacity-building regarding resource management, safety and environmental issues. Second, there is cooperation involving Norway's INTSOK and Nigeria's Department of Petroleum Resources (DPR) in order to enhance Nigerian local content. Third, there is cooperation at the level of individual companies on a commercial basis. Fourth, Norway and Nigeria are cooperating in making EITI a success to promote transparency, good governance and anti-corruption measures in addressing the challenges and opportunities represented by substantial public revenues from natural resources, so that those resources can be a blessing and not a curse for the Nigerian people. Fifth, Nigeria and Norway are cooperating in an effort to check oil spills and eliminate gas flaring by the new December 31, 2008 deadline. (It is estimated that Nigeria flares about 5.3 trillion cubic feet of associated gas every year.)

Norway’s business practices have been fairly well-received in Nigeria, which partly explains why its oil activities have not attracted the kind of hostility that companies like Shell have faced. One can only encourage Norway to increase its corporate social responsibility activities, especially in the Niger Delta region. There are important lessons for China in this observation, just as Norway’s future operations should be guided by the lessons from Nigeria’s perception of risks associated with China’s presence in the country.

5 Recommendations

The purpose of this section is to outline recommendations to Chinese, Norwegian and Nigerian policymakers arising from the analyses and perceptions of risk associated with foreign operators in Nigeria undertaken in this project. It begins with recommendations from each of the three research institutions and concludes with a set of common recommendations.

5.1 CASS

First and foremost, all the relevant parties should drop the "zero-sum" mentality and replace it with a "win-win" concept. In the era of globalization, countries of the world have been bound together and are today heavily interdependent. Divergence and differences will not naturally bring about confrontation. If we make the whole "pie" of African development bigger and bigger, the large size of one player's share doesn't necessarily mean another player's is smaller.

Identify and develop the comparative advantages of each side on the basis of evaluating the risks. After specifying the risks and the comparative advantages for mitigating them by each side, we can sort out which player could be the main body for dealing with the different types of risks. For example, violent political and international disputes are simply outside companies' control. Instead, the Nigerian government and relevant international or sub-regional organizations should be the main stakeholders in mitigating this kind of risk. China is good at, and enjoys a high reputation in, the fields of infrastructure building, agriculture and medical cooperation in Africa. So China could take more responsibilities in these areas. Since Norway has accumulated abundant experiences and expertise on "oil for development" and capacity building, it will no doubt continue carrying this flag forward.

A new model of Trilateral cooperation is likely to be established. At the moment, there are a number of cooperative programs between China and Nigeria under the South-South cooperation framework, such as Chinese agricultural experts dispatching. In terms of energy cooperation, human resource training, including training of energy staffs and technicians, and regulatory and institution building, could be strengthened. A trilateral training program could be set up under Norway's "oil for development" programme, with training venues in China, Norway and Nigeria on a rotating basis. The content of training could cover a wide range of areas, such as environmental protection, knowledge about EITI, etc. Through experience and value sharing the three sides could understand each other much better than before.

The role of trans-national oil companies should not be underestimated. During our interviews about the risks in the Niger Delta, we found that all the relevant players, including the federal, state and local government in Nigeria, trans-national oil companies and local communities, seem to shirk responsibilities and pass it on to others. Since the introduction of new ideas, values or paradigms of cooperation is often introduced by strong players, the trans-national oil companies have a vital role to play in this regard. For example, the introduction of the concept and cultivation the awareness of Corporate Social Responsibility in China has been mainly undertaken by those leading trans-national companies doing business in China. In this sense, both

Norwegian and Chinese oil companies could join hands together for increasing commitment to local development, e.g., starting with 1-2 specific projects.

After all, in the future, all risks and challenges will require closer international cooperation in order to address them. As far as China-Norway cooperation is concerned, we should jointly not only promote sustainable development of energy resources in Africa, but also cooperate in areas such as pushing for security and stability in Africa and removing terrorist threats, helping Africa’s economic and political development, raising the standards of education and public health in Africa, as well as helping African countries better adapt themselves to globalization. As major energy producing and consuming countries, Norway and China should not only cooperate closely with oil-producing nations but also with each other. They should smooth out relations between energy reserves, capital technology and transportation. They should exchange information on raising the economic efficiency of energy resources and protecting the environment while exploiting energy resources and developing oil derivatives and renewable energy.

5.2 ECON

Nigeria is gradually emerging from decades of stagnation, and the government has set out a credible strategy to improve the living standard to the people in the country. However this progress is tentative and fragile. It is still possible to exploit the system and for outsiders to obtain lucrative government contracts issued without the best interest of the Nigerian people in mind.

Governance is still a major challenge in Nigeria, and it is important that all foreign governments that deal with the Nigerian government stress the importance of due process in commercial engagements. Strategic government agreements that give state-owned oil companies, whether Indian, Russian, Korean, Chinese or Norwegian, preferential access petroleum licenses in exchange for loans and downstream investments are unlikely to be in the best interest of Nigeria because, without a competitive process, it is unclear whether the offer received is the best available in the marketplace.

The Nigerian government is recommended to open up the bidding process for exploration licenses and ensure a level playing field when contracts are awarded. The cost of bilateral strategic deals linking upstream and downstream investments is unclear. Subsidising downstream investments with exploration licenses is no real substitution for sector reform.

Although major governance challenges remain at the central level, many transparency mechanisms have been introduced in recent years which have improved the oversight over the flow of funds within the federal system. The main governance challenge in Nigeria is at the state and local level (see case study in section 4 for details). **An important key to reducing the tensions in the Niger Delta is to improve local-government resource management and ensure that more of public resources are converted to public services for the Delta communities**. The donor community could do more to assist the Nigerian government to address local governance issues.

The increased Chinese engagement in Nigeria could play a very important role in facilitating the development of the country by stimulating competition and increasing investment into infrastructure which is sorely needed. **However it is recommended**

that the Chinese ExIm Bank carefully review the sectors it wants state-owned companies to enter before committing financing to specific projects. The reason for a lack of investment in certain sectors (e.g., power, refineries) is often that the conditions for making profitable investments do not exist. By entering into sectors that are unprofitable, Chinese companies risk failed projects, wasted resources and a delay in reforms required to make the sectors commercially viable. The international community's agenda of sector reform *before* investments is the only one likely to succeed in the long run. However, there may be room to coordinate and phase the approaches.

5.3 NIIA

The Chinese government should put to rest all the concerns, misgivings and criticisms of China enumerated above under risk perception. Beijing should not dismiss risk perceptions described above as another product of "Western propaganda", but should endeavour to constructively transform (and/or correct) those perceptions to a more positive image for itself in Nigeria. Beijing must demonstrate without doubt that its intentions in Nigeria are different from, and better than, those of the earlier imperialists.

In the interest of a future of cordial and fruitful relations, China and Norway **must** endeavour to discard the old colonial mentality that they are in Nigeria on a civilizing (or developmental) mission. This mentality has been betrayed several times and in many respects in the course of this project. Globalisation notwithstanding, China and Norway, while engaging in their commercial activities in Nigeria, must allow Nigeria maximum space to take control of its developmental destiny.

Assuming genuine South-South cooperation and understanding, China should use its influence to explore strategic ways of cooperating with the West, and in influencing the UN and other multilateral organisations on critical issues concerning Nigeria, in order to address Nigeria's marginalisation from the mainstream of international affairs. The idea is that China's cooperation with the West (on behalf of Nigeria), would be more useful for securing Nigeria's interests than would China's competition with the West.

The Chinese government should regulate Chinese enterprises by laws, incentives and punishments so that their practices and products in Africa would conform to international best practices.

5.4 Joint recommendations

The relationship between Nigeria and China, on the one hand, and Nigeria and Norway, on the other, **must** be based on mutuality of respect, interests, and benefits.

Lack of public funds *per se* is not the main cause of underdevelopment in Nigeria. The challenge is rather to spend available public funds more wisely, i.e., where they have the greatest developmental impact.

Improved governance is essential for accelerating economic development in Nigeria. The Nigerian Extractive Industries Transparency Initiative (NEITI) is very important for enhancing transparency in the oil sector and related government institutions. Norwegian and Chinese companies operating in Nigeria are obliged by Nigerian law to comply with the NEITI reporting standards. **The Norwegian and Chinese governments**

should cooperate with the Nigerian government in the implementation of the NEITI.

One of the greatest governance challenges that Nigeria needs to overcome is at the state and local level. **More international support should be provided to increase transparency and oversight over local-level funds and enhancing the capacity of state and local governments to plan and execute projects**. This is likely to have a positive impact on the stability of volatile regions like the Niger Delta.

The Western-backed model for infrastructure development, with a heavy focus on attracting private capital, does not seem to work well in countries with weak governance institutions like Nigeria. **The Chinese approach of providing concessional loans for infrastructure development, including roads and railways, has effectively boosted infrastructure spending**. Based on Norwegian and other Western experience with development assistance in the 1960s and '70s, **however, it is important to ensure that there is also capacity to maintain the infrastructure that is being built. It is also important that concessional loans do not undermine the promotion of transparency and good governance.**

Norway has core competence in transparent development and management of petroleum resources and revenues from the petroleum sector. With limited resources set aside for assistance to Nigeria, the **Norwegian development assistance is likely to have the greatest impact if it is concentrated even more in the petroleum sector.** The development of this sector, including revenue management, is crucial for the overall development of Nigeria.

One area of possible cooperation between Chinese, Norwegian and Nigerian companies is in local-content development in the petroleum sector. Both Chinese and Norwegian companies have to comply with increasingly stringent local-content requirements in Nigeria. Mutual exchange of experiences, perhaps within the Norwegian local-content project in Nigeria, could be beneficial for all parties.

In hosting outsiders on its territory, the Nigerian Government must display confidence in taking the lead role. **The Government must, therefore, clearly define the terms and conditions under which foreign entities would operate in Nigeria's interest, with special reference to China and Norway in the petroleum sector.**

The trilateral institutional cooperation mechanism that has facilitated the present project is an innovative and useful initiative. If sustained, it will enhance long-term mutual understanding and cooperation among the three countries involved. **This momentum should be maintained by embarking on a follow-up project, specifically on Nigeria's expectations and agenda for engaging China and Norway in the petroleum sector. An extension of the process to another African country is also recommended.**

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ANNEX 1: Case study: Niger Delta instability and public service provision (NIIA)

Background to the Crisis in the Niger Delta

The Niger Delta has become topical or famous in international circles not only because of its rich and expansive deposits of oil and gas, but also because of the seemingly intractable crisis the region has been associated with over the past two decades. Beginning in 1999, when the country was returned to civil governance, the crisis has gained momentum.

In a sense, the crisis in the Niger Delta is a by-product of fear, anger and frustration occasioned by years of neglect, discrimination, marginalization and exploitation, begun by the colonial rulers and carried on by successive administrations (both military and civilian) after independence, as well as by transnational oil companies.

In the recent past, however, the crisis has manifested itself in the form of demands for restitution for damage done to the environment of the region as a result of oil exploration and exploitation. Environmental pollution is adversely affecting the livelihoods of some of the people who live in the Niger Delta, mainly fishermen and subsistence farmers. With their livelihoods threatened or jeopardized, the people have been disempowered and forced into, or kept in, poverty. Vast resources from the oil industry have barely touched pervasive local poverty in the six Niger Delta states of Akwa Ibom, Bayelsa, Cross River, Delta, Edo and Rivers. From street protests, demonstrations, human rights advocacy, seminars and conferences, to self-determination struggles, the crisis progressed dangerously to its apogee, now attaining the character of insurgency, with the added dimension of kidnappings of expatriates and local oil workers. The crisis also now includes a substantial degree of criminality that should be distinguished from its earlier genuine economic, social and nationalist character.

Though demands for autonomy and self-determination in the Niger Delta area began immediately after Nigeria's independence in 1960 with the Isaac Boro-led challenge to the authority of the Federal Government, the struggle is waged today on two identifiable fronts – political/constitutional and armed struggle. Several militia groups have emerged in the Niger Delta purportedly seeking restitution for the sufferings of their people - the most prominent being the Movement for the Emancipation of the Niger Delta (MEND), and the Niger Delta Volunteer Force (NDVF). The activities of such groups constitute a specific challenge to the stability of the Nigerian state. In other words, the crisis in the Niger Delta does not only harbour risks for the oil companies, but also has implications for the survivability of the Nigerian state itself.

Though several factors could be identified as precursors or catalysts to the crisis in the Niger Delta, it is *the underdevelopment of the region in comparison to other parts of the country that can be identified as the fundamental cause*. Over the years, arbitrariness and autocracy have created the structural underpinnings supportive of marginalization and poverty in Nigeria. This was in addition to the economic and social consequences arising from oil and gas exploration.

From loss of traditional sources of livelihood, extreme poverty, unemployment and social malaise to outright exploitation by different layers of the society, the people of the Niger Delta now consider their predicament worthy of a struggle, even through the barrel of the gun.

They have collectively articulated their predicament and demands in various declarations, the most prominent being the 1990 Ogoni Bill of Rights, the 1991 Addendum to that Bill, and the 1998 Kaima Declaration (See Appendix 1, 2 & 3).

Over the years the Nigerian state tried to respond to these demands through the institution of various bodies charged ostensibly with delivering development to the region. Special financial arrangements have also been made with respect to ecological issues and resource revenues. The Federal Government first established the Oil Mineral Petroleum Development Agency Commission (OMPADEC), which later was transformed into the Niger Delta Development Commission (NDDC) through an Act of the National Assembly in 2000. The Act was aimed at redressing the plight of the Niger Delta, which had remained largely underdeveloped and lacking in basic social infrastructure. The performance of this body has remained a subject of intense debate amongst the various stakeholders, with each side blaming the other for the poor result of intervention efforts in the Niger Delta. Suffice it to say that the Government's efforts do not appear to have met the peoples' expectations, especially since the dawn of democracy in 1999 with its numerous promises.

Current Sources for Funding Development

The Federal Government, through the creation of bodies like the OMPADEC and NDDC, and several enabling laws, provided platforms for funding development that include the states, local governments, and oil companies in partnership with international and local Non-governmental Organizations (NGOs).

The NDDC received over NGN 3.6 trillion from the Federation Account within the same period, while the total partnership funding and contributions from the oil companies to the NDDC was over USD 362 million as at December 2006 (NDEBUMOG, n.d). Also, the Federal Government revealed that while it allocated about NGN 24 billion to the NDDC in 2007, following constitutional provisions, it is now allocating about NGN 80 billion, for the 2008 fiscal year to the Commission to redress the problem of non-release of funds.

Specific Federal Government initiatives in the Niger Delta include the Multi-partner Micro-Finance Scheme, which involves counterpart funding arrangements with the state governments. During its launch in January 2006, the Rivers state government provided NGN 500 million as its own contribution to the scheme. The Scheme was designed by the Federal Government to create access to micro-finance targets and to enhance their empowerment by engaging in small-scale entrepreneurial endeavours.

As the table below indicates, between May 1999 and October 2007, huge amounts of revenue adding up to over NGN 2 trillion, were allocated to the six Niger Delta States in question. For example, Bayelsa state, with only eight local governments (LGs) received a total of NGN 435.9 billion; Delta, with twenty-five local governments, received a total of NGN 501.47 Billion, and Rivers state, with twenty-three local governments received NGN 628.70 billion. By several measures, these were impressive figures, especially when compared to several other states outside the region. And if these allocations had really been applied to addressing the pressing needs of the people, a significant positive change should have by now been noticed in their living conditions. But this has not been the case.

Table A1.1 Consolidated Table of the Distribution of Revenue Allocation to Six States of the Niger Delta May 1999- October 2007 (Total Net Amount) (NGN Billion)

States	No of LGs	1999	2000	2001
Akwa Ibom	31	2,651,994,748.89	24,696,749,554.10	26,595,947,032.10
Bayelsa	8	2,034,480,707.30	1,935,861,337.16	19,078,174,249.56
Cross River	18	2,023,656,757.82	7,727,012,944.62	7,137,021,666.81
Delta	25	2,938,067,702.71	31,013,192,666.89	35,166,697,272.35
Edo	18	1,910,844,234.79	16,345,092,332.08	8,316,871,401.56
Rivers	23	2,696,766,898.42	20,052,733,341.68	38,965,487,624.59
Total/Year		14,255,811,049.93	101,770,642,176.53	135,260,199,246.97

States	2002	2003	2004	2005
Akwa Ibom	19,585,785,537.90	35,409,456,763.00	56,205,264,918.30	76,795,955,681.50
Bayelsa	18,377,864,903.85	33,393,779,432.03	67,351,045,504.05	102,497,642,989.00
Cross River	7,792,550,021.33	10,495,629,557.05	16,713,018,939.27	22,410,866,396.34
Delta	41,942,093,251.63	53,740,487,325.22	70,999,571,664.92	83,664,700,218.14
Edo	7,141,292,853.09	11,574,862,926.98	18,217,610,007.62	22,698,546,975.32
Rivers	26,565,978,163.92	42,155,647,409.10	62,452,629,683.96	114,755,376,576.00
Total/Year	121,405,564,731.72	186,769,863,413.38	291,939,140,718.12	422,823,088,836.30

States	2006	2007	Grand Total/States
Akwa Ibom	93,631,562,047.18	110,712,140,838.55	446,284,857,121.52
Bayelsa	116,947,339,438.00	74,304,810,388.00	435,920,998,948.95
Cross River	27,513,539,763.77	25,161,914,925.52	126,975,210,972.53
Delta	104,077,045,228.87	77,929,123,623.70	501,470,978,954.43
Edo	28,958,595,506.57	24,568,249,615.33	139,731,965,853.34
Rivers	153,487,289,051.15	167,573,275,987.28	628,705,184,736.10
Total/Year	524,615,371,035.54	480,249,515,378.38	2,279,089,196,586.87

Source: Office of the Accountant General of the Federation, various years. (Please note that these figures are not exhaustive, they are only net amounts, after various deductions have been made)

Furthermore, figures available from the Niger Delta Budget Monitoring Group (NDEBUMOG) reveal that huge allocations have been made to Local Government Areas (LGAs) in the Niger Delta States. Disaggregating accruals to LGAs in the Niger Delta area from 1999 to 2005 shows the following allocations:

1. Akwa Ibom LGA: NGN 20,757, 099,978.86 billion

2. Bayelsa LGA: NGN 7,358,062,862.51 billion
3. Cross River LGA: NGN 13,926,582,605.23 billion
4. Delta LGA: NGN 18,607,428,019.70 billion
5. Edo LGA: NGN 14,458,353,856.99 billion
6. Rivers LGA: NGN 19,527,644,120.92 billion

The oil companies, as part of their Corporate Social Responsibility (CSR) in the Niger Delta, partner with reputable international governmental and Non-Governmental Organizations in some development projects. For instance, according to the Director of Communications of Shell Petroleum Development Company (SPDC), apart from being the biggest contributor to the NDDC, the Company spends approximately USD 160 million annually on local community related projects. This involves a tripartite approach bringing together local communities, NGOs and the company itself. However, Shell is also seen by some as the major culprit in the environmental degradation of the Niger Delta. It does not have a good record of working directly with local communities, but may have changed its policy by now relying more on local NGOs.

State of Public Service Delivery

As noted earlier, available statistics show that, since 1999, a lot of funds, running into trillions of naira, have been allocated to the six major Niger Delta states. In other words, even with the 13 per cent derivation principle (which is still being contested by people in the Niger Delta as too low), the Niger Delta states in Nigeria have had huge funds allocated to them during the period under reference. But the extent to which these phenomenal allocations have touched the living conditions of the people leaves much to be desired. Their cries of marginalization and their level of poverty, rather than being reduced, are actually on the increase.

The developmental priorities of the Niger Delta people include demands for the Government to urgently provide[PS1]:

- A*ccess to cheap but nutritious food.*
- *Employment of able-bodied people and social security for the aged and more vulnerable groups.*
- *Social Service Delivery, including access to education, health and potable water;*
- *Access to energy, including electricity, cooking gas and kerosene;*
- *Modern transportation system;*
- *Modern and affordable housing for all, etc.*

Governance and its institutions have totally failed to impact positively on the lives of the Niger Delta people. A cursory look at the human development indices in the area reveals a dismal failure to deliver basic and critical public service.

- Food: Hunger is still pervasive and food is still beyond the reach of the majority of the Niger Delta people. Because of the widespread poverty, foreign oil companies are known to use food to entice young (both married and single) women in exchange for sex, a sad practice which has taken its toll on the spread of the HIV/AIDS pandemic (NDEBUMOG, n.d).

- Education: There are structural barriers to education in the Delta communities, where parents cannot afford the boat transportation to ferry their wards to school and back daily. Drop-out figures are high and most of the affected (girl) children go into sexual contracts with some oil company workers each of who are known to keep up to six girls at fishing or sex camps. This again helps to spread the HIV/AIDS among innocent and vulnerable young women. And the boys affected by the barrier to education have been easily recruited as child-soldiers by militants. There is one primary school per 3,700 children serving an area of 14 square kilometres, and one secondary school per 14,679 children serving an area of 55 square kilometres. The secondary school system has been seriously afflicted by shortages of quality teachers (UNDP Niger Delta Human Development Report, 2006).
- Potable Water: Public water facilities are collapsing and there is a serious lack of access to clean water in the Niger Delta communities. Most of the people still drink water from the rivers, lakes or ponds, in which they also defecate. But, daily, huge consignments of bottled water could be seen being delivered to oil companies and government institutions in the surrounding state capitals (NDEBUMOG, n.d).
- Public Transportation: This service has also not improved. While oil companies in the Niger Delta use the latest oil exploration technology and cruise around in the latest state-of-the-art jeeps, the Niger Delta people depend on bicycles, motor-cycles and travelling on foot. Transport and communication are a source of misery in the area, as people trek long and excruciating distances due to high cost of motorcycle transport, the popular means of transportation (NDEBUMOG, n.d).
- Housing: Majority of the Niger Delta people still live in slums, without access to proper housing, which is predominantly of poor quality, especially in swamps and creeks where dwellings are made up largely of mud walls, and stilt or strip foundations.
- Health: In most of the Niger Delta states, there is one doctor to every 150,000 inhabitants (by comparison, the rate for the country as a whole, which is not very impressive, is around 20 doctors per 100,000 people). The majority of Niger Delta communities living in isolated areas lack the most basic modern medical care, including first aid. The few existing public healthcare centres are in critical need of repairs. Malnutrition, in addition to a wide range of diseases, is a major problem. (UNDP Niger Delta Human Development Report, 2006).
- Telecommunications: The number of telephone lines in the Niger Delta works out at about 38 per 1000 people. The dearth of telecom infrastructure in the Niger Delta region stifles the advancement of information technology and the development as well as technical empowerment of the people. (UNDP, 2006)
- Energy: Across the Niger Delta area, only 34 per cent of people use electrical lighting; 61 per cent use kerosene or lantern. The primary energy source in the region is firewood, used by 73 per cent of the people; while 25 per cent use kerosene, gas is used by only 1.2 per cent of the population.
- Environmental Degradation: This is becoming a trigger of conflict between Niger Delta residents and foreign oil companies. First, Nigeria is the largest gas flarer in the world today, with more than 80 per cent of locally produced gas being flared. Flaring spews toxic chemicals upon adjacent Delta communities, generating a weird permanent day light situation along with its concomitant health risks. The

> foreign oil companies are not committed to ending gas flaring by the 2008 deadline set by the Government, which has not been firm in stopping flaring. Second, between 1976 and 1996, there were more than 6,000 oil spills totalling more than 4 million barrels. And matters have not improved greatly in more recent times. In 2004 alone, according to Shell, there were 200 spills. Fishing and farming, the traditional occupation of most of the rural people, have thereby, been killed.

In summary, it is clear that the huge allocations to the Niger Delta, of funds running into trillions of naira, have not impacted on improving the human development circumstance of the people. The suspicion is that governance has failed in the Niger Delta states because the Governors, who apparently live above their means, have stolen or misappropriated most of the developmental funds allocated for the welfare of the people. Indeed, as the Port-Harcourt-based Center for Advanced Social Science (CASS) has observed, misappropriation of funds is a major source of the people's grievances against Governments in the Niger Delta.

The UNDP, in its study of public service expenditure in Nigeria between 2000 and 2006, also revealed that a large amount of budgeted resources were stolen by public officers. In Bayelsa state, for example, its former Governor, Diepreye Alamieyeseigha was said to have stolen over NGN 50.2 billion. Also, in 2006, former Governor Odili of Rivers state was said to have misappropriated over NGN 100 billion out of his state's budget of NGN 172.2 billion. In Delta state, Governor James Ibori was said to have stolen NGN 102 billion of state funds, and is presently being prosecuted (Ojukwu, 2007:1). These are indeed pointers that significant resources appropriated for developmental purposes were not applied towards their intended goals.

The deficit in public service delivery that has resulted from such lootings of the public treasury is the main cause of the vandalism of oil pipelines, illegal bunkering activities, hostage-taking and communal conflicts, which have in turn impacted negatively on Nigeria's production capacity, thus sustaining and aggravating the so-called resource curse. It is encouraging to observe, though, that with some recent institutional developments in governance, such as the NEITI project, a significant degree of transparency and accountability in handling development funds and service delivery is beginning to unfold.

Major Developments in the Security Situation in the Niger Delta

The major developments in the deteriorating security situation in the Niger Delta in recent times include, firstly, the increasing restiveness and militancy of local youths, with negative implications for the oil and gas industry. Associated with this deteriorating security situation is the emergence of ethnic militia groups contesting both the political and economic spaces with the Federal Government (Agbu, 2004), and the increased incidence of kidnappings of expatriates and local oil workers in the region. The emergence of ethnic militia groups could be attributed to both historical factors and contemporary developments.

The crisis in the Niger Delta should not be totally misconceived or misunderstood as purely a reaction to underdevelopment (though this is fundamental) bereft of political and psychological manifestations. Today, distorted federal practices, marginalization and environmental degradation as a result of oil and gas exploration have combined to re-invigorate resistance to a new level of militant ethnicity and insurgency resulting in serious security threats to lives and property to all living in the Niger Delta. This is also a serious threat to Nigeria's economic health and fragile democracy. In fact, the minority ethnic factions of the Niger Delta are not only struggling against the Federal Government and oil companies, but also fighting among themselves for diverse reasons, all within a context of pervasive poverty for ordinary people. It is indeed ironic that this area, which hosts enormous oil reserves, is ravaged by poverty and is bereft of the most basic of social infrastructure. This may be why agitation verges on aggression and desperation for survival.

In terms of demands, as an aggregate, the various movements in the Niger Delta are agitating for a constitutional restructuring of Nigeria's federalism that can guarantee them access to the control and management of their natural resources, protection of their environment, repeal of the Land Use Act and the various Petroleum Laws, and above all, self-determination. Some of the Acts include the Petroleum Act (51) of 1969 and 1991, which vests control and ownership of all petroleum resources in the hands of the Federal Government (enacted in the heat of the civil war by the then military regime), Offshore Oil Revenue Act (No.9) of 1971, which gives the Federal Government exclusive rights over the Continental shelf of the coastal states; and the Land Use Act (No.6) of 1978, which transferred ownership of all land from individuals and communities to the state (The Guardian, 2005:9). On the other hand, the people of the Niger Delta contend that mineral land rights and oil royalties, should rightly belong to the communities or states where they are located, and that the Federal Government should put in place appropriate institutional and financial arrangements to compensate their communities for the ecological problems they have faced since the 1960s (Agbu, 2004:33).

As generally observed and noted earlier in this study, the bottom-line at this point in time, is that *the Niger Delta problem is fundamentally one of underdevelopment. The people are poor in the midst of plenty, and generally unable to process this or accept it, they have therefore resorted to violence as a solution to their predicament.*

The response of the state has shifted from gradualist engagement to proactive military measures. It was initially gradualist, as the state was mindful of the implications of the crisis on the interests of the oil companies operating in the Niger Delta and the need to attract Foreign Direct Investment. For some time the official policy on the matter of ethnic militias was to discourage their activities and address each incident as it arose. Only in recent times has the state become proactive, especially by taking violence to those militias whose activities verge on criminality.

The crisis in the Niger Delta is also increasingly attracting extra-Nigerian military security interventions. America's Global War On Terrorism (GWOT), which appears to contain an important emphasis on security of energy supplies around the globe, is gradually enveloping the Niger Delta Region. The strategic imperatives driving American energy security interests in West Africa are increasingly reliant on crude military power for policing oil installations and increasingly dependent on joint Nigerian-American strategic planning to suppress threats to production in, and exports from, the West African "oil triangle", including the Niger Delta. Because of the spiraling crisis in the Niger Delta, in July 2005 American and Nigerian officials, in consultation with the UK and other European allies, evolved a plan for a joint working group on security in the Niger Delta entitled the "Gulf of Guinea Energy Security Strategy (GGES)". And any doubts about Nigeria's acceptance of the US African High Command (AFRICOM), has been laid to rest by the Nigerian President himself during his recent visit to the White House. Meanwhile, the US Navy has become a permanent fixture in the Gulf of Guinea represented by the European Command's (EUCOM) sixth fleet, to secure oil supplies in the Gulf (Lubeck, Paul et.al 2007).

Since 1999, instability in the Niger Delta Region has cost the Nigerian Government USD 6.8 billion in lost revenue (Kemadi and Davies, 2005). Insufficient attention has, so far, been paid to resolving the conflicts and human rights abuses in that region. It is clear that a "hardline", "stability-at-all-cost", security approach has not worked, as failure to address core development concerns has only ignited more insurgencies and increased criminality in the area. Democratic governance and more serious conflict resolution mechanisms appear to be the only sure route to securing the Delta.

Recommendations for Mitigating Deficit in Provision of Public Service

- The promotion of peace is the *sine qua non* for mitigating the deficit in public service provision in the Niger Delta. Top in the priority list should be the disarmament and demobilisation of militia groups. Then, youths who have become largely unemployable or unwilling to develop themselves must be given help to rehabilitate themselves. Stakeholders should embark on cross-cultural awareness efforts to reorient people towards human coexistence and mutual partnerships. And compensation to communities for oil production and pollution should be revisited. The participation of the people in development planning must be enhanced and the barriers of social exclusion removed to give them a feeling of ownership of their development project. An important element of peace-keeping in the Niger Delta is the development of an amicable working relationship between the foreign oil companies and the people. Perceptions of risks, which are mutual, must be clarified and understood, and genuine cooperative efforts made to address them.
- The best security measure in the Niger Delta would be to raise health, education, and general living standards, ensure free and fair elections, and broadly transform the people to bonafide owners who benefit from the oil business. Multilateral institutions, stakeholder-Governments (such as the US, Norway and China), their transnational corporations and the Nigerian Government must increase funding support for democratization programmes and show more commitments to development projects in the Delta.
- Good local governance will eliminate deficit in public service provision and enhance human development. Accountability, transparency and integrity must guide the use of development funds at all levels, especially local governments, which are closest to the people.
- The local monitoring of public funds must be encouraged through non-governmental organisations and civil society groups such as NDEBUMOG, in order to hold people in authority accountable. The monitoring of the expenditures of local governments, which is now being done by relevant agencies like the Economic and Financial Crimes Commissions (EFCC), the Independent Corrupt Practices Commission (ICPC), and the NEITI, which are sufficiently empowered to investigate corruption and transparency at all levels and bring defaulters to justice, is a step towards mitigating deficit in provision of public services.
- It is important to properly articulate the critical elements of the development programme that should be funded in the Niger Delta. Such a programme should include:

(a) Food production programmes, paying special attention to small and medium-scale farming, with provision for micro credit and auxiliary services, etc.

(b) Social services delivery (primary health, education and research, and access to potable water).

(c) Energy (electricity and energy fuels).

(d) Roads construction, rehabilitation and maintenance.

(e) Transportation.

(f) Housing

(g) Waste Disposal and Environmental Rehabilitation.

- The Federal Government's budget should take better account of the above-mentioned developmental priorities of the Niger Delta people. The Managing Director of the NDDC (the Federal government's main development agent in the Niger Delta) has revealed that the Commission was being heavily under-funded (for example, by as much as NGN 70 billion in 2006 alone) by the Obasanjo Administration. And as Senator Nimi Barigha, a PDP Senator from Bayelsa East, has observed, the 2008 Federal Government budget falls short of the expectations of the people of Niger Delta region. Referring to the NGN 444.6 billion in the budget for "security" in the Niger Delta, he said: "…it is not the acquisition of arms and deployment of troops that will solve the problem of the region… the Niger Delta people have been short-changed… what they need is development…" (The Guardian, 29 December, 2007, p.9).
- As part of the effort to curb the habit of Niger Delta state Governors using the 13 per cent derivation fund under their keep to buy airplanes and choice properties abroad for themselves, as they are rumoured to be doing, an independent commission should be set up outside the Governors' offices, with an independent account into which the derivation funds will be lodged. Such a Commission would initiate projects and deal directly with contractors from the various communities.
- The establishment of a Niger Delta Development Bank, as advocated by NDEBUMOG, is also recommended. The bank would be funded by the Federal, State and Local Governments in the region and would be capable of giving liberal credit facilities to the people of the Niger Delta.

To reiterate, the people of the Niger Delta want development. The revelations of Professor Nimi Briggs, the former Vice-Chancellor of the University of Port Harcourt, who is the latest abducted and released victim of the Niger Delta militants, point in that direction.

> Their grievances were…that they felt the Nigerian nation was not doing well and that in particular, the nation had no plans for the youths in this part of the country where oil and gas were being exploited. They felt that no plans were being made for the youths, who would occupy this land when oil that is being exploited would have ceased to flow. This is annoying to them… They talked about infrastructures and they worried that all these had collapsed. They insisted that the Nigerian state should give them jobs to do. They kept harping on the issue of

> job creation and wanted the people to be appropriately educated. They said these issues were dragging their people backward. (The Guardian, 29th December, 2007, p. 7)

Concluding Remarks

It will not be absolutely true to say that the Federal Government of Nigeria has not been funding development in the Niger Delta, at least since 1999. It will also not be quite true to say that the foreign oil companies have been nonchalant about the plight of the Niger Delta people, especially going by the various contributions they have made to the funding pool for development in the Niger Delta, and their various partnership arrangements with NGOs towards delivering development and social services. Nevertheless, it will equally be an over-exaggeration to say that the objectives of facilitating development for the Niger Delta people have been achieved.

Therefore, in the context of the democratization project and reforms being undertaken by the Nigerian government, all stakeholders, including the Niger Delta people, should be enjoined to take interest in the management of the resources devolved to the area. Individuals, NGOs and foreign oil companies should take advantage of the monthly publication of shared revenues to states and councils to monitor the use of these resources and raise alarm where necessary as a way of ensuring transparency and accountability. This kind of "community policing" will hopefully improve the efficient use of development resources at the local level and have direct impact in terms of providing quality governance for people in the Niger Delta.

ANNEX 2: Theoretical approach to risk analysis

Both private and public actors work with projects under budget constraints. Before a project begins, project managers are therefore concerned with both how uncertain the outcome of the project is and what the potential impact of deviations may be. Risk analysis and risk management techniques are designed to answer these questions.

Definitions

Much of the difficulty of analyzing risks stems from the definition of the unit of analysis. How does one define and analyze future events? The most common terms used are the terms *risk* and *uncertainty*. Sometimes these terms are used interchangeably and sometimes they are separated to distinguish situations which are subject to quantitative analysis from those which are not. According to the classical distinction between risk and uncertainty, risk is a quantity subject to empirical measurement while uncertainty is of the non-quantifiable type. (Reutlinger 1970, Pouliquen 1970) More recently however, the word risk is most often used for both situations. Instead *qualitative risk analysis* is separated from *quantitative risk analysis* depending on if dependable historical data is available or not. This is also the methodology chosen in this report.

A *risk* is often defined as an event which is (1) uncertain and (2) has a negative impact on some endeavour. (Galway 2004) *Risk analysis* is the process of quantitatively or qualitatively assessing risks while r*isk management* uses risk analysis to devise management strategies to mitigate risk. This involves an estimation of both the uncertainty of the risk and of its impact.

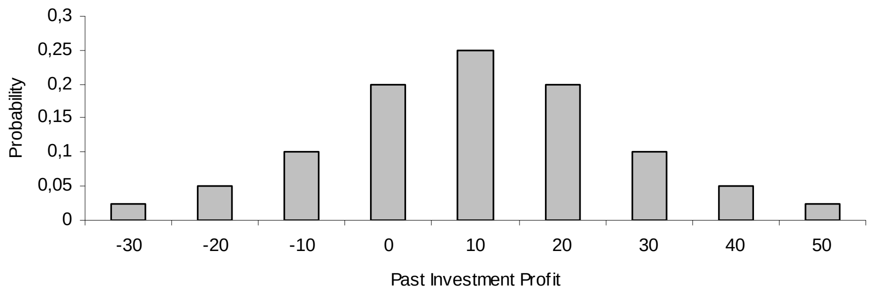
Risk analysis often involves the measures *Internal Rate of Return* (IRR) and *Net Present Value* (NPV). These calculations are used to make choices between different investment projects. The NPV of a project is defined as the sum of the present values of the future annual cash flows minus the initial investment. These cash flows are discounted or adjusted by incorporating the uncertainty and time value of money. IRR is the discount rate often used in capital budgeting that makes the net present value of all cash flows from a particular project equal to zero. It is the rate at which the present value of the project's incremental economic benefits is equal to the present value of its incremental economic costs.[28]

Quantitative risk analysis

Quantitative risk analysis models unknown outcomes and develops decision rules thereafter. They assign probabilities that changes in major quantifiable variables will actually occur by using historical data. If one has documented data of past investments, this data can be used to assign probabilities to the outcome of future investments as is visualized in Figure A2.1 below.

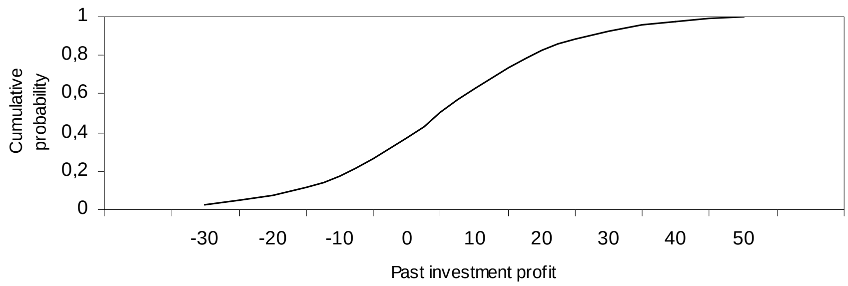
[28] IRR is sometimes referred to as Economic Rate of return (ERR)

Figure A2.1 Histogram of investment profit probability distribution



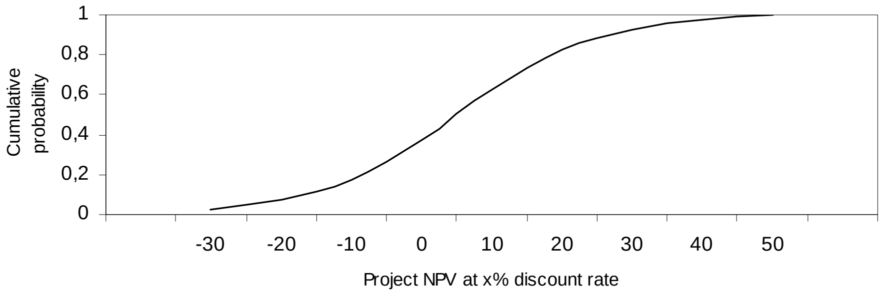
By assigning probabilities to different outcomes, a cumulative probability distribution function for the likelihood of events can be assigned.

Figure A2.2 Cumulative Probability Function (profit)



The same can be done for project NPV so that the probability of a negative NPV is identified.

Figure A2.3 Cumulative Distribution Function (NPV)



Decision makers can use these cumulative distribution functions to assign the expected value of their economic return and their degree of risk. The probability of the project NPV being negative as a result of variability is 37, 5 per cent in Figure A2.3.

This kind of risk analysis is equally applicable to projects of bilateral assistance which do typically not include calculations of net economic worth but which more often use cost-benefit analyses. The only difference here is that expected NPVs would be absolute measures of expected cost-effectiveness of outputs or impacts quoted together with distributions for those values.

Although qualitative risk analysis models may appear unbiased there are a number of issues which are subject to interpretation by the analyst. These issues include what level of aggregation that should be used for the components of the schedule or cost, how probability distributions should be obtained, how correlations should be dealt with and how to deal with limited information. The final outcome of qualitative analysis will therefore still to a great extent reflect the perception of risk held by the analysts.

Qualitative risk analysis

When reliable background data is not available, probabilities cannot be assigned and other techniques must be used to analyze prospective projects. One of the most common of these techniques is *Sensitivity Analysis*. This technique is frequently used when investing in emerging markets since outcomes of private or public investments are often uncertain. (ADB, 2002)

Sensitivity analysis assesses risks by identifying the variables that have the most influence on a project's net benefits by quantifying the extent of their influence. It tests the effects of variations in selected variables on the project's IRR or NPV to determine which variable that is the most critical for project success. (Typically, only adverse changes are considered in sensitivity analysis) Sensitivity analysis helps to identify weak design options and pinpoint the need for obtaining additional information on some variables or for preventative mitigation efforts. (Belli et al, 1997) It can also be used to choose the variables for the type of quantitative analysis explained above.

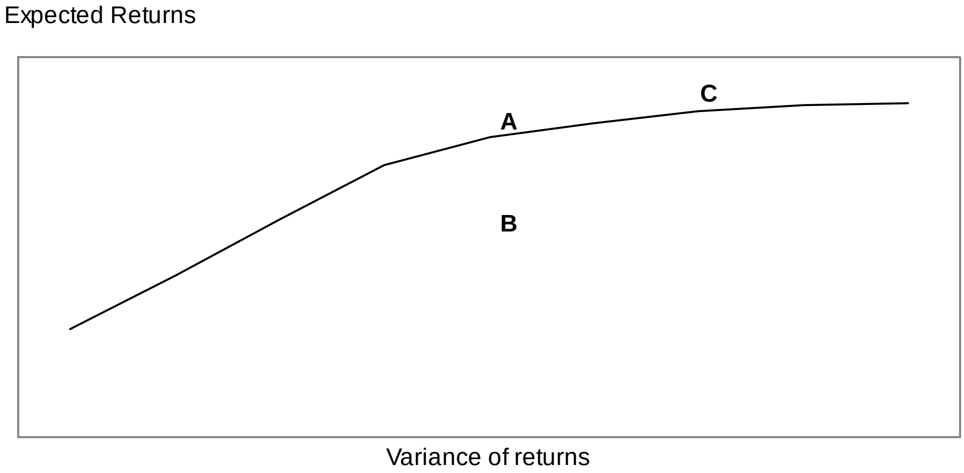
Sensitivity testing also has a number of limitations. Most fundamentally, it does not take in to account the probability of the events that it models. Therefore, sensitivity testing is a highly subjective technique. It's output depends ultimately on judgement and the perception of risks of the individual analyst rather that empirical evidence.

Risk Management

Quantitative or qualitative risk analyses are devices that decision makers use to better prepare for decisions. However, although useful for providing the decision maker with more information, the risk and uncertainty analysis are finally subjective. More or less risk avert project managers will come to different conclusions based on the same analysis because they weigh higher expected returns against increased variability differently. Individual choices can therefore only be understood if the analytical tools above are combined with an understanding of the decision makers' attitudes towards risk.

By using risk and uncertainty analysis, it is possible to rank different projects according to their expected returns (NPV) and their expected variability. These can be graphically combined in an expected return-variance frontier shown in Figure A2.4 below. This frontier shows the expected return and variance of projects A, B and C. It is clear from the graph that project B is inefficient given that it has a lower expected return than A but the same variability. The choice is instead between project A and project C. Project C has a higher NPV than project A but also a greater variability of returns. In this case, the higher NPV of C has to be weighed against the higher risk of the project. Different actors will come to different conclusions based on their willingness to take on risks. A more risk avert project manager will choose project A while the more risk prone manager will choose project C.

Figure A2.4 Expected Return – Variance Frontier



Different actors will also assess projects differently because of the goals of their actions. For a private investor, the choice is often between several similar projects as in Figure A2.4 above while for public institutions or international financial institutions, the choice is often done on a less comparable basis. ADB states that they are usually not interested in making choices between several mutually exclusive, competing projects but is more interested in reviewing projects individually. (ADB, 2002)

Country Risk Analysis

When investors lack the quantitative data and/or the qualitative experience allowing them to undertake independent risk analyses of a country, they often use one of the country risk rating services available. These services use a mixture of quantitative and qualitative measures to provide country risk or country credit ratings. These services include *World Bank - Doing Business Ranking*, *Control Risk Information Services, Economist Intelligence Unit*, *Institutional Investor*, *OECD Country Risk Classification Method*, *Political Risk Services: International Country Risk Guide (ICRG).*

Although the specific quantitative and qualitative measures taken into account by each service vary, there are significant similarities across the field. Most of the rankings transform quantitative economic indicators in roughly the same manner. The more important differences are found in the degree of and the specific factors included in the qualitative component of their risk index measures.

Most of the services base their rankings of surveys or on monthly data on a variety of political, financial and economic risk. These are used to calculate risk indices as well as a composite risk index. Many of the composition of the indices are confidential but an example of the ICRG system of five financial, thirteen political and six economic factors is shown below. This clearly visualises the subjectivity of the country risk analysis produced by many of these services. Political risk assessment scores are based on subjective staff analysis of available information. Economic risk assessment scores are based on quantitative data and financial risk assessment scores are based on an analysis of a mix of quantitative and qualitative data. Overall, the rating is most dependent on the risk perceptions of the designer of the index.

Table A2.1 Critical Factors in the ICRG Rating System

	Points	% of Individual Index	% of Composite
Political	12	12%	6%
Economic expectations vs. reality	12	12%	6%
Economic planning failures	12	12%	6%
Political leadership	10	10%	5%
External conflict	6	6%	3%
Corruption in government	6	6%	3%
Military in politics	6	6%	3%
Organized religion in politics	6	6%	3%
Law and order tradition	6	6%	3%
Racial and national tensions	6	6%	3%
Political terrorism	6	6%	3%
Civil War	6	6%	3%
Political party development	6	6%	3%
Quality of the Bureaucracy	6	6%	3%
	100	**100%**	**50%**
Financial			
Loan Default or unfavourable loan restructuring	10	20%	5%
Delayed payment of suppliers credit	10	20%	5%
Repudiation of contracts by governments	10	20%	5%
Losses from exchange control	10	20%	5%
Expropriation of private investments	10	20%	5%
	50	**100%**	**25%**
Economic			
Inflation	10	20%	5%
Debt Services as a % of exports of goods and services	10	20%	5%
International liquidity ratios	5	10%	3%
Foreign trade collection experience	5	10%	3%
Current account balance as a % of goods and services	15	30%	8%
Parallel foreign exchange rate market indicator	5	10%	3%
	50	**100%**	**25%**

Source: Erb et al (1996)

Conclusion

In sum, risk analyses and risk management are subjective actions and are based on the individual perceptions of analysts. Both qualitative and quantitative risk analyses need subjective interpretations when they are defined and their results are interpreted according to the project managers' level of risk aversion.