LIFE INSURANCE AS A SOURCE OF LONG-TERM SAVINGS IN NIGERIA: REGULATOR'S PERSPECTIVE

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1.0. INTRODUCTION

Life insurance is an insurance contract in which the insured transfers, and the insurer assumes, the risk of death for a specified period of time. As in other insurance businesses, the insured transfers the risk to the insurer, and receives a life insurance policy, upon payment of a premium. Apart from the insured and the insurer, there is usually a beneficiary who is the person (or persons) who is to receive the policy proceeds if the insured event (death) occurs within the policy period. One could also purchase a life insurance policy on the life of someone else. For instance, if a husband buys a life policy on behalf of his wife, he is the owner of the policy but she is the insured. It should be noted that the beneficiary of a life policy is not a party to the contract. He is only designated as such by the owner of the policy. The owner could even change the beneficiary subsequently if he wishes, except for policies that have irrevocable beneficiary designations. In an irrevocable insurance contract, the beneficiary must consent to changes in beneficiary, policy assignment, or borrowing of cash value before such changes can be effected.

A life insurance policy, like all insurance policies, is a legal contract which specifies the terms and conditions of the risk assumed. Special provisions apply, including a suicide clause which nullifies the policy if the insured commits suicide within a specified time from the policy date. Any misrepresentation by the owner or insured on the application is also a ground for nullification. The face value of the policy is normally the amount paid when the policy matures, although policies can provide for greater or lesser amounts. A life insurance policy matures when the insured dies or attains a specified age.

The most common reason for the purchase of a life insurance policy is to protect the financial interests of the owner of the policy in the event of the demise of the insured. The insurance proceeds, apart from paying for the funeral and other ensuing expenses, could be invested to provide income in replacement of the deceased's wages. Other reasons for taking out a life policy include real estate planning (mortgage protection) and planning for retirement. Since the death of the insured would be to the financial advantage of the policy owner, the policy owner must, by law, have an insurable interest in the insured's life. The "insurable interest" simply means the legitimate reason for insuring the other person's life. In fixing life insurance premiums, the insurer aims to cover claims to be paid, administrative costs as well as make some profits. Claims to be paid are determined by actuaries, using mortality tables. Actuaries are professionals who use actuarial science, which is based on mathematics (especially probability and statistics). Mortality tables are statistically based tables showing average life expectancies. Normally, mortality tables take into consideration certain factors, which include the insured's age, gender and lifestyles (e.g. such habits as the excessive use of alcohol and tobacco, etc). When an insurer collects the premiums from the policy owner, he invests the money using the time value of money and compound return principles to create a pool of money from which to invest, pay claims and finance the company's operations. Most of the money made by an insurer comes from direct premiums, while investment income supplements this. Rates charged for life insurance are sensitive to the insured's age because statistically, an insured person is more likely to pass away (and trigger a claim) as they get older. Since adverse selection can have a negative impact on the financial results of the insurer, the insurer investigates each proposed insured beginning with the application, which becomes part of the policy. Group life insurance policies are however an exception.

This investigation and the resultant risk evaluation are called underwriting. Health and life style questions are asked, answered and dutifully recorded. Certain responses by the insured will be given further investigation. Life insurance companies are never required by law to underwrite or provide cover for anyone. They should determine insurability and some people due to their health or life style are uninsurable. The proposal could be declined or the premium rate could be loaded. Premium loading means increasing the premiums to provide for additional risks relative to that particular insured discovered in the underwriting process.

Upon the death of the insured, the insurer will require acceptable proof of death before paying the claims. The normal minimum proof is a Death Certificate and the completed Claims Form of the insurer. Proceeds from the policy may be paid in a lump sum or in regular installments over the life of a specified person or over a specified time period.

As has been pointed out, a life insurance policy provides cover for a specified period of time. If the worst were to happen within this period of time, then the insurance company would be required to pay out the agreed sum to the beneficiary. If the person outlives the term of the policy, then the insurance policy ceases and no payment will be made. However, the value of a policy could increase over time by combining an investment element along with the insured sum. If the life-insured were to die, then the insured sum would be paid out along with the investment bonuses that have accrued. If it becomes necessary to terminate the policy before the end of the specified term period, or death of life covered, then once an investment bonus has been added, the life assurance policy will have an encashment value. It is therefore possible to cash a policy earlier than its usual termination date, in order to collect the investment portion. Some insurance companies place penalties on early encashment of policies. The world of finance is extremely complicated and there are many factors to consider when choosing any financial protection product. When looking for a policy, one should be clear about what one requires vis-à-vis what is on offer. This is to enable one obtain the right cover for one's needs.

An aspect which some people find confusing is the use of the terms “insurance” and “assurance”. What is the difference? The term “insurance” generally, refers to providing cover for an event that may or may not happened while assurance is the provision of cover for an event that is bound to happen (e.g. death). In recent times, the distinction between the two terms has become blurred. This is principally due to many companies offering both types of policy and rather than refer to themselves using both insurance and assurance titles, they simply settle for one.

There are five major lines of business in the life insurance industry individual life, individual annuities, group life, group annuities, accident and health.

The most important lines of business in terms of both revenues and profits are those involving asset accumulation products i.e. individual life and individual and group annuities. Group life and accident and health insurance are mainly indemnity (rather than asset accumulation) products. The importance of asset accumulation products is particularly noteworthy because this is the market where insurance faces the most vigorous competition from banks and investment advisory firms.

2.0. OBJECTIVES AND MOTIVATION FOR THE TOPIC-THE INHERENT BENEFITS

The motivation for the topic is to outline the intrinsic benefits of life insurance, assess its performance in the Nigeria situation and examine what a regulator could do to facilitate its development. The inherent benefits of life insurance could be categorized into three, viz; benefits to the individual, benefits to the government and impact on economic development.

2.1. Benefits To The Individual

Human history reveals a universal desire for security. As we shall see later, early societies relied exclusively on family and tribe cohesiveness for their security. With industrial development, migration to cities and urbanization, this security service weakened and was augmented by privately purchased and government-provided security porgrammes. Among the private programmes, life insurance has emerged as a universal response. The benefits of life insurance to the individual are enumerated as follows:

(a) By guaranteeing to pay a stated sum to a family on the death of its bread winner(s), life insurance provides families a measure of protection against the adverse financial consequences of premature death, and gives individuals a greater sense of economic security. This helps to reduce worry and distress, and thereby increase initiative. No other privately purchased financial instrument can perform this function.

(b) Life insurance cash value can serve as a means through which individuals save. Many people who might not otherwise save consistently will, nonetheless, pay their life insurance premiums regularly. Thus life insurance could constitute a form of quasi-compulsory savings.

(c) Life insurance products, especially annuities, provide a convenient and unique means by which individuals can make financial provisions for their retirement

(d) Life insurance can permit more favourable credit terms to borrowers (both individuals and businesses) and can decrease the risk of default. Life insurance can also minimize the financial disruption to businesses caused by the death of its key facilitators or promoters.

2.2. Benefits To The Government

The benefits of life insurance to the government (in addition to facilitating economic development as discussed below) is mostly in the area of easing the burden of government social welfare spending. Private life insurance can supplement, if not substitute for, benefits provided by government. This is why there is a significant negative correlation between social spending and life insurance premiums. The sharp rise in life premiums in the advanced countries may be attributed in great part to the mounting financial difficulties of pension schemes. Governments could concentrate their efforts on core social protection benefits, while allowing individuals to choose for themselves their desired level and type of additional protection.

2.3. Impact Of Life Insurance On Economic Development

Apart form the social role its plays by relieving government of some burden of meeting financial security needs, life insurance can assist economic development generally and the development of the capital market in particular. Because they have thousands of policyholders, insurance companies are able to amass a considerable quantum of funds that are important in supporting investment in an economy. They thereby serve as financial intermediaries between investors and economic agents that lack sufficient financing. These economic agents may be households, businesses and in some cases even governments. The emergence of life insurers as financial intermediaries, with features different from those of banks as regards the time frame of investments, makes a major contribution to the development of the financial markets. In the advanced countries, insurance companies are the largest institutional investors. Specifically, life insurance impacts positively on savings and development or investment financing in the following ways:

2.3.1. Quantitative And Qualitative Impact On Savings

Studies have shown that life insurance (just like contributory pension schemes) has a positive effect on aggregate savings. Where these contractual savings plans are instituted on compulsory basis (e.g. the new pension scheme in Nigeria will go along with compulsory group life assurance for employees), the resultant rise in the level of aggregate savings will be higher than the rate for which households would have opted voluntarily. Secondly, unlike banks, most of which specialize in deposit taking and short-term lending, contractual savings institutions such as life insurance companies usually adopt a longer-term perspective. Their long-term commitments and the stability of their cash flow provide ideal source of long-term financing for government and businesses.

2.3.2. Impact On The Development Of The Financial Markets

In supplying long-term financial products, life insurance triggers a series of effects which facilitates the development and structure of the financial markets in the following ways:

(a) It leads to specialization. If the banking sector makes adjustments in order to reap the benefits of its comparative advantage on short term products. This reduces the risk stemming from maturity differentials between bank assets and liabilities. The stability of the banking sector is therefore reinforced.

(b) It reduces the differentials between short-term and long-term interest rates. This prompts an improvement in the financial structure of business enterprises which take advantage of lower cost of long-term capital and a lessening of the risks of refinancing.

(c) It leads to, and facilitates, the development of the market for long term bonds. This greatly expands the options for government debt management.

(d) It enhances the efficiency of financial markets.It brings about a higher level of specialization and professionalism on the part of financial market players, making it possible to finance projects that are bigger or riskier (thus more lucrative), exploiting economies of scale, trimming transaction costs and encouraging financial innovation.

Considering these enormous benefits, the objective of this paper as stated earlier is therefore to evaluate the performance of life insurance in mobilizing long-term savings in Nigeria and determine what should be done at the level of a Regulator, to fast-tract its development and ensure that its great potentials are fully realized. But to put this in proper perspective, it is necessary to understand how life insurance evolved.

3.0. HISTORY OF LIFE INSURANCE

In China, insurance as a way of reducing the risk of traders began as far back as 5000 B.C. while early methods of transferring or distributing risks by Babylonian traders began in the 2nd millennium B.C. The Babylonians developed a system which was recorded in the famous code of Hammurabi in 1750 B.C. and practised by early Mediterranean sailing merchants. If a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the ship be stolen.

A thousand years later, the inhabitants of Rhodes invented the concept of "general average". Merchants whose goods were being shipped together would pay proportionally divided premium which would be used to reimburse any merchant whose goods were jettisoned during storm or sinkage. The Greeks and the Romans originated health and life insurance in 600 AD when they organized guilds called "benevolent societies" which had the responsibilities of taking care of the families and funeral expenses of their members upon death. Guilds in the Middle Ages served a similar purpose. In ancient Rome "burial clubs" provided monetary benefits to survivors and also bore the funeral expenses of members.

However, modern life insurance started in England in late 17th century, originally as insurance for traders. Merchants, ship owners and underwriters would meet to discuss deals at Lloyd's coffee house, predecessor to the famous Lloyd's of London. In the United States, the sale of life insurance began in 1760. The Presbyterian synods in Philadelphia and New York created the corporation for relief of poor and distressed widows and children of Presbyterian Ministers in 1759 while the Episcopalian Ministers organized a similar fund in 1769. Between 1787 and 1837 more than two dozen life insurance companies were started, but less than half a dozen survived. Prior to the American civil war, many insurance companies in the United States insured the lives of slaves for their owners. Their trustees voted to end the sale of such policies 15 years before the Emancipation Proclamation.

In Great Britain there was a snag in the evolution of life insurance when gamblers developed the bad habit of betting on other peoples' lives. Hence in 1774, the life assurance Act was passed. This Act made it a crime for anyone who had no interest in another person's life or its existence, to effect a life insurance policy on such a life. The life assurance companies Act 1870 in Great Britain was further promulgated to introduce government control of life insurance companies. Since then there had been tremendous growth in life assurance. Today in any modern nation insurance (including life insurance) as a business is well developed and a vital arm of the financial service sector.

4.0. THE SPREAD OF MODERN LIFE INSURANCE TO NIGERIA.

The spread of modern life insurance to Nigeria and other African countries was mostly through the former colonial powers. The aim was to protect the interest of expatriates' clients who had moved or established businesses in the colonies. But prior to this, it has been the African tradition for the citizens to take care of each other in times of adversity, through the extended family system. It was common for members of the family of an adversely affected person to rally round and compensate the victim. If a breadwinner died prematurely, financial contributions would be levied on the family members for the upkeep of his dependants. If necessary, his children could be distributed among his relatives. Similarly, where a material loss occurred as a result of such misfortunes as fire outbreak or robbery attack, relations and friends of the victim provided some form of succour through contributions, either in cash or kind. Depending on the peoples' culture, different approaches were used in providing these covers. In the Eastern parts of Nigeria, the age grade groupings were used. In the Western part, the tendency was more towards occupational groupings. There was also what is known as "esusu" whereby individuals who belonged to a group contributed money into a common fund. The total collections in the fund are then handed over to individuals in turns, until "everyone" had collected. There were groups where members contributed a pool of funds to enable their dependants receive payments if, and when any member of the group died. These socio-cultural methods of insurance, though quite useful, had no proven scientific basis (such as mortality tables, actuarial valuation, medical reports, etc.), and often resulted in some contributors benefiting more than others. In certain instances, some did not even benefit at all

With the scramble for Africa, which commenced in the early 20th Century, the European merchants who came into the continent through the West Coast of Africa brought along with them their ancient tradition, among which was modern insurance. The establishment of commercial firms by the Europeans led to the opening in the continent and Nigeria of branches of insurance firms existing in England, though as agents initially. Some of these were later incorporated as independent offices or companies with the basic objective of obtaining business for the parent bodies overseas.

4.1. Life Insurance As A Source Of Long-Term Savings In Nigeria Vis-À-Vis Other Countries

One could start by stating *ab initio* that life insurance has not made the required impact in the Nigerian economy but the potentials are very great. Appendix I shows the direct life and non-life premiums written in some selected countries (including Nigeria) for the year 2003. Six developed countries of the world and eight African countries were selected. To create a basis for proper comparison, the population and GDP of these countries have been included. It makes an interesting study. Firstly, it indicates that in the more advanced countries, the role of insurance as a mobiliser of long-term funds (life premiums) is very significant as compared to short-term funds (non-life premiums). Infact, in countries such as United Kingdom, Japan and France, the direct life premiums written in 2003 far outstrip the non-life premiums. The only African countries which exhibit this pattern, are South Africa and Zimbabwe. The reason is not far fetched. It is due to the presence of white settlers in those countries and their attitude towards life insurance, which is akin to a necessity. In the other African countries, the reverse is the case. It is disheartening to note the unimpressive performance of Nigerian in terms of insurance covers, as compared to other countries. In life insurance, apart from South Africa and Zimbabwe, which we had explained earlier, other countries such as Egypt with a population of 76 million, Morocco with a population of 32 million and Kenya (also 32 million persons) each generated long-term funds or life insurance premiums that far exceeds that of Nigeria. It is worthy of note that the GDP of both Kenya and Zimbabwe put together is about half of Nigeria's GDP. Yet each of these countries wrote more life premiums than Nigeria. This goes to emphasize our continued lamentation about the low level of life insurance penetration and awareness in Nigeria.

A look at appendices II & III shows that whereas non-life insurance premiums grew from N5.7 billion to N37.8 billion between 1993 and 2002, life premiums only increased from N812 million to N8.7 billion within the same period. Appendices IV and V examine the investment aspects of these funds. As at 2002, investment of life insurance funds in the various instruments amounted to N18.8 billion. This is out of a total insurance industry investment of about N40 billion for the same year. However, when it is considered that the figure for life insurance investment in 1993 was a paltry N2 billion, then it would be appreciated that even after making allowance for inflation the growth had commenced and only needed to be sustained. The task before us then is to create an enabling environment to sustain the momentum. Appendix VI shows the assets of both life and non-life insurance companies also for the period 1993 - 2002. We did state at the beginning of this segment that the potentials were great. Whereas life assurance companies' assets amounted to only about N3 billion in 1993, by 2002 it had jumped to over N34 billion. Hence, there is justification for optimism that the life aspect of insurance business in Nigeria is picking up and with time, would definitely get to the level where it would play a role similar to what obtains in the advanced countries. The reasons for such optimism are stated in a section below with the sub-heading “WHAT NAICOM IS DOING TO REDRESS THE SITUATION”. But before then, it is appropriate to firstly consider the challenges or constraints.

5.0. CULTURAL BARRIERS, PUBLIC AWARENESS AND OTHER INHERENT CHALLENGES

Factors militating against life insurance in Nigeria and elsewhere include cultural and religious factors. A study carried out on insurance demand in Nigeria revealed some interesting features. Whereas some top executives, captains of industry and wealthy entrepreneurs, although had one form of insurance or another, they seemed to lack confidence in the local insurance industry.

However, in all the groups, there was religious bias. Some Muslims displayed bias against life insurance, especially as Allah was the giver of life; He alone could take or preserve life. Similarly, some Christians believed that once covered by the blood of Jesus, nothing really mattered anymore. For both groups, there was no need for insurance especially life assurance. Thus, the religious inclination of a population may affect its risk aversion and its attitude towards the institutional arrangement of insurance. Religious opposition against life insurance, while stronger in European countries before the 19th Century, still persists in several Islamic countries today. Muslims are known to disapprove of life insurance because it is considered a hedge against the will of Allah. These notions of religious fatalism are inimical to the development of life assurance with its attendant benefits. Assuming God or Allah had ordained that a particular individual, Mr. X would die at age 50. If he had a subsisting life assurance policy and actually dies at age 50, the proceeds or benefits accruing from his life policy would certainly provide some succor to his immediate family or dependants;

indeed anyone else depending on the wish and interest of the policy owner or initiator. Prejudice against life assurance on grounds of religious bigotry should be gradually overcome through vigorous education and enlightenment on the subject.

5.1. Low Level of Education And Lack Of Insurance Awareness

The level of one's education determines his or her ability to understand the benefits of risk management and savings. Hence there is a positive correlation or relationship between people's life insurance consumption and their level of education. In an emerging economy such as Nigeria with a relatively low level of education, most consumers know little or nothing about the working of life insurance or the formal financial markets. Aside from bank deposits, consumers are not familiar with saving products or precautionary cover. In the advanced countries, most consumers enjoy comprehensive cover, which guarantee universal access to health care, retirement benefits, annuities etc. To this end, there is the need for enlightenment campaigns in emerging economies to educate the public on life insurance as well as preparation of prospectuses that explain the main features of life insurance products available.

5.2. High Rate of Inflation

High inflation rate, which characterize developing countries, is a definite obstacle to the development of life insurance. As life insurance savings products typically provide monetary benefits over the long-term, monetary uncertainty has a substantial negative impact on these products' expected returns or yields. Moreover, when fluctuating interest rates cycles affect financial intermediation in the financial markets, it has a disruptive effect on the life insurance industry. The volume of premium income in life insurance is highly sensitive to high inflation. For instance, in Bulgaria, when the rate of inflation jumped from 123% in 1996 to 1100% in 1997, life insurance premiums fell significantly from US$42 million to US$13 million. This was at a time when the country's GDP grew from US$9.2 billion to US$10.1 billion.

5.3. Low Level Of Income

The low level of income and general poverty in emergent economies militate against life insurance. Life insurance consumption rises with the level of income. Steady rise in the income of an individual creates a greater demand for life insurance (mortality cover) to safeguard the income potential of the insured and the expected consumption of his or her dependants. Life insurance belong to the category of products or goods which Economists classify as “Superior goods” where the demand curve is positively correlated with the income level. Rising income results in increasing ability to direct a higher share of income towards retirement and investment related life insurance products. Moreover, the overhead costs associated with administering and marketing insurance make bigger size policies less expensive per Naira of insurance in force, which lower price of life insurance policies. Studies have shown that the positive relationship between demand for life insurance and income level is true irrespective of whether we use aggregate national income data or individual household income data.

5.4. Challenges on the Supply Side

The other constraints facing the development of life insurance in Nigeria as well as other emergent economies are problems or challenges facing the life insurance providers or companies. These are several but we shall just state a few. These include:

(a) Lack of Reliable Actuarial Data

Insurance companies in emergent economies suffer from lack of reliable data bases, on which to base their actuarial calculations and tariffs. In countries where statistical data on health problems and mortality or death are not recorded properly and in which ways of life are undergoing rapid change, the use of life expectancy data cannot provide a sufficient basis for computing life premiums, even if the most sophisticated actuarial methods were used. It is only by instituting a comprehensive and reliable system of data collection that this problem can be overcome. To set up such a system is probably a matter for the state, but private insurance companies can help by constituting their own data bases and pooling them. As long as data are still insufficient, substantial margins of error will have to be factored in to ensure that pricing does not cause a deficit; some of the resultant income should then be returned to the insured in the form of profit sharing.

(b) Underdeveloped financial markets

In order to do business effectively, life insurance companies need to be able to invest their assets in financial markets that are sufficiently well developed and efficient. In most emerging markets, financial markets still offer a choice of products such as bonds with a variety of maturities and issuers, shares in companies and auxiliary services such as auditing firms and rating agencies, that are limited. Where these are not well developed and efficient, they inhibit extensive life insurance operations.

(c) Lack of experience and insurance techniques.

In most emerging economies, life insurance companies often lack experienced and qualified staff, which makes it difficult to estimate risks. Knowledge and skills are still lacking in risk management techniques, actuarial methods, risk selection methodology, new products design etc. This problem of lack of expertise is not peculiar to the insurance industry alone and it is an issue that would be gradually resolved over time as more professionals are turned out and more experience gained.

6.0. WHAT NAICOM IS DOING TO REDRESS THE SITUATION

Irrespective of which of the three standard measures of life insurance are used, the verdict is the same life insurance in Nigeria falls far short of expectation. The three standards measures are life insurance penetration, life insurance density and life insurance in force to GDP.

- Life Insurance Penetration is the ratio of premium volume to GDP. It measures the importance of life insurance activity relative to the size of the economy. Both numerator and denominator are in local currency.

- Life Insurance Density is defined as premiums per capita, expressed in US dollars. It indicates how much each inhabitant of the country spends on the average on life insurance in US dollars. To calculate this ratio therefore, we firstly convert the aggregate premium volume to US dollars and divide by the population size.

- Life Insurance In Force To GDP is the third measure of life insurance consumption, which is, the sum of the face value plus dividend additions of life insurance policies outstanding as a share of GDP. It is a quantity measure of life insurance consumption, the quantity being mortality risk underwritten plus savings accumulated. Life insurance in force thus contains both the cash value of policies, associated with the savings component of life insurance policies and the net amount of risk faced by life insurers.

As stated earlier, in all parameters, life insurance in Nigeria is nothing to write home about, as the contribution of the entire insurance industry premiums to GDP is less than 1%. So what steps are being taken, from the perspective of the regulator, NAICOM, to redress the situation?

(a) Insurance Sector Reforms

(i) Recapitalization and Consolidation

As a vital arm of the financial services sector, the insurance sector is currently undergoing a re-capitalization and consolidation exercise, which is being mid-wifed by NAICOM within the policy framework of government's reform agenda. Insurance companies are expected to beef up their capital base to a minimum of N2 billion for life insurance business, N3 billion for non-life business and N10 billion for reinsurance business not later than 28th February, 2007. With this increase, it is expected that there would be mergers and acquisitions (some have notified NAICOM actually) which would result in fewer but bigger and more solid insurance companies. NAICOM liaised with other regulatory agencies (e.g. SEC, CAC, NSE, FIRS, etc) and obtained some palliatives for the companies to facilitate the recapitalization and consolidation process. The benefits of the exercise would include increased domestic capacity, operational efficiency, sustainable earnings, growth and increased returns to stakeholders, elimination of insider abuses and better corporate governance. Others would include ability to engage highly qualified and experienced professional staff, adoption of modern technology (including ICT) etc. The exercise would yield a news insurance industry in Nigeria, which would be better positioned to contribute its quota to the development of the national economy.

(ii) The new pensions reforms makes it compulsory for employers to take out life insurance policies including group life and annuities for their workers. This will impact positively on the portfolios of life insurance companies and enhance their ability to mobilize long-term funds. Some life insurance companies have registered subsidiary companies as Pension Fund Administrators (PFAs).

(iii) Even the National Health Scheme has a life insurance element and the project cannot succeed without life insurance.

(iv) NAICOM is set to implement Section 72 of the insurance Act 2003, which provides for domestication of insurance businesses, including life insurance, emanating from the country. This is to stem the huge outflow of funds by way of insurance and reinsurance premiums on businesses ceded abroad. Under the provision, no one shall place a domestic insurance business with a foreign insurer or reinsurer, but where, in exceptional circumstances it is necessary to do so, prior approval of NAICOM must be obtained. The guideline for the implementation of this, is ready and shall soon be issued by the Commission. It is believed that about N50 billion could be saved being the amount lost per annum in respect of oil and gas insurance as past study has shown. This is an amount (N50 billion) that could be ploughed back to the local economy to grow more jobs and create wealth for the country. This will lead to increase in the purchasing power of the work force which has positive correlation to ability to purchase more life insurance.

(b) NAICOM Guarantees The Solvency Of Insurance Companies.
Apart from the comprehensive reforms and consolidation of the insurance sector, which is presently in full gear, the first objective of NAICOM as a Regulator is to protect the consumer by:

(i) Ensuring, through close supervision, the solvency of the insurance companies. This is necessary because a life insurance policy represents a promise to pay a future benefit if and when certain stipulated events occur. The transaction is therefore based on the customer's trust and confidence that the chosen company will honour its commitment. This confidence is particularly necessary with regard to life insurance because the amount involved may be very large and moreover, the commitments span a long (if not a very long) period of time.

(ii) Ensure strict compliance with the law especially investment e.g. life insurance investment in property is limited to 35% of such funds.

(iii) Check viability of investments to avoid careless and frivolous investments etc.

(c) NAICOM Ensures A Level Playing Field
To ensure that policy holders are given a high quality of service, NAICOM, as the regulator, has laid the foundations for a competitive market by instituting a level playing field for life insurance service providers. All companies can now apply and vie for any risks without restriction provided NAICOM approves it. Only within such framework can market forces ensure that insurers offer competitive prices and products that correspond to the consumers' demands. All such practices which are detrimental to healthy competition are drastically reduced through encouraging better corporate governance, better performance and more responsible institutions and will apply appropriate sanctions to enforce compliance including cancellation of operating license.

(d) NAICOM Exercises Effective Supervision on Life Insurers.
NAICOM exercises effective supervision on life insurers as the complexity of life insurance contacts demands a special effort to ensure that the most salient features of policies (as well as the so-called small prints) are conveyed clearly. The Commission ensures compliance of life insurance companies with mandatory auditing procedures and certification by independent actuaries and auditors etc. Regular field inspections are carried out, while principles of corporate governance and fit and proper criteria for company executives are strictly adhered to by NAICOM.

(e) Insurance Education
The low level of life insurance penetration and life insurance density in Nigeria is partly attributable to lack of insurance education and awareness. To redress the situation, NAICOM has embarked on reform measures that involve both formal and informal education on the subject. The Commission is liaising with the relevant authorities in the education sector to ensure the inclusion of insurance as a subject in the nation's educational curriculum at the secondary school level. Informal education on insurance is taking place through awareness creation campaigns. Besides, an appropriate measure has been taken to further deepen life insurance penetration through a grassroots pilot project in the six geo-political zones. The project involves the establishment of operational out station offices in each of the zones which will ensure the success of the grassroots development programme, post consolidation.

SUMMARY AND CONCLUSION
This article has in simple, clear terms, explained what life insurance is all about. It examined the benefits of life insurance, its history in brief and its spread to Nigeria. It then considered the performance of life insurance as an instrument for long-term savings in Nigeria in relation to some other countries by comparing their premium income volumes for a particular year (2003) while taking cognizance of their population and GDP estimates for the same year. It was crystal clear that life insurance was not yet playing

its expected role as a major source of mobilizing long-term savings in the economy, but given the large population, the growing GDP, the increasing level of education and awareness, it was observed that the sector has very great potentials, which needed to be tapped. The inherent problems or challenges were outlined, culminating in some measures NAICOM is taking, as a Regulator, to redress the situation.

It was observed that there is an on-going recapitalization and consolidation programme which would boost the paid up share capital of life insurance companies to a minimum of N2 billion and this is expected to give rise to bigger and better companies. We noted that other reforms that would enhance mobilization of long term funds by the life insurance companies include the compulsory group life insurance policies for employees that come with the pension reforms and annuities. The domestication of insurance pursuant to Section 72 of the Insurance Act 2003 was noted to be of equal importance. Then there is the grassroot insurance pilot scheme by NAICOM, which would cover the various geo-political zones.

Although the level of life penetration in the country is still very low, NAICOM reform measures are strategically aligned to ensure promotion of long term sustained investments in the economy as against the current short term investments which are largely contributory to the poor penetration of life insurance in the economy. NAICOM has continuously obtained and is still receiving inquiries and indications from tested foreign life insurance companies, which are willing to go into partnership with local life insurance companies. This aspect is being critically examined with a view to screening them vigorously to ensure integration of our local market with those with tested capabilities. There is the need to improve the culture and practice of life insurance in the country.

The reform measures of NAICOM proffer active support for health providers as well as (PFAs) in respect of which several life assurance offices have been registered. These measures are also geared towards effective and adequate implementation of the national health insurance scheme. The necessary building blocks in this respect have been put in place. NAICOM has engaged appropriate regulatory measures to ensure sustainability, effectiveness and transparency in pursuit of national policy objectives in the life insurance sector. This will culminate in adequate and appropriate domestic capacity building and improved human capital in the sector. There is no iota of doubt that life insurance shall take its rightful place as a major mobilizer of long-term funds for national development in Nigeria sooner than is being envisaged. However, there a great and urgent need for all to come to realization of the enormity of the challenges ahead so that all hands shall be readily available on deck to ensure the actualization of our dream to bequeath to the nation a strong and reliable insurance industry and economy, the starting block of which is the adequate development of the life assurance sector.

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APPENDIX I

DIRECT LIFE AND NON-LIFE PREMIUMS WRITTEN FOR SOME SELECTED COUNTRIES IN YEAR 2003

Country	Population (Million Persons)	GDP (USD)	US $ Millions Life Premiums	Non-Life Premiums	Total Premiums Written
United Kingdom	60.3	1.666 trillion	154,842	91,891	246,733
United States	293	10.99 trillion	480,919	574,579	1,055,498
Japan	127.3	3.582 trillion	381,335	97,530	478,865
France	60.4	1.661trillion	105,436	58,244	163,679
Germany	82.4	2.271 trillion	76,738	94,073	170,811
Israel	6.2	120.9billion	3,052	3,840	6,892
AFRICAN COUNTRIES					
South Africa	42.7	456.7 billion	20,728	4,670	25,398
Nigeria	137.3	114.8 billion	77	345	422
Egypt	76.1	295.2 billion	179	386	566
Morocco	32.2	128.3 billion	361	927	1,288
Zimbabwe	12.7	24.03 billion	277	205	482
Algeria	32.1	196 billion	15	384	399
Ivory Coast	17.3	24.5 billion	53	109	162
Kenya	32	33 billion	107	304	411

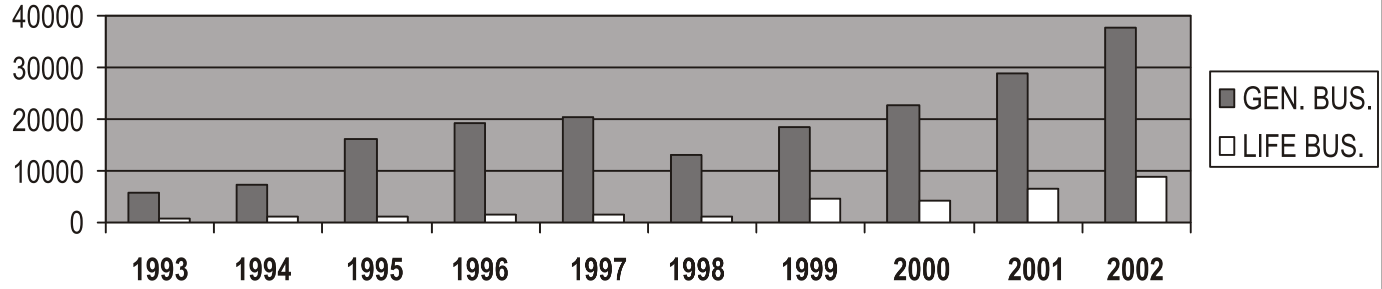
Source: International Insurance Fact Book: 2005

APPENDIX II

INDUSTRY TOTAL GROSS PREMIUM INCOME 1993-2000 (N MILLION)						
	YEAR	GEN. BUS.	LIFE BUS.	TOTAL GPI		
	1993	5,729.23	812.06	6,541.29		
	1994	7,393.86	1,004.98	8,398.84		
	1995	16,137.10	1,000.85	17,137.95		
	1996	19,086.47	1,514.50	20,600.97		
	1997	20,418.71	1,361.54	21,780.25		
	1998	13,152.85	1,322.53	14,475.38		
	1999	18,537.57	4,649.89	23,187.46		
	2000	22,531.46	4,396.33	26,927.79		
	2001	28,808.12	6,460.47	35,268.59		
	2002	37,765.89	8,708.90	46,474.79		

Source: Nigeria Insurance Statistics and Directory (NAICOM)

APPENDIX III



APPENDIX IV

LIFE INSURANCE BUSINESS INVESTMENTS 1993 - 2002 (IN MILLION NAIRA)

TYPE OF INVESTMENTS	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Govt Securities	545.98	450.54	415.89	731.03	1,045.01	2,241.71	607.59	981.88	967.49	763.35
Stocks & Bonds	752.1	895.81	1,510.91	2,237.68	2,123.25	1,952.68	2,233.73	2,532.18	3,491.45	4,319.33
Real Estate & Mortg.	284.62	583.15	1,203.87	1,184.25	1,204.81	84.85	168.56	145.83	222.97	627.68
Policy & Other Loans	138.53	188.65	335.11	511.55	540.67	1,459.18	3,021.55	2,913.78	4,652.91	6,307.20
Cash Deposits & Hand	289.98	378.9	451.78	609.25	868.05	279.75	1,754.61	1,587.95	712.79	1,025.49
Bills of Exch	18.39	50.42	191.73	21.04	64.90	708/07	2,566.70	3,642.84	4,704.66	5,775.73
Total Life Investments	**2029.6**	**2547.47**	**4109.29**	**5294.8**	**5,846.69**	**6,726.24**	**10,352.74**	**11,804.46**	**14,752.27**	**18,818.78**

Source: Nigeria Insurane Statistics and Directory (NAICOM)

APPENDIX V

TOTAL INSURANCE BUSINESS INVESTMENTS 1993 - 2002 (IN MILLION NAIRA)

Types Of Investments	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Govt Securities	818.07	784.28	1,076.81	1,546.16	2,012.01	4,145.88	2,987.21	35,558.95	3,942.71	3,752.08
Stocks & Bonds	1,423.76	1,825.38	2,623.84	4,047.81	4,095.38	3,633.17	4,174.04	49,992.87	6,786.26	8,350.85
Real Estate & Mortg.	791.94	1,200.44	2,516.91	2,523.20	2,682.50	211.95	332.65	282.34	359.33	960.31
Policy & Other Loans	789.07	373.61	563.12	795.98	842.11	2,301.22	4,124.47	5,212.08	6,706.40	7,901.01
Cash Deposits & Hand	1,198.21	1,569.95	1,743.77	3,347.06	3,815.91	1,993.19	4,184.16	3,844.37	4,284.55	4,095.40
Bills of Exch	34.93	107.99	1,555.53	119.30	164.17	3,371.47	5,780.93	7,302.03	10,178.02	11,881.22
Total Investment	5055.98	5,861.65	10,079.98	12,379.51	13,613.08	15,656.88	21,583.46	25,192.64	32,257.27	36,940.87

Source: Nigeria Insurance Statistics and Directory (NAICOM)

APPENDIX VI

TOTAL ASSESTS OF INSURANCE COMPANIES 1993 - 2002 IN MILLION NAIRA

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
GENERAL BUSINESS	6,457.66	8,215.72	14,389.13	21,332.84	29,312.50	30,847.77	34,616.78	41,493.52	51,674.03	57,549.47
LIFE	2,901.71	3,847.39	5,841.79	7,602.09	8,615.68	10,603.45	15,514.87	20,104.48	26,386.46	34,141.48
TOTAL	9359.37	12063.11	20230.92	28934.93	37928.18	41451.22	50131.65	61598	78060.49	60963.95

Source: Nigeria Insurance Statistics and Directory (NAICOM)

IMPERATIVE OF NATIONAL SAVINGS: A CASE FOR ADOPTION OF APPROPRIATE BENCHMARK PRICE FOR CRUDE OIL

BY
MOSES F. OTU[1]

MOSES F. OTU

INTRODUCTION

Budgeting involves the design of plans that aligns expected financial resources and expenditure to accomplish specific national goals and objectives. It is usually time bound and ensures judicious use of resources for sustainable growth if the basic principles and discipline are adhered to. Nigeria's annual budget estimates are closely associated with the anticipated oil revenue flows dictated by oil prices and production targets as predetermined by Organization of Petroleum Exporting Countries (OPEC).

One of the naughty problems faced by developing oil economy like Nigeria is fluctuations of the nation's revenue resulting from volatile crude oil prices in international market. Consequently, sharp declines in oil revenue are not uncommon and it affects smooth implementation of the budget. The oil sub-sector contribution to the gross domestic product (GDP) is very significant in Nigeria (about 26.0 percent), as such a shock in international price of crude oil would adversely affect total revenue,(Nnanna and Masha,2003). Fluctuations in revenue invalidate most of the basic assumptions and projections usually made to facilitate the budgeting processes. This subsequently, creates challenges for policy makers, analysts and facilitators.

Recently in Nigeria, a benchmark price for crude oil was adopted for the purpose of estimating oil revenue to mitigate the unnecessary disruptions of the annual budgetary processes and stabilize the revenue. This strategy was initially experimented for the appropriation bill of 2002 and internalized in the subsequent years. The strategy of adopting benchmark price for crude oil below the market price presupposes that there was a consensus for compulsory national savings to build up a pool of funds which would cushion the effect of shocks that could result from unfavorable developments in the future as well as ensuring high quality spending.

However, method of arriving at the benchmark price for crude oil for the budget has been criticized as being highly subjective and lacking in transparency as it was not based on any acceptable and predetermined principle. This has often resulted in heated debates and intensive negotiations between the executives and the legislative arm of government which often results in delayed release of the appropriation bill and the attendant adverse impact on the economy.

It is the objective of this paper therefore to develop a simple framework for deriving an acceptable bench mark price for crude oil for budgeting purposes. It is hoped that this would remove subjectivity in budgeting process and promote understanding between all the stakeholders in order to fast track the process of passage of the appropriation bill. Following this brief introduction, the next segment of the paper examines the need for national saving fund and constitutional provisions for national savings, while section three focuses on the international experiences. Section four presents the framework for deriving appropriate benchmark price for the national budget and the last section concludes the article.

2.0 The Need for National Savings Fund and Constitutional Provisions:

2.1 Stylized Facts on Savings Behavior:

The subject of savings has attracted many empirical research works and comments in contemporary economic literature since the Keynesian era. In line with the presentation of Keynes most of the economic literature agreed that there are many varied reasons why people save. Keynes (1936) produced the following celebrated list.

Precaution: To build up a reserve against unforeseen contingencies;

Foresight: To provide for an anticipated future relation between income and the needs of the individual

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or family different from that which exists in the present;
Calculation: To enjoy interest and appreciation;
Improvement: To enjoy gradually increasing expenditure;
Independence: To enjoy a sense of independence and a power to do things;
Enterprise: To secure a masse de manoeuvre to carry out speculative or business projects;
Pride: To bequeath a fortune;
Avarice: To satisfy pure miserliness, i.e. unreasonable but insistent inhibitions against acts of expenditure as such.

Corresponding to these reasons for saving, Keynes provided a list of motives for consumption: Enjoyment, Shortsightedness, Generosity, Miscalculation, Ostentation, and Extravagance. From the above, it is clear that there are many reasons why an individual might save; and many reasons he or she might not. Similarly, for a nation as an entity, numerous factors come to bear on their savings behavior, such as political and social considerations. For instance, in Nigeria, several efforts had been made to establish national savings funds in the past, which were however, short lived with limited impact on the economy. A brief highlights on Nigeria's attempts to institutionalize national savings is given in the next section.

2.2 Nigeria's Experience in National Savings

Attempt at institutionalizing national savings crystallized in the establishment of stabilization fund in 1990s where proceeds of excess budgeted revenue were kept. The main objectives of the fund were to provide buffer financial resources to the budgeted revenue in the case that the oil prices fall below a specified level, and in addition, the scheme was meant to support and sustain long term growth initiatives and investments in the economy. Other efforts at establishing saving fund include the proposed national savings certificate. In the same mould as the stabilization fund, the proposed national saving certificate has remained on the drawing board till date. Currently, Nigeria is operating excess crude account, a semblance of the defunct stabilization fund with a new name.

Stabilization fund was initiated during the military era without the appropriate enabling laws, and therefore, the design of the scheme lacked key success features that could have sustained the scheme, such as a clear policy on determination of the appropriate benchmark price for the budget, and policy on withdrawal from the fund. Moreover, the schemes were established to address exigencies and meet urgent national concerns after which the zeal to continue waned as the situation normalized. The operations of the funds were therefore, perceived to encourage corruption and fiscal indiscipline and thus their operations were suspended. Furthermore, it appears that establishment of national savings contradicts the provisions of the 1999 Nigerian constitution. Section 162 of the constitution stipulates that all revenues collected by the Government of the Federation shall be paid into the Federation Account, and shared to the federating units, except the independent revenue of the Federal Government. Probably, the constitutional stance worked against the actualization of national savings which the Fiscal Responsibility Act would be expected to address.

2.3 The Need for Sustainable Source of Funds In Nigeria:

Given the Nigerian government's ambitious growth targets, and the need in the present global environment to generate investable resources internally, the desire to establish sustainable pool of funds becomes paramount. It therefore, follows that contemporary policy designs and research agenda directed at enhancing saving should occupy the front burner in the scheme of priorities.

A saving fund is designed to create a store of wealth for future generations by converting a deplorable revenue stream into a perpetual income flow (Devlin and Titman, 2004). Nigeria as a political entity needs such income flows for more than one reason, perhaps the following may suffice:

Recently, Nigeria went through horrific experience in external debt management; ranging from debt rescheduling; to debt repayment, and eventually securing debt forgiveness. It should be underscored that during the heydays of external debt burden, the political machineries as well as the treasury was fully stretched by accepting to pay a proportion of the total indebtedness which was a staggering lump sum to the foreign creditors, before the debt relief was secured. Following this bitter experience, the appetite to acquire foreign loans and advances as a nation in the nearest future would be dampened, as any move in this direction to secure foreign loans would be vehemently resisted by the citizenry, as well as the national assembly and the labour union. This implies that there must be a well structured mechanism to generate fund internally; to cushion the effect of shocks in the system, to enjoy sustained increase in expenditure as well as a sense of independence and empowerment to create wealth.
Savings funds would serve simply as

a place to bank excess crude oil revenues until they can be efficiently invested. Since our revenues are largely generated from a commodity with a very volatile price, implementing an investment plan that increases slowly and smoothly overtime becomes much more challenging. An important role of savings funds is to allow the country to smoothen out investment expenditures and this increases the efficiency of investment by minimizing cost adjustments. Fiscal surpluses tend to be more inefficient and create more distortions that are also more vulnerable to political economy pressures evidenced by the wasting of the revenue windfall realized from crude oil sales during “Operation Desert Storm” the Iraqi invasion of Kuwait.

2.3 Constitutional Efforts at Establishing National Savings:

The quest for a sustained funding of the national budget was reechoed in the National Assembly and crystallized into the drafting of the Fiscal Responsibility Bill. The bill proposed a shift from annual budgeting to a medium term expenditure framework (MTEF) of three financial years. MTEF is a rolling process repeated every year and aims at reducing the imbalance between what is demanded by ministries, departments and agencies.

The proposed Fiscal Responsibility Bill advocates for development of a macroeconomic framework for the economy which makes adequate provisions for national savings. It was entrenched in the Bill that the underlying assumptions as well as evaluation and analysis of the macro economy should be clearly stated. Furthermore, it was spelt out that where the reference commodity price rises above the predetermined level, the excess funds derivable should be saved in the Central Bank on behalf of all the federating units. An extension of this provisions barred access to the funds unless the price of the reference commodity falls below the bench mark level for a period of three consecutive months, and places the authority to release the fund on the national assembly.

Considering the deteriorating infrastructure, poor welfare facilities and other social indicators, the question that readily comes to mind is, do we really need to save for the future in the face of these decaying lots? We are aware that individuals as well as economic units have optimum absorptive capacity, a situation where there is too much money in the economy chasing few goods and services results in inflation pressure. Secondly, it has been established that too much resources in the hands of government promotes recklessness as most of the funds would be diverted, embezzled and at best spent on white elephant projects, which usually are abandoned when the sources of funding receded. The cost of completion of such projects on resumption normally escalates due to inflationary factors resulting from cost overrun.

3.0 International Experiences

Saving funds has been practiced in many economies with different variance and at different terms as dictated my economic environment. The pioneers in this field are Alaska, Alberta and Papua New Guinea in the 1960's and 1970's. Other countries that came into the scene in early 1990's are Algeria, Ecuador, Iran, Norway and Venezuela. In an attempt to ascertain the effectiveness of saving funds, Davis and others (2001), using a pooled cross-sectional and time series data for 71 countries for 1970 2000, suggests that the funds have a dampening effect on government spending as a percentage of the GDP. In the same study, they maintained that the funds appear to raise fixed capital investment as a share of GDP by nearly three percentage points and that there is a positive relation between the balances held in the fund and fixed capital investment.

In his study of commodity stabilization funds, Fiess (2002) reported a favourable outcome in Chile, Norway and Oman. They indicated that the fund moderated significant volatility in government spending and delivered higher shares of gross fixed capital investment. Based on their result, they concluded that country specific circumstances matter a lot, in particular the use of fiscal rules and targets to guide spending decisions over a longer time horizon.

Norway's success story could be linked to strong mechanisms that break the cord between oil price behaviour and fiscal expenditure, generally in a form of fiscal rule. The saving fund is treated as central governments net cash flow and transferred to the treasury to finance the non oil deficit. Linking the fund accumulation to fiscal surpluses would help to avoid the problem of an overall deterioration in the government's net asset position. In the case of Chile, withdrawals from the fund are subject to the fiscal rule with the structured balance calculated by factoring out the cyclical component of the copper price and other cyclical factors (Fiess, 2002). In both cases, transfers to and from the fund require parliamentary approval.

Concerning the optimal size of funds to be accumulated, results of studies conducted in this area appear to be inconclusive. However, Crain and Devlin (2002), indicated that larger funds created management problem especially if the design of saving funds is not transparent. In addition, they maintained that political pressure on the government usually results in mismanagement of the funds and recommended that there must be an inbuilt mechanism for control reporting and evaluation of fund resources and operations. In his contribution on the management of the funds, Heilbrum (2002), stressed that the funds should be professionally managed with oversight by the Ministry of Finance or Central Bank. Cited the example of Norway, he indicated that the Ministry of Finance supervises the activities of the fund and sets guidelines or investments and reporting requirements.

Economic literature seems to be silent about the appropriate formula applied to determine the level of savings required. However, most studies mentioned in the passing the basis for deriving funds for national savings funds accumulation of excess above a target price as in the case of Chile's Copper Stabilization Fund; revenue contingent a set percentage of commodity revenues, as in the case of the Alaska's Permanent Fund; and a mixture of both, a set percentage of commodity revenue and a reference price as in the case of Venezuela's Stabilization Fund, are very common in the literature.

This study adopts price contingent to derive a scheme for benchmarking crude oil prices for the annual budgeting process and indirectly building up a pool of national savings funds. This would reduce the rancor that follows the annual ritual of fixing routinely this all important benchmark price.

4.0 Factors that Determines International Oil Prices and Trends of Spot Price:

4.1 Determinants of International Oil Prices

Temporary and permanent factors have been identified to influence crude oil prices in the international market. Oil prices fluctuate unpredictably because of temporary changes in global economic and political conditions that affect the supply and demand for oil. For instance, political crises in Nigeria, Iran, or Iraq could lead to temporary disruption of oil supplies, and cause prices to rise. In an attempt to stabilize prices, OPEC would direct their members to step up production quota in order to make up for the shortfall depending on the magnitude of the crises and the quantity of production involved in the trouble spot. Prices subsequently fall again as the problem is resolved. Similarly economic recession could lead to oil glut, a situation of over production resulting in a temporary oversupply that generates price declines.

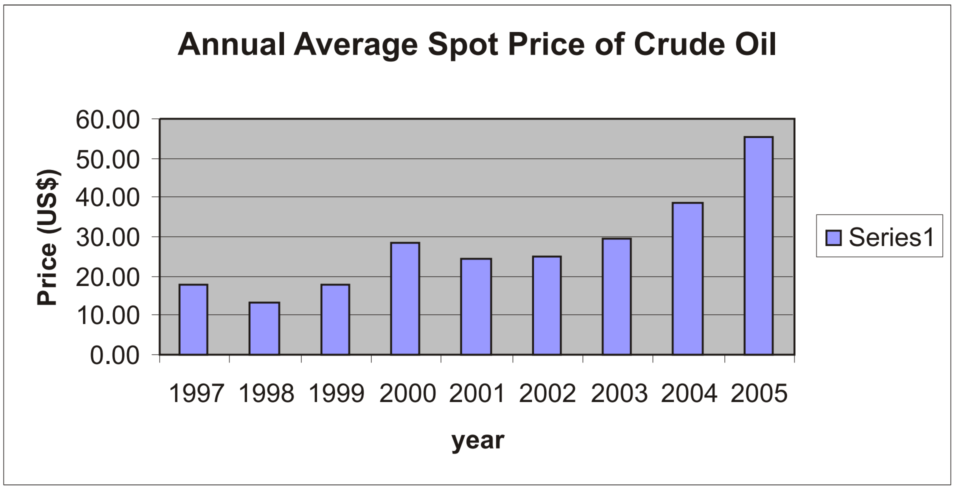
Permanent factors that influence oil price movement are development that culminated in sustained increase in demand or supply of crude oil in the market. Permanent changes can arise because of longer-lasting changes in demand arising from emergence of substitutes for fuel or stronger incentives for conservation of energy leading to less consumption of fuel. Other situations that could lead to sustained increased demand include technological changes and new discoveries that increase the supply of oil (Devlin & Titman, 2004). In summary, crude oil prices depend on the interplay of demand and supply as dictated by global politics, intricacies and perhaps technological advances and sometimes weather changes.

4.2 Trends in Oil Prices

Prices of crude oil fluctuate sometime with wide swings. For instance, the price of crude oil was as low as $10.0 per barrel in February 1997, however, at end-December, the same year, the price increased to $26.0 per barrel (Table 1).

The low price was traceable to economic recession in the Asian economy which resulted in suppression of demand for oil in the first of the year. While the extreme cold weather condition during the third and the forth quarters of the year increased demand for heating oil and thus the price of crude oil increased sharply.

Chart 1



On average, the price of crude oil was fairly stable at $17.96, $13.08 and $17.96 in 1997, 1998 and 1999, respectively.

Table 1 SPOT PRICE OF CRUDE PETROLEUM 1997-2005 (US$)

Months	1997	1998	1999	2000	2001	2002	2003	2004	2005
January	11.35	15.29	11.35	25.62	25.09	19.64	31.86	31.77	44.83
February	10.22	14.14	10.22	28.06	27.53	20.26	32.9	30.99	45.69
March	12.53	13.10	12.53	27.97	24.57	23.54	31.09	34.13	53.42
April	15.47	13.63	15.47	23.05	25.74	25.78	29.54	34.40	51.90
May	15.24	14.56	15.24	27.9	28.45	25.26	26.1	38.32	49.11
June	15.99	12.93	15.99	29.78	28.03	24.01	27.94	35.55	54.99
July	18.57	12.35	18.57	28.52	24.89	25.92	28.52	38.42	58.54
August	20.73	12.24	20.73	29.48	25.94	26.9	30.05	43.53	66.42
September	22.48	13.4	22.48	33.15	25.93	28.38	27.49	43.71	65.32
October	22.36	12.77	22.36	30.81	20.51	27.97	30.01	50.39	60.43
November	24.76	12.15	24.76	32.63	18.99	24.5	29	42.8	56.74
December	25.81	10.4	25.81	25.95	18.65	28.38	29.85	40.7	57.76
Average	**17.96**	**13.08**	**17.96**	**28.58**	**24.53**	**25.05**	**29.53**	**38.73**	**55.43**

Source: CBN Statistical Bulletin and Reuters

Similarly, in 2000, the average price increased to $28.55 per barrel from $17.96 in 1999, and edged upwards gradually to $25.05 and $29.53 in 2002 and 2003, respectively. The price of crude oil once again bounced back to $38.73 and $55.43 in 2004 and 2005 in the respective years. The recent increase in price of crude is attributable to increase in demand resulting from shortages precipitated by disruption of production in OPEC member states and in the Russian Federation.

4.0 Derivation of Appropriate Benchmark Price for Crude Oil

The process of arriving at acceptable price for crude oil is a contentious issue shrouded by political intrigue and interest. Several countries such as Chile and Russia have engaged in prolonged discussions and disputes over methods of determining appropriate benchmark price. In this study, a simple descriptive scheme which makes use of historical trends of prices of crude and the prevailing economic situation to arrive at the benchmark price. The strength of this approach is that inflationary factor can easily be built into the system as against the outdated incremental budgeting. The framework of the derivation is presented in the following equations.

$$\frac{(x_i ....x_N)}{N} * SF..........(1)$$

$$\frac{(x_{max}......x_{min})}{2} * SF......(2)$$

Where

X_i= Spot price of crude oil at month one,

X_N= Spot price of crude oil at end-December,

N = No of months,

X_{max} = Highest crude price obtainable in the period, and

X_{min} = Lowest crude price in the same period

SF = Saving factor whose value lies between zero and one.

This method assumes favourable price of crude oil in the international market and that the annual average crude oil price remains above the predetermined benchmark.

4.1 Saving Factor

The choice of saving factor depends on the fiscal stance and the level of savings desired by the nation. However, the drivers of the international price of crude could be a very reliable reference point for the choice of saving factor. For instance, if the global random process that determines the oil price in the preceding year is perceived to be temporary, it is a signal that the prices of oil may probably remain higher. The present value of future revenues is not very sensitive to changes in spot prices. A close watch of global dynamics would enhance fixing an appropriate level of the saving factor for a fiscal year.

Table 2

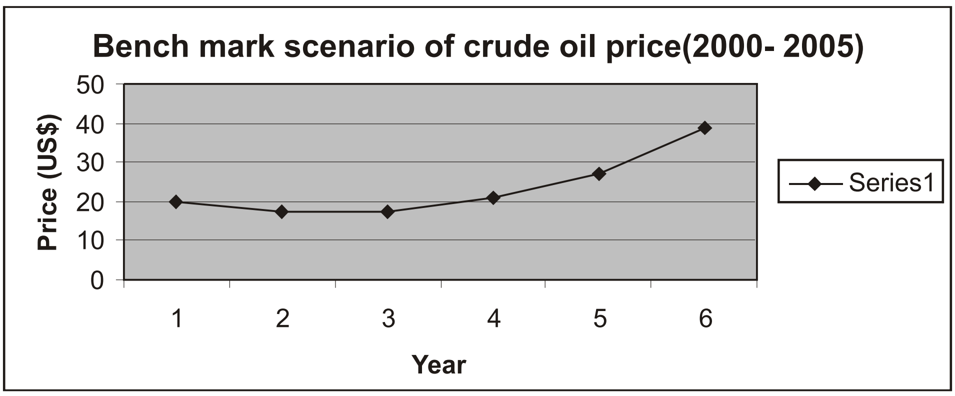
Price	2005	2004	2003	2002	2001	2000
Lowest	44.83	30.99	26.10	19.64	18.65	23.05
Highest	66.42	50.39	31.86	28.38	28.45	33.15
Average	55.63	40.69	28.98	24.01	23.55	28.10
S/Factor 1	0.60	0.60	0.60	0.60	0.60	0.60
Result 1	**33.38**	**24.41**	**17.39**	**14.41**	**14.13**	**16.86**
S/Factor 2	0.65	0.65	0.65	0.65	0.65	0.65
Result 2	**36.16**	**26.45**	**18.84**	**15.61**	**15.31**	**18.27**

Note: S/Factor = Sacrificial Factor i.e the present benefit foregone for future gains

Table 3

Price	2005	2004	2003	2002	2001	2000
Average Price	55.43	38.73	29.53	25.05	24.53	28.58
S/Factor 1	0.60	0.60	0.60	0.60	0.60	0.60
Result 3	33.26	23.24	17.72	15.03	14.72	17.15
S/Factor 2	0.65	0.65	0.65	0.65	0.65	0.65
Result 4	36.03	25.17	19.19	16.28	15.94	18.58

Chart 2:



Application of the Derived Formula

Application of the derived formula to the spot prices of crude oil from 2000-2005, is presented in tables 2 and 3. Results show that in 2000 using equation 1 and assuming that a saving factor of 65 percent was adopted the benchmark price for the budget should have been $16.86 per barrel, while the $14.13 and $14.41 per barrel for 2001 and 2002 respectively. In 2005 benchmark should be $33.38 per barrel in same scenario. However, a saving factor of 65 percent results in $36.16 per barrel in 2005 compare to the $35.0 which was eventually adopted for the 2005 appropriation bill. Similarly, application of formula two (Table3) indicates a benchmark price of $36.03 per barrel.

Comparing results (1-4), show that the result of each scenario (Saving Factor, 60,65 %) are similar with no significant difference. For instance, in 2005, the benchmark price using formula one is $33.38, while formula two gives $33.28 per barrel. This implies that any of the two formula could be used for the purpose of deriving appropriate benchmark price of crude oil for budgeting. However, formula one which incorporates the annual average price is more appealing in that a sharp increase in price in one period could result in a higher average price between the maximum and the minimum price implicit in equation one. Notwithstanding the bottom-line is adoption of a consistent framework which would reduce time wasting and rancor in the budgeting process.

Recommendations:

Attempt has been made to present a scheme for deriving a benchmark for crude oil price for the appropriation bill. It is envisaged that this approach will facilitate budgeting process and enthroned transparency. This strategy will lead to creation of a pool of funds that can absorb shock arising from unfavourable development in the international crude oil market. Adoption of this scheme will reduce wasteful spending and instill fiscal discipline as well as smoothening government revenue.

It is evident that previous efforts at institutionalizing national savings were not very successful because they were not backed by the enabling laws. It is apparent that constitutional provision does not favour national savings as such efforts should be made to address this issue. Probably, the passage of the Fiscal Responsibilities Act would address this and add value to this strategy as well as accelerate its implementation.

Concluding Remarks:

The nation has passed through bitter experience in the management and servicing of its external debt burden, it is about time we internalized national savings as a culture. The current favourable crude oil price could be a good starting point to build up national savings by setting aside a portion of our proceeds from oil sales. However, the method adopted to arrive at appropriate savings formula, has to be transparent and credible to earn acceptability by all the stakeholders.

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