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Nigeria's 2015 Budget
Fiscal and macroeconomic analyses

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Introduction

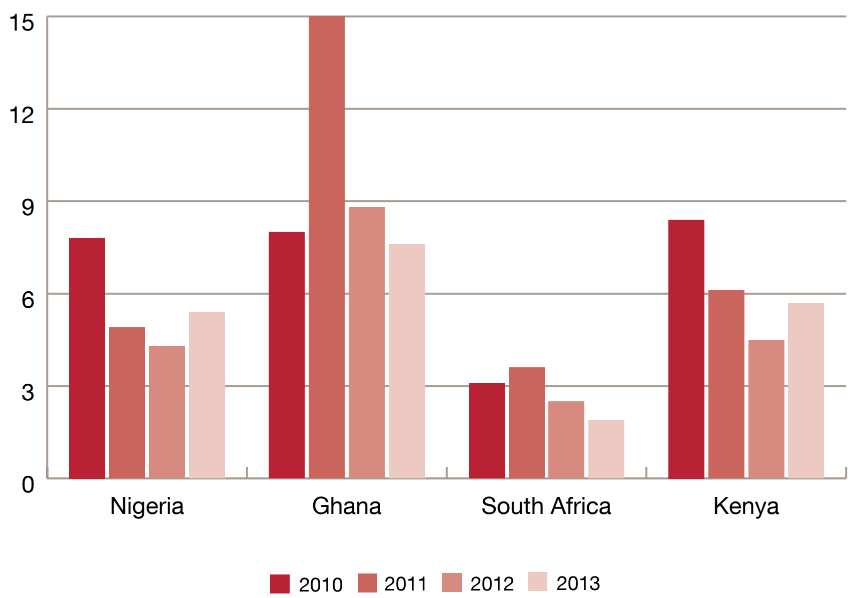
The 2015 Budget of the Federal Government of Nigeria (FGN) was presented to the National Assembly on 17 December 2014. Described as "A Transition Budget", the focus will be on "managing the revenue challenge in a manner that protects the most vulnerable while safely transiting to a broader based non-oil driven economy".

We provide the key highlights below and our insights on the tax and economic implications:

Highlights	2015	2014	Change
Crude oil indices:			
- Price per barrel	$65.00	$77.50	-16.1%
- Daily production (mbpd)	2.28	2.39	-4.6%
Aggregate Revenue FGN (N billion)	**3,602**	**3,731**	**-3.5%**
Expenditure Profile:			
- Recurrent (non-debt)	2,616	2,469	6.0%
- Capital (including SURE P)	634	1,120	-43.4%
- Debt service	943	712	32.4%
- Statutory transfers	412	409	0.7%
- Subsidy reinvestment program (SURE P)	103	268	-61.8%
Aggregate Expenditure FGN (N billion)	**4,358**	**4,725**	**-7.8%**
GDP Growth rate (budgeted)	5.50%	6.20%	-11.3%
US$ Exchange rate	165	160	3.1%
Fiscal deficit (% of GDP)	-0.79%	-1.24%	-36.3%

Macro-Economic Indicators

Annual GDP growth rate (%)



Source: World Bank

Economic Growth

In 2014, real GDP was projected to grow by 6.2% based on an outlook of increased agricultural production, stimulation of the non-oil sectors, and robust fiscal and monetary policies. The real GDP growth rate as reported by the National Bureau of Statistics (NBS) in the first, second and third quarters of 2014 was 6.21%, 6.54% and 6.23% respectively. This has been a good achievement relative to the Budget.

Based on results published by NBS, the non-oil sector recorded real growth of 7.51% in the third quarter of 2014, compared to 8.21% and 6.71% respectively in the first and second quarters of the year. The non-oil sector was driven by growth in activities such as crop production, textile apparel and footwear. Telecommunications and Real Estate sectors also contributed to growth in the non-oil sector.

On the other hand, the oil sector has faced production challenges in 2014 achieving an average daily production of 2.2mbpd compared to the budget of 2.38mbpd. Overall, the sector grew only in the first quarter by 5.14%. Second and third quarters declined by 6.6% and 3.6% respectively.

Given the declining oil prices and production challenges in an economy that is still predominantly oil based, the lower projected GDP growth rate of 5.5% for 2015 is about right. To achieve this, government must focus on fiscal and monetary policies that will drive the non-oil sectors of the economy.

Inflation

There was no indication of a target inflation rate in the 2015 Budget. However figures reported by the Central Bank of Nigeria (CBN) shows that headline inflation rate reduced from 8.5% to 7.9% between August and November 2014. In view of current events and given that Nigeria is an import dependent country, keeping the rate within this range would be a challenge in 2015. Factors that will put pressure on inflation in the coming months include:

- Increased spending due to the 2015 elections;
- The devaluation of the naira arising from falling oil prices and the depletion of external reserves; and
- Impact on food prices as a result of security concerns and poor harvest in some areas affected by insurgency in the northern part of the country.

Some of the measures taken by the CBN to cushion the impact of the above factors include the increase in the Monetary Policy Rate (MPR) from 12% to 13%. Unless oil prices recovers beyond the budget benchmark of $65 per barrel, the MPR may further go up in 2015 resulting in high cost of borrowing.

Exchange Rate

The CBN devalued the Naira by about 8% moving the midpoint from N155/US$ to N168/US$. The exchange rate in the 2015 Budget is however pegged at N165 to USD 1 compared to N160 in the 2014 Budget. There are genuine concerns as to whether the Naira can be sustained within the target exchange rate band considering a possible further decline in oil prices. In order to curb speculative tendencies, the CBN recently directed banks and other authorized foreign exchange dealers to reduce their foreign exchange (FX) trading position from 1% of shareholders' funds to 0%. The FX position is the total long/short position each trader has at the close of each day.

Crude oil indices

Despite the recent decline in oil prices from about $115 per barrel in June 2014 to about $60 per barrel in December, the 2015 Budget was based on a benchmark of $65 per barrel on the expectation that crude oil prices are expected to average about $65 to $70 in 2015.

This is a significant shift from the past approach of proposing a more prudent benchmark price for crude. In this instance, the proposal seems too optimistic and may expose the Budget to significant underperformance. For instance, commentaries from Platt's indicate that prices would fall further before they reach their balance and over time the price could end up around $50 to $60 per barrel. According to the government, further measures will be introduced if prices fall below the expected range. These measures were however not articulated in the Budget presentation.

It is expected that a drop in crude oil prices will result in some savings in subsidy cost. Estimates by the Petroleum Products Pricing and Regulatory Agency (PPPRA) indicate that $60 per barrel is the break-even crude oil price where the retail price of petrol (Petroleum Motor Spirit - PMS) will equal the current pump price of N97 per litre.

Key Budget Component

Revenue generation

Nigeria relies heavily on crude oil revenue to fund government spending. Oil accounts for about 15% of Nigeria's GDP but it makes up about 80% of government revenues. Due to the falling oil prices, austerity measures have been proposed for 2015. The Budget proposal has aggregate revenue of N3.602 trillion made up of oil revenue of N1.918 trillion and non-oil revenues of N1.684 trillion (implying a ratio of 53% oil revenues to 47% non-oil).

The government intends to increase tax revenue through measures that will be implemented not later than the 2nd quarter of 2015. The projected IGR receipts is about N450 billion. It was reported that the Federal Inland Revenue Service (FIRS) working with McKinsey & Co yielded additional non-oil revenue of about N143 billion in 2014 and projected about N160 billion for 2015 (and an aggregate of N460 billion from 2015 to 2017). In our view, these figures are not a significant leap in revenue compared to what the FIRS was achieving independently year on year before the initiative commenced.

It was mentioned that government will work with various agencies to ensure they remit funds to the Treasury and with banks to ensure strict compliance in order to achieve the revenue forecast. While it is difficult to predict what this means in exact terms, we anticipate a significant campaign against tax evasion in 2015 and this may relate to working with the

banks (within legal limits) to obtain information on undisclosed income by taxpayers and unremitted revenue by government agencies.

Recurrent expenditure (non-debt)

An aggregate expenditure of N4.358 trillion has been proposed for 2015. This is about 8% less than the amount for 2014. This expenditure figure consists of N412 billion for Statutory Transfers (for National Assembly, Judiciary etc.), N943 billion for Debt Service, N2,616 billion for Recurrent (Non-Debt) and N634 billion for Capital Expenditure (inclusive of SURE-P). The recurrent expenditure increased by about 6.5% while capital expenditure declined by 43%.

Government plans to curb recurrent expenditure through cuts in international travels and training, reduce nonessential administrative expenditure, and rationalisation of agencies. It was reported that N185.4 billion has been saved from these measures and over 60,450 ghost workers have been weeded from 359 ministries, departments and agencies.

Although these are commendable steps, more drastic measures are required to make real impact and reverse the trend of increasing recurrent expenditure and decline in capital expenditure. This will require making difficult decisions and reassessing the expenditure profiles of all arms of government especially the Executive and the Legislature.

Debt service and capital expenditure

In the 2015 Budget, debt service is expected to increase while capital expenditure is projected to decline. The proposed increase in debt service expenditure is 32.4% compared to 20.3 % in the 2014 Budget estimate. The cost of servicing debt has been on the increase in the past three years and is expected to gulp about 26% of 2015 aggregate revenue of the federal government. The national Debt Management Office attributed the high debt profile to six factors: Inefficient trade and exchange rate policies, unfavourable exchange rate movements, unfavourable interest rate movements, poor lending and inefficient loan utilisation, poor debt management practices, and accumulation of arrears and penalties.

Given the significant decline in capital expenditure, it appears that funds are being borrowed to finance recurrent expenditure rather than developmental projects. As a percentage of aggregate expenditure, capital expenditure accounts for only 14.5%. This is a sharp decline from 2014 when capital expenditure amounted to 23.7%. However, as a percentage of GDP, the deficit to GDP ratio is 0.79% of GDP down from 1.24% in the 2014 Budget and below the 3% of GDP specified in the Fiscal Responsibility Act of 2007. The deficit of N755 billion in 2015 will be financed largely (above 75%) by domestic borrowing.

Subsidy Reinvestment and Empowerment Programme (SURE-P)

The sum of N102.5 billion has been allocated as the SURE-P budget for 2015 which is a decline of 61.8% compared to the 2014 Budget. This sum consists of the federal government's share of N53 billion from the savings from the partial removal of subsidy on petrol and the estimated unspent balance of about N49.5 billion in 2014.

Structural Reforms and Sector Analysis

The government stated in the 2014 Budget that Agriculture and all infrastructural sectors would be top priority. This continues to be the case in the proposals for 2015. We highlight some of the key sectors below:

Sector	Focus areas and comments
Agriculture	• Expected to drive job creation and inclusive growth • About 750,000 entrepreneurs have been targeted within 5 years under the Youth Employment in Agriculture Program. • Establishment of a N50 billion Farm Mechanisation Fund. • $100 million Government and Donor Fund for Agricultural Financing in Nigeria (FAFIN) to provide long-term tailored financing for agribusinesses. • 10 million farmers benefiting from subsidy for fertilisers, seedlings etc. through E-wallet.
Power	• Establishment of the Nigerian Electricity Regulatory Commission (NERC) in 2005. • On-going reform and full deregulation. • In 2014, 10 National Integrated Power Projects (NIPPs) were embarked upon with a combined capacity to produce 5,455MW. • Current power generation capacity stands at about 7,000 MW of which 6,000MW is thermal. About 50% of the thermal capacity is underutilised due to gas supply constraints. • Measures have been introduced to increase gas supply by 900 million standard cubic feet. This includes raising the price of domestic gas from $1.50 to $2.50 per million British Thermal Units (Btu) with an additional allowance of up to $0.80 for gas transportation.
Transportation	• Increase in aviation transportation passengers. • Plan to improve road and rail transportation. • Reuters and Business Insider UK reported a $12billion deal with China for the building of a high speed technology railway in 2014. • In the 2011-2015 Transformation Agenda, the government planned to allocate N1.61 trillion towards 15 Railway projects • Completion/progress on major road projects including Lagos-Ibadan expressway, and the second Niger Bridge.
Housing	• In 2014, the Nigerian Mortgage Refinance Company (NMRC) was launched as a re-financing institution to provide mortgage banks with increased access to funds. • NMRC is working with 18 state governments and will cover more states in 2015. • 66,000 applications are currently being processed under the Affordable Housing Mortgage Finance scheme, for implementation in 2015.
Insurance	Over the next 3 years, government aims to: • Grow total insurance premiums from N300 billion to N1 trillion. • Increase the number of insurance policyholders from the current 3 million to 10 million. • Increase jobs generated by the sector from 30,000 to 100,000.
Manufacturing	• Implementation of the National Industrial Revolution Plan (NIRP) aimed at industrialising and diversifying the economy. • Continuous support for the private sector, particularly the SMEs. • Review and restructuring of the Export Expansion grant scheme (EEG) for sustainability.

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Oil & Gas	• Passage of the Petroleum Industry Bill to be a priority for 2015. • Implementation of gas industrialisation projects. • Refinery rehabilitation in order to improve products yield and capacity utilisation. • Commence the Delta Gas & Petrochemical Park in 2015 for gas infrastructure development. • Attract investments of over $16billion within the next four years.
Solid Minerals	• Assessment of the mining landscape in order to improve the processes of artisanal and small scale farmers. • In the medium term, solid minerals are expected to make substantial contributions to the Federation Account (about N14 billion in 2015). • A fiscal regime has now been completed for the sector.
Creative Industries	• Currently Nollywood accounts for about 1.4% of Nigeria's GDP. • The Government initiated the "Project Advancing Creativity and Technology (PACT)", a N3 billion grant programme for Nollywood. • The PACT initiative has led to the co-financing of over 90 films and has contributed to building capacity of over 200 film practitioners. • Augmented implementation of the PACT program will focus on tackling intellectual property and distribution challenges.
Information and Communication Technology	• Focus on creating an inclusive digital economy particularly for youth and women. • Deepen the Naijacloud project which is expected to create jobs in micro work, e-lancing and programming. • Training of additional 1,000 unemployed youths in every state of the federation. • Enhance on-going work in developing guidelines and policy to strengthen the sector.

Tax changes

Nigeria's tax to GDP ratio is reported as 6% (excluding oil) in the Budget presentation. Government is determined to improve tax revenues and reduce focus on oil revenue. Below are the highlights on taxation in the Budget:

Closing the tax gap	• **Pioneer status** - Review of existing tax waivers and exemptions especially pioneer status. The focus seems to be on upstream oil companies and whether they are entitled to pioneer status. The review may also affect other sectors and companies in terms of whether the specified conditions were met for the incentives. • **McKinsey & Co** - About N160 billion is expected in 2015 and an aggregate of about N460 billion over and above the 2014 levels in the 2015-2017 period through work being carried out by McKinsey. • **Tax raids** - The Debt Enforcement and Special Prosecution Unit ("DESPU") of the FIRS, has recently gone on the offensive, resorting to tax raids and prosecution of non-compliant taxpayers. We expect this trend to continue in 2015.
Value Added Tax	• Possibility of an increase in the VAT rate. In our view, the government may explore a VAT rate of 10% to 15% not only to raise revenue but also to align with the VAT rates of other West African countries (and make it easier to implement the Common External Tariffs).
Luxury Surcharges	Special levies have been introduced on luxury items in the Budget effective from 2015. The proposed luxury surcharges are expected to yield a total of about N10.56 billion in 2015. Details of these surcharges are as follows: • Purchase of new Private Jets will be subject to a 10% import surcharge. This is expected to yield about N3.7 billion in 2015; • Purchase of luxury Yachts will be subject to a 39% import surcharge which is estimated to raise N1.6 billion in 2015; • Purchase of luxury cars will be subject to a 5% import surcharge which is estimated to yield about N2.6 billion of additional revenues. • Purchase of champagnes, wines and spirits will be subject to a 3% luxury surcharge which should generate about N2.3 billion in 2015; • 1% FCT Mansion Tax on residential properties with value of N300 million and above to yield additional N360 million. • There will also be a surcharge on Business and First Class tickets on Airlines.

Digitisation Programme

The 2015 Budget seeks to deploy IT systems to promote transparency, improve efficiency and reduce recurrent expenditure. Some notable IT systems deployed by the current administration include:

Treasury Single Account (TSA)	In order to effectively manage the revenue of the country, the CBN called for an urgent implementation of the TSA which is an essential tool used for consolidating and managing cash resources. According to the IMF, a TSA system helps consolidate government cash balances, gives the ministry of finance/treasury oversight of all government cash flows, and brings improvements in budget control and monitoring.
Integrated Financial Management Information System	The Government Integrated Financial Management Information System (GIFMIS) is an IT based system for budget management and accounting designed to improve Public Expenditure Management processes, enhance greater accountability and transparency across Ministries and Agencies. GIFMIS will help the government plan and use its financial resources more efficiently and effectively.
Integrated Payroll and Personnel Information System (IPPIS)	This is a centralised database system for the Public Service known as the Integrated Payroll and Personnel Information System (IPPIS). The database is a single source of employee information that provides integration with other business applications. According to the Finance Minister, about N185.4 billion has been saved through the implementation of IPPIS. In addition, the current administration has weeded out 60,450 ghost workers from 359 MDAs.

Conclusion

The 2015 Budget is aimed at boosting the non-oil sectors of the economy and also to raise tax revenues. The introduction of a luxury tax regime buttresses the fact that oil revenue is expected to play a less significant role in 2015 and perhaps going forward. We hope that government will implement the National Tax Policy and be consistent in its fiscal and monetary policies designed to diversify the economy and increase the country's tax base.

As at September 2014, only 60% of the 2014 Budget has been implemented. More efforts should be directed towards reversing the trend of poor budget implementation. The legislature has a critical role to play in ensuring a speedy passage of the Budget proposal which should happen within the next few weeks.

Contact us

If you would like further advice or information in relation to the issues outlined in this bulletin, please contact

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