Analyses of Nigeria's 2016 Budget and Medium Term Expenditure Framework

Introduction

On Tuesday 22 December 2015, President Muhammadu Buhari presented the 2016 Budget to the National Assembly. Described as "the Budget of Change", the President first gave an overview of 2015 performance before providing the 2016 budget highlights. We provide some insights on the key areas of the 2016 Budget and the Medium Term Expenditure Framework (MTEF) and Strategic Fiscal Plans for 2016-2018 earlier approved by the government.

2015 Budget Performance

Highlights	2015 (Budget)	2015 (Actual) as at Sept.	Gap (over)/under
Revenue (NGN' billion)	3,452.35	2,257.49	35%
Aggregate Expenditure (NGN' billion)	4,493.36	3,420.64	24%
Recurrent Expenditure (Non-debt) (NGN' billion)	2,593.21	1,817.97	30%
Capital Expenditure (NGN' billion)	557.00	194.77	65%
Capital Expenditure to Aggregate Expenditure (%)	12.4%	5.7%	54%
Recurrent Expenditure Aggregate Exp. (%)	57.7%	53.2%	8%
Fiscal Deficit (NGN' billion)	1,041.01	1,163.15	(12%)
Fiscal Deficit/ GDP (%)	1.09%	0.99%	9%

Assuming a uniform spending pattern across the year, the expected gap on each item should be about 25%, representing one quarter (October to December 2015) in order to be in line with the budget. This shows that while recurrent expenditure is fairly on target, capital expenditure is significantly below budget while debt servicing has far exceeded budget. A supplementary budget of NGN574.5 billion was approved on 1 December 2015 in addition to the original expenditure of NGN4.5 trillion above essentially for fuel subsidy arrears and national security.

2016 Budget Assumptions and Analysis

Highlights	2016	2015	Change
Crude oil indices: - Price per barrel	$38.00	$53.00	(28.3%)
- Daily production (mbpd)	2.20	2.28	(3.5%)
Revenue available to FGN (₦ billion)	3,856	3,452	11.7%
Expenditure profile (₦ billion)			
- Recurrent (non-debt)	2,348.62	2,593.21	(9.4%)
- Special intervention program	300.00	0	100%
- Capital	1,760	557	215.9%
- Debt service (excl ₦113b for retirement of loan)	1,361.88	953.6	42.8%
- Statutory transfers	351.37	375.62	(6.5%)
- Subsidy reinvestment program	0	20.78	(100.0%)
- Aggregate expenditure (Net of Sure-P)	6,078	4,493.36	35.3%
GDP Growth rate (budgeted)	4.37%	5.50%	(20.5%)
US$ Exchange rate	197	190	3.7%
Fiscal deficit	2,222	1,041	113.4%
Fiscal deficit (% of GDP)	2.16%	1.09%	98%

Key macro-economic indicators

Economic Growth

In the 2015 budget, real GDP was projected to grow at 5.50%. However, according to the Nigeria Bureau of Statistics (NBS), the real GDP growth in the first, second and third quarters of 2015 were 3.96%, 2.35% and 2.84% respectively. This is not surprising as global economic performance also slowed down in 2015.

The oil sector faced significant challenges but also the non-oil sector performed below expectation. There was a consistent decline in growth rate of the non-oil sector from 5.59% in the first quarter to 3.05% in the third quarter. The decline is partly attributable to the cut back in both public and private sector spending and strict exchange control policy measures.

The oil sector performed marginally better in the third quarter of 2015 compared to 2014. The sector grew by 14.35% quarter on quarter due to increased production despite the drop in price.

Due to the economic challenges, the 2016 budget makes a conservative assumption of 4.37% overall GDP growth rate (5.5% was projected for 2015).

Inflation

Inflation has consistently been on the increase in 2015. It rose year on year, from 8.2% in January to 9.4% in November 2015. This was attributed to increase in price of food items and transportation due to shortage of fuel supply. In addition, the depreciation of the naira and stringent foreign exchange policies impacted on the cost of importation.

In November 2015, the CBN reduced the monetary policy rate (MPR) from 13% to 11%. The CBN also reduced the Cash Reserve Ratio (CRR) from 25% to 20%. These actions are expected to increase money supply and boost economic activities. Consequently inflation rate may hit double digit in 2016 due to increased money supply, and expected price increases of imported items due to unavailability of foreign currency. The government has indicated in the 2016 Budget that measures would be taken to manage inflation to a level that will not harm average Nigerians. In order to achieve this, there will be alignment of fiscal, monetary, trade and industrial policies.

Exchange Rate

Some analysts forecast that the shortage of FX supply may push exchange rate to as high as NGN280 to US$1 which is a huge gap from the current official rate and proposal of NGN197 to US$1 in the 2016 Budget. The CBN has devalued the naira twice in the last 12 months and faces a challenging task in continuing to defend the current exchange rate. Considering the large import dependence of the economy, a holistic economic plan has to be designed to stimulate local production in the medium term in respect of material imports such as (fuels, foods and agricultural products including sugar, automobiles etc). The president hinted in the budget speech that the CBN is considering measures to ease the currency burden for businesses that rely heavily on imports of raw materials, equipment, and spares.

Crude oil indices

The proposed oil price benchmark is $38 per barrel with a daily production of 2.2 million barrels per day. Both indices are lower than last year's budget.

The decline in price should justify the removal of subsidy on petroleum products. We understand that a new pricing template will be published from January 2016 expected to show a "modulated" price of about NGN87 per litre without subsidy. This is perhaps why the president stated in his speech that he has directed the PPPRA to review its template and selling price of petrol will be at NGN87 per litre "for now". It is not clear if this will lead to full price deregulation or mere suspension of subsidy.

Key Budget Components

Revenue

Government plans to reduce over-reliance on oil revenue and reduce the country's exposure to oil price volatility. Non-oil revenue (Corporate income tax, VAT, Customs & Excise Duties, Federation levies and FGN independent revenue) is estimated at NGN2.96trillion. This represents about 77% of budgeted revenue of NGN3.86trillion for 2016. In order to drive revenue for the economy, changes have been made to the leadership of the revenue generating agencies including the Federal Inland Revenue Service (FIRS), Nigerian National Petroleum

Corporation (NNPC), Nigerian Communications Commission (NCC), and the Nigerian Customs Service (NCS).

The government re-emphasised that it would focus on increasing tax collection. Corporate tax and VAT gross receipts are expected to increase to NGN1.8 trillion and NGN1.4 trillion compared to NGN1.4 trillion and NGN1.3 trillion respectively in 2015 budget (i.e. increase of 22% for CIT and 8% for VAT).

Independent revenue and remittance of operating surpluses from ministries, departments and agencies ("MDAs") is expected to improve significantly with the full implementation of the Treasury Single Account (TSA) system.

Recurrent Expenditure (non-debt)

Spending is planned to increase in 2016 (compared to 2015) by about 35% to an aggregate expenditure of NGN6.08 trillion. Non-debt recurrent expenditure for 2016 which represents about 39% of the aggregate expenditure is expected to drop by 9% to NGN2.3 trillion. This excludes a NGN300 billion budget for social intervention program.

In order to reduce recurrent expenditure, the government would focus on initiatives such as the Government Integrated Financial Management Information System (GIFMIS) and Integrated Payroll and Personnel Information System (IPPIS).

The top recurrent expenditures heads are NGN369.6 billion for Education; NGN294.5 billion for Defence; NGN 283.1 for Police, NGN221.7 billion for Health and NGN145.3 billion for Ministry of Interior.

Debt Service and Capital Expenditure

In order to fund the 2016 budget, borrowing will increase (and hence debt service expenditure). The debt service cost is expected to increase by 42.8% (to a record NGN1.36 trillion) accounting for about 23% of the budget. Nigeria's total debt profile will become 14% of GDP.

Capital expenditure is proposed to increase by about 216% to NGN1.8 trillion. While this is highly commendable, the challenge faced by previous administrations had been implementing the capital expenditure budget.

Statutory Transfers

There was a decrease in statutory transfers from NGN375 billion in 2015 to NGN351 billion in 2016. Based on the medium term expenditure framework, the aggregate amount is expected to increase in subsequent years.

Priority sectors

Agriculture

In the 2016 budget speech, the government plans to subsidise funding for the agricultural sector. This is expected to encourage participation in the sector and increase job creation. As part of the plans of boosting activities in this sector, the current administration is also looking at how to be self-sufficient in rice production and wheat over time.

The overall objective is to make agriculture one of the pillars of the Nigerian economy. In order to achieve this, other challenges, aside funding, need to be addressed. These include infrastructure, fiscal and investment policies.

Solid Minerals

Government wants to boost investment in the mining sector. Currently, there are about 34 minerals identified in Nigeria and these minerals abound in virtually all states of the federation. However, only 13 are actually mined, processed and marketed. They are coal, kaolin, baryte, limestone, dolomite, feldspar, glass sand, gemstones, gold, iron ore, lead-zinc, tin and its associated minerals and recently gypsum.

Some of the initiatives of the current administration targeted at boosting the solid minerals sector include:

- Reviving Ajaokuta and Aladja Steel Companies through policies and proper funding/ownership arrangements.
- Gold exploitation through policies and adequate funding to increase output.

In the 2016 budget, there are plans to provide subsidised funding to the solid minerals sector.

Tax changes

There was no proposal to change tax rates or impose new taxes in 2016. The budget speech was silent on the proposals to introduce a National Security Tax and the proposed increase in Tertiary Education Tax.

Government will however focus on measures designed to increase the tax base of the country.

Custom duties

Levies and duties on the value of imports are projected to reduce in 2016 compared to 2015. However, there is expected to be an increase in custom collection from NGN862 billion in 2016 to NGN921 billion in 2018. This is highly dependent on monetary policies of the CBN and security at the borders to check smuggling activities.

Corporate Taxes

The projection for corporate taxes is quite optimistic. Corporate tax collection is expected to grow from NGN1.87 trillion in 2016 to NGN2.23 trillion in 2018. This is as a result of heightened effort by the FIRS towards tax collection. Some of the initiatives include collaboration with financial institutions on tax collection and partnering with the corporate affairs commission in identifying non-compliant taxpayers.

Value Added Tax

The budget makes no mention of an increase in the VAT rate from the current 5% other than the fact that the rate was meant to increase to 10% by mid-2015 which was not implemented. However, VAT collection is expected to increase due to more enforcement of compliance.

Luxury tax

There is no mention of luxury tax in the 2016 budget speech. However based on the medium term expenditure paper for 2016-2018, the surcharge on luxury items is expected to generate about NGN15 billion in 2016.

Taxes for smaller companies

In order to address the unemployment situation in the country, it was mentioned that the tax rate for smaller businesses will be reduced. It is not clear what taxes will be reduced and what constitutes "smaller companies". It is noteworthy that a lower corporate income tax rate of 20% (rather than 30%) is currently applicable to small companies that meet certain conditions.

Further Insights on the Medium Term Expenditure Framework 2016-2018

Roadmap for implementation of the various plans and social development programs

The MTEF provides a high-level strategic policy direction of the government over the next 3 years. A social welfare package of about N500 billion was proposed for 2016 in the MTEF. The package is aimed at three areas; school feeding program initiatives, conditional cash transfer to the most vulnerable and post NYSC grant to promote entrepreneurship.

The government must be deliberate with implementation of the budget and take periodic stock of how well programs are being implemented. The value of each program to the economy and social wellbeing of citizens must be measured. Any program that does not add value beyond its associated cost should be discontinued or reviewed very quickly as the huge borrowing has to be justified by clear results.

Diversification of the Economy

The MTEF reiterates the emphasis on diversification of the economy. The main areas of focus are agriculture, and solid minerals. The current administration needs to ensure clear policies and regulatory framework for investors to thrive in these sectors. Ultimately these sectors should be able to earn significant foreign exchange to replace the shortfall from crude oil earnings. This will have a positive impact on the exchange rate and the economy as a whole.

Zero-Based Budgeting System

The MTEF is based on zero based budgeting system. If implemented properly it will encourage the attainment of a more prudent public fund management. It should help to reduce inefficiency and wastage especially in recurrent expenditure and free up more funding for infrastructural development.

Increase of Value Added Tax

The MTEF mentioned that the VAT rate was projected to increase by mid-2015 to 10% but was not implemented. The document does not suggest that VAT will be increased in 2016 as the projected 20% increase in VAT is on the basis of improving compliance. It is however not clear whether 5% will be maintained over the 3-year period to 2018, especially in view of the full implementation of the Common External Tariff for ECOWAS projected for 2019.

Infrastructure development and power

The MTEF highlights some effort on increasing access to energy supply and improving transportation infrastructure. In order to achieve this, the current administration would setup an infrastructure development fund.

One of the crucial extracts from the document is that the government will encourage off-grid power. While the mention of off-grid power was not detailed, it suggests that IPP projects will be encouraged while government focuses more on ensuring adequate investment in transmission infrastructure and regulation. This will impact on the regulation of tariffs and the ability of investors to earn commercial returns across the power value chain. Already we are aware of the announcement to remove the fixed charge component in electricity tariff.

Conclusion

The 2016 Budget is targeted at raising non-oil tax revenues and increasing capital spending. Due to declining oil revenue, the government plans to increase borrowing to fund the huge budget deficit. It is encouraging that government plans to align fiscal, monetary, trade and industrial policies. This along with other policies intended to reflate the economy and the ongoing oil sector reforms will help improve the economic fortune of businesses and individuals.

Over the medium term, the current administration has made a commitment to focus on pursuing macroeconomic policies that will achieve fiscal stability, non-oil sector competiveness, stable single digit inflation, increased non-oil revenue and a competitive exchange rate. If properly implemented, we believe that these are policies in the right direction.

PricewaterhouseCoopers Limited
Landmark Towers, 5B Water Corporation road, Victoria Island, P.O. Box 2419, Lagos
17 Chief Yesufu Abiodun Way, Oniru Estate, Victoria Island, Lagos (Annexe)
T: +234 (1) 2711700
F: +234 (1) 2703108 - 9
Email: enquiry@ng.pwc.com Website: www.pwc.com./ng