FALLING OIL PRICES:
AN OPPORTUNITY FOR REFORMS

budgIT

POLICY DOCUMENT

ABBREVIATIONS

BIR	Budget Implementation Report
BOF	Budget office of the Federation
BPP	Bureau of Public Procurement
CBN	Central Bank of Nigeria
CIT	Company Income Tax
CSOs	Civil Society Organisations
DMO	Debt Management Office
ECA	Excess Crude Account
FAAC	Federation Accounts Allocation Committee
FGN	Federal Government of Nigeria
FRA	Fiscal Responsibility Act
FRC	Fiscal Responsibility Commission
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
ICRC	Infrastructure Concession Regulatory Commission
IDA	International Development Association
IMF	International Monetary Fund
KPI	Key Performance Indicators
MDA	Ministry, Department and Agency of Government
MPR	Monetary Policy Rate
MSMEs	Micro, Small and Medium-sized Enterprises
MTEF	Medium Term Expenditure Framework
NASS	National Assembly
NDDC	Niger Delta Development Commission
NEIC	National Economic Intelligence Committee
NESG	Nigeria Economic Summit Group
NNPC	Nigerian National Petroleum Corporation
NPC	National Planning Commission
OAGF	Office of the Accountant-General of the Federation
PIB	Petroleum Industry Bill
PICA	Project Implementation Continuity Act
PPA	Public Procurement Act
PPDC	Public and Private Development Centre
PPT	Petroleum Profit Tax
SWF	Sovereign Wealth Fund
VAT	Value Added Tax

Opening Note

These are interesting times because the mono-product that Nigeria's finances hang on is being threatened. It is under intense attack from a global oversupply of oil, the drastic improvement in shale gas technology, the continuous efforts of the US to achieve oil independence and recent geo-political tensions with major oil producers. Oil prices should ordinarily be on the high side during this period because the current price is for January deliveries, a major winter season with high energy consumption rates. However, oil, true to its volatile state as a commodity is running its course and Nigeria, living off it, has to adjust.

This publication chronicles our continuous advocacy to optimize Nigeria's revenue towards a better and inclusive society. We strongly believe that if Nigeria adopts bold solutions towards reforming its oil and gas industry, diversifies its economy and cuts waste in governance, oil prices need not be a death knell of sorts for our existing mono-product economy.

About BudgIT

BudgIT is a civic startup driven to make the Nigerian budget and public data more understandable and accessible across every literacy span. BudgIT's innovation within the public circle comes with a creative use of government data by either presenting these in simple tweets, interactive formats or infographic displays. We have a goal to use creative technology to intersect civic engagement and institutional reform.

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NIGERIA:
QUICK NUMBERS

GDP
$521.8bn
NBS (2013)

POPULATION
174.5m
World Bank (2013)

EXTERNAL FOREIGN RESERVES
$36.85bn
CBN (Nov. 2014)

INFLATION RATE
8.1% YoY
NBS (Oct. 2014)

PRIVATE SECTOR CREDIT
N17.78tn
CBN (Oct 2014)

EXCESS CRUDE ACCOUNT
$4.11bn
CBN

OIL REVENUE (DISTRIBUTABLE)
N5.74tn
BUDGET OFFICE (2013)

NON-OIL REVENUE (DISTRIBUTABLE)
N2.23tn
BUDGET OFFICE (2013)

GDP PER CAPITA
$3,006
WORLD BANK (2013)

VALUE OF IMPORT
$91.6bn
RENAISSANCE CAPITAL

VALUE OF EXPORT
$56.4bn
RENAISSANCE CAPITAL

OIL PRODUCTION
2.23mbpd
BUDGET OFFICE (2014)

1999 - 2014: A Brief History of Oil Prices

The story of Nigeria's economy since the 1970s is incomplete without recounting the swings in oil prices. The huge revenue we have earned from oil and gas and a simultaneous lack of investment in infrastructure and sustainable projects remain a challenge for Nigeria. As at now, capital expenditure is wholly financed through debt and the entire oil revenue for the Federal Government is used for recurrent items.

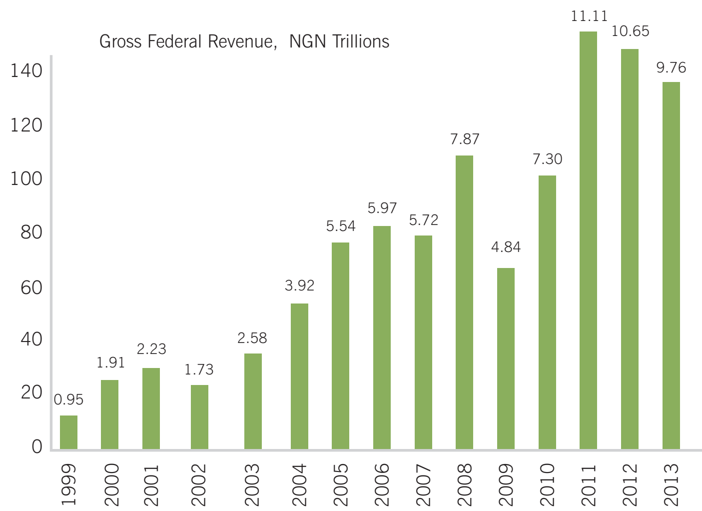
Oil Price (Brent Crude) 1999 - 2014, $ per barrel

Source: Central Bank of Nigeria

At the advent of democracy in 1999, expectations were high that oil revenue would be better managed by the new leaders. Starting from 2006, the agitation for resource control snowballed into violence and morphed to include kidnaping and vandalism. Revenue earnings from oil increased by 8% to N5.96tn in 2006. With growing restiveness in the Niger-Delta, Nigeria experienced a 4% drop in oil revenue in 2007, leaving total earnings at N5.72tn.

The global financial meltdown in 2009 left Nigeria's oil revenue sliding to N4.84tn, representing a 39% reduction in revenues at the end of the year. This showed the weakness of the Nigerian economy but the fault lines were not very visible, due to prior robust savings in the Excess Crude Account. The Global economy recovered in 2010, as did crude oil prices, resulting in government revenue rising to N7.3tn and N11.1tn in 2010 and 2011 respectively.

Gross Federal Revenue, NGN Trillions

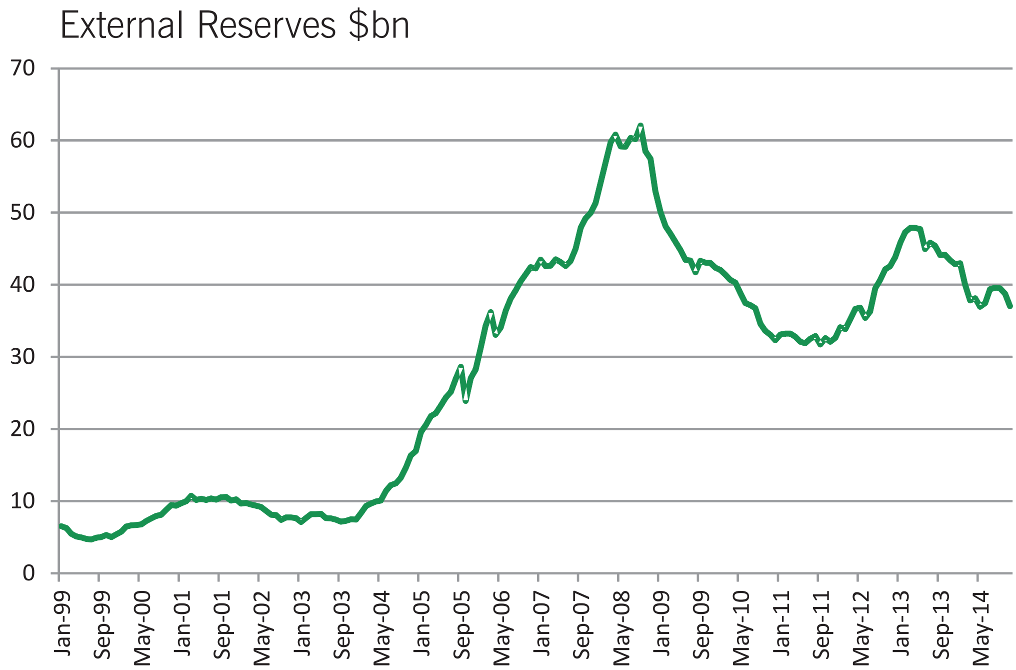


Source: Central Bank of Nigeria

Despite oil prices averaging above $100 per barrel in 2012, oil revenue slowed down considerably. The reduction was occasioned by increased oil production by the US, which in turn resulted in a reduction in imports from Nigeria and our inability to meet our own budget production targets. With the US not importing from Nigeria in 2014 amid falling global oil prices, government oil revenue will take a further hit. We believe it is unsustainable to continuously depend on oil and gas revenue, considering its fluctuation. The outlook does not show that things will improve in 2015 and oil prices might not rally beyond $80 within the fiscal period.

Nigeria will have to set a realistic oil benchmark price, possibly at a conservative price of $55 per barrel. This will possibly raise Nigeria's actual budget deficit from about N1tn to N2tn if oil production stays at 2.23m barrels per day.

Depletion of External Reserves in Boom Times



Source: Central Bank of Nigeria

On May 29, 2007, crude oil was trading at $67.2 per barrel and foreign exchange reserves which were hitherto at a dismal level of $4.72bn as at 1999, stood at $43bn. Nigeria's economy looked very healthy. Apparently, we had enough fiscal buffers, with the Excess Crude Account in double figures and foreign exchange reserves recorded at $62.08bn as at September 2008. External reserves were threatened during the global economic crisis, falling to $40bn as at April 2010, reaching a bottom balance by September 2011 ($31.74bn). However, after 41 consecutive months of oil prices above $100 (boom period), we wonder why our country is struggling to record savings of $37bn. Why did Nigeria's reserves fail to rise significantly during the oil-price boom times?

A quote in the Central Bank's MPC Document for October 2011 is striking and states that: "Similarly, the (Monetary Policy Committee) expressed concerns about the genuineness of demand for petroleum imports. This year alone, oil importers have bought over US$7.0 billion from wDAS, thereby, depleting the Nation's external reserves. This demand, in the Committee's view, might have been fuelled by rent-seeking and subsidies."

The external reserves will continuously come under pressure as payments in foreign currency might slow down with falling oil prices. In 2015, the new terminologies in our financial cycle might be austerity and budget cuts. Economists are projecting that Nigeria may have to borrow to pay salaries, with an extra deficit of N600bn if oil prices stay at $70 per barrel. If oil prices keep plunging low, Nigeria's external reserves will continuously be under pressure due to declining dollar receipts.

"With oil production at its most favourable level since 2006, and with oil prices back above $90 per barrel, the issue is why reserves have not risen further, not why they have 'fallen." Razia Khan, Head Research Africa Region, Standard Chartered Bank (2011)

75%

Oil accounts for 75% of government revenue

95%

Oil accounts for 95% of foreign exchange earnings

$125

Oil Price Needed to balance Nigeria's Budget

Source: BudgIT Estimates

$90

Oil Price Needed to keep Nigeria's Deficit as at 2013 level (N1.1tr)

Source: BudgIT Estimates

N500bn

Additional Deficit, if oil prices stay at $70 per barrel

Source: BudgIT Estimates

N828bn

Record Amount spent on servicing debt in 2013

Source: BudgIT Estimates

Nigeria: Implications of Oil Price Free Fall

The Oil Price has continued on a free fall and analysts are already forecasting $60 per barrel as average for 2015. The implication for a Nigerian economy which runs mainly on a single commodity is dire and we foresee the following as challenges:

1 Exchange Rate Volatility: 95% of Foreign Exchange Earnings are tied to oil and with shortened revenues in dollars terms, the Naira will be under continuous pressure. The Monetary Policy Committee has already devalued the Naira, shifting the band from N155 to N168 to $1. Despite devaluation, Nigeria will earn less revenue from oil and gas exports and imports of household items will be more expensive, with the burden passed on to Nigerians.

2 Savings Stagnation: With the Excess Crude Account at $4.11bn, declining oil prices mean that Nigeria might not be able to add additional revenue due to pressure from States who also run high recurrent expenditure. It might also be difficult for the FG to save funds in the Sovereign Wealth Fund, considering the austerity measures of the times. Accretion to the External reserves is also expected to slow down with falling crude prices.

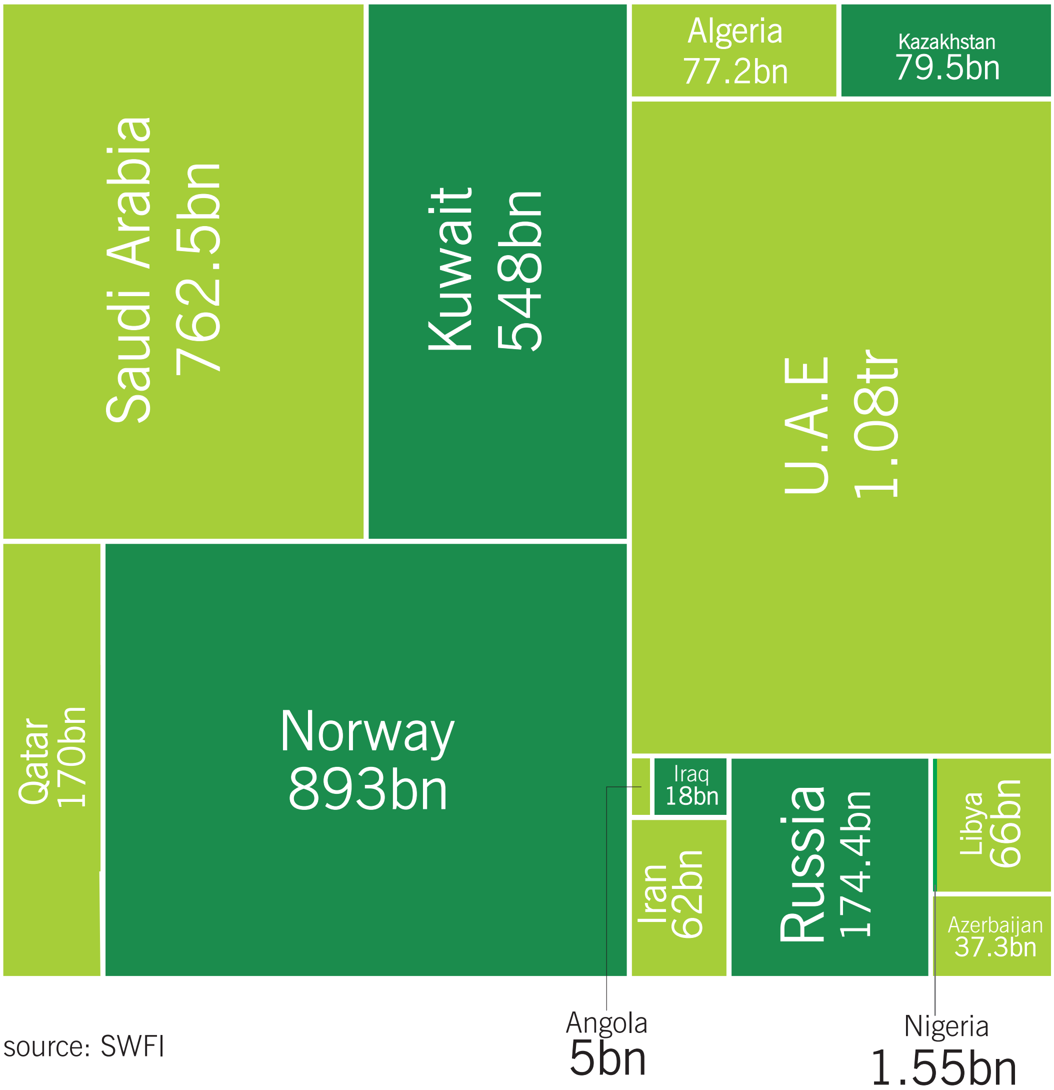
3 Debt Spiking: Debt servicing will possibly rise, especially foreign debts and Nigeria will need more funds to cover the budget deficit (difference between accrued revenue and expenditure). With stagnated Excess Crude Account savings, raising debts is the glaring alternative. The balance of the special accounts (ecology, stabilization and natural resources accounts) - which the FG borrowed N224bn from to augment a deficit - is currently unknown. We doubt the legality of this and also if this will be enough to close the gap between shrinking revenue and expenditure.

4 Capital Expenditure Under Threat: The haste to spend on recurrent items will remain, as they are fixed charges, unless drastic reforms such as downsizing personnel and sharp cuts in overhead costs occur. Capital Expenditure performance might be threatened by lower oil prices as government strives to keep its deficit within the limits of the Fiscal Responsibility Act whilst ensuring it meets its day-to-day obligations.

5 Employment: The Public Sector is still the largest employer of formal labour and with cuts to government expenditure due to falling oil prices, the number of new jobs will actually continue on a decline, following recent trends from 22,644 in Q3 2012 to 5,735 in Q3 2014 (NBS Estimates 2014). The private sector will have to lead the way for employment opportunities in Nigeria.

Sovereign Wealth Funds Versus Nigeria's Tiny Drop

Amount in Dollars



source: SWFI

Sovereign Wealth Funds serve as a fiscal buffer to save countries from economic shock and collapse in the event of drastic oil price falls. Oil-driven economies have their SWFs financed from taxes on sales of oil and gas, and are meant to safeguard the long-term stability of the economy. This is as a result of clear strategic planning and a basic understanding of a compulsory need to diversify resources. With respect to its population size and external reserves, Nigeria has minimal or low preventative measures to tackle shocks or problems arising from oil price decline, unlike in 2008.

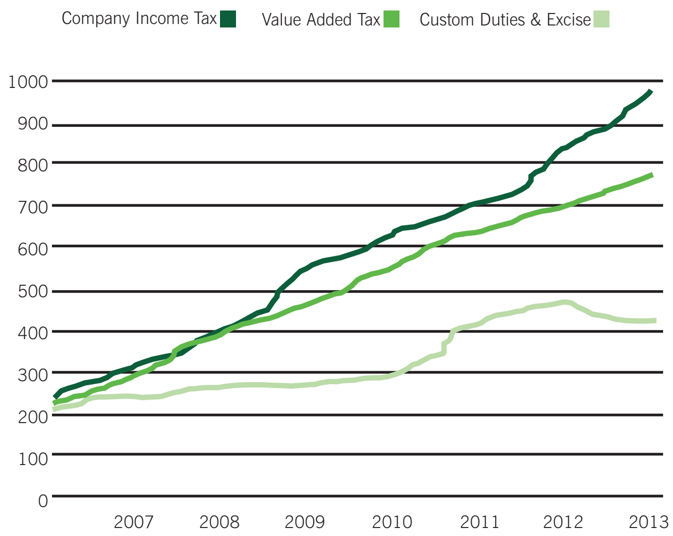
Nigeria has a higher population size than Brunei but has a smaller SWF. This poor balance may be related to a faulty distributive structure for oil in Nigeria and a poor intent to actually diversify the economy. Nigeria has found it hard to increase its Sovereign Wealth Fund, with State Governors citing the lack of legal grounding for existing savings mechanisms, including the Excess Crude Account and Sovereign Wealth Funds. Despite the bold attempt of the current administration, Nigeria has a shameful balance, insufficient to weather the looming storm of a situation where oil prices fall below $50.

Non-Oil Revenue Performance: Scratching the Surface

Description	2007	2008	2009	2010	2011	2012	2013
	N'b	N'b	N'b	N'b	N'b	N'b	N'b
Custom Duties &Excise	248.94	274.41	278.94	309.19	422.09	474.92	432.64
Company Income Tax	327.04	416.83	564.95	657.28	716.92	848.57	985.52
Value Added Tax	301.71	404.53	468.39	562.86	649.50	710.15	795.60
Education Tax	50.65	59.39	61.06	N/A	N/A	N/A	N/A
Non Oil Revenue	928.34	1155.15	1373.34	1529.33	1788.51	2033.63	2213.76

Source: Office of the Accountant - General of the Federation and Budget Office

NON-OIL REVENUE COLLECTIONS (2007-2013)



Due to the ease of generating oil revenue, institutional challenges and a lack of competitiveness in Nigeria, high energy costs and access to finance, Nigeria's Non-Oil Revenue is barely $14bn, as shared by all tiers of government. The decline in Nigeria's revenue from customs duties in 2013 is as a result of waivers on importation of agricultural machinery and increased levies on certain agricultural products which discouraged importation.

The revenue stream for Valued Added Tax is under threat with the elimination of VAT on stock market transaction fees, which is aimed at ultimately reducing the cost of transactions for investors. Also, the decision by West African Heads of State to enter the Economic Partnership Agreement with the European Union, will further reduce revenue from customs duties. Company Income Tax is a significant source of revenue and a tool for economic development. Even with a steady increase in revenue from CIT, the FG can further increase income by putting in place a more vibrant tax administration and also rethinking the current VAT rate in the country. The FG and States in Nigeria will have to improve their tax collection and IGRs by strengthening the Internal Revenue Boards and devising ways to bring more entities from the informal sector into the tax bracket.

"Data collected from the Nigeria Port Authority (NPA), Manufacturers Association of Nigeria (MAN) and through an independent survey of the automobile industry shows that grey import is striving and almost at par with official import volumes. Loss to government from grey import is N85.2bn between 2008 and 2011"
Bismarck Rewane, CEO, Financial Derivatives Company Limited

Oil Sector: Quick 6 Tasks

Pass the Right Petroleum Industry Bill which favours transparency in mining leases and licenses, taxes, royalties and respect for institutional procedures

Build a multi-stakeholder security system to stop crude oil theft as this secures production volume

Maximise returns from gas, with large scale investment in infrastructure and also end gas flaring

Ensure that Marginal Oil Fields are given to credible people and institutions with goals to mine it for the broader benefit of the society

Take a bullish attempt to reform NNPC with more transparency in its presentation of oil revenues to the public.

Resolve the challenge of opacity in beneficial ownership, with clear definition of patrons of Nigeria's oil and gas industry

Time for Inconvenient Choices

For nearly 900 days, Nigeria's Petroleum Industry Bill has been with the legislature and investments worth over N17.2tr ($109bn) are currently in limbo, without strategic direction to shore up our reserves. While the legislators apply an unhurried approach to the omnibus Petroleum Industry Bill that rewrites the 1969 Petroleum Act and several extant legislations, it is instructive to note that the world is leaving us at the door post, combined with the added squeeze of falling oil prices. Countries with huge shale gas reserves are our premium markets and analysts are taking positions that the era of oil peaks is fast ticking away. Oil-producing countries given to reason are amassing reserves in Sovereign Wealth Funds with the understanding that this non-renewable commodity is poised for dwindling revenues in the long term.

900

For nearly 900 days, Nigeria's Petroleum Industry Bill has been with the legislature and investments of over $109bn has been stalled.
Source: OPTS

With oil companies hesitant about new investments in Nigeria's oil industry citing harsh fiscal measures, especially with equal raises in royalty and taxes in the new PIB, the resultant effect has been a recent/planned trend of divestment by oil majors. The Brass and Olokola LNG projects which seem like the new pump within Nigeria's oil enclave have been halted, with the IOCs pulling out in succession. The issue of underfunded Joint Ventures which have made the NNPC unable to meet its obligations to its partners and allowed scenarios of Modified Carry-Overs (IOCs loaning NNPC its share in the Joint Venture investments) seems to recur. Nigeria has also failed to maximise the marginal fields; these have been undermined via awards based on short-term political criteria, lack of quality data, poor asset financing, as well as opaque and lengthy data. Of the 24 fields that were allocated to 31 indigenous oil companies in 2003, only seven have produced.

However, most imperative is to understand how we ensure that the benefits of the Nigerian oil industry are broadly shared and that sustainable revenues from these natural deposits elevate the Nigerian society. A key concern is to peer into the allocation of oil leases, mining rights and licenses. The loophole of arbitrary allocation as found in the Petroleum Act of 1969 gives unrestricted access to the principal (President/Head of State) handling the Nigerian oil industry. This allows the usage of national resources for patronage or to attract personal gratification, and should be expunged. Nigeria's Oil and Gas Industry has multiple challenges: when else can the real reforms begin if not now?.

Waivers and Pioneer Status

N25.8bn

2014 (Jan-May) Value of Waivers Granted

According to the Budget Office, the total waivers granted in the first five months of 2014 were worth N25.8bn. Ideally, these waivers are granted to encourage investments and stimulate economic development. A lot of effort is being put in place to ensure that waivers are granted to credible entities to reduce revenue losses by the federal government. In the past, a lot of waivers have been granted for ludicrous reasons and the recent exemptions portray a difference and more interest to safeguard government revenues.

At the discretion of the President as granted by the Industrial Development Act which was passed to encourage investment in the country, companies who build new plants or industries, are exempted from paying taxes for a number of years. These companies are granted Pioneer Status.

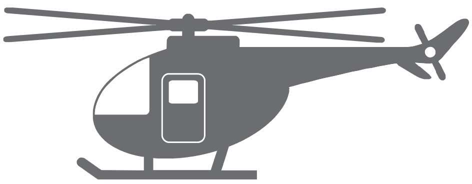
There is also the argument that the FG can review any gaps in the Pioneer Status scheme that offer no advantage to its income. Majority of the beneficiaries with Pioneer Status are companies in the oil and gas sector with bogus profits. They don't pay taxes and also repatriate gains to offshore tax havens. Some may argue that as a capital-intensive industry, that justifies their status. However, this is an industry that generates relatively few local jobs.

Such an industry deserves to be watched keenly, with government optimising its take. Government must monitor companies currently enjoying Pioneer Status to ensure compliance with set guidelines and ensure that profit is reinvested in the business. This opportunity has been recently abused, causing loss in government revenue. The Finance Minister Ngozi Okonjo-Iweala, acknowledged that 30% of companies with Pioneer Status abuse the privilege; now is the time to revoke those found wanting.

> "From 2012 to 2013, (Seplat) profits increased by 45%. In 2012, the Nigerian government collected taxes on these assets to the tune of $95m. By 2013, these same assets that generated tax for the government had somehow become 'pioneer' and ended up paying a big fat zero in taxes."
> Feyi Fawehinmi,Investment Consultant.

Nigeria's import waiver system has been abused for exemptions on luxury items:

African Women Peace Mission
50 Units of Assorted brands of BMW
Waiver granted: N138.6m



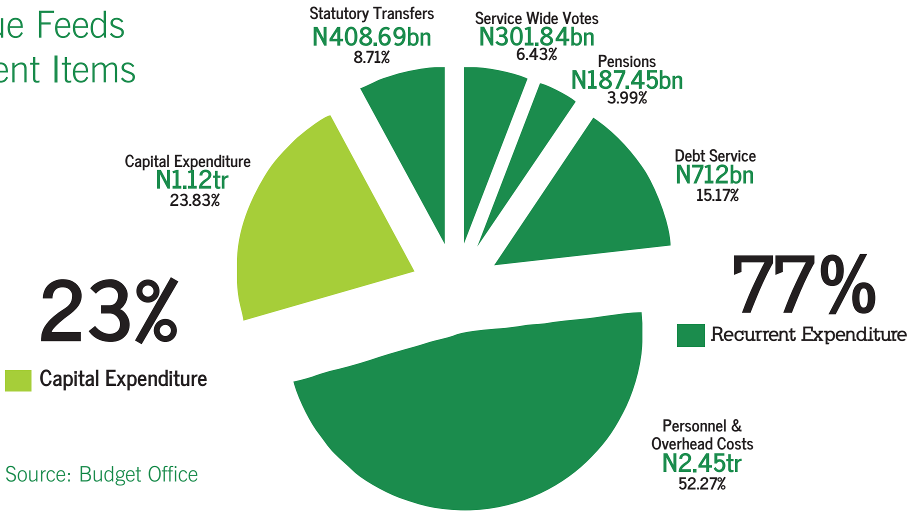
Rivers State Government
Two (2) Bell 412, Axis Helicopters and One Bombardier aircraft global Vision 5,000 series
Waiver granted: N2.18bn

However, recent data shows improvement

Beneficiary- Indorama Eleme Fertilizer & Chemicals Ltd
Utilization of Nigeria Natural Gas/Increase in power generation
Waiver granted: N6.960bn

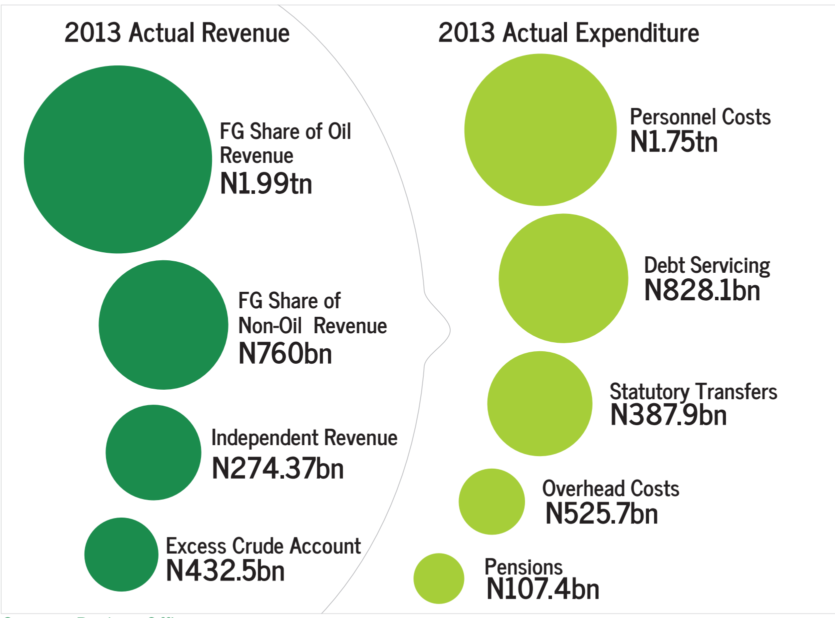
Source: Budget Office

Nigeria's Expenditure: How Oil and Non-Oil Revenue Feeds Recurrent Items



Source: Budget Office

This is the distribution pattern of the Federal Government expenditure. If Nigeria will make cuts it has to start with personnel costs of government workers, gross reduction in overheads, service wide votes and also statutory transfers to institutions such as the National Assembly, National Judicial Council and others. Austerity measures have to be encompassing for all arms of government. There are also opaque items known as capital supplementation that need to be checked and revised downwards.

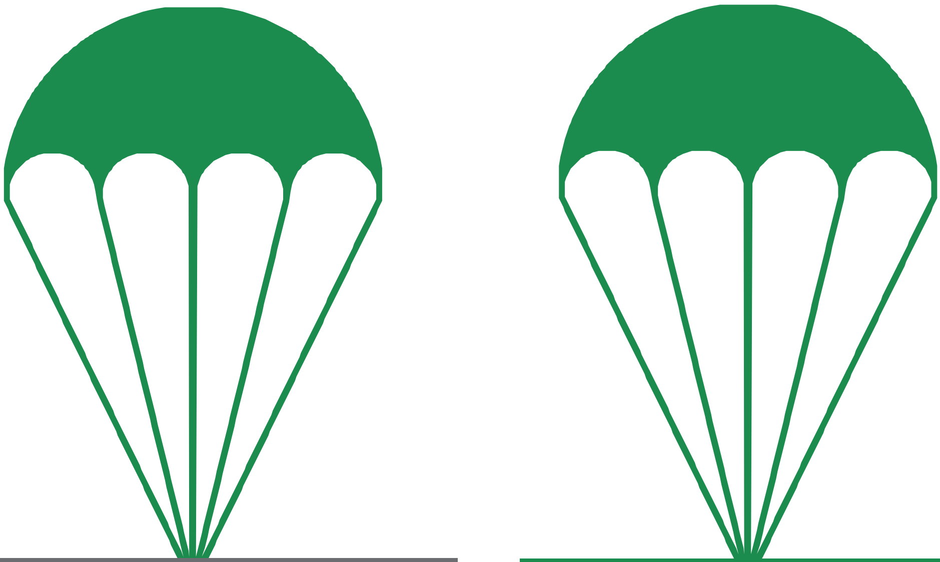


Source: Budget Office

Based on the 2013 Budget Implementation report, the Federal Government of Nigeria's revenue is used ENTIRELY for servicing recurrent expenditure. N3.5tn was the total revenue from the FG in 2013 and this offset recurrent expenditure worth N3.6tn. Our entire capital expenditure was financed via domestic debts and borrowings from special accounts. Does oil revenue actually benefit Nigerians?

"Due to profligacy, we have dismal human development indicators which are inconsistent with the scale of our earnings." Obiageli Ezekwesili, Senior Economic Advisor, Open Society Foundations (UNN Convocation Speech)

Fixing the Nigeria's Expenditure



1 Present the Nigerian budget with core consideration for austerity. Ensure that the budget is passed on time

2 Sincerely review and implement the Steve Oronsaye report by removing duplications and overlaps in government institutions and functions

3 Hasten the IPPIS exercise to cover all ministries with deft project management skills that remove all transition inadequacies

4 Stop arbitrarily increasing the present personnel costs of government. Focus should be on improving service delivery of current workforce

5 A prudent approach or freeze on certain overhead costs borne by ministries that do not add clear value to citizens

6 Institutions covered under all statutory transfers need to release a full breakdown of their budgets, not aggregate figures as found in budgets

7 Place a restriction on starting new projects except for under emergency measures; forge a common government-wide resolve and project plan to ensure current outstanding projects completed

8 Job creation can run more efficiently when areas of competitive advantage are assessed based on location, with budgets showing how government intends to activate these sectors

9 GIFMIS has to be rapidly scaled up across the ministries to profit from the benefits of maintaining a single treasury account that closes loopholes typically found in mismatched figures

10 Make available a clear list of projects to be funded by debts within the budget. This includes the project lifecycle and cost benefit analysis to citizens

Nigeria's Competitiveness: Time for Reform

The most problematic factors in doing business in Nigeria

Inadequate supply of infrastructure	26.1
Corruption	19.6
Access to financing	17.7
Policy instability	7.5
Inefficient government bureaucracy	7.4
Inadequately educated workforce	6.0
Poor work ethic in national labor force	3.1
Crime and theft	2.6
Tax regulations	2.2
Tax rates	2.1
Inflation	1.8
Foreign currency regulations	1.3
Insufficient capacity to innovate	1.2
Government instability/coups	0.6
Restrictive labor regulations	0.4
Poor public health	0.3

The Global Competitiveness Report assesses the competitiveness landscape of 144 economies, providing insight into the drivers of their productivity and prosperity. Nigeria ranks 127 out of 144 countries that were surveyed. Africa's largest economy, Nigeria will need to upgrade its infrastructure, reduce corruption, improve tax process, access to finance as well as improve its health and primary education system for better socio-economic indicators.

Source: World Economic Forum

Note: From the list of factors above, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The circles in the figures show the responses weighted according to their rankings.

"As a central part of our strategy, we have revised our oil price expectations over the short to medium term. But let me clearly state that we are not taking a point-estimate position as regards the future price of oil. We fully recognise that oil prices may fall lower or even rebound. Prices could fall to $70 a barrel, $65 or even $60. Prices could also rebound to $75 – $85 a barrel."

Ngozi Okonjo-Iweala, Minister of Finance and Coordinating Minister for Economy

10 QUICK FIXES

1 YouWIN: Continuously stimulate jobs in Nigeria's SME sector through direct interventions and also ensure that businesses are structured in a manner that can be funded by private sector.

2 Agriculture: Upgrade Nigeria's value chain through improvements in management of agriculture, production and post-production, pricing, transportation and distribution of produce.

3 Power: Focus on ensuring that Nigeria's deregulated generation and distribution systems as well as the centrally managed transmission systems are effectively managed, to improve competitiveness.

4 Access to finance: N300bn is termed as idle capital which can be used to support risk-minded individuals interested in value creation. Government needs to activate that, leading the discussion on how banks can benefit the economy through asset creation.

5 Business Registration and Port Reforms: Adequately ensure that business registration procedures are further simplified and port reforms as championed actually work for traders in Nigeria.

6 Solid Minerals: Nigeria is also blessed with numerous solid minerals including 42 tonnes of Bitumen that are currently underexplored. It is time to focus on this and ensure that we maximise all benefits.

7 Technology sector: Set up incubation hubs with seed capital for young entrepreneurs interested in fully exploiting the innovative mindset of young Nigerians.

8 Entertainment: Monitor and provide support for the Entertainment sector, to expand quality offerings to Nigerians and increase the number of practitioners in Nigeria.

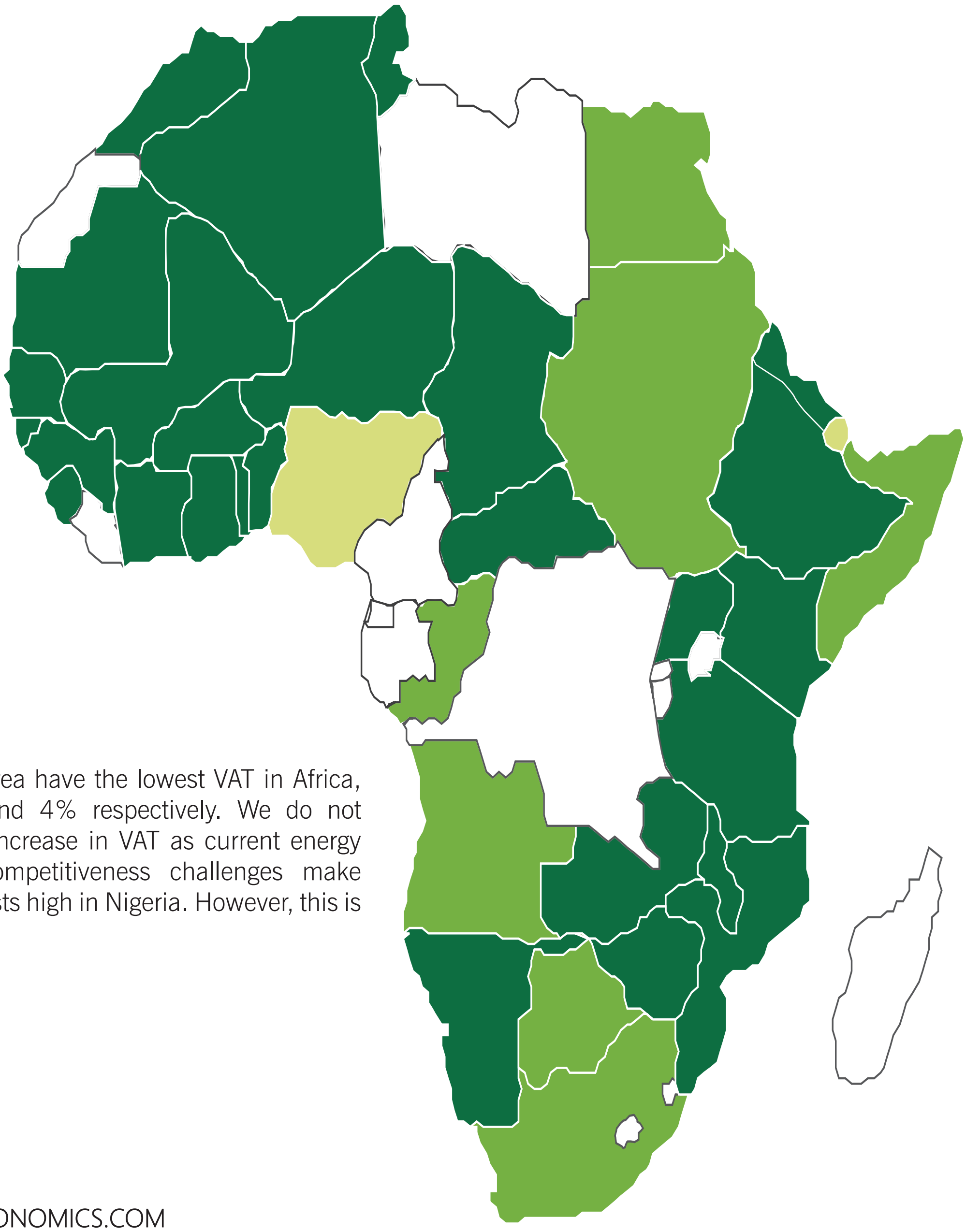
9 Workforce Training: Needed right now to ensure that the capacity of Nigerians in handling high-skilled jobs increases. Government, rather than placing priority on employment, should work on expanding the number of Nigerians that are employable.

10 Local Content Program: Expand the local content program beyond the Oil and Gas Industry, focusing on manufacturing and other relevant industries to propel an inclusive Nigeria.

VAT (SALES TAX) IN AFRICA

ESTIMATES AS OF 2014

NO DATA | BELOW 6% | 6%-9.99% | 10%-14.99% | 15%-ABOVE



Nigeria & Eritrea have the lowest VAT in Africa, put at 5% and 4% respectively. We do not advocate an increase in VAT as current energy costs and competitiveness challenges make production costs high in Nigeria. However, this is worth noting.

SOURCE: IECONOMICS.COM