The 2013 FGN Budget
Tax and economic analyses

Budget Highlights

October 2012

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Introduction

On Wednesday 10 October 2012, the President of the Federal Republic of Nigeria presented the 2013 Federal Budget proposal to the joint session of the National Assembly under the theme "**Fiscal Consolidation with Inclusive Growth**".

Summary of the budget

Highlights	2013	2012	Change
Crude oil indices:			
- Price per barrel	$75	$72	4.2%
- Daily production (mbpd)	2.53	2.48	2.0%
Revenue available to FGN (₦ billion)	3,890	3,644	6.8%
Expenditure profile (₦ billion)			
- Recurrent (non-debt)	2,410	2,425	-0.6%
- Capital	1,540	1,520	1.3%
- Debt service	592	560	5.7%
- Statutory transfers	380	373	1.9%
- Aggregate expenditure	4,922	4,877	0.9%
GDP Growth rate (budgeted)	6.5%	7.20%	-9.7%
Inflation rate	-	9.50%	-
US$ Exchange rate	160	155	3.2%
Fiscal deficit (% of GDP)	2.17%	2.85%	-23.9%

Crude oil indices

Considering the volatility of crude oil price in the past few years, the President has used a conservative benchmark price of US$75 per barrel in the budget proposal compared to the current market price of around US$100 per barrel projected for 2013 by the International Monetary Fund (IMF) in the October edition of its World Economic Outlook publication. The speech made by the leadership of the National Assembly in response to the budget however suggests that this benchmark will likely be revised upwards to $80 per barrel when the legislative arm begins its deliberation on the budget.

Revenue generation for government expenditure

The government has reiterated its intention to continue the reforms of the various revenue collecting agencies. This in part implies that the Federal Inland Revenue Service ("FIRS") and other revenue collecting agencies will be under pressure to meet their ambitious revenue targets.

Already the FIRS has concluded plans to introduce transfer pricing rules expected to become law before the end of 2012. In addition, thin capitalisation rules are also being considered which when gazetted, will prescribe an acceptable ratio of debt to equity for tax purposes.

Ironically, the federal government continues to introduce tax incentives which in some cases have negligible impact on the desired outcome yet they come at a significant cost to the treasury.

Recurrent expenditure (non-debt)

Given the need for a reduction in the budget deficit within acceptable boundaries in view of the Fiscal Responsibility Act and the Medium Term Expenditure Framework, the government has proposed a reduction in recurrent expenditures which have little or no long term positive impact on the economy. Recurrent expenditure, which accounts for about 48% of the total budgeted expenditure, is planned to reduce by 0.6% compared to 2012.

This reduction in recurrent expenditure (about N15 billion) is however considered too little in view of the inefficiencies in government at all levels. As a matter of urgency, government should focus on curbing waste in the public sector and intensify the fight against corruption.

Debt service and capital expenditure

Debt service and capital expenditure are expected to increase. The proposed increase in debt service expenditure is 5.7% compared to 13% in the 2012 budget estimate. Despite the lower increase the rising cost is a reflection of higher debt profile both internal and external. The President however indicated that domestic borrowing will be reduced in 2013.

Capital expenditure has been projected to increase by only 1.3% (about N20 billion) from 2012. As a percentage of aggregate expenditure, capital expenditure accounts for only 31% of total budgeted expenditure. This slight increase is definitely not enough to fund the various infrastructure projects planned under the “Transformation Agenda” of the government which could ultimately lead to more borrowing or reconsideration of fuel subsidy removal. There is no doubt that enormous investment is required for capital development especially in the areas of infrastructure such as electricity, transportation and so on, which are necessary for economic growth towards the attainment of Vision 20:2020

Statutory transfers

Although the increase of 1.9% is less than the 4.8% for 2012, the aggregate amount is on the increase.

GDP growth rate

The projected growth rate of 6.5% appears conservative given the potential for double digit growth and the necessity to achieve higher growth rate in order to actualise the Vision 20:2020 goal of becoming one of the top 20 economies in the world by the year 2020.

The need to improve security to provide the enabling environment for economic growth appears to be one of the reasons for the increase in the security allocation. The strategy would be to curb the unrest in the North and consolidate on the peace in the Niger-Delta post-amnesty. Another issue for the government to consider is disaster preparedness to deal with natural disasters such as the recent flooding in various parts of the country.

Key Sectoral Allocation

The expenditure breakdown for 2013 shows that social sectors like education and health got 8.7% and 5.7% against the international benchmarks for developing countries of 26% and 15% respectively. The increase in the allocation for education (an unprecedented N426.56billion) is commendable but still insufficient considering the level of deterioration in public education at all levels. The constant industrial actions, inadequate quality manpower, little investment in research, technological deficiency, and obsolete academic materials need to be addressed.

Also, agriculture and rural development despite its huge contributions to GDP and employment generation got a paltry allocation of 1.7% of the budget.

Other key sectoral allocations include Works, N183.5 billion (or 3.7%); Power, N74.26 billion(or 1.5%); Defence, N348.91 billion (or 7.1%) and Police, N319.65 billion (or 6.5%).

Inflation rate

The budget makes no mention of the projected inflation rate other than the fact that the rate dropped to 11.7% in August 2012. The 2012 budget prescribed a single digit inflation rate of 9.50% which obviously was not accomplished due to the impact of fuel subsidy reduction, depreciation of the Naira against major foreign currencies, unrest and natural disasters with knock on effects on prices of goods and services.

Also the increase in import duty on certain goods (such as rice and wheat) to encourage local production and encourage "cassava bread" may have contributed to the double digit inflation. We therefore expect that inflation rate would remain in double digits in 2013.

Exchange rate

With the pressure on Nigeria's foreign reserves, to maintain the exchange rate around N160 to US$1 will be a herculean task requiring more drastic monetary policy actions and exchange control. Oil and Gas production companies are already under pressure from the CBN with respect to the use of their foreign currency receipts. It will be recalled that in October 2011, the CBN issued a directive restricting companies to sourcing of foreign currency in the autonomous market for payment of dividends, repatriation of capital and proceeds of investment, sale of international tickets and consultancy services.

It is not clear to what extent these measures will help to stabilise the exchange rate without creating the incentive for round tripping in the autonomous market as a result of the higher margin.

Tax changes

There are no changes proposed to the corporate income tax rates.

However, to promote agriculture and industry, the Government has proposed the following fiscal changes effective 1 January 2013.

- To encourage local sugar manufacturing in Nigerian, machinery and spare parts imported for local sugar manufacturing will attract 0% duty (compared to 5% previously). There will also be a 5 years tax holiday for "sugarcane to sugar" value chain investors. Unless this is applied to unincorporated entities, in our view, there is already a framework for the tax relief under the Industrial Development Act.
- Again, to discourage the importation of sugar (raw or refined), the import duty and levy on raw sugar will now be 10% and 50% respectively. While refined sugar will attract 20% duty and 60% levy. In the past the duty for raw sugar was 10% with 0% levy. While the duty and levy for refined sugar was 20% and 10% respectively.
- In order to encourage the local production of rice, a 10% duty and 100% levy will be applied to both brown and polished rice. In the past the duty rate for brown rice was 5% without a levy. While the duty and levy for polished rice was 10% and 20% respectively.
- To improve air safety and reduce the burden of aircraft maintenance in Nigeria, all commercial aircrafts and aircraft spare parts imported for use in Nigeria will attract 0% duty and 0% VAT.
- Machinery and equipment imported for use in the solid minerals sector will now attract 0% import duty and 0% VAT. This was already covered in the Mining Act.
- To encourage the production of mass transit vehicles in Nigeria, duty on completely knocked down (CKD) components for mass transit buses of at least 40-seater capacity, will be 0%, down from 5%. Options will also be explored for providing incentives for energy efficient vehicles from the 2014 fiscal year.
- On the reforms in the petroleum sector, the President reiterated the government's efforts to enact the Petroleum industry Bill 2012 (PIB).

Other important aspects of the speech

Power roadmap

The president mentioned the efforts of government aimed at improving the power sector. Besides the ongoing privatisation of the generation and distribution companies, the government is set to complement the private sector investment with a proposed infrastructure Euro bond of about US$1billion to complete gas pipelines and other infrastructure investments in partnership with the private sector. It is not yet clear to what extent (if any) the Sovereign Wealth Fund will be applied to the development of infrastructure in the 2013 budget.

Job Creation

The focus of the proposed 2013 budget is to achieve inclusive growth by identifying and developing job creation opportunities. The agriculture, construction, aviation and solid mineral sectors will be the main drivers. Agriculture alone is projected to provide over 3.5million jobs by the end of 2015, although there was limited allocation in the budget. A recent regulation by the federal government also grants tax incentives for companies employing 10 or more individuals under certain conditions.

Gender Empowerment

The President stated the government's plan to empower Nigerian women by integrating women in the various sectors of the economy. The ministries of Health, Agriculture, Communication Technology, Water Resources and Works will champion the initiative. Already, the good number of women in the current cabinet is a demonstration of this objective.

Priority sectors

Although the President commented on the government's commitment to the development of sports, there was no mention of a concrete plan to improve the sector especially with the poor performance in recent international competitions and the Olympics. Private sector involvement will be required in this area and less control by government especially in identifying and developing the right talent.

In the agricultural sector, the President stated that in addition to the investments of over $7.8billion currently enjoyed by the sector, other key policy and fiscal measures have been proposed to take effect in 2013 as already outlined.

Apart from the agricultural sector, the government is set to provide an enabling environment for the private sector to provide affordable and adequate housing for Nigerians and also to use the construction sector as a means of creating the much needed jobs in the country. There was however, no fiscal measure proposed by the government to support its plans for the sector. In our view, government should address the various huddles militating against private sector's investment in infrastructure including property development such as Real Estate Investment Trusts (REITs).

In the area of transportation, the government is focusing on maximising the private sector partnership for the management of the aviation sector and to improve air travel standards across the country. The government emphasized its position by proposing new fiscal measures for the aviation industry in the proposed 2013 budget as outlined above. The railway modernization programme and rehabilitation of the existing road network will continue in 2013.

Conclusion

The focus of the government is to leverage on what has been achieved in 2012 in respect of fiscal consolidation, reduction of recurrent expenditure and development of non-oil revenue sources. The timeliness of the budget presentation is commendable and we hope that the legislative arm will expedite action to pass the budget before 2013.

Of utmost importance is the budget implementation. It is pointless to spend so much time and resources on a budget that will not be implemented. Hopefully the experience regarding the low level of implementation of the 2012 budget will not be repeated in 2013.

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Contacts

Taiwo Oyedele
Partner and Head of Tax and Corporate Advisory Services
taiwo.oyedele@ng.pwc.com

Kenneth Erikume
Senior Manager, Tax and Corporate Advisory Services
kenneth.y.erikume@ng.pwc.com