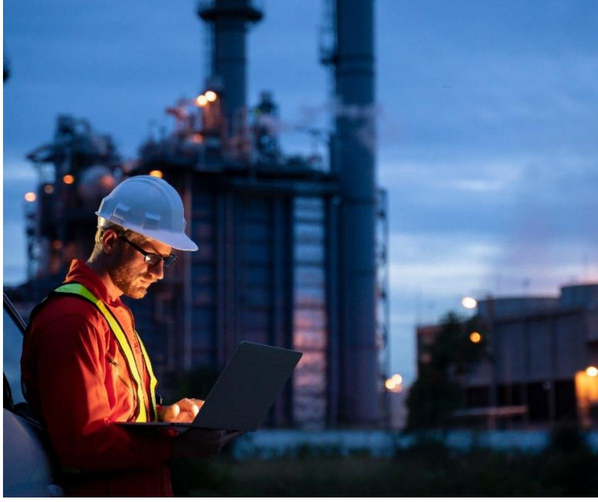
www.pwc.com/ng

Budget 2022

Expectations for growth and sustainability in the Oil & Gas Sector



February 2022

Introduction

For the third time in a row, the Nigerian government signed into law the Appropriation Act ahead of the fiscal year thereby allowing the budget to run in accordance with a calendar year. The 2022 signed Appropriation Act (2022 Budget) called the *“Budget of Economic Growth and Sustainability”* has an estimated expenditure of ₦17.1 trillion (a 13% increase from 2021 and almost three times 2016) and is by far the highest revenue and expenditure (in Naira terms) proposed by a Nigerian government. The table below shows a comparison of the Nigerian budget with that of other countries.

Nigeria			Ghana			South Africa			Kenya		
Rev. $	Exp. $	Exp. per capita $	Rev. $	Exp. $	Exp. per capita $	Rev. $	Exp. $	Exp. per capita $	Rev. $	Exp. $	Exp. per capita $
26bn	40bn	**195**	17bn	22bn	**733**	99bn	131bn	**2,183**	18bn	27bn	**480**

The amount budgeted per citizen is the worst in the table relative to comparable African countries.

In addition, Nigeria has a debt challenge, comprising a debt stock of N39 trillion and a high debt service to revenue ratio of 76% as at November 2021. Despite the bulk of our debt being taken to fund capital infrastructure, it is unlikely that the investment would be enough to lift more Nigerians out of poverty due to the insignificant amount budgeted per capita.

Highlights of the 2022 Budget

Nigeria projects to earn a revenue of N10 trillion and expend an estimated N17 trillion. This is predicated on the assumptions of a crude oil price of $62/barrel, a crude oil production estimate of 1.88 million barrels per day, inflation rate of 13%, exchange rate of N410.15/$1 and a growth rate of 4.2%. The budget presents a N6.3trillion deficit and a 4.3% deficit to GDP (November, 2021). Considering the dire state of the Nigerian revenue position relative to its debt service, such a huge deficit further puts Nigeria’s economy in jeopardy.

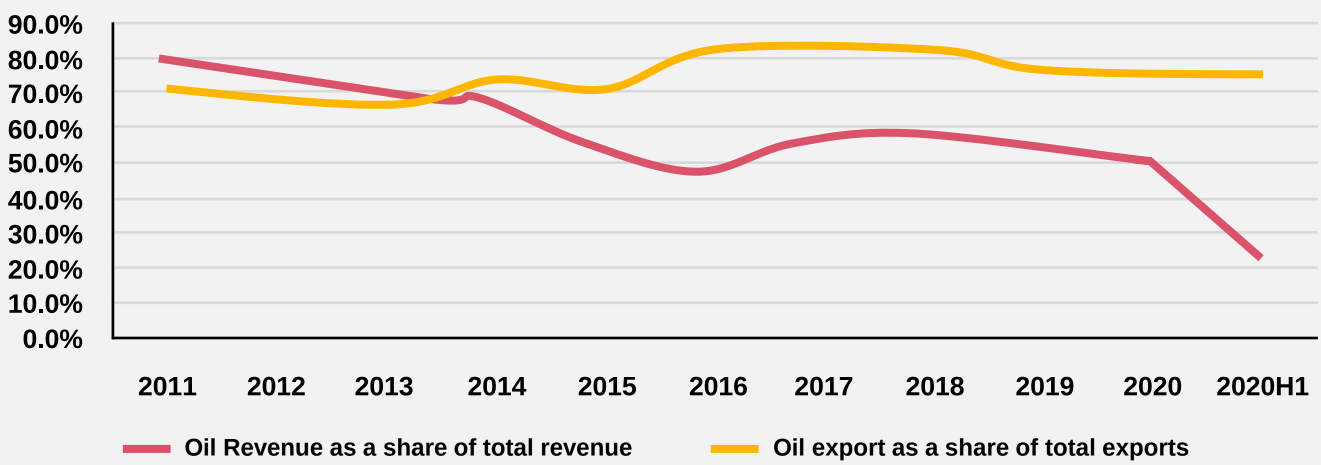
It is interesting to note that although the government intends to allocate sums representing 21%, 34%, and 40% of the 2022 Budget to debt service, capital expenditure, and non-debt recurrent expenditure respectively, there is no guarantee that this will be the actual rate of spending. Our past experience has taught us that things don’t always go as planned. For instance, 22.7%, 34% and 39% of the 2021 Budget were allocated for debt service, capital expenditure, and non-debt recurrent expenditure respectively. As at November 2021, the actual expenditure for debt service, capital expenditure, and non-debt recurrent expenditure represented 28.8%, 23.3% and 30.9% of the 2021 Budget respectively. Given that Nigeria cannot default on its debt obligations, capital expenditure seems to always take the hit for any expenditure redirection.

From a revenue perspective, Nigeria has over time not been able to meet up to 75% of its projected revenue for the years 2019, 2020 and 2021. Expenditure performance however has been top-notch as the country implemented more than 90% for the years 2019 to 2021. The challenge on the expenditure side is its basis which is mostly debt servicing and salary payment, as despite the massive deficit budget in the last 6 years there has been no remarkable improvement in the quality of life of the people and the infrastructure remains in a very sorry state.

Petroleum Industry Act (PIA) and the 2022 Appropriation Act

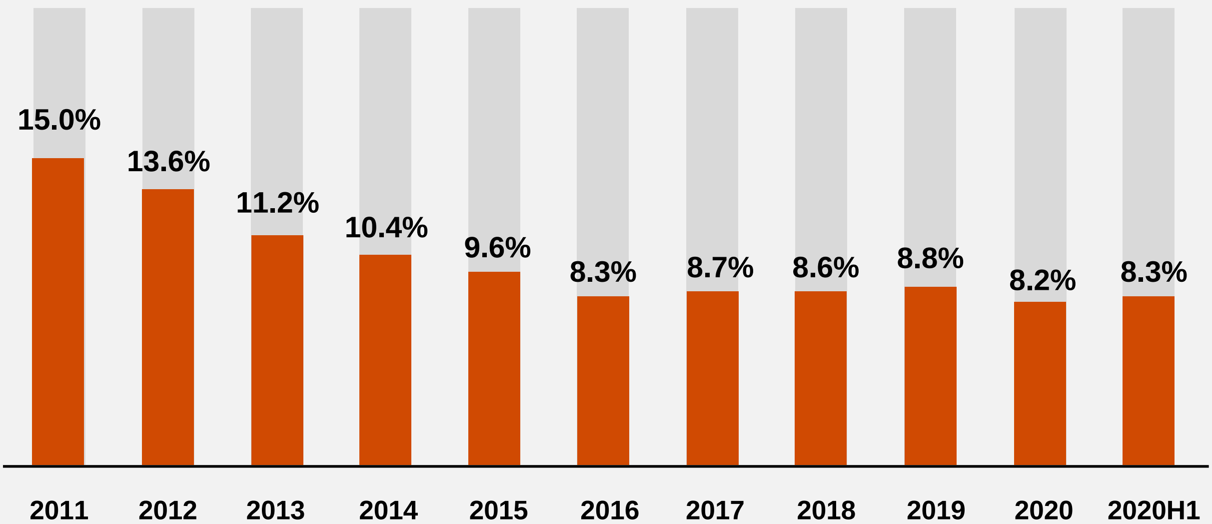
The PIA was signed into law on August 16, 2021, effectively achieving a major landmark in the effort to reform the Petroleum Industry. The Petroleum Industry remains a critical sector of the economy - although contributing lower than 10% of Nigeria's GDP, it accounts for almost 90% of foreign currency earnings and contributes about 80% of the Federal Government Revenue.

Share of Oil Revenue and Oil Exports



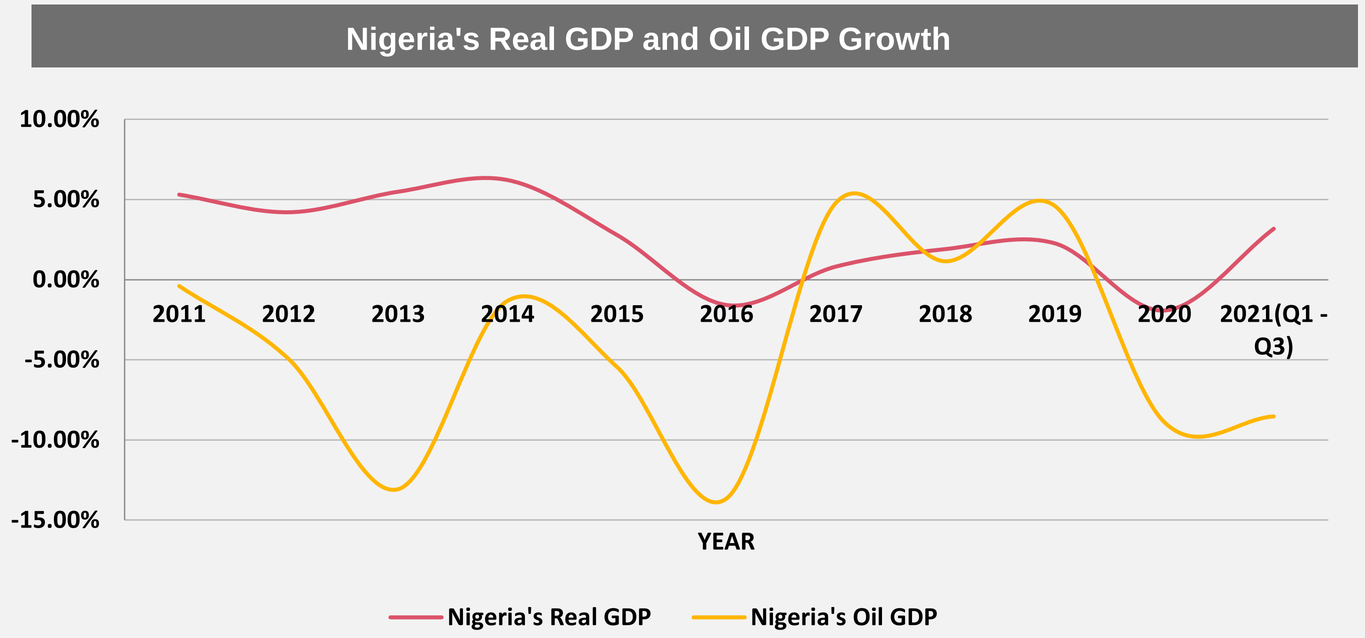
Note: 2021H1 data for oil revenue/total revenue covers the period Jan – May 2021

Nigeria's Oil GDP as a share of total GDP



Data Source: Central Bank of Nigeria, National Bureau of Statistics, Ministry of Budget, Finance and National Planning

The oil sector is pivotal to the Nigerian economy and the country twice went into a recession (between 2016 to 2021) on the back of a sharp drop in oil prices. Recovery in both instances was largely driven by increased oil prices - as these were achieved without any major reform of the Nigerian economy as shown in the diagram below.



Data source: Central Bank of Nigeria and National Bureau of Statistics

Prior to the advent of the PIA, the Nigerian oil and gas industry suffered a decline in the flow of foreign direct investments (FDI) into the country. Nigeria obtained only 4% of the $70billion Oil and Gas FDI into the African continent between 2015 to 2019, despite being the 2nd largest oil producer in Africa. The industry has been confronted with other challenges such as insecurity, crude oil theft, pipeline vandalism and oil spills, subsidy scams, inadequate infrastructure, funding constraints, complex contract approval process and multiple taxes & levies. In addition, the Federal Government share of oil revenue underperformed (53% of budget) based on the data for Jan to Nov 2021.

The PIA attempts to solve these problems by ushering in a change in the administration, governance and institutions, fiscal framework and treatment of host communities. With the key objective of the PIA being to foster a conducive business environment for petroleum operations, its successful implementation will help unlock the latent potential of the industry and attract the much needed investment.

Specific changes introduced by the PIA include:

- The introduction of two regulatory agencies - Nigerian Upstream Petroleum Regulatory Commission (NUPRC) and the Nigerian Midstream and Downstream Petroleum Regulatory Authority (NMDPRA)
- The transformation of the Nigerian National Petroleum Corporation (NNPC) to form NNPC Limited, a commercial entity to be jointly owned by the Ministry of Finance Incorporated and the Ministry of Petroleum Incorporated.
- The introduction of three new licensing regimes - Petroleum Prospecting Licenses (PPL),Petroleum Exploration Licenses (PEL) and Petroleum Mining Licenses (PML).
- The introduction of a dual income tax regime for upstream petroleum companies, i.e. Hydrocarbon Tax (HT) and Companies Income Tax (CIT). The HT is chargeable at a rate between 15% to 30% depending on acreage and distance from shore. This added to the 30% CIT payable from such profits will translate to a maximum tax rate of 60% under the PIA, which is significantly lower than the 85% tax rate applicable under Petroleum Profits Tax Act (PPTA).
- Incorporation of a Host Communities Trust Fund (HCTF) by license/lease holders for the benefit of their host communities and a host of other changes

Fiscal changes: A drive for growth in revenues

There's no doubt that the government is in dire need of revenue, and a good portion of this will be coming from the taxation of the oil and gas sector. There are certain aspects of the PIA which seek to ensure that upstream companies pay a reasonable amount of profit taxes by restricting the deductibility of more expenses relative to what was obtainable under the PPTA.

For upstream companies in relation to Hydrocarbon Tax, contributions to recognised funds such as the HCTF, environmental remediation fund, Niger Delta Development Commission (NDDC) fund and other similar contributions will be tax deductible. On the other hand, tertiary education tax, gas flaring costs and expenses that do not meet a 'reasonableness' criteria will no longer be deductible. Previously, the deductibility of operational expenses under the PPTA, was hinged on the principles of wholeness, exclusiveness, and necessity (WEN) of such expenses. The principle of "reasonableness" 'which was obtainable under the Companies Income Tax Act but excluded from the PPTA due to the peculiarity of the oil industry, has now been brought in by the PIA. This implies that certain expenses such as public relations to host communities might no longer be deductible by upstream companies.

In addition to the above, deductible expenses and capital allowances deductible will now be capped at 65% of gross revenues with the excesses carried over to subsequent years. This ensures that the government generates some level of revenue in taxes from operators in the upstream sector.

Possible Impact of PIA on Revenue Projection

Certain provisions of the PIA like the reduction in tax and royalty rates could negatively impact government revenue projections; however, these changes are expected to make the Nigerian fiscal environment more competitive and attract necessary FDI considering the spate of divestment by IOCs. This may be a tacit verdict that reforms introduced are too little, probably too late and may not have gone far enough to significantly improve Nigeria's competitiveness. This is particularly the case when considering other challenges facing the industry in Nigeria and the conversation around energy transition and focus on green/renewable energy.

The implication of the above along with the price volatility may put the realisation of government's projected revenue in doubt as has been the case in previous years.

Suggested Way Forward

As a nation, we need to address the sustainability of the debt position of Nigeria and the attendant impact on currency devaluation and the overall health of the economy. Nigeria needs to urgently reform its economy by diversifying foreign currency revenue sources, resolving security and power challenges, improving its productivity, improving the sea port system and addressing issues around cost of governance.

Nigeria needs to improve its spending quality, plug leakages in government, and address corruption. For example, why operate a cash-based rail system when the CBN has in place a cashless policy and has implemented the e-Naira. On the PIA, the implementation Committee needs to get to work considering 6 months have passed after its passage. A cue could be taken from the FIRS and other government agencies that have been proactive in organising stakeholder engagement sessions and workshops to get the industry ready for a post-PIA environment.

Contacts:

Ayo Akinduyite
Associate Director
Tax, Reporting and Strategy
ayo.akinduyite@pwc.com

Abiodun Kayode-Alli
Manager
Tax, Reporting and Strategy
abiodun.kayode-alli@pwc.com