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OPTIMIZING
FAAC Inflows & Outflows

At the FAAC Post Mortem Sub-Committee Workshop on "Federation Account Optimization in a Challenged Economy"
6th - 11th November, 2023

Presentation **Outline**

Nigeria's Fiscal **Federalism**

- Nigeria operates a federal system or federalism comprising federal, state and local governments.
- In a federal system, different governments provide different services to overlapping jurisdictions.
- Fiscal federalism denotes an intergovernmental fiscal relation defining functions and responsibilities among the various tiers of government as well as the financial resources to achieve stated objectives.
- It relates to the division of tax income and functional responsibilities among the various tiers of government in a federal state.
- Certain revenues are pooled and distributed among Nigeria's 3 tiers of government by the Federation Account Allocation Committee (FAAC)
- This distribution has always been central in financing government operations both at the national and sub-national levels.
- However, recent global development and prevailing domestic economic conditions are affecting FAAC distribution.

Revenue Sharing: **Historical Perspectives**

Section 162 of the 1999 Constitution of the Federal Republic of Nigeria mandates that any amount standing to the credit of the Federation Account shall be distributed among the three (3) tiers of Government.

Before May 1999, the Vertical formula for allocating federally collected revenue was:

- *Federal (48.5%), States (24%), Local Governments (20%), Statutory Stabilisation (0.5%), General Ecology (2.0%), Federal Capital Territory (1%), and Oil Mineral Producing Areas Development Commission - OMPADEC (3%).*

The 1999 Constitution replaced OMPADEC's 3% with a 13% derivation payable to Oil Producing States.

However, following a Supreme Court ruling in 2002, the Statutory Revenue Allocation Formula was adjusted as Federal (54.68%), States (24.72%), and LGs (20.60%).

The Statutory Revenue Allocation Formula was further modified in May 2003 through a Modification Order as follows: Federal (52.68%), States (26.72%) and LGs (20.60%).

There are recent amendments to this sharing arrangement.

- *The payment into the Nigeria Police Trust Fund of 0.5% of the total revenue accruing to the Federation Account and a levy of 0.005% of the net profit of companies operating in Nigeria for the training and retraining of personnel*
- *The North-East Development Commission is funded with 10% of annual statutory allocations due to the states in the north-east region, 10% of the Ecological funds for 10 years and 3% of annual VAT collection as first line charge for 10 years.*

Revenue Sharing: **Current Formula**

Federation Account Distribution
FGN (52.68%)
States (26.72%)
LGAs (20.60%)

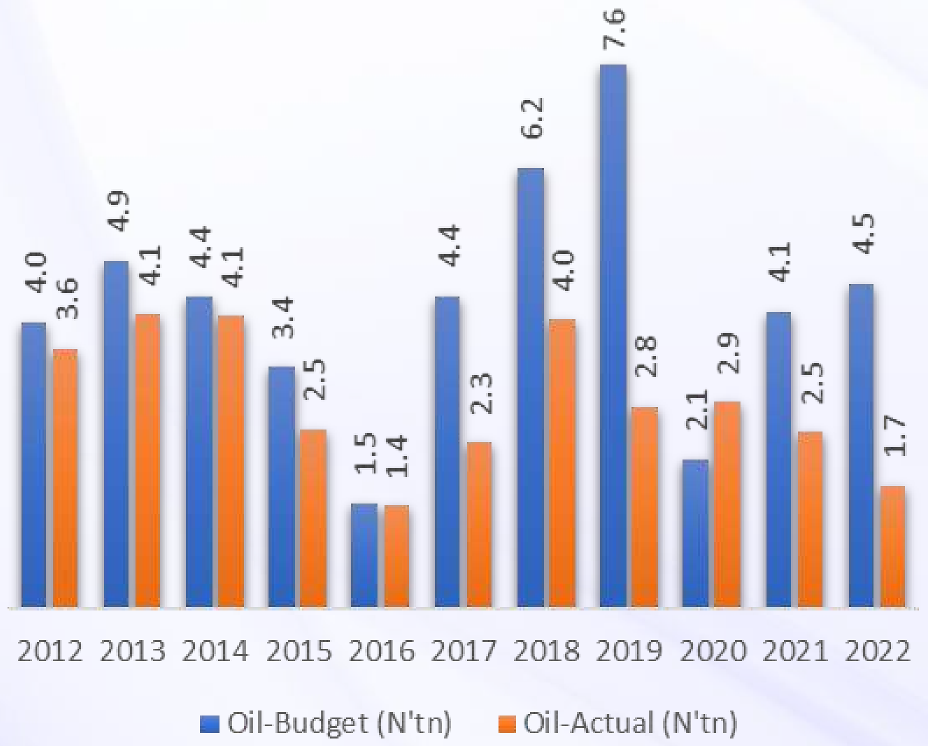
VAT Pool Distribution
FGN (15%)
States (50%)
LGAs (35%)

FGN portion consists of:

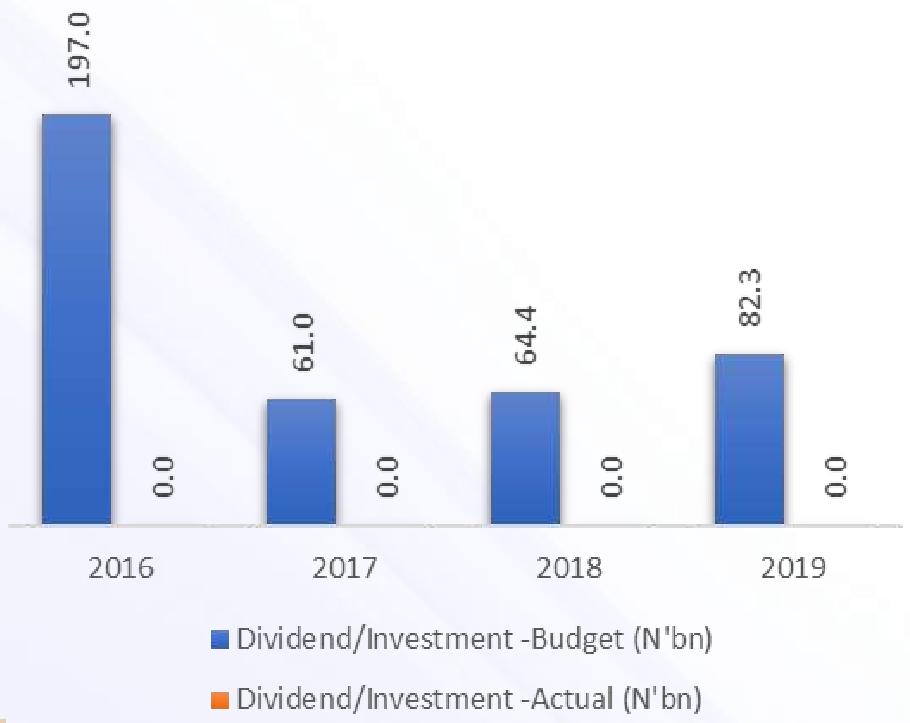
- FG — 48.5%
- FGN Share of Derivation and Ecology — 1%
- FCT — 1%
- Stabilization Account — 0.5%
- Development of Natural Resources — 1.68%

Sources and Contributions to FAAC: **Budget vs Actual**

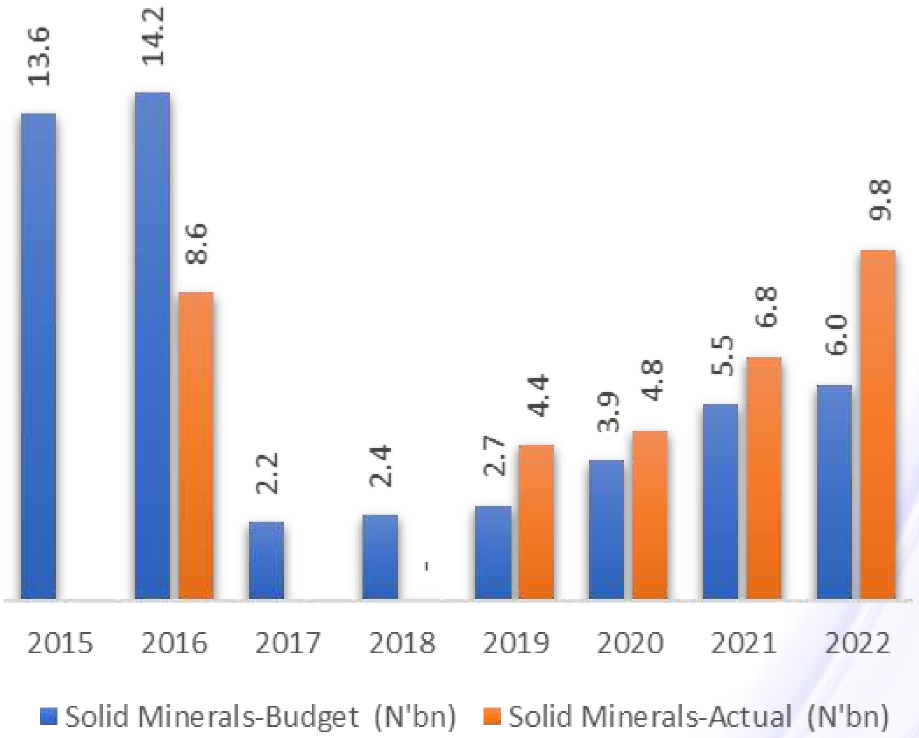
Oil Revenue to Federation Account



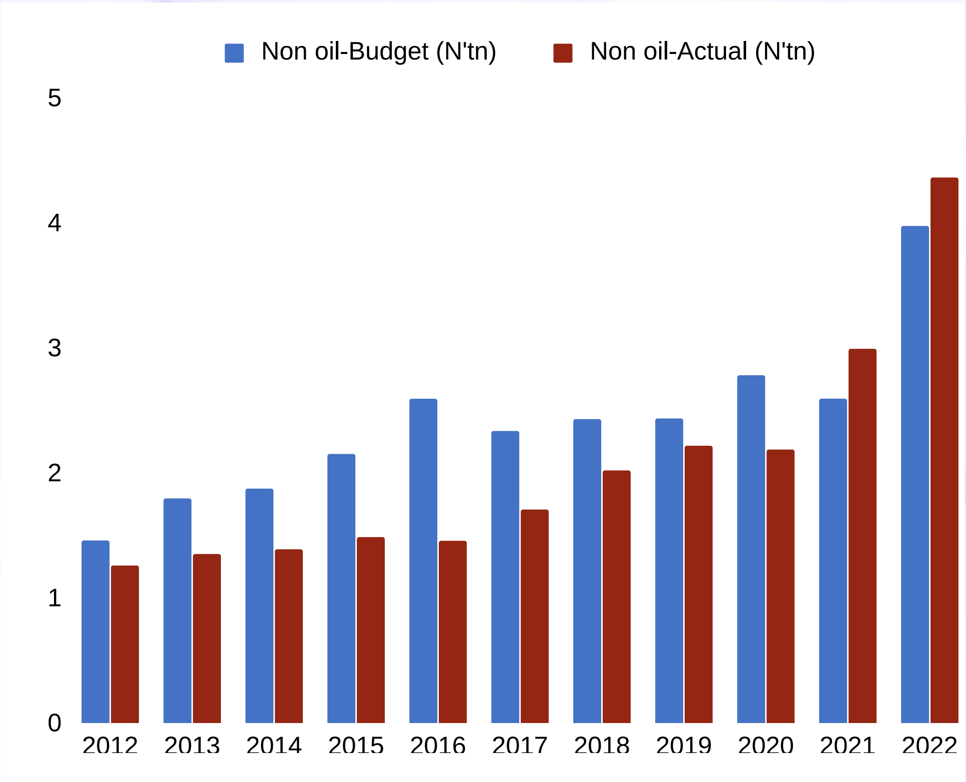
Dividend to Federation Account



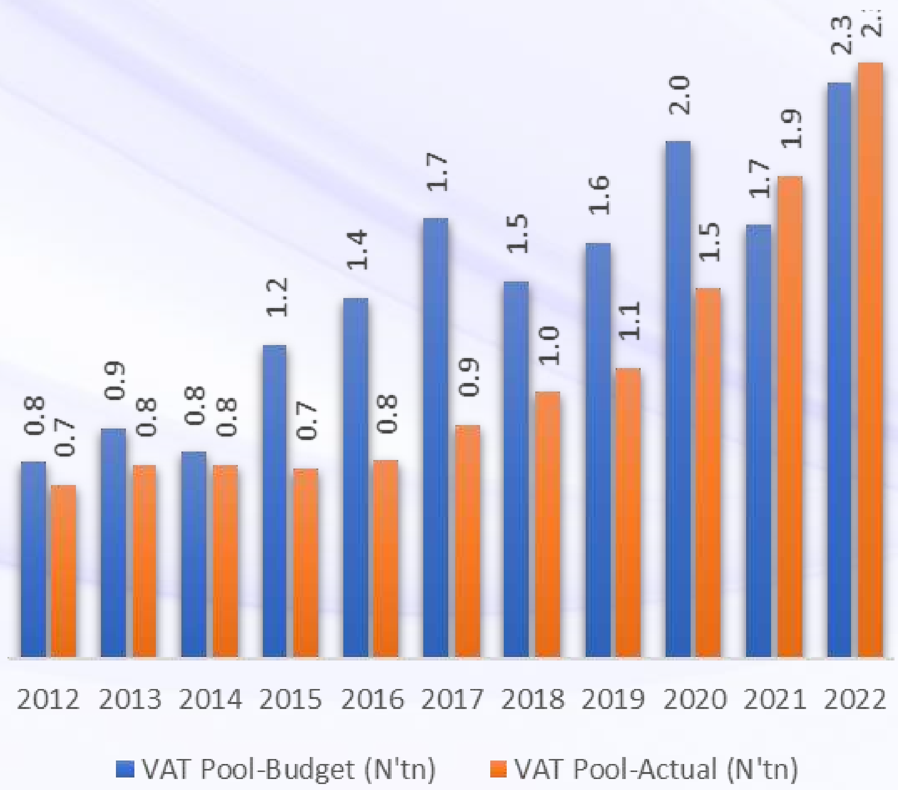
Solid Minerals to Federation Account



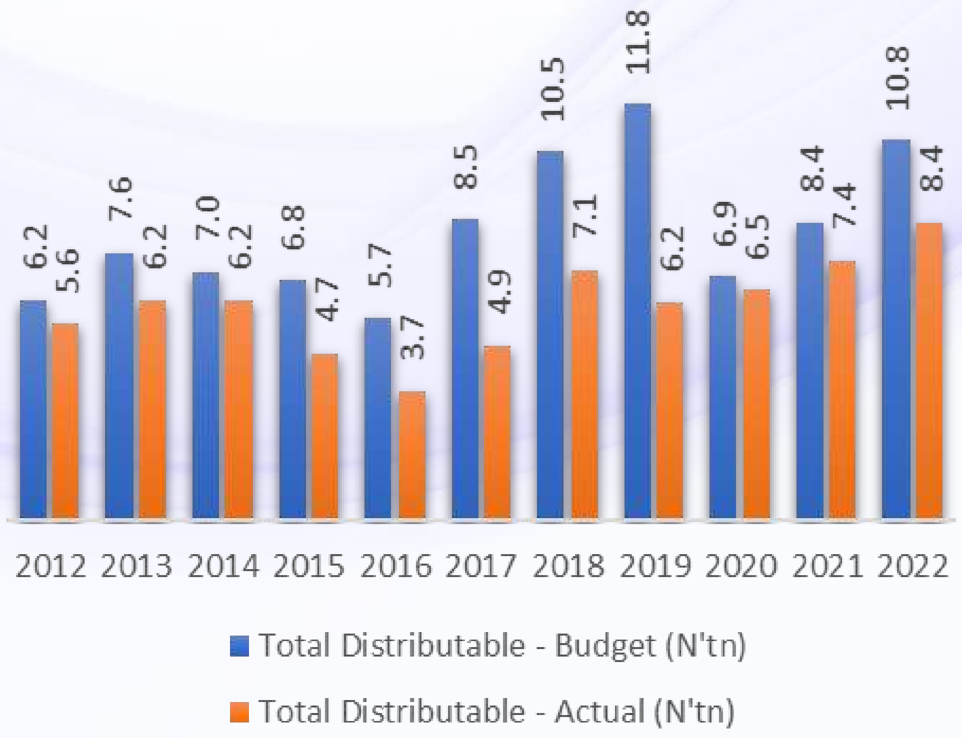
Non-Oil to Federation Account



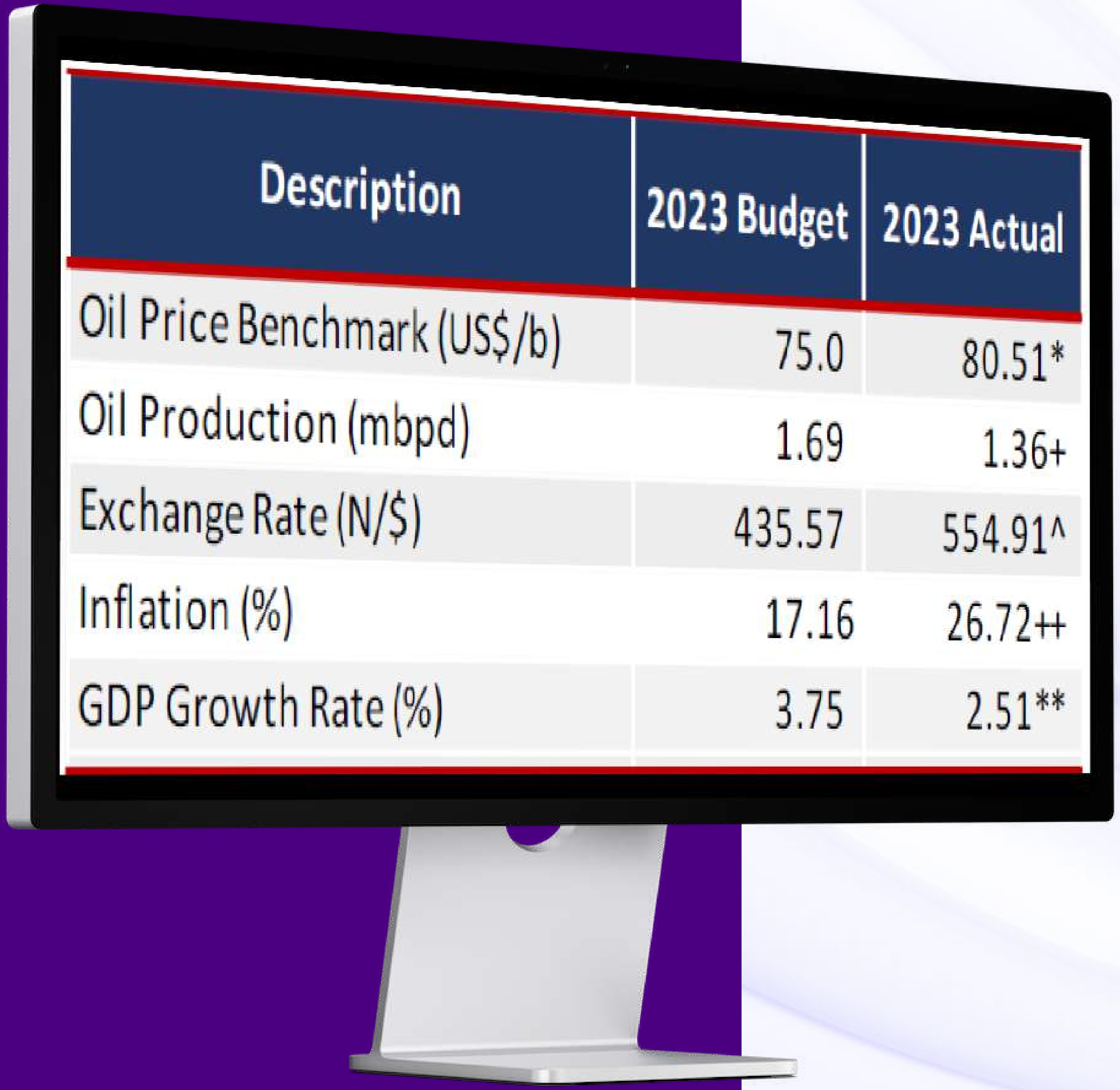
VAT Pool Account



Total Distributable



Performance of Federation Account, 2022 - **Assumptions**



Description	2023 Budget	2023 Actual
Oil Price Benchmark (US$/b)	75.0	80.51*
Oil Production (mbpd)	1.69	1.36+
Exchange Rate (N/$)	435.57	554.91^
Inflation (%)	17.16	26.72++
GDP Growth Rate (%)	3.75	2.51**

01

The oil price benchmark for 2023 was 75USS/b. However, an increase of 7.35% in oil prices was recorded by 2023 YTD.

02

Also, oil production was at 1.36mbpd in 2023 YTD, as against the budgeted estimate of 1.69mbpd (-19.53%)

03

The average official exchange rate for 2023 was 554.91N/S, which is higher than the estimated target by 27.4%.

04

Inflation rate was projected to be 17.16% in 2023. However, it increased by 9.56 percentage points in 2023 YTD, at 26.72%

GDP growth rate fell by 1.24 percentage points of its budgeted estimates

Performance of Federation Account, 2022

Fiscal Items	2022 BUDGET Annual (₦b)	2022 ACTUAL Annual (₦b)	2021 ACTUAL Annual (₦b)	VARIANCE Actual vs Budget (Annual in %)	VARIANCE 2022 vs 2021 (Annual in %)
Gross Oil Revenue	9,369.96	6,222.47	4,702.80	-33.59	32.31
Oil Revenue to Federation Account	4,583.93	1,724.30	2,465,34	-62.01	-30.06
Gross solid minerals	6.94	11.29	7.85	62.62	43.88
Solid Minerals to Federation	6.04	9.82	6.83	62.62	43.88
Gross Non-oil	6,659.34	7,145.57	5,246.36	7.30	36.20
Corporate Tax	1,987.78	2,821.50	1,721.41	41.94	63.91
Value- Added Tax	2,441.80	2,511.52	2,072.85	2.86	21.16
Electronic Money Transfer Levy (EMTL)	210.82	125.59	111.84	-40.43	12.30
Customs (Main Federation Account)	1,858.57	1,554.69	1,246.32	-16.35	24.74
Special Levies (Federation Account)	160.37	132.27	93.94	-17.52	40.80
Non-oil to Federation	3,972.71	4,360.10	2,989.93	9.75	45.83
Total Federation Account	8,517.67	6,094.23	5,462.10	-1.25	11.57
Total VAT Pool	2,262.08	2,338.73	1,894.92	3.39	23.42
Total Distributable	10,779.75	8,432.96	7,357.02	-21.77	14.62

Gross Oil Revenue had a 33.59% shortfall in 2022 compared to the budget estimate. It was, however, 32.31% higher than the 2021 value.

Gross Solid Minerals stood at ₦6.94 billion, portraying an increase of 62.62% above its projection and a 43.88% increase higher than 2021 figures.

Gross non-oil revenue was 7.3% above the budget estimate but was 36.20% higher than the 2021 recorded figure.

Total Federation Account had a 1.25% shortfall compared to the budget estimate. It, however, recorded an 11.57% increase from the 2021 figure.

The total VAT pool was 3.39% above the budget estimate and 23.42% higher than the 2021 recorded figure.

Total Distributable had a 21.77% shortfall compared to the budget estimate. It was, however, 14.62% higher than the 2021 recorded figure

FACC Distribution – **September 2023**

01 A communique issued by the FAAC indicated a total sum of N903.480 billion Federation Account Revenue was shared.

02 N320.54 billion, N287.07 billion and N210.9 billion were shared to the Federal, state and local governments, respectively.

S/N	Beneficiaries	2023 Total (N'b)	2022 Total (N'b)	% change
1.	FGN	320.54	294.24	8.94
2.	State	287.07	233.22	23.09
3.	LGCs	210.90	172.78	22.06
4.	13% of mineral revenue	84.97	59.99	4164
	Total	**903.48**	**760.23**	**18.84**

S/N	Description	2023 Total (N'b)	2022 Total (N'b)	% change
1.	Statutory	423.01	562.14	-24.75
2.	Exchange Difference Revenue	186.81	-	-
3.	Electronic Money Transfer (EMTL)	10.99	8.17	34.52
4.	VAT	282.67	189.93	48.83
	Total	**903.48**	**760.23**	**18.84**

03 A total sum of N84.97 billion (13% of mineral revenue) was shared to the relevant States as derivation revenue.

04 The total distributable revenue comprised of

- *Statutory revenue of N423.01 billion*
- *Value Added Tax (VAT) revenue of N 282.67 billion*
- *Electronic Money Transfer Levy (EMTL) revenue of N10.99 billion*
- *Exchange Difference revenue of N186.813 billion.*

Key Projections of Nigeria's Federation Account

- The oil price benchmark is projected to be 73.96USS/b in 2024 before declining to 73.76USS/b and 69.90USS/b in 2025 and 2026, respectively.
- Oil production is forecasted to continually increase from 1.78mbpd in 2024 to 1.80mbpd and 1.81mbpd in 2025 and 2026.
- Exchange is expected to be stable in 2024 but will decline in 2025, with a slight increase in 2026.
- Inflation is projected to average 21.4% in 2024 before declining to 20.3% and 18.6% in 2025 and 2026, respectively.
- Oil and Non-oil GDP are forecasted to continually increase from 2024-2026.
- The GDP growth rate is expected to increase from 3.76% in 2024 to 4.22% and 4.78% in 2025 and 2026, respectively.

Description	2023	2023 Revised Forecast (as at July 2023)	2024	2025	2026
Oil Price Benchmark (US$/b)	75.0	75.0	73.96	73.76	69.90
Oil Production (mbpd)	1.69	1.72	1.78	1.80	1.81
Exchange Rate (N/$)	435.57	700.00	700.00	665.61	669.79
Inflation (%)	17.16	17.16	21.40	20.30	18.60
Non-Oil GDP (N'bn)	214,049.5	214,049.5	223,989.2	249,188.0	278,251.7
Oil GDP (N'bn)	11,457.8	11,457.8	12,316.0	13,225.7	14,272.0
Nominal GDP (N'bn)	225,507	225,507	236,305.2	262,413.7	292,523.7
GDP Growth Rate (%)	3.75	3.75	3.76	4.22	4.78
Imports	24,385.6	24,385.6	32,453.5	33,401.3	34,515.4

Key Projections of the Federation Account: 2024 - 2026

Fiscal Items	2023 BUDGET	2024 Proposal	2025	**2026**
	N'trillion	N'trillion	N'trillion	N'trillion
Net Oil Revenue	4.60	13.82	14.09	14.60
Net Solid Minerals	0.75	0.94	0.12	0.12
Non-oil Revenue				
Corporate Tax	1.92	3.04	3.39	3.79
Net Customs (Main Federation Account)	1.96	2.65	2.80	2.95
Net Special Levies (Federation Account)	0.34	0.51	0.53	0.54
Net Federation Account	8.99	20.70	21.47	21.95
Net VAT Pool	2.74	3.67	4.26	4.91
Net Electronic Money Transfer Levy (EMTL)	0.14	0.17	0.19	0.21
Total Federation Account	11.86	24.54	25.93	27.07

Net Oil Revenue is expected to increase from N4.6 trillion projected in 2023 to N13.82 trillion in 2024.

Net solid minerals is forecasted to increase from N0.94 trillion in 2024 to N0.12 trillion in 2025 and 2026.

Total Federation Account revenue is projected to increase to N24.54 trillion in 2024, up from N11.86 trillion projected for 2023

Out of this:
The main Pool is projected to be N20.70 trillion
VAT Pool and EMTL are projected at N3.66 trillion and N174.26 billion, respectively.

The exchange rate effects, higher oil production projection, and the removal of fuel subsidy are mainly responsible for the increase in projected revenue inflows.

Optimizing Inflows

Oil

01

Nigerian production cost is considered relatively high compared to other oil producers.

- *At about $21 – $30pb, Nigeria has one of the highest unit production costs globally. This is a far cry from an average cost of $8.38pb in Saudi Arabia, $9.08 in Iran and $10.57 in Iraq*

02

The high cost of production starts from the method of production to transportation.

03

However, these costs can be minimized if correct measures are introduced,

- *proper control of oil well effluent from the underground reservoir to the surface, adequate processing, and storage for export*

04

Moreover, Nigeria's oil production has also been affected by crude oil theft incidents and insecurity challenges, across the oil-producing states.

05

As such, the government needs to review our laws and take strict measures against oil thieves. This will result in

- *Increased production*

06

Also, the country can maximize the rise in global oil prices (due to the Israeli-Hamas conflict), which would result in more revenue from sales of crude.

Optimizing Inflows

Investments

01

There has been declining investment in the petroleum industry. However, the passage of the Petroleum Industry Act (PIA) 2021 by the Nigerian government is commendable. *If properly implemented, the Act has the prospect to drive investment growth in the oil sector.*

02

Natural gas has been projected to be the fastest-growing fossil fuel in the next two decades.

03

It is projected to take over from coal by 2030 as the second largest source of energy after oil.

04

However, the potential of the nation's gas reserve has not been fully utilized.

05

Therefore, investments in gas infrastructures should be of priority to the government.

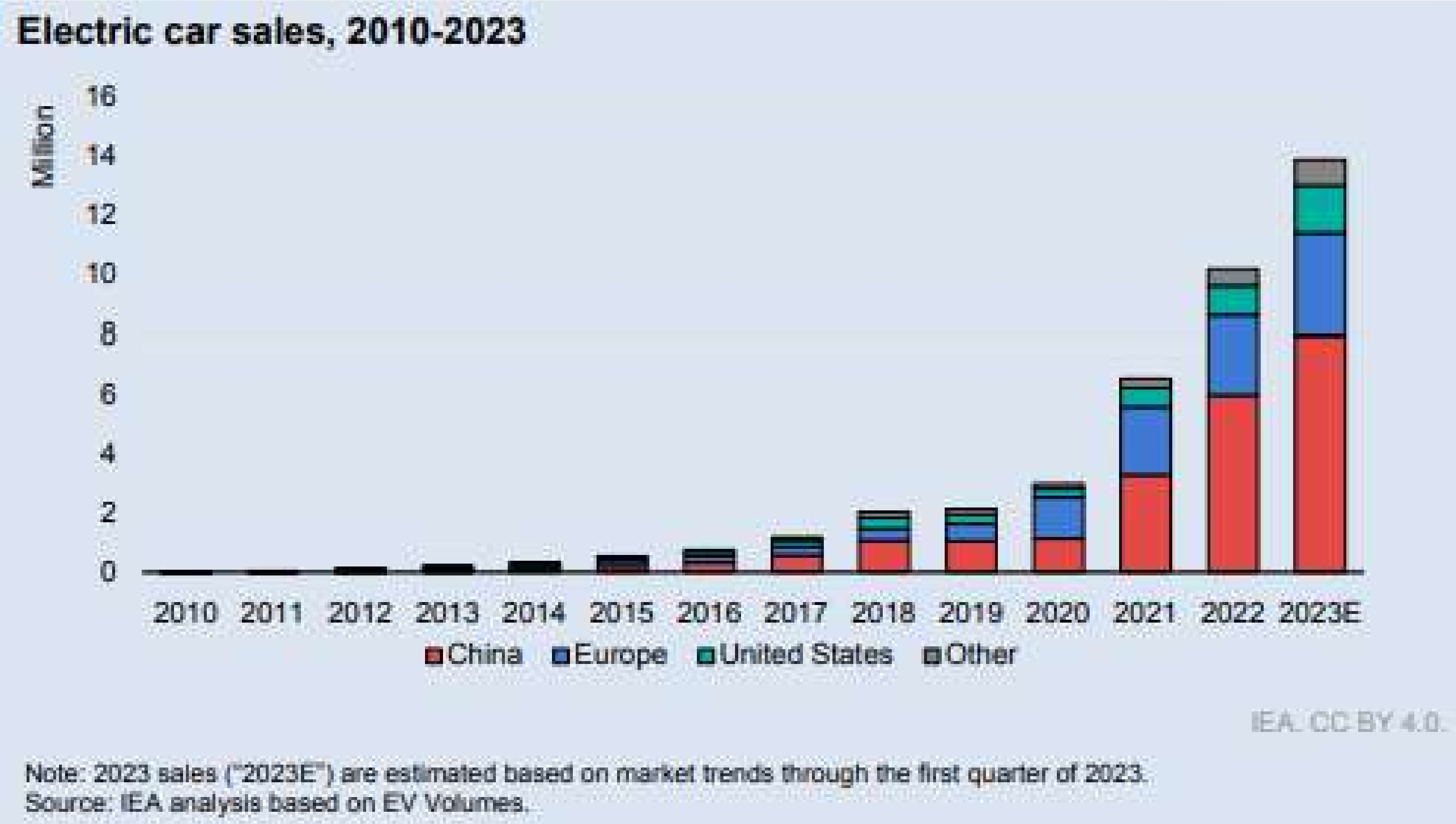
06

Expanding investment in critical infrastructures can be achieved through public-private partnerships. *This will maximize derivable revenue to the Federation Account*

07

Excess funds and Surplus from the refund of certain costs of collection can also be reinvested into other assets to generate more revenue.

Optimizing Inflows



Solid Minerals

- One key sector which offers great potential in improving other sources of revenue is the solid minerals sector.
  - *A developed solid minerals sector can generate as much revenue as crude oil if adequate attention is paid to its development.*
- Nigeria has gold, manganese, bitumen, lithium, iron, amongst others
  - *Recently, there has been an increasing demand for lithium, from high-end smartphones to electric car batteries*
- Nigeria can leverage its large metal deposit, which provides an opportunity to generate more revenue.
- Also, significant efforts in terms of infrastructure development and investment attraction are required to optimize the sector.
- Many quarrying and mining activities are carried out without remittance of due revenue.
- Thus, there is a need for policy and institutional reforms.

Optimizing Inflows

Value Added Tax (VAT)

Indirect Taxes

Nigeria's indirect taxes (such as VAT) rate is currently one of the lowest (7.5%) in the world compared to other comparable economies.

- *Yet, tax compliance and tax morale are still very low*

Countries Reform

The country can learn from the reforms of other countries.

- *Mauritania's reform of broadening its VAT base by extending coverage to the mining sector.*
- *Rwanda enforced VAT compliance by introducing electronic transaction devices (ETD) and increased the collection of tax arrears.*
- *The VAT system was reformed by submitting a new tax code to reduce many VAT exemptions in Uganda.*

VAT Review

Therefore, there is a need for a comprehensive review for Nigeria's current VAT exemptions to be streamlined to a better-targeted way.

Advocacy

IMF

There has also been advocacy by the IMF to increase the VAT rate to 15% by 2027 to allow for a comparable rate to Nigeria's peers.

- *However, the current situation of the country should be taken into consideration, in considering this.*

Optimizing Inflows

Companies Income Tax (CIT)

Currently, the tax is charged at the rate of 30% for companies with more than ₦100 million in turnover and 20% for companies with a turnover between ₦25-100 million.

Also, compliance can be improved through administration reforms. The FIRS should focus on enforcement measures on non-compliant taxpayers and basic compliance activities such as filing, payment, etc.

According to NBS, revenue obtained from company income tax more than tripled in the second quarter of 2023.

- *The manufacturing sector, financial and insurance sector and information and communication were the three largest contributors to CIT.*

A Presidential Committee on Fiscal Policy and Tax Reforms was inaugurated by the current government, which is responsible for various tax law reforms, fiscal policy design and coordination, harmonization of taxes, and revenue administration.

To further increase its tax revenues, the government should review and reduce tax waivers given to companies operating in Nigeria.

This is commendable, and an effective implementation of the committee is expected to improve Nigeria's revenue profile.

Optimizing Inflows

Customs & Excise Taxes

With the global economic downturn affecting revenue, the government has ramped its tax effort.

- *Yet, tax compliance and tax morale are still very low*

Therefore, efforts should be made to rationalize tax incentives and exemptions to broaden the tax base and implement initiatives to combat tax evasion and illicit financial flows.

- *Also, further increases in existing pro-health taxes, like excise on sugar-sweetened beverages, tobacco, and alcohol, may be considered*

Overall, raising excise rates and broadening the tax base could be effective measures to raise revenue quickly without fundamental changes to the tax system since they are more inelastic than other taxation sources.

African Continental Free Trade Agreement (AfCFTA), which promotes trade liberalization, presents an opportunity to open the Nigerian market to Africa at large. More revenue is obtained through increased competitiveness as a result of continental market access

Also, the government may consider opening the border to some items which are not adequately produced domestically and are often smuggled.

Optimizing Outflows

Deductions

Deductions such as fiscal deductions, cost of collections, and, just recently, transfers to the North East Development Commission and the Nigeria Police Trust Fund, are made before the Net revenue for FAAC distribution is determined.

- *If these deductions are high, it can reduce what enters the federation account.*

As such, government needs to review the rate of these deductions such as the 4% and 7% cost of collection on excise and special duties.

The government can ensure that more agencies are not added to receive revenue from the federation account.

Also the issues of some revenue-generating agencies paying their surplus to FGN instead of Federation Account needs to be resolved.

Also, the surplus obtained from the deductions from various entities should be duly monitored so as to optimally utilize the revenue.

Summary

One 01

FAAC distribution has always been central in financing government operations both at the national and sub-national level

Two 02

Nigeria's current revenue is well below its capacity and targets, implying that there is potential to further increase revenue.

03 Three

Factors responsible for low revenue include

- *lower crude oil production*
- *High production costs*
- *Oil theft and insecurity*
- *Inadequate investment in the Oil and Gas Sector*
- *Weak actual tax collections compared to potential*
- *Low tax rates and inefficiencies in tax administration*
- *Low income and growth levels*

04 Four

However, the total Federation Account revenue is projected to increase to ₦24.54 trillion in 2024.

- *Appears ambitious but desirable*

Recommendations

- It is important that the nation, using its relevant agencies, significantly improves crude oil production by:
  - *Stimulating increased investments in the sector*
  - *Curbing oil thefts/losses associated with vandalization of oil pipelines as well as the integrity of the pipelines.*
- Government should also rationalize tax incentives and exemptions to broaden the tax base
- Implementation of initiatives to combat tax evasion and illicit financial flows.
- Also, there is a need for a review of the rate of deductions from the Federation Accounts
- RMFAC needs to be empowered to enforce laws guiding inflows and outflows from the FAAC
- The surplus obtained from the deductions from various entities should be duly monitored so as to optimally utilize the revenue.
- Overall, the government should implement measures for revenue diversification and improved tax administration in order to enhance fiscal sustainability, and reduce dependency on volatile revenue sources.
- This will ultimately maximize inflows, and minimize outflows, thus enhancing the optimization of the federation account.

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