



# THE EFFECT OF INCREASED VAT **ON CONSUMPTION OF FOOD ITEMS IN NIGERIA**





# MACROECONOMIC OVERVIEW

The Nigerian economy has experienced marginal year on year growth since its exit from recession in the second quarter of 2017. Its Gross Domestic Product (GDP) in 2018 totaled \$397 billion making Nigeria the largest economy in Africa ahead of South Africa and Egypt (PWC 2018). Data from the National Bureau of Statistics (2019) shows that this growth was mainly driven by the non-oil sector, which accounts for approximately 90% of overall GDP.

In the third quarter of 2019, the sector grew by 1.85% in real terms contributing a total of 90.23% to GDP. Growth in the non-oil sector in 2019, was mainly driven by the Information and communications sub-sector which grew by 11.19% year on year in the third quarter of 2019.

Albeit not the strongest contributor to GDP, the oil sector still plays a significant role in the Nigerian economy. In the third quarter of 2019, Nigeria recorded average daily oil its highest in more than three years. This output was 0.1mbpd higher than the daily average production of 1.94mbpd recorded in the corresponding quarter of 2018, and 0.02mbpd up from the revised oil production levels in the second quarter 2019.

Nigeria held its sixth national elections in the first and second quarters of 2019. Following the elections, the incumbent president Mohammed Buhari who emerged victorious was sworn in for his second term. He immediately made known his priorities which include;

- 01 Fighting Corruption
- 02 Increasing Security
- 03 Tackling Unemployment
- 04 Diversifying the Economy
- 05 Enhancing Climate Resilience
- 06 Boosting the living standards of Nigerians

In the bid to reinforce past successes of the Buhari led administration and secure quick wins in his second and final term, the Federal Government has developed and introduced a number of policy reforms aimed at strengthening the local economy and boosting internally generated revenue. Part of the reforms introduced to ensure effective utilization of allocated resources and expand the fiscal space at national and subnational levels is the passage of the finance bill alongside the 2020 budget.



# THE FINANCE BILL

On the 13th of January 2019, President Muhammadu Buhari Signed the Finance Bill into Law enforceable from the 1st of February 2019. The finance bill consists of number of revisions to existing tax laws currently being implemented in Nigeria. These revisions are primarily aimed at boosting revenue generation and protecting Micro, Small and Medium-sized businesses within the local economy. The overall expectation is that these amendments boost the budget performance and align the revenue generation legislation to global best practice. Below the strategic objectives of the finance bill:



Among the revisions listed in the finance bill, is the increase in Value Added Tax (VAT) from 5% to 7.5%. Alongside other strict compliance protocols being introduced and implemented, the expectation is that the increase will result in expansion of the fiscal space attributable to value added tax. This will undoubtedly result in increased financial burden on taxpayers. This increased financial burden will have several effects on consumption especially for goods whose prices have risen or fallen as result of the changes to VAT.

In order to lessen the possible effects of the increase in VAT on low income earners within the population, the Federal Government has expanded the list of VAT exempt commodities. The expectation is that by expanding the list, certain “basic commodities” will remain affordable making them readily accessible by low income earners within the population. The list of VAT exempt goods consists of an expanded list of basic food items. These food items include:

- |  |  |
|--|--|
| <input checked="" type="checkbox"/> Bread, Cereal<br>(Raw Or Semi-Processed)   | <input checked="" type="checkbox"/> Cooking<br>Oil   |
| <input checked="" type="checkbox"/> Culinary Herbs<br>(If Raw And Unprocessed) | <input checked="" type="checkbox"/> Fruits<br>(Including Dried)                                      |
| <input checked="" type="checkbox"/> Fish<br>(Other Than Ornamental)            | <input checked="" type="checkbox"/> Nuts And Pulses<br>(Including Roasted,<br>Fried, Boiled, Salted) |
| <input checked="" type="checkbox"/> Flour And Starch<br>(Refined Or Unrefined) | <input checked="" type="checkbox"/> Roots<br>(Also In The Form Of Flakes)                            |
| <input checked="" type="checkbox"/> Salt<br>(Excluding Industrial)             | <input checked="" type="checkbox"/> Water<br>(Excluding Sparkling<br>Or Flavored).                   |
| <input checked="" type="checkbox"/> Vegetables<br>(Dried Or Ground)            | <input checked="" type="checkbox"/> Flour And Starch<br>(Refined Or Unrefined)                       |

In addition to the food items listed above, the finance Bill also states that sanitary items are to be included in the exemption list. It further clarifies that all services provided by Microfinance Banks and school fees paid towards nursery, primary and secondary education are VAT exempt.



# EFFECT OF INCREASED TAXATION ON FOOD CONSUMPTION

Economists agree that increases to Value Added Tax attached to certain goods often result in an increase in the prices of these goods as manufacturers and suppliers seek to transfer the financial burden resulting from the increase, to the end consumer. Depending on the importance attached to consumption of such goods, the increase in price often affects consumption decisions relating to these goods. Provided income levels remain unchanged, consumers have been seen to exhibit one of the following behaviors following an increase in price;



In both instances, the decisions lead to a fall in demand for commodities whose prices have increased following an increase in VAT. However, it is important to note that the degree to which either of these decisions are taken depend largely on the relative importance attached to the commodities and the purchasing power of the consumer. When considering consumption of basic food items such as grains and vegetables, one can expect either of the decisions/scenarios provided above. However, this is largely dependent on the purchasing power of the consumer, the importance attached to consuming particular food items and the knowledge of the nutritional value of the commodities under consideration.

Literature on taxation of junk food suggests that there is a direct relationship between taxation and food consumption levels. However, it assumes that consumers acted rationally when provided with information on the health benefits and consequences of continuous consumption of unhealthy food. The studies show an unimpressive change in behavior, in comparison to the restraint taxation of junk food placed on the economic activity.

This means that theoretically, while taxation may have a direct effect on the quantity of junk food consumed, in reality taxation alone may not be a cost-effective approach to controlling its consumption. Furthermore, it can be deduced that significant increases or decreases in consumption of unhealthy food items may not entirely be attributable to taxation. What this means is that although the expectation is that an increased value added tax may lead to decline in demand for particular food items, a significant decline in demand may be due to a combination of factors. Some of such factors include:

- Inflation
- Countervailing measures introduced by government e.g.
- antidumping measures and border closures
- Change in consumer preference/taste as result of new information

Alternatively, a decline in demand for food items can also result from an increase in the prices of their complements i.e. commodities that are consumed alongside basic food items or those that are required for 'completeness' of the items. For example, a significant increase in the price of spreads such as butter, jam and mayonnaise may lead to a decline in the demand for bread. In the same way, a significant increase in spices required to cook proteins in order to improve their taste or palatability may result in a decrease in demand for such proteins e.g. seasoning cubes and beef. However, this again is dependent on the purchasing power of the consumers concerned and their willingness to make the trade-off between price and nutritional value/palatability of the items under consideration.

It is noteworthy to mention that the list of VAT exempt foods comprises of Basic Food items requiring complements before they can be consumed. These complements are however not VAT exempt meaning that although the price of basic food items have remained unchanged, the overall price of meals that are prepared from such items may have increased. For example, although milk is VAT exempt, breakfast cereals such as Golden morn and Nutribum are not; meaning that the overall price of the meal has risen.

A stack of Nigerian Naira coins is shown on a calculator keypad. The coins are stacked on top of each other, and the calculator's display shows numbers like 2.81, 2.8, .31, 6.30, 8 000 000, and 7 000 000. The calculator buttons for multiplication, division, and addition are visible.

## WHAT DOES THIS MEAN FOR NIGERIA?

The Nigerian economy is highly stratified with widespread income inequality amongst its population. However, in between both income extremes lie a rapidly growing middle class particularly in its major cities and urban settlements. With different income levels also comes varying levels of literacy and exposure. To understand the effect an increase in VAT may have on consumption of food items and by extension the nutrition and overall health of the population, the different socioeconomic strata that exists within the population need to be considered individually.

The first socioeconomic strata to be considered will be the "Poor and uneducated". The 'Poor' in this instance refers to the percentage of the population with very low disposable income and minimal purchasing power. The major priority for those within this category is survival so resources are channeled mainly to food, shelter and clothing. Education is often sacrificed for food and shelter resulting in illiteracy and poor knowledge of basic sciences such as the nutritional content of food items.

The direct implication of the former is that decisions relating to consumption of food items are often made on the basis of purchasing power and price with little or no attention being paid to nutritional content of such food items. Therefore, the expectation for this category of people is; where an increase in VAT significantly

affects the price of a particular food item or the overall price of a meal that is prepared from it, demand for the food item will fall as consumers (within this category) will look for cheaper alternatives regardless of the nutritional benefits being forgone. However, where an increase in VAT has no significant effect on the overall price of the meals prepared from the VAT exempt food items, demand for such commodities within this socioeconomic stratum will remain unchanged.

The second category within the population are the wealthy or affluent. Wealthy/affluent refers to those who have high disposable income and very strong purchasing power. People within this category are often very educated and exposed. They would normally have an understanding of basic sciences including the nutritional benefits of food items being consumed.

This understanding shapes their consumption decisions and more often than not the tradeoff between nutritional benefit and price is in favor of nutritional benefit. Therefore, the expectation for this category is; where an increase in VAT significantly affects the price of a particular food item or the overall price of a meal that is prepared from it, demand for the food item will remain unchanged as consumers (within this category) will prioritize its nutritional benefits over cost savings achieved from forgoing them.





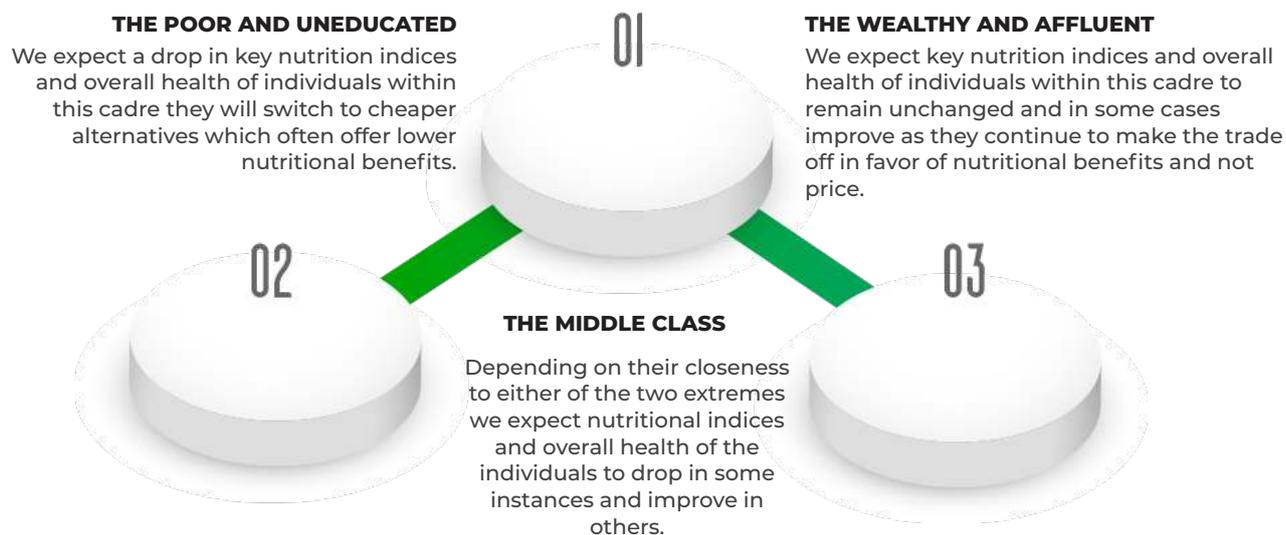
In between the two extremes, is the middle class or the “average income earners”. This socioeconomic stratum is a heterogeneous group with low to medium purchasing power and varying literacy levels. The expectation for this group is dependent on their closeness to either of the extremes discussed above.

For those closer to the low-income bracket, a significant increase in price of a meal resulting from increased VAT on certain components of the meal may cause them to make the trade off in favor of price over nutritional benefits. However, a marginal increase in price may not have this effect as people within this category have slightly stronger purchasing power than low income earners making them able to overlook slight increases in price.

On the other hand, for those closer to the upper extreme (the wealthy or affluent). The expectation is that they exhibit similar behaviors as the wealthy. However, for significant increases in price that result from increase on certain food items, we may see a deviation from this behavior causing them to make the trade-off in favor of price over nutritional benefits. This is mainly due to the fact their purchasing power is lower than those in the uppermost stratum making them unable to overlook increases in price beyond a particular threshold.

# IMPLICATIONS

The trade-offs made across the different socio-economic strata will have a number of implications on the health, nutrition and overall wellbeing of the individuals within each stratum. Some of such implications include;



All of the above will however be discussed in greater detail in the subsequent issue. Stay tuned!



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 acioeassociates

## ADDRESS

Suite 305, 3rd Floor  
Yobe Investment House  
Plot 1332 Ralph Shodeinde Street  
Central Business District, Abuja  
Nigeria

## CONTACT

**Phone:** +234 705 457 4057  
**Phone:** +234 806 1211 501  
**Email:** [contactus@acioe.com](mailto:contactus@acioe.com)  
**Website :** [www.acioe.com](http://www.acioe.com)

