KPMG

Flashnotes

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Impact Assessment of the 2023 Fiscal Policy Measures

Highlights

- **The Nigerian Government has implemented new taxes on beer, imported vehicles, and single-use plastics. The excise duty on beer and stout will start at N75 per liter in 2023 and will be raised to N100 per liter in 2024. The Green Tax on Single Use Plastics (SUPs) including plastic containers and bags will be charged at a rate of ten percent. Additionally, a five percent excise duty will be imposed on mobile telephone services, fixed telephone, and internet services. Imported wine will also have the same excise rate as beer. Vehicles with two-liter engines will be subject to a two percent Import Adjustment Tax (IAT), while those with four-liter engines or more will have a four percent IAT.**

- **The 2023 FPM may have more profound impacts on the beverages and tobacco and plastics sectors as well as on car importation but may have limited effects on the earnings of telecommunication service providers as they will find it relatively easier to pass on these costs to consumers. This may however have negative effects on other sectors as consumers may retain telecoms expenditure and prioritize consumption away from alcoholic beverages, tobacco, wines and spirits and plastics sectors, that are price elastic, have close substitutes and a well-established 'black-market' trade that can ensure continuous supply and evade taxes.**

- **The timing of the 2023 FPM may not be effective given the recovery status of the economy and current hyperinflation. Further price rises may squeeze consumers demand and worsen already declining business margins such that the expected revenue expected by government from the new duty may be unrealized.**

Event

The Federal government has introduced new Fiscal Policy Measures (FPM) for 2023 in a circular dated April 20, 2023. An analysis of the fiscal policy document signed by Zainab Ahmed, Minister of Finance, Budget & National Planning, shows the government has introduced additional excise taxes increases ranging from 20% to 100% on previously approved rates for alcoholic beverages, tobacco, wines and spirits, effective from 1 June 2023. Additionally, a Green Tax made up of excise duty on Single Use Plastics (SUPs), including plastic containers, films and bags was introduced at the rate of 10%. Furthermore, the 2023 FPM circular also confirmed the excise duty on telecommunication services earlier introduced via the Finance Act 2020 and prescribed in the Official Gazette No. 88, Vol. 109 of 11 May 2022 but which was suspended last year. This tax is applicable on mobile telephone services (GSM), fixed telephone and internet services, both postpaid and prepaid at the rate of 5%. Already the government has for the last few years increased rate of VAT to 7.5% and plans to further increase it to 10% in addition to other measures aimed at increasing and widening its tax and revenue collection, many of which has been focused on extracting more income from consumers and businesses.

Analysis/Opinion

While various reasons have been canvassed by the government for these changes including a need to fulfil its commitment to climate change adaptation and the mitigation of environmental degradation, as well as to discourage excessive consumption of sugar, tobacco and alcohol which contributes to several health conditions, it is evident that the more important priority is to generate revenue to plug the big and widening hole in its deficit financing. With FGN revenue to nominal GDP at about 3%, and a worsening budget deficit from about N1.1 trillion in 2013 to N6.3 trillion in 2022, Nigeria's debt has risen from N10 trillion in 2013 to over N46 trillion by the end of 2022. This does not include another N23trillion in Ways and Means advances from the Central Bank of Nigeria (CBN), which the National Assembly recently approved for it to be securitized. These means national debt will rise above N70trillion with a debt service ratio that might range between 100-150% of revenue. If nothing is done to increase revenues quickly, Nigeria will have to borrow not only to service its debt, but also, in order to run government operations.

Alternative measures to grow Revenue to the 2023 FPM

While we agree with the principle around these reforms especially relating to increasing government revenue especially relative to comparative countries, and the urgent need for government to increase its revenue to curtail its high debt and debt service payments and to fund much needed developmental expenditure, our concern lies with the timing of implementation at a time when consumers and businesses are dealing with substantial economic challenges. Thus, while excise duty can be an important source of added revenue for the government, careful consideration must be given to its impact on producers, consumers, and the broader economy before its implementation and in this regard, timing based on an assessment of the overall prevailing economic conditions is critical for its maximal impact. Ideally tax increases are better introduced at a time of economic boom. But Nigeria consumers and businesses has been grappling with the challenges posed by two economic recessions in 8 years which has resulted in slow and fragile consumer demand and growth, high double-digit inflation, unavailable and unstable FX among others.

Furthermore, it is worth considering the effect of higher costs from the new taxes on our ability to compete with export with other countries, considering the implementation of the African Free Trade Agreement on one hand and our whole export promotion strategies on the other hand. Already Nigerian manufacturing businesses are unable to compete favorably with other African countries and many other countries in the world, given our relatively higher costs of operations. However, the urgent need to guaranty long term FX availability and shore up foreign reserves and stabilize the FX exchange rate is substantially tied to our ability to produce more competitively and export more as well as attract FDI. However, both may be hindered by added taxes.

Accordingly, rather than place added burden on struggling consumer demand, business margins and profitability, and greater competition hurdles with other African countries in particular our recommendation would be to increase oil revenue and non-oil revenue via other measures that don't create added challenges for consumers and businesses and to adopt more efficient government expenditure.

For example, government could consider improving oil revenue by renegotiating or reconsidering our relationship with OPEC like Indonesia, Qatar did to avoid being capped to a limit when and if the output exceeds the Quota given our need for urgent revenues for development and at a time, we are facing mounting debt challenges. Furthermore, unlike all other OPEC countries, Nigeria has not benefitted from recent high oil prices due to persistent oil theft and pipeline vandalism. This will however, only become effective if it can have NNPC develop Joint Ventures midstream with companies building commercial size and modular refineries to process crude oil into derivatives as a means of increasing the revenues generated from selling extracts like PMS, LPFO, DPK, Jet A-1, AGO, PETCOKE, BITUMEN BINDERS, MARINE FUEL (that would obviously multiply the revenues generated from selling crude oil as a raw commodity).The Government needs to consider an independent Joint Venture model for its production sharing contract and encourage NNPC to raise cash-calls independently. This is important to raise Nigeria's revenue to GDP ratio to the emerging markets average of 18%, as a tool to reduce deficit financing that comes from unsustainable debt cycles without sacrificing our urgent need for huge development expenditure.

To protect its oil output, the NNPC needs to install high pressure sensors on all feeder lines that takes crude through flow stations from well-heads to terminals to be able to track and detect spikes, pulsations, surges that might occur from vandalization, pressure tapping at OCC terminals, and mobilize the office of the National Security Adviser, Nigerian Army, Marine Police, Nigerian Navy to arrest culprits and their back-end sponsors and accomplices. To counter possible deep-seated collusion, government might need to replace all security personnel responsible for detecting and acting on these detections with fresh

hands and consider replacing them every 3 months to avoid the possibility of them getting compromised and repeating the same patterns. The NNPC needs to also install modern metering technology at all 33 export terminals to avoid siphoning of crude oil inventories and reduce the difference between inventory delivered by feeder lines through flow stations from well-head to terminals.
We believe improving non-oil tax contributions should be focused on expanding the tax net to cover the informal sector that contributes only 3% despite accounting for 30-40% of the economy rather than increasing the burden on those already in the net. Measures to encourage and target FDI with the right incentives is also preferred as well as reconsidering the items contained in the government's expenditure framework to be more efficient to curtail wasteful, less efficient, or non-critical spending such as implementing the Steve Oronsaye report and reconsider 'under recovery' payments. Government might also need to review the current tariff duty and waiver and exceptions system and consider sale of moribund assets and debt for equity arrangements for other key assets. It is also important that government ensures revenue generating MDAs to adhere to sections 22 of the Fiscal Responsibility Act that specifies that MDAs set up a general reserve fund and allocate only a fifth at the end of the financial year, then remit four-fifth to back to the consolidated revenue fund.

We believe these and many other similar initiatives will be better to deal with our current revenue and debt challenges given the already difficult macroeconomic environment.

Impact of Excise Duties on Consumers and Businesses

Excise duty is essentially a tax levied directly on certain goods and services produced/imported but consumed within a country. Businesses may also have to incur additional costs in complying with excise duty regulations, such as maintaining records and filing tax returns. This can be a burden, especially for smaller businesses that may not have the resources to handle these requirements. Thus, when excise duty is imposed on a particular product, the cost of producing that product or the consumer price of that product increases, depending on whether it is borne by the producer/importer or passed on to the consumers. For instance, if an excise duty on cigarettes is introduced/increased, the cost of producing that cigarettes automatically rise. The impact of excise duty on consumers also depends on the price elasticity of demand for the product. If the demand for the product is inelastic, the producer can easily pass the cost to the consumers and consumers may continue to purchase the product despite the increase in price. On the other hand, if the demand for the product is elastic, the consumers may reduce their consumption of the product due to the increase in price so businesses may be reluctant to pass that additional cost to consumers and this will affect their profit margins. The price elasticity of demand of a product, in turn, is dependent on the availability of close substitutes, type or nature of the product (necessity good, a comfort good, or a luxury good and this varies across consumers), income of consumers (elasticity of demand for a commodity is generally very low for higher income level groups, whereas the price elasticity of demand is very high for people belonging to low-income level groups), the current price and the magnitude of change in price (goods that fall in a higher price segment are more likely to have high elasticity, while goods that belong to the low-price segment are generally inelastic or relatively less elastic), and time and duration of the change (economic boom or slowdown).
High excise duty can also encourage smuggling and black market activities, where goods are sold illegally at lower prices. This can hurt businesses that are operating legally and paying their taxes, (which is where the government expects to generate the added revenue) as they may not be able to compete with the lower prices offered by illegal sellers.

Recent Performance of the Affected Sectors

The telecommunications sector unlike most other sectors has benefitted immensely from the macroeconomic challenges that has faced the country, especially since the covid 19 pandemic. While the country grew by about 1.35% since 2015 (0.63% minus telecommunications), the telecommunications services sector grew by 7.64%. On the other hand, the food, beverage, and tobacco sector grew by 0.86% within the same period. Particularly, since the covid 19 pandemic in 2019, telecommunications services grew by 11.33%, while the food, beverage and tobacco sectors grew by 3.32%, with the whole economy growing by 1.71% (0.30% minus telecoms). With respect to manufacture of plastics, plastic and rubber GDP grew by 3.10% since 2015 and by 0.20% since 2019.
In 2019/20, 5.53% of total household expenditure was spent on telecommunications services compared to about 2% in 2009/10. At the same time, the share of household expenditure on alcoholic beverages declined from 0.53% in 2009/10 to 0.37% in 2019/20. Furthermore, the share of telecommunication services to total GDP rose from 8.6% in 2015 to 13.5% by 2022, while the share of food and beverages rose from 4.3% in 2015 to 4.4% by 2022. Also, the share of plastics and rubber in GDP has remained at 0.3% in 2022 between 2015 and 2022.

The Manufacturing sector as a whole contributed 32.3% of the total local VAT in 2022, making it the sector with the biggest shares of VAT for the year, followed by the Information and Communication sector (18.2% of the total local VAT), according to relative VAT data provided by the NBS in her Q4 2022 report. Regarding CIT, the Manufacturing industry also accounted for the greatest share of all local CIT in 2022, at 27.9%.

While the average inflation on telecommunication services stood at 6.95% since 2015 and 9.55% since 2019, the inflation rate on alcoholic beverages and tobacco stood at 11.45% since 2015 and 12.53% since 2019.

Impact on Households, Businesses and Government Revenue

The price elasticity of demand is expectedly low for telecommunication services in Nigeria, given that they have become necessities to households and businesses, especially since the covid 19 pandemic. Such services are now classified by most consumers as largely non-discretionary expenditure, especially in the absence of close substitutes and limited competition. Accordingly, increases in telecommunication services cost from the 2023 FPM, will have limited effects on the earnings of telecommunication service providers as they will find it relatively easier to pass on these costs to consumers. This may however, have negative effects on other sectors if it leads, as we anticipate, to a decline in the demand for the goods and services of other sectors including sectors that operate in the alcoholic, beverages, tobacco, wines and spirits and plastics sectors, that have close substitutes and a well-established 'black-market' trade that can ensure continuous supply and evade taxes. A 2019 study by NBS for example, revealed that increases in the price of food was the biggest shock experienced by households in 2019 and reducing consumption was a major strategy adopted by households to cope with shocks after receiving assistance from family and friends. Given that these sectors have price inelastic demands for their products, the introduction of the excise duty might force them to either bear most, if not all the higher costs from the duty, thereby negatively impacting on their margins, or pass it on to their consumers and risk a drop in demand and earnings.

With inflation already over 21%, consumers have already been rationalizing expenditures and this is showing up in the earnings of various Nigerian consumer product companies. It is our view, therefore, that the timing for this increase may therefore not be effective. Further price rises may squeeze consumers demand and worsen already declining business margins such that the revenue expected by government from the new duty may be unrealized. So, government loses three times. Excise duty does not come in as expected, VAT on those commodities decline as demand slows down and the higher costs and lower demand faced by businesses squeezes companies profit and reduces companies' income tax collected by government. Declining profitability also creates risks of layoffs in that sector as business tend to focus first on staff cuts when faced with such cost and profitability challenges. At the same time, it might not necessarily discourage consumption or achieve its environmental goals substantially, since there are so many informal channels to supply the same and similar substitutes that cause the same health challenges and environmental challenges.

With the imposition of Import Adjustment Taxes (IAT) on vehicles with two-liter engines (at a rate of 2%) and those with four-liter engines or more (at a rate of 4%), Nigerians may be forced to purchase more locally manufactured vehicles, and this might increase government generated revenue and reduce demand for FX used in importing vehicles.

Some Countries Case Studies

Kenya

In 2017, Kenya made it illegal to use single-use plastic bags, and in June 2020. They extended the ban to include single-use plastics including bottle waters, and disposable plates in national parks, forests, and relaxation areas. As of 2021, the excise duty for beer, including non-alcoholic beverages with an alcoholic strength of 6% or less, has increased from 116.08 shillings per liter to 121.85 shillings per liter.

South Africa

To regulate the import of used vehicles into South Africa, the government put in place strict measures to control the issuance of legal import permits. These permits are only granted to a limited number of vehicles that meet certain criteria, such as racing cars, vintage and collector's passenger vehicles, vehicles adapted for persons with disabilities, vehicles inherited by South African citizens and nationals, and vehicles driven by immigrants and returning South African residents and nationals. This is to make sure that local auto mobile industries are not threatened by foreign vehicle manufacturers and that the country can obtain revenue from the industry. While these policies may have been enacted, it a may seem as though, these policies did not entirely succeed as there might be issues with public awareness and resources to sustain these policies.

Canada

To reduce plastic waste and mitigate climate change, Canada banned the production and importation of single-use plastics in December 2022. Beginning in December 2023, the sale of certain plastic objects was outlawed. The nation has outlawed the production and importation of dangerous single-use plastics such as straws, cutlery, checkout bags, and problematic, difficult-to-recycle plastics. The existing 2% excise taxes on beer, wine, and other alcoholic beverages in Canada have been effective in raising money for the nation while lowering alcohol consumption.

India

Alcohol sales in India contribute an increasing amount to state tax collections. According to estimates, the states will earn one out of every seven rupees in 2022–2023 from state excise taxes, mostly from alcohol. Alcohol excise taxes have increased at a compound annual growth rate (CAGR) of 13.3%, outpacing the rise of other state revenue sources, which increased at a pace of 12.1%. Excise taxes have been effective at bringing in money for the government and lowering alcohol use in some places. Even while the ban on single-use plastics has been successful in decreasing plastic waste, it has had difficulties with implementation and enforcement.

United Kingdom

In United Kingdom, Beer and other alcoholic beverages are subject to an excise tax, which has been effective in generating revenue for the government. Businesses in the UK must pay an excise tax on alcohol based on the nature and potency of their products. Alcoholic beverages with an average alcohol level of less than 1.2% are assessed a rate of £0.14 per litre, whereas those with higher alcohol contents are assessed a higher rate of £21.70 per litre. Single-use plastics are also prohibited, which has had the desired effect of reducing plastic waste. Although the UK has made progress in promoting electric vehicles, it still striving to lessen its reliance on imported cars.

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