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Reasons why Taxing Agricultural Inputs is a Bad Idea



Introduction

Ugandan farmers recognize the need for every Ugandan citizen to pay their taxes and to raise adequate domestic revenue that will eventually reduce over reliance on external aid. The proposed taxes on agricultural inputs however, will undermine the agriculture sector growth, competitiveness and consequently make it harder for the poor small scale farmers to make a living and access inputs for farming purposes. It is our belief that taxing agricultural inputs is an erroneous idea that is demonstrated through the seven reasons presented in this publication.

Background

In Uganda there is pressure to fund the increasing government expenditure on infrastructure. This has among other things led to an increase in fiscal deficit from UGX 3,181bn in FY 2012/2013 to UGX 3.336bn in FY 2013/14¹.

This is however happening amidst declining donor aid from UGX 936.2 billion in 2012/13 to UGX708.7 billion in 2013/14². To bridge the gaps, the government has adopted tax proposals that have swept through the whole economy including removing tax exemptions, imposing VAT and excise duty on agricultural inputs and some products in order to increase revenue collection.



1 Annual Budgetary Central Government Finance Statistics 2013/2014 (Overall fiscal balance excluding grants)

2 Annual Budgetary Central Government Finance Statistics 2013/2014 (Grants)

Taxing agriculture sector in 2014/15 budget

Following the budget Speech for the FY 2014/15, the Hon Minister for FPED in Uganda announced government plans to increase revenue through scrapping of tax exemptions and introduction of new taxes within the various sectors. The worst hit is the agricultural sector where a number of exemptions were terminated, new VAT introduced and also excise duty increased. Below is a highlight of proposed taxes in the agricultural sector for FY 2014/15;

Income Tax

- Terminate the exemption on interest income on agricultural loans – 25.1bn

VAT

- Supply of Feeds for Poultry and Livestock; Supply of Agriculture and Dairy Machinery; and Supply of Packaging Materials to the Dairy and Milling Industries
- Supply of cereals, grown, milled or produced in Uganda
- Supply of processed milk and milk products; Supply of Machinery and Tools for Agriculture; and Supply of Seeds, Fertilizers, Pesticides and Hoes

Excise duty

- Increasing excise duty on sugar from 25/= to 50/=



Why taxing agriculture inputs is a wrong idea?

1. Inconsistency in government's position to modernize agriculture;

Among the medium term objectives for the FY 2014/15 is enhancing agricultural production and productivity, increasing access to agricultural credit, which stands at only 10%³, and encourage use of improved seeds and fertilizer, which remains low at only 24% and 7%⁴ respectively. The tax proposals towards this sector seem contradictory and ambiguous if government is to achieve its medium term objectives. Not only do they contradict the NRM manifesto but the current proposal to tax on agricultural inputs contradicts the Kyankwanzi resolution of October 2011. The President's four acre modeland Vision 2040 (transformed Ugandan Society from peasant to a modern and prosperous country).

As noted by a one Rev. Fr. Fred Jenga⁵, government cannot help poor rural farmers to fight poverty by adding taxes on the inputs and equipment they use. He further revealed that the government's position is similar to someone who sets out to build a house from his or her savings and at the same time embarks on stealing his/her own construction materials.

3 FINSCOPE: 2013

4 Uganda National Household Survey 2009/10

5 Rev. Fr. Fred Jenga: Put on hold taxes/agro inputs and equipment

2. Imposing tax on agriculture inputs will outstrip the revenue to be realized;

The preliminary analysis to quantify the potential farm-level and aggregate impacts of the proposed imposition of 18% value added tax (VAT) on key agricultural inputs in Uganda by Mbowe, S, et al. (August 2014)⁶, revealed that the potential costs of the proposed imposition of VAT on agricultural inputs appears to far outweigh the benefits. The impact of VAT imposition on only maize seed and fertilizer is estimated to contribute total tax revenues of \$10.29 million compared to estimated total losses to maize farmers of \$20.93 million. This implies a benefit-cost ratio benefit cost ratio of 0.49. In any case, agriculture empirically matters; a study by Benin, et al. (2007)⁷ showed that if agriculture in Uganda grew at 6% per annum, the poverty rate would be cut by an additional 7.6% points to 18.9%, much lower than the 26.5% that would be reached if agriculture continued to grow at the average rate of 2.8% per year.

It should therefore follow, that any strategy for sustained growth must center on rapid growth of the agricultural sector however this is deemed unachievable with the imposition of all the agricultural taxes.

3. The current proposed taxes on agriculture will affect the poor more than the rich;

Basic economics asserts that taxes should be equitable; what equity really means here is that the amount of tax should be in proportion to the abilities of the tax payer. It is one of the fundamental concepts to bring social equality in the country. On the contrary, these taxes on agricultural inputs are regressive since sections of the society with higher income are not heavily reliant on agricultural production hence pay lesser or no taxes as compared to the low income groups. A study conducted by Uganda Seed Trade Association (USTA), et al. (July 2014), revealed that a maize farmer with cultivatable land equivalent to 2 acres is bound to lose an average revenue of 374,000/= per harvest as a result of the VAT on seeds and fertilizer inputs⁸.

6 Mbowe, S, Were, S.O and Rusike, J. Is VAT on Agricultural inputs Cost Effective? Policy Brief (August 2014). Economic Policy Research Centre.

7 Benin, S., et al., (2007). Agricultural Growth and Investment Options for Poverty Reduction in Uganda. International Food Policy Research Institute (IFPRI), Discussion Paper 00790.

8 The effect of VAT on agricultural input sector/output and food security in Uganda by Uganda Seed Trade Association, Crop Life, The Grain Council of Uganda and Uganda National Agro-Input dealers' Association

4. The current proposed taxes on agriculture will lead a decline in agricultural production.

The immediate effect of the VAT charge on inputs will be an increase in both fertilizer and hybrid seed prices and reduce their use. Lower seed and inputs use will result into lower yields, leading to lower crop production estimated to be over 30%⁹, which in turn reduces supply, with implications on food security. For example a 50kg bag of NPK fertilizer that initially cost UGX 125,000 would now cost UGX 147,500 after the taxes. With the increase in the prices of fertilizer and seed, farmers may adopt different combinations and application rates to adjust to the price increase and the following two scenarios might occur;

- i) Farmers will reduce the input application rate and maintain the area under cultivation compared to previous season, resulting in lower yields and increased cost of production; and
- ii) Farmers will reduce the area under production and maintain the same input application rate, leading to a decline in production and supply of agricultural produce to the market and the consequent higher food prices;

5. The proposed taxes on agriculture will increase food and agricultural commodity prices thus fostering poverty;

As farmers face a higher price of inputs, output will certainly reduce. Thus the real implications of imposing VAT on inputs will go beyond the increase in input prices, reduce output and thus food inflation. Acknowledging this dual nature in the relationship of fiscal policy and food/commodities inflation is critical when stakes are so high.

On April 16, 2011, former World Bank President Zoellick stated that: “Food prices are the biggest threat today to the world’s poor. Already 44 million

9 The effect of VAT on agricultural input sector/output and food security in Uganda by Uganda Seed Trade Association, Crop Life, The Grain Council of Uganda and Uganda National Agro-Input dealers' Association

people have fallen into poverty as a result of rising food prices over the last year. Further 10% rise in the food price index could push 10 million more people into poverty". And on August 15, 2011 he further insisted again in reference to global food prices and financial markets volatility that "Persistently high food prices and low food stocks indicate that we are still in the danger zone".¹⁰

6. Taxes on agriculture input a threat to employment creation;

Empirical findings by the CSBAG (August 2014) using the Computable Generic Equilibrium (CGE)¹¹ model revealed that taxing the agricultural sector will lead to a drop in employment by 4.9% in the economy. This drop in employment will therefore affect the large population that is employed in the sector. Hence we propose the contrary that instead the government should rightly place emphasis on taxing the final outputs and offer subsidies in the agricultural sector since it employs majority of Ugandans.

7. Taxes on Agriculture inputs will lead to a decline in export for various commodities;

The reduced use of fertilizers and improved seed qualities due to taxes would in turn lead to decline in yields. Consequently this would lead to less export realization and hence less foreign exchange inflow. Further findings by Uganda Seed Trade Association (USTA), et al. (July 2014), using Food and Agriculture Organization maize export statistics revealed that Uganda will incur a loss equivalent to US dollars 73.5million¹² as a result of VAT imposition to the agricultural sector. Similarly empirical evidence from CSBAG indicates that for given exports such as Cocoa, Vanilla, Flower seeds and Tea will experience decline in export at 20.99% for cocoa and vanilla, 19.13%, and 18.26% for flower seeds and tea respectively.

¹⁰ World Bank, press releases, April 16 and August 15, 2011.

¹¹ A CGE model is one of the most rigorous, cutting edge quantitative methods to evaluate the impact of policy reforms on and economy.

¹² The effect of VAT on agricultural input sector/output and food security in Uganda by Uganda Seed Trade Association, Crop Life, The Grain Council of Uganda and Uganda National Agro-Input dealers' Association

Conclusion

Imposing taxes on agricultural inputs would effectively lead to higher input prices and this will have two possible effects. First, farmers at the margin will not be able to meet the additional cost, and will either reduce the acreage under cultivation or use less inputs per given crop area. Either possibility will result in lower farm output and hence reduced national supply causing food price inflation which will have trickledown effects to other sectors of the economy. Secondly, households that can afford to meet the increased cost of input, will ultimately face a higher costs of production. The real implications of imposing VAT on inputs will go beyond the increase in input prices, to reduce productivity, high food prices, less foreign currency and will spark off negative growth and inflation. This multiplicity of effects is likely to have significant negative implications on food security and income distribution particularly among poor and vulnerable consumers which can cause social economic unrest. We therefore call upon government to drop the tax proposals on the agricultural sector.





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