

TOBACCO CONTROL AND THE TRANSITIONAL ECONOMIES OF EUROPE: ASPECTS OF TAXATION IN EUROPE

Presented by Christina Ciecierski at the plenary on the Economics of Tobacco and Tobacco Control during the 12th World Conference on Tobacco or Health
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Slide 2: Poland's government has made numerous efforts to raise the full price associated with cigarette smoking. First, parliamentary actions have worked to raise the "indirect costs" of cigarette use by making it more difficult to obtain and publicly consume cigarettes. Efforts specifically include:

- youth access laws and limitations in the number of legal POS;
- restrictions and most recently, complete bans of tobacco advertising and event sponsorship;
- restrictions on smoking in public places; and finally
- counter-advertising through various types of cigarette pack labeling.

Even more importantly, the Ministry of Finance has actively increased the Monetary Costs of Cigarette use – that is, since 1993 excise taxes have been levied to try to raise the retail price of cigarettes.

Slide 3: During the last few years, Poland's Council of Ministers has been preparing the country's infrastructure for accession to the European Union. Among the many directives posed by the EU is the concern over taxation of tobacco products. In the case of cigarettes, Poland is required to both:

- A). Introduce a mixed excise tax system and
- B). Increase the tax to price ratio for the most in demand price category of cigarettes to 57%.

Slide 4: In the Mixed Excise Tax System, the total excise tax amount due stems from two parts: First, a specific or what is sometimes called, a fixed tax – where the tax is a defined amount per unit of cigarettes. The second half is an ad valorem tax and is determined as a percentage mark-up on the retail price of cigarettes.

Slide 5: The period between July '93 and May 31st, 2000 marks the first stage in Poland's open market excise tax system. During this historical window excise taxes were comprised of fixed elements only and applied different levels of taxes across 4 cigarette categories which included: domestically produced regular length filterless cigarettes, domestically produced regulars with filter, domestic King Size cigarettes and all international brands regardless if produced in Poland or abroad. The second stage was motivated by EU accession requirements and began in June, 2000. Here, the same per unit tax applies to all cigarettes but the total excise tax due varies by price categories because the retail price per pack remains variable across different segments of the market.

Slide 6: Generally, increasing tobacco taxes are expected to result in higher market prices for cigarettes. Graphical evidence based on data from Poland's Ministry of Finance ascertains that cigarette prices are indeed rising with taxes.

Slide 7: Poland's Ministry of Finance defines the specific per unit tax and in doing so, is responsible for maintaining a constant tax value. That is, the Minister routinely increases the specific tax amount to keep taxes in unison with the country's rate of inflation. Yet note that these seemingly aggressive and regular increases in nominal excise taxes are dampened by the country's general rate of inflation – and we graphically see that real taxes consistently fall below nominal levels.

Slide 8: Parliament sets the ad valorem excise rate. The current 25% rate remains unchanged since its introduction in 2000. Routine changes to counter inflation are less important to sustaining value here because the prices of cigarettes are likely to increase along with prices of other goods and services.

Slide 9: Nevertheless, other problematic aspects of this tax component do exist. Namely, because manufacturers and importers are required by law to define and post the retail price on all cigarette packs, the ad valorem component that's based on retail price creates an opportunity for market players to depress the suggested retail price and in turn, decrease the total excise tax due to the government. Recent price manipulation is most apparent for the King Size category. A plot of price data from the Ministry of Finance shows that nominal prices (depicted here in green) actually dropped shortly after the introduction of the ad valorem component while the real price fell slightly and returned to 2000 levels in 2002.

Slide 10: The data trends suggest that the industry is taking advantage of this tax limitation and is depressing cigarette prices in all categories as to minimize total tax liability across brands. Price manipulation is most pronounced among categories operated by multinationals – namely king size and international brand cigarettes.

Slide 11: In addition to minimizing taxes, these price cuts may also have a secondary goal – which is, category expansion. For example, the industry may expect price incentives to strengthen demand for King Size cigarettes whose market share has already been significantly increasing - from 30% in 95 to 43% in 1999. A category in need of price incentives is the international segment whose market share, according to industry statistics, has decreased from 22% in 1995 to 18% in 99.

Slide 12: The second focus of Poland's tax referendum to the EU is raising the tax-to-price ratio for regular length domestically produced filter cigarettes. The ratio was to equal 57% by 2002 yet current figures for 2002 reveal that only a 50% ratio was attained.

Slide 13: According to Poland's Council of Ministers, –“.. the requirement of reaching a 57% level of excise duty incidence within the short period of harmonization (i.e. by 2002) would lead to several inter-related market occurrences....”. In October 1999, with only 41% tax-to-price ratio, the Council had requested a 5-year transitional period arguing that this delay “...is desired from the point of view of market stability, state budget income, industry and commerce”. The Council names a number of economic “threats” – many of them, reminiscent of popular industry arguments against taxation.

Slide 14: First: A steep rise in excise duty will result in a retail price increase of 106.9% - but actual data shows that a 9% rise in the tax to price ratio between 1999 and 2002 resulted in only a 28% increase in real retail price – this suggests that a 106.9% rise in retail price just isn't likely.

Slide 15: Second: is the statement that inflation levels will rise as a result of rapid increases in cigarette prices – but in Poland, inflation levels have been gradually decreasing since 1993 - this despite rising tobacco taxes during the same period. Furthermore, cigarettes per se are not a component of Poland's current CPI index. Finally, even if cigarettes were or do become a component of the national CPI or other inflationary consumer index, and even if we assume a high share of monthly household expenditure on cigarettes – for example – 5%, then the 16% increase in tax-to-price ratio that was required in 1998 to reach the 2002-57% threshold would result in a .8 of a point increase in the CPI in the month of the tax hike.

Slide 16: Third: Another argued threat is that a decrease in legal cigarette sales due to significant price-sensitivity will result in decreased sales of 33% in 2002 versus 1998. But estimates of cigarette price elasticity based on aggregate data from Poland's Central Statistical Office reveal a relatively low price elasticity – in which, a 1% rise in real cigarette price lowers demand for cigarettes by only .8%. Furthermore, between 1998 and 2002, the real price of cigarettes rose by 22% suggesting a 1.76% not 33% reduction in sales between '98 and 2002.

Slide 17: Fourth: Another threat of the 57% ratio is that falling sales will lead to decreases in budget income – yet a graphical representation of tax revenues against real cigarette prices shows that for nearly a decade, tobacco revenues have been rising despite increasing real cigarette prices.

Slide 18: Fifth: Another perceived threat is: the loss of jobs as a result of a contracting tobacco industry. However, Poland's economy is not heavily dependent on tobacco production. Despite falling demand for cigarettes, tobacco production accounted for only 8% of total manufacturing in both 1995 and 2000.

Slide 19: And finally Sixth: The Council expresses concern over the development of mass scale organized smuggling. But as the WHO and World Bank recommend, rather than giving up the health benefits associated with falling prevalence rates, Poland should devise methods that control corruption as well as smuggling activity along its borders.

Slide 20: Despite the available evidence that recurrently refutes all of the alleged threats of a 57% tax-to-price ration, the EU member states granted Poland an exemption that moves beyond 5 years, that is, until 2009!