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AFTA and Tobacco Tax Policy

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Presentation Outline

- Tobacco tax and its economic impact
- Tax design
- Regional example
- AFTA and tobacco tax

Tobacco Tax and Economic Impact

- Tobacco taxes help to restore market efficiency lost due to negative externalities of smoking behavior
- Research shows that higher tobacco taxes:
 - improve public health
 - increase tax collection (even in the presence of smuggling)
 - do not have negative impact on employment
 - do not have negative impact on the poor

Taxation is the Most Effective Tobacco Control Measure

- Higher taxes induce **quitting**, **reduce** consumption and **prevent** starting
- A 10% price increase reduces demand by:
 - ◆ 4% in high-income countries
 - ◆ 8% in low or middle-income countries
 - ◆ long-run effects may be greater
- **Young** people and **the poor** are the most price responsive

Criteria for evaluating taxes

- **Efficiency** (neutrality for market incentives)
- **Equity** (fairness)
- **Simplicity**
 - ◆ Minimising public administrative costs
 - ◆ Minimising private compliance costs
- Vulnerability to **tax avoidance** (legal exploitation of tax loopholes)
- Vulnerability to **tax evasion** (reducing tax by illegal means)

Efficiency

- **A broad-based, uniform tax is hard to avoid by switching to another brand or type of tobacco**
 - **import duty could be avoided by switching to domestic brands**
 - **different tax rates on cigarettes and other tobacco products allows tax avoidance**

Equity (fairness)

- Generally, taxes should be designed to reduce **poverty**
- **Primary goal of tobacco taxes** is to improve public health, not to improve poverty. There are more **effective ways** to achieve fairness
 - ◆ **Broad-based (non discriminatory) consumption taxes**
 - ◆ **Income taxes**
- But, higher tobacco taxes **improve welfare** of the poor, public health
- Tobacco tax revenue can help to **fund health care** for the poor (**earmarked tax**)

Vulnerability to tax avoidance and tax evasion

- **Narrow-based taxes (i.e. taxes with multiple exemptions)** are easier to avoid, therefore **broad-based taxes** are preferred
- **Single rate taxes** are harder to avoid than **multiple rates**
- **Wholesale taxes** are preferred to retail taxes to **reduce taxing points and the number of cash transactions**

Categories of Taxes (1)

Ad valorem taxes

Applied as % of some value (for example, wholesale price)

Advantage: automatically indexed for inflation

Disadvantage: tax amount can be lowered by producing low-price, low-quality cigarettes

Categories of Taxes (2)

Specific taxes

Tax base is a **physical unit** (e.g. per kilo of tobacco or per stick), this is easier to measure than to determine value of a product

Advantage: treat all products equally, the most suitable to address the market externalities

Disadvantage: not automatically indexed for inflation, per stick taxes may encourage the production of longer cigarettes (e.g. “super king size”)

Should Tobacco Taxes be Earmarked?

Several countries have set aside part of tobacco tax revenue to:

- ◆ establish Health promotion foundations
- ◆ pay for health care, help tobacco farmers switch to alternative products

Can be a useful **political device** to sell higher tobacco taxes to voters

Can improve **equity** if well designed

Careful design is necessary otherwise resources may be used elsewhere

Malaysia (1)

Different tax for local and imported cigarettes,
lower taxes on other tobacco (**lower efficiency**
due to possibility of **substitution and tax**
avoidance - smuggling)

Locally produced cigarettes:

Excise tax 58 RM/kg + 25% sales tax

Imported cigarettes:

ASEAN countries: import duty 100 RM/kg
(previously 108 RM/kg) + excise tax 58 RM/kg
(previously 0) + 25% sales tax

Other countries: import duty 200 RM/kg
(previously 216 RM/kg) + excise tax 58 RM/kg
(previously 0) + 25% sales tax

Malaysia (2)

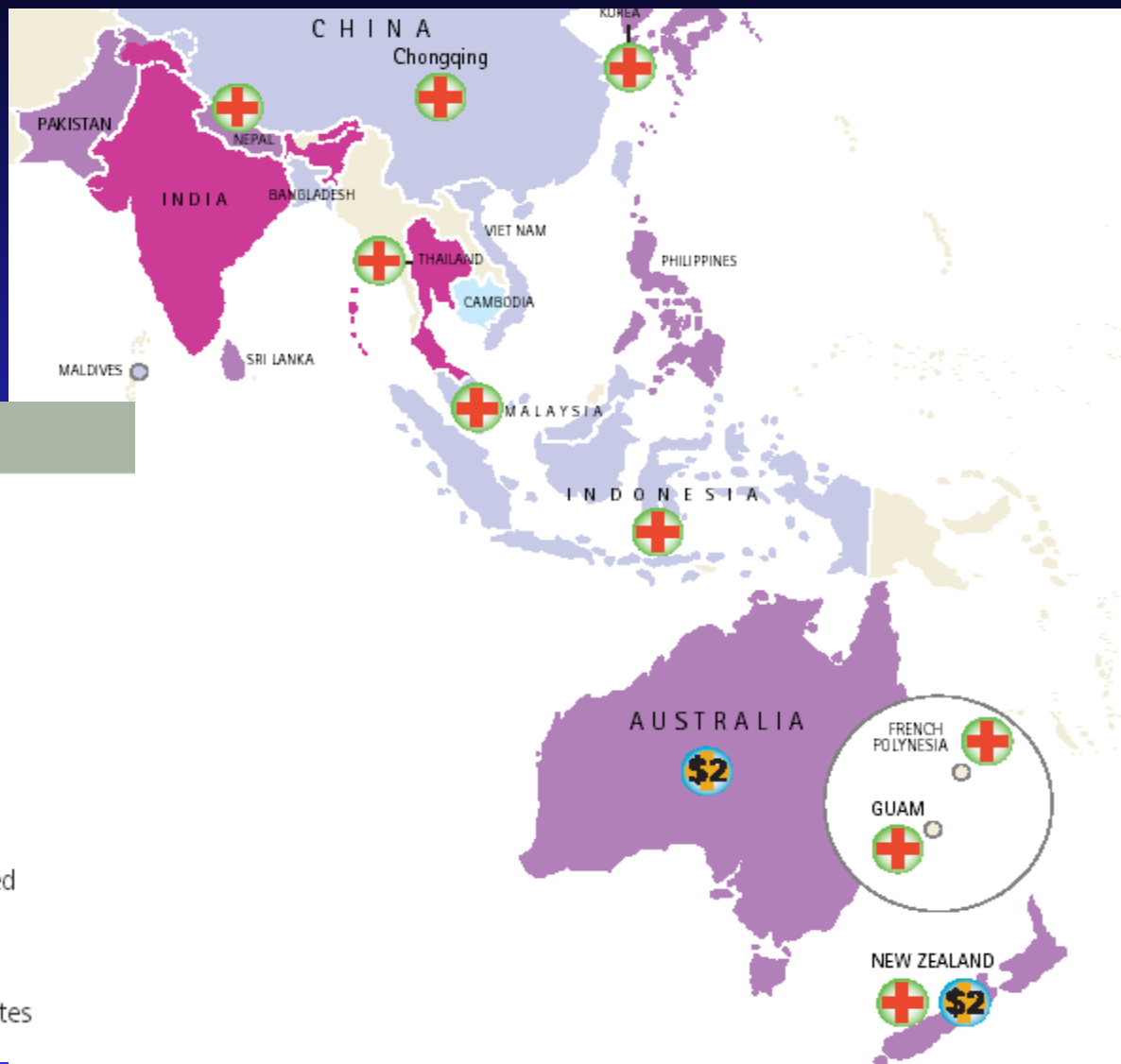
- **Tobacco tax level is not sufficient** to eliminate market inefficiencies associated with smoking and to maximize tax revenue: taxes on locally produced cigarettes (over 90% of the market) are **33% of retail price**
- **Equity can be improved by tax earmarking**
- **Danger of tax avoidance** due to tax based on weight
- **Taxes are not automatically indexed for inflation**
- **Taxes can be avoided by smuggling** (measures can be taken to reduce it – e.g. banderol, law enforcement, higher penalties)

What is the “right” level of tax?

Depends on various factors, such as degree to which society wishes to **protect children, revenue considerations, health care costs, state of public health & development, etc.**

- **Useful yardstick: tax at least 2/3 to 4/5 of retail price.**

SEA and Australian Region



Tax as a proportion of cigarette price

2000 or latest available data

75% or more

50% - 74%

25% - 49%

24% or less

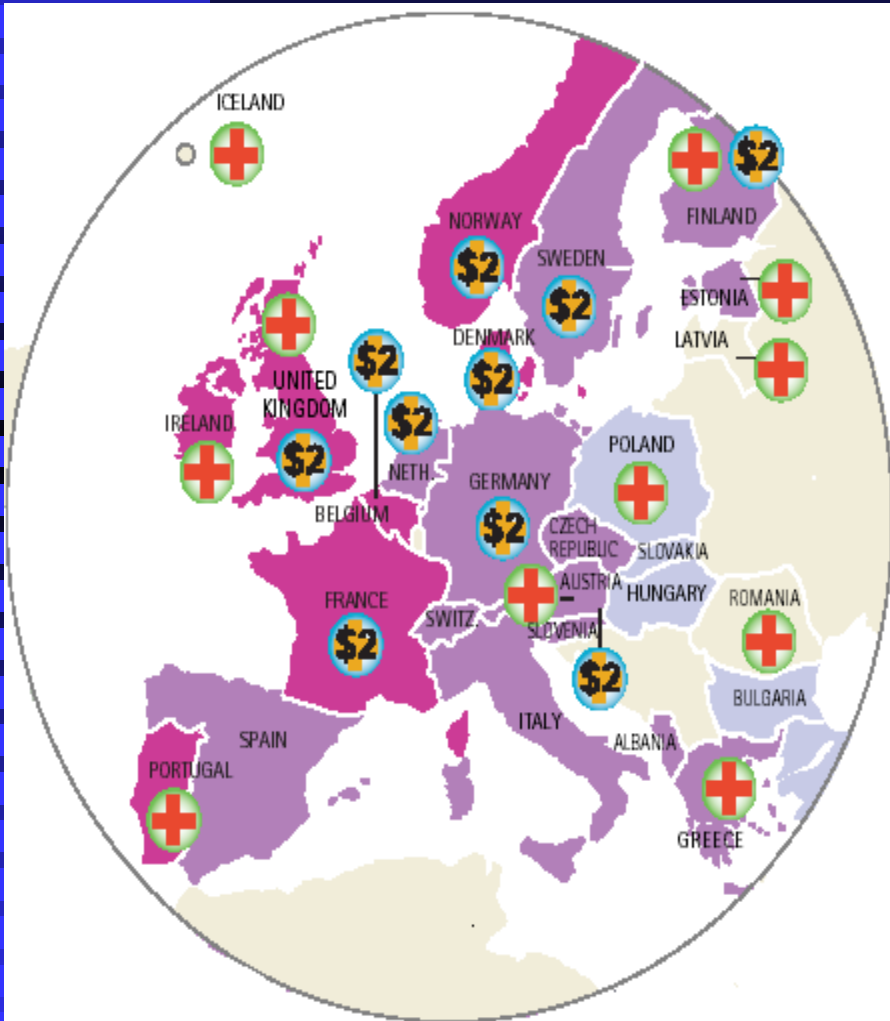
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countries or states with tobacco taxes dedicated to tobacco control, health promotion or general health care

countries with tax of \$2 or more for 20 cigarettes

Source: Judith Mackay, Michael Eriksen : Tobacco Atlas

European Region



Tax as a proportion of cigarette price

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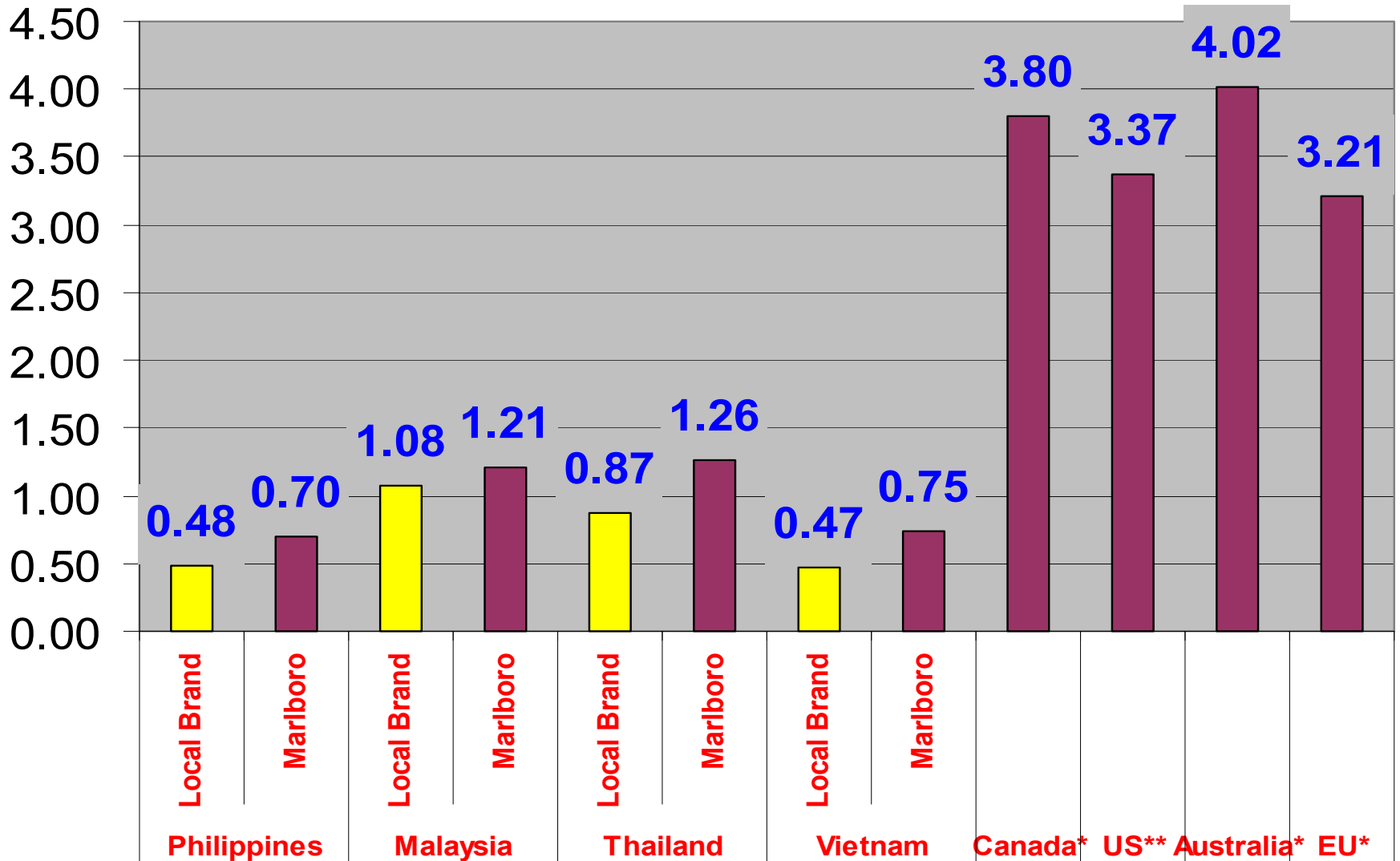
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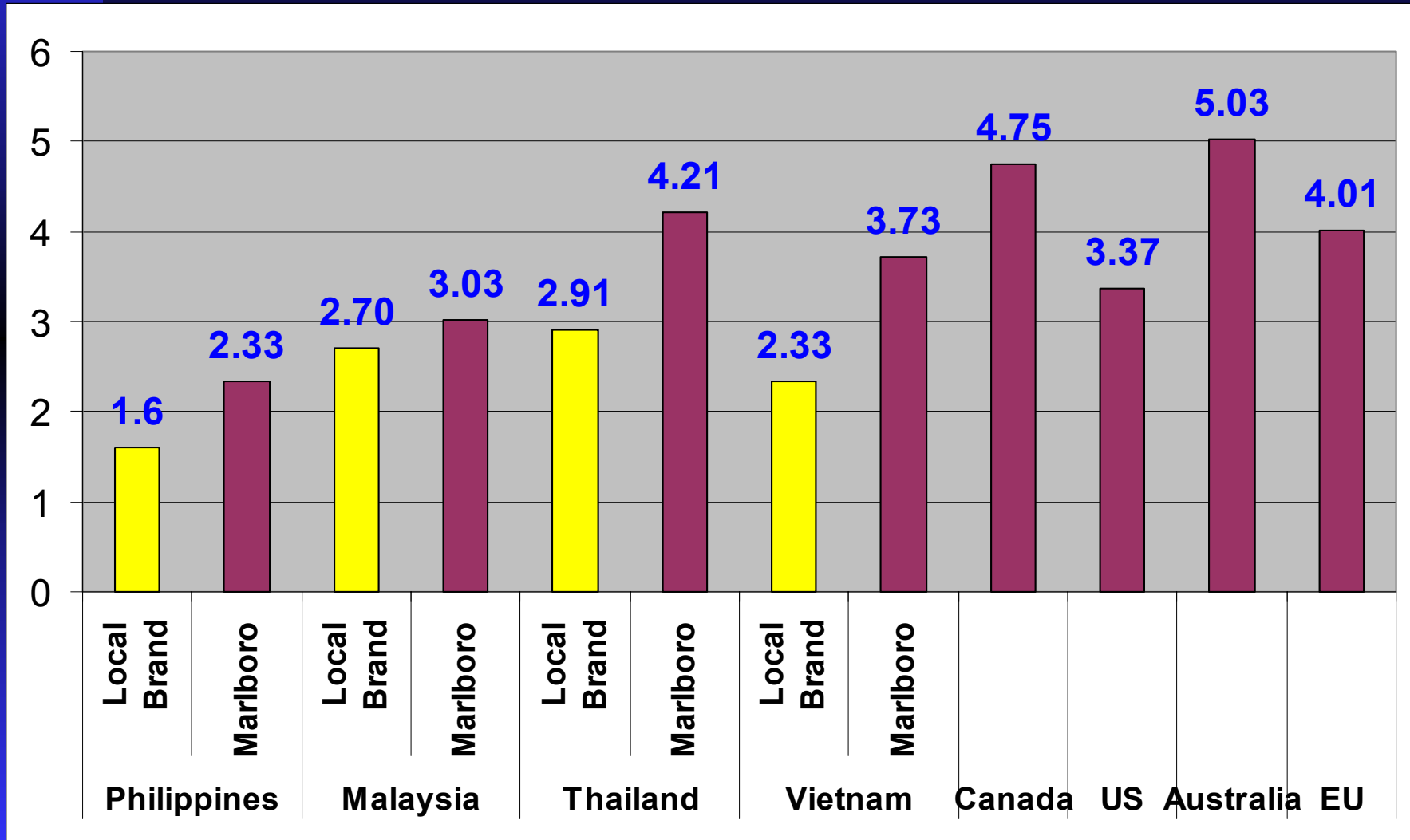
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Cigarette Prices in \$, 2001

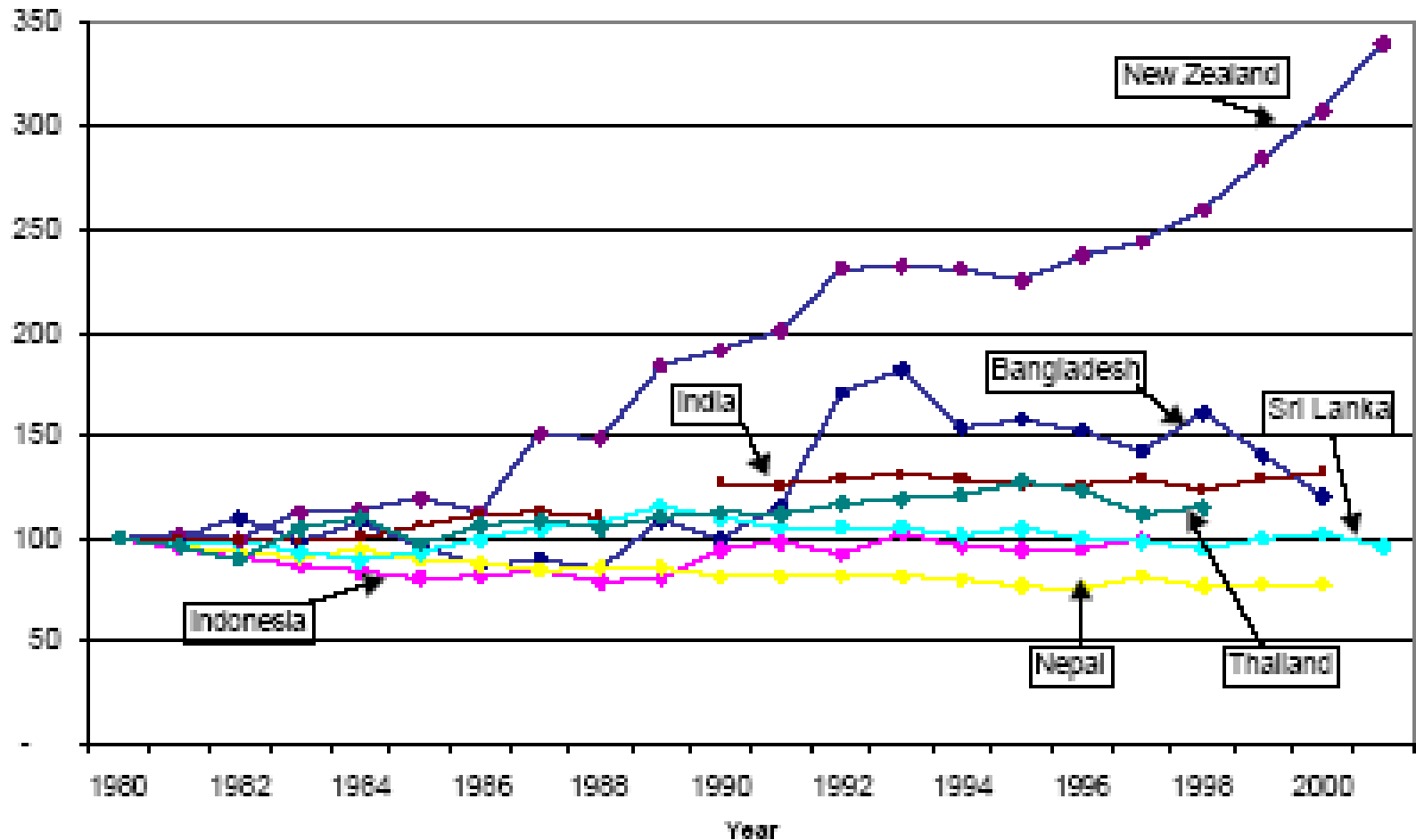


Cigarette Prices in PPP \$, 2001



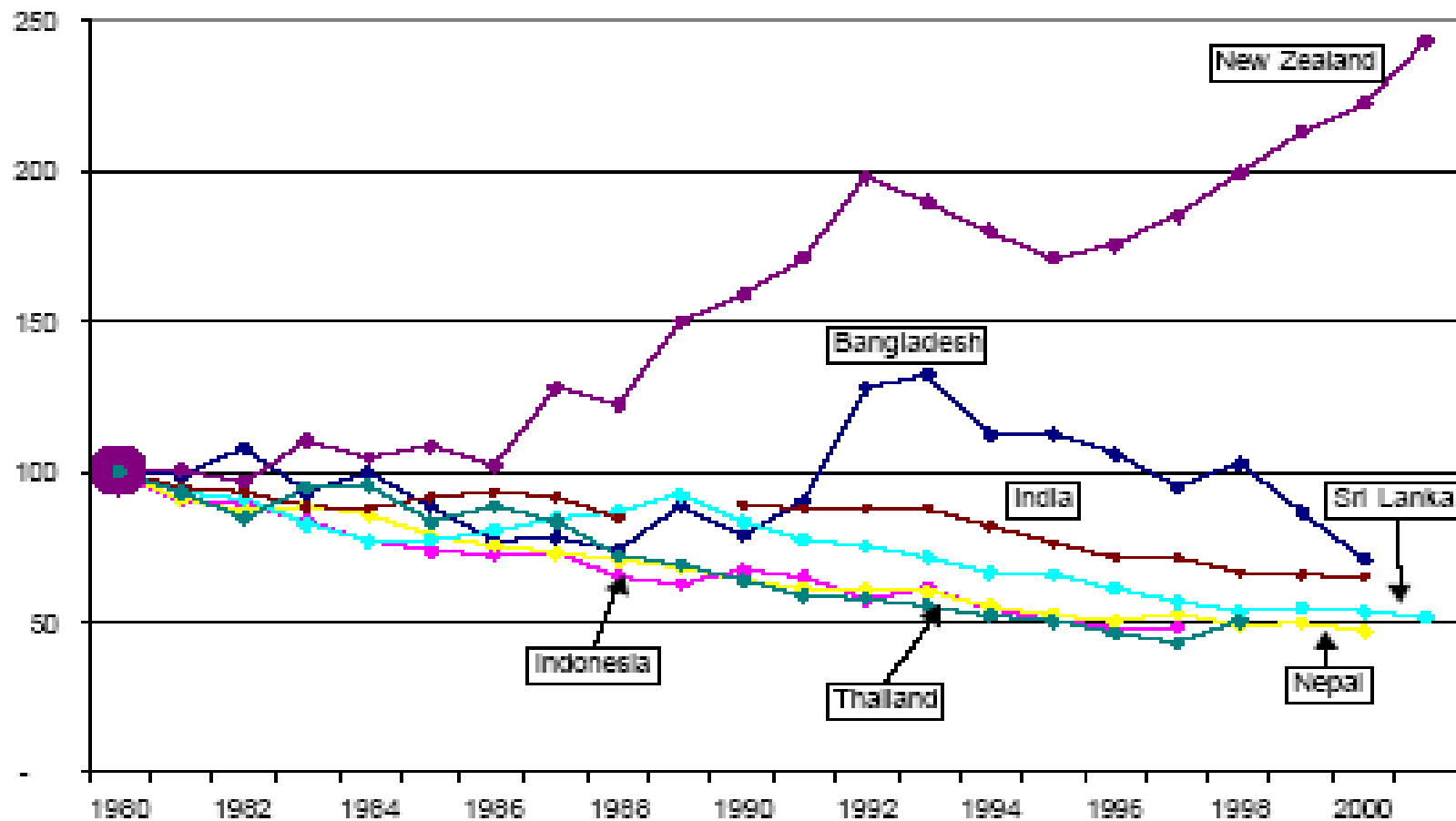
Real Prices of Tobacco Products, 1980-2000

(Consumer Price Index 1980 = 100)



Source: National statistical agencies and central banks

Affordability of Tobacco Products 1980-2000 (*CPI/GDP 1980 = 100*)



Source: National statistical agencies and central banks

Pressing Tobacco Tax Issues

AFTA calls for a uniform tax for domestic and imported cigarettes – necessity to **redesign tax systems** to maintain the current level of tax collection: this presents **an opportunity** to change inefficient features of current tax systems (e.g. introduce **uniform tax** on all tobacco products, introduce specific excise tax)

Earmarking tobacco taxes to improve public health and to **help the poor** to quit

Tax avoidance and tax evasion: improve enforcement, coordinate taxes in the region, eliminate duty-free shops