

# RAISING TAX ON TOBACCO



## WHAT YOU NEED TO KNOW



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# IN 2012, THE GOVERNMENT OF THE PHILIPPINES SUCCESSFULLY RAISED TOBACCO TAXES DESPITE STRONG OPPOSITION FROM THE TOBACCO INDUSTRY.

"The President certified the 'sin tax' reform bill as urgent," said Senate President Franklin Drilon. "He believes that the passage of this very important piece of legislation will buttress the government's health agenda and address the high prevalence of smoking in the country".

The Departments of Health and Finance joined forces to communicate, through a powerful media strategy, the health benefits of the tax reform bill. "This is not just a 'sin tax'. This is an anticancer tax. It is just right and responsible to tax the tobacco industry considering the billions of pesos that our health care is forced to carry because of the disease burden from smoking," said Teodoro Herbosa, Undersecretary of the Department of Health of the Philippines.

As President Benigno Aquino signed the tax bill into law he said, "Many believed it was impossible to pass the 'sin tax' bill as those blocking its passage were strong, noisy and organized, but we have proven that nothing is impossible for Filipinos who are sailing in the same direction, whose hearts are in the right place and who are ready to fight for their principles".

One year after the implementation of this tax, the government has collected more than the expected revenues, 85% of which will go to providing universal health coverage and improving health facilities for the people of the Philippines.

## INTRODUCTION

Raising taxes on tobacco is the most cost-effective solution for reducing tobacco use in all types of settings. The experience of the Philippines and other countries, including Egypt, France and Turkey, shows that raising tobacco taxes is feasible and has real benefits for the health sector and beyond.

Key to successfully increasing tobacco taxes is to outline their health and economic benefits, and to debunk myths spread by the tobacco industry in its attempt to block tax increases that will lower sales of their deadly products.

Tobacco use is the single largest cause of preventable death, killing around 6 million people worldwide every year. Tobacco use not only shortens the number of years that users live, it also shortens the number of healthy years when alive.


Tobacco use is a major contributor to noncommunicable diseases, such as lung cancer and heart disease, which kill 36 million people every year. Additionally, tobacco use generates considerable economic costs, including increased spending on health care to treat diseases it causes in people who use tobacco and those exposed to tobacco smoke, as well as lost productivity and income due to illness and premature deaths. Effective solutions exist to reduce tobacco consumption in all types of settings.


## RAISING TAXES ON TOBACCO IS THE MOST EFFECTIVE POLICY TO REDUCE TOBACCO USE


Raising taxes on tobacco – enough to increase tobacco price above inflation rates – makes tobacco more expensive. As with many consumer products, people tend to buy less of a product when the real price<sup>1</sup> increases and it becomes less affordable.

On average, raising tobacco taxes to increase prices by 10% is estimated to reduce tobacco use by 4% in high-income countries and by around 5% in low- and middle-income countries.

Price increases through taxes usually bring the biggest health benefit to people with the least amount of money, including young people. Reductions in use among

10%  in tobacco prices:

4%  Consumption in high-income countries

5%  Consumption in low- and middle-income countries

<sup>1</sup> Real prices are nominal prices adjusted to remove the effects of general price increases over time (inflation).

young people due to price increases are on average two to three times larger than those that occur among adults [1]. A 2010 study undertaken in 20 lower-middle income countries found that a price increase of 10% would reduce consumption in youth aged 14 by 18%, more than three times higher than the consumption reduction achieved by the same measure among adults [2].

Raising tobacco taxes is also considered the most cost-effective measure when comparing the significant benefits they produce for very little governmental expense.

A study looking at the impact of different tobacco policies<sup>2</sup> on smokers in 2000 showed that increasing tobacco prices by 33% through higher taxes cost 15 times less than other measures to obtain the same health benefit [3]. A more recent estimate has shown that raising tobacco taxes costs as little as US\$ 0.005 per person per year [4].

The recent experience of Turkey provides a good illustration of the impact of tobacco taxation and other policies on consumption and prevalence. Excise taxes have been steadily increasing since 2008 alongside the implementation of other policies, such as smoking and tobacco advertising bans. This led to a reduction in tobacco sales by 12% between 2008 and 2012 and a reduction in the proportion of tobacco smokers in the adult population from 31.2% to 27.1%, during the same period [5].

## RAISING TAXES ON TOBACCO SAVES LIVES

Increasing the price of tobacco through higher tobacco tax reduces the affordability of tobacco products, therefore discouraging their consumption, improving the health of people and communities and reducing the burden of disease and death in the world.

WHO calculates that if all countries increased taxes on cigarette packs by 50%, there would be 49 million fewer smokers (38 million fewer adult smokers and 11 million fewer young future smokers) and this would avert 11 million deaths from smoking (based on unpublished WHO simulations using 2012 data).

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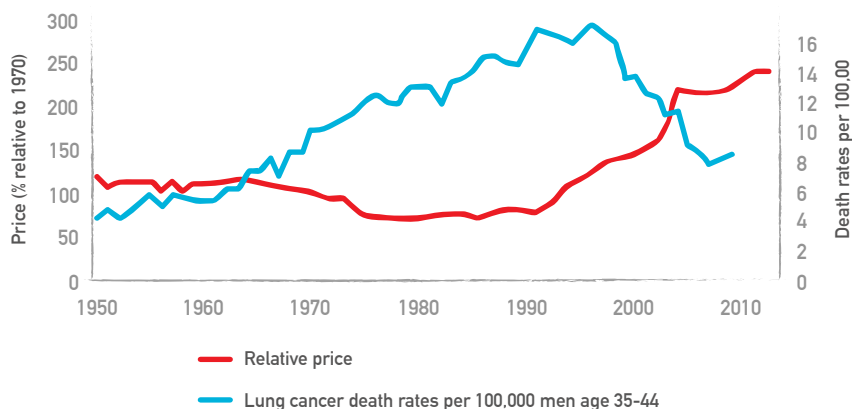
<sup>2</sup> The policies include price increases through tax increases and non-price measures such as smoking bans in public places, health information, counter advertising and banning tobacco advertising and promotion.

About half of the total drop in tobacco consumption results from reductions in the number of tobacco users, that is people who quit using tobacco. The other half of the impact comes from reductions in the amount of tobacco consumed by the remaining smokers.

The benefits of cessation are many and occur for a number of serious diseases soon after quitting. Only one year after quitting smoking, the risk of coronary heart disease is about half that of a smoker. The stroke risk is reduced to that of a non-smoker 5 to 15 years after quitting. After 10 years of cessation, the risk of lung cancer falls to about half that of a smoker, and there is a decreased risk of cancer of the mouth, throat, oesophagus, bladder, cervix and pancreas [6].

France, for example, increased its taxes substantially and regularly between the early 1990s and 2005, tripling its inflation-adjusted cigarette prices. This was followed by a reduction in sales by more than 50%. The health impact of this dramatic reduction in consumption was seen just a few years later with a reduction in lung cancer death rates for young men. Death rates went down by 50% during the same period [7,8]. After a period of unchanged tax rates between 2005 and 2009, France has started to regularly increase tobacco taxes since 2010 [9].

Price increases (due to tax increases) and lung cancer death rates, France 1950-2010



Source: Graph reproduced using data from Hill C., 2013

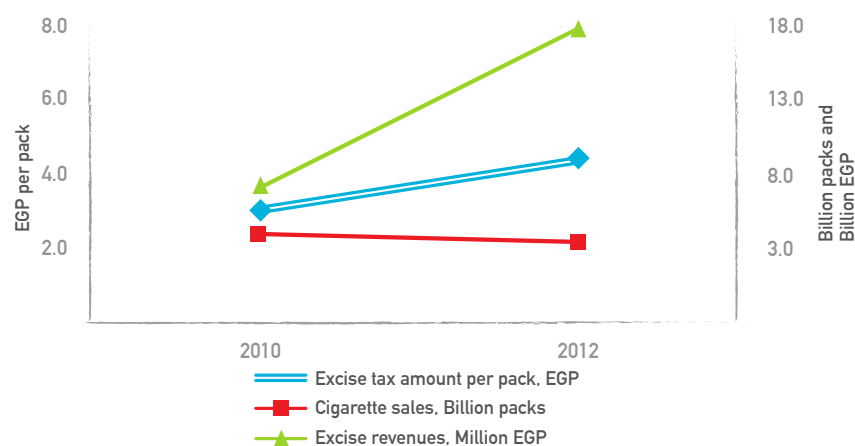


## RAISING TAXES ON TOBACCO GENERATES MORE REVENUES FOR THE GOVERNMENT

In addition to reducing tobacco use and the associated health burden, tax increases generate substantial additional revenues to governments. Tax increases are a win-win situation because they are good for both public health and government revenues. Government revenues raised in this way can be used for health and other public benefit.

In Egypt, the government substantially increased the tobacco tax in 2010. The tax per pack for the most popular brand of cigarettes increased by 46% from 2.95 Egyptian pounds (EGP) to 4.32 EGP. This reduced sales by 14% in only two years. The impact on revenues was colossal, increasing by 151%, from 7 billion EGP to 17.6 EGP between 2010 and 2012 [10].

Tax increases, consumption and revenue impact, Egypt 2008-2012



Source: Data for the most sold brand cigarette per pack of 20, WHO Report on the Global Tobacco Epidemic, 2013

WHO estimates that if countries increased tobacco taxes by 50% per pack, governments around the world would earn an extra US\$ 101 billion in revenue that could be put towards health and other social programmes, for example, for the prevention and control of noncommunicable diseases (based on unpublished WHO simulations using 2012 data).

**IF COUNTRIES INCREASED TOBACCO TAXES BY 50% PER PACK, GOVERNMENTS AROUND THE WORLD WOULD EARN AN EXTRA US\$ 101 BILLION IN REVENUE**

Between 2009 and 2011, 40 countries around the world dedicated by law a certain amount or proportion of tobacco tax revenues for health purposes (according to unpublished WHO data, 2011).

The Philippines is currently considering using a proportion of the extra revenues from its tobacco tax reform to fund the national health insurance scheme.

## **IT SHOULD BE SIMPLE IN ORDER TO BE EFFECTIVE**

Different types of taxes apply to tobacco products. In particular, excise taxes are important in achieving public health objectives, because the rates apply uniquely to tobacco products and, therefore, raise the prices of these products relative to those of other consumer goods and services.

A number of countries around the world impose complex systems of tobacco excise, which are difficult to administer and subject to loopholes. The tobacco industry takes advantage of these loopholes to avoid paying the full amount of taxes. The resulting loss of revenues for the government and the difficulty to translate into price increases and reduced affordability for consumers makes these taxes and tax increases ineffective.

The Philippines provides a good example of efforts to simplify its excise tax system and make it easier to administer and implement. Until 2013, the Philippines imposed a complex, four-tiered specific excise tax<sup>3</sup> on cigarettes. Each tier varied according to a defined level of price calculated using a formula. Those levels were adjusted over the years but were “frozen” for the brands of certain companies that operated in the country for many years, providing them clear preferential tax rates over other companies.

One of the consequences of this system was that cigarette taxes and prices in the Philippines were among the lowest in the world, contributing to very high rates of smoking. Following a strong battle by the government with support from civil society groups against resistance from the tobacco industry, a tobacco tax reform was adopted in 2012.

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<sup>3</sup> An amount paid per unit sold.

This reduced the tax tiers from four to two in 2013 and will bring them down to a single uniform rate in 2017. The reform also removed tax obligations which favoured one company over another. In addition, a provision was introduced to have automatic annual increases in the tax until 2017, with more rapid tax increases on lower priced brands. Since implementing the reform in 2013, the Government reports that tobacco prices have gone up, sales have gone down and revenues have increased substantially.

In the African region, Gambia changed the base for its excise on cigarettes from weight to volume in 2012. Evidence shows that basing taxes on weight of tobacco encourages the industry to produce lighter – but not less harmful – cigarettes to pay less taxes.

In 2013, Gambia also raised the excise on all tobacco products to the same rate. This has the benefit of discouraging consumers from switching to a cheaper product when taxes are increased. Governments around the world tend to impose higher taxes on cigarettes than on other tobacco products, leading to price differences and encouraging substitution from higher priced products (usually cigarettes) to cheaper tobacco products such as waterpipe tobacco or roll-your-own cigarettes. Taxing all products similarly leads to a harmonization of prices and reduces incentives for substitution.

## THE TOBACCO INDUSTRY OPPOSES AND UNDERMINES EFFORTS TO INCREASE TAXES

The tobacco industry does not like tobacco tax increases because it knows that they are effective in reducing tobacco use. This quote from secret internal documents from Philip Morris, made available through litigation, dates from 1985 but is still relevant today: “Of all the concerns, there is one – taxation – that alarms us the most. While marketing restrictions and public [sic] and passive smoking do depress volume, in our experience, taxation depresses it much more severely. Our concern for taxation is, therefore, central to our thinking about smoking and health. It has historically been the area to which we have devoted most resources and for the foreseeable future, I think things will stay that way almost everywhere” [11].

Tobacco tax increases are usually opposed by the industry. The recent reform in the Philippines met heavy opposition but the industry did not succeed in preventing its adoption. In Mexico, the industry continued to block tobacco tax increases until a well-coordinated campaign by tobacco control advocates supported the government to pass a significant tax increase in 2010. This increased the specific excise tax up from 0.8 to 7 pesos per pack and increased the ad valorem excise tax<sup>4</sup> from 150% to 160% [12].

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<sup>4</sup> A percentage rate based on the declared value of the goods sold.

## FIGHTING THE MYTHS SPREAD BY THE TOBACCO INDUSTRY

The tobacco industry tries stalling discussions over tax increases in many countries by using arguments that are untrue or by exaggerating the expected impact. It is time to break down those myths to shed light on the real impact of tobacco tax increases.

### MYTH: TOBACCO TAX INCREASES WILL REDUCE TAX REVENUE (BECAUSE CONSUMPTION GOES DOWN).

- **No:** Tax revenue actually increases (because reduction in sales is less than proportionate to the price increase). As demonstrated in Egypt and the Philippines, an increase in tobacco taxes does increase government revenues.

### MYTH: TOBACCO TAXES WILL REDUCE ECONOMIC ACTIVITY.

- **No:** Spending on tobacco will be replaced by spending on other consumer products and services.

### MYTH: TAXES CREATE A FINANCIAL BURDEN ON POOR SMOKERS SINCE THEY SPEND A LARGER SHARE OF THEIR INCOME ON TOBACCO PRODUCTS.

- **Not exactly:** Because people on lower incomes are more sensitive to price increases, they will alter their consumption behaviour by either quitting or reducing the level of tobacco consumption more than higher-income consumers. Consequently, higher taxes will help reduce their own personal spending on tobacco as well as improve their health.

### MYTH: TOBACCO TAX AND PRICE DIFFERENCES BETWEEN COUNTRIES CREATE AN INCENTIVE FOR ILLICIT TRADE IN TOBACCO PRODUCTS.

- **Not exactly:** There are other more important factors that encourage illicit trade, such as weak governance/lack of high-level commitment, weak customs and excise administration, corruption and complicity of cigarette manufacturers.
- **Consequently:** Tax increases should be introduced together with actions to strengthen tax administration (such as simplifying taxation, monitoring the tobacco products market and strengthening customs and police) to reduce incentives for tax evasion by manufacturers and criminal organizations.



## CALL TO ACTION

WHO encourages:

### GOVERNMENT LEADERS TO:

- support significant tobacco tax increases as an important public health policy.

### MINISTRIES OF HEALTH TO:

- raise awareness among different sectors of the government about the importance of tobacco tax increases as a public health policy
- support ministries of finance in their efforts to raise taxes and implement effective tax policies.

### MINISTRIES OF FINANCE/REVENUE TO:

- use regular tobacco tax increases as a central policy for consumption reduction
- implement simple tax measures
- work to effectively fight illicit trade in tobacco products
- prevent the tobacco industry from influencing tobacco tax policy development.

### NEIGHBOURHOOD, COMMUNITY AND CIVIL SOCIETY GROUPS TO:

- create enabling environments for tobacco users to quit
- discourage the sale and use of tobacco products from illicit trade.

### FAMILIES AND HOUSEHOLDS TO:

- encourage and support family members using tobacco to quit.

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