

# Tobacco Taxation Increases, II countermeasures, and illicit trade

## Framework Convention Alliance: Illicit tobacco trade and taxation in the Eastern Mediterranean

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# Outline

- 1. Why large tobacco tax increases**
  - *How large?*
  - *Decreasing affordability over time*
- 2. TI tactics to counter tax increases**
- 3. Links to illicit trade?**
- 4. How to address**
  - *Global experience*
  - *Monitor*
  - *Illicit trade protocol*

# Tobacco Taxation Increases

**Increasing tobacco taxes enough to increase the price of cigarettes is one of the most effective ways to decrease smoking prevalence**

- Especially when combined with a comprehensive tobacco control program

**As a result:**

- Government revenues increase
- Health improves and premature deaths decrease
- *Even where smuggling is an issue*

# What is the “Right” Level of Tax?

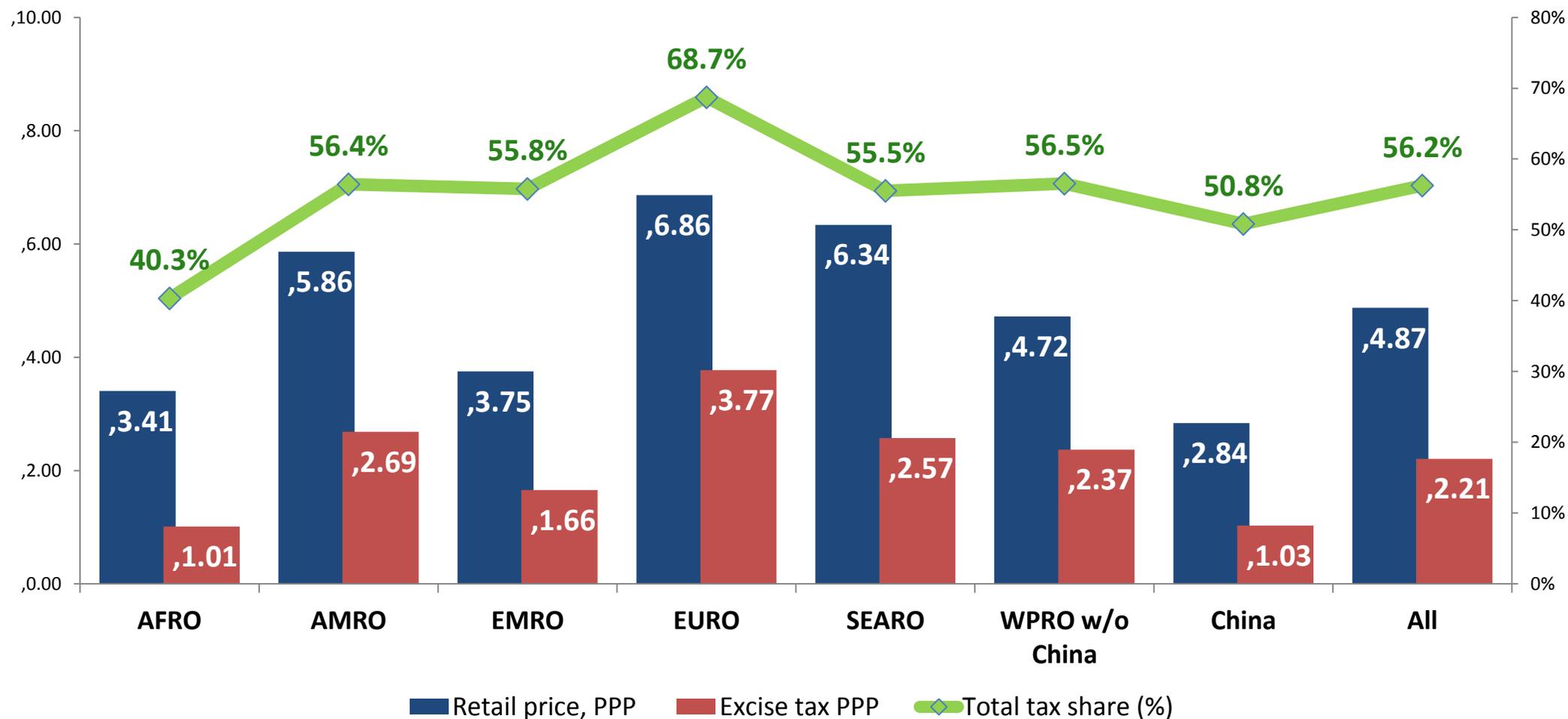
- The WHO suggests that all taxes, including VAT and sales taxes, should make up 75% of the retail price (WHO Global Tobacco Epidemic, 2015)
- **Affordability: once higher levels have been achieved**
  - Taxes need to continue to increase at least as fast as
    - Prices and
    - Incomes
  - In order to keep cigarettes from becoming more affordable over time
  - One way to measure: per capita income needed to purchase 2000 cigarettes (100 packs)

# What is the “Right” Level of Tax?

- **A higher rate will have a larger impact on improving public health through higher prices**
  - More people will quit
  - Fewer will start smoking
  - Those who continue will smoke fewer cigarettes
- **A higher rate will raise more revenue**
  - Even with potentially higher levels of tax avoidance and illicit trade
- **Both objectives can and have been achieved in many countries**

# Weighted Average Retail Prices and Taxes on Cigarettes (MSB)

By WHO Region, 2016

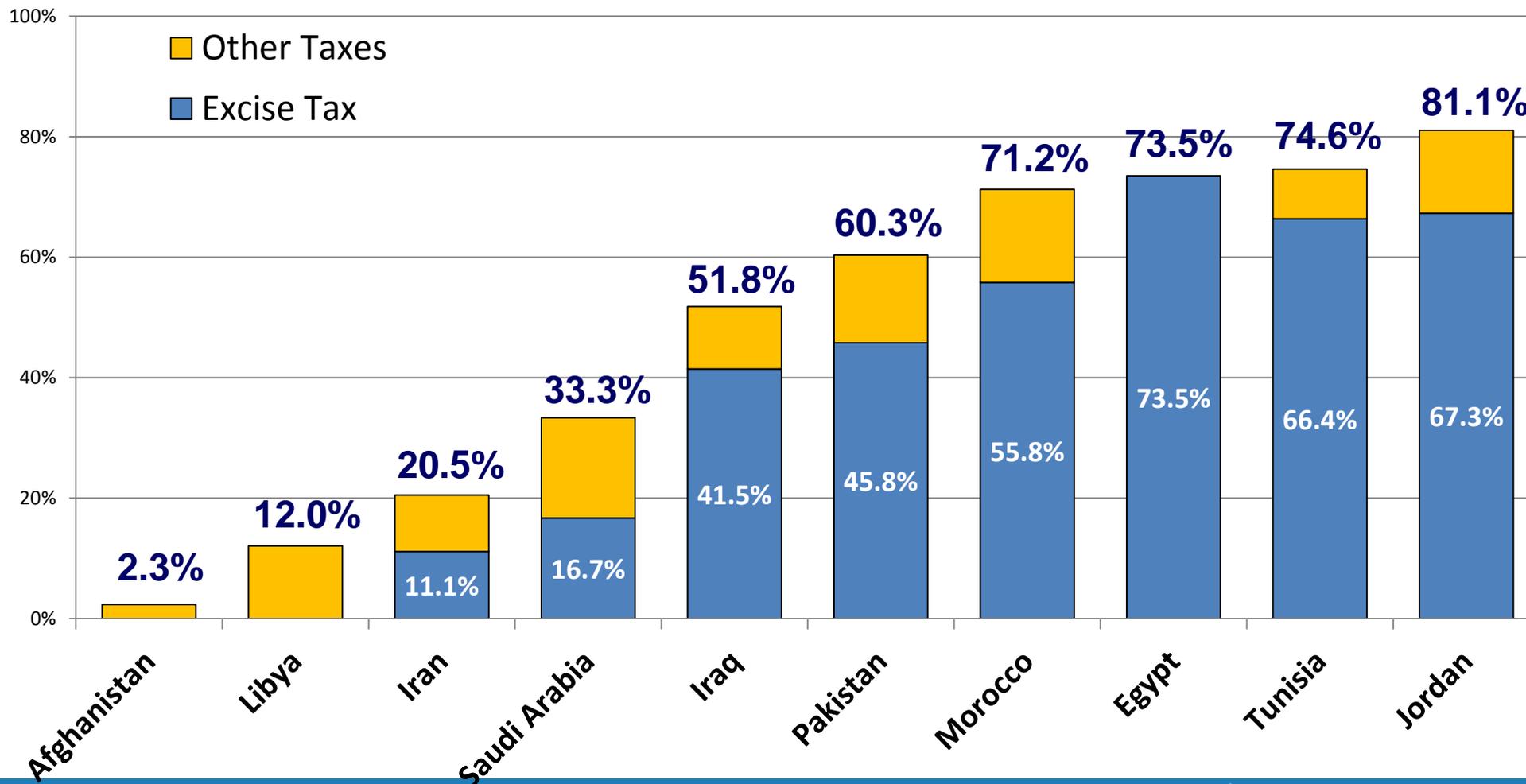


Source: WHO Report on the Global Tobacco Epidemic, 2017



# Total and Excise Tax Share of the Most Sold Brand (MSB) of Cigarettes

## Selected EMRO Countries, 2016

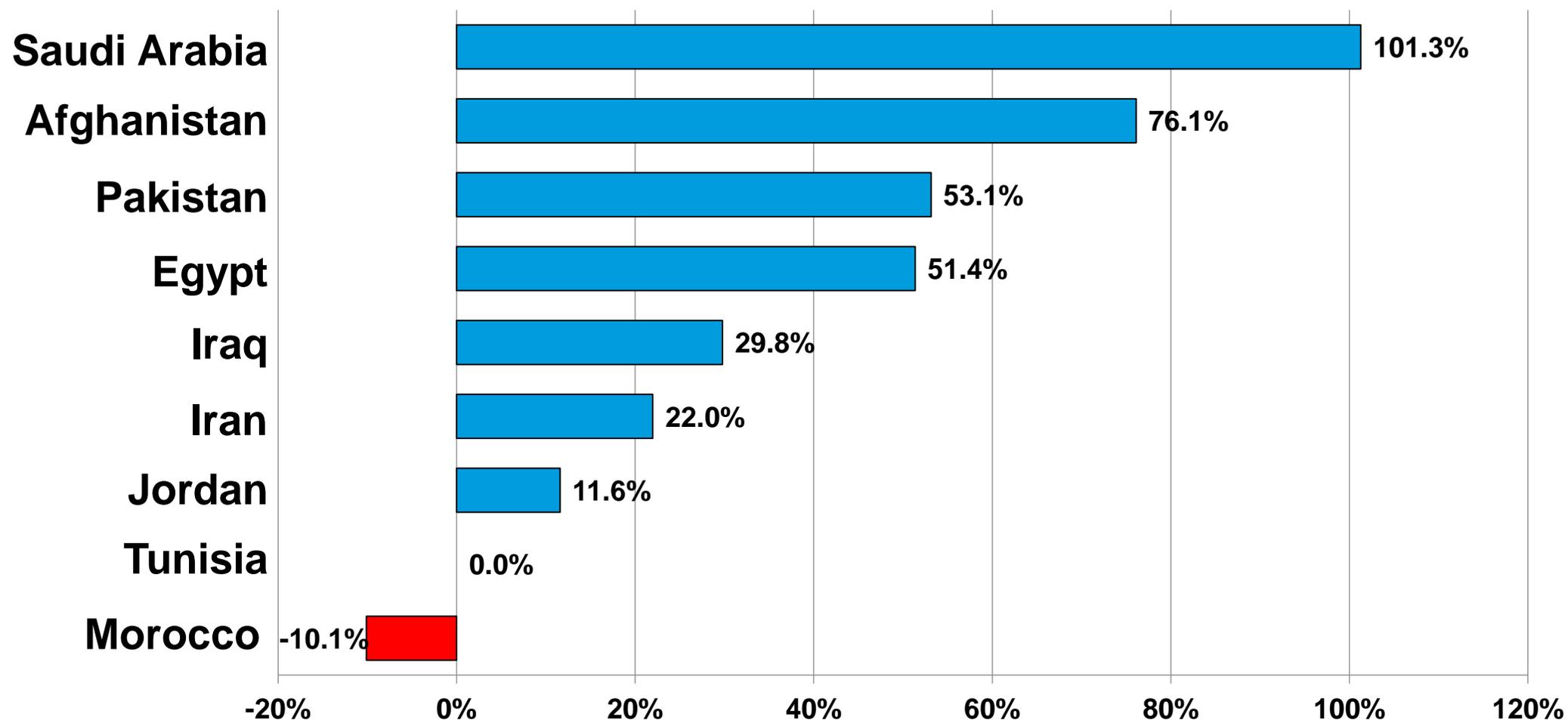


Source: WHO Report on the Global Tobacco Epidemic, 2017



# Change in Affordability of Cigarettes (% GDP p.c. to purchase 100 packs)

Selected EMRO Countries, comparing affordability from 2008 to 2016

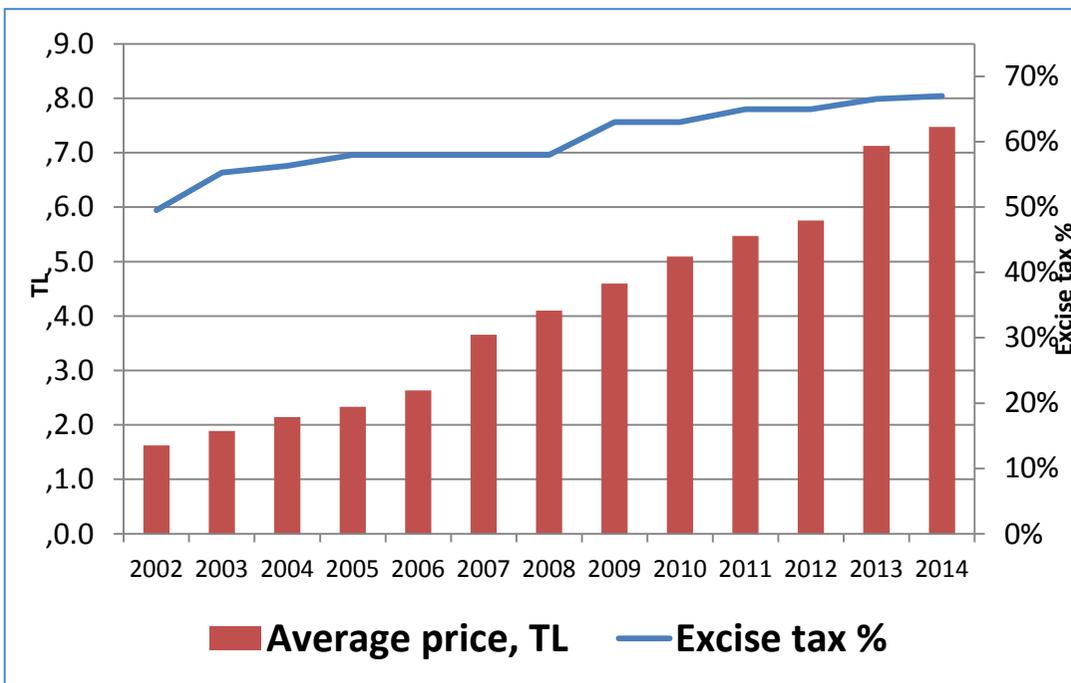


Source: WHO Report on the Global Tobacco Epidemic, 2017

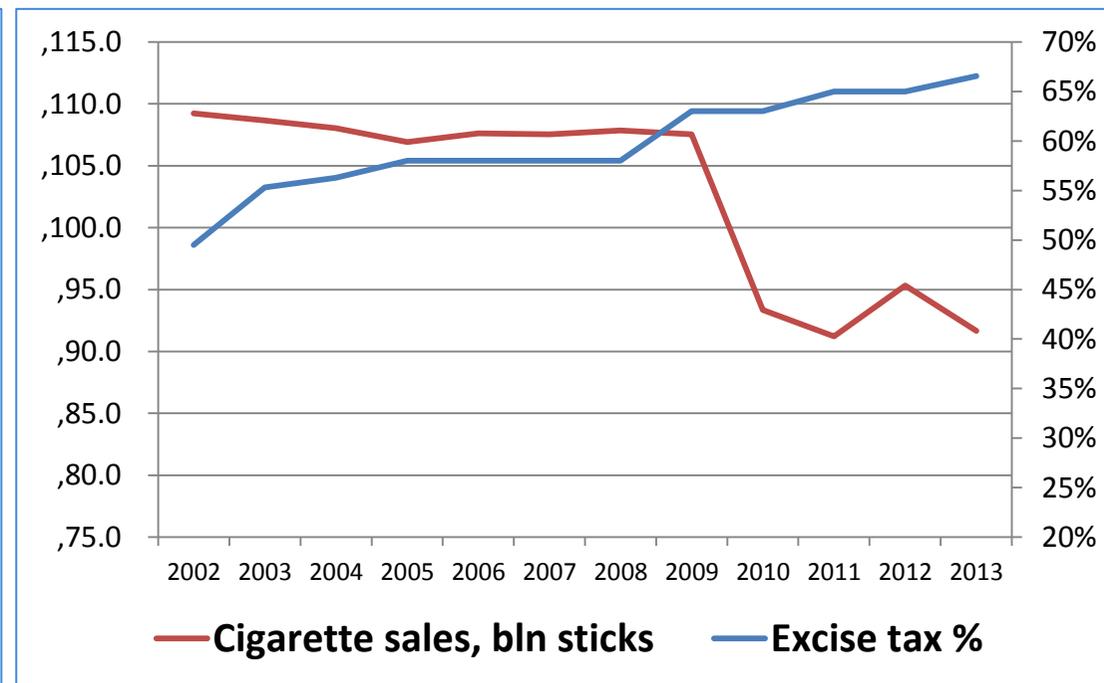
# Example 1: Turkey

Turkey has a 2 tier mixed system with a minimum specific tax  
 In 2014, the ad valorem rate was 65.25% of retail price with a specific tax of 0.13 lira/pack

As excise tax increases, prices increase

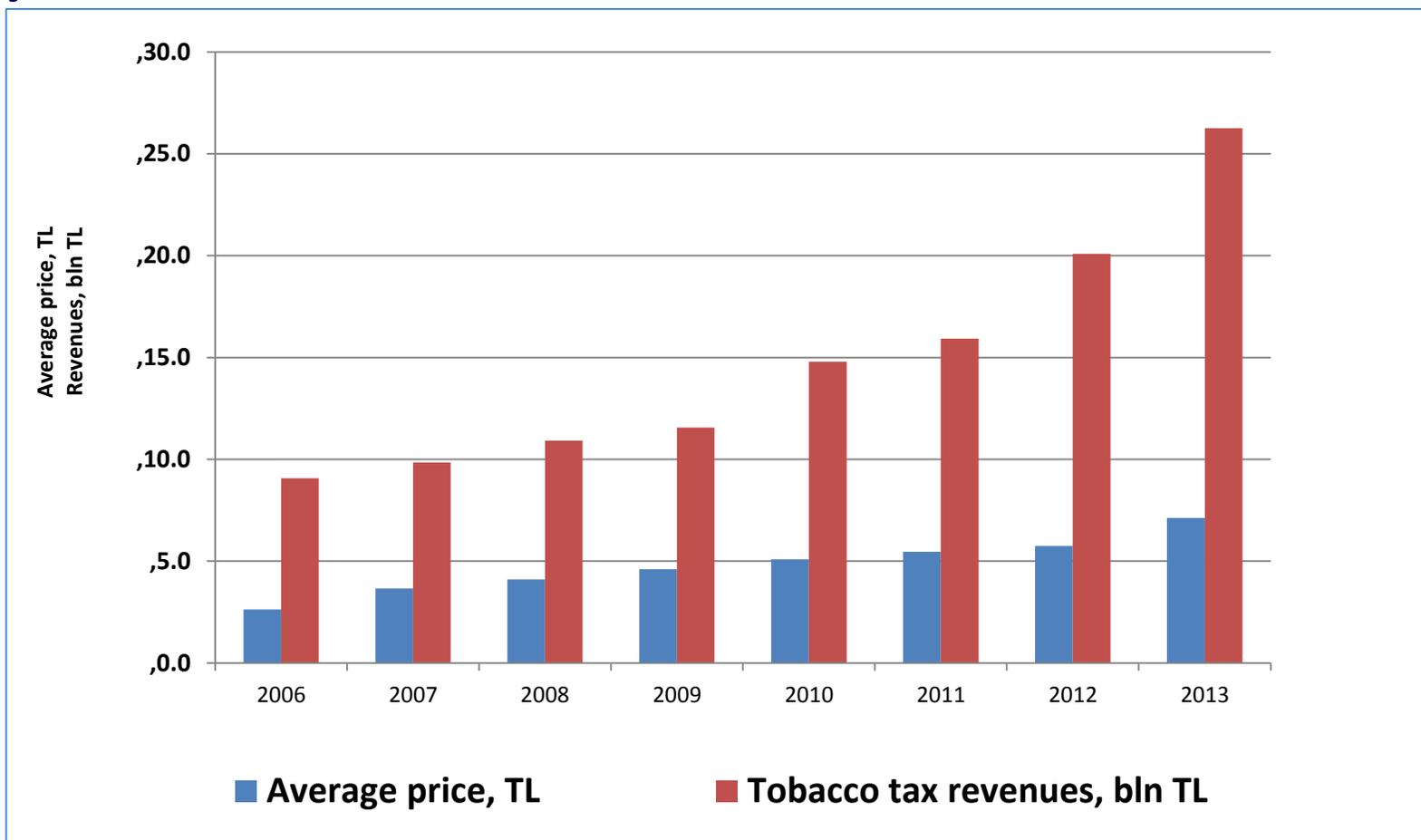


As excise tax increases, sales go down



# Turkey

- Turkey: Revenues also increase

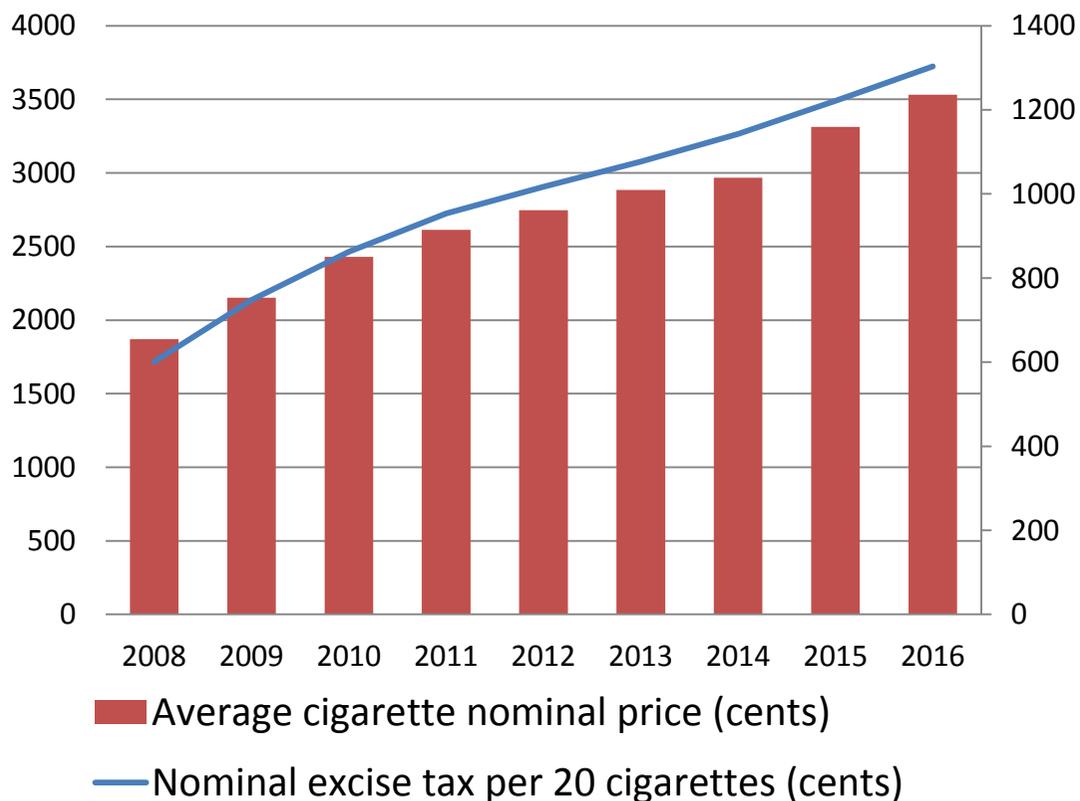


Source: Yurekli et al. 2012, Ministry of Finance, Turkey, Euromonitor

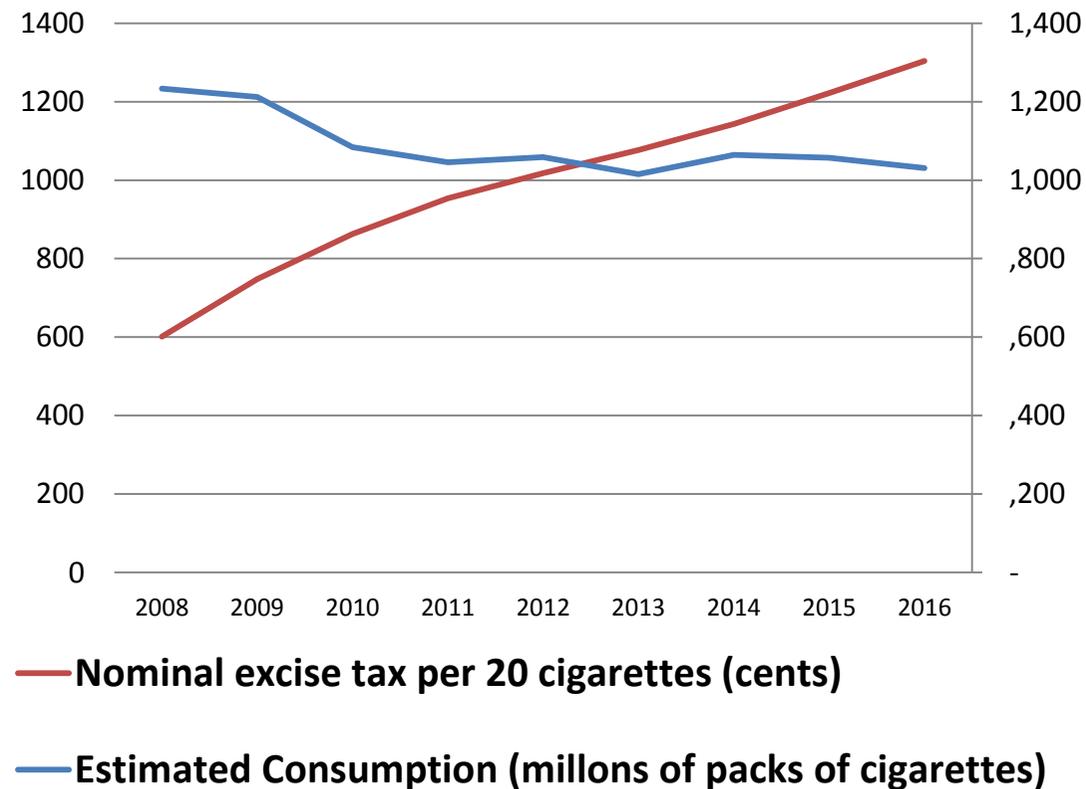
2015

# Example 2: South Africa

## As excise tax increases, prices increase

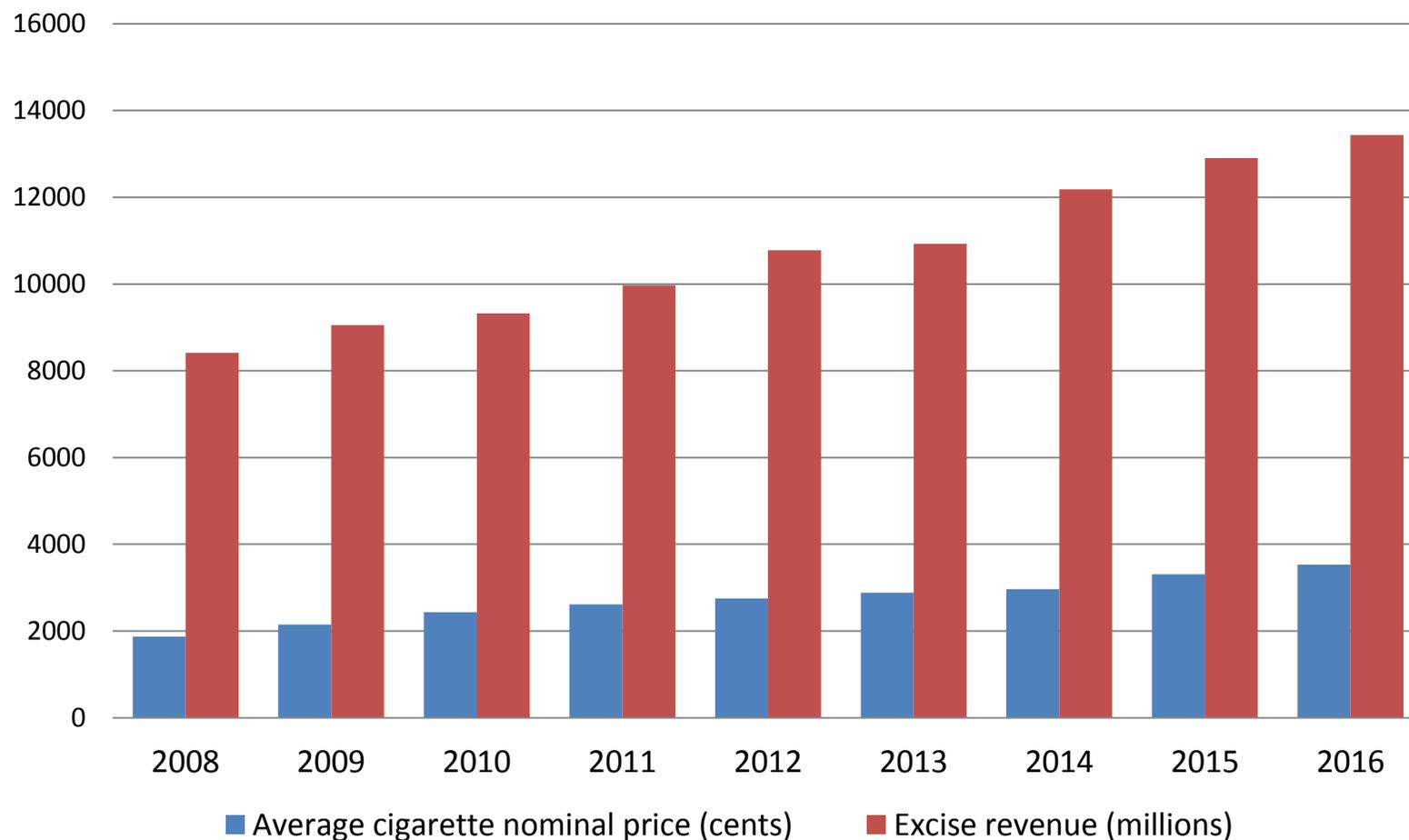


## As excise tax increases, sales go down



# South Africa

- South Africa: revenues also increase increase as well



Source: TFK 2012

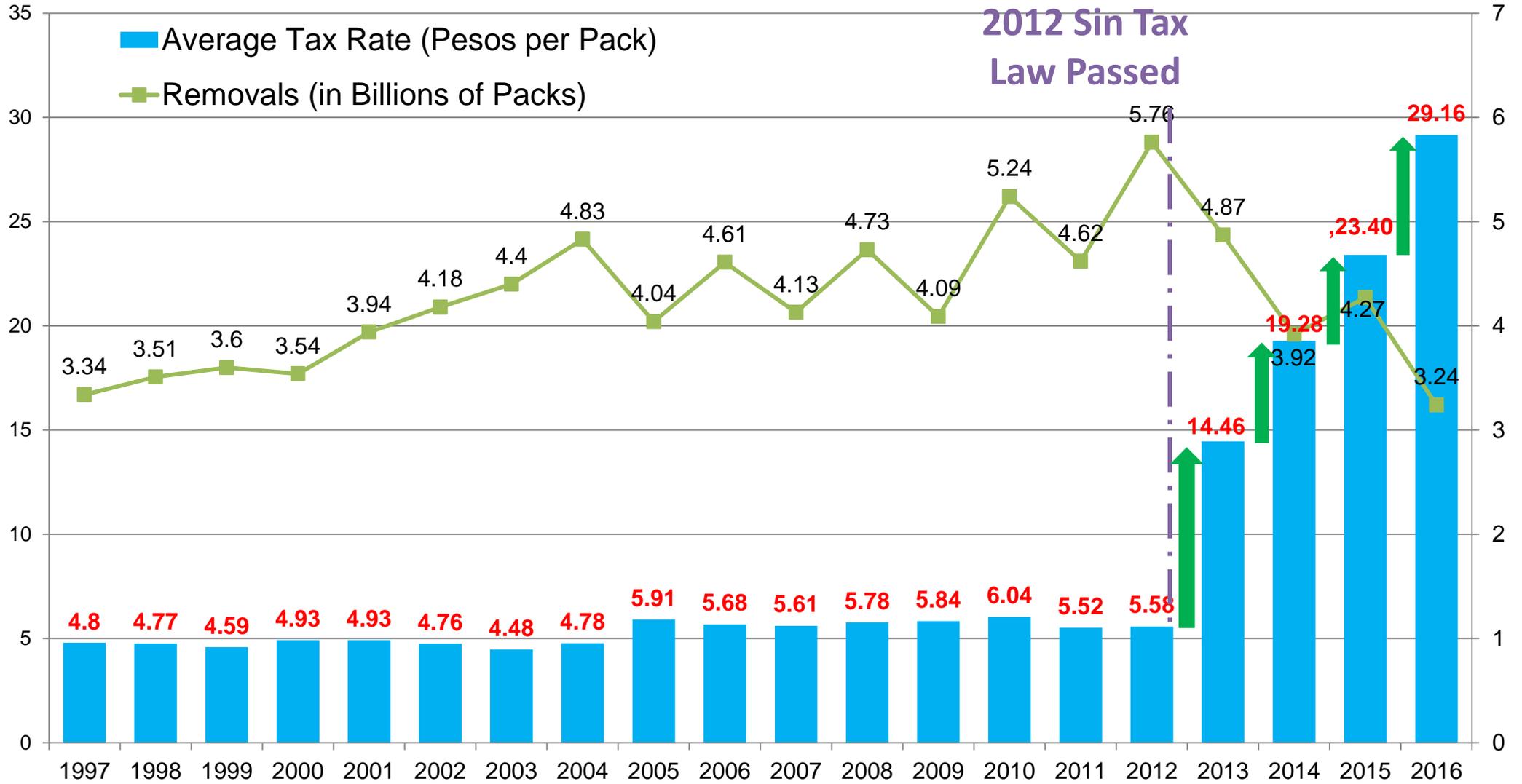


# Example 3: Philippine's 2012 Tobacco Reform

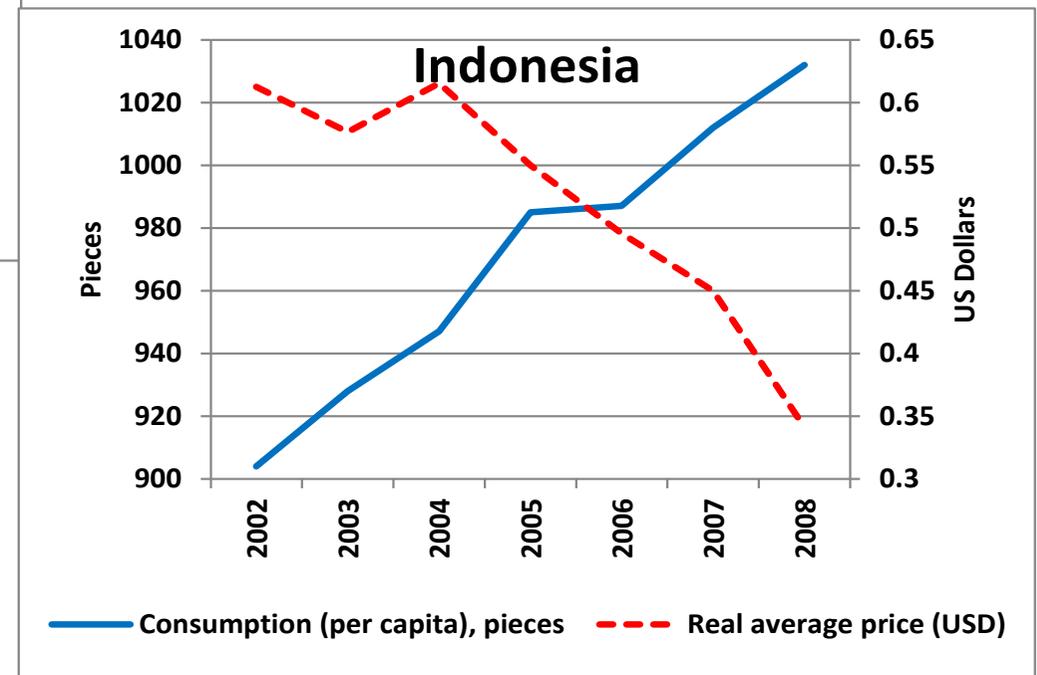
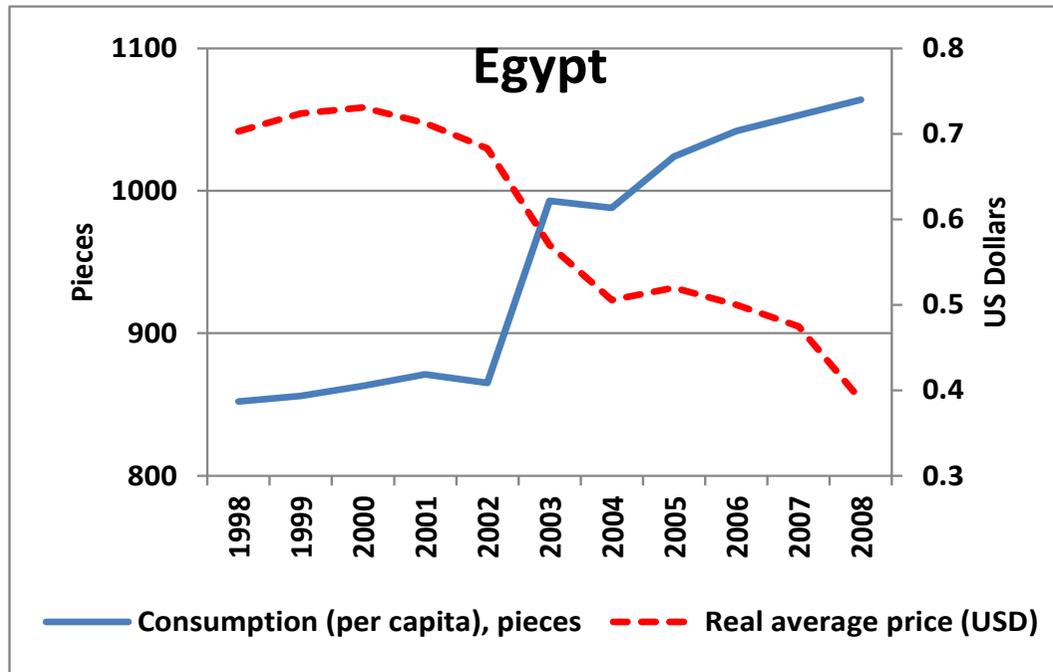
- **Simplification of the tax structure with a gradual move to a uniform tax by 2017**
- **Substantial increases in the tax rates**
  - **Tax rates indexed to inflation starting 2017**

**Tobacco and alcohol excise tax revenues increased from 0.5% of GDP in 2012 to 1.1% of GDP in 2015**

# Paradigm shift in thinking about tobacco taxation



# Negative relationship between price and cigarette consumption



# **Tobacco Industry Tactics**

# TI will always try to affect policy in order to maintain profits

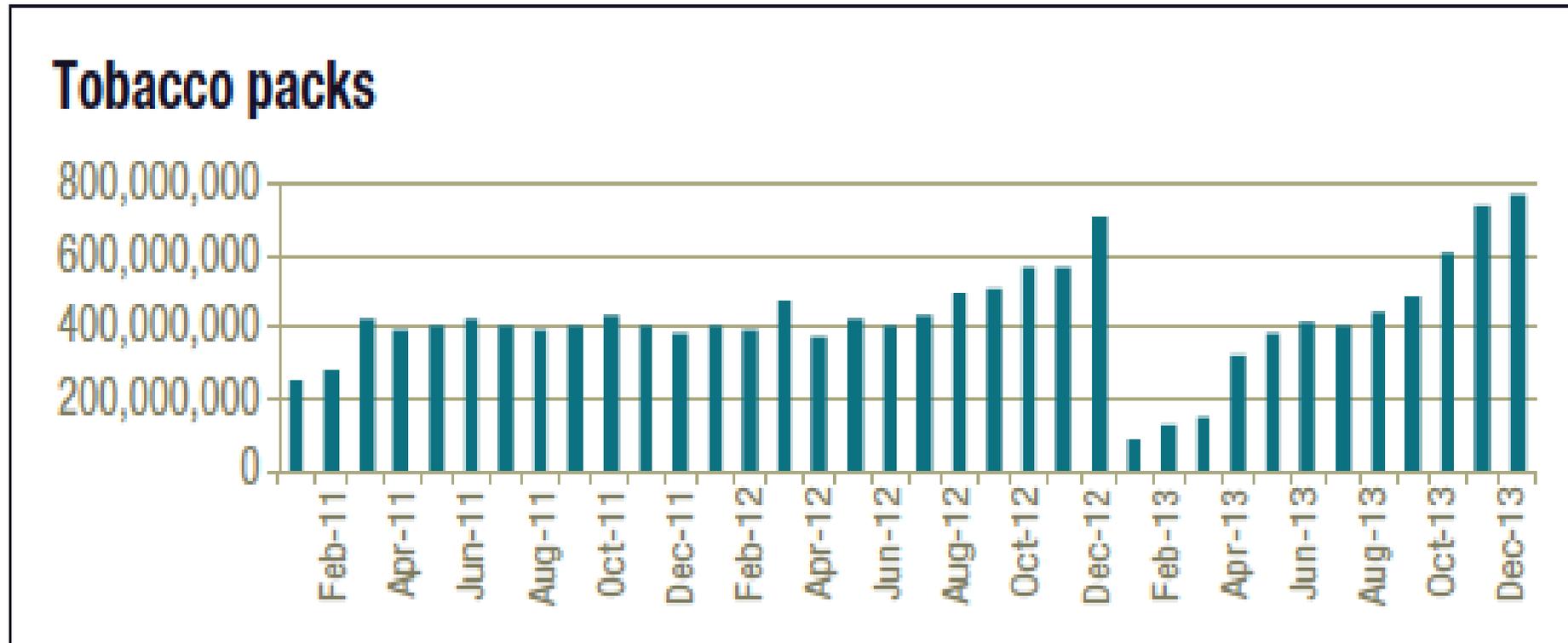
- They may support small tax increases or try to have larger increases spread over more years
- There are also a number of ways they can manipulate prices to slow the impact or hide price increases
  1. Stockpiling
  2. Changing attributes or production process
  3. Overshifting (increasing prices more than the tax increase)
  4. Undershifting (increasing prices less than the tax increase)
  5. Timing of price increases

# 1. Stockpiling

- **Stockpiling, forestalling or front-loading, is the over-supplying the market before a tax increase**
- **It leads to**
  - **higher sales before a tax increase and**
  - **lower sales after**
  - **The tobacco industry often attributes the decrease to higher illicit trade**

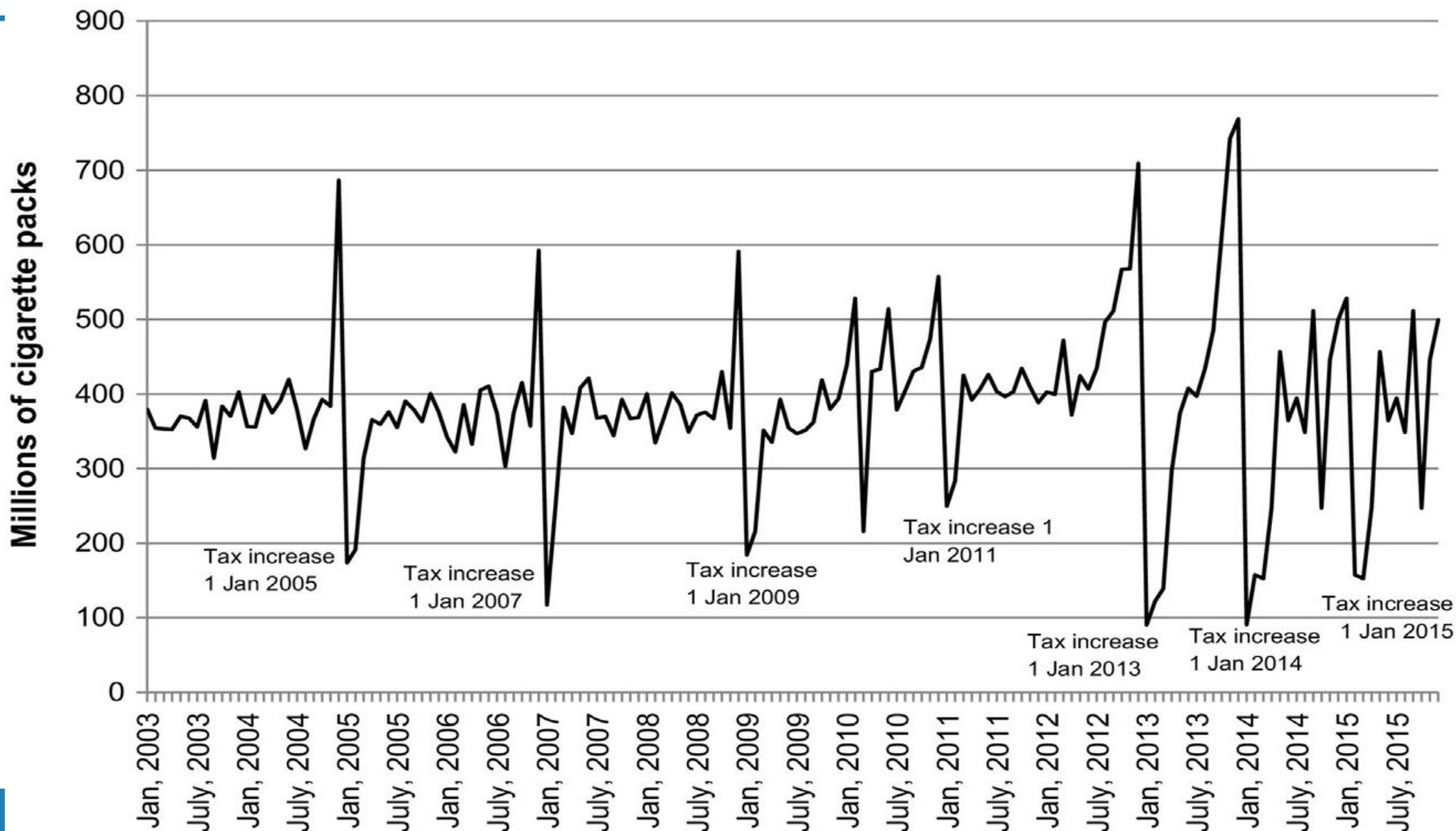
# 1. Stockpiling

Figure 1: Removals of Tobacco Packs, Philippines, 2011-2013



Source: Government of Philippines, 2014

# 1. Stockpiling: Volume of cigarette removals in Philippines (domestic production)



## 2. Changing attributes or production process

Table 1: Indonesia Tobacco Tax Structure, 2013

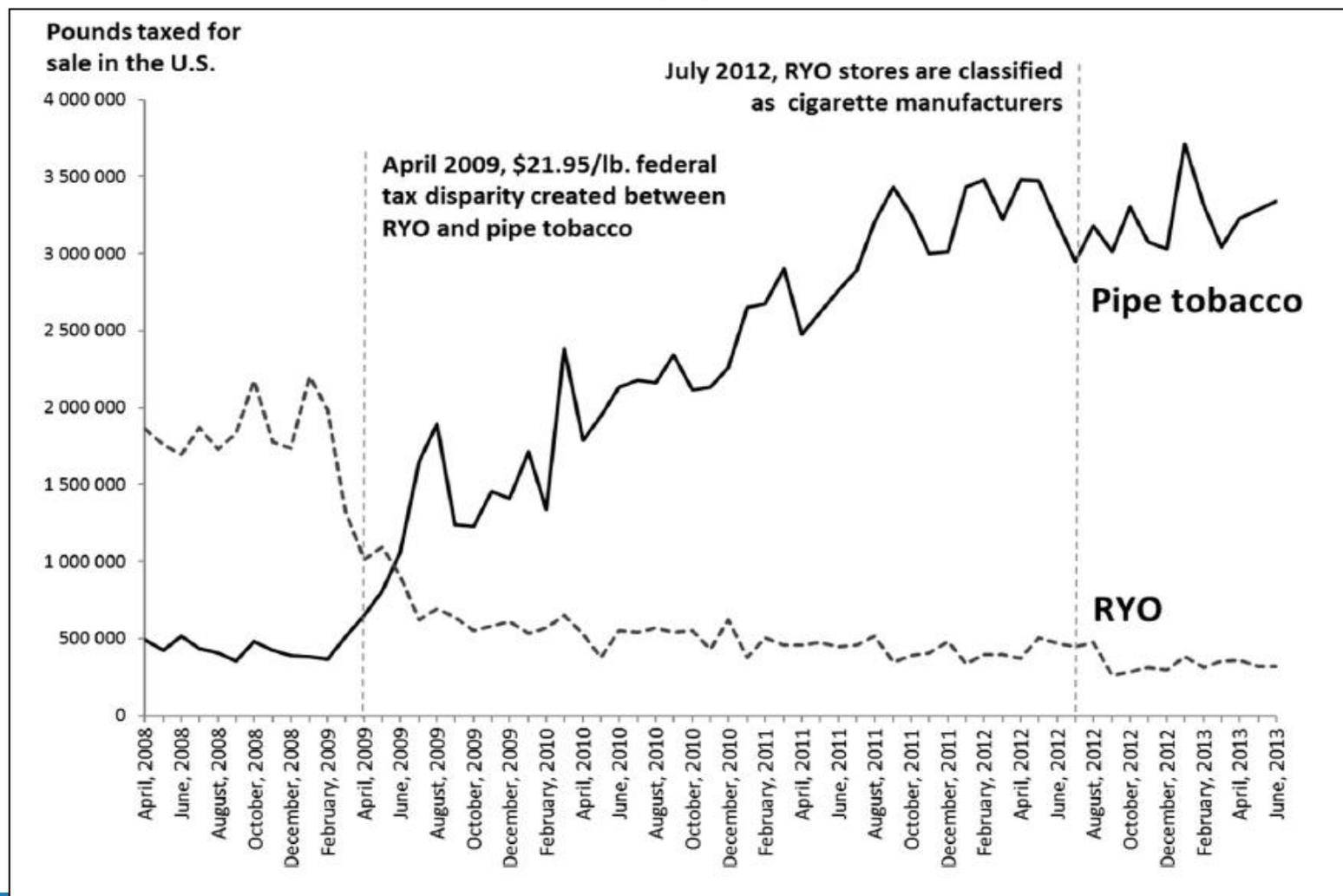
TYPES	PRODUCTION CATEGORY		HJE* RANGE PER STICK	2013 TAX PER STICK (RP)
	Group	Volume of production (billion sticks)		
Kretek cigarettes by machine	I	>2	670 631-669	375 355
	II	≤2	550 440-549	285 245
	I	>2	680	380
White cigarettes by machine	II	≤2	445 345-444	245 195
	I	>2	750 550-749	275 205
Kretek cigarettes by hand roll	II	0.4-2	380 350-379 336-349	130 120 110
	III	<0.4	250	80

\* HJE: government set retail price

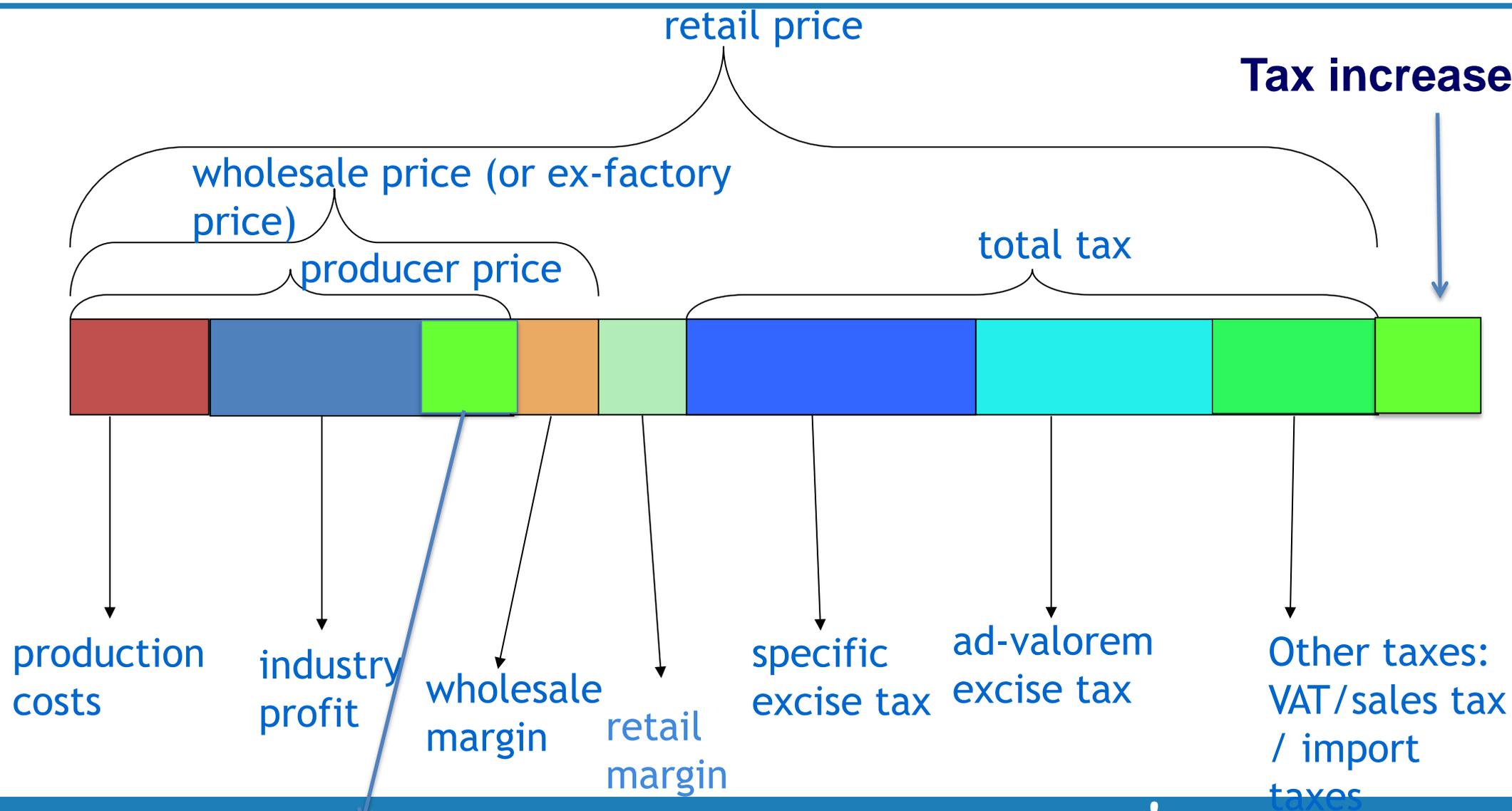
# Changing Attributes or Production Process

Impact of the industry relabeling of roll your own (RYO) as pipe tobacco in the US in 2009 when the government tax increase favored pipe tobacco

Sales of RYO and pipe tobacco 2008–2013



# Components of the retail price of a cigarette



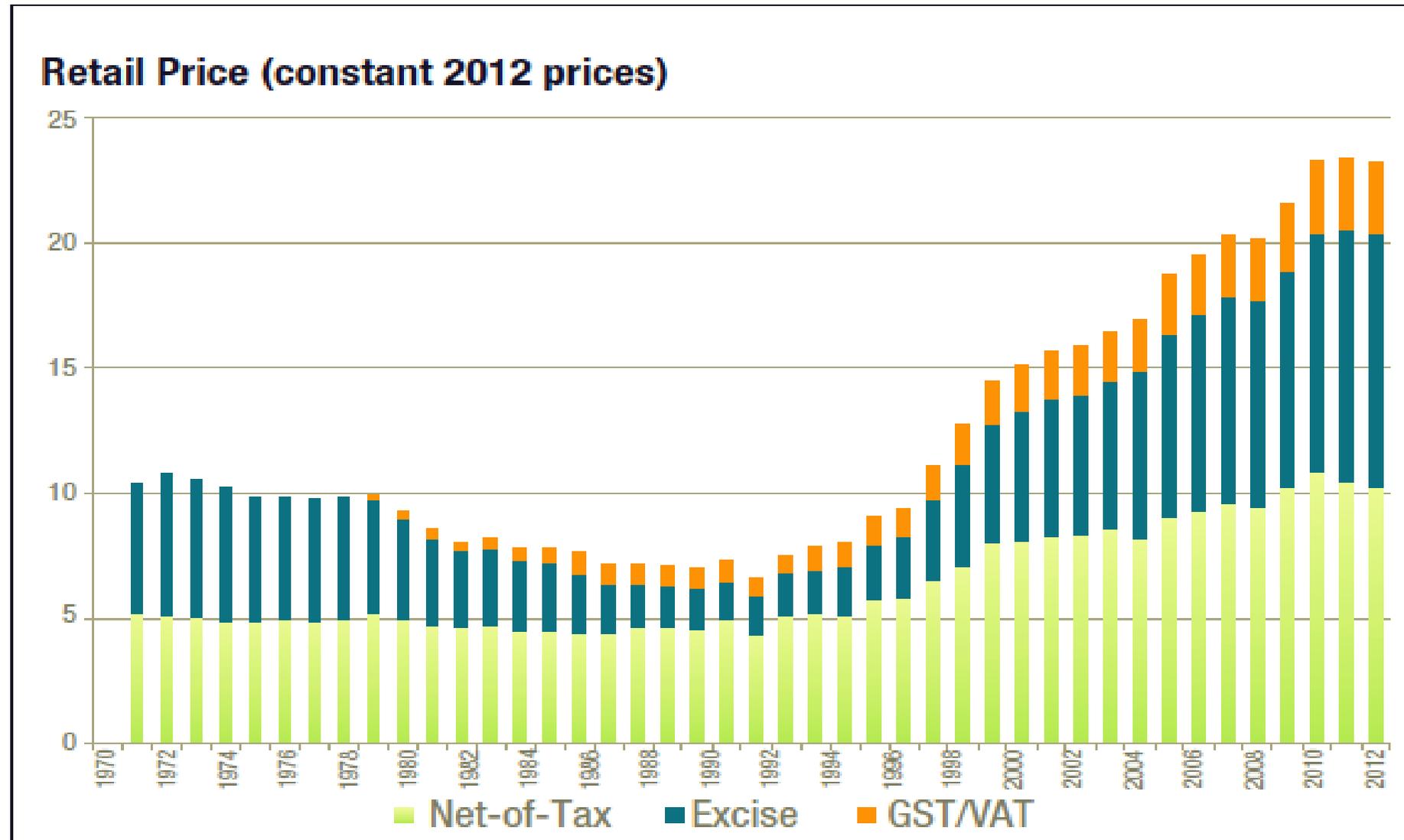
**Tax increase**



**World Health Organization**

# 3. Overshifting (increasing prices more than the tax increases)

Figure 3: Composition of Cigarette Retail Price, South Africa, 1970-2012

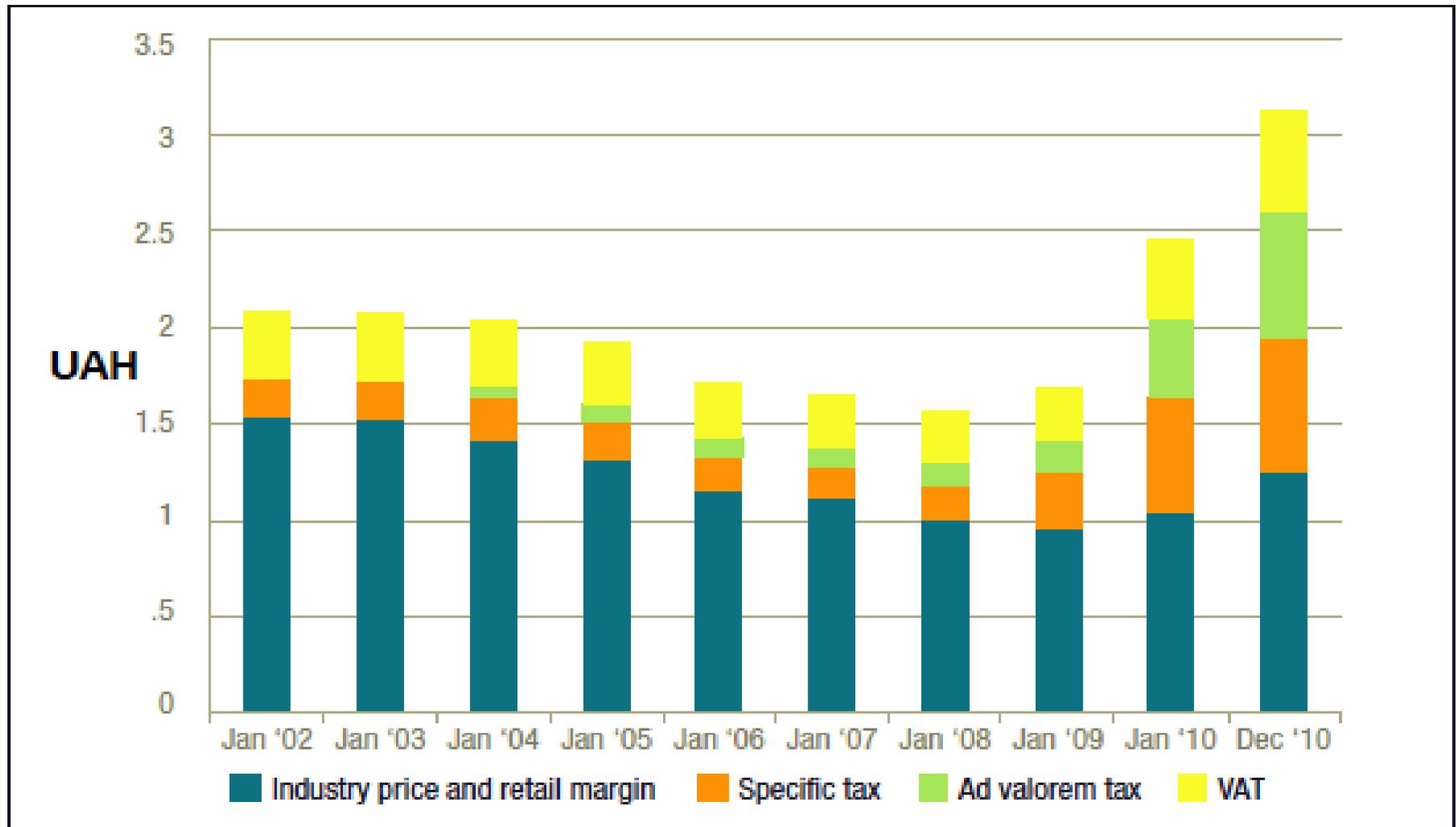


Source: van Walbeek C. Industry responses to the tobacco excise tax increases in South Africa. *South African Journal of Economics*. 2006;74(1): 110-122

# 4. Undershifting

## (increasing prices less than the tax increase)

Figure 4: Share of Taxes in Real (Inflation-adjusted) Filtered Cigarette Prices in Ukraine (2002-2010)



Source: Ross H, Stoklosa M, Krasovsky K. Economic and Public Health Impact of 2007 - 2010 Tobacco Tax Increases in Ukraine. Tobacco Control. 2012; Online First. doi:10.1136/tc.2010.040071

# 5. Timing of price increases

## Bosnia and Herzegovina

In 2009 BiH introduced a mixed excise system with annual increases in the specific part

Most cigarette prices are increased 1 January when the new tax rates come into effect

In 2012, Phillip Morris waited several months to increase the prices of their brands

Even though prices were only temporarily cheaper, it was a successful strategy

Phillip Morris increased their market share from 14.4% to 18.5% in 2012

# What can be done?

- **Monitor**

- Data to understand the effects of tax and price increases

- **Regulation**

- Tax stamps to prevent or limit stockpiling
  - Some countries limit the number of tax stamps or how long previous year stamps can be used

# **Tax and Illicit trade**

# Main Types of Illicit Trade

## 1. Large scale smuggling

- Transporting and selling large volumes of non-tax paid cigarettes, often by criminal organizations
  - Sometimes domestic tax paid cigarettes are exported legally but illegally imported into another country

## 2. Bootlegging

- Smaller amounts of cigarettes smuggled by individuals or small groups
  - Usually cigarettes purchased in low-tax jurisdictions and re-sold in higher-tax regions

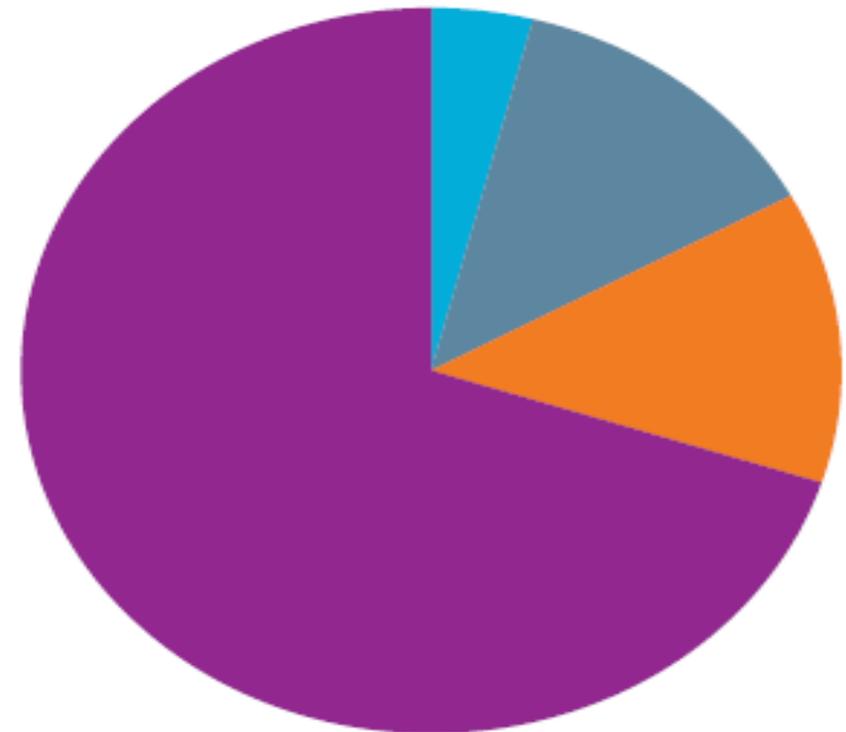
## 3. Illegal manufacturing

- Counterfeiting or production of legal brands to be sold illegally

# World Illicit Trade: 2010

- 70% is large sale smuggling
- 13% bootlegging
- 13% illegal manufacturing

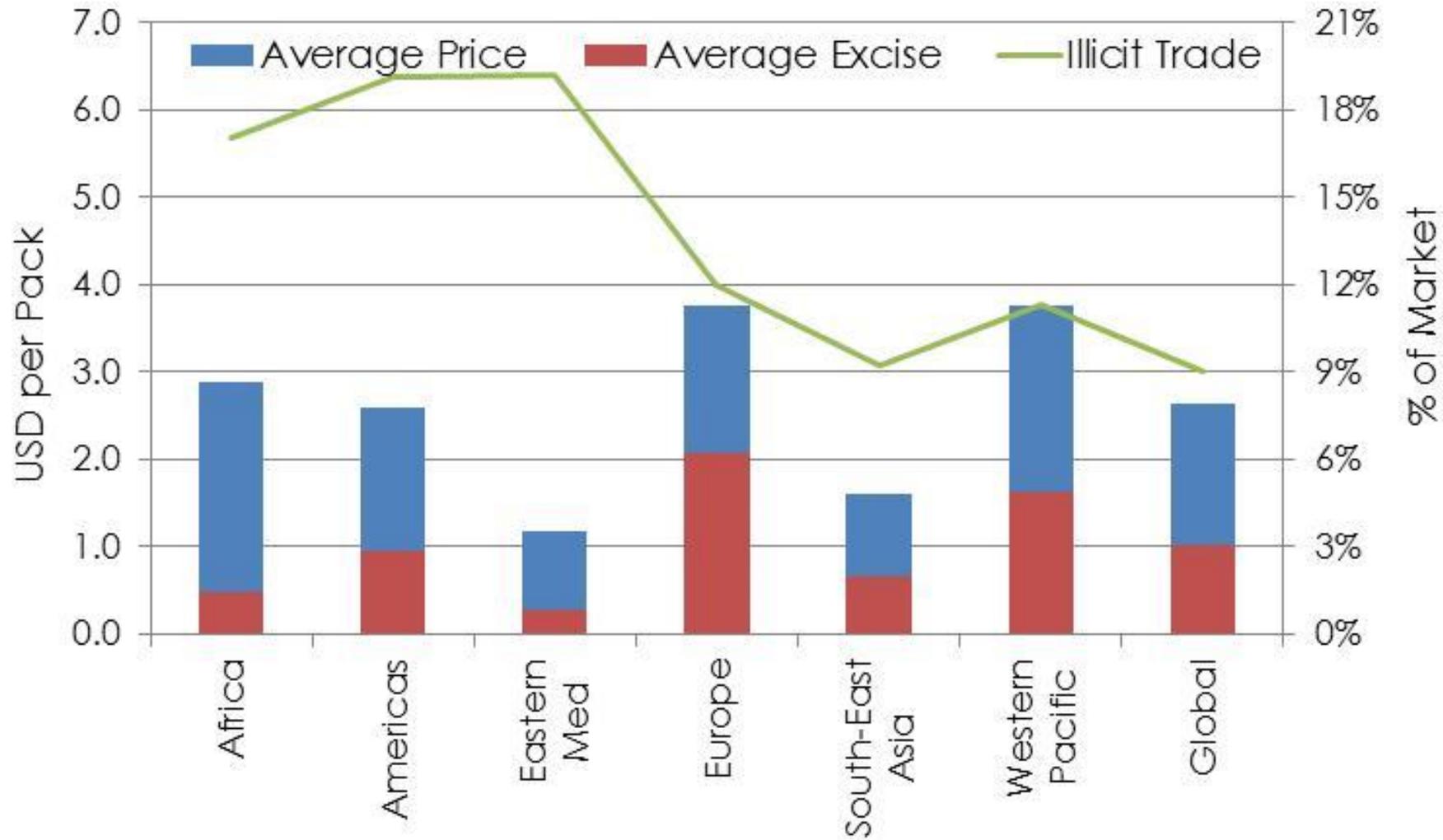
World Illicit Trade by Type



- Internet and other
- Illegal manufacture and counterfeiting
- Bootleg
- Large scale smuggling

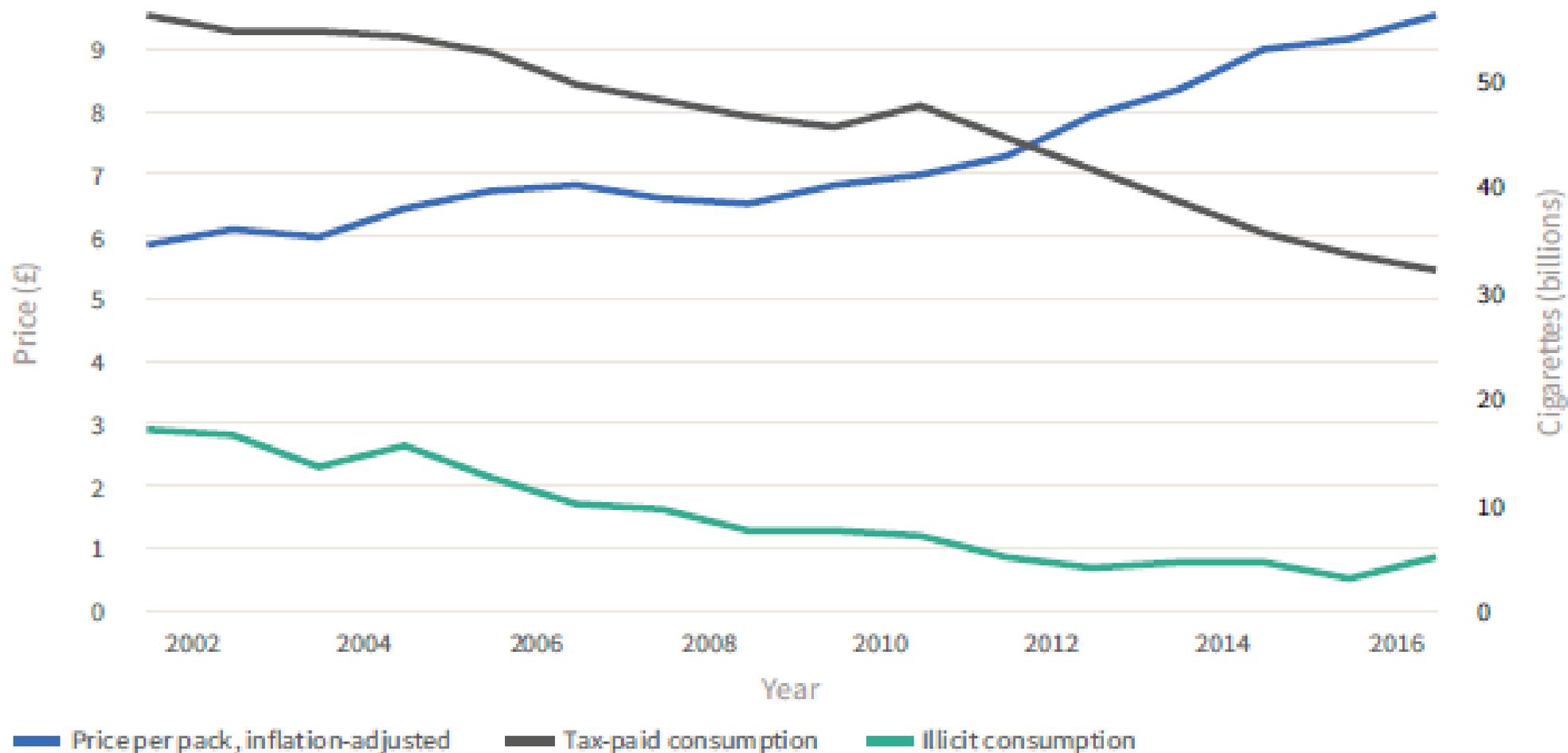
# Illegal trade is not mainly caused by price differences

## Price of most sold brand, excise per page and illicit trade by WHO region, 2010-2011



onitor, 2012

# Cigarette Prices and Illicit Trade: United Kingdom



The inflation adjusted price increased 63% between 2001 and 2016. Illicit trade decreased more than 70% over the same period.

Source: Tobacco Atlas 6<sup>th</sup> Edition, 2016



World Health Organization

# Cigarette Prices and Smuggling

**If price differences are not the main cause, what causes large scale illicit trade?**

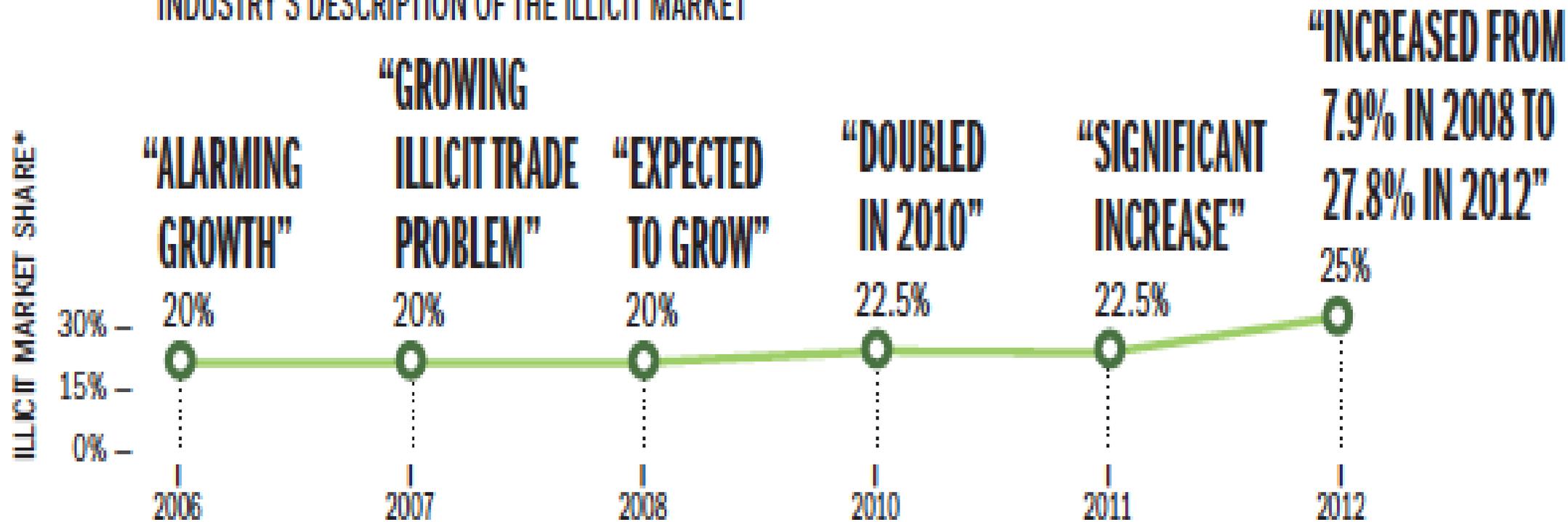
- **Existence of informal trade channels and easily crossed borders**
- **Weak governance and ineffective customs/tax administration**
- **Corruption and complicity of producers/importers**
- **Likelihood of getting caught and high penalties**

# Efforts to Decrease the Levels of Illicit Trade: Illicit Trade Protocol

1. Preventing illicit trade: controlling the supply chain
  2. Law enforcement: sanctions
  3. International cooperation
- Technology
    - Simple stamps to high tech chips
      - Digital stamps affixed in production facilities can record and send data to Ministries of Finance
  - Other methods
    - Physical control such as counting machines in factories
    - Licensing all producers and/or wholesalers
    - “Know your customer” rules

# South Africa-Tobacco Industry Statements vs Estimates about Illicit Trade

## INDUSTRY'S DESCRIPTION OF THE ILLICIT MARKET



\*Median from survey of media reports citing the industry

