

# Cigarette Tax Policy as a Tobacco Control Measure

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## Overview

- Why tax tobacco?
- Types of tobacco taxes
- Tobacco tax is the most effective measure to control tobacco use

## Why Tax Tobacco? (1)

Primary historical motive was efficient revenue generation

Still true in many countries today

Tobacco tax is very efficient source of revenue given:

- ✓ Low share of tax in price in most countries
- ✓ Relatively inelastic demand for tobacco products
- ✓ Few producers and few close substitutes

## Why Tax Tobacco? (2)

**Increasingly important motive: to promote public health** (based on substantial and growing evidence on the effects of tobacco taxes and prices on tobacco use; taxes are particularly effective among young, less educated, and low income populations)

“The Parties recognize that price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons.”

**(Framework Convention on Tobacco Control, Article 6)**

## Why Tax Tobacco? (3)

### **Cover the external costs of tobacco use**

Less frequently used motive

Account for costs resulting from tobacco use imposed on non-users

- Increased health care costs, lost productivity from diseases/ death caused by exposure to tobacco smoke
- Increased financial costs related to publicly financed health care used to treat diseases caused by tobacco use

Can also include “internalities” that result from addiction and time inconsistent preferences

## Types of Tobacco Taxes

- ✓ Taxes on value of tobacco crop
- ✓ Customs duties on tobacco leaf imports and/or exports
- ✓ Customs duties on tobacco product imports and/or exports
- ✓ Sales taxes
- ✓ Value added taxes
- ✓ Excise taxes (the most efficient for tobacco, alcohol products, fuel)

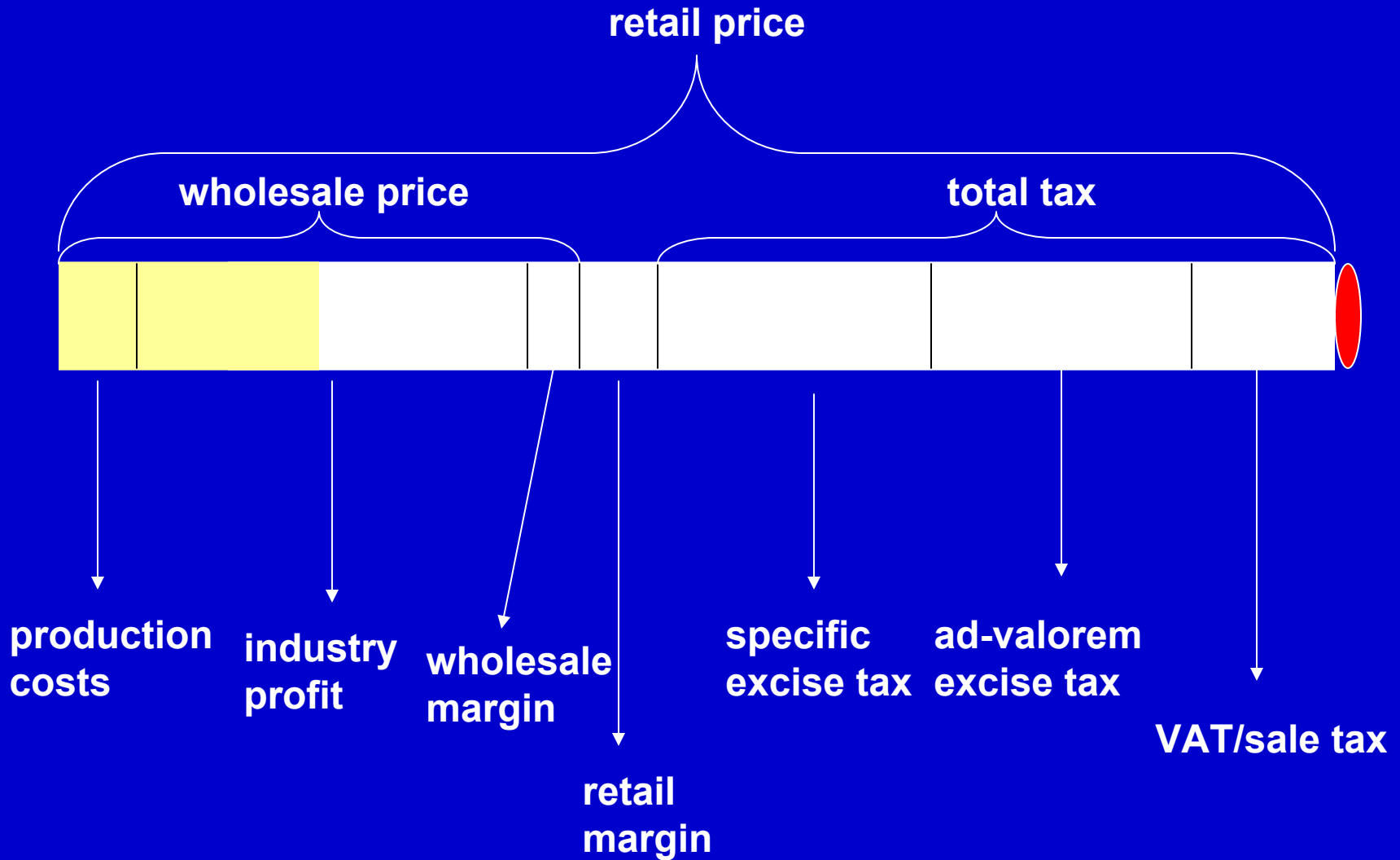
# Two Types of Tobacco Excise Taxes

Specific Taxes: excises based on quantity or weight (e.g. tax per pack of 20 cigarettes)

Ad Valorem taxes: excises based on value of tobacco products (e.g. a specific percentage of manufacturer's prices or retail prices)

- Some countries use a mix of specific and *ad valorem* tobacco excises
- Many countries apply different types of taxes and/or tax rates on different types of tobacco products (e.g. manufactured cigarettes vs. bidis)
- If reducing tobacco use is primary goal, specific tax generally preferred

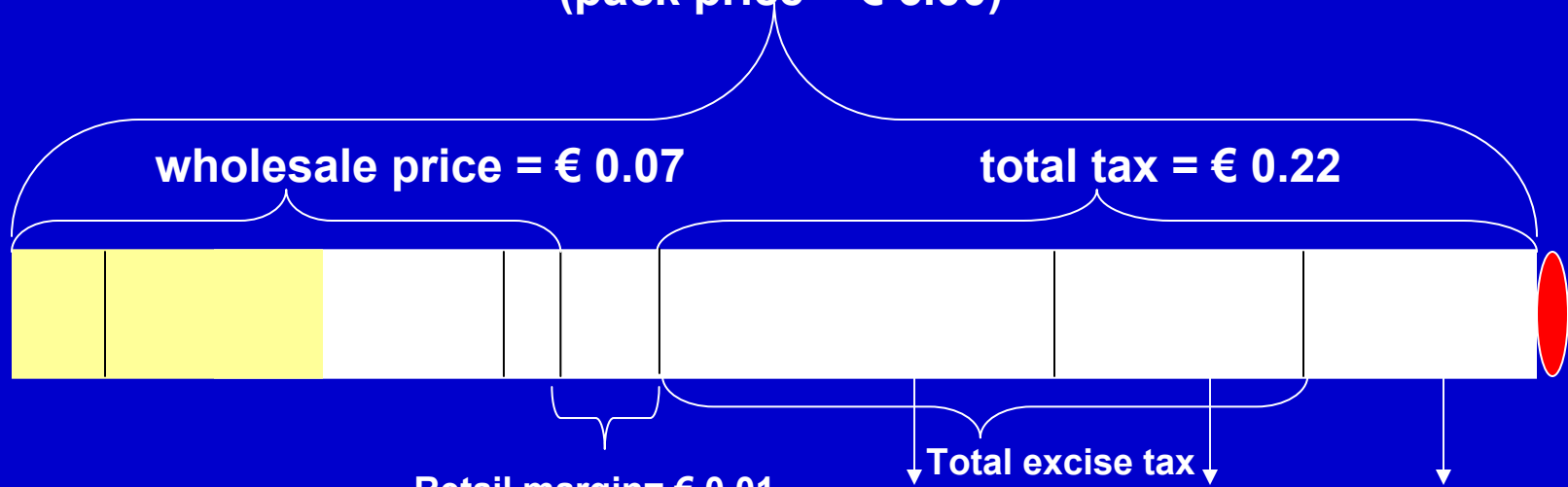
# Cigarette Price



wholesale price = ex-factory price

# Cigarette Price

retail price = € 0.30  
(pack price = € 6.00)



specific  
excise tax  
= € 0.09

ad-valorem  
excise tax: %  
of wholesale  
or retail  
price; e.g. €  
0.09 if rate is  
30% of retail  
price

VAT/sale tax:  
% of (wholesale  
price + excise  
tax); e.g. € 0.04 if  
VAT = 15%

What are we interested in:

- total tax as % of retail price ( $0.22/0.30 = 73\%$ )
- total excise tax as % of retail price ( $0.18/0.30 = 60\%$ )

# EU tax regulations

The balance between ad valorem and specific tax not determine, but the specific tax must be between 5 to 55 % of the total tax including VAT (in our example  $9/22 = 41\%$ )

Excise tax at least 57% of retail price, but min € 64 per 1000 cigarettes; or min € 101 per 1000 cigarettes if excise tax is less than 57% of retail price (in our example, excise tax = 60% or € 180)

VAT in most countries is 13 – 20% of retail price (in our example VAT = 15%)

Fine-cut tobacco tax: 36% of price or € 32 per kg (about 60% of tax incidence for cigarettes)

Most accession countries negotiated transitional period (2007 – 2009)

# Specific Tax

## **Advantage:**

It treats all products equally.

It is easier to administer since it is easier to measure quantity than to determine the value of a product.

It is the most suitable to recover the costs associated with smoking.

## **Disadvantage:**

It is not automatically indexed for inflation.

Per stick taxes may encourage the production of longer cigarettes (e.g. “super king size”).

# Ad Valorem Tax

## **Advantage:**

It is automatically indexed for inflation.

## **Disadvantage:**

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

## Specific tax (example)

What will 100% (from €3.60 to €7.20) increase in specific tax do?

|                 | Before Tax Increase   |                 | After Tax Increase    |                    |
|-----------------|-----------------------|-----------------|-----------------------|--------------------|
| (values in €)   | High Price Brand      | Low Price Brand | Before Tax Increase   | After Tax Increase |
| Wholesale Price | 1.60                  | 0.60            | 1.60                  | 0.60               |
| Excise Tax      | 3.60                  | 3.60            | 7.20                  | 7.20               |
| 15% VAT         | 0.80                  | 0.60            | 1.30                  | 1.20               |
| Retail Price    | 6.00                  | 4.80            | 10.10                 | 9.00               |
|                 | $\Delta$ price = 1.20 |                 | $\Delta$ price = 1.10 |                    |

# Ad valorem tax (example)

What will 100% (from 225% to 450%) increase in ad-valorem tax do?

|                        | Before Tax Increase           |                 | After Tax Increase            |                    |
|------------------------|-------------------------------|-----------------|-------------------------------|--------------------|
| (values in €)          | High Price Brand              | Low Price Brand | Before Tax Increase           | After Tax Increase |
| <b>Wholesale Price</b> | 1.60                          | 0.60            | 1.60                          | 0.60               |
| <b>Excise Tax</b>      | 3.60                          | 1.35            | 7.20                          | 2.70               |
| <b>15% VAT</b>         | 0.80                          | 0.30            | 1.30                          | 0.50               |
| <b>Retail Price</b>    | 6.00                          | 2.25            | 10.10                         | 3.80               |
|                        | $\Delta \text{ price} = 3.75$ |                 | $\Delta \text{ price} = 6.30$ |                    |

**THANK YOU!**

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