

Economic Rationale for Tobacco Taxes in the Current Health and Fiscal Context

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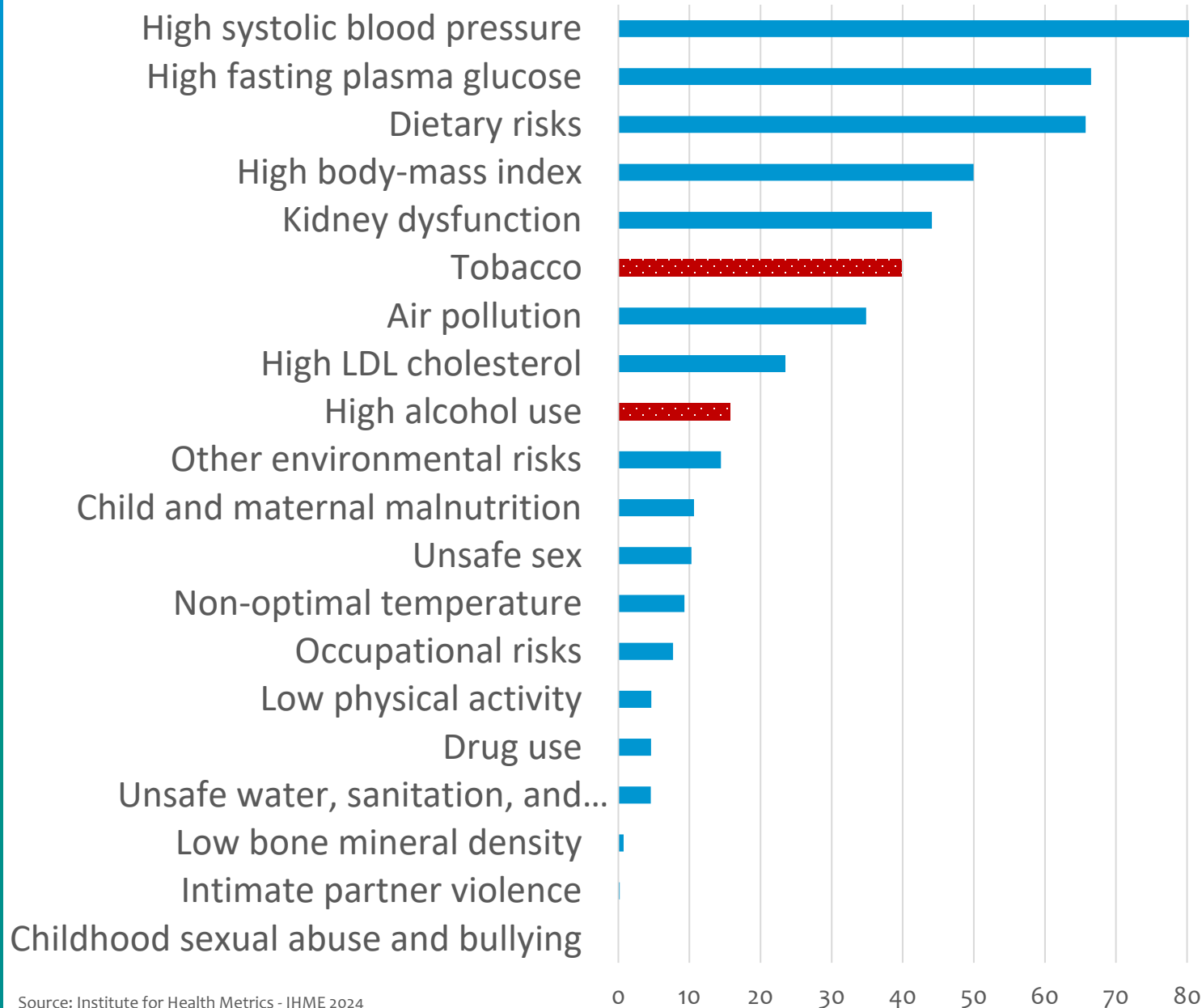
Take-aways:

Tobacco consumption causes significant **negative internalities and externalities** in LAC

Tobacco excise taxes are an effective way to correct this

Deaths in Latin America and the Caribbean

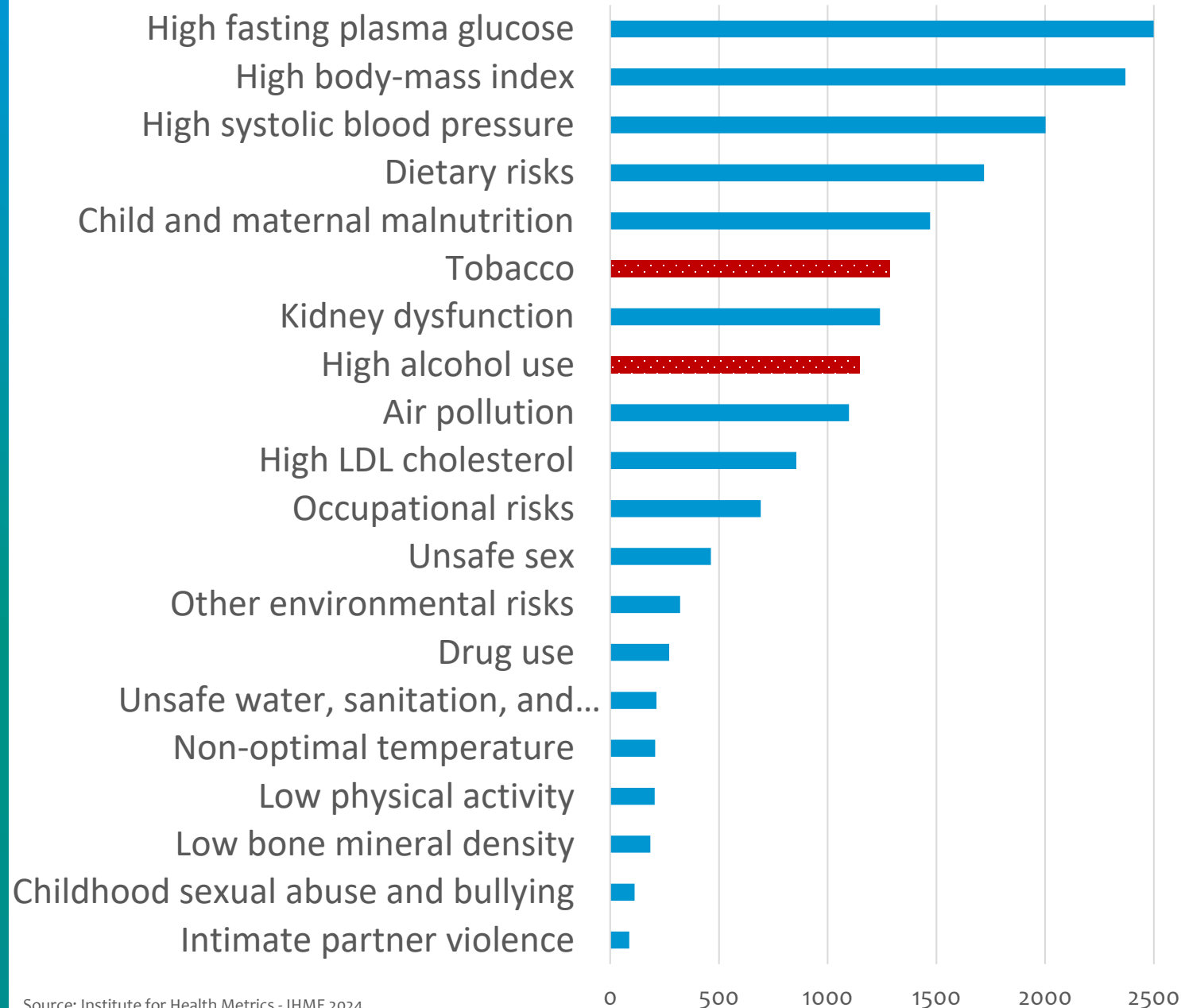
Deaths per 100,000 population



- Tobacco is the **single** most **preventable** cause of death in the region
 - All the ones on top of tobacco are multi-causal, not single, or not fully preventable

DALYs in Latin America and the Caribbean

DALYs per 100,000 population



- Tobacco is the **single** most **preventable** cause of death, disease and disability in the region
 - All the ones on top of tobacco are multi-causal, not single, or not fully preventable

How do Tobacco excise taxes work?

Economic framework

- Target consumption of products that generate health-related negative **externalities & internalities**
- Improved **tax structure** & increased **tax rates** → increase **prices** to account for these uninternalized costs

Improve health

- Increase **prices** → decrease **consumption**
Even though tobacco and alcohol are relatively inelastic, consumption responds predictably to increases in prices
- → improves **health** by increasing cessation; reducing initiation, intensity & concentration

Improve fiscal space

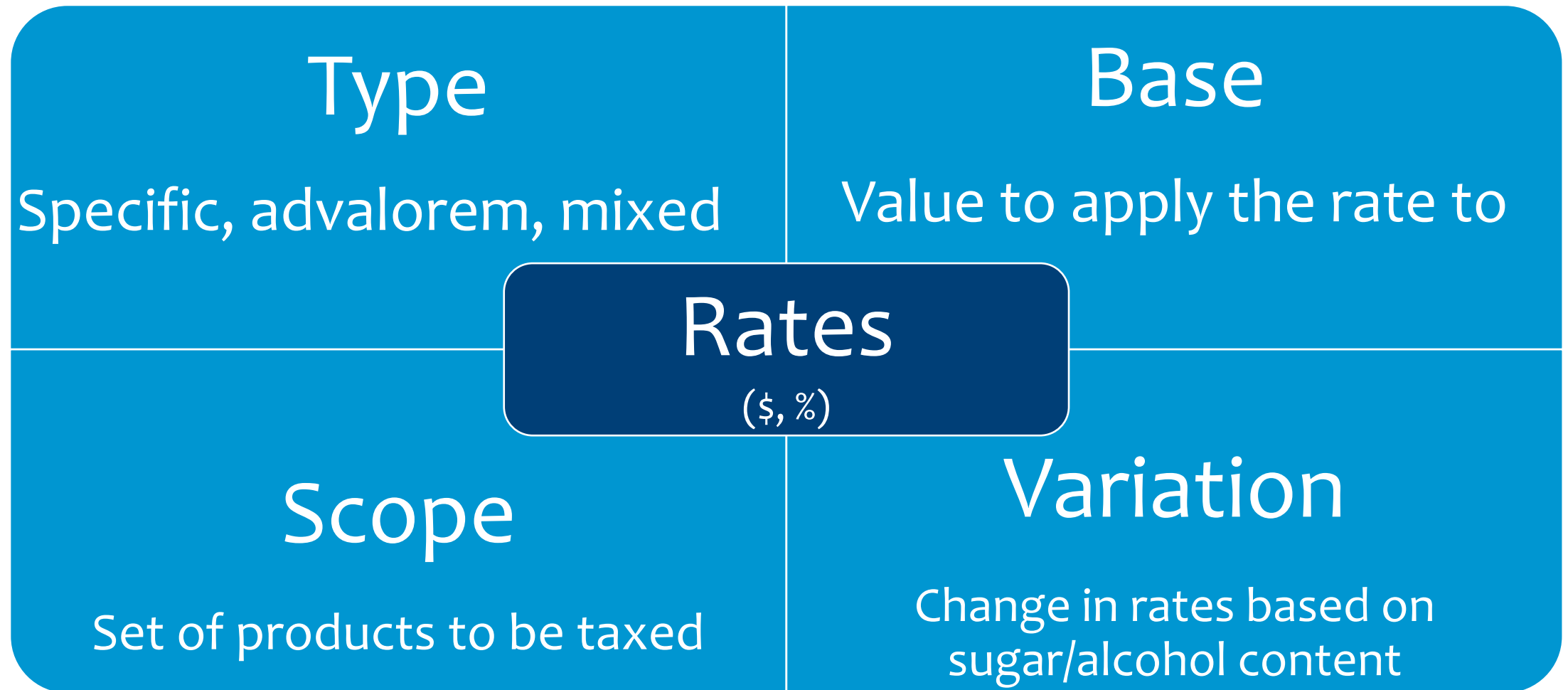
- Better taxes (structure & rates) generate additional **tax revenue**
Price inelastic demand ensures tax revenues increase even when consumption falls
- Create space for spending priorities (e.g. health, social programs,...)
- Improve **productivity** and **human capital**

Take-away:

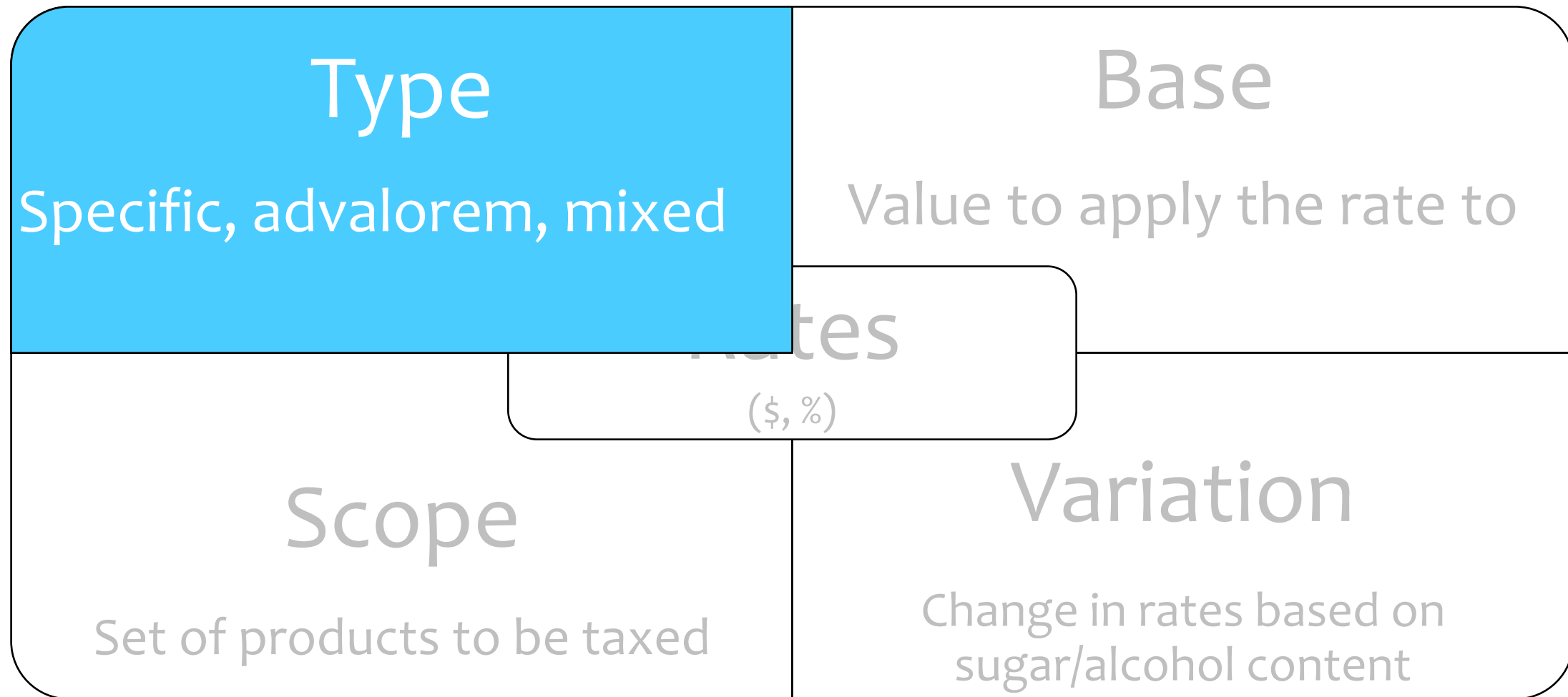
Well-designed tobacco taxes can improve health outcomes, especially for the poor

While increasing tax revenue

For tobacco taxes to be effective, it is crucial that they are well-designed in structure (type, base, scope, variation) & rates



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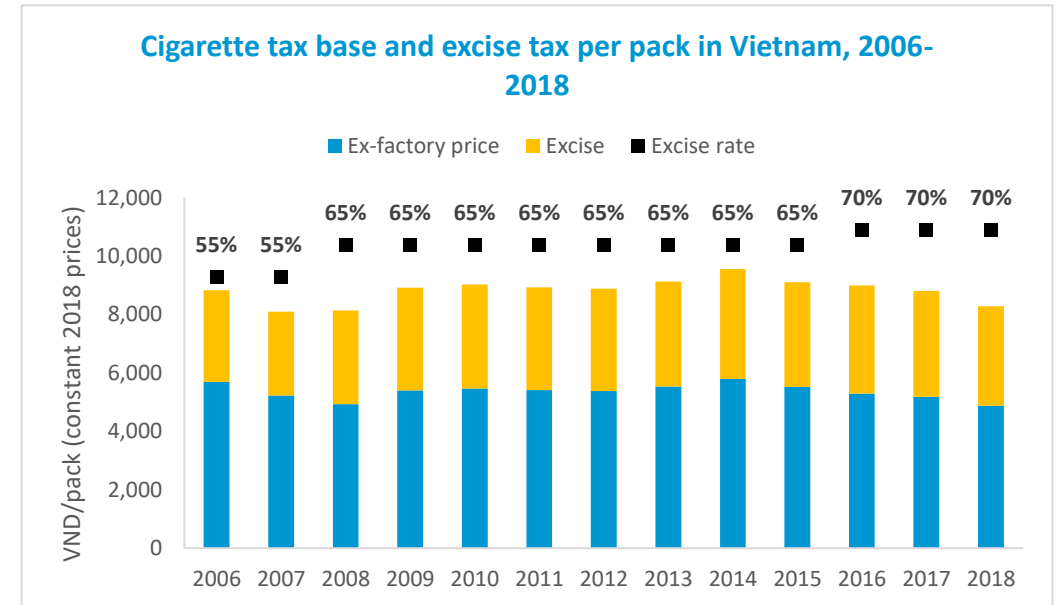


Tax Structure: Type

- ✓ **Specific** taxes have a more significant health and fiscal impact (due to effect on prices) and are more effective at targeting negative externalities and internalities:
 - a cheaper cigarette is not less harmful than a more expensive cigarettes
- ✓ In **mixed** types, **specific** should be much larger than the ad valorem component
 - In this way, the specific component will play the leading role

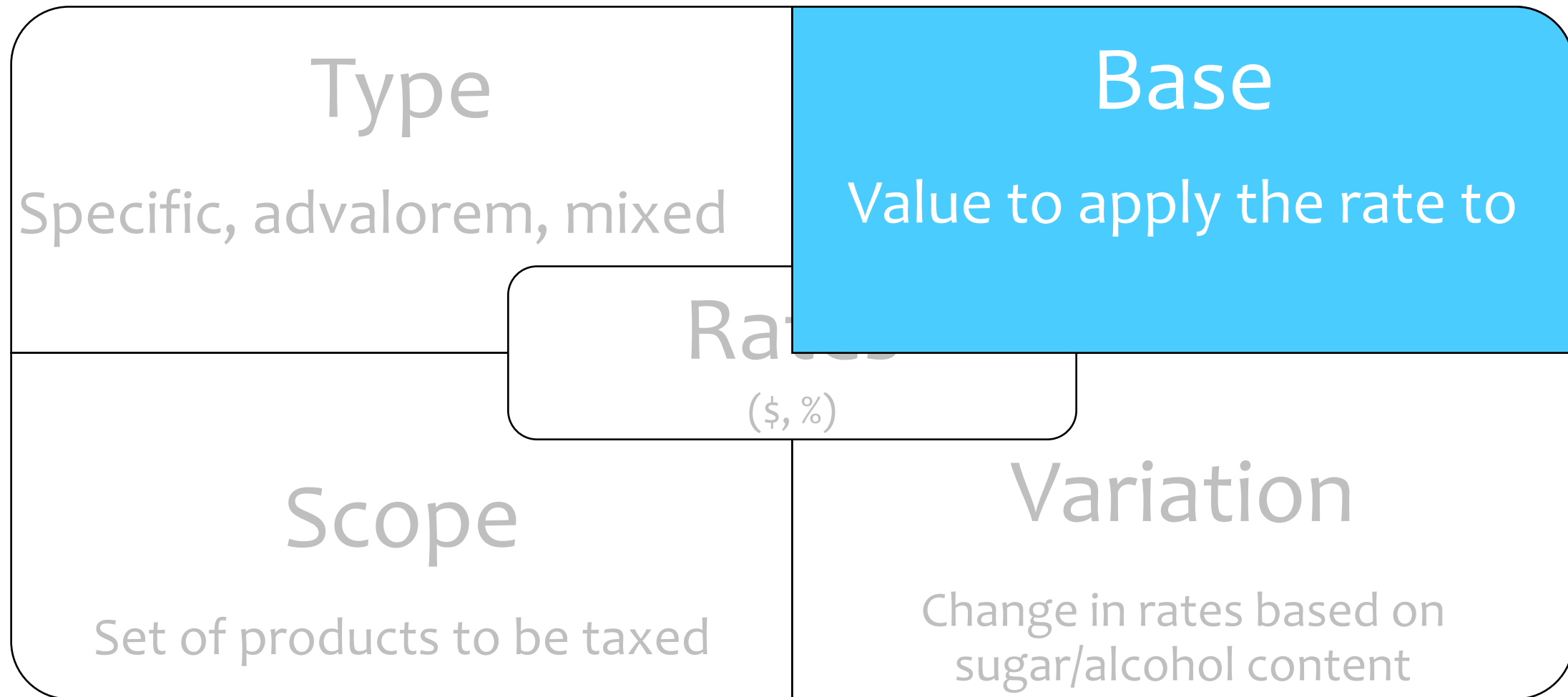
Ad valorem taxes, particularly when levied early in the supply chain result in smaller impact on prices and weakening the impact on consumption

- Country example: Vietnam applies an ad valorem excise on cigarettes, based on the ex-factory price
- This is early in the supply chain, meaning that the tax base is relatively small; even though the tax rate in 2018 was 70%, this only accounted for 29% of the price of the most sold brand (WHO, 2019)
- Between 2006 and 2018, tax rates increased from 55% to 70%, however the weighted average tax per pack only increase 9% since the weighted average ex-factory price declined by 14% (in real terms)
- The tax increases were *under shifted*, as producers cut ex-factory prices to maintain the effective tax value
- This led to retail prices declining in real terms: between 2008 and 2018 (shorter period): weighted average price declined by 14% (Euromonitor) and most sold brand by 2% (WHO, 2019)
- Since prices did not increase, there will be no impact on consumption or health; rather falling prices led to an 8% increase in sales volumes



Source: GTP update from Blecher and Le Thu Thu (2018)

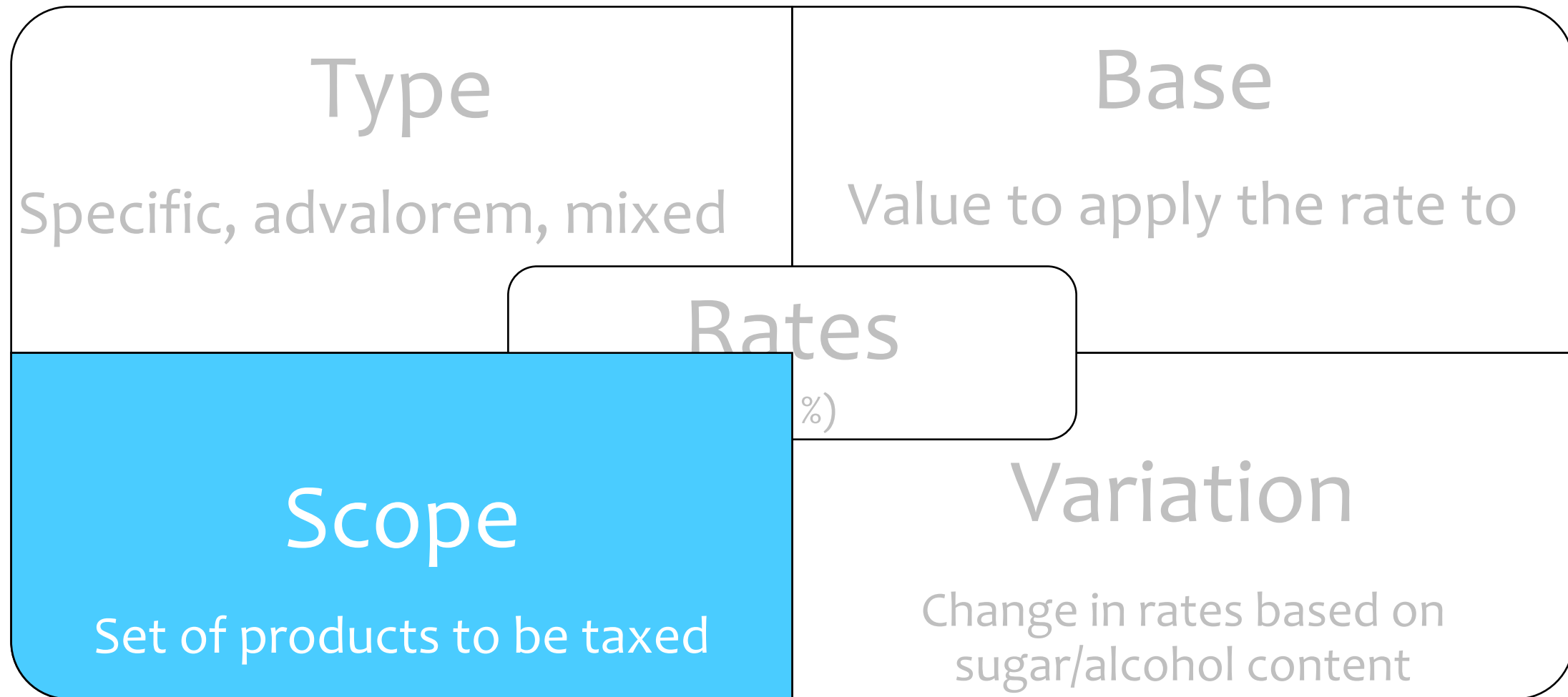
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Tax Structure: Base

- ✓ **Specific** taxes for cigarettes should use a cigarette or a pack of 20 cigarettes as the tax base
- ✓ In **mixed** types, **ad valorem** taxes should use the **retail price** as the tax base
 - ▶ Using the ex-factory price as the tax base leads to much lower effective taxes in the ad valorem component

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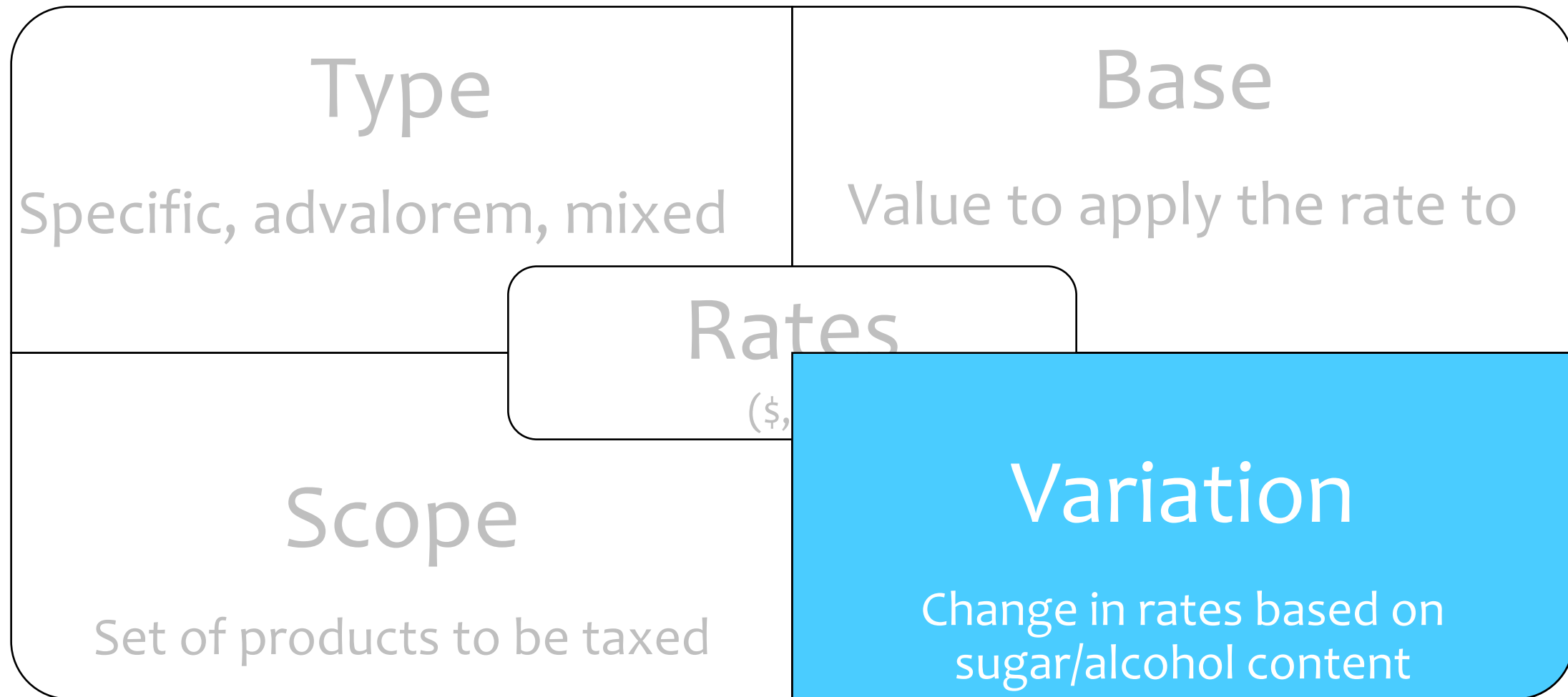
Tax Structure: Scope

✓ Include all tobacco products

- Cigarettes
- Heated Tobacco Products (HTP)
- Electronic Nicotine and Non-Nicotine Delivery systems (ENDS, ENNDS)
- Nicotine pouches
- Cigars, RYO, Chewing tobacco

✓ Harmonized system: Chapter 24 “Tobacco and manufactured tobacco substitutes”

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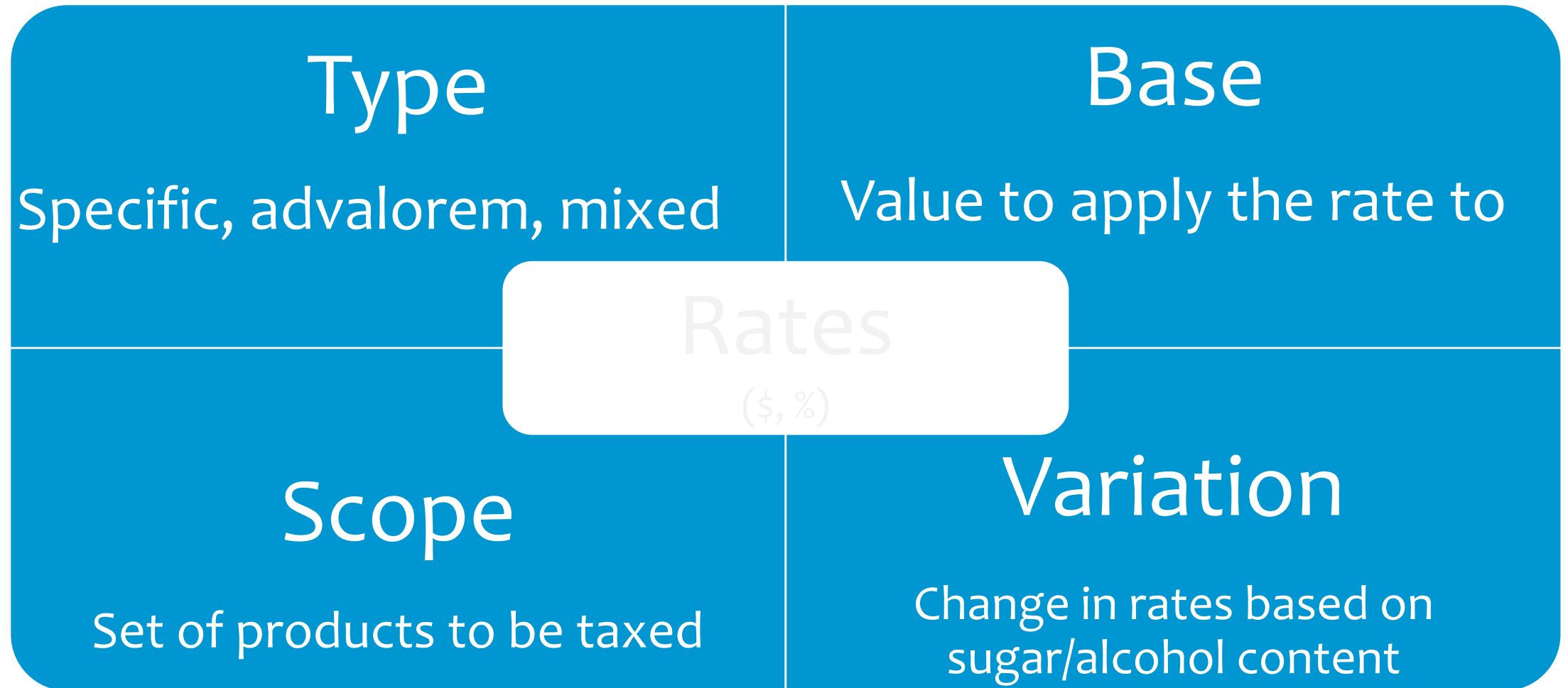
Tax Structure: Variation

- ✓ Uniform (no variation): same rate for all products
 - Product is homogenous (mostly cigarette)
 - The internality/externality is not associated with frequency, intensity and nicotine concentration
 - Negative externalities and internalities of cigarettes are not significantly correlated with the strength of cigarette (e.g., nicotine or tar)
 - Rather, harm is correlated with the length and intensity of exposure, i.e., number of cigarettes smoked per day multiplied by the years of smoking (often referred to as “pack years”)
 - Thus, the tax is almost always applied to the volume of cigarettes (number of sticks, pack, weight) independent of the characteristics of value
 - Tax structures that apply tax to value or via tiers do not effectively target the externalities and internalities
 - No known examples where the tax base is linked to the strength of the cigarette

- ✓ No evidence on risk reduction in new products
 - HTP aerosol contains other toxicants sometimes at higher levels than in tobacco smoke (glycidol, pyridine, dimethyl trisulfide, acetoin and methylglyoxal)

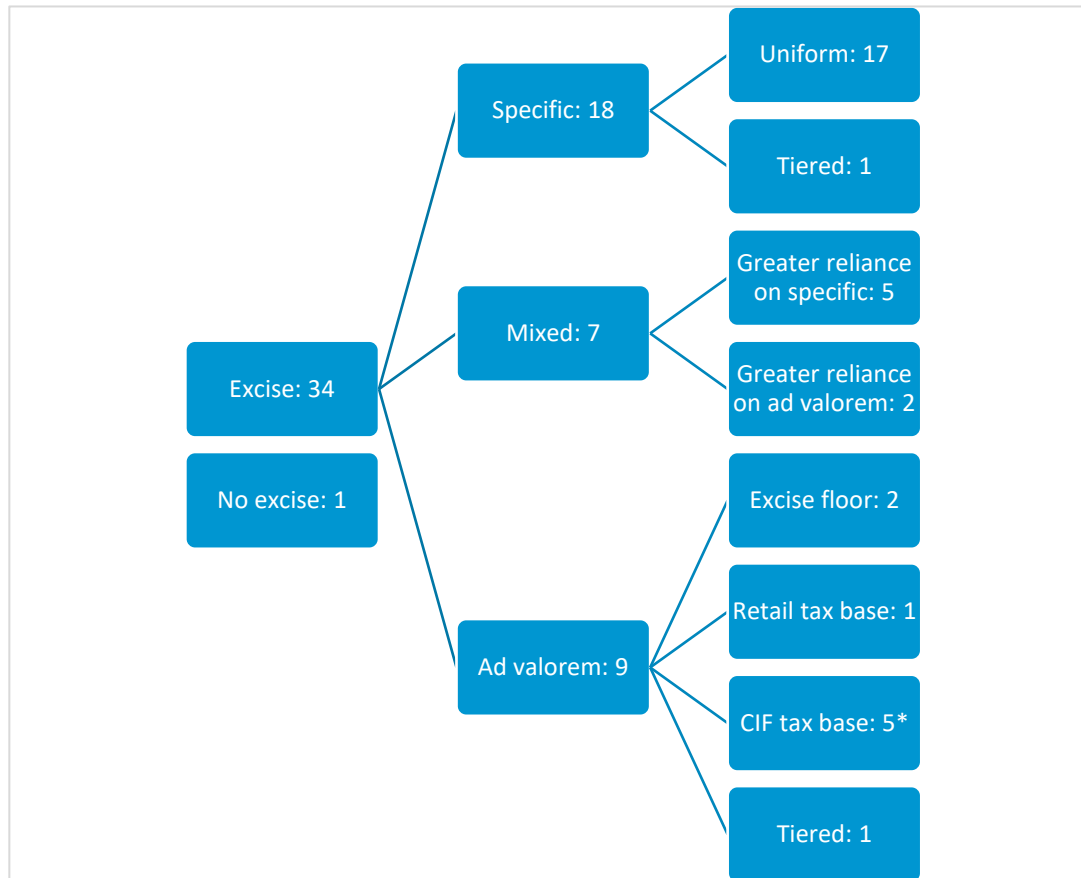
- ✓ No differential tax treatment for new products
 - Country-specific work can be conducted to avoid tax designs incentivizing substitution across products

Tobacco Tax Structure



While there is a lot of variation in tobacco tax structures in the LAC region, most countries have well designed tax structures

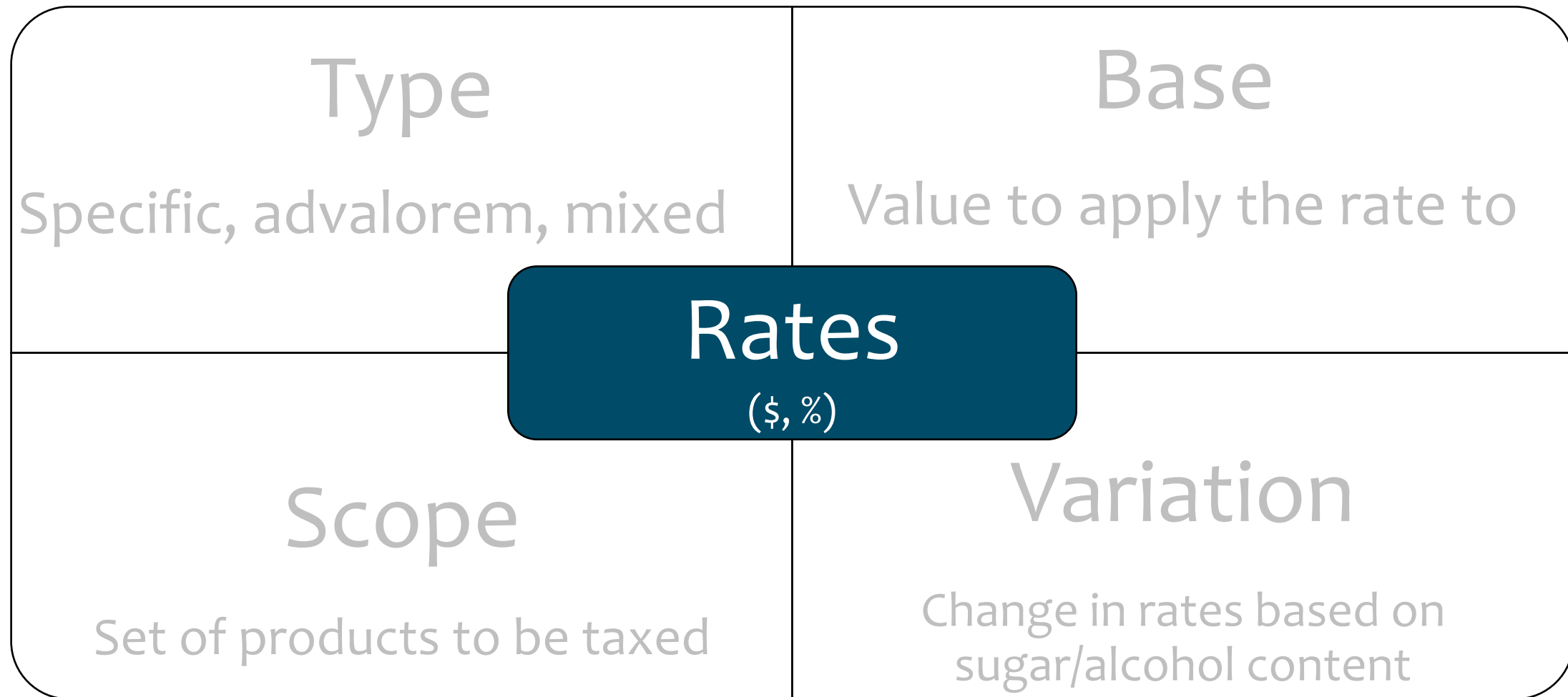
Tobacco tax structures in LAC region (2022)



- Majority of countries have **specific or mixed** systems (25/35)
- Few of these countries undermine effectiveness of specific taxes with tiers (1/18) or mixed systems by dominant ad valorem components (2/7)
- Even among countries with ad valorem taxes, several use other mechanisms (e.g., retail prices as the tax base or a tax floor) to bolster the system
- Only 7 countries have particularly weak tax structures (1 tiered specific, 5 ad valorem early in the supply chain)

Source: GTP estimates based on the WHO Report on the Global Tobacco Epidemic (2023)
 Note: * 8 when including countries with the excise floor and tiered who all have a CIF base

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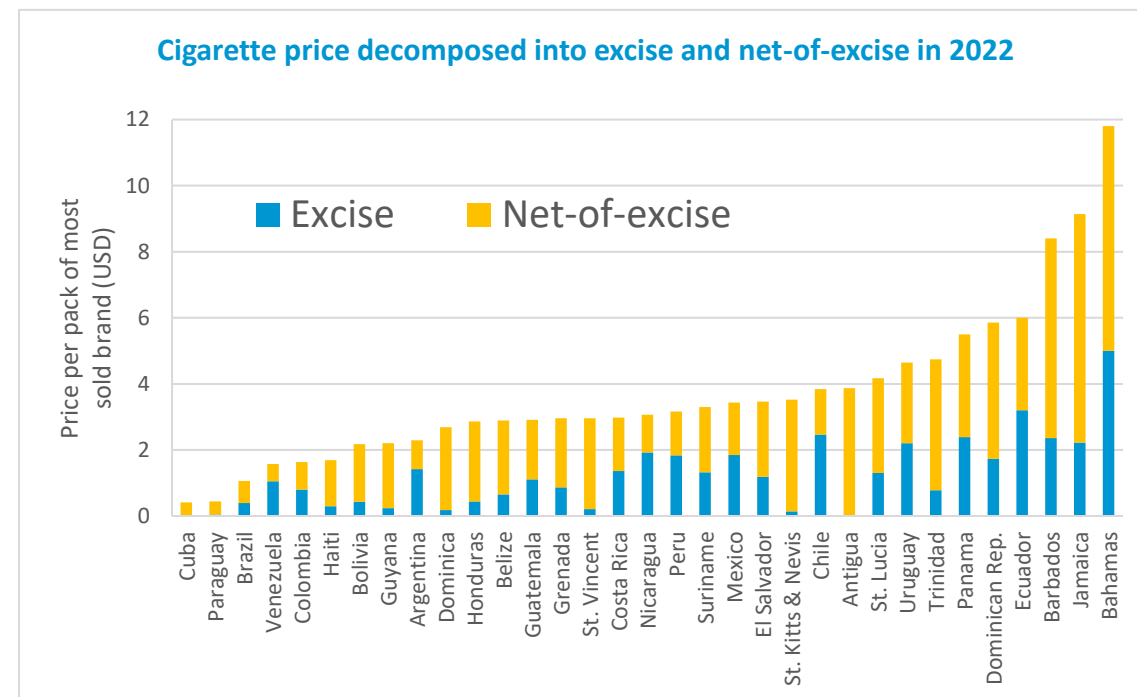
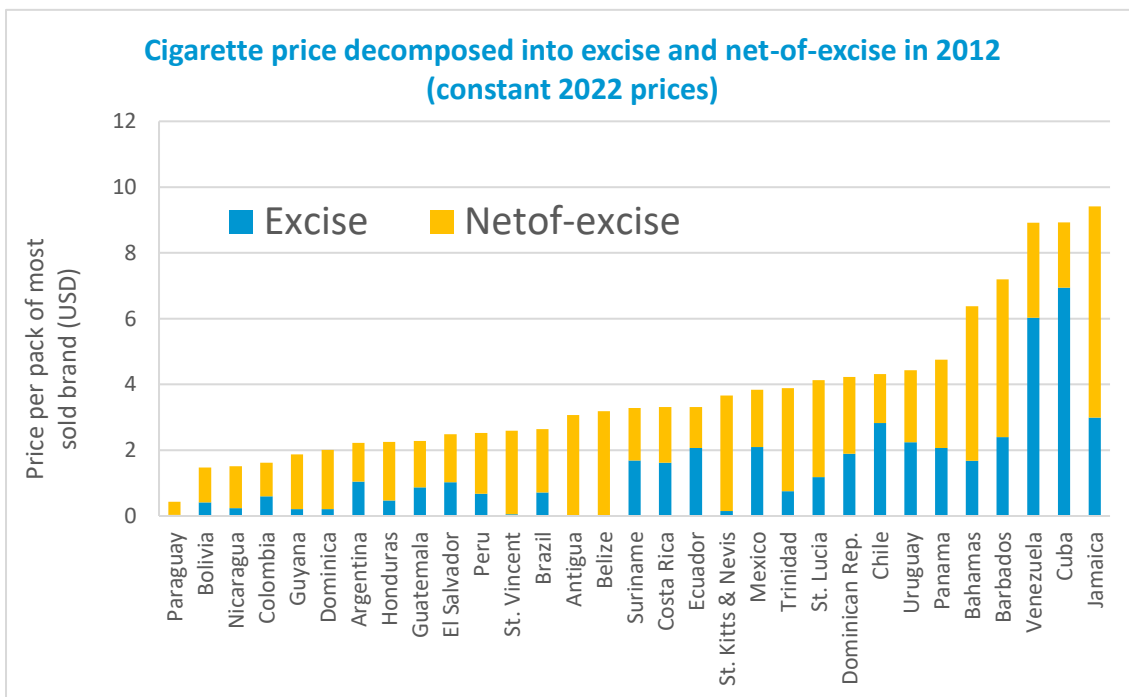
Tax Structure: Rates

- ✓ **High** rates to correct for externalities and internalities
- ✓ Specific rates **automatically** adjusted for inflation and income growth
- ✓ After tax hikes, continuous **monitoring & evaluation** to inform implementation of new hikes in tax rates regularly (≈ 3 years)

Even with relatively well-designed tax structures, taxes and prices have not increased in LAC countries over the last decade

- While well-designed **tax structures** are a necessary condition to ensure that **tax rate** increases are effective in increasing prices, reducing consumption and raising revenue
- However, **large tax rate increases** are still required to achieve reductions in **consumption** and improvements in health

	Price		Excise	
	2012	2022	2012	2022
Average	3.75	3.69	1.56	1.34
Median	3.28	3.06	1.04	1.18
Minimum	0.43	0.42	0.04	0.05
Maximum	9.41	11.80	6.95	5.00
Coef. of variation	0.60	0.65	1.04	0.81



Thanks! Gracias! Obrigado!

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<https://www.worldbank.org/en/programs/the-global-tax-program>