

# Revenue generation potential of tobacco taxes in Latin America

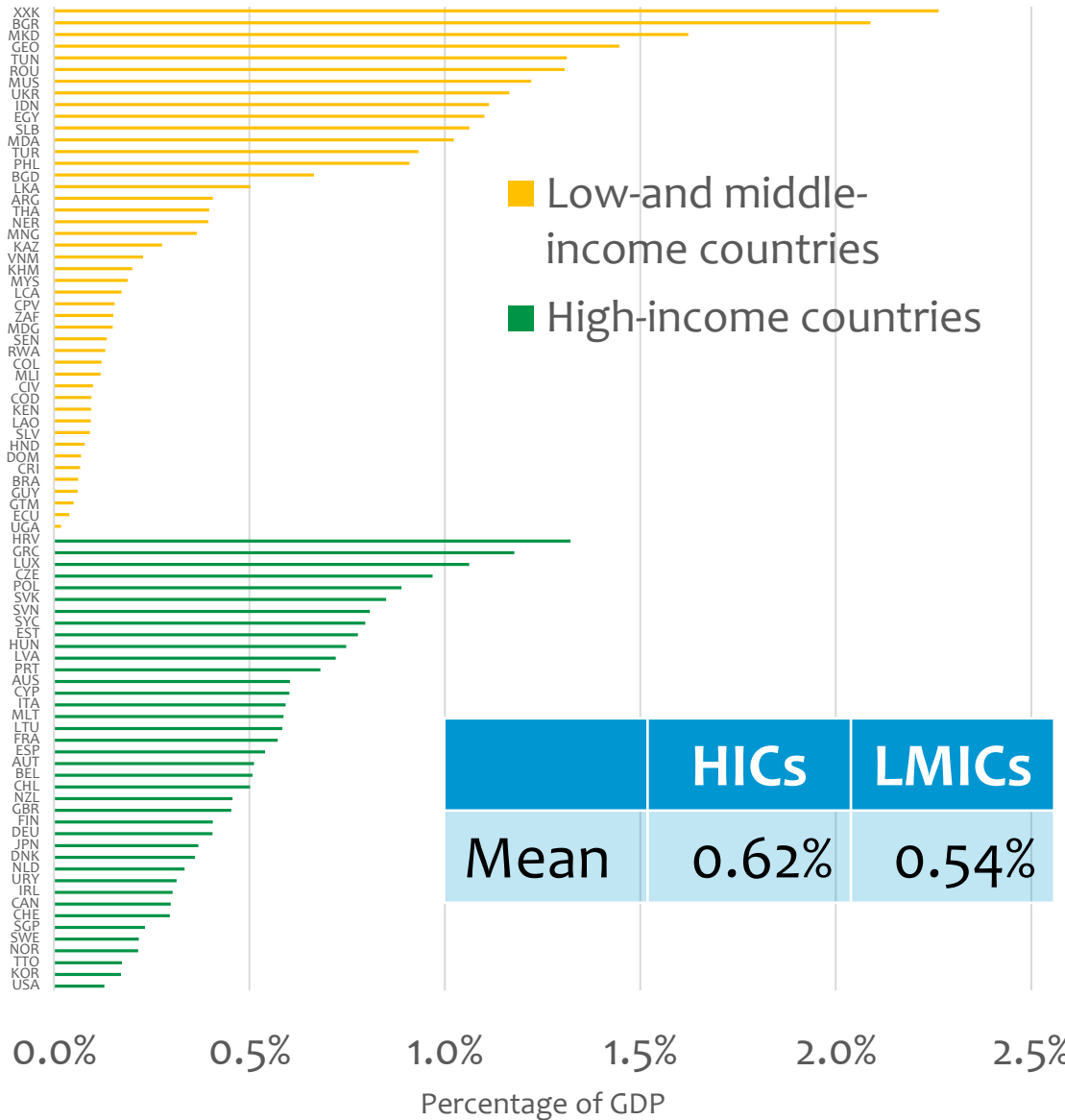
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# Message 1:

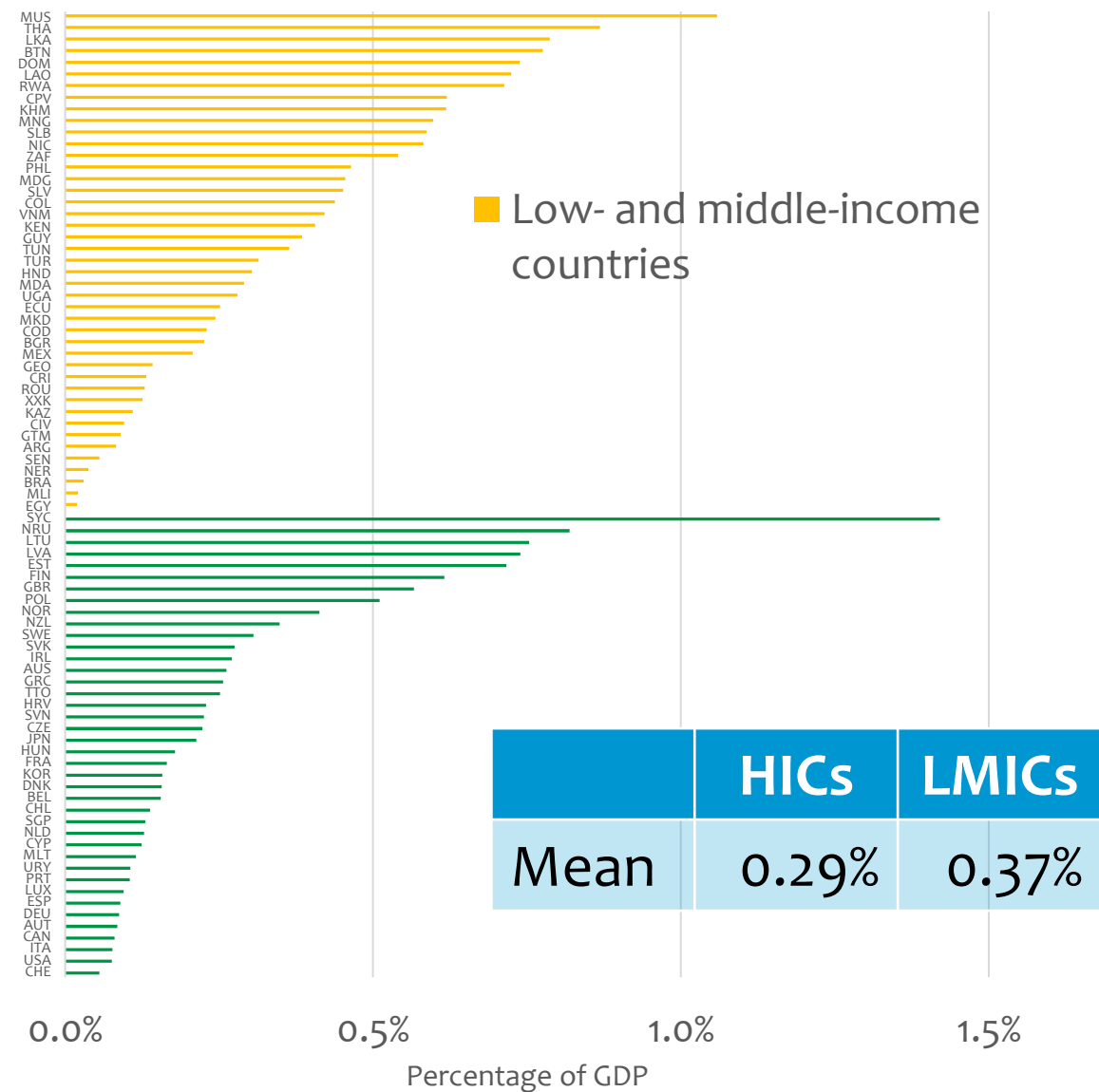
Well-designed tobacco taxes have the potential to generate considerable revenue Globally and in LAC

# Magnitude of tobacco tax revenues?

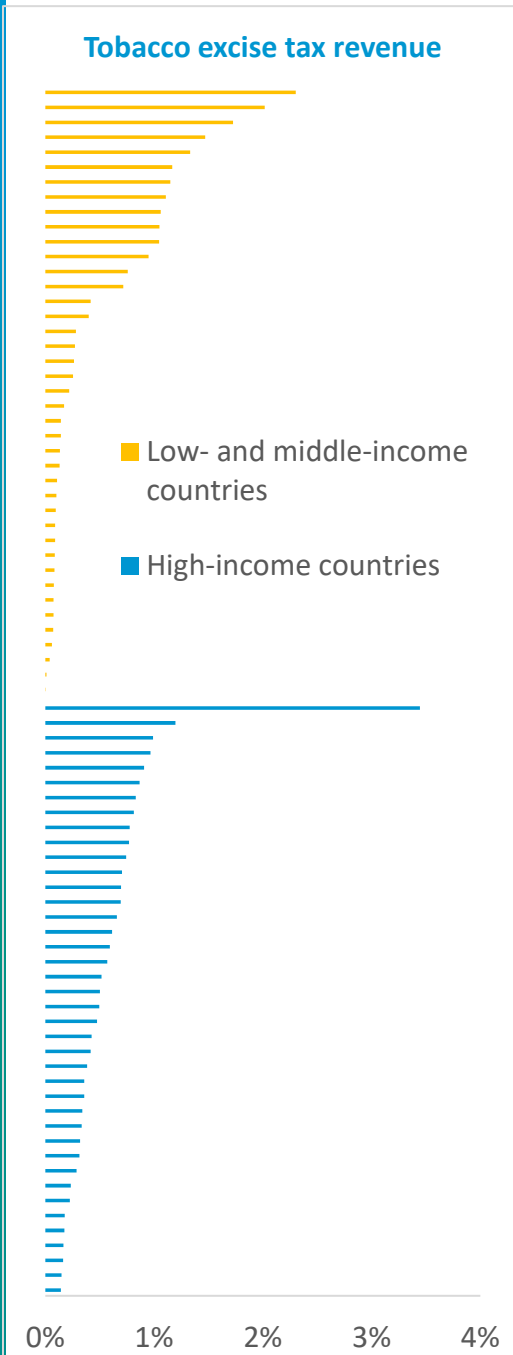
## Tobacco excise tax revenue (2021)



## Alcohol excise tax revenue (2021)



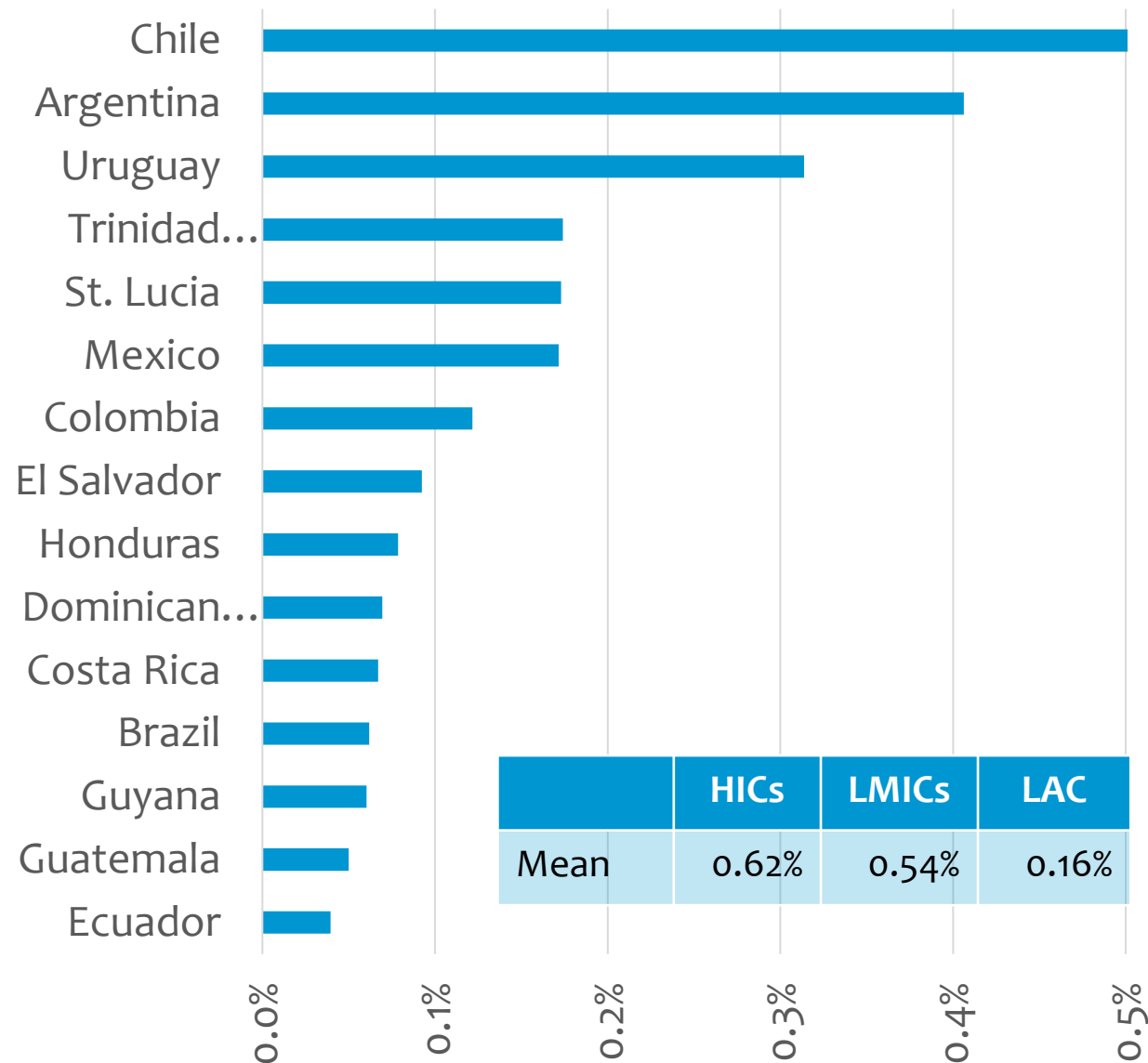
Sources: European Commission; OECD Global Revenue Statistics; WHO Report on the Tobacco Epidemic; World Bank GTP country engagements.



# What do we know about the **magnitude** of tobacco tax revenues?

- Magnitudes vary significantly between products and countries, but health taxes generate *meaningful tax revenues*
  - ▶ In 2019, **tobacco** and **alcohol** taxes generated an average of **0.6%** and **0.3%** of **GDP**, respectively
  - ▶ No significant difference between HICs and LMICs:
    - **tobacco** averaged 0.6% and 0.5% in 40 HICs and 41 LMICs;
    - **alcohol** averaged 0.3% in 40 HICs and 38 LMICs
  
- In most cases, **SSB taxes** generate significantly less tax revenue than tobacco and alcohol taxes
  - ▶ Averaging **0.07% of GDP** (highest 0.19%); often includes non-alcoholic beverages
  - ▶ Lower magnitude due to relatively lower tax **rates**, more elastic price **elasticity** of demand, narrow **scope** of the tax and/or tax **structures** that generate supply side responses

# Tobacco tax revenues in the LAC



- LAC is below HIC and LMIC mean

# What determines the magnitude of health tax revenues?

- Behavioral factors
  - Quantities of tobacco products consumed in the country (volume)
    - Baseline consumption: prevalence, intensity
    - Type of products
    - Quantities of each product (volume)
  - Elasticities: consumers' price-responsiveness to changes in prices
    - Nominal prices
    - Substitution between products
- Structural factors
  - Tax design: structure + rates
  - Tax administration
- Supplier Response
  - Industry behavior (pass-through, stockpiling, tax base discretionary changes in advalorem)
- Effectiveness of tax administration

# What determines the magnitude of health tax revenues?

	HICs		LMICs		
	Greece	Norway	Cambodia	Philippines	South Africa
Tobacco excise revenue (% of GDP)	1.2%	0.2%	0.2%	0.8%	0.3%
Tobacco excise per smoker (US\$)	1,128	848	24	143	101
Effective tax per pack (US\$, most sold brand)	\$3.39	\$5.92	\$0.08	\$0.91	\$1.01
Smoking prevalence (adult)	27%	12%	15%	18%	17%

## Tax structures

- Countries with specific taxes (e.g., Philippines; South Africa) and mixed systems (e.g., Greece; Norway) tend to have higher tax revenues than countries with ad valorem taxes (e.g., Cambodia)
- Ad valorem taxes later in the supply chain (e.g., Greece; Norway) generate more revenue than ad valorem taxes based later in the supply chain (e.g., Cambodia)

## Baseline consumption

- Higher levels of baseline consumption results in higher tax revenues (e.g., Greece vs Norway)

## Tax rates

- Countries with higher tax rates have higher levels of tax revenues
- Countries with higher effective tax rates (affected by tax structure) have high levels of tax revenues

## Tax administration

- Countries with weak tax administration or acute tax administration challenges will have lower tax revenue (e.g., South Africa)

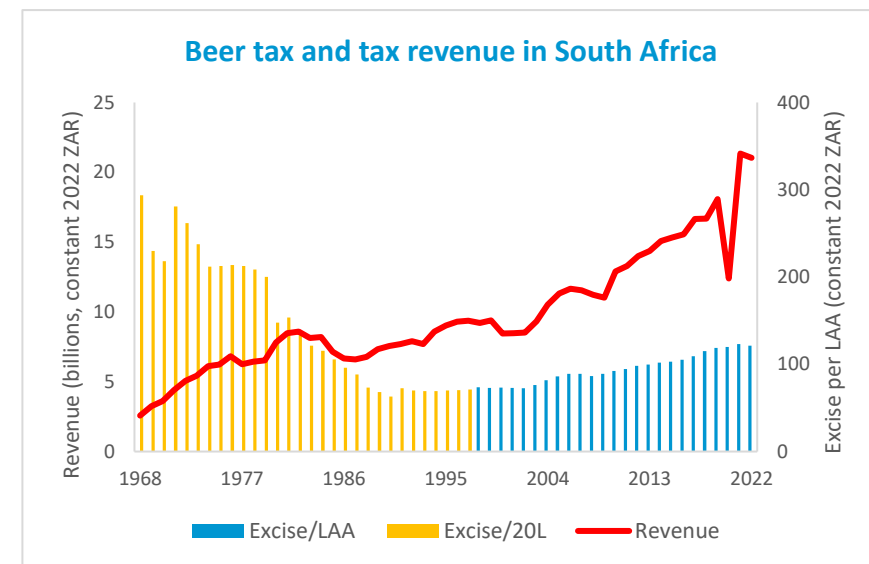
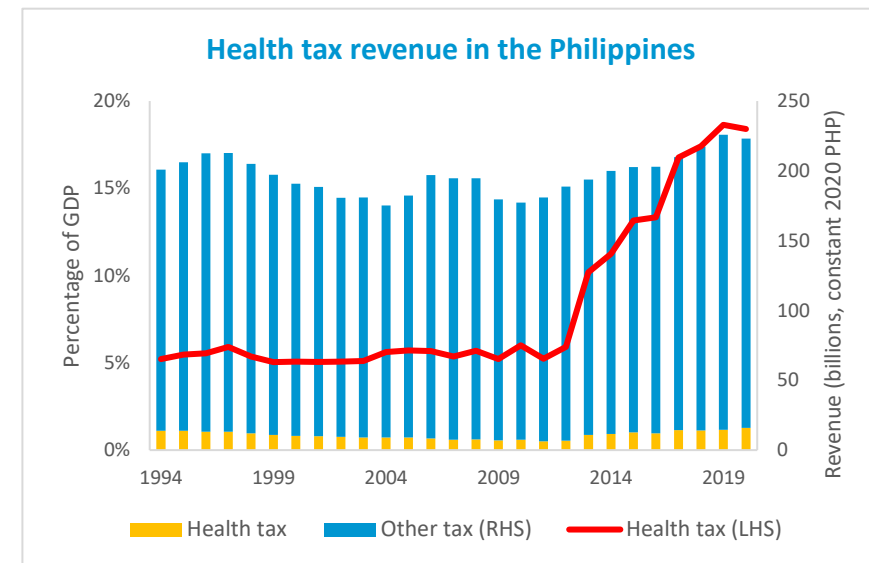
## Message 2:

Tax design and tax administration are the main structural factors influencing potential revenue generation



# The impact of health tax reforms on increasing tax revenue

- Increases in tobacco and alcohol taxes result in relatively large increases in tax revenues because they are nearly always inelastic
  - ▶ Health tax reforms including **increasing tax rates and reforming tax structures** can raise substantial tax revenue, **quickly** and efficiently
  - ▶ In addition to rapidly increasing tax revenues, **sustained** tax increases can generate additional tax revenues over long periods of time
- Tax pass through also affects tax revenue, however the impact depends on the tax structure, including the type of tax and the tax base
  - ▶ Ad valorem taxes can result in increasing tax revenues even when tax rates remain unchanged, although this is dependent on the tax base
  - ▶ Tax increases under an ad valorem tax may not generate the same degree of tax revenue, especially when applied early in the supply chain





Type

Rates

Scope

Variation

Base

Tax design matters

# Tax design matters for tax revenues

- Type
  - Ad valorem taxes lead to lower tax revenue because of value (price) has wide variation and can be strategically defined in response to changes in taxes
  - Improve tax revenue by using **specific** taxes (per unit of product)
- Base
  - In mixed systems, the ex-factory price/CIF price leads to a much lower tax base, and therefore much lower declared and effectively paid taxes (and not verifiable)
  - In mixed systems, use **retail price** as the tax base for ad valorem
- Scope
  - **All** tobacco products should be taxed
  - Exclusion of products leads to consumer substitution to untaxed products, and so to lose tax revenues

# Tax design matters for tax revenue

- Variation
  - **Uniform** rates on cigarettes
  - Differential rates complicate tax administration and create opportunities for evasion and elusion
- Rates
  - Low rates lead to low revenues, high rates to permanent high revenues



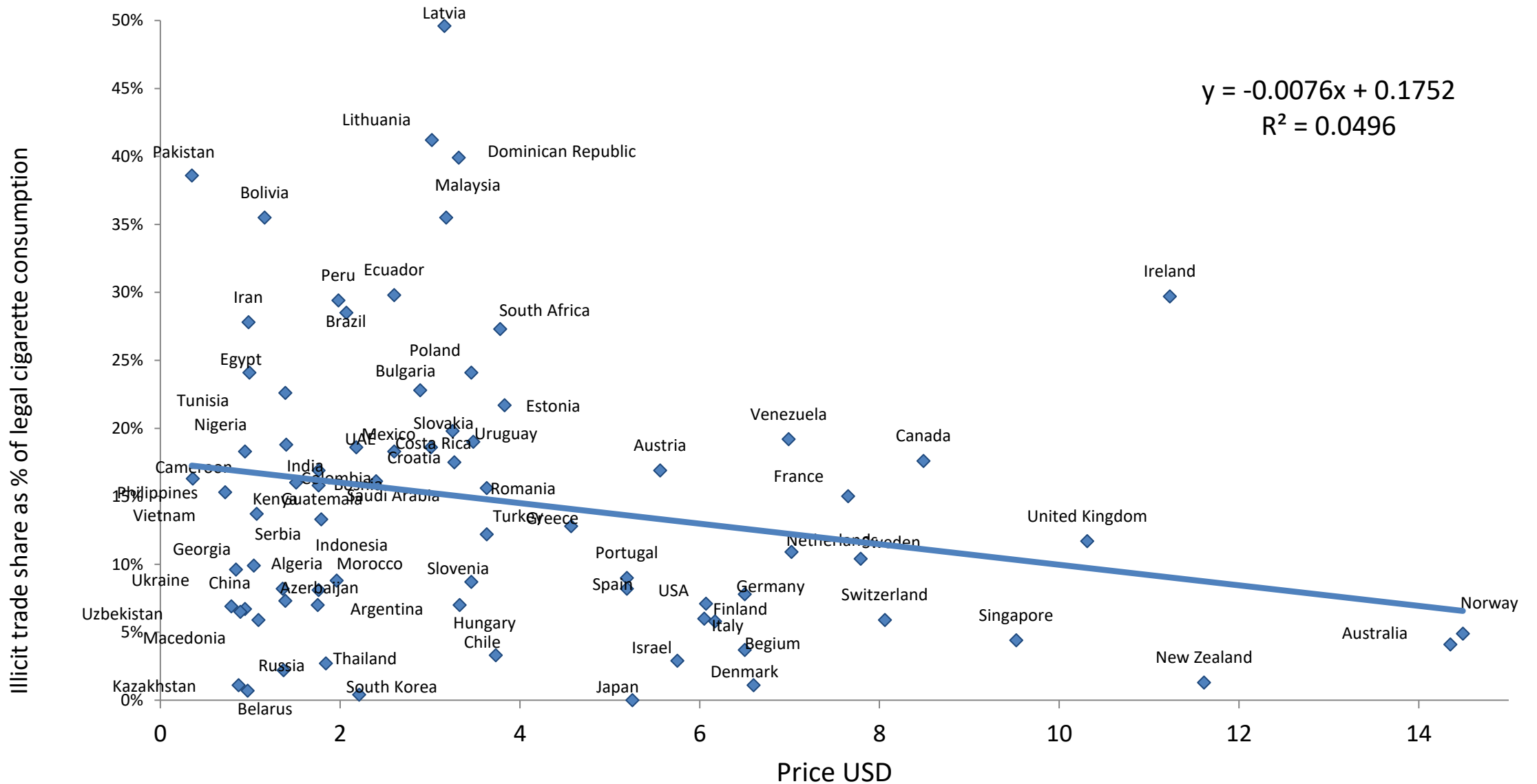
## Tax design matters for tax revenues

- Improve tax structure AND increase rates
  - ▶ **Rate** increase is a **necessary but not a sufficient** condition. “Increase health taxes” is not enough
  - ▶ Tax **structure** with low rates is ineffective in domestic resource mobilization
- Well-designed tobacco taxes are excise taxes where structure and rates are based on
  - ▶ Scientific evidence
  - ▶ Best practices
  - ▶ Experience working with countries: World Bank, World Health Organization, International Monetary Fund, OECD

## Message 3:

Improvement of **tax design** and strengthening of **tax administration** are the next steps to reach the potential **tax revenue** in LAC

# What does NOT motivate illicit trade: price/tax



# Tax revenues, Tax Evasion, Illicit trade

As last chart shows, higher tobacco excise tax and price are NOT the cause of illicit trade.

There are effective policies to address illicit trade

- ▶ Strengthen tax administration
- ▶ Regional cooperation and alignment
- ▶ Protocol to eliminate illicit trade of tobacco products (**ratify/implement**) is the policy
- ▶ Implementation of these interventions **increases tax revenues** as well
- ▶ These interventions also benefit **overall** tax administration



# Key messages

## Message 1:

Well-designed tobacco taxes have the potential to generate considerable revenue in LAC

## Message 2:

Tax design and tax administration are the main structural factors influencing potential revenue generation

## Message 3:

Improvement of tax design and strengthening of tax administration are the next steps to reach the potential tax revenue in LAC

# Thanks! Gracias! Obrigado!

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