

TOBACCO TAXATION



Highlights:

- Increasing tobacco taxes is an effective and reliable way to increase government revenues while decreasing smoking.
- Most smokers want to quit smoking, and higher taxes help them achieve their objective.
- Even though poor people tend to smoke more than rich people, tobacco tax increases are economically progressive.
- High levels of taxation can discourage young people from starting to smoke and/or encourage them to smoke less.
- To achieve a decrease in overall tobacco use prevalence, it is important to ensure that prices and taxes keep pace with other tobacco control advancements (promotion and display bans and smoke-free spaces).

The Case for Tobacco Taxation:

If current smoking trends continue, as many as 650 million people alive today will die from diseases related to smoking¹. International literature has established that raising taxes on tobacco products provides governments with a substantial and reliable increase in revenues that can be used, among other things, to cover the cost to society of tobacco use². It has also been demonstrated that the single most effective way of reducing tobacco use is through high prices. It is thus important to ensure that prices are high enough to serve as a real deterrent to smoking, by making tobacco products ever more unaffordable (raising prices beyond inflation and increases in incomes).

Ad valorem vs. Specific tax

There are two primary types of tax: *specific* taxes, which are a fixed amount per unit of tobacco (e.g. a tax of \$1 per pack of 20 cigarettes), and *ad valorem* taxes, which add a percentage to the price (e.g. a tax of 50% of pre-tax price). *Ad valorem* taxes can be harder to implement and can raise less revenue than expected, if manufacturers lower prices. However, they automatically rise with price increases. Specific taxes are easier to administer but need to be adjusted regularly to keep pace with inflation and rising affordability. As the Canadian example shows, high specific taxes can also make it easy for manufacturers to increase their profit margins and hence their ability to promote their products heavily.

Therefore, the best approach may be to combine the two types of tax, as in the European Union.

Progressive vs. Regressive:

Many commentators assume that tobacco taxes are regressive, since in many countries smoking rates are higher among the poor than among the rich. Some even suggest that taxes on tobacco should be low so as to not unduly burden the poor. However, because poor people are also more price-sensitive than the rich, they are much more likely to quit in the face of a tax increase, thus improving both their health and their financial situation. Overall, tobacco tax increases shift the tax burden *away* from the poor and *towards* the rich.

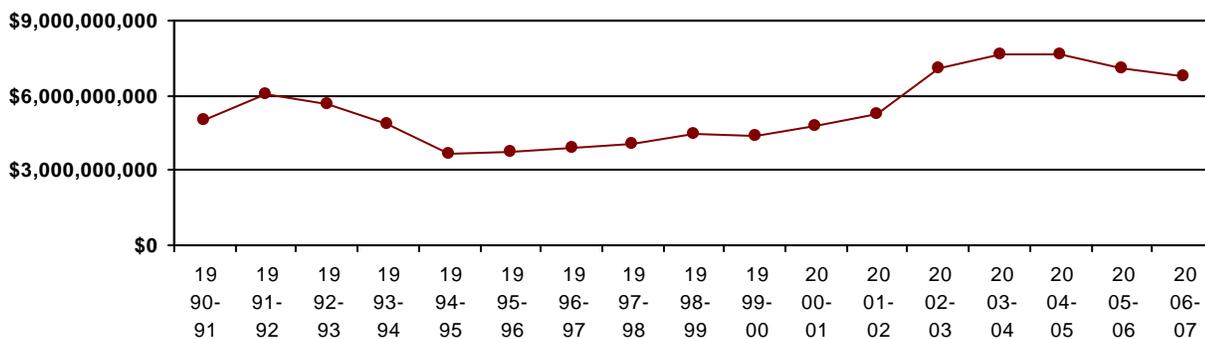
Moreover, studies show virtually all smokers regret having started to smoke and most now wish to quit. They are thus likely to see tobacco tax increases as a benefit rather than a burden.

Young people have been shown to be more price-sensitive than adults; as a result, higher taxes would have the added benefit of helping them choose to quit, or to not begin to smoke in the first place.

The Canadian Experience:

Canada has a long history of implementing tax increases and decreases. Between 1982 and 1992, the Canadian government increased tobacco taxes by 500%, which caused a significant 40% decline in per capita consumption of cigarettes³. Among youth, daily smoking prevalence declined by 60%⁴. At the same time, federal and provincial tax revenues increased by 240%⁵. However, in response to an increase in illegal cigarette smuggling (mainly from the U.S.), in 1994 the Government of Canada drastically reduced tobacco taxes in an attempt to control the smuggling. As Figure 1 shows, in the years following 1994 tax revenues sharply decreased and then gradually rose as taxes were slowly increased after 1994. The lowering of tax revenues after 1994 was accompanied by a sharp increase in cigarette consumption and consequently, health damage caused by smoking, as experienced in Canada and other countries⁶.

Figure 1. Total Federal & Provincial Tobacco Revenues in Canada 1991-2007



Source: *Physicians for a Smoke-Free Canada*, 2007

REFERENCES:

- 1 Gruber J, Kószegi B. A Modern view of Tobacco Taxation. Paris: International Union Against Tuberculosis and Lung Disease; 2008.
- 2 The International Union Against Tuberculosis and Lung Disease. Factsheet 01: Tobacco Taxation. Available at: <http://www.tobaccofreeunion.org/content/en/14/>
- 3 Sweanor D, Martial LR. The Smuggling of Tobacco Products: Lessons from Canada. Canada: Non-Smokers Rights Association/Smoking and Health Action Foundation; 1994. Available at: www.nsra-adnf.ca/cms/index.cfm?group_id=1202
- 4 *ibid*
- 5 *ibid*
- 6 Jha P, Chaloupka FJ. Curbing the Epidemic: Governments and the Economics of Tobacco Control. Washington: The World Bank; 1999.

RESOURCES:

A modern economic view of tobacco taxation:
<http://www.worldlungfoundation.org/publications.php>
Governments and the economics of tobacco control:
<http://go.worldbank.org/N4BBVY9V0>
The World Bank Tobacco Control Toolkit:
<http://www1.worldbank.org/tobacco/toolkit.asp>
A win-win: Enhancing public health and public revenue:
<http://www.nsra-adnf.ca/cms/file/pdf/taxreport2004.pdf>
Do cigarette taxes make smokers happier?:
<http://econ-www.mit.edu/files/121>
Tax incidence with individuals are time-inconsistent: the case of cigarette excise tax:
<http://econ-www.mit.edu/files/119>
Physicians for a smoke-free Canada - Canadian Federal and Provincial Tax Revenues
<http://www.smoke-free.ca>