

TOBACCO TAXES: GOVERNMENTS CAN BOOST REVENUES, AND HEALTH

Introduction

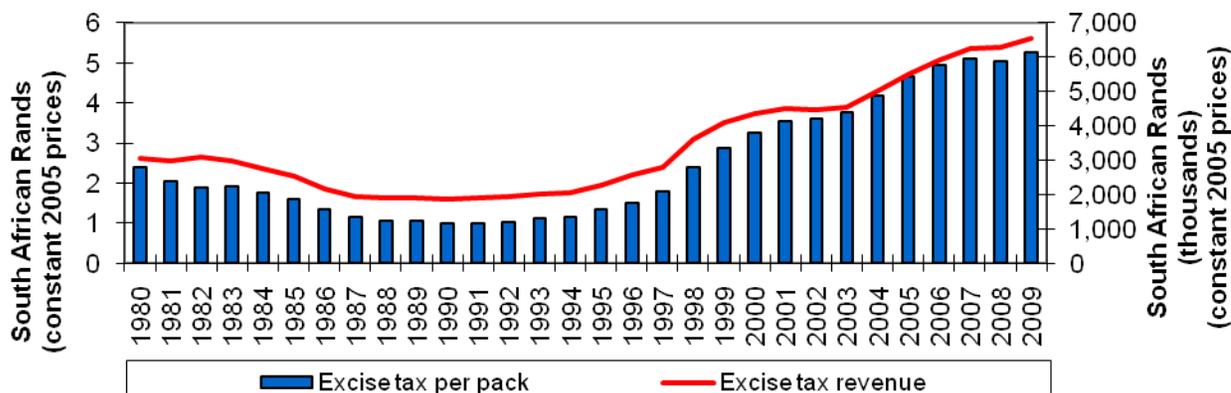
Governments seeking to increase revenues during tough economic times need look no further than tobacco taxes. Universally, states that have introduced these taxes – or increased existing tobacco taxes – have generated revenues. An additional benefit is that by discouraging smoking, tobacco taxes also contribute to improved health among the population.

FCA is calling on the Conference of the Parties (COP) to the Framework Convention on Tobacco Control (FCTC), meeting in Uruguay in November 2010, to set up a working group to develop guidelines on tobacco taxation. Its mandate would include drafting guidelines that would assist states to develop the most appropriate and effective tobacco tax for their particular situation.

Higher taxes AND higher revenues

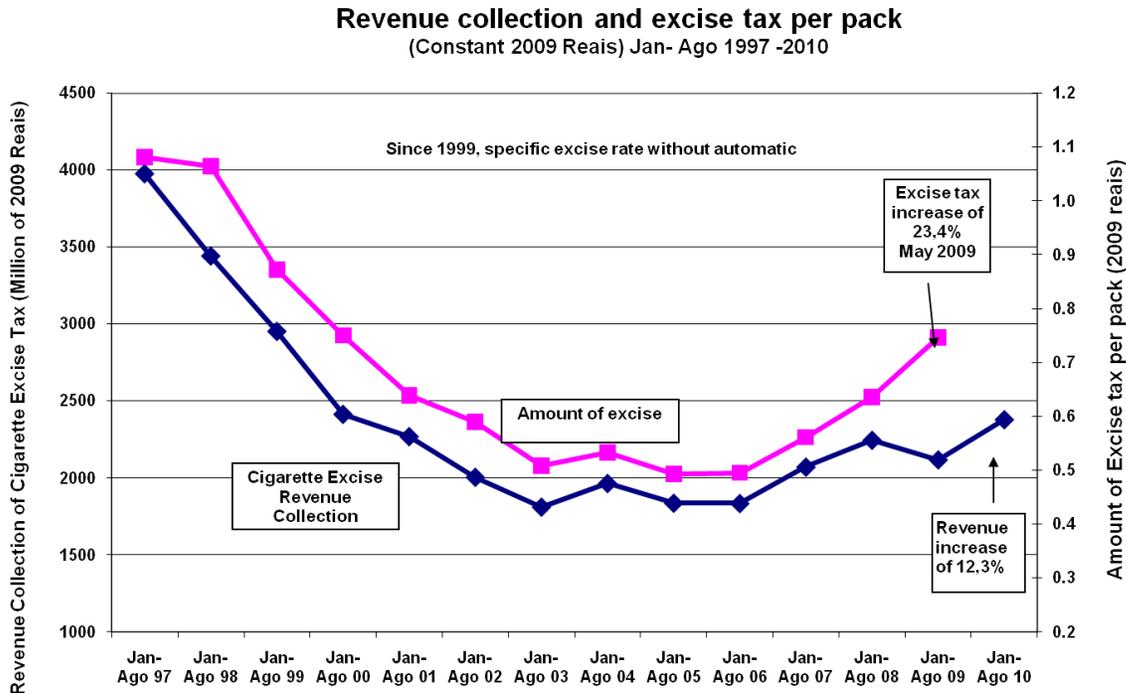
Tobacco taxes are unique. While the introduction of other consumption taxes results almost immediately in a drop in purchases, the behaviour of tobacco users changes very slowly when taxes rise because there is really no substitute for this addictive substance. So, while consumption drops gradually after taxes are introduced, the increased tax rate immediately generates higher revenues, which more than offset revenue lost through lower sales. However, one important and almost immediate outcome of higher tobacco prices is a drop in the number of youth who take up smoking – most young people do not have enough money to spend on expensive tobacco products.

Take the case of South Africa. As the chart below illustrates, between 1980 and 1991, tobacco taxes in that country declined in real (inflation-adjusted) terms, and tax revenues decreased. However, since 1991, the Government of South Africa has introduced new policies that resulted in a hike in tobacco taxes. Consequently, tax revenues have grown steadily, more than doubling from their 1991 levels.



Brazil's increased revenues

The lessons from Brazil are similar, as the chart below demonstrates. From 1997 until 2005 the excise tax rate in that country declined, and so did tax revenues. In 2006 taxes were hiked and revenue began immediately to climb. Specifically, in May 2009 the tax was raised by 23.4%, resulting in revenue growth of 12.3%.



Source: Secretariat of the Federal Revenue of Brazil

The spectre of smuggling

The tobacco industry tries to scare governments that are considering an increase in tobacco taxes by warning that smuggling will result. This is not true. There is no direct correlation between higher tobacco taxes and illicit tobacco trade. If there were, we would expect smuggling to be rampant in Scandinavian countries, where cigarette taxes are among the highest in the world, but it is not. Instead, states like Cambodia and Albania have major smuggling problems, alongside low tobacco taxes.

Of course illicit trade in tobacco exists. In February 1995, the Government of Canada attempted to address tobacco smuggling by drastically reducing taxes. As a result, youth tobacco use skyrocketed, and governments lost C\$1.2 billion in revenue from tobacco taxes in a single year. The example of Spain shows that measures other than lower taxes are most effective at preventing and combating the illicit tobacco trade. Between 1997 and 1998, Spain joined forces with neighbouring countries to better control its border. Strategies focused on reducing the supply of smuggled cigarettes at the container level – cooperating with states where the contraband originated, rather than suppressing distribution of products at the retail or street level. As a result,

contraband cigarettes which had accounted for an estimated 12% of the Spanish market in early 1997, held only 5% by mid-1999 and only an estimated 2% in 2001.¹

Strengthening intelligence, increasing customs activity, and developing international collaboration are proven, effective measures for combating illicit trade. Under the auspices of the global treaty, the Framework Convention on Tobacco Control (FCTC), the world's states have already completed four rounds of negotiations on an Illicit Trade Protocol (ITP), an agreement that would strengthen collective efforts to fight tobacco smuggling worldwide.

FCA recommends

The Framework Convention Alliance (FCA), a civil society alliance of more than 350 health and tobacco control organisations from more than 100 countries, is calling on the Conference of the Parties (COP) to the FCTC, meeting in Uruguay in November 2010, to set up a working group to develop guidelines on tobacco taxation. Its mandate would include drafting guidelines that would assist states to develop the most appropriate and effective tobacco tax for their particular situation. In particular, guidelines would:

- Make it easy for national governments to increase tobacco taxes;
- Attempt to simplify the process of tobacco collection;
- Bring people together to discuss best practices and ideas;
- Build on the work that has started via negotiations on an ITP.

¹ Report on Smuggling Control in Spain. Luk Joosens. Non-Smokers' Rights Association and the Smoking and Health Action Foundation. World Health Organization.