Putting the FCTC Article 6 guidelines to work
Introduction

In October 2014, most of the world’s countries gathered for a meeting about the Framework Convention on Tobacco Control (FCTC). At this meeting, generally known as COP6 (for Sixth Session of the Conference of the Parties) delegates adopted guidelines for the implementation of the FCTC article that deals with tobacco taxes, Article 6.

Guidelines are documents negotiated between all the Parties to the FCTC (= 177 countries, plus the European Union, as of May 2014) that set out their consensus on what it means to do a good job implementing a particular article of the Framework Convention.¹

So what makes Article 6 guidelines a big deal? The fact that, for the first time, governments are agreeing on what makes – and what doesn’t make – good tobacco tax policy. That makes the guidelines an exceptionally good tool for advocacy and action.

Who is this guide for?

This guide is for tobacco-control advocates, whether inside or outside government. It does not assume you’re an expert on FCTC processes and documents, or on tax issues.

¹ Once adopted, guidelines are posted on the FCTC Secretariat website, at http://www.who.int/fctc/guidelines/adopted/en/.
How you can use Article 6 guidelines

For decades, health advocates in various countries have pressed their governments to raise tobacco taxes in order to reduce consumption and prevalence of tobacco use, especially among young people.

For even longer, the tobacco industry has argued that tobacco taxes need to be kept low. The industry adjusts its arguments depending on the country and the government it is trying to influence, but its claims typically include the following:

1. Higher tobacco taxes won’t actually lead to higher tax revenues.
2. Higher tobacco taxes don’t reduce consumption or youth smoking.
3. Higher tobacco taxes cause smuggling and boost organised crime.
4. Higher tobacco taxes are unfair to the poor, who are more likely to smoke (this is referred to as ‘ regressivity ’).

Each of these arguments is answered in the Article 6 guidelines – which, as mentioned, were written by FCTC Parties, not by tobacco-control advocates, individual economists, or even the World Health Organization. The authors based the guidelines on evidence and the experience of countries that participated in the working group.

As we will see, the guidelines also include practical advice on how to structure tobacco taxes and how to improve tax administration. They also recommend that governments decide on long-term tobacco tax policies, with numerical targets – a potential game-changer in many countries.
1. Tobacco taxes: good for health and governments’ bottom lines
(based on Article 6 guidelines, section 1: Guiding principles)

There are two reasons for governments to tax tobacco products.

First, it’s a good way to get money. Tobacco is an easy product to tax and raise revenue from. In economic jargon, demand for tobacco is price inelastic – that is, tobacco users do react when prices go up – they are price sensitive – but they reduce their consumption by less than the percentage increase in price, which means they end up paying more in tobacco taxes. Also, in most countries there are relatively few producers of tobacco products, which means tax is easier and less expensive to collect than on most other products.

Second, higher tobacco taxes are good for smokers, even better for prospective smokers – and even have benefits for non-smokers.

A basic principle of economics is that price increases for almost any product result in lower demand for that product (if all other things are held constant). There are at least two ways to look at this. First, there is a whole range of things that many of us would like to buy – more than most of us can afford. If one product becomes more expensive, but the others stay at the same price, we will tend to redirect some of our spending towards the items that have remained comparatively cheap – this is known as the price effect.

Second, if a smoker has a budget of $100 to buy cigarettes for the month, and the price of cigarettes goes up, the consumer will have to decrease their consumption of cigarettes. This is known as the income effect.

Of course, some smokers will react by reducing their consumption of other items, and will go on smoking as much as before. Tobacco products are, after all, highly addictive. But in aggregate, when you look at the population as a whole, consumption of tobacco products goes down when prices go up.

Another thing to note: the guidelines refer, in the guiding principles and elsewhere, to effective taxes. In most countries, governments do not directly control the price of tobacco products, but can influence them through taxation. But taxes and tax increases are not all created equal – if a system is poorly designed and/or the tobacco industry is adept at manipulating it, tax increases do not always lead to price increases. This is discussed in more detail when we get to Part 3 of the guidelines, Tobacco Taxation Systems.

“Tax and price policies are widely recognized to be one of the most effective means of influencing the demand for and thus the consumption of tobacco products.”
— Introduction to the guidelines for implementation of WHO FCTC Article 6 (price and taxes)

“The increase in tax normally outweighs the decline in consumption of tobacco products.”
— Article 6 Guidelines, Guiding Principle 1.3

“Effective taxes on tobacco products that lead to higher real consumer prices (inflation-adjusted) are desirable because they lower consumption and prevalence, and thereby in turn reduce mortality and morbidity, and improve the health of the population. Increasing tobacco taxes is particularly important for protecting young people...”
— Guiding Principle 1.2
Inflation and “real prices”

If you’re not familiar with economic jargon, you may be wondering what the “real” prices referred to in guiding principle 1.2 are, and how they are calculated.

Despite the name, “real” prices are not the prices you see on price stickers – those are the ones economists refer to as “nominal” prices. The problem with tracking nominal prices over time is that the prices of many things as well as incomes increase over time. So you can’t tell whether a higher nominal price actually means something is getting more expensive compared to other things that people buy.

Real prices take inflation into account. Inflation is used to describe increases in the general price level – it’s the increase in the average of all prices over a period of time. Almost all countries experience inflation, but in some countries inflation is high, whereas in others it’s very low.

To account for inflation, economists and national statistics offices typically use a Consumer Price Index or CPI (sometimes called a Retail Price Index), which is based on the nominal prices of a typical basket of goods and services.

For example, if the CPI was at 100 in 2000 and rose to 150 by 2010, that means there was 50 percent inflation over that 10-year period.

Let’s imagine the average price of a pack of cigarettes increased in the same time from $2.00 per pack in 2000 to $2.60 in 2010 (a 30 percent increase).

What is the “real” price of cigarettes?

Well, that depends on the reference year – typically, we refer to the real price in dollars from a particular year. In this case, let’s take 2010 as our reference year.

In other words, between 2000 and 2010, the real price of a pack of cigarettes has fallen, from $3.00 to $2.60 in 2010 dollars. (You can take any reference year you like and the calculation should still show a lower real price in 2010.)

That means cigarettes are getting cheaper compared to other products.

But that doesn’t necessarily mean that they are getting more affordable for people. As we will see in the next section, that depends also on what’s happening to incomes.

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2. How tobacco taxes improve people’s health

(based on Article 6 guidelines, section 2: Relationship between tobacco taxes, price and public health)

2.1 Price elasticity

There have been many, many studies looking at what happens to tobacco use when tobacco prices increase (usually because of taxes) – the guidelines provide two of the best references for detailed information on this: Volume 14 in the IARC handbooks series¹, as well as the WHO Technical Manual on Tobacco Tax Administration².

For advocacy purposes, there are two things to keep in mind in this section.

First, there are three routes via which price increases reduce tobacco consumption:

1. Some existing smokers quit entirely. (This provides the biggest immediate health gains, as these are the people most at risk of getting sick and dying in the coming years.)
2. Some people, mostly teenagers, who would otherwise have started to use tobacco, refrain from doing so. (This is the youth smoking prevention effect – very important for the long term.)
3. Some people continue to use tobacco, but reduce how much they use per day. (This is better than nothing, but provides more modest health gains, unless it’s a prelude to quitting in the future.)

The first two effects – existing smokers quitting, and teens not starting – both show up as declines in prevalence, whereas the third effect is what the guidelines refer to as “intensity”. As the guidelines mention, the impact on prevalence accounts for about half of the decline in consumption that follows a tax increase.

The second point worth emphasising is that the poorer and/or the younger a tobacco user is, the more price-sensitive they are likely to be. This is true for whole countries – tobacco consumption drops more quickly in poorer countries than in richer countries, when faced with an equivalent tax increase. It is also true for various segments of the population, such as younger age groups compared to older age groups, urban poor compared to urban middle class and so on.

This means that the health benefits of tobacco tax increases go disproportionately to the poor – a good advocacy argument in most countries! This is a direct counterpoint to the tobacco industry argument that tax increases are regressive, affecting the poor more than the rich. The truth is that tobacco use itself is regressive and that tax increases assist the poor more than the rich.

² http://www.who.int/tobacco/publications/tax_administration/en/

“Worldwide evidence suggests that the impact of a price increase is felt approximately half on prevalence and half on intensity... Most estimates of the price elasticity of demand lie between -0.2 and -0.8.”
— Section 2.1

“...higher taxes and prices reduce the demand for tobacco most sharply in lower-income population groups or in countries where tobacco users are more responsive to price increases, thereby contributing to the fight against health inequalities.”
— Section 2.1

The price elasticity of demand is the percentage change in consumption as a result of a percentage change in price. In essence, this is a measure of the responsiveness of tobacco use to price changes. For example, if the price elasticity of demand is -0.5 this means that a 1 percent increase in price will result in a 0.5 percent decline in consumption, or, scaled up, a 10 percent increase in price will result in a 5 percent decline in consumption.
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2.2 Taxation and affordability

When do increases in the real price of a product not lead to declines in consumption? When incomes are rising even faster than prices, and people can therefore absorb the price increase. This is known as “income elasticity” – as people get richer, they can afford more things, and so demand for some products goes up. (Not all products – for example, demand for brooms may go down as people get rich enough to buy vacuum cleaners.)

In the case of tobacco products, rising incomes definitely do tend to lead to higher consumption – unless tobacco taxes keep rising to cancel out this income effect.

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Take the example of the Czech Republic:

In real terms (after adjusting for inflation) the country’s per capita Gross Domestic Product, (GDP), is growing by about 2.5 percent per year. Incomes are probably rising at a similar rate. Inflation is running at about 4 percent a year. That means that cigarette prices need to increase by at least 6.5 percent per year just to ensure that cigarettes don’t become more affordable.

Yet nominal cigarette prices have, on average, increased at only 6 percent per year, meaning that cigarettes have actually become more affordable, even though they have been increasing in real terms.

To stop tobacco products from getting more affordable, countries can tie tobacco tax levels to wages, which can rise either because of inflation or because the overall standard of living is actually going up. That is the system in place in Australia, where tobacco taxes are benchmarked to nominal wages and adjusted twice a year.

In countries where up-to-date, reliable data on wage levels doesn’t exist, a good alternative is to tie tobacco taxes to per capita GDP.

Recommendation [section 2 of guidelines]

“When establishing or increasing their national levels of taxation Parties should take into account – among other things – both price elasticity and income elasticity of demand, as well as inflation and changes in household income, to make tobacco products less affordable over time in order to reduce consumption and prevalence. Therefore, Parties should consider having regular adjustment processes or procedures for periodic revaluation of tobacco tax levels.”
3. What type of tobacco tax is best?
(based on Article 6 guidelines, section 3: Tobacco taxation systems)

There are various different types of taxes that may have an impact on the price of tobacco products. These include:

- income taxes on tobacco companies, wholesalers and retailers;
- licensing fees for tobacco brands or companies;
- sales taxes such as VAT (Value Added Tax) or GST (General Sales Tax, or Goods and Services Tax);
- import duties or tariffs;
- excise taxes (that is, taxes uniquely applied to particular categories of products).

The guidelines do not discuss the first two, indirect ways of raising tobacco prices, which the introduction declares are outside the scope of Article 6 guidelines.

VAT and GST are generally not of much interest for tobacco control, as they are usually applied to a wide range of products at the same rate. That means that changes in VAT or GST rates do nothing to make tobacco products more or less expensive compared to other products.

Tariffs or import duties, by definition, apply only to imported goods. They are rarely a very good tobacco control tool: if governments raise them substantially, the tobacco industry will likely react by transferring some of its production to domestic facilities. One exception would be small countries where there is no local manufacturing industry. If the market is small enough, it is unlikely the industry would set up a new factory locally just to get around the tariffs.

That leaves excise taxes (sometimes also referred to excise duties, but that risks confusion with tariffs on imports). These are taxes on particular categories of goods, the most frequent targets being fuel, alcohol – and tobacco products.

Excise taxes come in two primary types: **specific taxes** and **ad valorem taxes**.

Specific taxes involve a fixed monetary value per quantity (or weight) of product – say, $1 per pack of 20 cigarettes, or $10 per 1,000 g of tobacco. Sometimes countries have separate specific tax rates for different categories of products (called tiers or slabs), such as $1 per pack of 20 filter cigarettes, but only $0.50 per pack of 20 non-filtered cigarettes. (The guidelines discourage this type of complication by referring repeatedly to “uniform specific taxes” – that is, a single rate for all types of cigarettes.)

Ad valorem taxes involve a **percentage** mark-up, such as 25 percent of the wholesale or import price. That means the amount of tax smokers pay on a pack of a more expensive brand is higher than the amount they pay on a cheap brand. (Some countries complicate matters by charging different percentage rates for different types of cigarettes.)
Example: A two-tier ad valorem tax in Senegal (existing system), compared with single-tier ad valorem and uniform specific tax

Scenario 1: In 2012, when this analysis was performed, Senegal charged a 20 percent ad valorem tax on “economy” brands, and a 45 percent tax on “premium” brands. This resulted in a 250 FCFA price difference between the two leading brands in the country, Camelia (“economy”) and Marlboro (“premium”) – the latter was almost twice as expensive as the former.

Scenario 2: Moving to a uniform ad valorem rate of 45 percent would have reduced that price differential to 177 FCFA.

Scenario 3: Moving to a uniform specific tax of 186 FCFA would reduce the price differential to 122 FCFA.

For both revenue and public health, in this case a uniform specific tax yields better results. The bigger the price difference between brands the greater the opportunity for consumers to trade down to cheaper brands, making tax increases less effective.
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From an administrative perspective, specific taxes are clearly preferable for governments. With specific taxes, you only have to know the quantity of tobacco products sold to know how much tax is due, and this is relatively easy to monitor. With ad valorem taxes, on the other hand, you have to decide what price the tax applies to, and then monitor not just how much is sold, but at what price.

Some countries apply the tax to the actual retail price, some to the recommended retail price, some to the wholesale price and so on. In each case, there is always a danger of under-reporting – for example, whole-salers may say they are selling cigarettes at $1 per pack, to reduce their tax bill, but actually charge $1.25.

In terms of tobacco control, there are arguments for both types of taxes:

- Specific taxes are better at raising the price of cheaper brands. They effectively create a floor price for tobacco products, as few manufacturers can afford to subsidise sales for long by selling a product for less than the taxes that are payable on it. In contrast, ad valorem taxes encourage price competition – as manufacturers cut their prices, the amount of tax payable also goes down, because the tax is a percentage of the price.

- Ad valorem taxes change in value as the tobacco industry increases (or decreases) its prices. That means that when there is inflation, the value also increases. In contrast, specific taxes, if their rates are left unchanged, are worth less and less in real terms. (This can be fixed by indexing taxes to inflation.)

To complicate matters, some countries have a mixed tobacco tax system, with both specific and ad valorem taxes. For example, a country could have a $1 per pack specific tax and a 50 percent ad valorem tax at the same time, or apply only whichever is higher (i.e. $1 per pack specific tax unless the 50 percent ad valorem value is higher than $1 at which time that would then apply. This ensures that at least $1 is payable per pack, no matter how cheap the brand).

The advantages and disadvantages of ad valorem, specific and mixed tax systems were one of the most hotly debated topics between Parties as they drafted the Article 6 guidelines. The recommendation at the end of section 3.1 boils down to this:

- Simpler systems are better than complicated ones (i.e. avoid multiple different tax rates, such as separate rates for “luxury”, “medium” and “discount” brands);

- Specific systems are generally preferable to ad valorem systems;

- If you have an ad valorem system, you can make it better by introducing a specific element into it – either by adding a specific tax (making it a mixed system) or by imposing a specific tax floor.

Recommendation [section 3.1]

“Parties should implement the simplest and most efficient system that meets their public health and fiscal needs, and taking into account their national circumstances. Parties should consider implementing specific or mixed excise systems with a minimum specific tax floor, as these systems have considerable advantages over purely ad valorem systems.”
Tax avoidance and transfer pricing

Most cigarettes in the world are produced and sold by large multinational companies that operate in many countries. Often they produce in countries where they can operate most efficiently and at the lowest cost, and in recent years there has been significant consolidation of manufacturing facilities to make larger and more efficient factories. This means that many countries, especially small ones, import a lot of cigarettes.

Under these circumstances there are many opportunities to avoid and even evade taxation. One of the most common of these methods is called transfer pricing, essentially an under-valuation of cigarettes, which is very effective under ad valorem regimes.

Consider the following example:

ABC Tobacco operates in two countries, A and B, however it only manufactures in country A, exporting to country B. In country A, it sells cigarettes to wholesalers at $1 per pack. But the exclusive importer in country B — which happens to be controlled by ABC Tobacco — pays only $0.50 per pack. Why? Because this minimises the amount of tobacco tax payable in country B, which has a purely ad valorem (= percentage) tax. The importer then sells the cigarettes to a number of distributors, all of whom are also controlled by ABC Tobacco — and these distributors add a huge mark-up when selling to retailers. This allows ABC Tobacco to make similar profits in both countries, but to pay less tax (and sell at lower prices) in country B.

How can countries improve their tax administration so that they are not defrauded as a result of transfer pricing? Obviously, close cooperation between customs and tax collection agencies in both countries can help; however, the use of specific excise taxes removes the need to address this issue. Additionally, countries can use ad valorem taxes on the retail rather than wholesale or import prices, but this still does not remove the possibility of undervaluation of retail prices.

(Transfer pricing is an issue for many sectors of the economy, not just tobacco. For more information on the general problem of transfer pricing, consult the Tax Justice Network’s website, at http://www.taxjustice.net/topics/corporate-tax/transfer-pricing/.)
3.2 Level of tax rate to apply

Wouldn’t it be great if governments could agree on a (high) tobacco tax level that they would all try to achieve? Advocates could criticise their governments if their country was far below that “ideal” level, or congratulate them if they made substantial progress towards it.

Although the idea was discussed during the negotiations that led to the Article 6 guidelines, it ran into two obstacles, one political and one practical.

The political obstacle is that countries are very resistant to surrendering any of their power to set their own tax rates – even by way of agreeing to global “ideal” levels.

The practical obstacle is that it’s difficult to find an ideal tax level that is applicable across a wide range of countries with different economic conditions. For example, a tax of $5 per pack would be low in a high-priced, high-income country; yet it would be extremely high in a low-income country, where wages and prices are much lower.

One possible way around this problem is to look at tax share. If tobacco taxes account for 80 percent of the retail price in both countries, then in one sense the two countries have comparable tobacco tax policies.

The Article 6 guidelines take a different approach. They mention the idea of looking at tax shares, and even include a footnote mentioning that the WHO Technical Manual on Tobacco Tax Administration recommends an excise tax share of 70 percent. But the actual recommendation calls on Parties to set their own targets, without specifying either the type of target or the level to be achieved.

This is not as weak as it might look at first glance, because the recommendation calls for something more: “coherent long-term policies”, with targets for tax rates, all with a view to achieve particular objectives within a set time. For example, a country could announce that within five years, it wanted to increase excise taxes until they account for 65 percent of the retail price of cigarettes, as part of a plan to reduce youth smoking by 75 percent.

The guidelines also recommend regular tax rate adjustments to keep up with inflation and with increases in income levels – a particularly useful recommendation in countries where there has been no tobacco tax increase for several years.

Recommendation [section 3.2]

“Parties should establish coherent long-term policies on their tobacco taxation structure and monitor on a regular basis including targets for their tax rates, in order to achieve their public health and fiscal objectives within a certain period of time.

Tax rates should be monitored, increased or adjusted on a regular basis, potentially annually, taking into account inflation and income growth developments in order to reduce consumption of tobacco products.”
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3.3 Comprehensiveness/similar tax burden for different tobacco products

As mentioned previously, some countries charge different tax rates on different types of cigarettes, such as those with and without filters. Other countries have different tax rates for different “grades” of brands, such as “premium” and “non-premium”. (A few countries, such as Bangladesh, have multiple price bands.)

This differing tax treatment causes various types of administrative problems. It also makes it harder to predict the impact of tobacco tax increases – some smokers may migrate from one product type to another rather than quitting or reducing their consumption.

A related but different problem is roll-your-own tobacco. In many countries, it is substantially cheaper to buy tobacco and cigarette papers or tubes and assemble one’s own cigarettes rather than to buy them ready-made. Many smokers will find this too much hassle and continue to buy ready-made cigarettes – but when tobacco taxes rise, they may switch to roll-your-own.

The price difference, in many cases, is the result of lower effective taxes on roll-your-own tobacco compared to cigarettes. Sometimes this is deliberate policy: some governments believe, mistakenly, that the availability of low-priced, roll-your-own will prevent illicit trade in cigarettes. More often, it is because cigarettes are taxed by the stick, while roll-your-own is taxed by weight.

Many countries assume that it takes 1 g of roll-your-own tobacco to make one cigarette. But manufacturers have found methods to “puff up” tobacco, so that some brands of roll-your-own require only 0.4 g per self-rolled cigarette – thus effectively reducing the tax rate by 60 percent.

Recommendation [section 3.3]

“All tobacco products should be taxed in a comparable way as appropriate, in particular where the risk of substitution exists.

Parties should ensure that tax systems are designed in a way that minimises the incentive for users to shift to cheaper products in the same product category or to cheaper tobacco product categories as a response to tax or retail price increases [...]”

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4. Helping governments keep track of tobacco taxes
(based on Article 6 guidelines, section 4: Tax administration)

Setting tax rates is one thing. Actually collecting the taxes is quite another. In many countries, governments have many difficulties in getting companies to pay the taxes they owe – because of tax avoidance (= search for legal loopholes to reduce tax bill) and tax evasion (= illegal failure to pay taxes).

Tax evasion often involves corruption: companies find it is cheaper to pay tax inspectors to turn a blind eye to their business activities than to pay the taxes owing.

In the case of tobacco, one tactic that large cigarette companies use where they can get away with it is to withhold tax payments, then volunteer to make a payment when the government is particularly strapped for cash. The not-so-subtle message to governments is that they should bend over backwards to accommodate the cigarette companies’ interests, or else this source of revenue may dry up.

Governments are vulnerable to these sorts of tactics when they have no way of checking for themselves who is selling what quantity of tobacco products to whom. So most of the crucial measures in tax administration involve trying to make sure that governments know what is being manufactured, imported into and sold in their country – at least up to the point where taxes are paid.

Hence, one of the key recommendations for all governments is to collect tax as close to the point of production as possible – as products leave the factory, in the case of domestic production, or as they enter the country, in the case of imports.

Recommendation [section 4.2]
“...In order to reduce the complexity of tax collection systems, excise taxes should be imposed at the point of manufacture, importation or release for consumption from the storage or production warehouses.”

Two other important steps are:

- requiring all tobacco companies, importers, wholesalers and so on to apply for licences (see 4.1);
- requiring tax stamps, or other kinds of fiscal markings, to make it easier to distinguish legal, tax-paid product from illegal, tax-unpaid products (see 4.4).

For countries that are planning to raise tobacco taxes substantially – which we hope all Parties to the FCTC will eventually do! – a further concern is stock-piling by the industry, by wholesalers or even by retailers. That is, if companies know a tobacco tax increase is coming, they can buy large quantities of cigarettes before the tax comes into effect, pay the existing lower tax rate, and then either continue selling at the pre-increase price or raise prices, blame the government, but actually pocket the money themselves. (This tactic is also known as front-loading or forestalling.)

The two main approaches to dealing with this problem are inventory taxes – a special tax on whatever companies have in stock at the time of a tax increase – or limits on purchase levels in the days (or weeks) leading up to a tax increase. (See section 4.3.)
5. To ear-mark or not to ear-mark tobacco taxes
(based on Article 6 guidelines, section 5: Use of revenue)

Even at their present low levels, there is probably no country in the world where tobacco taxes raise less money than what governments spend on tobacco control. Indeed, according to the 2013 Global Tobacco Control Report, governments around the world raise roughly $145 from tobacco taxes for every $1 spent on tobacco control – and 96 percent of all tobacco control spending occurs in rich countries.

Because tobacco control is underfunded in many countries, many tobacco-control advocates have suggested that a portion of tobacco tax revenue should be used to increase national tobacco-control budgets – either by legal obligation (so-called hard ear-marking) or by political commitment (soft ear-marking).

While the idea of hard ear-marking is very attractive for tobacco-control advocates, it is worth looking at why many Finance ministries are strongly opposed. There are several reasons:

1. Tobacco use is very costly for governments – and for society at large. Smokers get sick and, in countries with public health-care systems, that means increased health-care costs. Smoking also causes damage to buildings (increased fire risk, higher cleaning bills). Finally, tobacco users who get sick are less productive – they may not be able to work and hence pay less taxes. One purpose of tobacco taxes is to compensate for some of the revenue lost to governments because of tobacco use. Money spent on tobacco control is an additional expense, not (partial) compensation for the costs of tobacco use.

2. Tying specific types of spending to particular revenue sources can make the budget process much more complicated. If the government is legally obliged to spend a fixed percentage of tobacco tax revenue on tobacco control, then others will argue that fuel revenue should go to road repairs, alcohol tax revenue should go to treating alcoholics and funding the police etc. Soon the Finance ministry has no flexibility in what it spends money on, and important but less visible functions can’t be funded.

3. Writing budgets is always about setting priorities – there are always more things that people want the government to do than the government has money to do. A dedicated tax puts a particular issue at the front of the queue, without any weighing of competing priorities. What if there is suddenly an epidemic of a new bacterium, or catastrophic floods in the country? Why should the tobacco control programme be protected from temporary budget cuts while other programmes are not?

Some countries do have some form of hard ear-marking. The best-known example is the Thai Health Promotion Foundation, which is funded by a two percent surcharge on tobacco and alcohol taxes. More recently, Panama and Botswana, amongst others, have also decided to dedicate a portion of tobacco tax revenue to tobacco control.
While these are all serious arguments, tobacco-control advocates have several counter-arguments:

1. **Tobacco-control spending increases the social acceptability of higher tobacco taxes.** One of the most frequent arguments against higher tobacco taxes is that governments are simply using smokers as “cash cows”, and that because of tobacco tax revenue, governments actually prefer smoking to stay high. A balanced, comprehensive tobacco-control programme, including helping to smokers to quit, demonstrates that this is not the case – the purpose of higher taxes is to help reduce smoking.

2. **In many countries, some people feel they are not getting value for money for the taxes they pay.** In particular, citizens in many countries believe their taxes line the pockets of corrupt politicians or provide lavish salaries to do-nothing civil servants. While this is often far from the truth (particularly the latter!), it can be a widely held view. A law obliging the government to spend revenue from a particular tax in a particular way helps solve this perception problem.

As you can imagine, this topic – ear-marking of tobacco tax revenue – was a particularly controversial one during the drafting of Article 6 guidelines. After lengthy debates, Parties agreed on compromise language, in essence noting that some countries have ear-marking, whereas others do not, and that Parties “could consider” ear-marking – or using revenue from other sources to pay for tobacco control.

**Recommendation [section 5]**

“Parties could consider, while bearing in mind Article 26.2 of the WHO FCTC, and in accordance with national law, dedicating revenue to tobacco-control programmes, such as those covering awareness raising, health promotion and disease prevention, cessation services, economically viable alternative activities, and financing of appropriate structures for tobacco control.”
6. A reminder why tax-free/duty-free sales should be phased out
(based on Article 6 guidelines, section 6: Tax-free/Duty-free sales)

Most international airports have duty-free shops that sell alcohol, tobacco products, perfumes, chocolates and other products to departing international travellers. The basic reasoning for governments is simple: if people are leaving our country anyway, it's better that they buy products in our country, even if they pay no taxes on them, rather than buying the products abroad.

Of course, since virtually all countries have such shops, all governments lose revenue through this system – returning residents buy duty-free products abroad and pay less tax at home. (Some countries also allow duty-free stores for returning travellers also, to capture some of this “lost” business, but this still means a loss of tax revenue.)

In the case of tobacco products, the end result isn’t just lost revenue for all governments – it’s cheaper tobacco products for anybody who travels regularly (or knows somebody who does), higher smoking rates and more tobacco-caused illness.

A further problem with duty-free is that duty-free shops are usually supplied with tobacco products on which no tax has been paid. That means there are wholesalers who have a legitimate excuse to stock large quantities of untaxed product. This product can be shipped around the world and, in many cases, diverted into the illicit trade.

These problems were recognised already when the FCTC was negotiated. Article 6 of the Convention calls on Parties to “adopt... measures which may include... prohibiting or restricting, as appropriate, sales to and/or importations by international travellers of tax- and duty-free tobacco products.”

Unfortunately for tobacco-control advocates, the duty-free industry has lobbied heavily over the years against implementation of this measure. The Article 6 guidelines are helpful in that they provide some of the rationale for banning duty-free sales, but the recommendation on this issue is largely the same as what is already in the Convention.

1 To reduce leakage of untaxed product from wholesalers who claim to be supplying duty-free shops, it is possible to levy tobacco taxes on all tobacco products — even those headed to duty-free shops — then provide tax rebates to duty-free retailers on sales that they make.
Some tips on using Article 6 guidelines for advocacy

1. Remind governments that these guidelines were written by the Parties themselves. The Article 6 working group (which was set up by COP4) and the drafting group (which was set up by COP5) included representatives from dozens of Parties from all regions of the world, with roughly equal numbers of officials from Health and Finance ministries.

2. Ask your government contacts what arguments they’ve heard against raising tobacco taxes – the industry varies its approach, depending on the country, and there’s no use wasting your time debunking arguments that haven’t been made.

3. Tobacco taxes are gaining acceptance globally. Some recent examples that you could share:
   - The Philippines have adopted a plan to merge four tax tiers into a single tier – by 2017 – meaning a tax increase of more than 1,000 percent on the country’s cheapest brands.¹
   - Bill Gates and Larry Summers launched Global Health 2035, calling for higher tobacco taxes²


5. The text of the draft guidelines only is available at: https://tinyurl.com/odyhakl. The text of the adopted guidelines will be available on the FCTC website at a later date – http://apps.who.int/gb/fctc/E/E_cop6.htm.

6. Membership of the Article 6 drafting group can be found at: https://tinyurl.com/kozb2jc.

² See www.globalhealth2035.org
Putting the FCTC Article 6 guidelines to work

Appendix 1 – Sample memo to a government official

From: James Chong, Smoke-free Nullia
To: Argon Non, Ministry of Finance
Re: Need for simplified tax structure and large, sustained tobacco tax increases

Thank you again for meeting with me yesterday. I found our discussion fruitful. To follow up, it is our view that Nullia’s tobacco tax structure is needlessly complicated, costs millions in lost revenues, and keeps smoking rates higher than they otherwise would be.

At present, we have four different ad valorem rates for cigarettes (10 percent on ‘traditional’, 25 percent on non-filter, 40 percent on filtered ‘economy’ and 50 percent on filtered ‘premium’), as well as the ‘temporary health levy’ of N$0.25 per pack, a specific tax. This contravenes one of the key recommendations in the FCTC Article 6 guidelines, adopted in Moscow last October by unanimous decision of 178 Parties, including Nullia. Those guidelines talk about the need for countries to “implement the simplest and most efficient system that meets their public health and fiscal needs... Parties should consider implementing specific or mixed excise systems with a minimum specific tax floor...”

As the guidelines point out, “revenues from ad valorem tax are more difficult to forecast, less stable, and more dependent on industry pricing strategies.” This is particularly the case here in Nullia, because of the ad valorem tiers, which are subject to manipulation by the tobacco industry. The 2012 increase in ad valorem rates was followed by an actual decline in revenue. Nullia Tobacco, the owners of the most popular brand in the country, Garlboro, lobbied your ministry successfully to have a new brand variant, Garlboro Red, classified as an ‘economy’ brand, and it captured nearly 30 percent market share almost immediately. This meant an average reduction in the tax rate on Garlboro (all variants) of 8 percent.

Apart from this classification issue, we’ve also seen an increase in sales of ‘traditional’ and non-filter products, particularly in the poorer municipalities around the capital. Some of these smokers would have quit if they didn’t have access to cheaper brands; others would have continued to smoke, but paid higher taxes. So down-trading has cost you revenue and led to higher smoking rates.

Based on tax revenue and sales figures from 2013, the average tax paid per pack in Nullia was N$0.83. We suggest one of two options:

1. Replace all existing taxes with a single, permanent specific tax of N$1.00 pack. This will mean large price increases for cheaper brands, but moderate reductions for premium brands. You can present this as part of your overall effort to make Nullia’s tax system more modern and more efficient.

2. If this is too drastic for you, move to a mixed tax system. We suggest starting by instituting a minimum specific tax floor – this could be N$0.50 per pack to start with. Then you could announce a gradual harmonization of the ad valorem rates, at 40 percent by 2019.

At the same time, we urge you to establish a long-term tobacco tax policy, in line with one of the key recommendations in the Article 6 guidelines (which your own government was involved in drafting as a member of the Article 6 working group.) That recommendation says:

“Parties should establish coherent long-term policies on their tobacco taxation structure and monitor on a regular basis, including targets for their tax rates, in order to achieve their public health and fiscal objectives within a certain period of time.”

Your government recently announced a plan to reduce the percentage of young people leaving school without a diploma from 40 percent to 20 percent by 2020. May we humbly suggest you consider a similar formula for smoking: a promise to increase tobacco taxes every year, so as to cut youth smoking in half by 2020?
FCA is an alliance of nearly 500 civil society organisations in over 100 countries. We’re dedicated to advancing global tobacco control, particularly the WHO Framework Convention on Tobacco Control.

www.fctc.org