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 Key issues for the INB-4
 A briefing for the Government of Malaysia

Tobacco taxes and duty free

Tobacco taxation in practice

Tobacco prices and tax incidence vary considerably around the world, and within the region. The following table gives typical prices and tax incidence as a fraction of the retail price for South East Asian countries and a selection of other markets around the world¹.

Table 1. Prices and tax incidence

Asia			Other countries for comparison		
Country ^a	Price (20 ^b) US\$	Tax %	Country	Price (20 ^b) US\$	Tax %
Hong Kong	3.97	52	UK	6.56	79
Indonesia	0.43	48	Poland	0.92	69
Japan	2.18	61	USA	2.96	26
S. Korea	1.02	68	Canada	3.40	58
Malaysia	1.21	34	Brazil	0.57	75
Philippines	0.44	41	Nigeria	0.18	21
Singapore	3.99	53	Australia	3.87	67
Taiwan	0.91	44	Jordan	0.99	59
Thailand	0.80	56	India	0.57	58

a. Data not available for all ASEAN countries

b. Most popular price category (not necessarily the same cigarettes in each country)

The tax rates, structure chosen for taxation and the underlying net price imposed by manufacturers accounts for the wide differences in prices and tax incidence.

Health impact of price changes

Tobacco demand does respond to normal laws of supply and demand. The World Bank suggests tobacco price elasticities of -0.4 for high-income countries and -0.8 for low and middle-income countries². The price elasticity is the ratio of change in demand for a given change in price – thus a price elasticity of -0.4 means that a ten percent rise in price will cause a four percent drop in consumption, *all other things being equal*. The researchers for the World Bank calculated the effect of a 10 per cent global price rise³. For the 1995 population, they conclude:

... 40 million people worldwide would quit smoking, and many more who would otherwise have taken up smoking would be deterred from doing so. Given that not all quitters would avoid death, the number of premature deaths avoided is still extraordinary by any standards -10 million, or 3 percent of all tobacco-related deaths - from this price increase alone. Nine million of the premature deaths avoided would be in developing countries, of which 4 million would be in East Asia and the Pacific

Economic consequences of tobacco taxation

This policy not only potentially saves many million lives, but it is an extremely efficient form of taxation. If the government has to raise revenue to finance its expenditure and debt, then tobacco tax is superior to taxation on employment or investment or other forms of consumption. Tobacco produces harm, whereas work, general consumption and investment produce well-being. As the 18th century economist Adam Smith put it⁴:

"Sugar, rum, and tobacco, are commodities which are no where necessities of life, which are become objects of almost universal consumption, and which are therefore extremely proper subjects of taxation..."

Increasing incomes

The picture of taxation is complicated by growth in incomes and spending power. As countries become wealthier, so the 'affordability' of cigarettes increases. In effect, less working time is required to earn the money to pay for 20 cigarettes. Consider the following simplified comparison:

Table 2. Prices and incomes

Country	Price of 20 US\$ (Table 1)	Per capita income (US\$ PPP)⁵	Minutes of work for 20 cigarettes*
Malaysia	1.21	10,300	14.1
Philippines	0.44	3,800	13.9
Indonesia	0.43	2,900	17.8
Japan	2.18	24,900	10.5
United States	2.96	36,200	9.8
UK	6.56	22,800	34.5
Nigeria	0.18	950	22.7

* Illustrative calculation only – based on 120,000 minutes of work per year. In practice the working year will differ between countries, and income distribution for smokers may differ from the whole population.

This develops a different picture to that shown in Table 1. It shows that cigarettes are most affordable in Japan and United States, and that despite having substantially higher prices, Malaysia has more affordable cigarettes than Indonesia.

Tax policy in the FCTC

Tax issues are covered in section F of the FCTC working texts. The discussion suggests that incomes should be a factor in considering tax regimes. Given the differences in tax rates, and the political sensitivity of tax policy, rigid harmonisation is unlikely to be acceptable within the FCTC. However, in order to stop tobacco products becoming more easily affordable, the FCTC could promote policies that aim to increase taxes at no less than the rate of growth of incomes. In national reports (section P of working texts), each country could report affordability of its tobacco products to an agreed formula.

Duty free sales

The working text of the FCTC has a proposal to ban duty free sales (F2a). Duty-free represents a tax subsidy to international travellers and to the travel industry – it also encourage travellers to spend in the 'international' economy rather than in the local economy of their destination. It is difficult to identify any real justification for it, other than travellers like it – as most people do enjoy any subsidy.

Duty free also facilitates illegal sales by creating legitimate tax-free outlets that can act illegally if the owners or employees are corrupted or if they turn a 'blind eye' to quantities ordered by customers. Duty free outlets often have heavy point of sale promotion and sell in large quantities. Duty free sales have been abolished within the European Union. Following its amendment in 1999, there are no obstacles with the Kyoto Convention on duty free that would prevent a global ban on duty free tobacco world-wide.

¹ Tobacco Journal International, *Yearbook 2002*, World summary of cigarette taxation and pricing

² Jha P, Chaloupka FJ. *Curbing the epidemic: governments and the economics of tobacco control*. Washington, DC. The World Bank, 1999. Chapter 4.

³ Ranson, Kent, P. Jha, F. Chaloupka, and A Yurekli. *Effectiveness and Cost-effectiveness of Price Increases and Other Tobacco Control Policy Interventions*. Background paper.

⁴ Adam Smith, *An inquiry into the causes of the wealth of nations*, 1776

⁵ Central Intelligence Agency, *World Fact Book*, 2001. PPP = Purchasing power parity, a correction to reflect the reality that one dollar tends to buy more goods in lower income countries