
Tobacco Taxation

MYTHS AND FACTS



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1 MYTH: Higher tobacco tax does not reduce consumption

FACT: Consumers are sensitive to price changes and there is systematic evidence that taxation works towards a reduction in both the amount of tobacco consumed (consumption) and the proportion of the population who consumes tobacco (prevalence). However, the relative success of tax policies in achieving health and fiscal outcomes has been impeded by strategies employed by the tobacco industry.

The strength of the impact of tax policies on the demand for tobacco products can be measured by **price elasticity**, which measures the willingness of consumers to buy a commodity after a price change. If, for instance, the price elasticity of a product equates to -0.1, it means that if the price of a product increases by 10%, the consumption of that product decreases by 1%. For tobacco products, it is estimated that the price elasticity varies from -0.25 to -0.5. Research suggests that even though people living in high-income countries are less sensitive to price increases, they do respond to higher prices e.g. a 10% increase in price will reduce consumption by 3% (elasticity -0.3). In mid- to low-income countries, a similar price increase would reduce tobacco consumption by 4% to 5% (elasticity -0.4 to -0.5).¹ The varying reaction to a price change can be explained by the fact that those with lower incomes are more responsive to changes in price.

Numerous studies have documented the impact of higher tobacco taxes on tobacco use and smoking prevalence. In the U.K., for instance, where excise duties on tobacco products increased steadily between 2009 and 2015 by up to 5% annually, cigarette sales declined from 50.5 to 42.6 billion per year.² At the same time, the tobacco industry took action to undermine tax policies by introducing packs with fewer than 20 cigarettes and launching packets of 10g roll-your-own (RYO). This had the effect of reducing the perceived price of tobacco products, and eventually led to a 46% increase in the consumption of RYO products, despite the 17% decrease in cigarette sales.³ For this reason, tax increases must be applied comprehensively so as to avoid loopholes and prevent the tobacco industry from undermining the fiscal and public health benefits of higher taxation. A good example of such comprehensive policy is the Tobacco Product Directive (TPD)'s provision for a minimum number of 20 cigarettes in packs and a minimum weight of 20g for RYO.

In the long run, the impact of a tax increase can be up to twice as powerful compared to its short run effects.⁴ While the price change has immediate effect on cigarette smoking, the effects of resulting higher price levels persist over time.⁵ In addition, tax increases have a greater impact on young people (18 to 24 years old). With 98% of smokers starting before the age of 26,⁶ higher tobacco tax has an important effect on future smoking prevalence. Finally, the peer effect of lower youth smoking prevalence will amplify the impact of higher taxes. In the long run, more people will also succeed in their quit attempts, further reducing smoking prevalence.

1 Goodchild, Mark, Anne-Marie Perucic, and Nigar Nargis. "Modelling the impact of raising tobacco taxes on public health and finance." *Bulletin of the World Health Organization* 94, no. 4 (2016): 250.

2 Hiscock R, Branston JR, McNeill A, et al. 'Tobacco industry strategies undermine government tax policy: evidence from commercial data.' *Tobacco Control* 2018;27:488-497. <https://tobaccocontrol.bmj.com/content/27/5/488>

3 Ibid.

4 Jha, Prabhat, and Richard Peto. "Global effects of smoking, of quitting, and of taxing tobacco." *New England Journal of Medicine* 370, no. 1 (2014): 60-68.

5 Victoria Stevens, Ryan Diver, Michal Stoklosa, Dana Flanders, Lee Westmaas, Ahmedin Jemal, Jeffrey Drope, Susan Gapstur, Eric Jacobs (2017) "A Prospective Cohort Study of Cigarette Prices and Smoking Cessation in Older Smokers" *Cancer Epidemiology and Prevention Biomarkers* Jul;26(7):1071-1077

6 "Fact Sheet - Youth And Tobacco Use - Smoking & Tobacco Use". 2018. *Smoking And Tobacco Use*. https://www.cdc.gov/tobacco/data_statistics/fact_sheets/youth_data/tobacco_use/index.htm.

2 MYTH: Higher tobacco tax results in more illicit trade

FACT: There is limited correlation between the prices of tobacco products and their supply via illegal channels. The legal, administrative and enforcement frameworks are the important determinants of illicit trade in tobacco products. Additionally, the tobacco industry's concerns about illicit trade need to be examined in the context of its extensive track record in facilitating and promoting the smuggling of its own products.

Many tobacco companies and lobbying organisations claim that higher taxes fuel the black market and contribute to illicit trade. However, even the industry's commissioned studies such as the 2017 KPMG Project Sun, show that the consumption of counterfeit and contraband cigarettes declined by 24% in the EU between 2013 and 2017.⁷ Furthermore, most cigarettes traded illicitly start off as legal and get diverted into the supply chain.⁸ Indeed, the four largest tobacco companies have paid billions of dollars in fines and settlements for the smuggling of their cigarettes in the EU and Canada.⁹

Moreover, because of tax discrepancies between countries, it is the responsibility of governments to control the illicit trade of all goods, not just tobacco products. The Illicit Trade Protocol is aimed at addressing these problems by requiring the introduction of a set of policies to secure the supply chain including a global tracking and tracing system. At the EU level, the tracking and tracing system, which should be operational in May 2019, aims to facilitate the identification of illicit tobacco products, in order to discourage their supply.

In the UK, due to periodic cigarette tax increases, the inflation-adjusted price of cigarettes increased by 63% from 2001 to 2016, making them amongst the highest cigarette prices in Europe and indeed in the world. At the same time, the illicit market dropped by over 70%, and smoking prevalence also dropped from 35% to 21% due to a comprehensive tobacco control strategy that included improvements in tax administration, gathering intelligence and implementation of strong law enforcement measures, as well as a comprehensive ban on smoking in public places, on sales from vending machines, putting tobacco out of sight in shops and mass media campaigns.¹⁰

7 KPMG, *Project Sun*, 'A study of the illicit cigarette market in the European Union, Norway and Switzerland', 2017, <https://assets.kpmg/content/dam/kpmg/uk/pdf/2017/07/project-sun-2017-report.pdf>

8 Tobacco Atlas. *Illicit Trade* | Tobacco Atlas. [online] Available at: <https://tobaccoatlas.org/topic/illicit-trade/>

9 Cancer Research UK. *Smuggling, the tobacco industry and plain packs*. 2012. [online] http://www.cancerresearchuk.org/prod_consump/groups/cr_common/@nre/@pol/documents/generalcontent/smuggling_fullreport.pdf

10 Tobacco Atlas. *Illicit Trade* | Tobacco Atlas. [online] <https://tobaccoatlas.org/topic/taxes/>

3 MYTH: Higher tobacco tax hurts the poor the most

FACT: Since the poor are more sensitive to higher prices, higher tobacco tax decreases consumption more amongst this group, ultimately leading to better health. This also leads to reduced health inequalities.

Consumption taxes affect a higher proportion of disposable income from the poor than from the rich. This is the case not only for tobacco but also for goods such as bread and milk or for services such as education and health care. The concern about poor smokers being hit disproportionately by tobacco tax increases is therefore legitimate. However, people with lower incomes are more likely to reduce their consumption or quit smoking as a result of higher tobacco prices, leaving them with more disposable income in addition to the health benefit stemming from reducing tobacco use.¹¹ It should also be noted that the redistributive power of any fiscal system depends mostly on how tax revenue is spent rather than on how it is generated, and indeed the assessment of such power needs to account for both taxes and benefits. This means specifically that in order to reduce socioeconomic inequalities in health, governments should apply high tobacco taxes and simultaneously fund cessation programmes and therapies in order to help smokers to quit.

4 MYTH: Tobacco tax is a tool of the “Bully-State”

FACT: Tobacco taxation benefits the society as a whole, the economy, public health as well as individuals.

The Framework Convention on Tobacco Control (FCTC) has been ratified by 181 governments, which thus undertook an obligation to introduce demand and supply measures to reduce tobacco use. These legal obligations include price and tax measures (Article 6 of the FCTC). The tobacco industry has been invoking the “freedom to smoke” to influence public policies since as far back as 1966¹². However, tobacco, an addictive product, is the only legal product which, used as intended, kills half of all long-term smokers.

The damage done by tobacco is not only borne by its consumers but it is also imposed on the rest of the society, through second-hand smoking, healthcare costs, increased environmental damage and harm to sustainable development. Furthermore, most tobacco users have started during adolescence, when the risks of smoking are not taken seriously. By the time these risks are properly assessed, consumers are already addicted. It is thus a legitimate and necessary role of governments to protect and safeguard their citizens from tobacco consumption.

11 World Health Organization. *Tobacco control economics*. [online] Available at: <http://www.who.int/tobacco/economics/background/en/index3.html>

12 Brown & Williamson, ‘If you enjoy smoking...act now to protect your freedom to smoke’, 15 April 1966, available at: <https://www.industrydocumentslibrary.ucsf.edu/tobacco/docs/#id=rppd0052>

5 MYTH: The tobacco industry pays excises and contributes largely to national budgets

FACT: Tax (including excise and VAT/ sales tax) accounts for three quarters of the total price of a pack of cigarettes. These are consumption taxes and are paid entirely by the consumers, not by the tobacco industry.

The revenue generated from a tax increase usually exceeds the loss of tax due to the decline in the consumption of tobacco products. Furthermore, the reduction of healthcare costs and improved productivity engendered by a reduction in consumption are critical factors generating a positive economic impact of a tax increase.

In a study conducted by the World Bank, the real net-of-tax price of cigarettes increased by 153% from 1993 to 2014. During the same period, the revenue of the tobacco industry increased by 69% and the real excise tax revenue went up by 220%¹³. This goes to show that increases in duties on tobacco products usually increase fiscal revenue. Additionally, in the EU, the total cost of tobacco smoking (healthcare expenditure, smoking-related loss of productivity and premature mortality) in 2009 equated to 4.6% of the total EU GDP¹⁴. These costs are reduced when consumption of tobacco declines after a tax increase. It can thus be said that increases in tobacco taxes lead to both additional revenues for national budgets and budgetary savings due to lower smoking-related costs.

6 MYTH: Tobacco tax destroys jobs and harms farmers

FACT: The reduction in tobacco consumption has limited impact on employment in the tobacco sector and its related industries.

Employment in the tobacco sector in Europe is already very low. Tobacco growing in Europe has decreased significantly over the last decade since it stopped receiving EU subsidies. Tobacco control policies decrease tobacco consumption gradually, leaving plenty of time for the market to adjust.¹⁵ Additionally, the share of expenditure previously dedicated to tobacco purchasing will be redirected toward different goods, hence fuelling the creation of a variety of jobs in other sectors. The loss of employment in the tobacco sector is usually offset by the increased spending in other sectors.¹⁶

13 Meiro-Lorenzo, Montserrat. 2014. "Tobacco Taxation: Purpose And Myths. The Role Of The WB". *Who.Int*. <http://www.who.int/fctc/implementation/WorldBank.ppt>.

14 "A Study On Liability And The Health Costs Of Smoking". 2008. *Updated Final Report*. https://ec.europa.eu/health/sites/health/files/tobacco/docs/tobacco_liability_final_en.pdf.

15 "Myths And Facts Of Tobacco Control". 2011. *Worldbank.Org*. <http://siteresources.worldbank.org/INTPH/Resources/376086-1289321994364/MythsAndFacts.pdf>.

16 Chaloupka, Frank J., Ayda Yurekli, and Geoffrey T. Fong. "Tobacco taxes as a tobacco control strategy." *Tobacco control* 21, no. 2 (2012): 172-180.



SFP's vision is a world where **all children** can grow up **healthy**, and **free** from the **harm caused by tobacco**



Smoke Free Partnership

Rue de l'Industrie 24, 1040-Brussels, Belgium

www.smokefreepartnership.eu · info@smokefreepartnership.eu

+32 (0) 2 430 73 59

SFP MAIN PARTNERS:



SFP ASSOCIATE PARTNERS:



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