



Tobacco Industry Strategies to Reduce Tax Liability

Hana Ross

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[About the Author\(s\):](#)

Hana Ross: School of Economics, SALDRU, Economics of Tobacco Control, University of Cape Town, South Africa.

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Tobacco Industry Strategies to Reduce Tax Liability

Hana Ross

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Abstract

Literature review and data collection from key stakeholders from low- and middle-income countries. The collected data were categorized and analyzed using an economic framework. I have identified six strategies used by tobacco companies to influence the debate about tobacco tax policies: messaging on negative effects of tobacco tax increases, negotiating tax road maps, threatening to move business out of the country, demanding reduction or elimination of import tariffs, establishing a favorable tax climate as a condition for an investment, and direct lobbying. The messaging strategy has at least five different elements. The discussion of each strategy addresses the motivation for tobacco companies to engage in such strategies, the consequences of the strategy for governments and companies, and measures that governments can take to counter tobacco industry actions to undermine tobacco tax increases. Each strategy is illustrated with one or more country case studies. The article also focuses on illegal activities by the industry that reduce its tax liability and mitigate the impact of tax increases: illegal imports, illegal exports, and illegal production and sale. The tobacco industry often pulls together multiple strategies and adapts them over time for maximum impact. The governments can engage in monitoring and surveillance that will provide data for formulating effective responses to the industry's effort to reduce the impact of tobacco control.

Keywords: illicit tobacco trade, tobacco industry, public health

1. Introduction

Publicly, the tobacco industry expresses concerns about the amount, stability and predictability of governmental excise tax revenues and offers its expertise to help governments to establish "optimal" excise rates. However, internal industry documents reveal that the industry goals are very simple: the excise tax should be as low as possible, and any increases should not be greater than the general level of inflation. This will maintain the affordability of tobacco products and allow the industry to extract the maximum profit.

The tobacco industry works hard to prevent tobacco tax increases using a variety of tactics and strategies, including developing and delivering messages on the negative effects of tobacco tax increases, proposing road maps for tobacco tax increases, and threatening governments with not investing/withdrawing investment if tobacco excise taxes are increased.

If, despite all these efforts, a tax is increased, the industry uses both legal and illegal means to mitigate the impact of the tax increase.¹ Driven by its desire for profit, the industry strategizes about how to reduce its tax liability even without the imminent threat of a tobacco tax increase. Being the ultimate decision maker with respect to the products' prices, the industry has an arsenal of tools at its disposal, including price adjustments, changes in the product mix and packaging, changes in products' attributes, under-declaring the number of products released to the market, and selecting distributors known for tax avoidance and tax evasion.

This report will describe tobacco industry efforts to pay as little taxes as possible. Each activity will be first defined and explained in terms of the industry's motivation. This will be followed by the implication of the particular activity and suggestions how to counter it. Case studies demonstrate how the tobacco industry applies these strategies, and where available, show a successful counter response on the part of governments and the tobacco control community.

The report is organized in two sections. The first section will cover industry efforts to prevent tobacco tax increases, minimize these increases if they cannot be averted, and to reduce existing taxes. The second section will deal with illegal responses to a tax increase. The legal responses to a tax increase have been already covered in a separate report².

2. Activities of the industry to prevent tax increases, minimize them, or to reduce the existing tax

The tobacco industry has a long history of attempts to influence public policies; tobacco taxation is one of their priority issues, since both the tax level and the tax structure directly affect sales volume and profits. The industry resists tobacco tax increases in general, and particularly dislikes taxes earmarked for tobacco control.

¹ This report does not cover the legal means to reduce the impact of a tax increase, because the topic has been already covered in a separate report (see Hana Ross and Jean Tesche. Undermining Government Tax Policies: Common strategies employed by the tobacco industry in response to increases in tobacco taxes. Prepared for UCT Economics of Tobacco Control Project and UIC Institute for Health and Policy. Washington DC 2015. DOI: 10.13140/RG.2.1.4992.9121 (also available in Spanish DOI: 10.13140/RG.2.1.3813.2640 and French DOI: 10.13140/RG.2.1.2108.8161) <http://tobaccoecon.org/publications/reports/>)

² Hana Ross and Jean Tesche. Undermining Government Tax Policies: Common strategies employed by the tobacco industry in response to increases in tobacco taxes. Prepared for UCT Economics of Tobacco Control Project and UIC Institute for Health and Policy. Washington DC 2015. DOI: 10.13140/RG.2.1.4992.9121

Even though tobacco companies often lobby separately to influence tobacco tax structures, each seeking to implement the structure that benefits its own brand portfolio over that of its competitors, they usually collaborate when it comes to preventing tobacco tax increases, seeking to keep tobacco taxes low and specifically to prevent large tax increases and earmarking tobacco tax for tobacco control.

The industry's goals and tactics vary depending on the economic, political, and historical contexts of the country in question. Key industry tactics include: establishing 'front groups', securing credible allies, commissioning supportive/informative research prepared according to industry specifications, direct lobbying, and mass media/publicity campaigns. The industry often deliberately mixes the issue of tobacco tax increases with broader tax debates to confuse proposals for tobacco tax increases with other unpopular tax increases.³

2.1 Messaging on negative effects of tobacco tax increases

By exaggerating the negative consequences of tobacco tax increases, the industry is trying to divert policy attention from the most effective measure to reduce tobacco use in favor of measures that have been proved not to be very effective such as educational programs.

The industry uses a variety of arguments, often combining several of them, but uses them selectively according to the country's specific situation, the target audience, and the author of the tax increase proposal.

This section will first discuss the individual arguments and then provide an example of how these arguments are often combined in a systematic anti-tax campaign.

2.1.1 Warning that tax increase will increase smuggling, which will hurt tax revenue, while tobacco use will stay the same

Definition

The industry claims that tax increases will result in substitution from legal to illegal cigarettes, which are more harmful due to the lack of quality control. As a result, higher taxes will have a minimal impact on tobacco use, possibly resulting in worse health impacts, while the government will lose tax revenue. The market will be flooded with illicit tobacco products, encouraging a culture of tax evasion and crime while making it easier for youth to get hold of tobacco products. Fighting illegal cigarette sales will divert police attention away from other (more violent) crimes and hurt local business by reducing its profit from legal cigarettes sales. Such a business climate will deter investment and further weaken the tax base.

Motivation

This is one of the most common messaging to discourage tax increases. The goal is to persuade policy makers that by approving a tax increase they could hurt the economy at large. This argument is being used even in countries where smuggling is not a significant issue, suggesting it is not context-specific.

³ Katherine E Smith, Emily Savell, Anna B Gilmore. What is known about tobacco industry efforts to influence tobacco tax? A systematic review of empirical studies. *Tobacco Control* 2013;22:144–153. doi:10.1136/tobaccocontrol-2011-050098

Implications

This speculation enables the industry to attract the support of non-traditional, credible allies such as customs, the police, or retailers' associations. The industry often stimulates smuggling in order to support claims that tax increases have contributed to more illicit trade.

What can be done?

Policy makers and the public need to know that tobacco taxes are not the primary driver for cigarette smuggling and that the benefits of higher tobacco taxes in terms of better health and more revenue have been significant even in countries where smuggling exists. Many countries have increased tobacco taxes without experiencing changes in smuggling/illicit production.

Research shows that the level of contraband is positively correlated with the degree of corruption in a country. For example, despite high cigarette prices and some of the highest taxes on cigarettes, smuggling is almost non-existent in Scandinavian countries, Australia, and New Zealand. In contrast, smuggled cigarettes can be easily purchased in Albania, Cambodia, and in Eastern Europe, where taxes are low and cigarettes are cheap.⁴ Tax increases can lead to more tax avoidance such as cross-border shopping, which is legal within the limits provided by law. If the limits are exceeded and the applicable taxes are not paid, tax evasion is committed. However, such behavior is usually temporary and fails to undercut the larger public health benefits of higher taxes. Governments that decided to reduce tobacco taxes in response to industry pressure have experienced an increase in youth and adult smoking and a decline in government revenue.

It is important to disseminate information about the industry's role in smuggling schemes. For example, an uncovered conspiracy between the tobacco industry and organized crime in Canada to supply the market with illegal cigarettes has been reported on in numerous publications⁵. The [International Consortium of Investigative Journalists](#) (ICIJ)⁶ plays a particularly important role in disseminating evidence of various industry schemes to supply the market with illegal products.

The tobacco control community needs to support a sufficient combination of measures to combat illicit trade. Experience shows that cigarette smuggling can be controlled by legal means (e.g. use of prominent tax stamps, serial numbers, special package markings, health warning labels in local languages) and by law enforcement (e.g. identifying and prosecuting those involved in illegal supply of tobacco products, increasing penalties for offenders, improving corporate auditing, better tracking systems, good governance). Revenue generated by the tax increase can finance these activities.

When proposing a tax increase, the public health community needs to present the impact of the new policy, including possible changes in tax revenue and cigarette consumption, under different market response scenarios. If tax rates are increased, the impact of such increases on revenues, consumption, and smuggling should be monitored to demonstrate the inadequacy of tobacco industry forecasts and to encourage authorities to continue to raise tobacco taxes in the future.

Case Studies

United Kingdom

The UK has one of the highest tobacco tax rates in the world, thanks to its policy of above-inflation rate tax increases over the last 20 years. In 2015, a pack of cigarette in the UK cost on average 9.56

⁴ IARC Handbooks of Cancer Prevention-Tobacco, vol. 14, Effectiveness of Tax and Price Policies for Tobacco Control, 2011.

⁵ The Gazette (Montreal), April 8, 2009; Media Advisory; Washington, D.C., 2009.

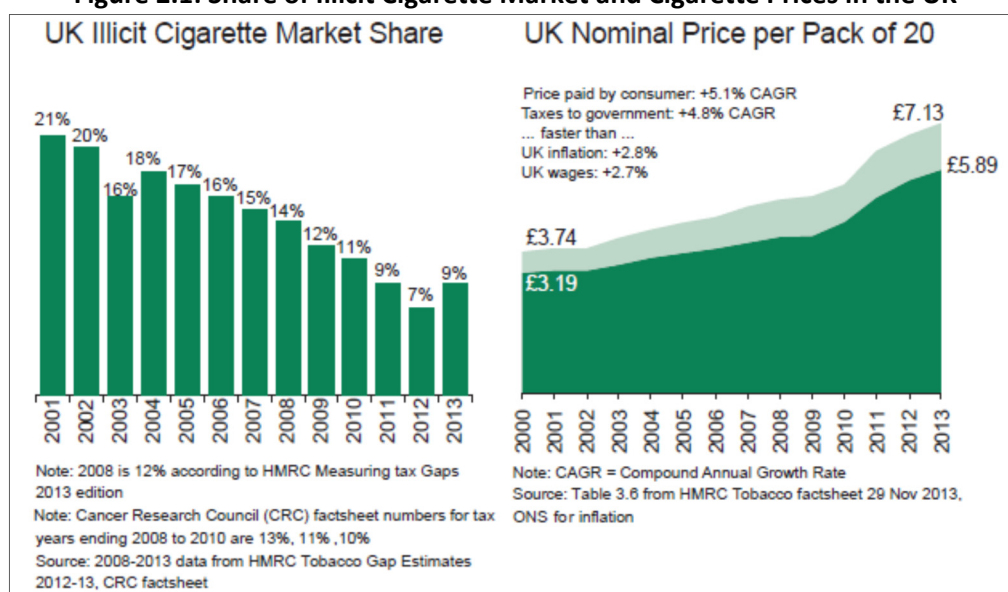
⁶ [International Consortium of Investigative Journalists](http://www.icij.org/) www.icij.org/

Euro, out of which excise tax accounted for 6.45 Euro and the remaining tax amounted to 1.60 Euro, making the total tax burden 84.1%.⁷ Despite this policy, the levels of illicit trade have been falling since their peak of around 21% of total consumption in 2001 to about 10% of total consumption in 2013-14.⁸ Such success has been achieved thanks to the government's anti-smuggling strategy implemented since 2000. This, however, did not prevent the tobacco industry from claiming that the 2011 and 2012 proposed tax increases would increase illicit trade.

Even though the industry warned that the large price differences between the UK and the rest of Europe would motivate illicit trade, the industry was increasing its own prices along with the tax rate: between 2006 and 2009 price increases were driven almost equally by tax increases (responsible for 52% of the total price increase) and by the industry price strategy (responsible for 48% of the total price increase).⁹ Such industry response to tax increases is inconsistent with its stated concerns about illicit trade, if the industry truly believes that higher prices are driving illicit trade.

To put UK tobacco tax evasion/avoidance into perspective, about 9% of the total cigarette market was not taxed in 2012-2013, causing an estimated revenue loss of about £ 900 mil. In the same fiscal year, 16.9% of self-assessed income taxes and 8.7% of corporate taxes were not paid, resulting in an estimate loss of £ 8.9 billion, about 10-times more than the loss due to untaxed cigarettes.¹⁰

Figure 2.1: Share of Illicit Cigarette Market and Cigarette Prices in the UK



Source: Tobacco smuggling. First Report of Session 2014-15. Home Affairs Committee, House of Commons, HC 200, UK, 14 June 2014.

Ukraine

In June 1998 the government of Ukraine proposed a significant increase in its tobacco excise rate. The industry predicted that such an increase would not raise tax revenue, but, on the contrary, would lead to "increased contraband and the breakdown of Ukraine's tobacco industry".¹¹ In August

⁷ Excise Duty Tables. Part III – Manufactured Tobacco. European Commission, July 2015.

⁸ Tackling illicit tobacco: From leaf to light. HM Revenue & Customs. March 2015

⁹ Gilmore AB, Reed H. The truth about cigarette price increases in Britain. Tobacco Control 2014;23: e15–e16.

¹⁰ Measuring tax gaps 2014 edition Tax gap estimates for 2012-13. HM Revenue & Customs. October 2014.

¹¹ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. Tobacco Induced Diseases. 2010;8(10).

1998, the excise tax increased from 4.2 UAH to 10 UAH per 1000 cigarettes, almost a 140% tax increase.

Government revenues increased from 129 million UAH (70 million USD) in 1997 to 287 million UAH (117 million USD) in 1998.¹² The tobacco industry did not collapse. In fact, the production of cigarettes in Ukraine increased from 54 billion cigarettes in 1997 to 59 billion cigarettes in 1998.¹³

Another substantial (200%) tax increase in Ukraine was approved on March 31, 2009 and taking effect on May 1, 2009. The industry forecasted no decline in tobacco consumption, because illicit products would supposedly replace one third of the legal cigarette market. Some industry analysts even claimed that smuggled and counterfeit products would capture almost 50% of the market.¹⁴

The proponents of the tax increase predicted a decline in cigarette consumption by 5% and a possible increase in the share of illicit cigarettes up to 8% of total consumption.

A survey evaluating the impact of the 2009 tax increase revealed a significant decline in smoking prevalence from 25.6% in 2008 to 23.5% in 2009, or by 8%, while the government reported that the legal sales dropped by 10% (or 13 billion cigarettes).¹⁵

Another survey found that only 1.5% of smokers in Ukraine consumed illegal cigarettes at the end of 2009. The industry disagreed with that estimate and reported that about 10% of the market was illicit by the end of 2009. This was still much lower than the originally-predicted one-third illicit market share.¹⁶

It became evident that the industry predictions were incorrect. The results of the 2009 tax increase were so persuasive that the government proposed another substantial excise tax increase in April 2010, effective as of July 2010. At this time, the tobacco industry did not make any public comments. Ukraine continues increasing its tobacco excise tax - the share of total tax in the retail price went up from 57.6% in 2012¹⁷ to 75% in 2014.¹⁸ This increase is accompanied by a continuous decline in smoking prevalence: the latest nationally representative estimate shows that 21.8% of the adult population smokes; national statistics point to a steady decline in mortality from stroke, other cardiovascular diseases, tuberculosis, and sudden infant death syndrome.¹⁹ The penetration of illicit cigarettes in Ukraine continues to be low – only about 3.5% of smokers possessed cigarettes with an incorrect health warning in 2013.²⁰

Figure 2.2: Cigarette Sales, Tax Rates, Excise Revenue and Number of Smokers in Ukraine,

¹² Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

¹³ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

¹⁴ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

¹⁵ Konstantin Krasovsky. Tobacco excise taxation policy in Ukraine. Presented at 8th European Conference on Health Economics. 2010, Helsinki, Finland.

¹⁶ Konstantin Krasovsky. Tobacco excise taxation policy in Ukraine. Presented at 8th European Conference on Health Economics. 2010, Helsinki, Finland.

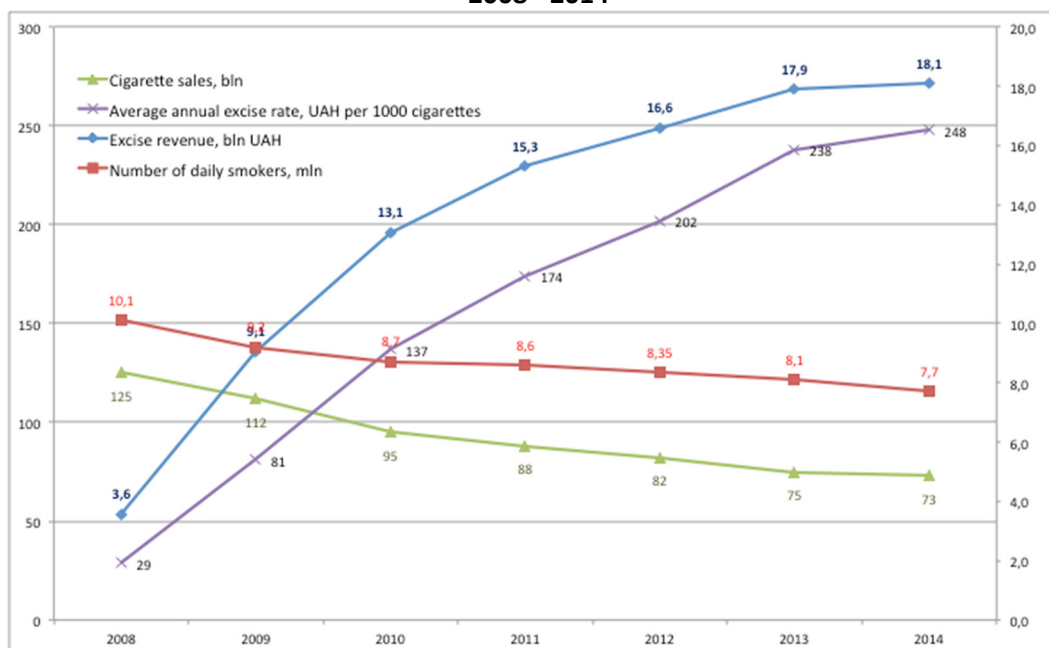
¹⁷ WHO Country profile: Ukraine. 2014

¹⁸ WHO report on the global tobacco epidemic, 2015: raising taxes on tobacco. WHO 2015

¹⁹ Krasovsky, Konstantin; Andreeva, Tatiana; Grygorenko, Alla; Polishchuk, Mykola; Skipalsky, Andriy; Stoyka, Otto. Tobacco Control in Ukraine. Second National Report. Kyiv: Ministry of Health of Ukraine. 2014

²⁰ Krasovsky, Konstantin; Andreeva, Tatiana; Grygorenko, Alla; Polishchuk, Mykola; Skipalsky, Andriy; Stoyka, Otto. Tobacco Control in Ukraine. Second National Report. Kyiv: Ministry of Health of Ukraine. 2014

2008 - 2014



Source: Data from the Ukraine State Statistical Office. Compiled by Konstantin Krasovsky, 2015.

Canada

In response to a series of tobacco tax increases in the early 1980s the tobacco industry began to supply the Canadian market with illegal products that were first legally manufactured in Canada, and then exported to the United States and illegally smuggled back into the country. By the mid-1990s, illicit cigarette consumption accounted for 30% of the total Canadian market.²¹ The federal government and some provinces responded by lowering their tobacco tax rates in 1994 in order to reduce the size of the illicit cigarette market. Even though the tax cut temporarily reduced the supply of illicit cigarettes via the export/import scheme, new sources of illicit cigarettes quickly emerged thanks to illegal manufacturing in central Canada and in specific Aboriginal communities.²²

The 1994 tax cut resulted in higher smoking rates, especially among youth, and in lower tax revenue. This led the federal and provincial governments to reevaluate their decisions, restoring the excise taxes to their pre-1994 level by June 2002.²³ At the same time, criminal charges and civil lawsuits have been brought against tobacco manufacturers involved in tobacco smuggling (Imperial Tobacco, Rothmans, Benson & Hedges, JTI, and RJR Reynolds).²⁴ In 2008 and 2010, these companies agreed to pay a total of \$1.7 billion dollars in criminal fines and civil restitution for their role in smuggling schemes.²⁵

By 2010, the federal excise tax was higher compared to the pre-1994 tax cut level and the size of the illicit cigarette market was cut by more than half due to a multipronged anti-smuggling strategy

²¹ Understanding the U.S. illicit tobacco market: characteristics, policy context, and lessons from international experiences. National Academy of Sciences; 2015.

²² Royal Canadian Mounted Police. Contraband tobacco enforcement strategy. 2008.

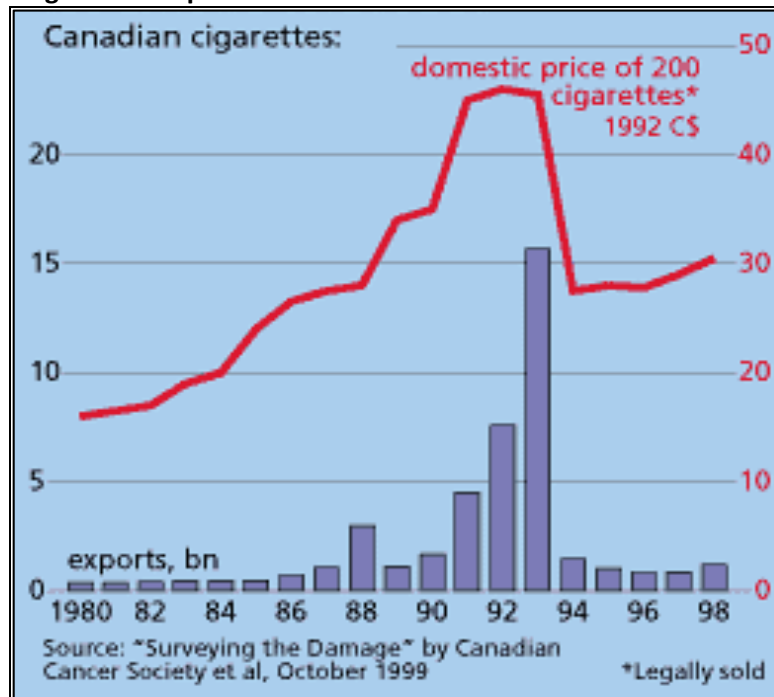
²³ Royal Canadian Mounted Police. Contraband tobacco enforcement strategy. 2008.

²⁴ Royal Canadian Mounted Police. Contraband tobacco enforcement strategy. 2008.

²⁵ Daudelin J, Soiffer S, Willows J. Border integrity, illicit tobacco, and Canada's security. Macdonald-Laurier Institute; March 2013.

adopted by the Canadian government.²⁶

Figure 2.3: Export from Canada to the US and Canadian Prices



2.1.2 Predicting negative distributional consequences (higher taxes will hurt the poor)

Definition

The industry asserts that higher tobacco taxes will impose an unfair burden on the poor and other marginal groups. It argues that poor people have only few pleasures, and higher taxes will make smoking unaffordable to them. The industry also claims that the greater tax burden will crowd out spending by poor households on necessities like food and shelter.

Motivation

With this strategy, the industry is trying to secure anti-tax support from non-traditional allies, including labor groups (e.g., unions), organizations representing minority ethnic groups, and left-leaning politicians.

Implications

This type of messaging can make a tax increase sound like a risky proposition for a policy maker and can convince him/her to vote against the measure.

What can be done?

Counteract industry messaging by disseminating research evidence that clearly demonstrates the negative consequences of tobacco use among the poor. In many countries, tobacco use is heavily concentrated among low-income groups and this results in crowding out resources for necessities

²⁶ Hana Ross. Controlling illicit tobacco trade: International experience. Prepared for the Economics of Tobacco Control Project, School of Economics, University of Cape Town and Tobacconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago. May 2015. <http://tobaccoecon.org/publications/reports/>

like food and shelter. Tobacco use also contributes to health inequities, leaving many poor households in a state of poverty when they incur health care costs associated with smoking or revenue loss due to premature death of a breadwinner.²⁷

Tax increases bring disproportional benefits to the poor and other vulnerable populations. Although tobacco taxes do represent a higher share of the income for the poor, the poor are more responsive to price changes, which means that the tax increases are progressive, because a larger share of the poor will stop smoking or reduce consumption compared to the rich. The drop in household expenditures on cigarettes following the reductions in smoking that result from higher taxes will free up much-needed resources for spending on other goods and services, including food and education, likely leading to an improvement in food security and future earning potential.

Higher tobacco taxes will save lives, while keeping tobacco products affordable for the poor will hurt them by imposing unfair economic and health burdens associated with tobacco use. Given the greater concentration of tobacco use in low-income groups, the poor bear a disproportionate share of the health and economic burden of tobacco use. Therefore, higher tobacco taxation can help to address both income and health disparities.

The potential for higher taxes to impose additional financial burden on households that continue to smoke makes it critical that at least some of the new revenue generated by higher tobacco taxes be used for programs targeting low-income households, especially those that would help them to quit smoking.

Proposed tobacco tax increases that envision spending some part of the tax revenue on tobacco control and/or other health programs usually receive greater public support.

Case Studies

USA

Between 1987 and 1997, the tobacco industry created a political partnership with the Coalition of Labor Union Women (CLUW), a group representing female trade unionists in the U.S., in order to encourage CLUW's opposition to excise tax increases by emphasizing the burden of these taxes on the poor, confusing the impact of higher taxes in general with the impact of higher tobacco taxes, and encouraging opposition to earmarking cigarette taxes to pay for specific programs. During this time, CLUW received both financial support and in-kind support from the tobacco industry.²⁸ Even though individual states were increasing the state cigarette taxes, the federal excise tax on cigarettes was lower in real terms in 2008 compared to 1970. The federal tax was finally increased in 2009 when it went from US\$0.39 to US\$1.01.

To address the impact of this substantial tax increase on the poor in the USA, a researcher²⁹ projected its impact using existing estimates of price sensitivity by income levels and found that higher-income individuals, i.e. individuals whose income was greater than 200% the federal poverty line, would pay for the majority of the 2009 tax increase. On the other hand, the benefits of the tax increase measured by the reduction in the number of deaths were expected to occur among the

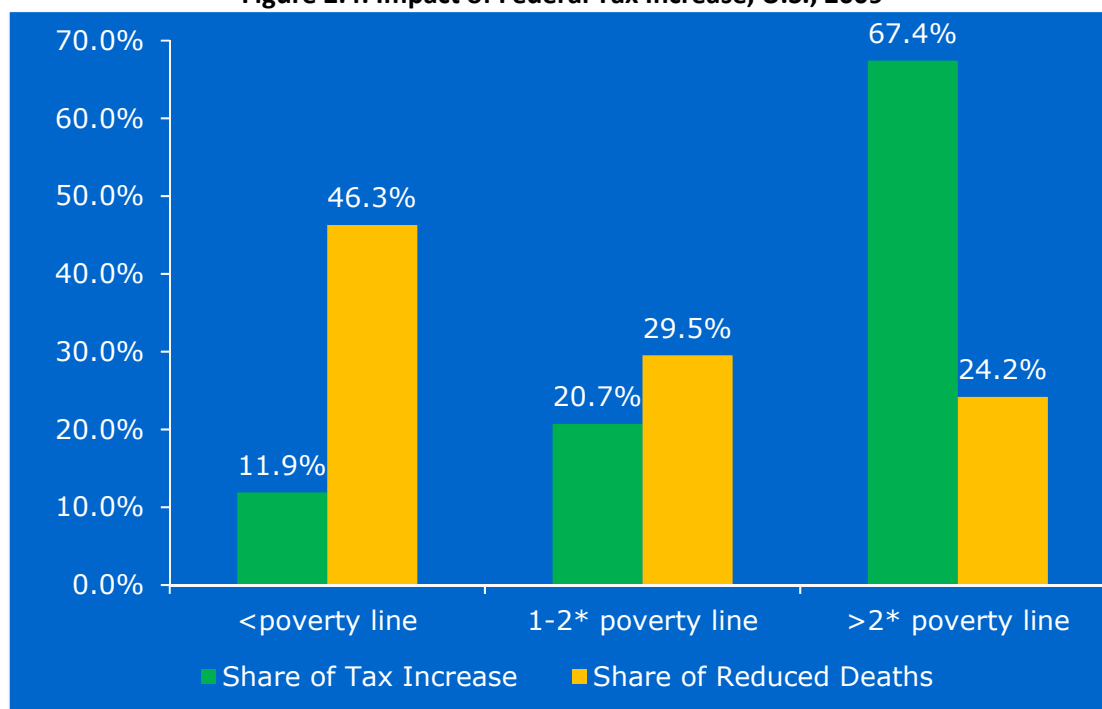
²⁷ Systematic review of the link between tobacco and poverty. World Health Organization 2011

²⁸ Edith D. Balbach and Richard B. Campbell. Union Women, the Tobacco Industry, and Excise Taxes. A Lesson in Unintended Consequences. American Journal of Preventive Medicine 2009;37(2S):S121–S125

²⁹ Frank Chaloupka. Science Behind Tobacco Taxation. Presentation at the National Conference on Tobacco or Health, August 16 2012, Kansas City, MO, USA.

lower-income individuals, i.e. by those whose income was below the federal poverty line or at 100-200% of the federal poverty line. This is because lower-income tobacco users quit or reduce tobacco consumption more than higher-income tobacco users.

Figure 2.4: Impact of Federal Tax Increase, U.S., 2009



Source: Frank Chaloupka. Science Behind Tobacco Taxation.

Presentation at the National Conference on Tobacco or Health, August 16 2012, Kansas City, MO, USA.

Turkey

Turkey has a relatively high smoking prevalence - about 27% of adults smoked cigarettes in 2012.³⁰ To address this public health issue, the government has been increasing the cigarette excise tax. By 2013 the cigarette excise tax represented 65% of the average retail price, a substantial increase compared to 2003 when this share was only 55% of the average retail price.

In light of the significant increases in the excise tax, a study³¹ using the 2003 Turkish Household Expenditure Survey investigated the impact of this policy on the poor in terms of their household budget allocation and smoking behavior.

The results revealed that the poor spent a relatively higher share of the household expenditure on cigarettes compared to the rich. However, the poor were more sensitive to tax and price increases. This means that the share of household expenditures devoted to cigarettes declined the most among the lowest expenditure tertile (the poor), suggesting that increases in cigarette excise taxes were progressive. Furthermore, the highest expenditure tertile (the rich) contributed the most to the cigarette excise tax revenue and their contribution increased with higher excise taxes.

The study concluded that the poor smoking households benefited the most from increases in excise taxes. They reduced their cigarette consumption significantly more compared to the rich smoking household and as a result, their share of cigarette excise payment declined – both in terms of their

³⁰ Önder Z, Yürekli AA. Who pays the most cigarette tax in Turkey. Tobacco Control 2016;25:39-45

³¹ Önder Z, Yürekli AA. Who pays the most cigarette tax in Turkey. Tobacco Control 2016;25:39-45

household budgets and also in terms of their contribution to government cigarette excise tax collection. From the health perspective, the poor will also be better off, since their cigarette use declined. As government revenue increases after a cigarette tax increase, the government could fund the enforcement of tobacco control measures and provide cessation services for the vulnerable population. This would further enhance the progressivity of cigarette tax increases.

2.1.3 Predicting job losses, negative impact on businesses selling tobacco, higher inflation, lower tax revenue, and an overall negative impact on the economy

Definition

The industry claims that tax increases will lead to significant reductions in employment in tobacco growing and manufacturing, as well as wholesale, retail, and other economic sectors. It asserts that higher taxes will hurt local businesses selling tobacco, while higher prices will contribute to higher inflation. The reductions in tobacco sales caused by a tax increase will be so large that it will offset the impact of the increased tax rate and overall tax revenue will decline. Consequently, the tax increases will have an adverse impact on the entire economy. On the other hand, the industry reports that tobacco tax restraint such as tax freezes (e.g. Hong Kong) or tax reductions (e.g. Canada, Sweden, Denmark) are successful in supporting economic development.

Motivation

The industry wants to convince policy makers of the overall negative economic impact of a tax increase, and the positive impact of lower taxes, even though internal industry documents reveal that the management of tobacco companies did not believe that this was true.³² The industry is also looking for allies among small business communities by trying to demonstrate the negative impact of higher tobacco taxes on sales and overall profit.

Implications

The job loss argument can help the industry to secure anti-tax support from labor unions, tobacco growers, and/or other type of business associations. The lost business argument is gaining some support among the convenience stores and small business associations. Policy makers in countries with high levels of inflation may be reluctant to support a tax increase out of fear that it will increase overall inflation.

What can be done?

Demonstrate that tobacco growing and manufacturing account for a small and, in most countries, declining share of economic activity. Generally, employment in tobacco farming is low relative to other farming activities. Tobacco farmers are much more vulnerable to adverse industry business decisions than to any tobacco control measures. The market for tobacco leaves is global and is not affected by a tax increase in any one country. Any decline in the demand for tobacco leaves will be gradual, allowing tobacco farmers plenty of time to transition from tobacco to alternative crops.³³

Tobacco manufacturing generates very few jobs and those jobs are also declining due to the tobacco industry's automation and mechanization of the manufacturing process, as well as due to industry concentration and regionalization of the production.

³² Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

³³ Geist HJ, Chang K, Etgesc V, Abdallah JM. Tobacco growers at the crossroads: Towards a comparison of diversification and ecosystem impacts. *Land Use Policy* (2009), doi:10.1016/j.landusepol.2009.01.003

Those who will respond to a tax increase by reducing their consumption will spend the money previously spent on tobacco products on other goods and services, thus generating a positive impact in other sectors of the economy, most likely resulting a net gain in employment. The new revenue government gets from a tax increase is also spent, generally on activities that are more labor intensive compared to the tobacco industry, thus creating additional jobs.

It is important to show that there is minimal or no loss to businesses when tobacco taxes are increased. The sale of tobacco products generally represents a small share of most stores' turnover. Stores that are more dependent on tobacco sales tend to be small, thus more agile in responding quickly to changes in tobacco sales. As result, the higher tobacco taxes do not negatively impact the number of retail establishments and overall employment in the retail sector.

In most countries tobacco products represent a small share of the overall consumer basket, therefore contribute minimally to overall inflation. Some countries no longer include tobacco products in these baskets.

Higher tobacco taxes applied across all tobacco products will result in higher tax revenues. The demand for tobacco products is inelastic, which means that the proportionate reduction in demand is smaller than the proportionate size of a tax increase. Thus, even though demand is reduced when prices increase as a result of higher tobacco taxes, the higher tax rate will result in overall increases in tax revenues. As these new revenues are spent, they create new jobs in the economy.

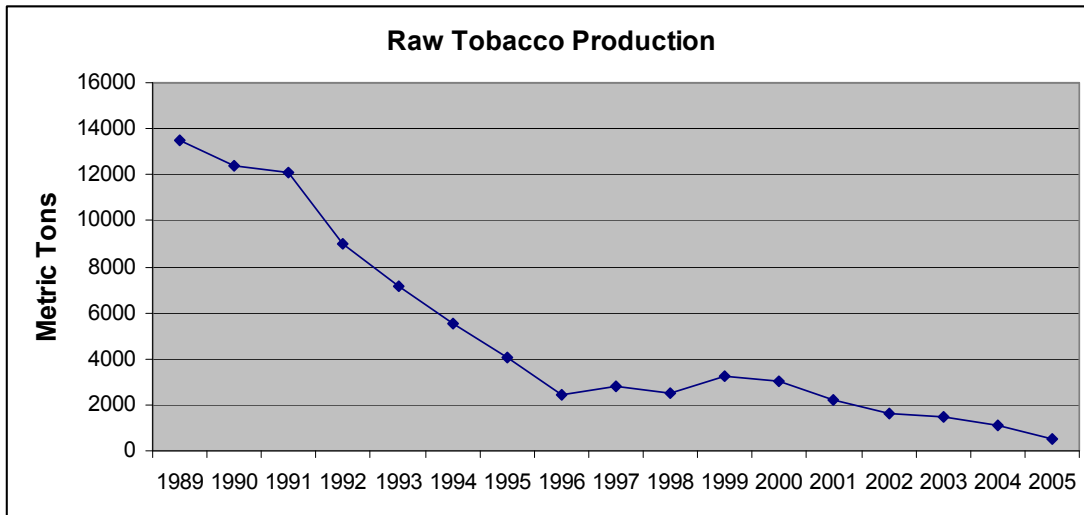
Case Studies

Ukraine

Even before tobacco taxes began to increase in Ukraine in 2008, employment in tobacco farming was disappearing due to the tobacco industry preference for a different quality of raw tobacco. By 2005, almost all domestically-produced cigarettes used imported tobacco leaves.³⁴

³⁴ Ross H, Shariff S, Gilmore A. Economics of Tobacco Taxation in Ukraine. Paris: International Union Against Tuberculosis and Lung Disease; 2009

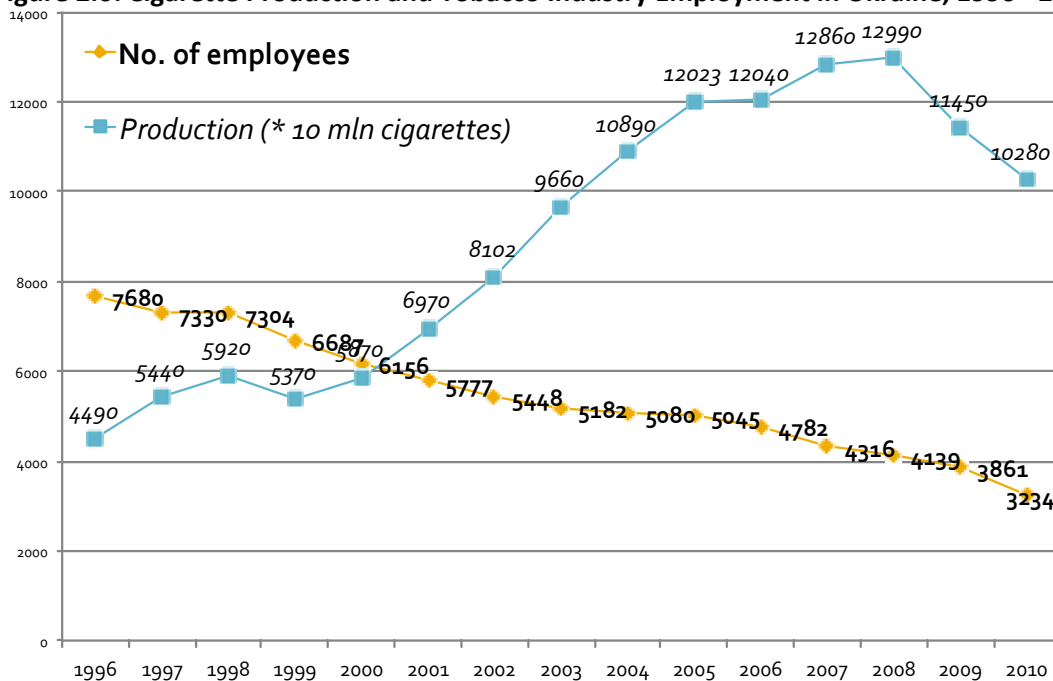
Figure 2.5: Raw Tobacco Production in Ukraine, 1989 - 2005



Source: Ross H, Shariff S, Gilmore A. Economics of Tobacco Taxation in Ukraine. Paris: International Union Against Tuberculosis and Lung Disease; 2009

From 2000 to 2006 the real tobacco tax in Ukraine was virtually unchanged and cigarette production was growing. Yet the employment in cigarette manufacturing had been falling during the entire period. Tobacco taxes began to increase substantially only in 2008, which resulted in a decline in cigarette production with no changes in the employment trend that has shown steady declines since the mid-1990s.³⁵

Figure 2.6: Cigarette Production and Tobacco Industry Employment in Ukraine, 1996 - 2010



Source: Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. Tobacco Induced Diseases. 2010;8(10).

³⁵ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. Tobacco Induced Diseases. 2010;8(10).

As the Ukraine government began to discuss a change in its tobacco tax policy in 2008, the tobacco industry claimed that the proposed 200% tax increase would decrease the number of licensed tobacco retailers from 90,000 to 30,000, and that cigarette production would drop to 75 billion cigarettes, a 50% reduction.

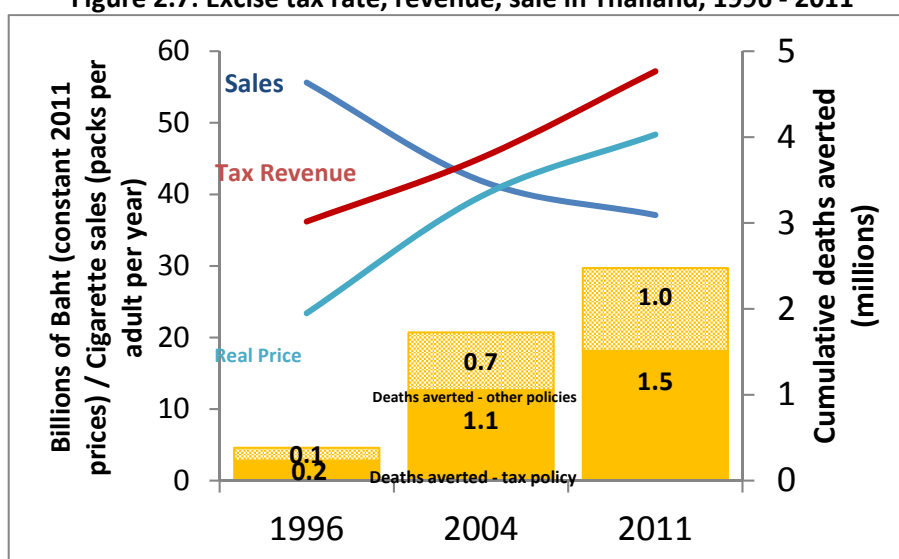
The tobacco tax finally doubled in May 2009. There were 90,891 licensed tobacco retailers in Ukraine in 2009, and despite the industry forecast, that number increased slightly to 90,916 by December 2010. The 2009 cigarette production declined, but only by 12% compared to 2008. In that year, Ukraine produced 115 billion cigarettes, 53% more than the industry forecasted.³⁶

Thailand

Cigarette taxes in Thailand have steadily increased from 1991 to 2012. Despite substantial tax/price increases and implementation of other tobacco control policies, tax revenue more than doubled, the sales of cigarette declined, and many premature deaths were prevented during this period. About 10 thousand premature deaths were averted in 2011 alone thanks to tobacco control policies implemented in the period of 1991 - 2006.³⁷

According to the World Bank, the GDP of Thailand grew by 219% from 1991 to 2012, while the revenue of the Thai Tobacco Monopoly grew from 38,223 million Baht to 63,042 million Baht, or by 65% from 1996 to 2012.³⁸ In December 2013, the Thai Tobacco Monopoly was rated as one of the most profitable state-owned enterprises in the country. There is no evidence that the policy of continuous tobacco tax increases has hurt the Thai economy or the Thai tobacco industry.

Figure 2.7: Excise tax rate, revenue, sale in Thailand, 1996 - 2011



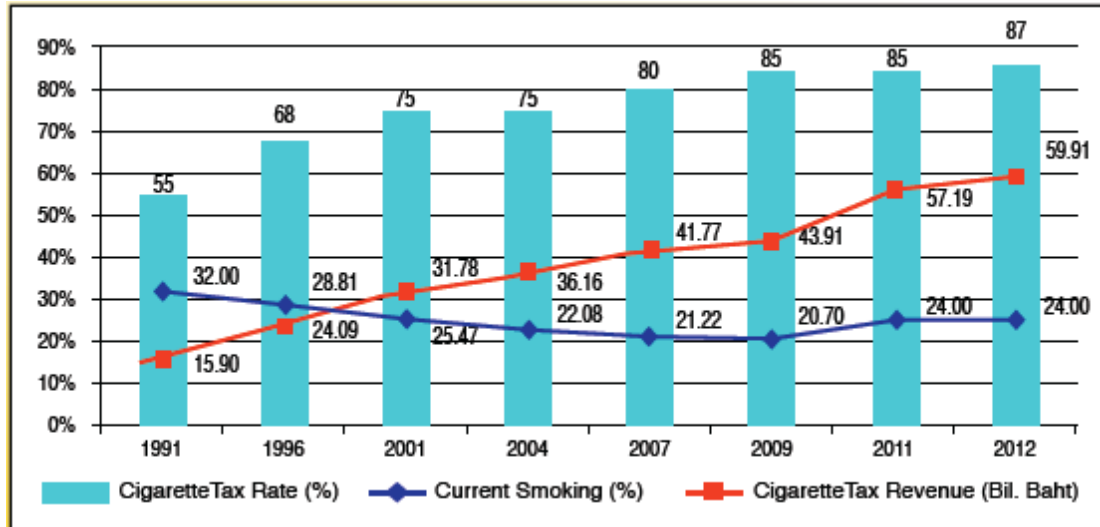
Source: David Levy, Sarunya Benjakul, Hana Ross, and Bung-on Ritthiphakdee. "The Role of Tobacco Control Policies in Reducing Smoking and Deaths in a Middle Income Nation: Results from the Thailand SimSmoke Simulation Model" *Tobacco Control*. 2008;17:53-59.

³⁶ Konstantin Krasovsky. Tobacco excise taxation policy in Ukraine. Presented April 2012.

³⁷ David Levy, Sarunya Benjakul, Hana Ross, and Bung-on Ritthiphakdee. "The Role of Tobacco Control Policies in Reducing Smoking and Deaths in a Middle Income Nation: Results from the Thailand SimSmoke Simulation Model" *Tobacco Control*. 2008;17:53-59.

³⁸ Thailand and Vietnam: Regulations Review. *Tobacco Asia Magazine*, 2014

Figure 2.8: Excise tax rate, revenue, and smoking prevalence in Thailand, 1991 - 2012



Source: ASEAN Tobacco Tax Report Card, SEATCA, May 2013

USA

Retailers and tobacco-backed retail organizations in the USA often argue that higher cigarette taxes reduce the sales of cigarettes and therefore negatively affect the retail business, particularly small convenience stores. As result, the convenience store associations often oppose higher cigarette taxes and other tobacco control policies.³⁹ Despite this opposition, the average state excise cigarette tax in the USA went up from \$0.47 in 1997 to \$1.27 in 2009.

A study⁴⁰ investigating the impact of this tax policy on the density of convenience stores, a proxy for profit of outlets responsible for approximately 51% of the annual total retail sales of tobacco products in 2002, found a small positive effect of higher tobacco taxes on convenience store density across states during the period of these tax increases. The results were robust to multiple model specifications, taking into account the overall state of the economy, the unemployment rates and the impact of gasoline prices, since gas stations are also a type of convenience stores in the US. Thus, contrary to tobacco industry and related organizations' claims, higher cigarette taxes and stronger tobacco control policies do not negatively affect convenience stores.

2.1.4 Comparing affordability of cigarettes with high-income countries to show that the tax is high already

Definition

The industry claims that tobacco products are already taxed very heavily relative to consumers' purchasing power and compares the percentage of income or expenditures needed to pay for the tax with a similar percentage in other, usually high income countries. Further, the industry claims that low affordability of tobacco products motivates people to escape taxes, both legally and illegally, encouraging dishonesty, which hurts both legitimate business and government revenue.

³⁹ Jidong Huang and Frank J Chaloupka. The economic impact of state cigarette taxes and smoke-free air policies on convenience stores. *Tobacco Control* 2013;22:91-96.

⁴⁰ Jidong Huang and Frank J Chaloupka. The economic impact of state cigarette taxes and smoke-free air policies on convenience stores. *Tobacco Control* 2013;22:91-96.

Motivation

This message tries to elicit sympathy with and global solidarity among smokers, asking governments to extract the same relative tax (measured as the share of income) from a smoker independent of his/her country of residence. By demanding "fair" tobacco taxation in all countries and by selectively choosing the benchmarks, the industry is trying to prevent any new taxes.

Implications

Policy makers could be persuaded that a tax increase would be unfair towards their fellow citizens and vote against the tax increase.

What can be done?

Show how the industry manipulates the benchmark for this comparison and provide examples of other countries where the tax as percentage of income is larger than in the country in question. Further, help policy makers understand that making tobacco products less affordable is one of the best ways to keep their consumption low and to prevent young people from picking up the habit. Therefore, tobacco taxes need to be increased regularly so that the prices of tobacco products keep up not only with inflation, but also with income growth, in order to reduce tobacco use and improve public health.

Case Studies

The Association of Southeast Asian Nations (ASEAN)

A 2005 analysis supported by the tobacco industry⁴¹ argued that the affordability in many ASEAN countries is very low. It claimed, for example, that cigarettes in Vietnam were about ten times less affordable than in the US, nearly five times less affordable than in Hong Kong and three times less affordable than in Australia and the UK. According to the study, the cigarettes in the Philippines were half as affordable as in the US and on a par with Hong Kong. The report pointed out that high tobacco taxes are responsible for the low level of affordability in these countries and this encourages smuggling and other illegal trade in tobacco.

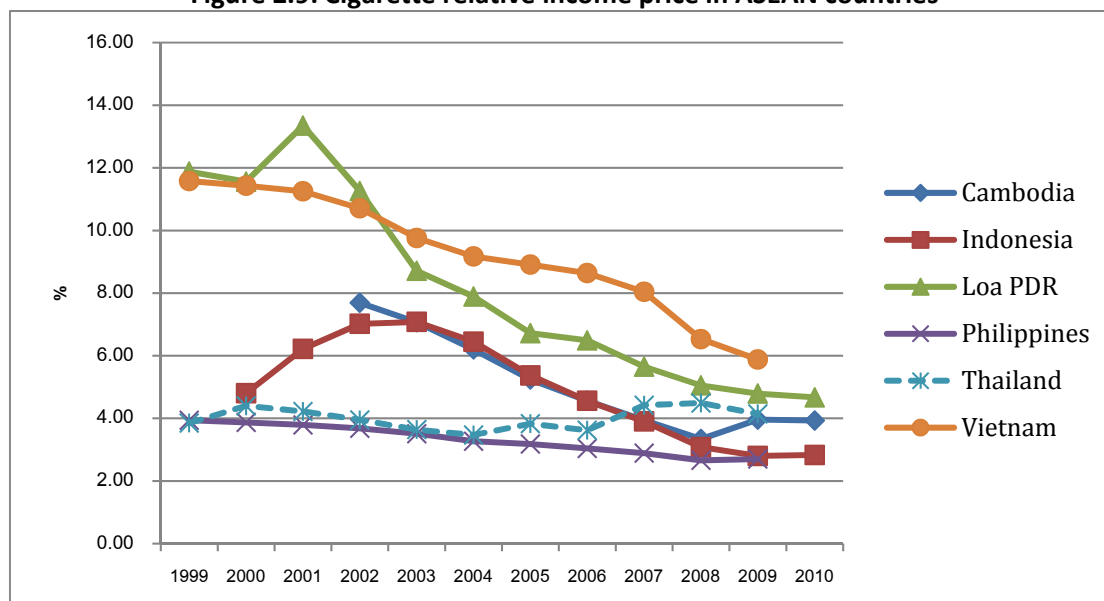
The report took a static view of affordability when the prices and incomes are measured at one point in time. The dynamic concept of affordability studies the prices relative to income (or the relative income price, RIP) over time. This dynamic concept of affordability is much more relevant for consumers' decisions, since people respond to changes such as a change in the market price or a change in income.

The analysis by the Southeast Asia Tobacco Control Alliance (SEATCA)⁴² employed this dynamic approach to demonstrate that cigarette prices relative to income have decreased overtime in most ASEAN countries, making cigarette more, not less affordable over time. Thailand was the only exception, because the Thai government implemented adequate tobacco control policies including regular tobacco tax increases that prevented an increase in cigarette affordability (Figure 2.9)

⁴¹ The Affordability of Cigarettes in ASEAN Countries: Implications for Tax Policy. Special Report by International Tax & Investment Center and Oxford Economic Forecasting. July 2005

⁴² Affordability of Cigarettes and the Impact of Raising Tobacco Excise Taxes in Southeast Asia: Cambodia, Indonesia, Lao PDR, Philippines, Thailand and Vietnam. SEATCA, January 2012

Figure 2.9: Cigarette relative income price in ASEAN countries



The SEATCA study concluded that tobacco taxes needed to be raised to reduce the affordability of tobacco products in ASEAN countries. Tobacco tax increases need to be regular in order to keep up with income growth. Such a policy will achieve both the fiscal (higher revenue) and public health objectives of excise taxation. SEATCA also appealed to the governments to strengthen their tax administration in order to effectively control illicit tobacco trade and tax non-compliance.

Many of these recommendations have been recently implemented in the Philippines where the 2012 Sin Tax Law increased the average excise tax rate by 150% in 2013 alone. Additional tax increases and tax system simplification will continue until 2017, when a uniform tax is achieved, with subsequent annual increases aimed at keeping up with inflation.⁴³

On the other hand, the amendment of tobacco tax policy adopted by the government of Vietnam in 2014 has been a disappointment: it increased the tax from 65% of wholesale price (or 39.4% of the retail price) to 70% in 2016 and to 75% (or 42.9% of the retail price) in 2019. This will keep Vietnam on the path of increasing cigarette affordability until at least 2020 due to a negligible impact of these tax increases on the cigarette prices and expected income growth.⁴⁴

European Union

The 2003 report prepared by the International Tax & Investment Center on the subject of tobacco taxation in the EU accession countries⁴⁵ argued that imposing the EU tax level on the new Member States would make cigarettes in these countries unaffordable and that the poor smokers living in these countries would suffer deprivation. The report recommended that more time be allowed to implement the EU tobacco tax policy in the accession countries. The tobacco companies lobbied collectively for delaying the tax increases in the new EU member states, citing the report's recommendations. This strategy was successful; 8 out of 10 new EU members were granted a 3 to 5 year delay before imposing the higher EU tobacco tax. Contrary to industry arguments, data show that cigarettes in the new EU member states became more affordable post-accession and that the

⁴³ Republic of the Philippines. (2012). Republic Act No. 10351: Sin Tax Reform Act of 2012. Manila

⁴⁴ Comments on the government's proposal. Roberto Iglesias. World Bank. February 14, 2014.

⁴⁵ International Tax & Investment Center Cigarette Taxation: Issues for EU Accession Countries. November 2003.

industry took advantage of the initial low tobacco taxes and raised their own prices in order to gain extra profit.⁴⁶

2.1.5 Higher level of taxation cannot be justified by economic theory

Definition

The industry is correct when it claims that the economic rationale for the excise tax is to compensate society for extra social costs caused by smoking. The industry then asserts that since smokers have shorter lives than non-smokers, their premature deaths save on pension payments and healthcare costs that would occur if they lived as long as an average non-smoker. At current levels of excise duties, the industry says, smokers already pay their fair share, and probably even more. Therefore, a tobacco tax increase would be unfair and punitive towards smokers.

The industry further claims that by imposing excise taxes on tobacco products in excess of the costs that smokers impose on others, governments are interfering with consumers' freedom of choice by actively trying to discourage them from smoking. According to the industry, governments' responsibility should end with disseminating information about the risks of smoking.

Motivation

To demonstrate that tobacco taxes cannot be justified or defended on economic grounds and that the effort to curtail tobacco use is a form of state paternalism that has nothing to do with sound economic policy.

Implications

The logic of this argument may sound appealing to policy makers that support a minimal or small role of government in society. The premature death benefit argument could backfire because it assigns economic benefit to premature death.

What can be done?

The smoking addiction imposes costs on non-smokers in the form of diseases and related financial costs caused by secondhand smoke or by maternal smoking, the payment for smokers' health care from the public sources, costs due to fires caused by smoking, etc.

Evidence shows that a smoker will cost society more over his/her lifetime compared to a non-smoker, while higher tobacco taxes will improve health and prevent tobacco-related illness, and thus reduce health care costs, even when considering additional medical costs from life years gained.⁴⁷

The overwhelming evidence demonstrates that at the time of their smoking initiation, the majority of people are not fully informed about the harmful consequences of smoking. Most smokers begin smoking at an age when they don't fully appreciate the risks of tobacco use and addiction, and heavily discount the future costs of smoking they do recognize at that age. Tobacco is not like any other consumer good. Tobacco is an addictive substance and, by the time smokers decide to quit,

⁴⁶ Risako Shirane, Katherine Smith, Hana Ross, Karin E Silver, Simon Williams, and Anna Gilmore. Tobacco industry influence in the Czech Republic in times of major political change: manipulating tobacco excise tax and tobacco advertising policies. *PLoS Med* 9(6): e1001248. doi:10.1371/journal.pmed.1001248, June 26, 2012

⁴⁷ U.S. Department of Health and Human Services. *The Health Consequences of Smoking—50 Years of Progress. A Report of the Surgeon General.* Atlanta, GA: U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2014.

they are addicted.⁴⁸ At the same time, the tobacco industry spends billions of dollars each year to market its products, to minimize the perceived risks of tobacco use, and to make people think that tobacco use is glamorous and cool.

Some economists argue that since many smokers face a conflict between the short-run desire to smoke and long-run goal of smoking cessation, they over-consume tobacco products from the individual's utility maximization perspective. In that case, some internal costs of smoking such as the price paid for tobacco products could be considered external costs.⁴⁹

For all these reasons, the choice to smoke is different from the choice to consume other products. Governments have the responsibility to intervene and use the most effective measures such as higher taxes to prevent children from starting to smoke and to reduce the costs that smoking imposes on society. The majority of smokers want to quit and higher prices induce smokers to do so. Many smokers welcome a tax increase, because it motivates them to quit.⁵⁰

Case Studies

Czech Republic

In an attempt to delay tobacco tax increases due to the Czech Republic's entrance to the EU, Philip Morris (PM) commissioned a study on the cost of smoking in the Czech Republic.⁵¹ The study, conducted by the consulting firm Arthur D. Little and released in June 2001, concluded that, in 1999, smoking yielded a net gain of \$145 million for the Czech national budget. The cost-benefit analysis included an estimate of savings on medical care, pensions, and public housing not used by elderly smokers, because they don't live long enough to use them. By dying prematurely, every dead smoker saved the government \$1,227 on health care, pensions, and housing.

In July 2001, the PM's report on the "early death benefit" reached the media and became a widely reported story in the United States.⁵² The unwelcome attention sent the tobacco giant reeling and on July 26, 2001, a PM executive apologized for the report, telling *The Wall Street Journal*, "We understand that this was not only a terrible mistake, but that it was wrong."⁵³

Even though the company canceled plans for similar studies in four other Central European countries, it achieved its goal: the Czech Republic and seven other new EU member states asked and were granted derogation to postpone the application of the EU's minimum tobacco excise duty.

A subsequent critique of the PM report demonstrated that the industry employed erroneous assumptions and data and refuted the conclusion that smoking represented an economic benefit to Czech state finances. In fact, the correction of only one among numerous errors in assumptions and calculations in the Phillip Morris study led to the opposite conclusion: Instead of savings of \$150

⁴⁸ U.S. Department of Health and Human Services. *The Health Consequences of Smoking—50 Years of Progress. A Report of the Surgeon General.* Atlanta, GA: U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, Office on Smoking and Health, 2014.

⁴⁹ Gruber J, Koszegi B. *A Modern Economic View of Tobacco Taxation.* Paris: International Union Against Tuberculosis and Lung Disease; 2008.

⁵⁰ IARC *Handbooks of Cancer Prevention-Tobacco*, vol. 14, Effectiveness of Tax and Price Policies for Tobacco Control, 2011.

⁵¹ A. D. Little International Inc. (2001). *Public balance of smoking in the Czech Republic.* Report to Philip Morris CR

⁵² Hana Ross. Critique of the Philip Morris study of smoking in the Czech Republic. *Nicotine & Tobacco Research*, Volume 6, Number 1 (2004) 1–9.

⁵³ Statement by Steven Parrish, a Phillip Morris senior vice president. Associated Press, July 27, 2001.

million per year, smoking drained at least \$373 million from the state budget annually, nearly 0.8% of the Czech gross domestic product. The net loss to society would be even greater if all pertinent costs and benefits were calculated properly.⁵⁴

European Union

At the end of 2006, the European Commission was due to submit a report to the Council of Ministers and the European Parliament with its views on tobacco tax policy in the EU. In the anticipation of this report, an economist supported by the tobacco industry, Sijbren Cnossen, published a paper in May 2006 arguing that because smokers tend to live shorter lives than non-smokers, they save on pension payments and healthcare costs of age-related diseases, and thus should receive a 'credit' for the savings they bring to society due to their premature death. He argued that taxes in the EU are already high enough to cover any costs smokers impose on society, and therefore there is no reason to tax smokers any further.⁵⁵

Canada and the USA

A higher cigarette tax that reduces cigarette consumption can bring benefits to the consumer that are either higher or lower than the costs of consuming tobacco, leaving the consumer either better or worse off, respectively. If higher taxes help smokers to get rid of an unwanted habit or prevent them from starting it, the change in behavior caused by the taxes may actually raise welfare among those who are at risk of smoking.

A 2005 study⁵⁶ assessed the effect of cigarette taxes on a person's happiness after a tax increase using both subjective and objective well-being data from the USA and Canada, respectively. It found that cigarette excise taxes made those with a propensity to smoke happier. The increased happiness was observed only for cigarette excise taxes, not for other excise taxes. These results suggest that higher cigarette taxes are likely to improve the welfare of current and potential future smokers and that the effects of cigarette taxation are far more complex than simple rational economic models might predict.

2.1.6 Earmarking tobacco taxation is a dangerous proposition resulting in budgetary inefficiency and misuse of government resources

Definition

The industry takes the position that cigarette excise tax revenues should be part of the general government budget and be not earmarked for particular purposes. It argues that earmarking introduces budgetary rigidity when spending is not allocated based of needs, but by default through the earmarking regime. The industry also claims that earmarking weakens public scrutiny of the value and effectiveness of government spending and raises issues of political accountability. Lastly, the industry asserts that the earmarked taxes and spending circumscribe the ministry of finance's ability to use fiscal policy to support macroeconomic objectives. This, according to the industry, restricts the ability of governments to plan for long-term needs, which is critical for successful economic growth in developing economies.⁵⁷

⁵⁴ Hana Ross. Critique of the Philip Morris study of smoking in the Czech Republic. *Nicotine & Tobacco Research*, Volume 6, Number 1 (2004) 1–9.

⁵⁵ Sijbren Cnossen. *Tobacco Taxation In The European Union*, CESifo Working Paper No. 1718. Category 1: Public Finance. May 2006

⁵⁶ Jonathan H. Gruber and Sendhil Mullainathan. Do Cigarette Taxes Make Smokers Happier. *Advances in Economic Analysis & Policy*. Volume 5, Issue 1 2005

⁵⁷ International Tax and Investment Center (ITIC). *ASEAN Excise Tax Reform: A Resource Manual*. Asia Pacific Tax Forum, Indonesia. 2015.

Motivation

Since some countries do earmark tobacco tax revenue to promote tobacco control, by opposing earmarking, the industry is trying to limit the governments' resources for tobacco control, which directly threatens industry sales and profit.

Implications

Higher tobacco taxes can gain more public and political support when the revenue provides funding to meet the government goals, especially if these goals are related to the provision of health care and/or reducing the regressivity related to tobacco use. The opposition towards earmarking reduces the public/political support for higher tobacco taxes.

What can be done?

Explain to the government that the industry's position on tobacco tax earmarking stands in contrast to the Article 6 Guidelines agreed upon by 180 States Parties to the WHO FCTC. The Guidelines recommend that Parties consider, in accordance with national law, dedicating revenues to tobacco-control programs 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.

Demonstrate how tobacco tax earmarking helped countries to achieve multiple goals including the reduction of tobacco use and better access to health care for the underserved.

Case Studies

The Philippines⁵⁸

In 2012, the Philippines passed a new Sin Tax Law (STL) increasing excise taxes on tobacco and alcohol products. The previous tobacco tax system suffered from a number of shortcomings, including the existence of a 'tier' system under which lower price cigarettes were taxed at lower tax rate, grandfathered lower tax rates for certain brands and insufficient inflation adjustments. Such a complex tax structure invited tax avoidance and tax revenues were steadily declining from 1.25% of GDP in 1997 to only 0.5% of GDP in 2012. In 2010, Philippine taxes on tobacco as a proportion of retail sales prices were the lowest in ASEAN (with the exception of Cambodia) while cigarette consumption was higher than in most countries with similar levels of GDP per capita.

When the government faced fiscal pressure while being politically committed to increase social spending, it began to consider the new STL, which was expected to increase sin tax revenues by 60%, and reduce adverse health consequences of smoking and drinking. The tax reform also promised to improve governance and transparency of policy making.

The STL was not an easy law to pass since previous attempts to reform tobacco and alcohol tax systems failed repeatedly due to the combined opposition of the tobacco industry, tobacco farmers, critics of the adverse effects of increased alcohol and tobacco taxes on the poor, and those who argued that increased smuggling and tax evasion were likely to offset much of the anticipated revenue gain.

To overcome such opposition, the STL was positioned as a way to achieve multiple goals: to improve excise tax revenue/administration, to improve health outcomes by raising prices and curbing

⁵⁸ Richard M. Bird. Tobacco and Alcohol Excise Taxes for Improving Public Health and Revenue Outcomes. Marrying Sin and Virtue? Policy Research Working Paper 7500. World Bank. November 2015

tobacco/alcohol demand, to finance expanding health coverage for the poor and to provide resource for tobacco farmers to diversify away from tobacco growing. Therefore, 85% of the incremental revenue collection was to be earmarked for the programs of Department of Health and Philippine Health Insurance Corporation while the remaining 15% of the additional revenue was dedicated to tobacco farmers.

In addition, the new system was phased in gradually in order to minimize the transitional costs and implemented through an elaborate and transparent accountability system intended to reassure people that the earmarked funds were being properly targeted and spent.

The STL is simpler, more transparent, and better than the previous tax regime. The experience of the Philippines with 'sin' tax reform shows that with good design, careful marketing, and adequate political backing, even countries facing difficult and complex economic and political circumstances can take important steps towards better public and fiscal health.

2.2 Negotiating tax road maps

Definition

The industry appeals to the government to adopt a long-term fixed plan for tobacco tax policy that outlines all future tax increases. The industry usually proposes small, predictable, and infrequent tax increases. The industry seeks "clarity and certainty" in the business environment.

Motivation

The industry does not like surprises when it comes to tax increases. It likes to operate in a stable and predictable environment, because it reduces the uncertainty with respect to sales volume and profit forecasts. A stable tax environment allows the industry to strategize about its prices and product lines and focus on competitors rather than spending resources to fight every single tax increase. Once the road map is agreed upon, the industry can focus on other aspects of its business.

By engaging in dialog with government, the industry acts as if it is an ally, helping the government to create a stable business environment with predictable tobacco tax revenue. But in fact, the industry is pursuing its own agenda to increase profits, and save on its tax lobbying efforts while the road map is in place.

Implications

"Road maps" are an industry tool to influence tobacco tax policy for the long term. Once the plan for future tax policy (the "road map") is adopted, it is usually quite difficult to change it. The industry often lobbies for tax increases that will not keep pace with inflation and rising incomes, but rather preserves or increases the affordability of tobacco products over time. This is also an opportunity for the industry to lock in a favorable tax structure that usually conflicts with public health interests.

Having a plan for future tax increases is not necessarily a negative development. If the "road map" is developed independently from industry input, it can demonstrate a government's commitment to decreasing tobacco use while communicating to tobacco companies that they cannot influence future tax changes. Ideally, a government-driven road map would include large (rather than small, incremental) and regular tax increases, since research suggests that those are effective in reducing smoking. However, a tax increase that is announced just before its implementation is usually the most effective, since it doesn't allow the industry to prepare a counter response. This advantage is sacrificed by adopting a road map.

What can be done?

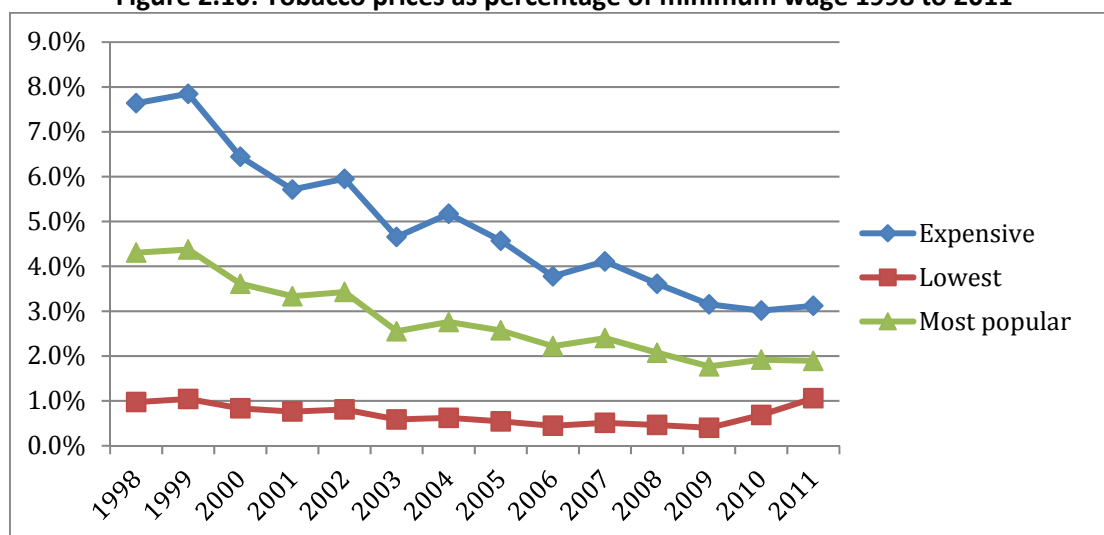
Tobacco control stakeholders should monitor industry negotiations with the government about any “road map” to make sure that the government protects public health policies from commercial and other vested interests of the tobacco industry as required by the Article 5.3 of the Framework Convention on Tobacco Control. It is important to study industry proposals, assess their impact on future tobacco use and tax revenue, and propose an alternative “road map” that will be beneficial for public health. In addition, information about the effectiveness of unannounced tax increases in comparison with tax increases announced well in advance should be disseminated.

Case Studies

Vietnam

The affordability of cigarettes in Vietnam has been steadily increasing since 1998. Figure 2.10 shows the declining percentage of monthly minimum wage in Vietnam needed to purchase three different types of cigarette brands. In 1998 smokers earning minimum wage spent 7.7% of their monthly income for a pack of the expensive brand, 4.5% on a pack of the most popular brand and 1.0% on a pack of the cheapest cigarette brand. In 2011, they needed to spend a substantially smaller share of their monthly income: only 3.1% and 1.9% for a pack of the expensive and the most popular brand, respectively. The affordability of the cheapest brand did not change during this period.

Figure 2.10: Tobacco prices as percentage of minimum wage 1998 to 2011



Source: Report on Tobacco Affordability and Impacts of Tobacco Taxes. Vietnam Ministry of Finance, Department of Tax Policy, 2013.

Since 2012, the tobacco industry in Vietnam has worked closely with the government to adopt a 2015 – 2018 road map for tobacco taxation that included two tobacco tax increases. The original proposal called for an increase from 65% to 75% of ex-factory price in 2015, and for another increase to 85% of ex-factory price in 2018. During the negotiations, the industry managed to both reduce and postpone the tax increases. The law adopted in November 2014 called for one tax increase in 2016 (from 65% to 70% of ex-factory price), and one in 2019 (from 70% to 75% of ex-factory price).⁵⁹ Both of these tax increases will increase price by only about 6% during the five-year period, which is not enough to keep up with a projected income growth of 4-5% per year. In addition, levying a tax on ex-factory price allows the industry to manipulate the base price, thus the amount of taxes paid.

⁵⁹ The National Assembly of Vietnam, Law No. 70/2014/QH13

It is politically very difficult to alter either the rates or the timing of the planned tax increases, which means that no substantial increases in taxes or prices will be possible until 2020. The road map guarantees an increasing affordability of cigarettes in Vietnam for at least 5 years and represents a growth opportunity for the tobacco industry and a threat to public health.

Bosnia and Herzegovina

In July 2009 a new tobacco excise tax law came into effect with the goal of increasing tax rates to the (then) European Union (EU) minimum of 64 Euros (KM 126) per 1000 cigarettes was reached. The specific part of the tax was to increase by a minimum of 7.5 KM per 1000 cigarette each year with the goal to reach 45 KM per 1000 by 2014, along with a 42% ad valorem rate. On this path, the country will reach the EU minimum by 2017.

Although this is a very long road map, the total increase is substantial. Given the complex government structure in the country and its inability to pass legislation, such a road map ensures that tax increases will continue. The local currency KM is pegged to the Euro, so inflation is low. Real GDP per capita is not growing, which means that the affordability of cigarettes will be declining each year, although there is always a possibility that inflation and economic growth will increase faster than anticipated by the road map.

Even though this road map has some positives from the perspective of tobacco control, tobacco companies can fully plan their price and product launch strategies to maintain sale volumes and profit.

2.3 Threats to move production and the associated jobs elsewhere

Definition

The tobacco industry claims that if excise taxes in a cigarette-producing country are increased, it will relocate its facilities to another country with lower excise rates.

Motivation

This strategy threatens the government with a possible loss of foreign investment, jobs, and tax revenue, which would reflect poorly on government policy makers. The government could be blamed for failure to create a business-friendly environment.

Implications

Governments may try to prevent the tobacco industry from leaving and agree to tobacco tax policies favored by the industry. This will result in lower cigarette taxes, lower cigarette prices, and detrimental consequences for public health.

What can be done?

Provide evidence to the contrary. The research shows that the closure of facilities in some countries and concentration in others is an aspect of consolidation that is not linked to taxation, but rather primarily driven by cost reduction in general, economies of scale motivating the creation of regional hubs, as well as by global, regional, and bilateral trade agreements that reduce barriers to trade. The choice of country as a regional hub seems to be primarily determined by the potential size of the market and convenience of trading, not by tax levels.

Case Studies

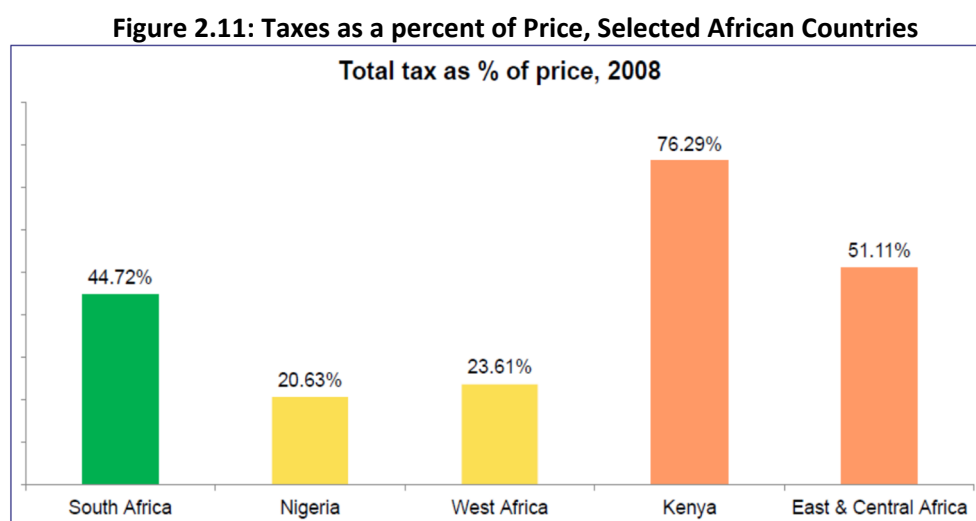
BAT in Africa

In 2006 and 2007, BAT closed factories in Uganda, Ghana, Mauritius, Zambia, and Cameroon, supplying these markets instead from its main production facilities in South Africa, Nigeria, and Kenya. This decision could not have been motivated by the low tax level in countries where BAT decided to concentrate its production, because South Africa and Kenya have some of the highest taxes on the African continent.

The 2011 BAT Annual Report explained the decision: "Our companies have closed or downsized some factories and consolidated production elsewhere in recent years. These changes enable us to rationalize our machinery and technology to establish a more cost-effective operational base for the future."

The concentration of production created regional hubs that are supplying the rest of the region: Kenya is a production hub for Central and East African countries (about 30% of total exports in 2010 went to that region); Nigeria supplies West African countries (66% of total exports in 2011 went to West African countries); South Africa exports to both sub-regions (48% of total exports go to Central and East Africa and 25% of total exports is destined for West Africa).⁶⁰

BAT's consolidation of production was driven by cost savings, the dominance in the local market, and by the size of the local market. It was not a response to tobacco tax policies in the countries where factories were closed.



Source: Anne Marie Perucic and Nicole Vellios, "Does tobacco taxation have an influence on industry consolidation" presented at APACT, 2013, Japan

Kyrgyzstan

In 1998 Reemtsma acquired Kyrgyzstan's only cigarette production plant by establishing a joint venture with the government. Reemtsma (acquired by Imperial Tobacco in 2002) became a monopolistic domestic producer of cigarettes.⁶¹ At that time the production capacity of the country was only 850 million cigarettes per year. In 2000 Reemtsma opened a new production facility with the capacity of 8 billion cigarettes per year, a ten-fold increase.⁶²

⁶⁰ Comtrade, 2012.

⁶¹ A B Gilmore, M McKee. Tobacco and transition: an overview of industry investments, impact and influence in the former Soviet Union. *Tobacco Control* 2004;13:136–142

⁶² A B Gilmore. Tobacco and Transition: Understanding the Impact of Transition on Tobacco Use and Control in the Former Soviet Union. 2005. <http://repositories.cdlib.org/tc/reports/SovietUnion>

Despite the fact that Kyrgyzstan has one of the lowest tobacco excise taxes in the region⁶³, Imperial Tobacco decided in 2010 to close its factory in Kyrgyzstan and replace domestic production by imported cigarettes. According to industry sources, the decision was made after an analysis of the company's worldwide production footprint.⁶⁴

The Imperial factory, the only cigarette factory in Kyrgyzstan, finally closed in July 2014 and the country now relies on cigarette imports. In 2014, 82% of the imported cigarettes came from Kazakhstan and the Russian Federation, countries with substantially higher cigarette taxes and cigarette prices.⁶⁵

The timing of the factory closure may have been related to the imminence of Kyrgyzstan joining the Eurasian Customs Union. Kyrgyzstan became a member of the Union in May 2015, which freed all cigarettes imported from customs duty.

Another likely reason for the closure of the manufacturing facility is the size of the market - in 2014 there were about 1.6 million adult men and 1.9 million adult women living in Kyrgyzstan, a market much smaller compared to the source countries for cigarette import - Kazakhstan and the Russian Federation.⁶⁶

2.4 Demanding reduction or elimination of import tariffs

Definition

In an attempt to reduce its tax liability, the industry demands a substantial reduction or an elimination of import taxes, arguing that these are means of trade protection, distort markets, damage consumer welfare, and hinder the development of competitive markets.

Motivation

The transnational tobacco companies want to secure access to protected markets and argue for a level playing field with the local tobacco industry, even though the transnationals are much more powerful and better resourced to win the competition with the local, much smaller companies.

Implications

If tariffs are reduced, the country can expect an influx of foreign tobacco products and fierce competition for market share, both between the domestic and foreign companies, but also between the foreign companies who want to establish themselves in the market. This will result in more advertising and promotional activities, and can also lead to price wars with subsequent price cuts. If countries do not respond with effective tobacco control policies, overall tobacco consumption and smoking prevalence will increase.

What can be done?

It is difficult to argue for high import tariffs in an era of increasingly freer trade. The best solution is to focus on implementing strong domestic tobacco policies that can alleviate the consequences of the market opening. Such policies would severely restrict marketing and promotional activities and

⁶³ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁶⁴ Imperial closing Kyrgyzstan factory. Tobacco Reporter. July 7, 2014.

<http://www.tobaccoreporter.com/2014/07/imperial-closing-kyrgyzstan-factory/>

⁶⁵ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁶⁶ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

establish a tobacco tax policy that would not only discourage price reduction but would lead to regular and substantial price increases to render tobacco products less affordable over time.

Case Studies

Japan, Taiwan, South Korea, Thailand

In the late 1980s, the US tobacco industry exploited Section 301 of the Trade Act of 1974 and demanded that the U.S. Trade Representative bring cases against Japan, Taiwan, South Korea, and Thailand. All these countries were threatened by US sanctions in order to lower their cigarette and other tobacco products' import duties and to reduce other market restrictions on US tobacco companies.

After allowing the US products to enter the markets, the U.S. cigarettes market shares increased while overall demand for cigarettes increased as well. Research suggests that the market share of U.S. cigarettes was more than 600% higher and average per capita cigarette consumption was almost 10% higher in 1991 than it would have been if the markets remained closed.⁶⁷ The higher consumption in these countries was attributed to lower cigarette prices resulting from more competition among cigarette makers. Increased advertising and promotional activities that accompanied the entrance of new market participants might have also boosted cigarette consumption.

Thailand was the only country that was able to take advantage of the cigarette trade dispute. Following the GATT adjudication between Thailand and the US, Thailand had to open its market to foreign cigarettes, but was allowed to impose strict non-discriminatory tobacco control policies such as an advertising ban, labeling and ingredient disclosure. This motivated the Thai government to pass a very tough tobacco control bill that banned all forms of cigarette advertising, cigarette promotions and free samples, required visible health warnings on all packs, and banned smoking in public buildings.⁶⁸ At the same time, the government increased the tobacco excise tax, which caused about 200 000 young smokers to quit. These policies have reduced the social acceptability of smoking, making subsequent tax increases politically easier.⁶⁹ This success encouraged the tobacco control community to draft in 1999 the Health Promotion Fund Bill that proposed to use 2% of taxes collected from producers and importers of alcoholic drinks and cigarettes for promoting public health in Thailand. The bill was passed in 2001 and enabled Thailand to implement one of the most progressive tobacco control policies in the world.

Taiwan

Within three years after the 1986 forced opening of the Taiwan market and the import tariffs reduction, there was a 6% increase in adult male smoking prevalence and a 13% increase in the youth smoking rate. The market share of imported cigarettes increased from less than 2% in 1986 to nearly 50% by 2000, and per capita cigarette consumption increased by 15% during the same period. Another consequence of the market opening was a rapid growth in cigarette smuggling. The illicit cigarette market that almost did not exist before the market opening accounted for about 15% of the entire market by the first half of the 1990s, and the number of smuggled cigarettes on the market equaled or even exceeded the number of legally imported cigarettes. Thus, the foreign

⁶⁷ Chaloupka FJ and Laixuthai A. US trade policy and cigarette smoking in Asia. National Bureau of Economic Research Working Paper No. 5543, 1996.

⁶⁸ Sombat Chantornvong, Duncan McCargo. Political economy of tobacco control in Thailand. Tobacco Control 2001;10:48–54

⁶⁹ Sombat Chantornvong, Duncan McCargo. Political economy of tobacco control in Thailand. Tobacco Control 2001;10:48–54

tobacco companies reduced their tax liability both by the tariff reduction and by supplying the market with products without paying the proper local tax.⁷⁰

Table 2.1: Market Share of Foreign Brands After Reduction of Import Tariffs

Year market opened	Japan	Taiwan	South	
	(1987)	(1987)	Korea (1989)	Thailand (1990)
Year before market opened	5%	2%	0.1%	1%
1990	13%	16%	5%	1%
1993	19%	33%	6%	3%
1995	18%	27%	14%	5%
1998	30%	38%	8%	13%
2000	24%	48%	9%	18%

Sources: Annual statistical report of the Monopoly Bureau (Taiwan data)¹; British American Tobacco Company³⁹ (other countries in 1993) and Tobacco Control Country Profiles¹² (other countries in 1990, 1995, 1998, 2000).

Source: C P Wen, T Y Cheng, M P Eriksen, S P Tsai, C C Hsu. The impact of the cigarette market opening in Taiwan. Tobacco Control 2005;14(Suppl I):i4–i9. doi: 10.1136/tc.2004.008516

Hungary

Philip Morris (PM) lobbied to reduce import duties in Hungary shortly after the acquisition of an 80% share in the state-owned enterprise Egri Dohánygyár (ED, Tobacco Factory of Eger) in 1991. At that time, Hungary applied a 96% import duty for imported tobacco, which was hurting Philip Morris’s imports of both tobacco leaves for the newly acquired factory, and certain cigarette brands (e.g. Marlboro) that were not manufactured in Hungary. A business forecast for PM stated: “To put this issue into perspective it is important to highlight that in Hungary the Marlboro brand incurs a duty of \$3.50 per 1,000 [cigarettes]. Should Hungary adopt the common EC [European Community] external tariff it would yield a duty saving of \$2.5 million on our 1991 revised forecast volume, a figure which is higher than our 1991 projected income from operations in Hungary.” The PM lobbying was successful: the Hungarian finance and agricultural ministries both supported the discontinuation of import duties in 1991 that until then had been protecting local tobacco growers.⁷¹

2.5 Establishing a favorable tax climate as a condition for an investment

Definition

The tobacco industry tries to negotiate a favorable tax rate and tax structure before making an investment in a country.

Motivation

In these cases, the industry is taking an advantage of the privatization of state-owned tobacco business or opening of previously closed markets, or a country desperately in need of foreign

⁷⁰ C P Wen, T Y Cheng, M P Eriksen, S P Tsai, C C Hsu. The impact of the cigarette market opening in Taiwan. Tobacco Control 2005;14(Suppl I):i4–i9. doi: 10.1136/tc.2004.008516

⁷¹ Szilagyi T, Chapman S. Tobacco industry efforts to keep cigarettes affordable: a case study from Hungary. Cent Eur J Public Health 2003;11:223e8.

investment. At such times, tobacco and economic policies are often in a state of flux, and local governments both need money and lack experience in negotiating with large global businesses.

Implications

Investment in the local tobacco industry can come at the price of low tax rate that deprives the government of much needed revenue and a tax structure that weakens the effectiveness of tobacco tax as a public health measure.

What can be done?

Countries can rely on international experience and expertise (including legal expertise) when negotiating with the tobacco industry. The majority of countries are parties to the Framework Convention on Tobacco Control and can utilize resources provided by the Convention Secretariat and other international agencies and non-governmental organizations that work in tobacco control.

Case Studies

Uzbekistan

Prior to investing in Uzbekistan, British American Tobacco (BAT) worked closely with the Uzbekistan Minister of Finance to design a new tobacco taxation system that was very advantageous for the industry and exploited the government's lack of experience with tobacco excise tax policies. A BAT representative commented in 1994: "If [reduced tax rate from 90% to 40% is] approved by the Council of Ministers then for the time being the excise issue should not hinder the deal completion." The lower tax rate was adopted in 1995 and BAT made its initial investment in the same year, purchasing 51% of the state monopoly. BAT was also granted a temporary exemption from the newly proposed tobacco tax stamp system. This facilitated BAT's established practice of cigarette smuggling, increasing its competitive advantage by evading tobacco taxes in Uzbekistan. The investment was so successful that in 1998 BAT increased its holding in the Uzbek state tobacco monopoly to 97%.⁷²

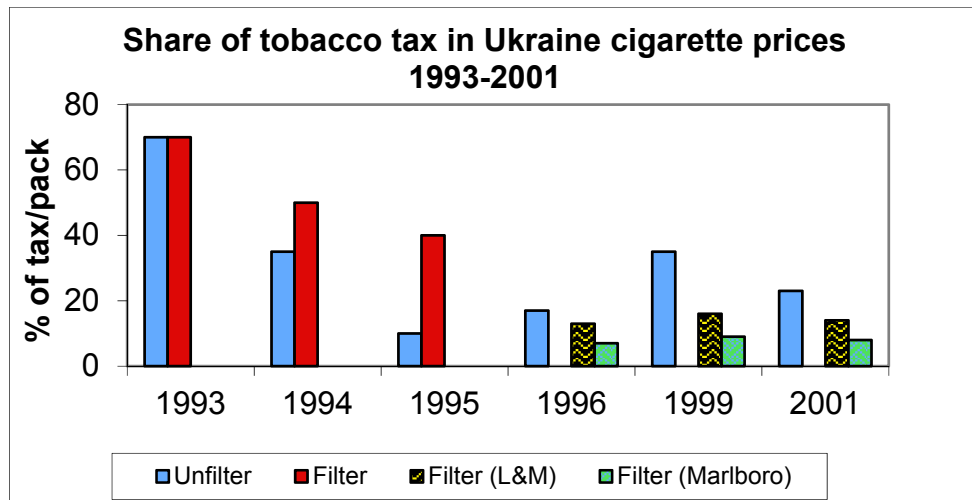
Ukraine

The 1992 BAT's business plan for investing in Ukraine explicitly stated that as a precondition of their investments, the excise system must change. The primary goal was to reduce the tax rate in order to guarantee high profitability for the investment. While officially demanding that the government reduce the tax rate, BAT was ready to invest even without such changes, as revealed in its internal documents: "...the rates are now not substantially different from those in neighbouring countries." "...overall the project remains financially extremely attractive [even without lowering of tax rates]". BAT worked directly with the Ministry responsible for the tobacco industry to prepare and submit a proposal for a change in the excise tax level and the excise tax structure. The proposal was well received and between December 1993 and October 1994, the government lowered tax rates from 70% of ex-factory price to 40% and 10% of ex-factory price for filtered and non-filter cigarettes, respectively. This resulted in a massive loss of government revenue, because even the increase in cigarette sales of 12% from 1993 to 1995 could not compensate for the lower tax rate.⁷³

Figure 2.12: Tobacco excise taxes as a percentage of retail cigarette prices in Ukraine

⁷² Gilmore A, Collin J, Townsend J. Transnational tobacco company influence on tax policy during privatization of a state monopoly: British American Tobacco and Uzbekistan. *American Journal of Public Health*. 2007;97(11):2001-9

⁷³ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).



Source: Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

Fortunately, the government subsequently reversed its low tobacco excise tax policy. During the 2008 – 2010 period the total tobacco tax was raised five times (Figure 2.13) and the share of tax in retail price increased from 36% to 60%, causing the real price per pack to go up by 117%. During the same period, tobacco sales dropped by 13%, the government collected an additional US\$1.4 billion in tobacco taxes, and the number of smokers decreased by an estimated 2.7 million.⁷⁴

⁷⁴ Source: Tobacco Tax Success Story. Ukraine. Campaign for Tobacco Free Kids and American Cancer Society. October 2012

Figure 2.13: Tobacco Tax Increase in Ukraine, 2008 - 2010

	Specific Excise in UAH/Pack	% Increase in the Specific Tax	Ad Valorem
prior to SEPT 2008	0.28		12.5% of max retail price minus VAT minus excise
SEPT 2008	0.60	█ (↑114%)	16% of max retail price minus VAT minus excise
FEB 2009	0.75	█ (↑25%)	16% of max retail price minus VAT minus excise
MAY 2009*	1.20	█ (↑60%)	20% of max retail price minus VAT only
JAN 2010	1.38	█ (↑15%)	25% of max retail price minus VAT only
JUL 2010	1.80	█ (↑30%)	25% of max retail price minus VAT only

* Beginning May 2009, ad valorem was applied to maximum retail price minus VAT only, effectively doubling the amount of ad valorem excise levied.

Source: Tobacco Tax Success Story. Ukraine. Campaign for Tobacco Free Kids and American Cancer Society. October 2012

2.6 Direct lobbying

Definition

In this strategy, the tobacco industry seeks to influence politicians or public officials to oppose tobacco control legislation, and particularly tobacco tax increases. The industry lobbies vigorously at all levels of government and with international organizations. The lobbying consists of political campaign contributions, gifts, donations, helping regulators write new tobacco control rules, threatening legal action against reforms, and paying bribes. Tobacco companies often describe their lobbying efforts as "educating" policy makers about the complexities of their business environment; they also demand participation in the development of policies that affect their business.

Motivation

The tobacco industry seeks to manage the regulatory environment for its business by keeping the number and severity of regulations at a minimum and tobacco taxes as low as possible.

Implications

Proposed tobacco control policies, including tobacco tax increases, are either not adopted or are delayed or weakened during the process of political negotiations.

What can be done?

Article 5.3 of the Framework Convention on Tobacco Control requires governments to protect public health policies from commercial and other vested interests of the tobacco industry. The Guidelines for article 5.3 recommend a set of measures such as conducting any necessary interaction with the industry with full transparency and preventing tobacco-related conflicts of interest for any government official, representative, and/or employee. Adhering to the principals of Article 5.3 will limit the opportunity for direct lobbying by the industry.

Countries can also require the industry to document and disclose all lobbying, PR, and marketing expenses as well as political contributions.

Case Studies

USA

The tobacco industry in the USA formed the Tobacco Institute in 1958 as an organization to communicate the industry's positions on health and economic issues to the general public (i.e. public relations) and to federal, state, and local governments (i.e. lobbying).

In the 1990s the Tobacco Institute allocated about 30% of its overall annual budget to lobbying activities at the state and local levels.

Between 1991 and 1997, the average annual budget for state-level lobbying was US\$ 10.6 million (expressed in real 2000 US\$), with approximately 27% allocated to state lobbyists, 3.9% to local lobbyists and 3.8% to special projects.

Research has found particularly significant associations between lobbying expenditures and cigarette excise tax levels and shown that a state or a local effort to raise cigarette excise taxes attracted more lobbying resources to undermine these efforts. The Tobacco Institute was disbanded in 1998 as the result of the settlement between the US states and the tobacco industry.⁷⁵

Ukraine

The 1999 budget of BAT's CORA (Corporate and Regulatory Affairs) unit allocated US\$140,000 for lobbying on tobacco taxation in Ukraine. The money was used to organize a seminar for senior government officials where BAT presented its proposals on tobacco tax. The money also paid for a visit of Ukrainian ministers, parliamentarians, and customs officials to the UK and Germany to examine tax structures in those countries, because BAT viewed those tax structures as favorable to the BAT product mix.⁷⁶

2.7 Indirect lobbying via front groups and other allies

Definition

Lobbying can be done either directly by tobacco companies themselves, or indirectly via special interest groups and front organizations. Indirect lobbying consists of influencing existing, sympathetic organizations and credible public interest groups to support the industry interest, or creating and financing new organizations for the same purpose.

Motivation

To obscure the vested interests of the tobacco industry in keeping tobacco taxes as low as possible, and to recruit credible allies demonstrating that the tobacco industry is not the only stakeholder opposing higher tobacco taxes and other tobacco control policies.

Implications

The industry allies itself with a wide range of pre-existing organizations not normally associated with tobacco, thereby increasing the perceived credibility of anti-tax arguments. Policy makers could be convinced that there is a broader opposition against tobacco control policies, including tobacco tax increases, and may not adopt, delay or weaken the proposed legislation.

⁷⁵ C P Morley, K M Cummings, A Hyland, G A Giovino, J K Horan. Tobacco Institute lobbying at the state and local levels of government in the 1990s. *Tobacco Control* 2002;11(Suppl I):i102–i109

⁷⁶ Krasovsky KS. "The lobbying strategy is to keep excise as low as possible" – tobacco industry excise taxation policy in Ukraine. *Tobacco Induced Diseases*. 2010;8(10).

What can be done?

Expose connections between the special interest groups/front organization and the tobacco industry. Investigative journalists could be particularly helpful in this respect. Once the connection is made, disseminate that knowledge to policy makers and remind them of the country's obligation under the Article 5.3 of the Framework Convention on Tobacco Control that requires governments to protect public health policies from commercial and other vested interests of the tobacco industry.

Case Study

Indirect lobbying has been primarily documented in North America, but it is likely that the tobacco industry uses it in other parts of the world as well.

In an effort to find sympathetic organizations among labor and minority ethnic groups, the tobacco industry emphasized the regressive nature of tobacco taxes. Groups that were successfully recruited by the industry and argued against tobacco tax increases included the Coalition of Labor Union Women (CLUW), Citizens for Tax Justice, Citizen Action, Women Involved in Farm Economics, the National Taxpayers Conference, the Congressional Black Caucus and the National Black Police Association.

The industry also used claims that tobacco tax increases would lead to increases in smuggling to ensure the support of business groups such as retailers' associations and police groups. Finally, in seeking to divert earmarked funds away from tobacco control programs, the industry was able to ally itself with private healthcare organizations and groups representing medical professionals and healthcare organizations in the USA.

California

In the USA, the tobacco industry established Californians Against Unfair Tax Increases (CAUTI), a front group argued that higher tobacco tax causes cigarette smuggling and related criminal activities while diverting police attention away from other crimes, making the state less safe. Through CAUTI, the industry was able to secure endorsements from the Californian Sheriffs' Association and the California Peace Officers' Association, which lent credibility to such claims.⁷⁷ However, a report demonstrating that the impact of the tax increase on smuggling was likely to be negligible, and exposing the CAUTI funding source resulted in police groups dropping their support for the industry position.

Arizona

Philip Morris and the Tobacco Institute (a trade association of US cigarette manufacturers) established two front-groups "Enough is Enough" and "No More Taxes" in order to defeat a proposed tobacco excise tax increase in Arizona. Since the proposal also included tax revenues earmarked for tobacco prevention/education programs, tobacco-related diseases and prevention research, the industry was also trying divert funds away from tobacco control programs. The goal was to frame the proposal as an attempt to divert large amounts of public funds to programs favored by the proponents of the new legislation. The front groups were pointing to California where, they claimed, tobacco control programs were misusing public funds. In addition, the direct tobacco industry lobbying intensified as well: the number of paid tobacco industry lobbyists at the state legislature rose from approximately 4 to 18.

⁷⁷ Traynor MP, Glantz SA (1996). California's tobacco tax initiative: the development and passage of Proposition 99. *J Health Polit Policy Law*, 21:543–585.

Despite this effort, the proposal passed. At that time the tobacco industry legally challenged it and threatened local authorities with legal action over tobacco control programs. As result, the programs experienced a range of problems and were never fully implemented as planned.⁷⁸

USA

In 1993, Philip Morris (with subsequent co-funding from other US tobacco companies) hired Burson-Marsteller, a PR firm, to set up the National Smokers Alliance (NSA). The NSA, a PR organization, advocated against tobacco control regulation, and particularly higher tobacco taxes, It portrayed smoking as socially acceptable behavior, called into question the potential health effects of tobacco use, and opposed proposed tobacco tax increases.

The NSA operated throughout the US from 1994 to 1999 with the goal of creating the appearance of public support through public relations, through the engineering of consent theory, and by using editorials newspaper articles and pro-tobacco columns that called for the free use of tobacco.⁷⁹

The NSA also organized national and regional press conferences, issued press releases, monitored media coverage of tobacco, made radio talk show appearances, issued alerts to NSA members, provided public speakers, placed advertisements, and corresponded with legislators.

However, the NSA's success record was mixed as its attempts to weaken tobacco regulations including proposals to increase taxes were effective only in some instances. The NSA was most successful at the national level where it supported four major winning campaigns and only one losing campaign. At the state and local levels, the NSA was involved in 20 winning and in 15 losing campaigns. Not all campaigns concerned tax increases.⁸⁰

3. Industry illegal activities to reduce its tax liability and to mitigate the impact of tax increases

There is evidence that the tobacco industry was willing to engage in illegal activities as a response to tax increases or to lower its tax payments.

The industry used several schemes, which might or might not have involved movement of goods across a border. Such tax evasion not only lowers the industry's tax payments, it also assures that the industry's forecast with respect to an increase in illicit cigarette trade after a tax increase becomes a reality. Selling some cigarettes without paying the appropriate taxes allows the industry to reduce the average price of its products, which promotes sales, prevents the most price sensitive customers from quitting, and secures future customers.⁸¹

3.1 Illegal Imports

Definition

This consists of importing tobacco products without declaring them to relevant government authorities, thus not paying import, VAT, or excise taxes. This includes re-import when a company declares products for export, but the goods either do not leave the country or leave it briefly but

⁷⁸ Bialous SA, Glantz SA (1999). Arizona's tobacco control initiative illustrates the need for continuing oversight by tobacco control advocates. *Tob Control*, 8:141–151.

⁷⁹ Givel M (2007). Consent and counter-mobilization: the case of the national smokers alliance. *Journal of Health Communication*, 12:339–357.

⁸⁰ Givel M (2007). Consent and counter-mobilization: the case of the national smokers alliance. *Journal of Health Communication*, 12:339–357.

⁸¹ IARC Handbooks of Cancer Prevention-Tobacco, vol. 14, Effectiveness of Tax and Price Policies for Tobacco Control, 2011.

then reenter with the intent to sell on the local market. Oversupplying lower tax foreign markets that have established illicit supply channels to higher tax countries is another way the tobacco companies promote illegal imports. The industry often engages third parties in order to camouflage its involvement.

Motivation

Tobacco companies escape paying applicable taxes on some of their products, and demonstrate that higher tax leads to more illicit tobacco trade. In its business report, for example, BAT used to consider smuggling a primary "profit contributor".⁸²

Implications

Tax revenue will be less than predicted, since the government does not collect taxes on some cigarette sales. The impact of a tax increase on cigarette use will also be lower since the average price of tobacco products will increase by less than expected. The presence of illicit cigarettes on the market may discourage future tax increases, increase disparity in tobacco use (if more vulnerable populations switch to illegal products instead of quitting), and motivate more young people to start smoking due to limited compliance of illegal products with youth access laws and their generally lower prices. Tax collection in the oversupplied country that is the source of illicit imports will increase. However, illegal trade in tobacco products can promote other illegal activities, dilute resources for crime prevention, and encourage corruption.

What can be done?

Estimating the size of the illegal tobacco market will provide information on the scope of the problem. This can be done by using a toolkit entitled "Understanding and Measuring Cigarette Tax Avoidance and Evasion: A Methodological Guide" (available at <http://tobaccoecon.org/publications/reports/>).

Closely monitoring tax revenue and comparing it with expected tobacco tax revenue can provide a warning signal: a sudden deviation without any changes in the tax rate may indicate an increase in illegal tobacco sales.

It is also important to strengthen tax administration, customs capacity, and enforcement, as described in the FCTC Protocol on Illicit Trade. Governments need to disseminate information about cases that have been successfully prosecuted and the severity of the punishment. Doing so will help with collection of other taxes as well.

Investigative journalism can expose industry involvement in tax evasion.

Case Studies

Taiwan⁸³

Within two years after the Taiwan market opened to global cigarette competition in 1986, legal imports increased 10-fold, but the seized amount of contraband also rose nearly 10-fold (Table 3.1). A study revealed that the main source of these illicit cigarettes was Japan Tobacco International (JTI)

⁸² British American Tobacco. Marketing strategy 1993–1997. Bates No. 500124923/4934. <http://bat.library.ucsf.edu/tid/bpt61a99>.

⁸³ C P Wen, R A Peterson, T Y D Cheng, S P Tsai, M P Eriksen, T Chen. Paradoxical increase in cigarette smuggling after the market opening in Taiwan. *Tobacco Control* 2006;15:160–165. doi: 10.1136/tc.2005.011940.

that set up a Swiss plant as a legal cover for smuggling 10–20 times its legal quota of exports to Taiwan. This brought JTI extraordinary financial gains. Since the Taiwanese government decided to resell the seized contraband cigarettes into the market, the market share of JTI rose and provided the company market domination as a benefit of their illegal activity.

Smuggling of cigarettes to Taiwan contributed to increased consumption of foreign brands, particularly by the youth. Smoking rates among younger men, aged 18–25, increased from 37.3% in 1986 to 42.0% in 1990, a 12.8% increase. Among younger women, the rise was even more pronounced, albeit smaller in absolute number, increasing from 0.9% in 1986 to 1.4% in 1990, a 56% increase.

Table 3.1: Legal and Illegal Market in Taiwan, 1986 – 1995.

Year	Legal market	Legal imports (% of market)	Smuggled estimates (% of legal imports)	Amount seized (% smuggled)	Estimated tax revenue lost as % of actual revenue from legal imports (US\$ in million)
1986	3119	52 (2%)	NA	4.8	
1987	3427	580 (17%)	NA	17	
1988	3678	576 (20%)	553 (96%)	45.1 (8%)	96% (\$168 million)
1989	3489	526 (18%)	570 (108%)	36.5 (6%)	108% (\$187 million)
1990	3506	573 (16%)	791 (138%)	57.4 (7%)	138% (\$249 million)
1991	3556	505 (14%)	660 (131%)	1.4 (0%)	131% (\$224 million)
1992	3570	1141 (28%)	708 (62%)	129.7 (18%)	62% (\$241 million)
1993	4373	1461 (33%)	760 (52%)	67.4 (9%)	52% (\$248 million)
1994	3672	814 (22%)	588 (72%)	38.1 (6%)	72% (\$192 million)
1995	3791	1019 (27%)	544 (53%)	27 (5%)	53% (\$172 million)
Average 1988–1995	3704	827 (22%)	647 (78%)	50 (8%)	89%

Source: C P Wen, R A Peterson, T Y D Cheng, S P Tsai, M P Eriksen, T Chen. Paradoxical increase in cigarette smuggling after the market opening in Taiwan. *Tobacco Control* 2006;15:160–165. doi: 10.1136/tc.2005.011940.

Note: The size of the legal market is in 1000 cases, each case consists of 10,000 cigarettes.

Lebanon⁸⁴

Taking advantage of weak governance and chronic political instability, the tobacco industry used to supply cigarettes to Lebanon using both legal and illegal channels during the 1970s, 1980s, and 1990s. This strategy has resulted in relatively high cigarette sales. There was no motivation for the industry to change its product mix, as evidenced by the fact that the possibility of setting up a manufacturing facility in Lebanon was seen as a threat to the profitable contraband business. Some of the cigarettes imported illegally to Lebanon were further smuggled to Syria and Jordan. A report for the Philip Morris board of directors stated that although there were no legal sales to Syria and Jordan, the contraband from Lebanon generated estimated market shares of 18% and 9% in these two markets, respectively.

The industry continued to supply the illegal products despite appeals by the government to stop this activity, which severely undermined its revenue collection.

United Kingdom⁸⁵

For years, politicians in the U.K. and other parts of the European Union have alleged that tobacco companies effectively endorse smuggling by intentionally oversupplying cigarettes in low-tax jurisdictions, knowing they will be purchased there and brought back to higher-tax regions. In 2014,

⁸⁴ R Nakkash and K Lee. Smuggling as the "key to a combined market": British American Tobacco in Lebanon. *Tob. Control* 2008;17:324-331

⁸⁵ U.K. Fines British American Tobacco for Oversupplying Cigarettes in Belgium. Reuters; By Peter Evans, Nov. 13, 2014.

BAT in the UK was fined £650,000 (\$1.03 million) for oversupplying cigarettes to the low-tax Belgium market, which is a known source of smuggled cigarettes to the UK. Professional smugglers make regular trips from the UK to Europe to buy large quantities of cheaper cigarettes in order to sell them back in the UK. A pack of 20 premium cigarettes cost around £8.47 in the U.K. in 2014, compared with £4.75 in Belgium. These activities deprive the UK government of nearly £2 billion a year of tax revenue.

3.2 Illegal Exports

Definition

Products are declared as destined for the domestic market, all domestic taxes are paid, but then the products are illegally exported to other countries. No taxes are paid in the country of destination.

Motivation

The difference between the lower taxes in the country of origin and the higher taxes in the destination country brings extra profits along with more sales/larger market share in the higher tax country.

Implications

Tobacco tax revenue and cigarette production in the country of origin is greater than the cigarette consumption adjusted for trade flows. Governments in the country of origin are not motivated to intervene since they collect taxes on products that are consumed in other countries, and the illegal activities are happening outside their borders. In the destination countries, consumption of cigarettes will be higher if the illegally imported products are sold for a lower price, and the tax revenue will be lower if consumers are buying the illegal products instead of the fully taxed products. Both governments should be concerned about the role of criminal networks in this operation.

What can be done?

Monitor domestic production, legal export, legal import, and consumption, in order to discover and study any sudden unexplained deviation from the trend. It is important to strengthen tax administration, customs capacity, and enforcement, as suggested by the FCTC Protocol on Illicit Trade. International collaboration and data and intelligence sharing will play an important role. Investigative journalism can expose industry involvement in tax evasion, which can help to discredit the industry as a credible partner in policy debates.

Bringing domestic tax rates closer to the level in the destination country will decrease the incentive for this kind of trade while replacing the tax revenue loss related to illegal trade with higher tax revenue from higher tax rates on legal domestic sales. This will also have the additional benefit of lowering domestic tobacco use.

Case Studies

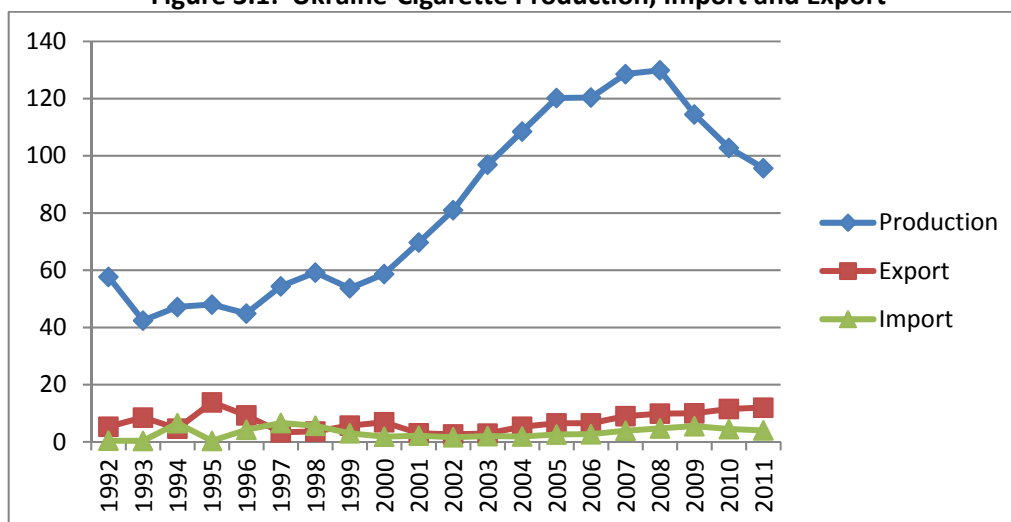
Russia and Ukraine

Russia and Ukraine are major sources of illegal exports, with the European Union being the prime destination due to proximity and large differences in price levels. According to industry sources, an estimated 9.8% of contraband cigarettes in the EU in 2010 came from Ukraine and Russia, respectively.⁸⁶ The tax paid sales in both countries are about 30-35% higher compared to their estimated consumption.

⁸⁶ KPMG. Project Star, 2010 Results. Aug. 22, 2012

Figure 3.1 shows cigarette production in Ukraine and its substantial increase since 2000. While the cigarette consumption in Ukraine grew initially, it stabilized in 2002 – 2005 and then began to decline, as evidenced by prevalence (Table 3.2). The disjoint pattern of production and consumption suggests massive increases in cigarette export, which is not confirmed by official statistics. Evidence suggests that most of these excess cigarettes were exported to EU countries⁸⁷. When a JTI manager in Ukraine was asked whether the tobacco industry loses money to the illicit trade in Ukraine, he responded: “What do you mean by loss? From the point of view of a company operating on the market, production of extra goods means extra profits.”⁸⁸

Figure 3.1: Ukraine-Cigarette Production, Import and Export



Sources: State statistics in Tobacco Control in Ukraine. Graph by Krasovsky, 2013.

Table 3.2: Adult Daily Cigarette Smoking Prevalence in Ukraine 2001 – 2010

Adults 18+	2001	2002	2005	2007	2008	May 2009	Oct. 2009	2010*
Total	-	-	35	27	27	27	25	28,8
Men	57	67	67	52	50	49	47	50
Women	14	17	20	11	8	9	7	11,2

Sources. Andreeva and Krasovsky, 2007; NES at CEFIR, 2012; Ross et al., 2009; GATS 2010.

Note: GATS data for 2010 are not directly comparable with the previous survey due to different age definition of adults.

Belarus

The production of cigarettes in Belarus has grown rapidly since 2005. By 2014 it had increased 2.6 times to 34.1 billion cigarettes. Legal sales grew along with production and totaled 25.9 billion

⁸⁷ Source: Ukraine’s ‘Lost’ Cigarettes Flood Europe June 29, 2009; <http://www.publicintegrity.org/investigations/tobacco/articles/entry/1438/>

⁸⁸ Source: Ukraine’s ‘Lost’ Cigarettes Flood Europe June 29, 2009; <http://www.publicintegrity.org/investigations/tobacco/articles/entry/1438/>

cigarettes in 2014. Simultaneously there was a sharp decline in imports due to trade policies pursued by the Belarusian government. The legal export of cigarettes in 2009-2012 was relatively low, but picked up in 2013-2014 (Table 3.3).

Table 3.3: Belarus - Cigarette Production, Export, Import, Sales (Million Sticks) and Prevalence

Production	10400	9400	11350	10600	12600	13050	15650	18300	19500	21100	25100	28900	33198	34237	34092
Import	6 500	3 500	4 150	3 000	3 600	3 035	1 497	1 503	1 231	513	405	620	567	578	750
Export	-	-	-	-	-	-	-	-	-	38	113	252	1 138	5 165	8 506
Sales	15 690	15 570	16 100	16 350	16 420	16 030	17 175	18 945	20 750	21 865	25 510	28 515	29 140	28 600	25 900
Prevalence															
Male	54,00	53,30	53,00	52,10	51,20	50,60	49,90	49,70	49,50	49,30	49,10	48,70	48,30	47,90	47,40
Female	6,70	6,30	6,30	8,60	8,60	8,40	8,30	8,20	8,00	8,00	8,10	7,90	7,70	7,50	7,30
Total	28,30	27,70	27,60	28,40	28,00	27,60	27,20	27,00	26,80	26,80	26,70	26,40	26,10	25,80	25,50

Source: Euromonitor, 2015

The massive increase in production and sales did not correspond to changes in prevalence. From 2000 to 2007 the adult cigarette smoking prevalence in Belarus was pretty stable at 27-28%, with smoking intensity unchanged. Since 2008, overall prevalence began to decline slowly, primarily due to reduction in male smoking prevalence. The prevalence trend, combined with negative to zero population growth, does not correspond to the fast growth of official cigarette sales that increased by 65.1% in 2000 – 2014. The data suggest the many cigarettes are leaving the country without being captured by official export statistics. According to industry sources, Belarus is one of the major supplier of illegal cigarettes to the EU.⁸⁹

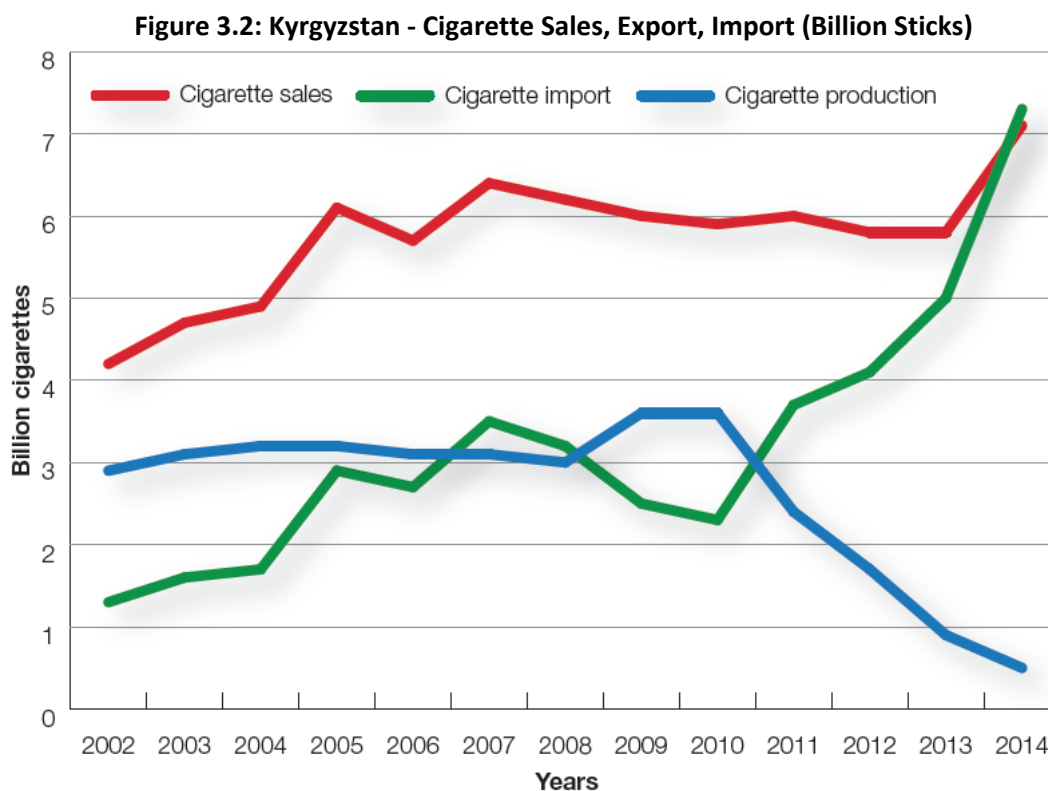
⁸⁹ KPMG. Project Star, 2010 Results. Aug. 22, 2012

Kyrgyzstan

In 1998 Reemtsma became a monopolistic domestic producer of cigarettes in Kyrgyzstan by acquiring the only cigarette production plant in the country.⁹⁰ Shortly after the acquisition Reemtsma (now part of Imperial Tobacco) built a new production facility in Kyrgyzstan, increasing the local production capacity ten-fold.⁹¹

In 2010 Imperial Tobacco decided to close the only cigarette factory in Kyrgyzstan and replace domestic production by imported cigarettes.⁹² This process involved a gradual reduction in local production and an increase in cigarette importation from Kazakhstan and the Russian Federation. The factory was finally closed in July 2014.⁹³

Sales data (calculated as the domestic production minus export plus import) indicate an increase in local consumption in 2002 – 2008, a period of declining cigarette excise taxes. When cigarette taxes began to increase in 2009 – 2013 (albeit not enough to seriously challenge the affordability of cigarettes), cigarette sales were stable or slightly declining. A sudden increase in cigarette sales started in mid-2013 and was accompanied by an increase in cigarette imports and a decline in local cigarette production.⁹⁴



Source: Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁹⁰ A B Gilmore, M McKee. Tobacco and transition: an overview of industry investments, impact and influence in the former Soviet Union. Tobacco Control 2004;13:136–142

⁹¹ A B Gilmore. Tobacco and Transition: Understanding the Impact of Transition on Tobacco Use and Control in the Former Soviet Union. 2005. <http://repositories.cdlib.org/tc/reports/SovietUnion>

⁹² Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁹³ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁹⁴ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

In 2014, the import of cigarettes further increased while the total cigarette sales rose by 23%, or by 1.3 billion cigarettes compared to 2013 (Figure 3.2). Analysts provided two possible reasons for this increase: illicit re-export and/or forestalling.⁹⁵ Forestalling (selling cigarettes on the books before the physical transaction occurs to save on higher excise taxes in effect at the time of the actual sales) can account for only a small portion of the higher sales in 2014, due to the limited shelf life of cigarettes. This makes the illicit re-exporting to neighboring countries with higher tax rates a more likely reason related to the decision of Imperial Tobacco to close its production in Kyrgyzstan.⁹⁶

3.3 Illegal Production and Sale

Definition

A portion of production is released to distribution without being declared to tax authorities. This can be achieved by running production facilities off hours or by failing to record all production. These untaxed, illegal products can be sold domestically and/or exported.

Motivation

Tobacco companies escape paying taxes on some of their products in order to increase sales and profit.

Implications

Tax revenue will be lower than expected, since the government does not collect taxes on all cigarettes being sold. Tobacco use will be higher if the untaxed products are sold for less. If the undeclared production is sold for the same price as the declared production, there will be no impact on tobacco use, but the companies will make more profit.

What can be done?

Strengthen tax administration and customs capacity, which will help to improve collection of other taxes as well. Since there are a limited number of factories producing cigarettes in a country, monitoring of production is feasible. Implementing tracking and tracing system in most cases eliminates this type of tax evasion.

Case Studies

Brazil

The tobacco industry in Brazil asserted that illicit cigarette consumption represented 27-30% of total consumption. The illicit market did not seem to respond to lowering of the excise tax rates in 1999, nor to very modest tax increases (less than inflation) implemented in the 2000s. The primary source of illegal cigarettes was domestic illegal production that was estimated at 10 billion cigarettes a year in the period of 2000–2009.

Starting in 2007, Brazil began to substantially increase its tax rates while at the same time adopting measures to reduce illegal consumption. This was done with a combination of legislation, technology, better coordination of tax and customs administration, and intelligence gathering. The track and trace system exposed seven manufacturers' engagement in illicit domestic manufacturing and led to the closure of their operations during the first two years of the system's implementation. The change in tax policy accompanied by the implementation of the track and trace system increased real cigarette prices, reduced both legal and illegal cigarette consumption (Figure 3.3), and increased tax revenue (Figures 3.4). The number of smokers in Brazil declined from 21.35 million in

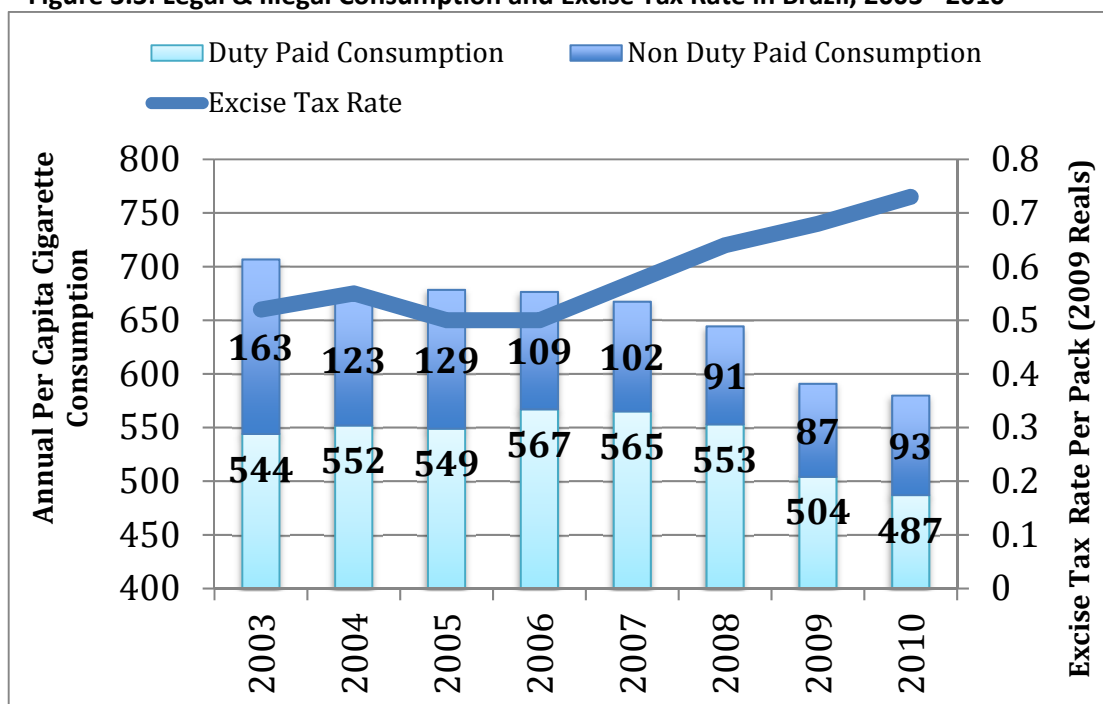
⁹⁵ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

⁹⁶ Tobacco taxation policy in Kyrgyzstan. Regional Office for Europe of the World Health Organization. 2015

2006 to 18.10 million in 2012. This reduction in the number of smokers is consistent with the observed reduction of legal cigarette sales and with data showing that smokers quit or reduced daily consumption instead of switching to illicit cigarettes. The decline in illegal consumption was primarily due to the elimination of domestic illegal production.

Despite the decline in legal cigarette sales between 2006 and 2013, revenue from tobacco excise taxes increased by 47.5%, from 3.5 billion (US\$ 1.76 billion) to 5.1 billion Reals (US\$ 2.56 billion) in constant 2013 values (Figure 3.4).⁹⁷

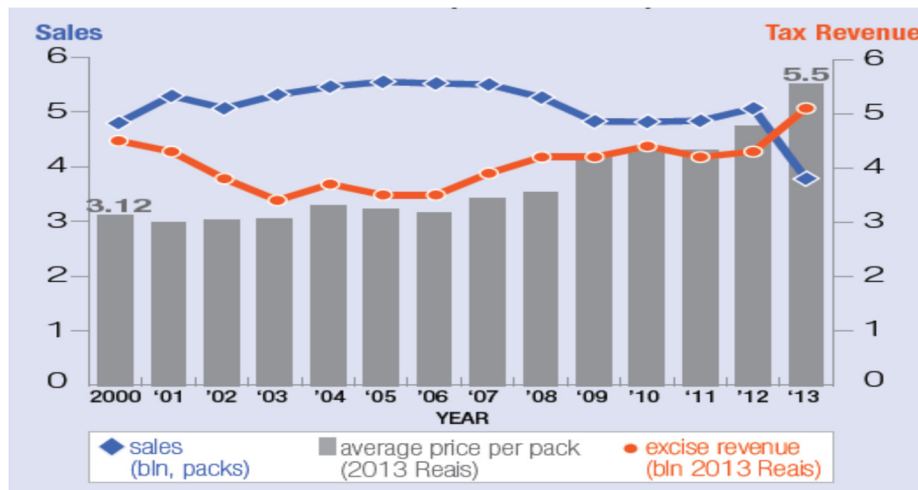
Figure 3.3: Legal & Illegal Consumption and Excise Tax Rate in Brazil, 2003 - 2010



Source: ERC Group. World Cigarette Report, 2010

⁹⁷ Hana Ross. Controlling illicit tobacco trade: International experience. Prepared for the Economics of Tobacco Control Project, School of Economics, University of Cape Town and Tobacco Economics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago. May 2015. <http://tobaccoecon.org/publications/reports/>

Figure 3.4: Cigarette Prices, Sales, and Excise Revenue in Brazil, 2000 – 2013.

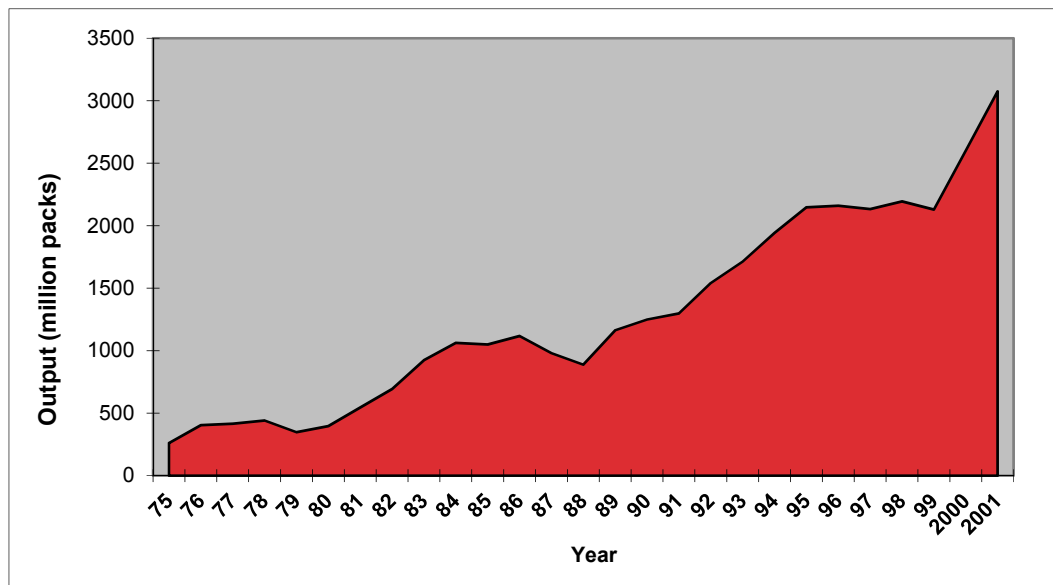


Source: Tobacco Free Kids. Tobacco Tax Success Story Brazil. 2012.

Vietnam

In 2000 the government introduced tax stamps on domestically manufactured cigarettes in order to reduce illicit cigarette sales. This policy forced the local tobacco industry to report its production more accurately. The production data show a large increase in domestic production in 2000 as result of the tax stamp policy. This means that before 2000 some part of the production was not being declared to tax authorities.

Figure 3.5: Production of Cigarettes in Vietnam, 1975 - 2001



Source: GSO Vietnam, Statistics Yearbook 2000 and ERC 2002

4. Discussion and Recommendations

The tobacco industry is aware of the power of higher tobacco taxes to reduce the demand for its products. To safeguard its profits, sales, and market shares, the industry has developed sophisticated communication strategies to prevent future tax increases or to reduce the taxes already in place.

Traditionally, the industry argued that higher taxes would result in job losses, that any tobacco tax increases are unfair due to their impact on the poor, and that smokers are more than paying their fair share of the social costs of smoking. In the late 1990's, the industry recognized that these traditional arguments needed to be updated and set up a special task force consisting of both industry representatives and representatives of national manufacturing associations to development a comprehensive set of arguments against further tax increases.⁹⁸

These arguments are being used selectively, either individually or in combination based on the target audience, the specific situation of the country where they are used, and whether the tax increase is proposed by an individual country or by a group of countries (e.g. EU).

There may be additional industry strategies that have not been identified while new strategies are evolving all the time in response to the regulatory environment.

A study from Ireland⁹⁹ demonstrates how the industry arguments and its strategy evolve over time. It captures the tobacco industry annual submissions to the Department of Finance and to the Minister for Finance for pre-budget discussions in the period of 2000 – 2009 to contested higher tobacco taxes. Table 4.1 outlines the types of arguments the industry was making and shows which ones were gaining/losing importance over time, with some being repeated each year. Clearly, the illicit trade argument gained a lot of weight with time while calling the UK tobacco tax policy a failure in terms of illicit trade disappeared with the mounting evidence that UK is able to control and even reduce the size of the illicit cigarette market while increasing tobacco taxes. Despite these efforts to prevent tobacco tax increases, the tobacco industry was raising its own prices to maximize the profits.

⁹⁸ Report of The Linkage Group. June 2000. US Department of Justice vs Philip Morris

⁹⁹ Fenton Howell. The Irish tobacco industry position on price increases on tobacco products. Tobacco Control 2012; 21:514-516

Table 4.1: Government and tobacco industry tax/price increases, and key themes emerging from tobacco industry lobbying submissions, Ireland, 2000-2009

	00	01	02	03	04	05	06	07	08	09
Tax/price increases (cents) after tobacco industry submissions										
Government tax increase	0	13	50	25	0	0	50	80	2.7	21.5
Tobacco industry price increases	10	21	16	13	10	20	10	10	2.3	23.5
Tax element of tobacco industry increase	4	7	6	5	4	7	4	4	0.8	8
Key themes from tobacco industry submissions										
Increasing price will increase the illegal trade	+	+	+	++	++	++	++	+++	+++	++++
Ireland's taxes on tobacco are among the highest in the world	++	++	++	++	++	++	++	++	++	++
Do not increase price in the forthcoming budget	+	+	+	+	+	+	+	+	+	++
The impact of a high tobacco tax policy in the UK and illegal trade	++	++	++	++	++	++	++	++	nc	nc
Loss of revenue to the State from cross border sales	+	nc	nc	++	+	+	+	++	+	+
Critical comment from tobacco industry concerning previous year's price increase	+	±	+	±	+	nc	nc	nc	+	nc
Provision of own data on the extent of the illegal trade in Ireland	nc	nc	nc	nc	nc	++	++	+++	+++	++++
Tobacco price increases will impact disproportionately on poorer smokers	+	nc	nc	+	+	+	nc	+	+	+
Tobacco price increases will impact negatively on inflation	+	+	+	+	nc	+	+	nc	nc	nc
Benefit of a price differential between Ireland and Northern Ireland	nc	+	++	++	nc	—	nc	nc	nc	—
Tobacco price increases will impact negatively on legal traders	nc	nc	nc	nc	+	nc	+	+	+	+
Tobacco price increases will lead to increased sales to minors as illegal traders will not ask for proof of age	nc	nc	+	nc	nc	nc	+	+	nc	nc
Tobacco price increases will lead to increased internet sales	nc	nc	+	nc	nc	nc	nc	nc	nc	nc
Tobacco price increases will lead to increased wage demands	nc	nc	+	nc	nc	nc	nc	nc	nc	nc
Do not remove tobacco products from consumer price index	nc	nc	+	nc	nc	nc	nc	nc	nc	nc
Reduce value added tax on tobacco products	+	nc	nc	nc	nc	nc	nc	nc	nc	nc

-/+ denote the strength and tone of comment with +++ indicating the highest degree of strength and tone of comment; nc, no comment.

Source: Fenton Howell. The Irish tobacco industry position on price increases on tobacco products. Tobacco Control 2012; 21:514-516.

The targets of the industry messages, such as policymakers and journalists, ought to be alert to these arguments, even if they appear to have emerged from grassroots or independent sources, because of potential industry involvement in their creation.

Tobacco taxes are generally popular with voters, so it is important not to let the industry confuse tobacco tax increases with the overall tax burden in the mind of the public by explaining the difference between excise taxes and other forms of tax.

It can be helpful to identify the differences in tobacco companies' positions on tobacco taxation. If the messaging from different tobacco companies is contradictory, pointing it out lowers industry credibility. For example, the industry failed to stop a tax increase in Hungary because of the divided position of the industry with respect to a tax increase proposal. Both British American Tobacco (BAT) and Philip Morris (PM) lobbied for a lower-than-proposed tax increase, but BAT wanted an increase in the ad valorem component of the tax while PM argued for an increase in the specific component

of the tax. According to the Hungarian MPs, the difference between the lobbying strategy of BAT and PM “had injured the industry’s credibility and created the opening for the tax increase.”¹⁰⁰

By understanding the motivation behind industry decisions about the (re)location of its production facilities, governments can resist the pressure to lower tobacco taxes, change tax structure or, reduce its import tariffs in exchange for few extra jobs generated by tobacco manufacturing.

Government representatives should become familiar with Article 5.3 of the Framework Convention on Tobacco Control that provides a set of principles on how to deal with the tobacco industry in order to protect public health interests from commercial and other vested interests.

Governments can adopt measures to reduce illegal tax evasion by following the guidance of the FCTC Protocol on Illicit Trade and engaging in international collaboration and data and intelligence sharing with other countries.

All these government activities should be supported by industry monitoring and data collection on various aspects of the tobacco market such as cigarette sales, cigarette export and import, tax revenues, the size of the illicit cigarette market, promotional and PR expenditures by the industry, among others. Timely data analyses will allow authorities to respond quickly and effectively to industry efforts to reduce their tax liability. This will also enhance tax collection and improve public health by increasing the effectiveness of tobacco tax policy. The prospect of higher tax revenue can justify the costs of data collection and any other additional administration expenses.

¹⁰⁰ Szilagyi T, Chapman S. Tobacco industry efforts to keep cigarettes affordable: a case study from Hungary. *Cent Eur J Public Health* 2003;11:223e8.



The Southern Africa Labour and Development Research Unit (SALDRU) conducts research directed at improving the well-being of South Africa's poor. It was established in 1975. Over the next two decades the unit's research played a central role in documenting the human costs of apartheid. Key projects from this period included the Farm Labour Conference (1976), the Economics of Health Care Conference (1978), and the Second Carnegie Enquiry into Poverty and Development in South Africa (1983-86). At the urging of the African National Congress, from 1992-1994 SALDRU and the World Bank coordinated the Project for Statistics on Living Standards and Development (PSLSD). This project provide baseline data for the implementation of post-apartheid socio-economic policies through South Africa's first non-racial national sample survey.

In the post-apartheid period, SALDRU has continued to gather data and conduct research directed at informing and assessing anti-poverty policy. In line with its historical contribution, SALDRU's researchers continue to conduct research detailing changing patterns of well-being in South Africa and assessing the impact of government policy on the poor. Current research work falls into the following research themes: post-apartheid poverty; employment and migration dynamics; family support structures in an era of rapid social change; public works and public infrastructure programmes, financial strategies of the poor; common property resources and the poor. Key survey projects include the Langeberg Integrated Family Survey (1999), the Khayelitsha/Mitchell's Plain Survey (2000), the ongoing Cape Area Panel Study (2001-) and the Financial Diaries Project.

www.saldru.uct.ac.za
Level 3, School of Economics Building, Middle Campus, University of Cape Town
Private Bag, Rondebosch 7701, Cape Town, South Africa
Tel: +27 (0)21 650 5696
Fax: +27 (0) 21 650 5797
Web: www.saldru.uct.ac.za

