

CTCA Factsheet on Tobacco Taxation in Africa

Overview of Tobacco Taxation

The overall demand for tobacco products is significantly affected by changes in tobacco product taxes and prices. Raising taxes to increase the price of tobacco products is the most effective means to reduce tobacco use (WHO, 2010). Price affects all aspects of tobacco consumption, with higher prices preventing initiation among potential users, inducing cessation among current users, and reducing the frequency of consumption and amount consumed by continuing users. Tobacco tax increases that increase prices improve population health (Fichtenberg and Glantz, 2000). Higher tobacco taxes are especially effective in reducing tobacco use among lower-income groups and preventing especially the youth from starting to smoke. However, this measure has registered the least progress according to WHO Global Progress Report 2012. In 2008, 7% of people worldwide (490 million people in 22 countries) were subject to tax rates sufficiently high to represent 70% of the retail price of cigarettes. In 2012, that had increased to only 530 million people (8% of world population) in 32 countries. Low-income countries, which are in greater need of government funding for tobacco control programmes, are the least likely to have sufficiently high tax rates.

Specific taxation is the appropriate instrument when targeting public health, as it has two favourable effects. First, increases in specific excises would lead to relatively higher price increases, causing price sensitive consumers to reduce their consumption relatively more. Second, it reduces consumers' incentives to substitute lower-priced brands for higher-priced ones, especially when consumers find it difficult to quit or reduce consumption after a tax increase. This impact will be greater on poor and youth smoking behaviour given their budget constraints.

Current Tobacco Taxation in Africa

According to the African Union status report on 'The Impact of Tobacco Use on Health and Socio-Economic Development in Africa', the region is still lagging behind in terms of tobacco taxation with only two countries (Madagascar and Mauritius) in the recommended WHO - share of excise tax in the retail price of at least 70%. Madagascar's share of total taxes in the retail price of the most widely sold brand of cigarettes is 76% followed by Mauritius (73%), Seychelles (67%), Rwanda (66%) and Zimbabwe (58%) in the top five countries. The least five tobacco-taxed countries are Togo and Sao Tome and Principe, both with 12% as the share of total taxes in the retail price of their most widely sold brands of cigarettes followed by Liberia and Benin, both with 13% and, Mauritania (15%).

Countries in Africa use different tax structures and systems when taxing tobacco products. According to the 2012 Global Progress Report on implementation of the FCTC, 56% of the parties in the WHO African Region reported² that they levy ad valorem tax only; 26% levy a specific excise tax only and only 9% levy both ad valorem and specific excise tax on tobacco products, whereas 9% do not levy any tax on tobacco products or the structure is not known. The Report further noted that the mean total tax rate as a share of average retail prices in the WHO African region is 55.5%³ while a 48%⁴ increase in the mean average prices per pack of 20 cigarettes from 2010 to 2012 was also noted. The existence of differential excise tax system in some African governments has created price gaps among brands and since this system is based on various product characteristics, it provides incentives for tax avoidance to the extent that manufacturers can alter their pricing or production decisions to avoid higher tax liabilities.

In Egypt², for example, the retail price of one of the premium brands in 2009 was reduced in order to avoid higher taxes, consequently falling into the mid-level category on which a lower tax was applied (Hanafy et al., 2009). Egypt has since 2010 adopted a uniform specific excise tax system, which is preferable in generating more revenues, by reducing non-compliance and unfavourable pricing strategies among producers, while reducing cigarette consumption by increasing average cigarette prices. Furthermore, a uniform specific excise reduces price gaps between brands and tobacco products, minimizing substitution behaviour of consumers among brands and products.

¹ In the 2010 reporting period, 19% of the parties in the WHO African Region reported that they levied ad valorem tax only; 22% levied a specific excise tax only and only 7% levied both ad valorem and specific excise tax on tobacco products, whereas 52% did not levy any tax on tobacco products or the structure was not known.

² The World Bank recommends that the share of total taxes in the retail price of a pack of cigarettes should account for two-thirds to four-fifths (World Bank, 1999).

³ The mean average reported prices per pack of 20 cigarettes in the WHO African region was US \$ 1.31 and US \$ 1.94 for the 2010 and 2012 reporting periods respectively.

Key Facts in Tobacco Taxation

- The most cost-effective tobacco control strategy is increasing the price of tobacco products by raising tobacco tax². Higher and more uniform specific tobacco excise taxes result in higher tobacco product prices and increase the effectiveness of taxation policies in reducing tobacco use (WHO Technical manual on tobacco tax administration, 2010)
- Increases in tobacco excise taxes that increase prices result in a decline in overall tobacco use (Gallus et al., 2006).
 - Increases in tobacco excise taxes that increase prices reduce the initiation and uptake of tobacco use among young people, with a greater impact on the transition to regular use (Tauras et al., 2001).
 - Increases in tobacco excise taxes that increase prices reduce the prevalence of tobacco use among young people (Walbeek, 2002 and Kostova et al., 2001).
 - Increases in tobacco excise taxes that increase prices lower the consumption of tobacco products among continuing users (Farrelly et al., 2001).
 - Tobacco use among young people responds more to changes in tobacco product taxes and prices than does tobacco use among adults (Farrelly et al, 2001).
 - Tobacco tax increases increase tobacco tax revenues (Jha and Chaloupka, 1999).
- Considering the addictive nature of tobacco use, the impact of a permanent increase in price of tobacco products will be larger in the long run than in the short run (Tauras et al., 1999b).
- Tobacco industry (TI) price discounting strategies, price reducing marketing activities, and lobbying efforts mitigate the impact of tobacco excise tax increases (Slater et al., 2007).
- Tax avoidance³ and tax evasion⁴ reduce, but do not eliminate, the public health and revenue impact of tobacco tax increases (Merriman et al., 2000).
- With strong enforcement, higher taxes do not necessarily lead to increases in smuggling and other tax avoidance activities as claimed by the tobacco industry (Joossens, 2003).

Best Practices in Tobacco Taxation

- *Taxes must keep pace with inflation and economic growth.* Taxes need to be increased periodically to offset the effects of inflation and of rising incomes and purchasing power lest tobacco becomes relatively more affordable.
- *Tobacco taxes should be increased on all tobacco products* to avoid substitution among products caused by an increase in the price of one product. All tobacco products compete with each other and all have health effects that warrant a tax.
- Set tobacco excise tax levels so that they account for *two-thirds to four-fifths*² of the retail prices of tobacco products
- A simpler tax system is better in terms of administration and impact on reduced consumption and more revenue generation.
- Rely more on specific tobacco excises as the share of excise taxes in retail prices increases more than any other tax on tobacco.
- Adopt comparable taxes and tax increases on all tobacco products
- Eliminate tax and duty free sales of tobacco products
- Adopt new technologies to strengthen tobacco tax administration and minimize tax avoidance and evasion

⁴ In July 2010, the eight-tiered specific tax structure on cigarettes was replaced by a simpler, uniform tax structure comprised of a specific tax of US\$ 0.23 per pack and an ad valorem tax of 40% of retail price. On average, these taxes account for approximately 65% of retail prices

⁵ Article 6 of the WHO Framework Convention on Tobacco Control states: " ... price and tax measures are an effective and important means of reducing tobacco consumption ... [Parties should adopt] ... measures which may include: ... tax policies and ... price policies on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption"

⁶ Tax avoidance includes legal activities and purchases in accordance with customs and tax regulations, most of which include the payment of some tobacco taxes, and are done by individual tobacco users, including cross-border shopping, tourist shopping, duty free shopping,

⁷ Tax evasion includes illegal methods of circumventing tobacco taxes, such as the purchase of smuggled and illicit manufactured tobacco products.

Specific excises vs. Ad valorem excises

- Specific excises tend to increase consumer prices relatively more than ad valorem excises, and hence lead to relatively higher reductions in consumption.
 - Consumer prices are more likely to rise by more than the tax increase when the tax is specific (tax over-shifting²).
 - Specific excises provide incentives for more appealing and higher-priced products, as well as greater variety.
 - Specific excises are less likely to induce substitution from high-to low-priced brands (e.g. switching down³).
 - While the ad valorem tax helps tobacco prices to keep up with inflation, excise specific taxes provide more predictable revenue and make it harder for the tobacco industry to influence retail prices of tobacco products.
- tax system by first reducing the specific tiers gradually and have just one rate in the mid- to long term, and then adopt a minimum specific floor (with both excises or only the ad valorem tax) to close the gap between price bands in the short term and adopt a uniform specific excise in the long term.
- New technologies like the new high-tech tax stamps (banderole) should be viewed as tools to enhance enforcement and reduce the size of the illicit market. In order to reduce tax evasion, governments in Africa still need to implement other effective measures including employing more enforcement officers supported by strong laws.

Summary/Conclusions

- In order to improve public health by reducing tobacco use, governments should adopt relatively simple tobacco excise tax structures that emphasize specific taxes and that include regular tax increases that outpace growth in general price levels and incomes.
- A simple and unified specific excise system can be considered a well-designed tax policy in terms of ensuring transparency, easy definability and increasing tax administrations' efficiency. It should tax all cigarettes (or tobacco products) at the same level.
- Governments that use a differential tax system in Africa should pursue efforts to adopting a uniform specific excise

⁸ Given the problems of quantifying the various social costs and offsets, particularly for developing countries with limited data, the World Bank urged that countries, which want to adopt comprehensive tobacco control policies, should use, as a yardstick, a rule that tax should account for two-thirds to four-fifths of the retail price of a pack of cigarettes (World Bank, 1999).

⁹ Tax over-shifting means that, when tax increases, the consumer price rises by more than the tax increase itself

¹⁰ Consumers of tobacco products may reduce consumption of their preferred brand or may "switch down" when facing tax or price increases

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