

Tobacco taxation in the Eastern Mediterranean Region

Introduction

As backed by international evidence, increasing taxation on tobacco products is one of the most significant measures to boost tobacco control. Raising taxation on tobacco products can provide considerable short- and long-term benefits to governments, generating additional revenues and also providing important financial resources to benefit national efforts in tobacco control.

Evidence also shows that increased taxation on tobacco products helps to avert significant numbers of premature deaths. Higher prices deter youth from using tobacco and encourage adult smokers to quit. This leads to substantial reductions in the health and economic burden caused by tobacco use.

Despite this, data from the WHO Eastern Mediterranean Region suggest that taxation on tobacco products has been one of the most underutilized resources that is able to provide significant short- and long-term financial and health benefits to support tobacco control. The prices of tobacco in the Region and taxation incidence are among the lowest when compared to the rest of the world. More importantly, many other forms of smoking and smokeless tobacco, such as waterpipe (*shisha*), cigars and snuff have not been fully brought into the tax net.

The Eastern Mediterranean Region has 21 Member States, most of which are either low- or middle-income economies. These countries could benefit considerably if appropriate taxation policies were adopted. The Region has recently seen some successful examples from Egypt and Pakistan, providing a significant boost to government revenues there. Even Member States in the high-income group are not using the full potential of the tobacco taxation system that not only could provide huge monetary benefits but positive health impacts in the form of the reduced burden of noncommunicable diseases related to tobacco use.

Tobacco taxation facts

- Tobacco products are generally good candidates for taxation, as they are produced by a small number of manufacturers, have few substitutes and have relatively inelastic demand; so tobacco products have the potential to generate considerable revenues while creating fewer distortions in the market.
- As the health consequences of tobacco use are becoming evident, tobacco taxes are considered as a way to promote public health and to finance national tobacco control initiatives and improve health care services.
- Governments across the world impose various types of taxes on tobacco products, which include excise taxes, custom duties, value added taxes (VAT), general sales tax and other specific taxes to fund particular programmes.
- Of all the types of taxes, excise taxes are of most importance, as these raise the prices of tobacco more relative to other consumer products, providing dual benefits of additional revenues and reduced consumption.
- Tobacco is consumed in many different forms. Apart from cigarettes, other forms include raw tobacco for *bidis*, handrolled tobacco and tobacco for waterpipes, chewing tobacco, tobacco snuff and *snus*. These products are either minimally taxed or are even out of the taxation bracket. There is a potential to enhance revenues many folds by bringing these into the tax net.

Tobacco industry arguments against higher taxation

International evidence proves that higher tobacco taxes increase revenues in spite of the expected relative reduction in consumption trends. Although proportions vary by country; on average, a 10% increase in price is likely to reduce consumption by 8% for middle-income and by 4% for high-income countries, however, this would still provide substantial revenues to governments, outweighing any false arguments being voiced against raising taxation.

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Table 1. Comparison of various excise tax regimens

	Specific excise	Ad valorem excise	Ad valorem with specific floor	Mixed specific and ad valorem excise	Mixed specific and ad valorem excise with a minimum specific tax floor
Tax base	The unit of product (e.g. 1000 cigarettes).	The value of the product. (e.g. retail, wholesale or manufacturer price).	The excise is calculated on an <i>ad valorem</i> basis; however, if the calculated tax falls below a specified minimum floor, a specific tax rate applies.	Unit and value of product.	Both unit and value, unless tax below specified minimum, in which case the tax base is the unit.
The tax should be collected at the point of manufacturing and at the time of importation.					
Administrative requirements	Low as only the volume of the products has to be ascertained.	Requires strong tax administration with technical capacity. Otherwise, the administrative burden can be high.	Requires strong tax administration with technical capacity. Otherwise, the administrative burden can be high as with a pure <i>ad valorem</i> regime.	Requires strong tax administration with technical capacity. Otherwise, the administrative burden can be high as it requires assessing and collecting both <i>ad valorem</i> and specific excises.	Requires strong tax administration with technical capacity. Otherwise, the administrative burden can be high as it requires assessing and collecting both <i>ad valorem</i> and specific excises, as well as minimum floor compliance.
Undervaluation	Not an issue.	Susceptible to undervaluation, but this can be overcome by establishing a minimum retail sale price.	This provides an easy tool to prevent undervaluation of low-priced brands subject to the specific floor.	The <i>ad valorem</i> part of the excise collection may be susceptible to undervaluation depending on the choice of tax base.	The specific tax floor prevents possible <i>ad valorem</i> tax base undervaluation of low-priced brands.
Impact on product "quality"	Upgrading effect tends to reduce the relative tax on higher-priced brands.	Multiplier effect provides a disincentive to costly "quality" improvement.	No incentive to upgrade higher-priced brands.	No incentive to upgrade higher-priced brands.	Eliminates incentive to upgrade higher-priced brands while at the same time provides such an incentive for lower-priced brands.
Impact on price	Tends to lead to relatively higher prices, particularly for low-priced cigarettes.	Tends to lead to relatively lower prices; price reductions will be "subsidized" if the multiplier effect is strong.	Tends to lead to relatively higher prices for low-priced cigarettes.	An increase in the specific tax will increase the <i>ad valorem</i> payment as well.	An increase in the specific tax will increase the <i>ad valorem</i> tax amount as well. Increases in the <i>ad valorem</i> and/or specific tax will raise the minimum tax paid, if floor is a percentage of total tax on weighted average price (WAP). It will reduce price gaps given impact on "quality".
Inflation	The real value of the excise will be eroded unless adjusted in line with inflation.	The real value of the excise will be preserved as prices increase; at least, to the extent that tobacco product prices follow inflation.	The real value of the specific floor will be eroded over time unless adjusted in line with inflation.	The real value of the specific excise will be eroded unless adjusted in line with inflation.	The real value of the specific excise tax and floor will be eroded unless adjusted in line with inflation.
Health benefits	The taxes will discourage consumption of tobacco products irrespective of the price.	The tax may encourage more "trading down" in favour of cheaper cigarettes reducing health benefit.	Specific floor reduces incentives for trading down.	May reduce trading down.	Reduces trading down.

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The tobacco industry has long argued that higher prices increase cross-border smuggling and illicit trade. Evidence shows that effective laws to monitor tobacco production, the import and supply chain, and a strong and efficient tax administration system effectively overcomes the challenges of illegal domestic and cross-border trade. In order to address international challenges of illicit tobacco trade, a strong international treaty is also being negotiated and will soon be finalized by the Parties to the WHO Framework Convention on Tobacco Control (FCTC) under the provisions of Article 15 of the Convention.

Types of taxation regimens

Various forms of taxation are applied on tobacco products at various stages of a product cycle, however, excise taxes constitute a greater share of taxation, produce most of the revenues for governments and are likely to have the greatest public health impact.

Mostly, cigarettes are the only tobacco product to be regulated and are prone to taxes at all levels. All other forms are minimally taxed and contribute least to the revenues. Table 1 provides a comparative overview of the various forms of taxation.

Tobacco taxation in the Region

As in all other parts of the world, cigarettes constitute by far the most prevalent form of regulated tobacco product in the Eastern Mediterranean Region. However, various other forms of tobacco are also prevalent; waterpipe being the most popular among these and is widely used across the Region. Similarly the use of smokeless tobacco is prevalent in countries such as Afghanistan, Egypt, Pakistan and Yemen; and its use is increasing in the rest of the Region as well.

Regional tobacco taxation systems

Various taxation regimes exist in Member States of the Eastern Mediterranean Region. The economic profiles of Member States vary as does pricing

among countries. However, prices and the taxation on tobacco products do not correspond to respective economic profiles. Table 2 shows salient features of taxation structures in Member States and the share of taxation based on the prices of the most popular brands.

Overview of tobacco price and tax share in the Region

- The Eastern Mediterranean Region has the lowest average prices compared to other WHO Regions.
- The average tax incidence is also the lowest and accounts for 40% of prevalent retail prices (Figure 1).
- As there is a variation of taxation structures, the prices of cigarettes and the total tax share also vary considerably across the countries. Figure 2 below provides a general overview of share of total and excise tax for every country based on average prices, grouped by income level.
- Despite the fact that prices rise considerably from low- to high-income countries, the total share of taxes does not follow the same trend. Particularly, there is no excise taxation system in high-income countries. The resultant taxation incidence therefore falls well below the general trend prevalent across the world.

Best practices and the way forward

The following examples highlight the best practices around the world in reviewing taxation policies on tobacco.

- Use tobacco excise tax increases to achieve the public health goal of reducing death and disease caused by tobacco use, particularly among the poor and the young.
- Introduce an excise taxation system that accounts for at least 70% of the retail prices for tobacco products. This would deter youth from smoking in addition to bringing significant increases in tobacco tax revenues.

Table 2. Taxation structures and share of taxation in the Eastern Mediterranean Region

Member States (by economic status)	Price of most popular brand* (US\$)	Types of excise taxation		Total tax share† (% of RP)	Additional information/explanation
		Specific excise (%)	<i>Ad valorem</i> excise (%)		
Low-income					
Afghanistan	0.51	0.00	0.00	7.79	No excise taxation; import duty only Tax system vulnerable to import prices/bilateral trade agreements Absence of excise taxation implies lost opportunity for sustainable revenues
Yemen	0.75	0.00	47.37	47.37	<i>Ad valorem</i> excise taxation only Lower tax incidence implies opportunity to enhance revenues
Pakistan**	0.31	40.1	7.3	61.2	Complex multi-tiered with combined specific and <i>ad valorem</i> tax structure; ranges from 60.1% on low-cost to 70.1% on high-cost brands, encouraging increased market share of low-cost brands Minimal taxation on non-cigarette tobacco; mostly not regulated due to lax enforcement
Middle-income					
Egypt**	0.70	31.3	38.7	70.0	Combined specific and <i>ad valorem</i> excise taxation Recent tax changes aim to provide significant additional revenues
Djibouti	0.68	0.00	43.51	43.51	<i>Ad valorem</i> excise taxation only Lower tax incidence implies opportunity to enhance revenues
Islamic Republic of Iran	1.32	0.00	5.13	19.16	<i>Ad valorem</i> excise tax; import duty; VAT Lower tax incidence implies opportunity to enhance revenues
Iraq	0.63	0.00	8.53	22.75	<i>Ad valorem</i> excise; import duty Lower tax incidence implies opportunity to enhance revenues
Sudan	0.97	0.00	58.91	71.95	<i>Ad valorem</i> excise; VAT
Jordan	1.97	22.86	31.99	68.64	Combined specific and <i>ad valorem</i> taxation; VAT
Morocco	2.16	0.57	50.05	66.36	Combined specific and <i>ad valorem</i> taxation; VAT
Syrian Arab Republic	0.62	3.00	12.30	30.30	Combined specific and <i>ad valorem</i> taxation; VAT
Lebanon	1.33	0.00	33.38	44.01	<i>Ad valorem</i> excise taxation; import duty; VAT
Libyan Arab Jamahiriya	0.80	0.00	1.96	1.96	Only <i>ad valorem</i> excise taxation Lowest tax incidence in the Region; implies opportunity to enhance revenues
Tunisia	1.30	2.35	47.33	64.94	Combined specific and <i>ad valorem</i> taxation; VAT
High-income					
Bahrain	1.6	0.00	0.00	33.33	No excise taxation; import duty only Tax system vulnerable to import prices/bilateral trade agreements Absence of excise taxation implies lost opportunity for sustainable revenues
Kuwait	1.7	0.00	0.00	34.04	
Oman	1.56	0.00	0.00	33.33	
Qatar	1.65	0.00	0.00	33.33	
Saudi Arabia	1.6	0.00	0.00	33.33	
United Arab Emirates	1.77	0.00	0.00	30.77	

Source: WHO Technical manual on tobacco tax administration. Geneva, World Health Organization, 2010. Author's calculations based on reported data from the Global tobacco control report updated at the end of 2008.

*Price of the most sold brand in the country converted into US dollars using official (principal or market) exchange rates at end of time period.

†Total tax share includes specific excise, *ad valorem* excise, VAT, import duty (if the most popular brand in the country is imported), and others (if applicable).

**Pakistan and Egypt figures have been updated as tax changes took place in June and July 2010, respectively.

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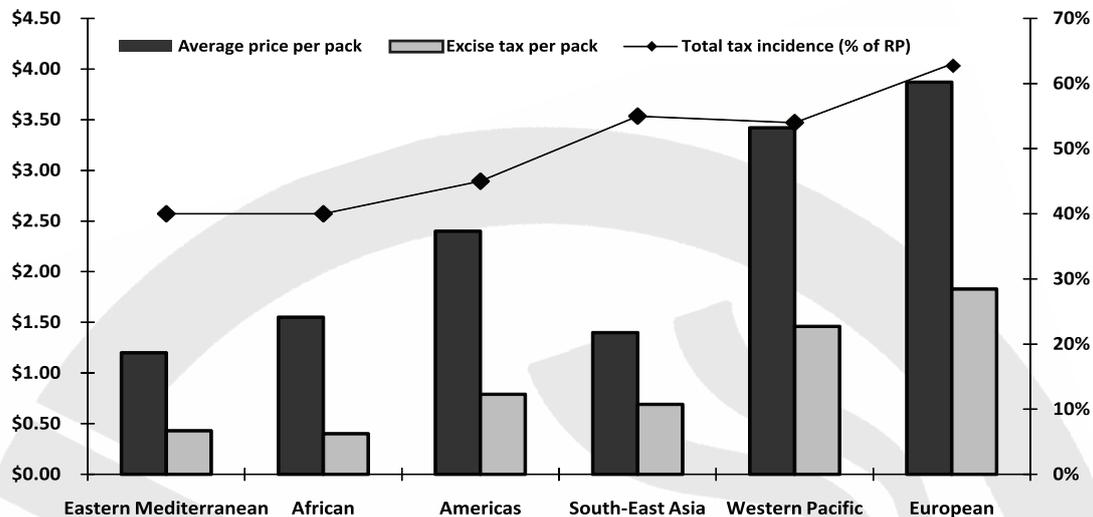
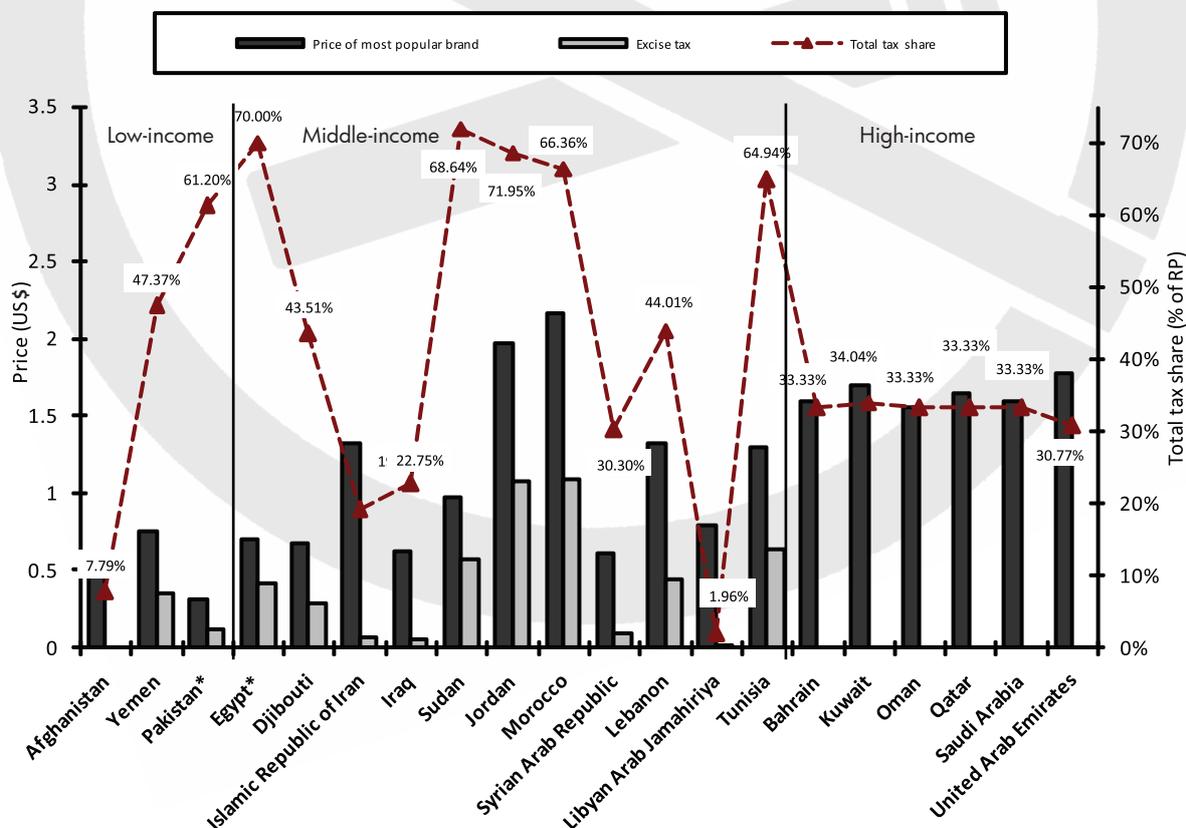


Figure 1. Tobacco price and tax share in WHO regions



Source: WHO Technical manual on tobacco tax administration. Geneva, World Health Organization, 2010. Author's calculations based on reported data from the Global tobacco control report updated at the end of 2008. Egypt and Pakistan data updated based on changes in taxation in 2010.

Figure 2. Comparison of average price, excise tax and total tax incidence among countries in the Region

- Simplify the structure of tobacco excise taxes. This will ease tax administration, reduce tax avoidance and evasion and enhance revenues.
- Apply the same specific tax to all brands of tobacco. This reduces the price gap between various brands, thus limiting opportunities for users to switch down in response to tax increases.
- Rely more on excise taxes than on import duties, as import duties are vulnerable to bilateral, regional and global trade agreements.
- Include all tobacco products in the tax net. An increase in taxes on all tobacco products maximizes the public health impact and will also generate larger increases in tobacco tax revenues.
- Eliminate tax and duty free sales of tobacco products. This will ensure reducing opportunities for tax avoidance and evasion.
- Tax increases on tobacco products are more effective in achieving short- to medium-term public

health goals and will immediately generate new revenues for governments.

- Tax structures should ensure the automatic adjustment of specific taxes so as to keep pace with inflation; this is an important policy measure for the longer term.
- Governments should include tobacco excise tax increases as part of a comprehensive strategy to reduce tobacco use. Such a strategy should include the creation of comprehensive smoke-free air policies, implementing total bans on tobacco company marketing activities, issuing strong warnings about the consequences of tobacco use, undertaking broad efforts to help current users quit and conducting mass media public education campaigns.
- Implementation of a comprehensive strategy to reduce tobacco use leads to greater reductions in the consequences of tobacco use, builds public and political support for higher taxes and maximizes the effectiveness of tax increases in achieving public health goals.

Sources

WHO Technical manual on tobacco tax administration. Geneva, World Health Organization, 2010.

WHO Report on the global tobacco epidemic. Geneva, World Health Organization, 2009.

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