Taming the Tobacco Industry: Tax Assessment, Monitoring and Evaluation System (TAMES)

Warning on Tobacco Products – Capacity Building within Legislative Framework

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Overview

Tobacco taxation is the most effective way to control the spread of tobacco use and reduce demand for it (WHO, 2019). Governments in low-middle income countries face a serious dilemma in earning revenue without annoying the high tax payers such as tobacco industry. The government in Pakistan also burdened by the public pressure and finds it politically challenging to implement new tax regimes. The situation gets further compounded by the fears and sometime ill-founded claims by the tobacco industry, for example increased unemployment, expanding uncontrolled illicit markets, health burden on national economy and consequent unfair burden on poor. Contrary to these claims, tobacco taxation has been used around the globe as the most appropriate tool for utilizing the earned revenues to meet issues such as health burden. Tobacco Industry (TI) claims to be one of the largest if not the largest tax contributors nationally in Pakistan. Literature shows that raising the tobacco tax is the most cost effective way for reducing tobacco use. Burki et al. (2013) contend that a uniform specific tax that accounts for 70% of the cigarette price, has been found to be instrumental in reduction of 7.5% consumption, simultaneously adding Rs. 27.2 billion in national exchequer as tax revenue. Such pricing – tax ration leads to 500,000 users quitting, resultantly saving estimated 180,000 deaths and preventing another 725,000 new smokers (especially youth) from taking up smoking.

The tax related problems in Pakistan include: 1) revenue pilferage at collection point; 2) Tobacco industrial pressures; 3) blaming the illicit market; 4) lack of research required for ensuring due tax is paid between the crop and the end product.

In this vein this brief is aimed at briefing the policy makers as technical expert on the current tax regime and making recommendation for an efficient yet robust tax regime.

Definitions

The Inevitability of Tobacco Taxation

WHO study reveals that raising the tax to account for at least 70% of the retail price has multiple benefits: 1) it leads to significant price increase; 2) induces quitting; 3) prevent new users to start smoking; 4) decrease in number of cancer and tobacco related deaths; 5) improved national health; 6) generate significant increase in tobacco tax revenues, and; 7) with price elasticity at play, prevents brand-switching. It is however important to note that the chances of ‘quitting’ are more in case of low income individuals, while brand-switching is a possibility among high-income individuals. Therefore such a move helps government lower the health cost (by increasing number of quitters) and generate extra revenue through those who continue smoking. Government also needs to increase taxes in-line with the inflation and increase in real income. The evidence shows that in low-Middle income countries smoking increases with the rise in income. National research on this issue is scant in Pakistan and there is a need to study this aspect through locally collected scientific and empirical evidence.

Need for Progressive Tax Increase

In these trying economic times, Pakistan needs to develop a comprehensive and long term tobacco taxation policy that promises to have four outcomes: 1) fosters reduction in consumption through high taxation; 2) as a result
of reduced consumption seek improved public health; 3) generating enough revenues to cater for budgetary shortfalls for sectors such as health and education etc. and; 4) plan effectively for long term revenue generation and utilization through a sustained taxation policy.

On the flip side, government could face multiple challenges while aspiring to raise tobacco taxes because: 1) government is constrained by the desire to collect more revenue, but the institutional infrastructure might not be supportive; 2) lack of technical, human and administrative capacity at FBR could be another source of frustration; 3) there is a need to have a simple taxation system to avoid tax evasion, tax avoidance and generate taxes in a sustained manner; 4) TI pressure is omnipresent through national and international actors; 5) FBR, mostly if not always, aims at collecting a given target amount of taxes regardless of the considerations of issues such as health burden and social impact etc.

The argument made by TI is the loss of jobs due to increased tobacco taxes. Pakistan Tobacco Board, which is responsible for promoting tobacco, estimates almost 150,000 people related directly and indirectly to the tobacco including vendors. WHO study shows that there is either no net impact on employment or, more likely it will result in increase in small number of jobs, for example in monitoring segment and other sectors. Crop diversification programs that support farmer and training focusing on alternate jobs could be funded by the tobacco revenue. A detailed research looking into this aspect is highly desirable to strengthen the case for increased tobacco taxation.

**System of Tobacco Taxation in Pakistan**

Multiple taxes are levied on tobacco products around the globe. However, ‘excise tax’ is the best and time tested tool which ensures that tobacco product prices are increased relative to other commodities, goods and services, and can best be utilized to meet health costs. A single-rate specific taxation is ideally suited to raise the price of tobacco products such as cigarettes and reduce the share of ‘cheap brands’. For example if the prices of two packs of different cigarette brands is Rs. 50/- and Rs. 100/-, single-rate increase of Rs. 50/- per pack would mean that the new prices of the same brands would be Rs. 100/- and Rs. 150/- respectively.

The second, ad valorem tax or Value Added Tax (VAT) is also an effective tool to collect revenues, but this will have minimal effect on rate of tobacco consumption. VAT, by definition is tax imposed at different rates depending upon the stage of processing. For example, as the tobacco is received at Green Leaf Thresher (GLT), it could be taxed, as it goes to the manufacturing unit and is shaped into a cigarette, it could again be taxed, since the value has been added to it, and third place of taxation could be point of sale. However, this is not the most appropriate method to ensure reduction in consumption, because the tax increase at point of sale will be a much smaller part of the overall increase in VAT. The selection of any one of above would depend upon the desired level of required revenue. However, for long term benefits, single-rate specific taxation is ideally suited.

Simplicity is also important in taxation system to keep the lower monitoring costs, prevent tax avoidance and ensure sustained revenues. Tax avoidance includes illicit trade and illicit production, it may involve genuine and counterfeit products. Very high taxes induce smuggling, especially when enforcement is weak or is absent, penalties are less and justice is delayed. In Pakistan the penalty for violating tobacco laws is Rs. 10,000 fine across the board (including retailer, wholesaler and manufacturer) with an additional possibility of two years as jail term. Such weak penalties are generally viewed as ineffective.

Tobacco taxation literature shows that increasing tobacco-product taxes increases tax revenues over the short to medium term. Tax constitutes a small percentage in the price of the product, and therefore increase in tax will have
lesser percentage of people quitting. Many countries around the world have used the increased tobacco revenues to fund tobacco control research, activities, health promotion activities and health-care systems. In Pakistan tier system of taxation is followed which is as under:

Table 1: Source multiple SROs and Media Report

<table>
<thead>
<tr>
<th>Period</th>
<th>Tier</th>
<th>Retail Price (per pack)</th>
<th>FLD (per pack)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jun 3, 2016 – May 28, 2017</td>
<td>First More than 80</td>
<td>68.72</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second 80 or less</td>
<td>30.68</td>
<td></td>
</tr>
<tr>
<td>May 29, 2017 – Apr 29, 2018</td>
<td>First More than 90</td>
<td>74.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second More than 88.5 up to 90</td>
<td>38.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third 88.5 or less</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>Apr 30, 2018 – Sep 17, 2018</td>
<td>First More than 90</td>
<td>79.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second More than 88.5 up to 90</td>
<td>58.52</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third 88.5 or less</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td>Sep 18, 2018 to date</td>
<td>First More than 90</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Second More than 88.5 up to 90</td>
<td>56.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Third 88.5 or less</td>
<td>25</td>
<td></td>
</tr>
</tbody>
</table>

Table 1 above shows the incorporation of third tier and change in taxation and revenue collection. The reason for implementation of the above three tier system as argued by the FBR is curbing the counterfeit production. Health officials and tobacco control experts do not agree to this as it does not help in reducing the consumption. Introduction of third tier without a ban on tier shifting by the TI resulted in increased production, sales and consumption, yet loss of revenue, because the popular brands were moved from higher tiers to lower tier. For understanding purposes, for example, if the pack of Marlboro was priced at Rs 85/- in January 2017, its price was increased to Rs 90/- in June 2017. This gave a false impression that with the increase in price revenues will go up. Actually by creation of a new tier, Marlboro fell into second tier. As shown in the Table 1 above, the price was Rs 90/- which means revenue of Rs. 33.4/- per pack as compared to Rs. 68.72/- per pack, charged under two tiers system. This resulted in overall loss of almost Rs. 30 Billion in revenues for the national exchequer in 2017. Simultaneously, according to the statistics in 2017-18 the profits of Philip Morris (manufacturers of Marlboro) went up by 160% and Pakistan Tobacco increased by 105% as per their financial statements. Total cigarette production during 2017-18 was around 83 billion sticks, while in the break-up of market share multi-national companies traded 96 to 98 percent of the total market while the local industry share was between 2 to 4 percent. This also refutes the TI claims of 40% share of smuggled/counterfeits.

The tobacco taxation is closely related to the most desirable e-tracking system. In Pakistan, it will be first step at industrial level to gauge production in potentially tax evading sectors, where production is hidden and minimized to evade taxes at manufacturing level. The Request for Proposals (RfP) for tax stamps was first issued in 2007 by the FBR, and was intended to focus on sugar, beverages, cement, fertilizer and tobacco industries. This concept of this Track & Trace System encompasses semi-visible security features on the tax stamps. Such stamps will cost nothing to the government of Pakistan and the cost will be reimbursed through minor increase in price. These stamps will be installed at the manufacturing units and would be monitored remotely as well on-site. On the farming side of the tobacco crop the system needs to gauge the exact amount/extent of production that becomes usable. In case of tobacco this can best be monitored through Green Leaf Thresher (GLTs). There are total 10 GLTs in Pakistan and all 26 tobacco manufacturers buy from these GLTs. Four GLTs in Khyber Agency have yet not been regularized but will add to existing known GLTs after FATA’s merger in KPK. Such system is ideally suited for Pakistan to be installed at all production sites (GLTs, cigarettes, smokeless tobacco and ports of entry).
**Policy Recommendations**

1. The tobacco taxation system needs to be made simple and effective. A comprehensive taxation assessment monitoring and evaluations system (TAMES) needs to be developed and incorporated. This will ensure increase in tax revenues and decrease in consumption, decrease in illegal trade and curb counterfeit tobacco in the market.

2. FBR should initiate the Track & Trace System and tobacco product in every form (both smoking and non-smoking) bear a tax stamp. Such tax stamps need to be added to the tobacco bales at GLTs and to cigarette packs and non-smoking tobacco at the manufacturing sites, besides ports of entry for legally imported product.

3. The Third Tier from the existing tax bracket needs to be eliminated and all the brands need to be priced in 1st and 2nd tiers.

4. Placement of Tax Stamps on pack of cigarettes is another contentious issue and in this regards Pakistan's international treaty obligations (FCTC and its guidelines) must be kept in mind. The placing of stamps should be on the side of cigarette pack, and the space for pictorial and textual WARNING should at no cost be compromised.

5. Taxation policy must include same stamps at the port of entry to be purchased and placed by the importer. As recommended by the FBR, such tax stamps need to contain multiple semi-visible security features.

6. Need to include tax on imported e-cigarettes and smoking devices such as Juul etc. E-cigarette market in US alone is likely to reach $ 44 Billion by 2024. It would be naïve to think that such devices will not make it to low and middle income countries such as Pakistan.

7. Small tobacco manufacturers in Kashmir and other parts of the country should be brought under same tax regime. Any gaps left (such as tax exemption) would make the entire exercise futile and hard to implement.

8. The tobacco taxation policy should include robust implementation through multiple penalty brackets. Any smuggled or counterfeit product being manufactured, imported, or found in the market should be confiscated and those responsible should be fined an amount commensurate to the quantity recovered and the size of the business violating. Such penalties should ensure deterrence and rates should vary between shopkeepers, wholesalers and manufacturers.

**Conclusion**

**References**
