

Tobacco **Taxation** in Pakistan: Unravelling the Revenue Loss of **Rs 567b** to exchequer



**POLICY
BRIEF**

TOBACCO TAXATION IN PAKISTAN: UNRAVELLING THE REVENUE LOSS OF RS 567B TO EXCHEQUER

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ABSTRACT

Taxation has been one of the least attended MPOWER measures proposed by the World Health Organization (WHO). Like most of other low and middle-income countries, Pakistan has no proper tobacco taxation policy which is the cause of a weak tobacco taxation structure. Most of the taxes are imposed during the yearly budget, completely depending upon the will of the government in office.

Owing to the interference in the government policies in Pakistan, tax collection projections and expectations remain unmet. Foregoing this view, this study examines the Federal Board of Revenue data and finds that during the last decade an estimated loss of Rs 567 billion has been incurred to the national exchequer by the tobacco industry. This study stresses the need for developing a long-term tobacco taxation policy based on the global best practices, Article 6 of the WHO Framework Convention on Tobacco Control (FCTC), and guidelines to the article.

Keywords: Tobacco taxation, WHO, FCTC, Cigarettes sale

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1. INTRODUCTION

The World Health Organization (WHO) obligates the world governments to implement Article 6 of the Framework Convention on Tobacco Control (FCTC 2017) to enact price and tax reforms in order to lessen the tobacco smoking. High -income countries have effectively employed these measures to decrease tobacco consumption, but two decades post-FCTC adoption, this intervention is being ignored in various low and middle-income countries, including Pakistan (Masud et al. 2023).

Pakistan has no clear-cut strategy to use tobacco taxation and prices as a public health tool.

Federal Excise Duty (FED) remains the major tax levied on cigarettes in Pakistan, which encompasses: 1) a specific tax on inexpensive brands; 2) an ad valorem tax on premium brands, and 3) a combined specific and ad valorem tax on mid-range brands. In 2013, the ad valorem tax was replaced by a two-tier specific tax system based on retail prices (excluding GST). This two-tier system remained operational till 2016-17 with annual upward adjustments to the tax rates for both tiers.

In 2017, the federal government formulated a new three-tier excise duty structure for cigarettes sale. It included a new tier for less expensive brands. The tax percentage on this new tier was reduced by 50%, i.e. from Rs 1.5 per stick to Rs 0.8 per stick.

However, under the pretense of controlling illicit/illegal/smuggled tobacco market in Pakistan, a three-tiered tax structure led to profiteering by the tobacco companies. Through price manipulation at retail, the tobacco industry increased its profit-to-tax ratio. The study aims to unravel the circumstances leading up to this tax relief to tobacco industry and the consequential loss to the national exchequer. The study also makes certain recommendations to strengthen tobacco taxation in Pakistan.

2. DATA

This study uses secondary data from yearbooks published by the Federal Board of Revenue (FBR) , Senate Special Committee Report , and the Auditor General of Pakistan. A thorough analysis of the documents was conducted that will be discussed in the ensuing sections.

3. ANALYSIS & FINDINGS

The data extracted from the FBR yearbooks serves as a valuable resource in understanding the intricacies of the fiscal landscape and identifying areas where policy adjustments may be necessary to safeguard the economic well-being and revenue collection in the country.

a. Tobacco Industry Interference

Safeguarding tobacco tax policies from vested interests is imperative for the effective development, implementation, and enforcement of public health initiatives. FCTC Guidelines for Implementation of Article 6 mandates:

“The development, implementation, and enforcement of tobacco tax and price policies as part of public health policies should be protected from commercial and other vested interests of the tobacco industry, including tactics of using the issue of smuggling in hindering the implementation of tax and price policies, as required under Article 5.3 of the WHO FCTC and consistent with the guidelines for its implementation as well as from any other actual and potential conflicts of interests.”

Contrary to the guidelines, a situation unfolded in Pakistan where multinational companies persuaded the government to alter its taxation policy and introduced a third tier to combat illicit tobacco trade. A report, instead of showing exact figures (i.e. almost 9%), mentioned that the illicit/illegal/smuggled cigarette trade is over 40 %, which is highly exaggerated (Parveen 2019).

Similarly, a country brief of the World Bank (2019) reported that cases of several countries testified that the tobacco industry used exaggerated estimates of illicit trade to argue against tobacco tax increases. It noted that the changes in the excise rate on cigarettes boosted the sales. The size of the illicit sector is not as large as the one claimed by the tobacco companies. In Pakistan, the report says, the illicit cigarette sale is below 9% and tobacco industry carefully planned this decline of revenue (probably back in 2013) with the aim to reduce excise rate. It emphasizes three kind of actions by the industry: 1) forestalling – increasing the production or stock in anticipation of a tax increase; 2) price over shifting – increase the price of the cigarettes more than the tax increase; and 3) overestimating the illicit trade by altering public and policymakers’ perception.

The introduction of the third tier of taxation not only caused billions of rupees loss to the national exchequer, but also increased tobacco consumption and industry profits, simultaneously putting more burden on the health care system.

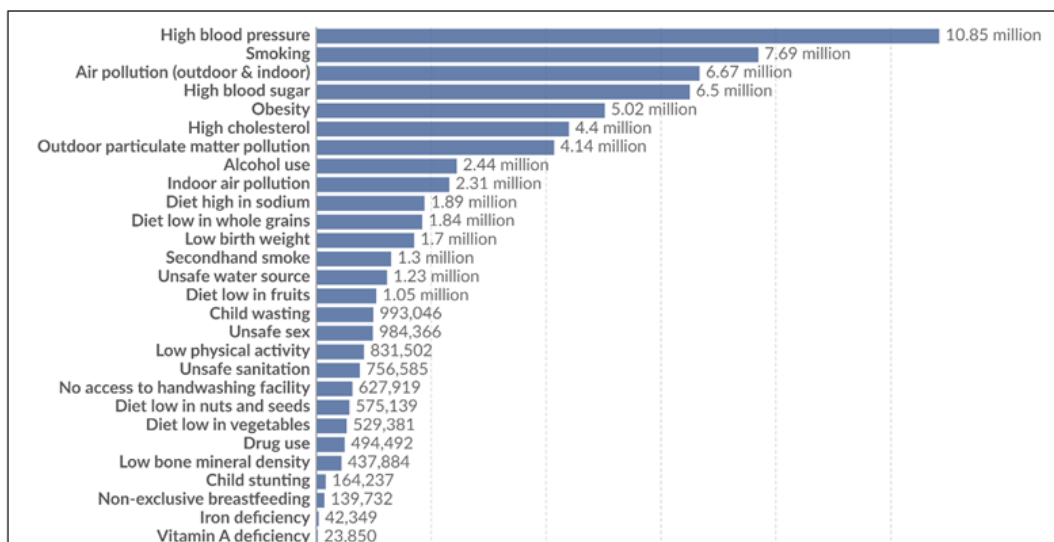
b. NAB Inquiry

In April 2018, the National Accountability Bureau (NAB) initiated an inquiry into tax savings worth Rs33 billion obtained by two global cigarette manufacturers in the aftermath of revision in the tax tier system (Ali, 2018b, Ali, 2018a, Hussain 2018). According to the NAB probe, these two manufacturers profited by moving high volume popular brands from top to the second or to the lowest category.

The Senate Special Committee on Tobacco directed the FBR to offer an explanation for the drop in tax collection from the tobacco business following the implementation of the third tier (Parveen 2019). In a report submitted to the special committee, the Auditor-General of Pakistan (AGP) countered the FBR's arguments regarding the benefits of instituting the third tier of the FED. The AGP observed that after the third tier was put into place, both Pakistan Tobacco Company and Philip Morris International showed an increase in their sales turnover, i.e. 31% and 33% respectively in the fiscal 2017–18 (ibid). Despite a massive increase in sales turnover of 32 % of both companies of Rs 143.7 billion in 2017-18 as compared to Rs 109.2 billion in 2016-17, the collection of FED in the same period remained at Rs 65.4 billion was 13 % less as compared to the previous year (ibid).

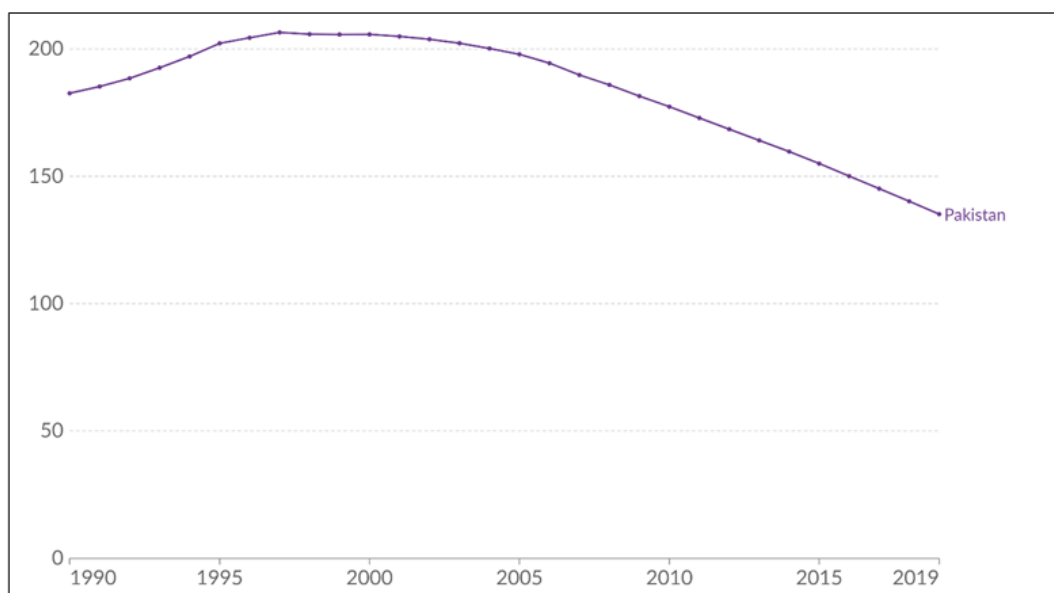
c. Public Health Implications

Pakistan ranks among the top 10 countries in tobacco consumption putting excessive strain on the already challenged health system. FBR's rationale behind introducing a lower tier (Tier-III) was to curtail the illicit tobacco trade, however, health care costs were not given due weightage while taking this decision. Currently, the health burden of Pakistan directly attributable to tobacco use is Rs 615.07 billion and total direct and indirect cost of cancer, cardiovascular and respiratory diseases amount to Rs. 437.76 billion, which is almost four times higher than the overall tax revenue from the tobacco industry (Nayab et al. 2021).



Graph 1: Global Death by Risk Factors (IHME, 2019)

Graph 1 above shows the risk factors causing global deaths. Smoking and Secondhand smoke are among the leading risk factors causing close to 8 million annual deaths.



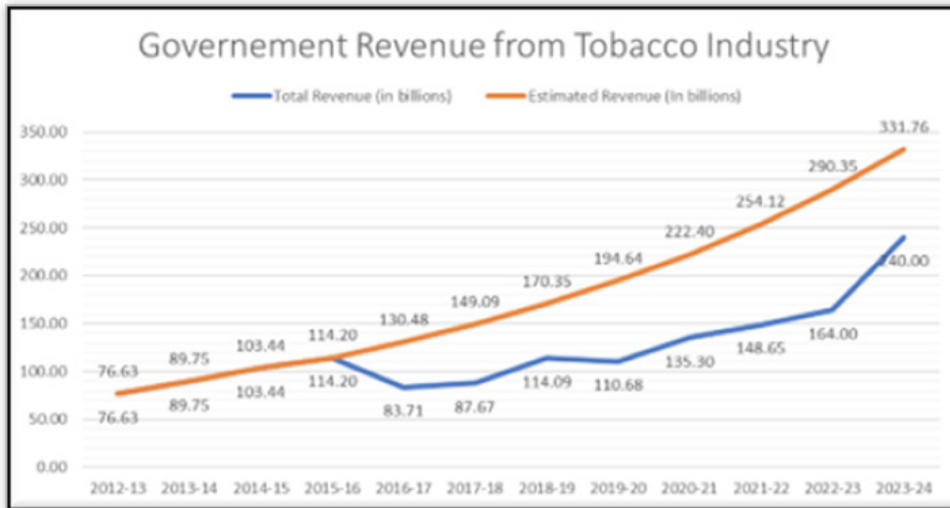
Graph 2: Deaths in Pakistan due to Smoking (IHME, 2019)

As evident from Graph 2 above, the number of deaths due to smoking in Pakistan is significant, and as noted by Hafeez et al. (2023) tobacco consumption is one of the leading causes of death in 2019. Similarly, the WHO estimates more than eight million deaths each year because of tobacco use. In 2019, the estimated number of deaths in Pakistan was recorded at 135.14 per 100,000 people.

There are around 31 million adults (aged 15 +) or about 19.7% of adults who use tobacco (Institute for Health Metrics and Evaluation [IHME] 2019). Owing to changes in the tax structure, cigarettes became more affordable as tobacco taxes witnessed a long period of stagnation, which resulted in added consumption and more pressure on the health care system. Raising excise tax on cigarettes by 30% would result in 200,000 fewer smokers and an increase of at least 25% in excise tax revenue (Social Policy and Decevelopment Centre [SPDC] 2022).

d. Analyzing the Revenue Loss

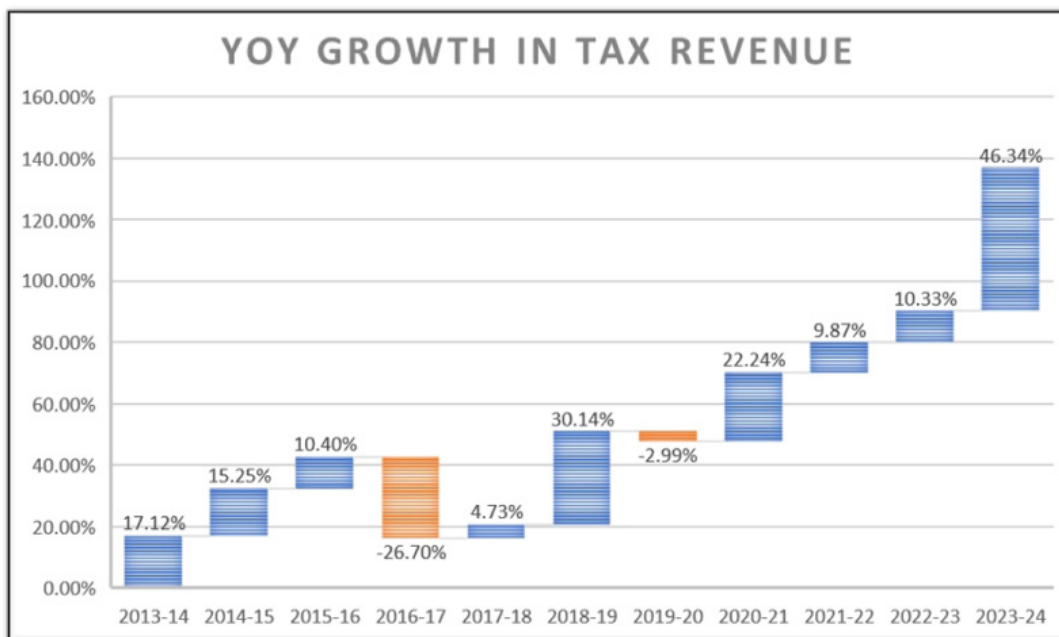
The fiscal year from 2012-13 to 2013-14 witnessed an increase in tax collection with the total revenue ascending from Rs 76.63 billion to Rs 89.75 billion.



Graph 3: Graph Developed by the Authors (Data from FBR, 2023)

This period exhibited a Year-over-Year (YoY) growth rate of 17.12% in revenue collection, signifying a substantial expansion in the financial inflows to the government. The next fiscal year, i.e. 2014-15 witnessed more than 15 % YoY growth taking the total revenue collection Rs 103.44 billion, meeting the target like the past year. In 2015-16, the government collected Rs 114.20 billion in revenue from the tobacco industry with over 10 % YoY growth, following the projections.

The fiscal year 2016-17 saw a significant dip with the total revenue dropping to 83.71 billion against



Graph 4: Graph Developed by the Authors ((Data from FBR, 2023)

an estimate of Rs 130.48 billion revenue based on a 14 % average growth rate of the past three years. Contrary to projections and estimates, the industry revenue showed a negative YoY growth of 26.70 %.

In fact, there was a slight recovery in 2017-18. The total revenue remained Rs 87.67 billion which is far below the estimated Rs 149.09 billion. However, after suffering one of the highest losses in terms of YoY growth (i.e. -26.7%), the revenue collection reflected a meager growth of 4.73 %. In FY 2018-19, the revenue from the tobacco industry was estimated to be Rs 170.35 billion but the actual collection was Rs 114.09 billion. The fiscal year saw the highest or over 30 % YoY growth. According to the FBR data, a revenue of Rs 110.68 billion was collected from the tobacco industry in FY 2019-20 against the target of Rs 194 billion, but the actual collection witnessed another YoY dip, of -2.99 %. In the next fiscal year, i.e. 2020-21, the FBR collected Rs 135.30 billion against the estimated Rs 222.40 billion with a more than 22% YoY growth. Similarly, the government collected Rs 148.65 billion in FY 2021-22 against an estimated Rs 254.12 billion. YoY growth of 9.8 % was reported.

In FY 2022-23, the estimate for revenue in terms of tax collection from the tobacco industry was at Rs 290.35 billion, but once again the actual amount collected was Rs 164 billion with 10.33 % YoY growth. The data shows that the government estimated Rs 1795.46 billion collection from 2013 to 2023 (Federal Board of Revenue [FBR] 2023) whereas the actual revenue was Rs 1228.12 billion. In short, the government incurred a loss of Rs 567.34 billion in revenue during this period due to the influence of the tobacco industry.

4. POLICY RECOMMENDATIONS

- There is a need to consider fiscal policies carefully while imposing taxes on different sectors and how these policies may affect revenue collection.
- There is an urgent need to develop long-term tobacco taxation policy in Pakistan. The policy needs to be based on Article 6 of FCTC (Price and tax measures to reduce the demand for tobacco), WHO's Manual on Tax Administration – 2021, Ministry of Health's National Tobacco Control Strategy-2023, 12th Five Years Plan 2018-23, National Health Vision 2016-25, and Action Plan NHR&C 2019-23.
- A uniform and simple tobacco taxation system must incorporate an annual increase in the excise rates by at least 30% to ensure the reduction in tobacco consumption and growth in tobacco revenue.
- Tobacco industry interference must be reduced in policy formulation and pricing strategies must be stringently monitored to avoid use of forestalling, differential shifting, and shrinkflation etc. (Sheikh et al. 2021; Iftikhar and Naqvi 2022).
- Tobacco industry efforts to infringe upon the track and trace system must be curtailed and monitored through excessive surveillance.
- Regular evidence collection must continue to gather data related to smoking prevalence, tobacco consumption, illicit/smuggled tobacco, and tobacco pricing.

5. CONCLUSION

This study highlights the intricate dynamics of Pakistan's tobacco industry and its significant impact on the nation's fiscal landscape. The examination of FBR data and associated factors reveals a staggering Rs 567 billion revenue loss over the past decade, underscoring the critical need for tobacco taxation policy development and tobacco revenue policy reforms.

The influence of multinational companies, coupled with the introduction of a three-tier excise duty structure, has raised concerns about tax evasion and its adverse effects on public health. As we navigate these findings, it becomes evident that safeguarding revenue streams while prioritizing public health necessitates a careful reevaluation of tobacco tax policies. The insights gleaned from this study call for a proactive approach to address these challenges, fostering a balance between economic interests and the well-being of the population. Moving forward, policy adjustments must be considered to ensure sustainable revenue generation and mitigate the negative consequences associated with public health.

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