



## Tobacco Prices & Public Health

*Of all the concerns, there is one – taxation – that alarms us the most. While marketing restrictions and public and passive smoking do depress volume, in our experience taxation depresses it much more severely. Our concern for taxation is, therefore, central to our thinking about smoking and health. It has historically been the area to which we have devoted most resources and for the foreseeable future, I think things will stay that way almost everywhere.*

(1985 Philip Morris International memo<sup>1</sup>)

Raising the price of tobacco is one of the simplest and most effective methods for rapidly and significantly reducing tobacco use, especially in developing countries and among young people. Benefits include:

### Reduction of youth tobacco use:

Children are more sensitive to changes in cigarette prices because they have less disposable income than adults and are less addicted to nicotine. In Canada, when tobacco prices were raised dramatically in the 1980s and early 1990s, youth consumption plummeted by 60%, while overall consumption dropped 38%.<sup>2</sup>

**Greater reductions in smoking rates in developing countries:** On average, while increasing the price of a pack of cigarettes by a modest 10% in high-income countries would reduce demand by about 4%, in low and middle-income countries -- where lower incomes tend to make people more responsive to price changes -- demand would fall by around 8%.

### Gains in government revenue:

According to the World Bank, increasing the price of a pack of cigarettes by a modest 10% would actually increase government revenues by around 7%. This is because cigarette consumption will fall by a smaller percentage than the rise in price. Furthermore, some of the money saved by quitters will be spent on other goods and services that are also taxed.<sup>3</sup>

**Reduction of costs to society:** By lowering consumption, increased tobacco taxes can also reduce current and future costs to society such as increased health care costs, lost productivity, fires and environmental degradation.

## Considerations in Establishing Effective Tobacco Price Policies

### Large versus small tobacco price increases:

The health and economic benefits of a tobacco price increase rise in proportion to the size of the increase. It is also important that tobacco prices be increased regularly or indexed to inflation to ensure that tobacco does not become more affordable due to inflation or rising disposable incomes.<sup>4</sup> The World Bank suggests that tobacco taxes represent between two-thirds and four-fifths of the total retail cost.<sup>5</sup>

### Setting aside tobacco tax revenue for tobacco control and other politically popular programs:

The power and popularity of a tobacco tax increase can be dramatically enhanced by using the revenue to fund tobacco control and other popular programs. In Australia and other nations, this

approach has been used successfully to create health promotion and health sponsorship funds that have replaced tobacco industry funding of sports and the arts, as well as aggressive mass media, public education and smoking cessation programs.<sup>6</sup>

### “Specific” versus “ad valorem”

**taxes:** Specific taxes impose a set amount of tax per unit of tobacco product while “ad valorem” taxes impose a tax as a percentage of the price. Specific taxes have the greatest effect on the least expensive brands, and thus may have a greater impact on consumption. Yet a significant disadvantage is that, unless they are indexed to inflation, they can lose their impact in a few years. Ad valorem taxes rise with inflation, and thus are less likely to lose value over time. However, because they are based on the sales price, ad valorem taxes can lead the industry to charge a lower base price, thus negating the intent of the tax. Many countries, including most of the European Union nations, have imposed both kinds of taxes at once, reaping the benefits of each.

### Imposing equivalent taxes on all tobacco products to avoid substitution:

Unless equivalent taxes are placed on all tobacco products, users may simply substitute one form of tobacco addiction for another. For this reason, WHO suggests that cigarettes, bidis, roll-your-own tobacco, oral tobacco, cigars and pipe tobacco all should be taxed at equivalent rates.<sup>7</sup>



## Tobacco Industry Resistance to Price Increases

Because tobacco companies recognize that tobacco price increases are one of the most serious threats to the growth of their business, they make resisting such increases a top priority in their lobbying efforts. Typically, the industry will organize, fund, and rely heavily upon allied organizations representing advertisers, retailers, anti-tax advocates and others. Arguments put forward by the industry include:

**"Price Increase Will Lead to Increased Smuggling":** Tobacco companies frequently claim that a significant price increase will cause massive cigarette smuggling from low price countries to high tax countries. Yet out of thousands of tobacco tax increases successfully implemented in the world, there are only a few cases in which a smuggling problem developed that was large enough to cause a government to revoke the increase. While the industry often cites the case of Canada, which experienced a surge of smuggling in the early 1990s, it turns out that the industry was heavily involved in the smuggling operations.<sup>8</sup> Rather than foregoing tax increases, governments should crack down on such criminal activity.

**"Tax Increases Will Lead to Unemployment":** Tobacco companies

argue that large job losses will occur if tobacco prices are increased. Yet independent economists who have studied the industry's claims have concluded that they greatly exaggerate the potential job losses.<sup>9</sup> In any event, research suggests that the total number of jobs in most economies will rise in response to falling smoking rates, as money spent on tobacco will be redirected to less harmful sectors of the economy.<sup>10</sup> In many developing countries, the economic gains could be magnified as profits that are now exported to the home countries of multinational tobacco companies are redirected into the domestic economy.

**"Tobacco taxes harm the least well-off":** Tobacco companies argue that prices should not be increased because to do so will harm low-income people. Research shows, however, that low-income populations are most harmed by smoking itself, which imposes massive costs in terms of morbidity, mortality, health care expenses and lost wages. Low-income people are also the primary beneficiaries of higher tobacco prices because they are much more likely to quit, cut back or avoid tobacco addiction entirely in response to a price increase.<sup>11</sup> The benefit to poor people is even greater if the revenue from a tax increase is used to fund programs that benefit the least well off.

## Conclusion

Raising tobacco prices through tax increases can be one of the most powerful weapons in the fight to control tobacco-related disease and death. It can provide dramatic public health benefits, raise substantial new government revenue, fund important health programs and generate a surprising level of public and political support.

## Resources on the World Wide Web

World Bank, *Curbing the Epidemic: Governments and the Economics of Tobacco Control*, 1999  
<http://www1.worldbank.org/tobacco/reports.htm>

Frank Chaloupka and Ken Warner, "The Economics of Smoking," in *The Handbook of Health Economics*, Joseph Newhouse and Anthony Cuyler, eds. (New York: Elsevier/North-Holland, 2000)  
<http://www.uic.edu/~fjc/Presentations/Papers/handfinal.pdf>

Frank J. Chaloupka, Teh-wei Hu, Kenneth E. Warner, Rowena van der Merwe and Ayda Yurekli "The Taxation of Tobacco Products" in *Tobacco Control in Developing Countries*, edited by Prabhat Jha and Frank J. Chaloupka (Oxford: Oxford University Press, 2000)  
<http://www.uic.edu/~fjc/Presentations/Papers/tax.pdf>

<sup>1</sup>The Perspective of Philip Morris International on Smoking and Health Issues (Text of the discussion document used at the meeting of top management), 29 March 1985 (<http://www.pmdocs.com/getallimg.asp?DOCID=2023268329/8337>), Appendix 1: "General Comments on Smoking and Health," <http://www.pmdocs.com/getallimg.asp?DOCID=2023268339>

<sup>2</sup>David Sweanor and L.R. Martial, *The Smuggling of Tobacco Products: Lessons from Canada*. (Ottawa, Canada: Non-Smokers' Rights Association, 1994).

<sup>3</sup>World Bank, *Curbing the Epidemic: Governments and the Economics of Tobacco Control*, 1999; <http://www1.worldbank.org/tobacco/reports.htm>

<sup>4</sup>Frank J. Chaloupka, "The Impact of Proposed Cigarette Price Increases," Health Science Analysis Project, Advocacy Institute, April 1998; <http://www.scarcnet.org/hsap/tax.htm>

<sup>5</sup>World Bank, *Curbing the Epidemic: Governments and the Economics of Tobacco Control*, 1999; <http://www1.worldbank.org/tobacco/reports.htm>

<sup>6</sup>World Health Organization, *Guidelines for Controlling and Monitoring The Tobacco Epidemic*, 1998; [http://www.who.int/substance\\_abuse/docs/guide/](http://www.who.int/substance_abuse/docs/guide/); T. Hu., X. Xu, T. Keeler, "Earmarked Tobacco Taxes," *The Economics of Tobacco Control: Towards an Optimal Policy Mix*, Abedian, et al., eds. (Cape Town: Applied Fiscal Research Center, 1998). See, for example, the website of the Victorian Health Promotion Foundation [www.vichealth.vic.gov.au/about/index.htm](http://www.vichealth.vic.gov.au/about/index.htm)

<sup>7</sup>World Health Organization, *Guidelines for Controlling and Monitoring The Tobacco Epidemic*, 1998; [http://www.who.int/substance\\_abuse/docs/guide/](http://www.who.int/substance_abuse/docs/guide/)

<sup>8</sup>Non-Smokers' Rights Association, "Imperial Tobacco, Imasco, and the Smuggling of Cigarettes into Canada," 25th April 2000 (<http://www.nsr-aadnf.ca/english/imptob/Imperial%20Tobacco%20smuggling.html>)

<sup>9</sup>Arthur Andersen Economic Consulting, "Tobacco Industry Employment: A Review of the Price Waterhouse Economic Impact Report and Tobacco Institute Estimates of Economic Losses from Increasing the Federal Excise Tax," October 1993.

<sup>10</sup>Ken Warner, G.A. Fulton and D.R. Grimes, "Employment Implications of Declining Tobacco Product Sales for the Regional Economies of the United States," *Journal of the American Medical Association*, Vol. 275 No. 16, April 1996.

<sup>11</sup>U.S. Centers for Disease Control, "Responses to Increases in Cigarette Prices by Race/Ethnicity, Income and Age Groups - United States, 1976-1993," *Mortality and Morbidity Weekly Report*, Vol. 47, 1998.