Undermining Global Best Practice in Tobacco Taxation in the ASEAN Region

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The Southeast Asia Tobacco Control Alliance (SEATCA) is a regional multi-sectoral, non-profit, non-governmental alliance that supports ASEAN Member States in developing and implementing effective, evidence-based tobacco control policies in line with the World Health Organization Framework Convention on Tobacco Control (WHO FCTC). SEATCA works closely with governments, non-government organizations (NGOs), development agencies, and the academe to advance tobacco control in the ASEAN region by facilitating increased participation and cooperation among advocates, organizing regional forums for sharing best practices and lessons learned, and acting as a regional leader to tackle urgent priority issues affecting the region.

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The International Trade and Investment Center (ITIC) launched its ASEAN Excise Tax Reform: A Resource Manual (hereafter “the Manual”) during the 12th annual Asia-Pacific Tax Forum, organized by ITIC and held on 5-7 May 2015 in New Delhi, India. According to ITIC, the Forum was attended by representatives of Australia, Bhutan, Cambodia, Chinese Taipei, France, India, Indonesia, Hong Kong, Lao PDR, Myanmar, the Netherlands, Pakistan, the Philippines, Singapore, Switzerland, Tajikistan, Thailand, the United Arab Emirates, the United Kingdom, the United States, and Vietnam.

Following the launch, the ITIC has continued to disseminate the Manual widely within the ASEAN region. For example, on 22 September ITIC’s President Daniel Witt and Senior Advisor Wayne Barford launched the Indonesian version of the Manual at the IPMI International Business School in Jakarta, in an event attended by representatives from the Ministry of Finance, the President’s Office, and the Parliamentary Budget and Economics Committee. This was closely followed by a release of the Manual in the Philippines on 28-29 September 2015, where the ITIC President and the ITIC Senior Advisor held a series of meetings to present the Manual to key stakeholders including members of the Parliament (e.g. Rep. Romero Quimbo, the Chair of the House Ways and Means Committee; Sen. Sonny Angara, the Chair of the Senate Ways and Means Committee), the academic community (the School of Economics at the University of the Philippines), and business representatives (the Philippine Chamber of Commerce and Industry). Copies of the Manual were also presented to Senate President Frank Drilon and other senators.

Given that this heavily promoted and widely distributed Manual contains a section on tobacco products, the Southeast Asia Tobacco Control Alliance (SEATCA) commissioned an academic review of the Manual to understand how its recommendations overlap with or differ from the governments’ legal obligations under the World Health organization (WHO) Framework Convention on Tobacco Control (FCTC), and particularly the Guidelines for implementation of Article 6 of the WHO FCTC (price and tax measures to reduce the demand for tobacco), which were unanimously adopted by the Conference of the Parties to the WHO FCTC in 2014. Therefore, this review focuses only on tobacco taxation and does not consider recommendations with respect to taxing other products included in the Manual and their implication for public health or the overall economy.

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Comments on the general section (Chapter 1) of the Manual

The Manual focuses on a fairly narrow area of tax policy, excise taxation. Since excise tax policy cannot work in isolation from overall tax policy, the Manual cannot be used for a comprehensive evaluation of any tax system. Instead, this document comes across as a tool for promoting special interests rather than a tool designed to help governments.

On the surface, the Manual and the WHO FCTC Article 6 Guidelines (hereafter “the Guidelines”) seem to be aligned on several issues. However, the main principles/views that the Manual promotes often contradict its analysis and its recommendations.

The Manual’s premise is that the ASEAN excise tax policy should facilitate the improvement of the investment environment within the ASEAN Economic Community (AEC). Such an environment would certainly involve a healthy labor force. If the governments were to follow the Manual’s advice, the attractiveness of investment in the region would be jeopardized by high rates of tobacco use.

Both the Manual and the Guidelines acknowledge that governments have a sovereign right to determine and establish their taxation policies. Most economists would also agree with the Manual’s premise that excise tax policies should help facilitate efficient allocation of resources. For this to occur, the excise tax policy should correct for externalities associated with tobacco use. Following the Manual’s recommendations with respect to tobacco products will guarantee exactly the opposite – inefficient allocation of resources due to the failure to correct for externalities associated with smoking.

Tax harmonization helped the new and the less developed EU member states to adopt a pro-health tobacco tax policy that controlled smoking rates while generating much needed tax revenue.

The issue of tax harmonization is one of the main topics of the Manual, which deals with it rather schizophrenically. On one hand, the Manual stresses several times that the creation of the AEC does not mean that countries should move in the direction of tax harmonization across ASEAN and that there is no need to align the excise tax levels. On the other hand, the Manual’s analysis and examples support tax harmonization. For example, p. 64 of the Manual states that tax and price differences across countries motivate illicit tobacco trade, which undermines the governments’ revenue collection.

The Manual’s opposition to tax harmonization is surprising given the success of such an approach in the European Union (EU). The tax increases (labeled as “tax shocks” by the Manual) in the Eastern part of the EU after adopting the harmonized EU tobacco tax directives did not destabilize the markets nor government revenues, but instead helped the
new and the less developed EU member states to adopt a pro-health tobacco tax policy\(^5\) that controlled smoking rates while generating much needed tax revenue.\(^6\)

The Manual calls for a balanced tax policy that avoids sudden, sharp increases in excise tax rates, as these allegedly could trigger the emergence and rapid growth of illicit trade. This recommendation ignores the fact that many tobacco tax policies, which successfully increase revenues while reducing consumption, involve precisely these types of sharp tax increases,\(^7\)\(^8\) and that in many cases these tax increases have no impact on the size of illicit trade.\(^8\) A tobacco tax “road map” that the Manual promotes is one of the well-known tobacco industry strategies that allows the industry to lock in pro-industry tax rates and tax systems while keeping the demand for tobacco products high.\(^9\)
Comments on Chapter 4 of the Manual that deals with tobacco products

The Manual ignores countries’ commitments to WHO FCTC Article 6 Guidelines.
Chapter 4 of the Manual provides recommendations on tobacco excise taxation but ignores the fact that 180 States Parties (including all but one ASEAN countries, Indonesia) are obligated to implement WHO FCTC Article 6 (price and tax measures to reduce the demand for tobacco) as clarified in the Article 6 Guidelines.

The Manual and the Article 6 Guidelines agree only on few issues.
There are only few issues on which the Guidelines and the Manual are in an agreement when it comes to taxing tobacco. They both favor specific over ad valorem tax and promote single tier over multi-tier tax structures. They both view the ad valorem system as particularly problematic when prices other then the retail sales price are used as a tax base.

Both documents shy away from using the tax share in price (or tax burden as a percentage of price) as an appropriate way to assess the tax burden, the excise tax yield, the impact of tax on retail price and/or the affordability of cigarettes.

The Manual presents the issue of affordability as a static concept, but bases its recommendations on a dynamic concept, for which it has no support.
Where the Manual differs from the Guidelines is on the issue of affordability. First, the Manual presents affordability as a static concept, calculating affordability at one point in time. The Guidelines use affordability as a dynamic concept in which the trend in affordability and tobacco taxes in a country is evaluated over time. Research clearly demonstrates that it is the change in price/affordability that changes behavior, including smoking.10

Indonesia serves as an example of a country with the highest taxes in terms of affordability. This, according to the Manual, drives illicit trade. Yet another ITIC documents claims that Indonesia has the lowest penetration of illicit tobacco products.
Despite the fact that the Manual presents affordability as a static concept, it uses a dynamic concept of affordability when it claims that substantial tax increases in low income member states would make cigarettes unaffordable and therefore encourage a sharp increase in illicit trade. Since the Manual presents only static data at one point in time, it does not provide any evidence supporting this claim. Interestingly, the Manual’s data show that excise taxes in terms of affordability measured by the relative income price are highest in Indonesia, yet according to another ITIC report11 Indonesia has the lowest penetration of the illicit cigarettes among all ASEAN countries in 2013.

Brunei is left out from the key analysis.
The Manual reports that Brunei has the highest penetration of illicit trade and claims that unaffordability of cigarettes drives illicit trade, yet Brunei has been left out of all affordability analysis in the Manual.
The warning against substantial tobacco tax increases is not warranted given experience in the ASEAN region.

The Manual cautions that if tax rates rise too far (without defining what “too far” means), there will be a large drop in duty-paid consumption due to consumers’ switching to lower-taxed or illicit products, which will cause tax revenues to decline. There are numerous examples in the ASEAN region that demonstrate that even substantial increases of excise taxes such as the recent increase in the Philippines led to much higher than anticipated tax revenue. Similar experiences have been recorded in Thailand and Singapore, for example.

The Manual uses Singapore to demonstrate the application of the Laffer curve theory, which is intended to help with setting up optimal tax from the revenue perspective. However, the case study misses the point, because the decline in tax revenue was not due to “excessive” taxation, but due to an increase in illicit cigarettes on the Singaporean market. The theory of the Laffer curve does not address the issue of illicit trade. Once Singapore implemented appropriate enforcement measures, the illicit market diminished, and tax revenue began to increase again. Thus, Singapore cannot be used as an example of a country that reached the top of the Laffer curve. On the contrary, Singapore serves as an example of how to respond to the illicit cigarette market – by enforcement and other measures reducing illicit trade, as outlined in the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products, and not by reducing tobacco taxes. Singapore increased its cigarette excise tax again in February 2014, a fact that the Manual omits because it would not fit its story about “how a government learned not to increase taxes any more”.

The affordability of cigarettes is driven not only by tobacco taxes, but also by the industry prices.

The Manual asserts that “the countries in ASEAN with relatively low tax rates are often those which have the least affordable cigarettes”, but forgets to mention that affordability depends not only on taxes, but also on the prices set by the industry. For example, according to the Manual cigarettes are least affordable in Myanmar, but the affordability of the excise taxes on these cigarettes are only in the middle of the ASEAN distribution, making these taxes the 6th most affordable in the region. This means that it is not the tax, but the industry price/profit that makes cigarettes in Myanmar unaffordable.

A tobacco tax roadmap developed in collaboration with the tobacco industry is a dangerous proposition for both tax revenue and public health.

On the surface, the Manual and the Guidelines seem to have a similar view on the development of a plan for tobacco tax increases over time. The fundamental difference between the Manual and the Guidelines is the goal of these plans. The Manual focuses on tax revenue and market stability for the industry (i.e. a focus on the industry’s profit), while the Guidelines’ goal is to reduce affordability of tobacco products over time in order to lower their consumption while also achieving tax revenue targets (i.e. a focus on public benefit).

Research has established that higher tobacco taxes will lead to higher tobacco tax revenue, and even more so if the tax increase is a surprise to the industry, because it does not allow the industry to develop ways to avoid/evade taxes.
The “road map” section of the Manual also points to another of its inconsistencies: the Manual praises the Philippines for its medium-term tax reform plan, but in another section, the Philippines is criticized for a significant tax increase that according to the Manual resulted in a sharp increase in illicit trade.

The Manual showcases the 2007 Indonesian Ministry of Industry’s Roadmap of the Tobacco Industry\(^\text{16}\) as an important policy document shaping the government’s excise tax policy. Public health professionals condemned this pro-tobacco industry roadmap for failing to take the government’s health objectives into account while also inflating the tobacco industry contribution to employment in the country.\(^\text{17}\) Despite that, the Manual applauds the roadmap and fails to mention the inability of the Indonesian government to reduce its multiple tax tiers, a measure that is recommended by both the Manual and the Article 6 Guidelines.

The updated tobacco tax roadmap published in August 2015 by the Indonesian Ministry of Industry\(^\text{18}\) deviates from the 2007 plan by doubling cigarette production targets from the original annual production of 260 billion sticks during the period 2015-2025 to 524 billion sticks planned for 2020. This is in sharp contrast to the previously announced priorities of the Indonesian government that were supposed to be dominated by health objectives in the period 2015-2020.

The Manual’s very strong opposition to tobacco tax earmarking is in sharp contrast with the Article 6 Guidelines recommendations.

The Manual devotes a special section to opposing tobacco tax earmarking, paraphrasing arguments of the ITIC/Oxford Economics 2013 paper.\(^\text{19}\) The Manual’s position on tobacco tax earmarking stands in sharp contrast to the Article 6 Guidelines agreed upon by 180 States Parties to the WHO FCTC. The Guidelines recommend that Parties consider, in accordance with national law, dedicating revenues to tobacco-control programs such as those covering awareness raising, health promotion and disease prevention, cessation services, economically viable alternative activities, and financing of appropriate structures for tobacco control.

The Manual falsely claims that the industry’s system supposedly designed to deal with illicit trade is compliant with the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products.

The Manual falsely claims that the tobacco industry system, Codentify, complies with the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products. A study commissioned by the WHO FCTC Secretariat points out that Codentify does not meet all the Protocol requirements, particularly the requirement that the tracking and tracing systems be controlled by the Parties to the Protocol.\(^\text{15}\)
Can the quality of the advice in the Manual be trusted?

In its analysis of tobacco taxation, the Manual relies on data from the tobacco industry that clearly has a vested interest in keeping tobacco taxes low. Its estimates of illicit trade and the associated revenue losses are based on another ITIC report that has been discredited by an academic review due to its methodological weakness, the use of unreliable data, biased conclusions, and abundance of mistakes and errors.\

Judging by the quality of other ITIC reports in collaboration with the Oxford Economics, and their support of the tobacco industry vested interests, governments should be wary of the recommendations in this Manual.

Discussion

The major weakness is the section on affordability of tobacco products that employs a static view of affordability to obscure the fact that cigarettes have become more affordable in many ASEAN countries.

SEATCA recognizes the importance of excise tax to government budgets and view excise tax as a tool to achieve economic and social objectives. Where SEATCA and the Manual differ is in the way to achieve these objectives. SEATCA believes that better health of the population as result of higher excise taxes on tobacco (and alcohol) will lead to better labor productivity, speedier economic development and to more happiness/less suffering in the region. The healthier and happier population of the region will have the energy to drive the economic performance of the AEC. Currently tobacco is responsible for more than 500,000 deaths annually in the ASEAN region. Tobacco related deaths result in loss of productivity and countries have yet to put a price tag on this loss.

The Article 6 Guidelines of the WHO FCTC on tobacco taxation clearly state that tax policies are covered the general obligation set out in WHO FCTC Article 5.3. The ITIC is an organization funded and steered by the tobacco industry. Indeed four of the major transnational tobacco companies (PMI, BAT, JTI, and ITG) are listed as sponsors and three of them are listed as represented on the Board of Directors of ITIC. ITIC has a long history of activities on behalf of the tobacco industry. While ITIC underplays its association with the tobacco industry by stating it is being “supported by more than 100 corporate sponsors”, the Manual uses estimates of tobacco illicit trade, which have been generated thanks to funding from Philip Morris International.
Recommendations

1. Governments should familiarize themselves with and follow their obligations under the WHO Framework Convention on Tobacco Control (FCTC), and particularly Article 6 and Article 5.3 Guidelines of the WHO FCTC.

2. Governments should be wary of the recommendations in this ITIC’s Excise Tax Reform Manual.

3. Governments should establish coherent long-term policies on their tobacco taxation structure and monitor on a regular basis including targets for their tax rates, in order to achieve their public health and fiscal objectives within a certain period of time.

4. Tax rates should be monitored, increased, or adjusted on a regular basis, potentially annually, taking into account inflation and income growth developments in order to reduce consumption of tobacco products.

5. WHO urges all countries to follow a non-engagement policy with ITIC.²⁵

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¹ WHO FCTC Article 5.3: “In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.”

References


