The background of the entire page is a dark, atmospheric image of white tobacco smoke rising and swirling. A large, semi-transparent red oval is centered on the page, containing the title text.

# **Tobacco Taxation in Pakistan**



**TheNetwork**  
for Consumer Protection

## Overview

Pakistan is headed towards a darkening tobacco epidemic era shaped up by 24 million adults aged 15 or above using tobacco. As indicated by statistics this is one of the highest prevalence of tobacco use in the world. With 50% of our population contributing to our youth, the shoddier part of the picture is the rise of pro smoking trends in younger populations who have not yet attained adulthood, a malignancy spreading out to children 10 years of age or even younger. Recognizing trends from developing and developed nations which have managed to curtail the deadly tobacco epidemics it is beyond doubt that increased taxation on tobacco products would lead to hyper inflation in their prices taking them out of the buying power of people, especially children. Raising tobacco taxes, as an effective tobacco control measure is relatively novel to Pakistan, therefore limited numbers of studies have been conducted to assess its needs and impacts. The Framework Convention on Tobacco Control (FCTC) is the first ever international treaty negotiated under the auspices of the World Health Organization to which Pakistan is a signatory since 2005 with an international obligation for its fulfillment within five years of ratification<sup>1</sup>. Article 6 of the FCTC requires appropriate price and tax measures to be adopted to reduce the consumption of tobacco products. Pakistan is faced with serious challenges in fulfilling its commitments to FCTC resulting from a backlash from the powerful and politically well positioned tobacco industry whenever steps towards effective tobacco control measures are taken. In order to overcome these obstacles for protecting our citizens especially youth from tobacco, it is crucial that the government takes a strong stance against the tobacco industry to introduce pro tobacco control regulations with austere enforcement. Existing effective evidences and new researches have been incorporated in this report to logically validate the argument that effective increase in taxation would invariably lead to decreased cigarette consumption and production but increased tax revenues. Cigarette excise taxes in Pakistan account for 57.5% of the retail price, which is far below than the level recommended by FCTC article 6, i.e. 70% of the retail price. Hence raised tobacco taxes would aid in fulfilling international commitments to FCTC and also act a sturdy repellent against the growing trends of tobacco products use.

## Health and Economic Consequences of Tobacco

### Health and Economic Consequences of Tobacco

Tobacco use kills nearly six million people worldwide each year. According to the World Health Organization (WHO) estimates, globally, there were 100 million premature deaths due to tobacco in the 20<sup>th</sup> century. If current trends continue, this number could rise to more than 1 billion preventable deaths in the 21<sup>st</sup> century<sup>2</sup>.

In Pakistan the high prevalence of tobacco use kills more than 110,000 people each year which is approximately 300 deaths every day. During the time frame from 2003 till 2009 cigarette consumption rates were observed to have grossly increased by up to 30%.

Tobacco usage can have grave and life threatening consequences as every part of the body is exposed to its hazards. Various types of cancers, cardiovascular diseases and respiratory problems are often seen in cigarette

<sup>1</sup> .WHO (2015) [http://www.who.int/fctc/signatories\\_parties/en/](http://www.who.int/fctc/signatories_parties/en/). Viewed on March 24, 2016.

<sup>2</sup> The MPOWER package, warning about the dangers of tobacco. Geneva: WHO; 2011. WHO Report on The Global Tobacco Epidemic.

smokers. Second hand smoke from cigarettes also affects the health of non-smokers particularly pregnant women, infants and children<sup>3</sup>.

Approximately 5000 people are admitted to hospitals every day in Pakistan due to tobacco-related illnesses<sup>4</sup>. No studies have estimated the economic costs of tobacco use in Pakistan though in India, the estimated cost of tobacco related diseases for the persons aged 35-69 was calculated as \$ 22.4 billion in 2011<sup>5</sup>. In Pakistan majority of the health costs are transferred to people translating into out of pocket spending instead of the government. Health expenditures from public sources were seen to be 1.16% whereas out of pocket accounts contributed to 1.73% of the GDP in 2005<sup>6</sup>. In 2014, the total health expenditure was 2.6% of the GDP<sup>7</sup>. According to the World Bank, the government's spending on health was only 0.9% of the GDP, ranking the country as lowest in South Asia spending on health compared to other similar countries such as India which spends 1.4% and Sri Lanka 2.0% of its GDP<sup>8</sup>. The State Bank Statistical Bulletin Report of Pakistan revealed that more than 62 billion cigarette sticks were consumed during the fiscal year (FY) 2015<sup>9</sup>. In 2013 alone, Pakistanis spent PKR-250 billion on buying cigarettes<sup>10</sup>. This scenario depicts that with the growing trends of tobacco use among the population due to easily availability and access to tobacco products and limited access to free health care services our country could be headed towards a severe tobacco epidemic.

## Tobacco Taxation

Increased tax on Tobacco products has a directly proportional relationship with its end price. This is widely considered as the single most effective tool for reducing tobacco use and health care costs which is an important component of FCTC. Pakistan tax system constitutes of different types of taxes such as excise tax, sales tax and import duty on cigarettes. Excise is the most efficient tax to which can be used to raise price of the cigarettes. Pakistan's tax structure on cigarettes is relatively complex as compared to other countries. In 2013-14, FBR removed the ad-valorem component also reducing the number of tax tiers from 3 to 2 tiers<sup>11</sup>. Currently Pakistan has two price tier system on locally produced cigarettes with a larger price differential of the products falling in either of the tiers. This system provides an opportunity to smokers to switch between brands which are more pocket friendly instead of going tobacco free.

Pricing of cigarettes is an essential marketing pillar used by the industry to avoid taxation. Lower price, low tax coupled with a 2 layered tier system have made cigarette prices lowest in Pakistan among South East Asian region. Recent study conducted by IMF revealed that the increase of one rupee tax on Cigarette leads to only 0.8 paisa increase in retail price<sup>12</sup>. Random evidence from the past show that less increases of taxes proved ineffective in

<sup>3</sup> Burki et al (2009) tobacco curbing its use. Available at <http://www.sjbipp.org/publications/PR/projectreport/PR-03-08.pdf>.

<sup>4</sup> Smoky truth (2015) *TheNetwork for Consumer Protection*

<sup>5</sup> [http://www.searo.who.int/india/topics/tobacco/economic\\_burden\\_of\\_tobacco\\_related\\_diseases\\_in\\_india\\_executive\\_summary.pdf](http://www.searo.who.int/india/topics/tobacco/economic_burden_of_tobacco_related_diseases_in_india_executive_summary.pdf) viewed on May 16, 2016.

<sup>6</sup> Nishtar (2015) choked pipes reforming Pakistan's mixed health system, p81.

<sup>7</sup> <http://www.who.int/countries/pak/en/> viewed on August 9, 2016/

<sup>8</sup> <http://data.worldbank.org/indicator/SH.XPD.PUBL.ZS> viewed on May 15,2016.

<sup>9</sup> State Bank of Pakistan [http://www.sbp.org.pk/reports/stat\\_reviews/Bulletin/2014/Nov/index.htm](http://www.sbp.org.pk/reports/stat_reviews/Bulletin/2014/Nov/index.htm) viewed on March 24, 2016

<sup>10</sup> Smoky truth (2015) *TheNetwork for Consumer Protection*.

<sup>11</sup> Burki et al (2013) the economics of tobacco and tobacco taxation in Pakistan.

<sup>12</sup> . <https://www.imf.org/external/pubs/ft/wp/2016/wp16179.pdf> viewed on August 30,2016.

reducing affordability of cigarettes, significantly. An FED of 70% of the retail price along with annual inflation adjustments is the most workable solution for preventive tobacco abuse and also acts in boosting the economy.

The table below shows the percentage of FED levied on cigarette brands in FY 2015-16 and 2016-17 compared to the proposed FED in order to fulfill Pakistan’s commitment to FCTC. In the budget announced in the FY 2016-17 the Government had only increased PKR 4.6 FED (per cigarette pack) on lower priced brands i.e. those falling in the lower tier of the tax net, where as PKR 11 (per cigarette pack) on higher priced brands i.e. those following in the upper tier of the tax net. Reviewing the two major tobacco selling companies PMI and PTCs brands, it was seen that out of 6 brands of PMI only 1 brand i.e. Marlboro was lying in the upper tier whereas rest its 5 brands were in the lower tax net. Similarly Pakistan Tobacco Company had 3 of its brands in the upper tier out of its total 6 brands. A

**Analysis of FED changes in 2015-16 & 2016-17 and Proposed FED to Fulfill FCTC Recommendations**

Brands	FED Finance Budget 2015-16			Increase in Retail Price %age	FED Finance Budget 2016-17			Proposed FED to fulfill FCTC recommendations	
	Retail Price	FED %age (lower tier FED =26.4 (Upper Tier FED=60.06)	Cumulative FED %age		*Retail Price	FED %age (lower tier FED =33 (Upper Tier FED=74)	Cumulative FED (%Age)	Proposed FED on Cigarette Packs	Retail Price after Proposed FED & %age
Marlboro	102.56	58.56%	<b>56%</b>	9.2%	112	66%	<b>57.5%</b>	<b>Uniform FED PKR 75 (70% of retail Price)</b>	113 66.37%
Red & White special	56.41	46.8%		17.7%	66.4	49.7%			108.4 69.18%
Red & White KSF	52.99	49.82%		17.5%	62.25	53%			104.25 71.9%
Morven	48.72	54.18%		27.7%	62.25	53%			104.25 71.9%
Diplomat	44.44	59.4%		30.8%	58.1	56.8%			100.1 75%
K2/Philip Morris	44.44	59.4%		30.8%	58.1	56.8%			100.1 75%
Gold Leaf	94.01	63.88%		18.2%	111.11	66.6%			112.11 66.9%
Capstan by Pall Mall	48.71	54.71%		26.3%	61.53	53.6%			103.53 72.4%
Embassy	44.44	59.4%		28.8%	57.26	57.63%			99.26 75.5%
Dunhill	111.96	53.64%		11.4%	124.78	59.7%			125.78 59.6%
B & H	103.41	58.07%		12.4%	116.23	63.6%			117.23 64%
Gold Flake	48.71	54.71%		26.3%	61.53	53.6%			103.53 72.4%

uniform tax abolishing the tier system would without favoring any brand raise the prices of all brands of all companies at an equal scale.

An analysis of cigarette packs revealed that current average FED on each pack was 57.5% falling much below the 70% FED recommended by WHO FCTC. Therefore it is imperative in order to fulfill article 6 of the FCTC a uniform specific tax of PKR 3.75 per cigarette stick (lump sum of 75 rupees on each cigarette pack of 20) should be employed.

The graph below shows the comparison of current cigarette pack retail price and projected retail price after the proposed FED of 70 % or PKR 75.

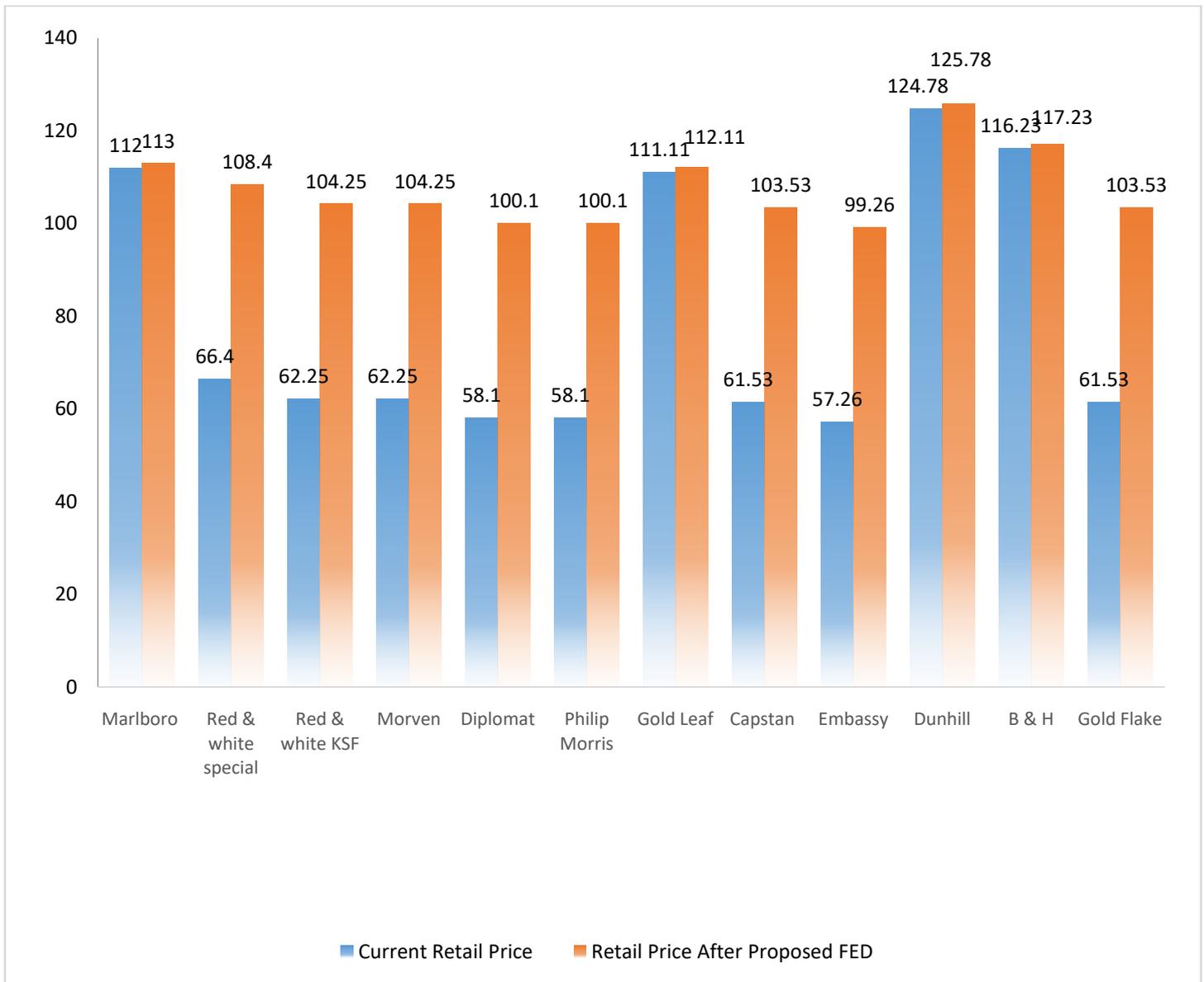


Figure 1: Current Retail Price and Retail Price after Proposed FED

Based on existing analysis and current estimates the best proposition is to abolish the tier system employing a uniform specific excise tax of 75 rupees should on every 20 cigarettes pack. This way the cigarette excise tax would account for 70% of the retail price. Replicating the price elasticity estimates from the ‘Economics of Tobacco and Tobacco Taxation in Pakistan’ this measure, if applied will help curtail tobacco consumption by 8.5%.It will also help decrease production from 64 billion to 58 billion sticks of cigarettes and still generate additional revenue in the existing revenue of up to PKR 58 billion.

## Countering Tobacco Industry's Arguments

Tobacco industry uses various arguments to counter tobacco control measures such as to increase the price of cigarettes by raising tax on cigarette packs in accordance to FCTC. Some of their arguments with their counter arguments have been highlighted below;

### Tobacco Industry Claims:

#### 1. Higher taxes will reduce revenue

Tobacco industry claims that they contribute PKR 135 Billion in Pakistani Revenue in terms of tax and increased Tobacco Taxation will have negative impact on government revenue as it will lead to increase in illicit trade<sup>13-14</sup>. The veracity is ascetically in contrast to this as an increase in taxes will lead to an increase in revenue generation with decreased cigarette consumption rates as an addendum. To substantiate this claim an example of Philippines can be seen where it after specific excise taxes were increased from 12 PHP (PKR 26) to 25 PHP (PKR 54) on high-priced brands and 2.72 PHP (PKR 6) to 12 PHP (PKR 26) on low and medium-priced brands in 2013, the average price per pack increased from 21.12 PHP (PKR 45) to 31.26 PHP (PKR 67) between 2012 and 2013. This lead to increased revenues for the government from 31.2 billion PHP (PKR 67 Billion) in 2012 to 66.4 billion PHP (PKR 143 billions) in 2013<sup>15</sup>. Further, by replicating the price elasticity estimates from the 'Economics of Tobacco and Tobacco Taxation in Pakistan' if Pakistan Government applied uniform specific Tax of PKR 75, this measure will generate additional revenue up to PKR 58 billion<sup>16</sup>. Another important point is that the tobacco industry can repatriate its profits and original investment back to its home country anytime it wants to which are far more than the revenue collected by the government<sup>17</sup>. This leads to a win-win situation for the tobacco industry where as Pakistan gets stuck in a raw deal faced by increased disease burden and decreased productivity leading to long term economic losses far greater than the taxes being generated.

#### 2. Higher Taxation on cigarettes will lead to massive increase in Smuggled cigarettes;

Smuggling of tobacco products and tobacco taxation are independent but slightly overlapping areas which if effectively regulated can lead to desired outcomes of reduced tobacco use. According to WHO tobacco taxation has been known to be the most effective measure to achieve significant health and revenue gains. Taxes on inexpensive tobacco products should be equivalent to higher-priced products, such as premium-brand cigarettes, to prevent substitution in consumption. Taxes need to be increased regularly to correct for inflation and consumer purchasing power<sup>18</sup>.

<sup>13</sup> THE CHALLENGE OF ILLICIT TRADE IN CIGARETTES, IMPACT AND SOLUTIONS FOR PAKISTAN <http://customnews.pk/wp-content/uploads/2015/09/Illicit-Tobacco-Trade.pdf>

<sup>14</sup> <http://www.dawn.com/news/1281078>

<sup>15</sup> Tobacco tax success story Philippines [http://global.tobaccofreekids.org/files/pdfs/en/success\\_Philippines\\_en.pdf](http://global.tobaccofreekids.org/files/pdfs/en/success_Philippines_en.pdf) viewed on March 20, 2016.

<sup>16</sup> The Economics of Tobacco and Tobacco Taxation in Pakistan. <http://tobacconomics.org/research/the-economics-of-tobacco-and-tobacco-taxation-in-pakistan/>

<sup>17</sup> Foreign Private Investment (Promotion & Protection) Act 1976

<sup>18</sup> [http://www.who.int/tobacco/mpower/raise\\_taxes/en/](http://www.who.int/tobacco/mpower/raise_taxes/en/)

The effectiveness of increased taxation cannot be undermined as every 10 percent increase in cigarette prices reduces youth smoking by about seven percent and total cigarette consumption by about four percent<sup>19</sup>.

Another important statistic taken from the tobacco industry funded research conducted by Neilson is that out of the 82 billion cigarette sticks consumed in Pakistan in 2014, 2.6 % of the total were smuggled where as the rest 21.1% were local tax evaded cigarettes. This means that out of the 19.5 billion sticks (smuggled and local tax evaded) 2 billion sticks only were classified as smuggled cigarettes. This further reinforces the fact that increased taxes would not lead to increased smuggling. Rather more stringent enforcement actions are needed to curb the local tax evading tobacco industries.

It has been seen that Tobacco taxes are not the primary reason for cigarette smuggling and cigarette tax avoidance rather it was seen in a recent study of illicit trade in Europe, armored earlier findings that factors than price influence illicit trade.

These include:

- How easy it is for smugglers to operate in a country, including the cost;
- The participation of the tobacco industry;
- How well crime networks are organized;
- The likelihood of being caught, and the punishments, and Corruption levels.

Many countries have significantly increased tobacco taxes without experiencing changes in smuggling/illicit productions. If such illegal activities are controlled by legislative or regulatory means (e.g. use of prominent tax stamps, serial numbers, special package markings, health warning labels in local languages) and by customs and law enforcement (e.g. improving corporate auditing, better tracking systems, and good governance) and stronger penalties for violators. Revenue generated by a tax increase can finance these activities

Smuggling is an affair linked to weakly enforced law instead of increased taxes. Rather increased taxes with proper management to curb smuggling can lead to great success in reducing tobacco consumption<sup>20</sup>.

In Pakistan it has been during 2012-13, the abolishment of the three tier system by Federal Board of Revenue lead to increase taxes on cigarettes which showed a significant reduction of -18.4% in domestic trade of illicit cigarettes<sup>21</sup>. This further substantiates the false claim of the tobacco industry that higher taxes would lead to a growth in illicit trade.

### **3. Tobacco taxation has no impact on Consumption**

Tobacco industry claims that increase in Tobacco Taxation has no impact on Cigarette Consumption but evidence from various studies conducted in countries with higher taxes shows that a higher price leads to reduced consumption patterns with added benefit substantial revenue generated to fund essential services. Historical data shows that during 1990's when cigarette price was at a decline, a significant 40% per capita increase of cigarette

<sup>19</sup> Increasing The Federal Tobacco Tax Reduces Tobacco Use, Campaign For Tobacco Free Kids. <https://www.tobaccofreekids.org/research/factsheets/pdf/0021.pdf>

<sup>20</sup> . Ayda A. Yurekli, PhD (2007) illicit trade in tobacco, *Johns Hopkins Bloomberg School of Public Health*.

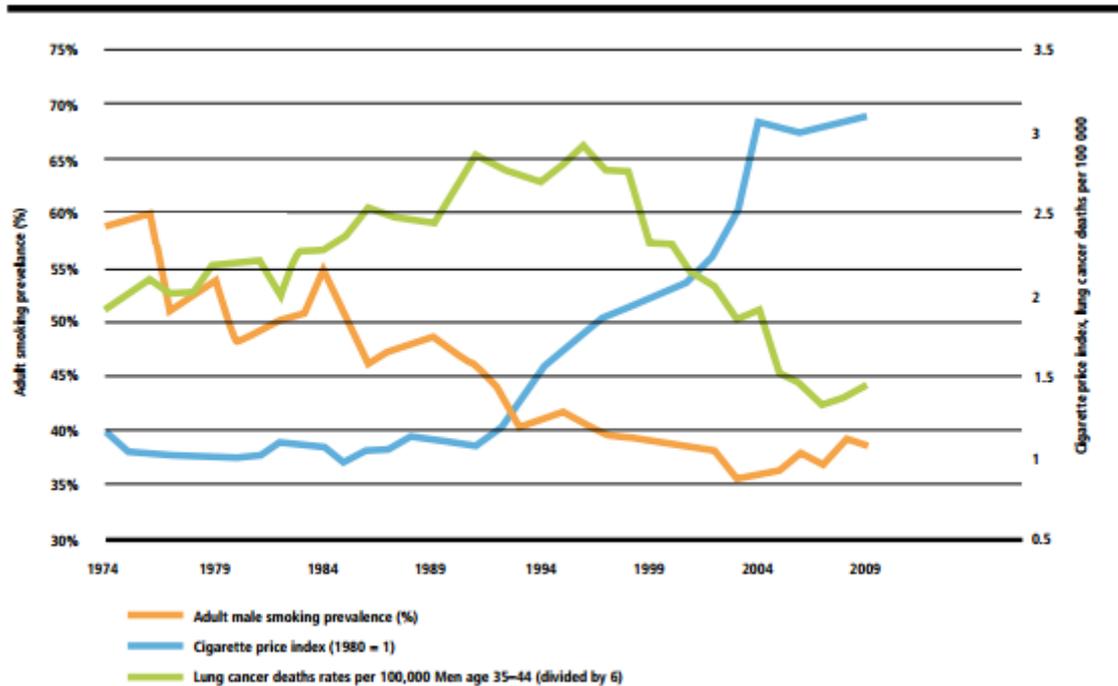
<sup>21</sup> Asia-14, Illicit Tobacco Indicators 2013

consumption was seen. On the other hand during 2000-2004 consumption was reduced by 11% per capita due to increase in cigarette price.

In Australia the government has announced 12.5% increase in tobacco tax every year from 2017-2020 aiming to raise the price of pack of cigarettes by 2020, to AUD 45(US\$34) approximately PKR 3400 viewing this increase as a significant preventive health measure. This will also bring the country into line with World Health Organization (WHO) by 2020, where 69% of the cost of an Australia packs of cigarettes will be tax, raising \$4.7bn in taxes over the next four years<sup>22</sup>.

The results in low and middle income countries are more variable, but often point to a larger reduction. Evidence from France highlights these evidences

**DECLINES IN SMOKING PREVALENCE AND LUNG CANCER DEATHS ACCOMPANY LARGE PRICE INCREASES IN FRANCE (DATA 1974–2009)**



Source: (19–22).

Note: lung cancer death rates were divided by 6 to enable visual comparison.

WHO REPORT ON THE GLOBAL TOBACCO EPIDEMIC, 2015 23

These examples show clearly the impact of tobacco taxation on cigarette consumption hence strengthening the arguments that the level of taxes on cigarettes must be enhanced significantly to reduce tobacco use in Pakistan<sup>24</sup>.

**4. Increased taxes on tobacco are inefficient because smokers use tobacco with full information about health consequences.**

<sup>22</sup> <https://www.weforum.org/agenda/2016/05/which-countries-have-the-highest-tax-on-cigarettes>

<sup>23</sup> [http://apps.who.int/iris/bitstream/10665/178574/1/9789240694606\\_eng.pdf?ua=1&ua=1](http://apps.who.int/iris/bitstream/10665/178574/1/9789240694606_eng.pdf?ua=1&ua=1)

<sup>24</sup> . Burki et al, (2009) Tobacco Curbing its use. Available at <http://www.sjbipp.org/publications/PR/projectreport/PR-03-08.pdf>.

Statistics from the government owned global youth tobacco survey Pakistan (GYTS 2013) for children aged 13-15 shows that every 2 in 5 ever smokers initiated cigarette smoking before the age of 10. Understanding that Pakistan has a population buldge of youth where approximately 50% are below the age of 18 years the statistics from this survey show that approx 11% of the youth between the ages of 11-13 were active tobacco users. Cigarettes contain nicotine which is addictive and habit forming. With weak regulations easy access and availability with attractively packaged and displayed tobacco products it becomes an enticing product for the children who are keen to transgress into a new era of their lives labeling themselves as adults. This is established by the fact that approximately 88% of the 13-15 year olds easily obtained cigarettes from any shop, whereas 35% had no problem in buying cigarettes as single sticks<sup>25</sup>. Linking these facts one can see that most smokers start before the age of 18 years. With high rates of illiteracy in Pakistan (approximately 60%) many do not understand or are too young to understand the hazards associated with tobacco smoking. Taking it up due to peer pressure curiosity or merely to achieve a sense of adulthood they are caught unaware that it leads into addiction dependence and a life full of tobacco related health hazards.

The cumulative effect of illiteracy and the tobacco Industry spending huge amounts on advertising its products to youth is taking its toll where more and more children are taking up smoking. Approximately 1200 children take up smoking every day in Pakistan. According to statistics in 2002 industry spent PKR 61 million on advertisement while only PKR 2 million was allocated for tobacco related health education by Pakistan Ministry of Health<sup>26</sup>. Measures made by some developed nations like USA & UK suggested that increase in tax on tobacco reduces consumption. 10% increase in tax will lead to reduced overall consumption of tobacco products by 2.5–5%.-27.

### Conclusion

International and national findings and data generating pro and anti-tax related voluminous debates when seen with the correct vision can bring a change in perspectives to clearly see that raised taxes are the most effective way to reduce tobacco consumption. This has been substantiated with facts from not only around the world but from within Pakistan itself by reducing the tier system in 2013-14. Understanding that tobacco use is the globally acknowledged only preventable cause of mortality and morbidity, it is high time that our state owns up its responsibility of prioritizing life and health over other monetary and economic issues. With a youth swell of approx 50% less than 18 years old, easy attractive accessibility and availability of hazardous tobacco products can lead to an upcoming diseased and less productive generation translating into losses which will be far greater than the mere taxes collected from the tobacco industry. It is the need of this far sightedness that the government needs to incorporate into its policies for the benefit of the society as a whole. Needless it is imperative to mention here that the arguments of the tobacco industry are not new and similar patterns have been observed whenever new tobacco regulations are brought in or current are made more stringent but the studies have shown the effects of better regulations has always helped curtailing this menace.

In Pakistan there is seepage of increased tobacco consumption patterns alarmingly more in our youth where children younger than 10 years of age are becoming active tobacco users and addicts for life. Leading factor for this remains the easy affordability of such products. Raising taxes has led to positive outcomes by reducing tobacco use in various countries including developing countries like Pakistan. Pakistan is at the brink of a deadly tobacco epidemic and also falling back on fulfilling its international commitments to FCTC to increase taxes on tobacco products to a minimum of 70%. Concluding it is eminent that the best possible and most profitable solution would be to raise taxes on tobacco making it unaffordable especially for children. This would also give a boost to the economy in terms of larger profits in tobacco taxes and a healthier productive nation. Based on the existing analysis and current estimates from this study it is proposed that abolishing the tier system with a uniform specific excise tax of PKR 75 should be levied on a pack of 20 cigarettes bringing up the excise tax on cigarettes to 70% of the retail price. Consequently this would result in a whopping 8.5% reduction in cigarette consumption but at the same time add to the government revenues an additional 58 billion rupees indefinitely a winning situation for the government and our children.

End.....

<sup>25</sup> Global Youth Tobacco Survey Pakistan 2014. [http://www.emro.who.int/images/stories/tfi/documents/GYTS\\_FS\\_PAK\\_2013.pdf?ua=1](http://www.emro.who.int/images/stories/tfi/documents/GYTS_FS_PAK_2013.pdf?ua=1)

<sup>26</sup> <http://www.pjcm.net/index.php/pjcm/article/viewFile/185/176> viewed on March 28, 2016.

<sup>27</sup> . Frank J. Chaloupka, PhD (2007) tobacco taxation, *University of Illinois at Chicago International Tobacco Evidence Network*.