



POLICY BRIEF

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TOBACCO TAX STRUCTURE IS KEY TO REDUCING TOBACCO USE AND RAISING GOVERNMENT REVENUE

INTRODUCTION

With 37.8 million (35.3%) adults consuming tobacco products, Bangladesh is one of the largest tobacco consuming countries in the world (GATS, 2017). Although the overall prevalence of tobacco use declined by 18.5% from 2009 to 2107, the consumption of cigarettes and smokeless tobacco (SLT) remains very high. The economic cost of tobacco use was estimated at BDT 305.70 billion (USD 3.6 billion), which is about 1.4% of GDP in 2018 (Faruque *et al.*, 2019). A tobacco tax structure matters because how tobacco taxes are structured has implications for protecting public health and enhancing government revenue. Increases in tobacco taxes that result in significant increases in prices are highly effective in reducing tobacco use, particularly among the youth and the poor. At the same time, increasing tobacco taxes can bring in new revenues to finance health and development efforts.

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OVERVIEW OF TOBACCO TAX STRUCTURE IN BANGLADESH

The government has developed a complex tax structure of tobacco products, which is characterized by multi-tiered *ad valorem* tax system, low tax base, tariff value for SLT, and larger variations in prices and taxes within and across different tobacco products (Table 1). These factors have contributed to the affordability of tobacco products in Bangladesh.

ISSUES PERTAINING TO TOBACCO TAX STRUCTURE

The issues that emanate from the multi-tiered *ad valorem* excise tax system in Bangladesh are the following:

Cigarette prices and taxes

Compared with several developing countries, cigarette taxes and prices are much lower in Bangladesh (Table 2).

Table 1. Tobacco tax structure in Bangladesh, FY 2018-19

Tobacco Products	Category	Tax base	Price (Taka)	VAT (%)	SD (%)	HDS (%)	TTI (%)
Cigarette (10 sticks)	Low	Maximum retail price (MRP)	35	15	55	1	71
	Medium		48	15	65	1	81
	High		75	15	65	1	81
	Premium		105	15	65	1	81
Biri (Sticks)	Without filter (25 sticks)	Maximum retail price (MRP)	12.5	15	30	1	46
	With filter (20 sticks)		15	15	35	1	51
SLT (Pouch of 10 gram)	Zarda	Tariff value	12	15	100	1	116
	Gul		6	15	100	1	116

Source: National Board of Revenue (NBR) data

Notes: 1. MRP is inclusive of all taxes in cases of cigarettes and biris.
2. In case of SLT, tariff value does not include taxes. Rather taxes are added to the tariff value.

Table 2. Cigarette prices and taxes, Bangladesh and selected countries (international purchasing power parity USD)

Country	Cigarette	
	Price	Taxes, % of retail price
Pakistan	2.2	60
Bangladesh	3.4	77
Indonesia	5.2	57
Nepal	5.7	26
Thailand	7.1	74
India	9.2	43
Sri Lanka	19.6	62

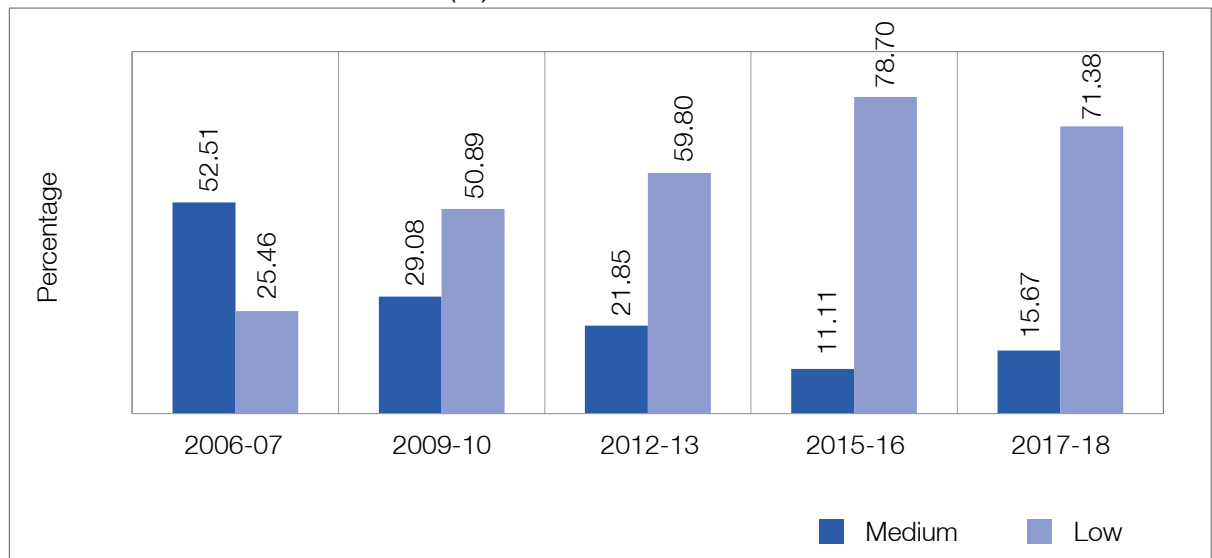
Source: WHO 2015

Product substitution

Large price gaps between brands create opportunities for consumers to switch to cheaper brands in response to increased taxes (Chaloupka, Kostova and Shang, 2014). In Bangladesh, the differential tax treatment has led to product substitution from the medium tier to the low tier of cigarette. The market share of the low tier increased from about 25% in FY 2006-07 to about 71% in FY 2017-18. On the other hand, the market share of the medium tier declined from about 53% in FY 2006-07 to about 16% in FY 2017-18 (Figure 1).

Different tax rates for different tobacco products provide incentives for tax avoidance as manufacturers can alter their pricing or production decisions in order to avoid higher tax liabilities that can lead to revenue loss for the government.

Figure 1. Market shares of medium and low tiers of cigarettes from FY 2006-07 to FY 2017-18 (%)

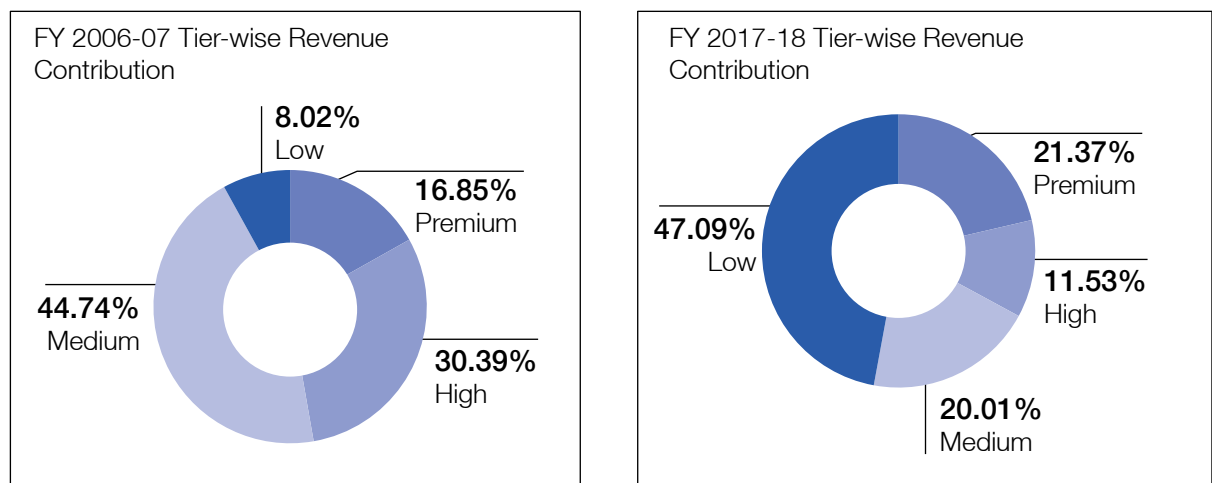


Source: Based on NBR data

The effect of substitution is evident from the fact that the revenue share of the low tier of cigarettes increased from 8% in FY 2006-07 to about 47% in FY 2017-18. On the other hand, the revenue share of the medium tier declined from about

45% in FY 2006-07 to about 20% in FY 2017-18 (Figure 2). The overwhelming share (about 71%) of low tier of cigarettes in the market leads to loss of government revenue as the low-priced tier yields lower revenue (47% in FY 2017-18).

Figure 2. Revenue shares of all tiers of cigarettes, FY 2006-07 and FY 2017-18 (%)



Source: Based on NBR data

Informality and heterogeneity of SLT products

In Bangladesh, 22.0 million (20.6%) adult people use SLT, of whom 16.2% are men and 24.8% are women (GATS, 2017). SLT is an area of growing concern for public health and it contributes only 0.22% of the NBR tobacco revenue. However,

there are challenges of regulating SLT products because of heterogeneity of SLT products, which are often manufactured in small and unlicensed units, with tax evasion and illicit trade common. Therefore, SLT manufacturing units need to be formalized by bringing them under registration process and then the existing tariff value may be replaced with the maximum retail price as the tax base.

SPECIFIC VS. AD VALOREM TAXES

- With respect to the impact on tobacco product prices, *ad valorem* taxes result in greater price differentials between high- and low-priced products than is the case for a single specific tax. This creates more opportunities for users to switch down to cheaper brands in response to tax increases resulting in reduction in revenue.
- In terms of revenue, a specific tax is likely to generate more stable and predictable revenue than an *ad valorem* tax.
- Specific excise taxes tend to be easier to administer than *ad valorem* taxes.
- Empirical evidence from different countries shows that specific taxes are more effective than *ad valorem* taxes in reducing tobacco use and raising tax revenue (Barkat et al, 2012; Ho et al, 2018; Rodriguez-Iglesias and Blecher, 2018; Shang et al, 2017).

TOBACCO TAX ADMINISTRATION

National Board of Revenue (NBR), the apex tax policy making and tax collection authority, is not strong enough to enforce tobacco tax policy effectively due to the shortage of trained personnel, and a track and trace system. Therefore, there is the need for strengthening the capacity of the NBR through legal reforms and institutional development.

POLICY IMPLICATIONS

The results of a recent study suggest that the consumption of smoking tobacco products does respond significantly to price changes (Ahmed *et al.* 2019). Poor households are found to be more responsive to the changes in the prices of cigarettes and biris than the rich households. This is expected as the poor households respond more to the changes in the prices of cigarettes and biris than the rich households. A cigarette tax increase would prevent cigarette smoking initiation, promote cessation, lower consumption among the continuing smokers, and reduce the death, disease, and economic costs of smoking. The study recommends using a specific tax structure instead of existing multi-tiered *ad valorem* tax system. It is proposed to increase biri taxes substantially through a uniform specific biri excise tax that significantly raises biri prices and reduces its use. Measures may also be taken for formalizing SLT manufacturing units by bringing them under

the registration process and replacing the existing tariff value with the maximum retail price as the tax base of SLT.

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