

# **Additional examples of common strategies employed by the tobacco industry in response to tobacco tax increases**

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The Economics of Tobacco Control Project is hosted by the South African Labour and Development Research Unit at the School of Economics, University of Cape Town in partnership with the American Cancer Society, the Bill & Melinda Gates Foundation and the African Capacity Building Foundation. The aim of this project is to expand current research efforts in the economics of tobacco control and to enhance the knowledge of economic and tax issues among tobacco control advocates and policymakers to strengthen support for tobacco tax and price increases in sub-Saharan Africa. Visit [www.tobaccoecon.org](http://www.tobaccoecon.org)

## Introduction

This working document adds more country examples to the 7 examples already presented in the report: “*Undermining Government Tax Policies: Common strategies employed by the tobacco industry in response to tobacco tax increases*” available at <http://tobaccoecon.org/publications/reports/>.

We would like to invite all interested parties to share their experiences (and data) describing tobacco industry responses to tobacco tax increases in their countries and regions. We will be updating this document regularly as we identify additional examples. Partners who share experiences and data will be properly acknowledged. We hope that these examples and the *Undermining Government Tax Policies* report will become a useful resource to the tobacco control community.

### Additional example 1: Latvia

#### Strategy 1: Stockpiling

**Definition:** Stockpiling (also referred to as forestalling and front-loading) occurs when tobacco companies over-supply their products to the market before a tax increase takes effect (Source: Ross and Tesche 2015).

#### Case study: Latvia

Thanks to joining the European Union, Latvia had to significantly adjust its tobacco tax structure and increase the tax rate. The fixed excise tax on cigarettes that applied until June 2003 was changed to a mixed tax structure with both fixed and ad valorem components in July 2003. At the same time, the excise tax rates on cigarettes began to increase (Table 1).

**Table 1: Excise tax rate on cigarettes in Latvia (2004 – 2009)**

	2004	2005	2006	Jan 2007	July 2007	2008	2009
Specific tax rate, Euro per 1000 pieces	9,39	9,82	10,81	11,95	14,23	25,33	32
Ad valorem, % of MRSP (Maximum Retail Selling Price)	6,1	10,5	14,8	19,2	25	32,2	34,5

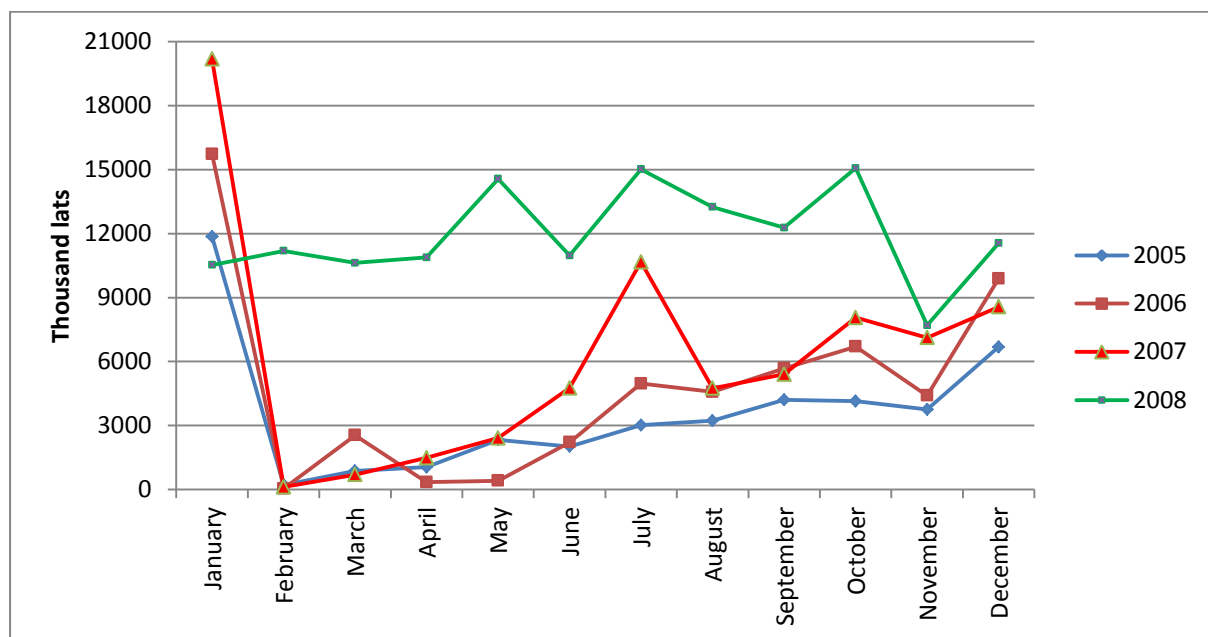
Source: Salmina (2009)

In response to these excise tax increases, the tobacco companies adjusted the amount of stock released for distribution according to the timing of the tax increases, as shown in

Figure 1. Larger than normal amounts of stock were oversupplied in January of 2005, 2006 and 2007 so that the pre-tax-increase tax would be paid. In the following month (February), the Latvian government received very little tax revenue, because the tobacco companies declared the release of only a few cigarettes to the market. It took the market a several months to absorb the oversupply. Only at that point the industry began to pay the new higher tax rate and the tax revenue returned to its equilibrium level, that is the level higher compared to the level before the tax increase.

A new law in 2008 addressed the industry's stockpiling strategy by introducing tight controls on the inventory system accounting for all existing stock at the time of the tax increase. Following the new law, the tobacco companies are now required to pay the government the difference between the old and new tax on all cigarettes in stock. This secured evenly distributed and predictable excise tax revenue to the budget by eliminating an oversupply of cigarettes before excise tax increases.

**Figure 1: Impact of inventory on the flow of excise tax revenue 2005 – 2008, thousand lats**



Source: Salmina (2009)

## Additional example 2

Submitted by Corné van Walbeek ([cwalbeek@gmail.com](mailto:cwalbeek@gmail.com)). The full report is available at: <http://tobaccoecon.org/corne-van-walbeek/>

### Strategy 4: Over-shifting or increasing prices more than a tax increase

**Definition:** Over-shifting occurs when the tobacco industry increases the retail price by more than the tax increase.

#### Case study: Jamaica

In April 2005, the Minister of Finance announced an increase in tobacco tax from J\$25.36 (\$0.39) to J\$38.40 (\$0.58) per pack of cigarettes. The excise tax system at the time was complicated. Other than applying a specific tax, the government imposed an ad valorem tax of 39.9% on the wholesale value, should the wholesale value be greater than some threshold value. At the same time as announcing the increase in the specific tax the government increased the wholesale price threshold for applying the ad valorem tax from J\$50.48 to J\$86.76 per pack. This meant that the ad valorem tax of 39.9% was paid only on cigarettes whose wholesale price exceeded J\$86.76, resulting in the tobacco industry having to pay less ad valorem tax. The industry took advantage of these tax changes and increased wholesale prices, effectively overshifting the tax increase (Table 2).

**Table 2: Impact of the April 2005 tax increase taxes on a pack of the most popular brand of cigarettes**

	Before tax changes	After tax changes	Difference
Wholesale price	87.23	107.04	19.81
Specific tax	25.36	38.40	13.04
Ad valorem tax	14.66	8.09	-6.57
Other taxes	52.75	66.47	13.72
Tax inclusive retail price	180.00	220.00	
Change in taxes			20.19

Source: Van Walbeek (2015). Wholesale values were derived from information received from the Ministry of Finance.

A day after the tax increase, the BAT-affiliated cigarette producer and distributor in Jamaica changed the recommended retail price of the most popular brand from J\$180 (\$2.74) to J\$220 (\$3.34) per pack. Even though the total tax increased by J\$20.19, the retail price increased by J\$40 generating an extra profit of J\$19.81 per pack for the industry. The specific tax on cigarette increased by 51% (J\$13.04 per pack), and this increase in the tax was headline news. What was not reported was the fact that the increased threshold for the ad valorem tax reduced the amount of ad valorem paid per pack by J\$6.57. Smokers were

led to believe that the increase in the retail price was attributed solely to the increase in the excise tax.

This case study highlights the importance of monitoring the industry's behavior after a tax change in order to counter the industry's arguments that the increase in prices is the sole responsibility of the government. In addition, the government needs to take into account the tax structure when it proposes tax changes, because the industry may be lobbying for changes that could nullify the desired effect of a tax increase. In the case of Jamaica, the increased threshold for imposing ad valorem tax that previously acted as a disincentive for the industry to increase its prices allowed the industry to increase its profit per while lowering the tax revenue from the ad valorem tax.

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