

Experts find that the tobacco tax increase in India's Union budget 2017 is insufficient to improve public health

WHAT DID THE UNION BUDGET PROPOSE ON TOBACCO TAXES?

- **The Union Budget 2017 modest tax increase will raise cigarette prices by about only 16 paise per stick (a 6% tax increase resulting in a 3% higher sales price). This increase is too small to reduce consumption.**
- The 16 paise average cigarette increase **does not keep up with increases in income and consumer spending**, meaning that in relative terms, the Union Budget could contribute to **an INCREASE in smoking, especially among younger smokers.**
- **This is the second year in a row that the most important tax on cigarettes has not been raised.**
- The lack of a BIG tax increase enables the cigarette industry to use the modest higher tax to raise prices more than just the tax, conveniently pocketing the extra profits. Thus, the Union Budget tax hike may **raise profits for the tobacco industry versus yielding greater revenues for the Government of India.**
- **The tax structure remains too complex.** India's tax structure, after years of influence by the cigarette industry allows smokers to switch down to cheaper cigarettes. This can negate ANY public health benefit of reduced consumption.
- By contrast a **single large BIG tax per stick on ALL lengths** would decrease switching by smokers, simplify tax collection and decrease tax evasion by the tobacco industry.

WHAT IS NEEDED?

- The Ministry of Finance should announce a **SPECIAL Rs. 4 per stick excise** on ALL lengths of cigarettes.
- There is NO difference in health risks between machine and hand rolled bidis. The Ministry of Finance should **tax both at the new rate of Rs. 78 per thousand sticks.**

Background:

India already has 1 million smoking deaths a year. Smoking deaths continue to rise. The absolute number of smokers has increased from 88 million in 1998 to 120 million in 2015, of which among men alone the increase was from 79 million to 108 million (Table 1), even though overall smoking prevalence fell slightly in men. Young men aged 15-24 accounted for the largest proportion of increased cigarette smoking. More daily smoking of cigarettes or bidis means higher death risks, with particularly elevated risk ratios for smoking 8 or more cigarettes a day (Figure 1).

Further, cigarettes are slowly but steadily displacing bidis. While cigarette smoking has become more popular among rural men and among younger men (15-29), it is twice as prevalent among men (30-69 years) and up to four times more prevalent among youth (15-30 years) in recent years as compared to a decade ago. The smoking cessation in India is also very low with only one ex-

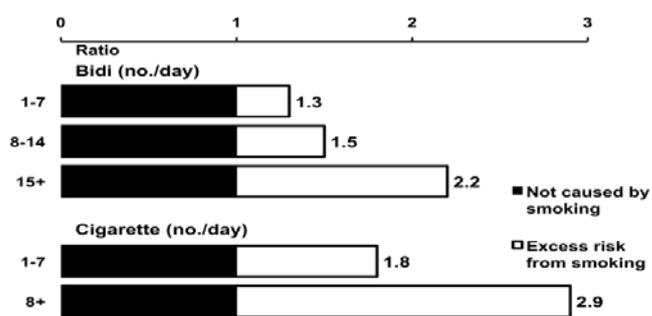
smoker for every four smokers. Unless substantial cessation rates are achieved, smoking deaths will continue to rise creating enormous health, economic and social costs for the society at large.

Tobacco taxation is the most effective intervention to curb smoking and tobacco-attributable mortality and morbidity. A sharp reduction in tobacco consumption, and subsequently deaths, would occur from raising the cost of smoking through a large and coordinated increase in the excise tax (such as a tripling) on tobacco products.

Table 1: Smoking & Smokeless population, ages 15-69 (millions)

Gender	1998	2015
Smoking		120
Men and women	88	120
Men	79	108
Rural men	61	77
Urban men	19	31
Smokeless		241
Men		158
Women		83

Figure 1: Risks of death by amount ages 30-69



Note: Relative risks adjusted for alcohol use, education and age
Source: Jha et al. 2008 and CGHR 2013

The tobacco tax increases in the Union Budget- 2017

The Minister of Finance, the Honourable Mr. Arun Jaitley proposed no change in the basic excise duty (BED) on cigarettes. **The BED is the largest and most important tax**, as it forms the largest component of total cigarette excise. **This is the second consecutive year without a hike in the BED for cigarettes.** The health cess, also known as the additional excise duty, will go up 45%. But because it's a tiny component of the tax, it will have little impact on the sales "street" price.

For hand rolled bidis, the BED will be increased from Rs. 21 per thousand to Rs. 28 per thousand and for machine-rolled bidis it will be raised from Rs. 21 per thousand to Rs. 78 per thousand sticks. This is also distortionary, as there is no difference in health impact between machine and hand rolled cigarettes.

BEDs were raised modestly (6%) on cigars, cheroots, and other related tobacco products (to Rs. 4,006 per thousand from Rs. 3,755 earlier). The BED on pan masala is increased to 9% from 6% and the BED on other unmanufactured tobacco is increased to 8.3% from 4.2%. These products are a small proportion of the tobacco market and there is an ongoing switch from these products to manufactured cigarettes, which is aided by the tax structure.

Is the tobacco tax increase large enough?

The Union Budget 2017 is too small to reduce tobacco use and improve health.

Cigarettes are the most important public health concern (because they are growing and displacing bidis, especially among the young and among the poorest smokers). The cigarette tax structure in India is too complex with excise taxes being imposed based on the lengths of the cigarette rather than equally across all lengths. This allows smokers to switch down to cheaper cigarettes more easily due to price differentiation negating the public health benefit of reduced consumption.

In the 2017 budget, the overall cigarette tax increase is a meagre 6% (Table 2); even lower than the modest 10% increase in the 2016 budget. There is no increase in the BED for the second consecutive year. The average tax increase for filtered cigarettes is therefore only about 16 paise per cigarette stick (10 paise per stick for the less than 65mm cigarettes and 25 paise increase for the 75mm+ cigarette category). This enables smokers to switch down more easily to shorter, cheaper cigarettes and the cigarette industry to manipulate what it brings to market and what it reports (thus increasing tax evasion).

Table 2: Impact on cigarette categories with largest market share after Union Budget-2017

Cigarette category (and market share in %)	Largest component of excise tax (Basic Excise Tax) per 1000		Special Tax† for 2016 & 2017 (No increase in 2017)	Health cess/ Additional excise tax		Total excise tax/1000 sticks		Increase in total tax rate over last year (%)	Extra cost in paise
	2016	2017		2016	2017	2016	2017		
Non-filter 65-70 mm (8%)	2335	No change	145	370	541	2850	3021	6.0%	17
Filter: 65-70 mm (51%)	1740	No change	90	260	386	2090	2216	6.0%	13
75-85+ mm (35%)	3375	No change	190	560	811	4125	4376	6.1%	25
Average filter	2171	No change	119	345	505	2636	2796	5.6%	16

Note: *Market share is estimated using cigarette category wise data from A.C. Nielsen (Jan 2014-Nov 2014). †The special tax here refers to the National Calamity Contingent Duty. All excise tax rates i.e. NCCD, Health Cess and basic excise tax are in Rs./1000 sticks. Sources: Tax rates are taken from the Finance Bill 2016-17 & 2017-18. NCCD information is from 7th Schedule of Finance Act 2001 (<http://www.cbec.gov.in/excise/cxt2012-13/appx3.pdf>).

It may be noted here that the last major increase in cigarette BED was in 2014-15 when for the less than 65mm cigarette category with a small market share it was increased by 76% while the most popular cigarette categories saw a 17% BED increase.

Filtered cigarettes constitute more than 94% of the total market share of cigarettes in India. The 6% tax increase will result in a small 3% - 3.5% increase in cigarette street prices. Indian GDP will grow at a rate of about 6.75% to 7.5% as per the Economic Survey 2017-18. Further, with an inflation rate pegged at 5.5% - 6%, the cigarette price increase will be below inflation. This means that cigarettes will become more affordable relative to income. Further, it is well understood that after each budget cycle the cigarette industry increases the street price of cigarettes by more than the actual increase in tax, conveniently pocketing a much higher profit. The 2017 Union budget may thus increase profits for the cigarette industry.

Bidis continue to be taxed at an insignificant rate. The BED increase on bidis is negligible: only 6 paise increase per bidi stick.

What is the impact of the tobacco tax hike on consumption in India?

This unhealthy move will not only encourage cigarette smokers to continue smoking and perhaps smoke more intensely, but also incentivize smoking initiation among younger smokers. It will further encourage an ongoing trend of more bidi smokers switching to cheaper brands of cigarettes, substantially increasing the profits of the tobacco companies.

What can be done to save lives and reduce smoking deaths?

First Proposed action: Tax ALL cigarette lengths with a BED of Rs. 4 per stick and add the highest proposed Central Goods and Services Tax of 28% (Table 3)

- The Ministry of Finance could adopt a simpler, easy to explain tax regime: **Apply a BED tax rate of Rs. 4 per stick to ALL lengths plus the top proposed CGST of 28%**. This would raise the average tax per stick from about **Rs. 2.8 to Rs. 5.2** (inclusive of other applicable taxes, and maybe even more with state GST which should ideally apply the top rate in each state). This represents about an **85% increase**, which is comparable to large increases in the Philippines, Uruguay, and other countries.
- This Rs. 5.2 average tobacco tax per stick would raise street prices **by about 45%** for filtered cigarettes. This is well above the rate of income growth, meaning such an increase would lower consumption substantially.
- The uniform increase of Rs. 4/stick BED plus CGST would narrow the price ratio between the 65-70mm and 75+mm (two most popular types) from **1.6 to 1.2** which will discourage switching.
- The uniform tax rate is **simpler** (as most economists recommend), **provides a steadier revenue stream, and minimizes industry manipulation and tax fraud**. Indeed, the higher taxes would yield about **Rs 1.5 lakh million in additional revenue** (i.e. more money for the government and less profit taking by the cigarette industry).

Table 3: Tax impact calculation with uniform BED of Rs. 4/ stick and top CGST on cigarettes categories with largest market share

Cigarette category (and market share in %)	Base price*, pre-tax/ stick in 2015	Proposed CGST tax (in Rs.)	BED/ stick (in Rs.)	Proposed tax/ stick (in Rs.)	Final price/ stick (in Rs.)	Tax/ stick in 2017 (in Rs.)	Current market price 2017
Non-filter 65-70 mm (8%)	2.0	0.6	4.0	4.6	6.6	3.0	5.0
Filter: 65-70 mm (51%)	3.8	1.1	4.0	5.1	8.9	2.2	5.8
75-85+ mm (35%)	5.2	1.5	4.0	5.5	10.7	4.4	9.4
Average filter only	4.3	1.2	4.0	5.2	9.5	2.8	6.6

Note: *Base prices are calculated from Market price A.C. Nielsen's Data (Jan 2014-Nov 2014) and is adjusted for inflation @ 5.9% in 2015. No increment in raw material prices is considered in 2015 Source: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>.

Second Proposed action: Regulate bidis better, so as to enable future taxation

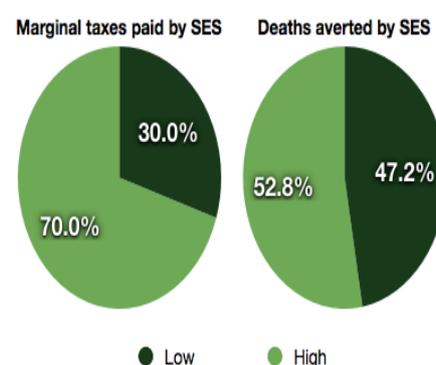
The World Health Organization has suggested that there is NO difference between machine and hand rolled bidis. Both have similar adverse health impact. The right solution would therefore be to tax all hand rolled or machine-made bidis at the new rate of Rs. 78 per thousand sticks. It is essential that the Indian Government takes the following steps to regulate the bidi industry:

- Eliminate the price differential between handmade and machine rolled bidis by taxing them increasingly at higher rates.
- Prohibit the sale of unbranded bidis.
- mandatorily require manufacturer names to be printed on bidi packs.
- Eliminate current tax exemption for small bidi producers.
- Make it mandatory to report sale and purchase of processed bidi and tobacco by any persons or entity.

What will be the consequences of the Rs. 4 BED tax on cigarettes?

- Over a few years, the total 45% higher street price on cigarettes would lead to about 21 lakh current adult smokers quitting, and about 17 lakh children never starting. This would **avoid about 16 lakh smoking deaths** (7.5 lakh among current smokers and 8.5 lakh among children never starting).
- Non-legal cigarettes have been reported as a problem (about 8-15%, depending on source of information), but even in their presence, **consumption would fall and revenue would rise**. Efforts to strengthen tax compliance work best to counter such criminal activity, not keeping tax rates low. Turkey has taken similar action. Non-earmarked allocations to better tax administration and enforcement (as the Canadian and Turkish governments have done recently) are a **win-win-win (less smoking, more revenue, less tax evasion)**.
- This tax hike on cigarettes would **not** lead to smokers switching down to bidis- (people do not want to move down in the luxury ladder). There is little substitution or complementarity between bidis and cigarettes, which is consistent with the observation that the markets for the two products are quite distinct (bidis are more often smoked by lower socioeconomic groups than are cigarettes). Moreover, the core pricing strategy of the cigarette industry is to keep taxes low on its smaller cigarettes so as to encourage switching from bidis to cigarettes.
- **Tax hikes would not hurt the poor.** The Asian Development Bank (ADB) reported on the impact of higher cigarette taxes by socioeconomic status (SES) group for India. They found that the extra tax burdens from a 50% price rise are borne mostly by the rich (Figure 2). The poor respond more to price than the rich, and so quit more than the rich. However, given that the prevalence of smoking is greater among the poor, the reduction in mortality is strongly concentrated among the poor in India. In India, the low SES group would account for 30% of marginal taxes paid, but 47% of smoking deaths averted. Thus the health to tax ratio is 1.6.

Figure 2: ADB projections of SES impact of a 50% increase in cigarette prices



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