

# High Taxes hit Cigarette Consumption

## Introduction

Pakistan is grappling with a major health problem as more than 31 million adults (ages 15 and above) are estimated tobacco users (in various form), this number translates to nearly one-fifth of the adult (ages 15 and above) of the country.

High and middle-income countries have successfully used tobacco taxation and price increase as measures to reduce tobacco consumption.

However, Pakistan faces the formidable challenge to determine and administer an optimal tobacco tax and ensure that prices of cigarettes are high enough to reduce consumption, generate maximum revenue and achieve the public health goals.

The Federal Board of Revenue (FBR) data from last seven years serves as an eye opener as the country lost a staggering Rs 567 billion due to flawed policies influenced by giants of the tobacco industry particularly the multinational cigarette companies.

The government has now embarked on a course correction to address these challenges. One notable step in this direction has been the decision to increase the Federal Excise Duty (FED) rates.

Pakistan made significant strides by increasing the FED on cigarettes in line with the recommendations of World Health Organization (WHO) to discourage the consumption in general and among the vulnerable population in particular.

In this respect, the fiscal year 2022-23 FED rates on cigarettes underwent three upward revisions, ending three-year period of stagnation.

According to details, the first adjustment, effective from July 1, 2022, witnessed a 13.5 percent increase for high-priced (premium) brands and a 12.1 percent increase for low-priced (economy) brands.

The second increase, enacted on August 22, 2022, resulted in a FED rate hike of over 10.2 percent.

The third change was made on February 14, 2023 through Finance (Supplementary) Act 2023 under which the FED rates were substantially enhanced by 146 per cent and 154 per cent for economy and premium brands, respectively.

The decision, which experts and health advocates hail as a step in the right direction, has started bearing tangible results – the number of cigarette smokers has witnessed a decline after the prices of cigarettes were increased.

Figure 1: Changes in FED rates on cigarettes

	FED Rate (PKR per 20-cigarette pack)			
	Low-priced/Economy		High-priced/Premium	
	Rate	change	Rate	% change
2019-20 to 2021-22	33		104	
July 01, 2022	37	12.1%	118	13.5%
August 22, 2022	41	10.8%	130	10.2%
February 14, 2023	101	146.3%	330	153.8%

*Sources:* Finance Act 2021, Finance Act 2022, Tax Laws (Amendment) Ordinance 2022, Supplementary Finance Act 2023

This survey offers insights into cigarette consumption and investigates how changes in price influence consumption patterns.

## **Tobacco Taxation Background**

The FED structure on cigarette/tobacco had been complex, encompassing a specific tax on inexpensive brands, an ad valorem tax on premium brands, and a combined specific and ad valorem tax on mid-range brands.

In 2013, the ad valorem tax was replaced by a two-tier specific tax system based on retail prices (excluding GST). This two-tier system remained in the field until 2016-17, with annual upward adjustments to the tax rates for both tiers.

In 2017, the FED on cigarettes was effectively cut by a whopping 50 percent with the introduction of a three-tier excise duty framework for cigarettes, incorporating a new tier specifically designed for low-priced brands. The tax rate applicable to this newly introduced tier underwent a reduction of 48 percent, decreasing from Rs 1.5 per stick to Rs 0.8 per stick.

The motive behind introduction of the Tier-III, according to the FBR, was to increase the government revenue but the plan backfired within weeks of implementation. Major industry players duped policymakers that the move will help curtail smuggling/illicit trade.

The tobacco industry argues that smuggling is caused by the market forces i.e. by the price difference between countries from where cigarettes are cheaper to where they are expensive.

**World Health Organization (WHO) views smuggling of cigarettes into a country is a way for multinational tobacco companies to enter otherwise closed markets, create pressure to open markets to imports, undermine regulation, create a desire for smuggled brands, and earn a substantial profit.**

**The WHO studied Pakistan's tobacco industry and noted that situation in Pakistan was no different.**

**“Cigarettes have been smuggled into Pakistan as a means of creating brand awareness of, and loyalty to, international brands when import restrictions or high import taxes and customs fees preclude the introduction of legally imported cigarettes,” the world body said in a detailed study<sup>1</sup> on Pakistan.**

**The study further revealed that “Brands smuggled into Pakistan fell into two types: international brands (such as Dunhill and Marlboro) and return cigarettes, typically from Afghanistan, which were first exported from Pakistan then smuggled back into Pakistan.”**

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<sup>1</sup> <https://applications.emro.who.int/dsaf/dsa703.pdf?ua=1>

Researchers say that the “cigarette smuggling is not caused principally by market forces. It is supply driven, caused mainly by fraud through the illegal evasion of taxes”<sup>2</sup> and that the “true beneficiaries are the tobacco companies.”

Researchers also claim that the illicit tobacco issue is usually blown out of proportion by tobacco sector. They use it as a tool to get cuts in taxes.

In several countries, industry urged governments to reduce taxes to deal with smuggling and increase/restore revenue.

In Canada, for example, when government reduced cigarette tax in response to industry pressure the results were disastrous – consumption increased and revenue took a nosedive.

The same happened in Pakistan after the introduction of Third Tier.

Multinationals cigarette companies manipulated the decision (Third Tier) by lowering prices of its most sellable products which were in Tier-II and shifted them to Tier-III instead of paying tax at the rate of 33.4 per pack of 20 they were paying only Rupees 16 per pack of 20 cigarettes. And as a result, the government revenue plummeted.

The situation drew attention of the upper house of the parliament that ordered to probe the matter and determine the factors behind decline in tax collection from the tobacco sector.

In its report submitted to the Senate, the Auditor General of Pakistan (AGP) contradicted FBR’s view pint of regarding benefits accrued from bringing in third tier of FED on cigarettes because after the introduction of third tier the sales turnover of Pakistan Tobacco Company and Philip Morris International showed upward trend reflecting an increase of 31% in case of PTC and 33% in case of Phillip Morris International during the year 2017-18.

Despite massive increase in sales turnover 32 % of both the companies of Rs 143.7 billion in 2017-18 as compared to Rs 109.2 billion in 2016-17, the collection of FED in the same period remained Rs 65.4 billion that was 13 % less compared to the previous year<sup>3</sup>.

FBR’s reasoning for introducing a lower Tier-III was to curtail illicit tobacco trade. This entirely ignored health costs of such an action.

More importantly, by effectively allowing cigarette producers to lower their prices to take advantage of lower taxation, the government essentially reduced the expected revenue from taxes on these highly sellable brands. This mean that cigarette consumption increased and tax revenue decreased.

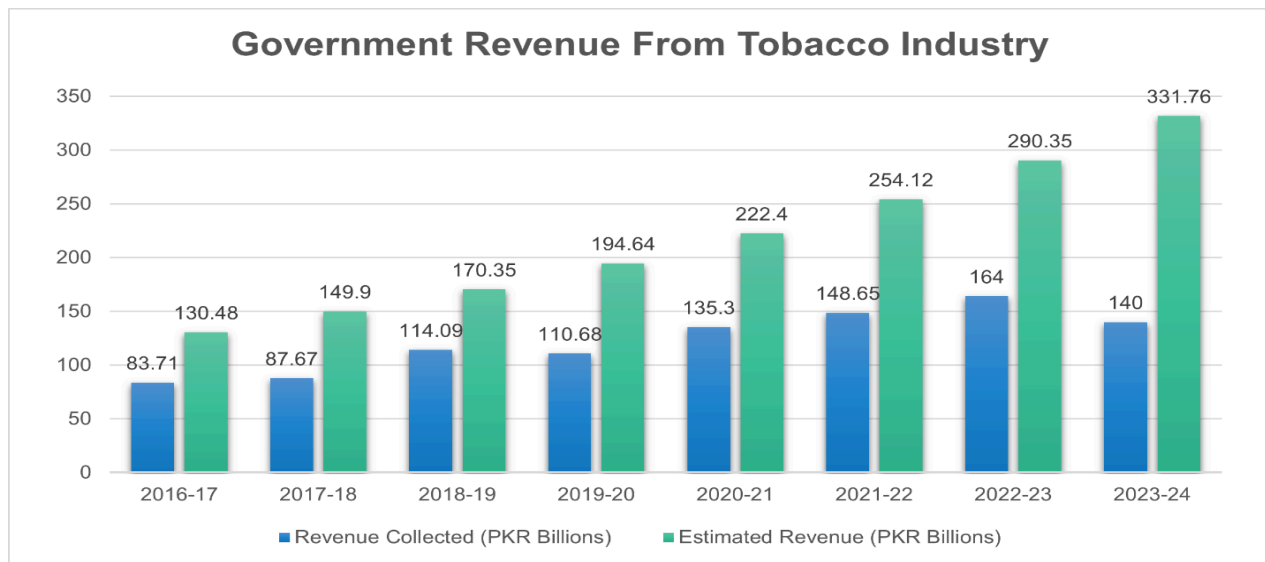
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<sup>2</sup> <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC1118741/>

<sup>3</sup> [https://senate.gov.pk/uploads/documents/1552287245\\_370.pdf](https://senate.gov.pk/uploads/documents/1552287245_370.pdf)

The decision to slash FED and reduce prices of the cigarettes made Pakistan a rare exception in the world. In fact, this was a breach of the FCTC that specifically identifies price increase on Tobacco products a way to discourage its consumption and keep youth away from it.

According to the FBR’s yearly data about revenue collection, Fiscal year 2016-17 saw a significant dip, with the total revenue dropping to 83.71 billion against an estimate of Rs 130.48 billion revenue based on 14 % average growth rate of past three years. Contrary to projections and estimates, the industry revenue showed negative YoY growth of 26.70 %.



At the same time, it was proved through findings of several surveys and researches that the price cut gave an upward push to consumption as the decision played havoc with the nation’s health and finances. The decision to cut prices also ignored the fact that high rates of tobacco use impose a large health and economic burden in Pakistan.

According to the WHO, around 80% of the 1.3 billion tobacco users worldwide live in low- and middle-income countries where the burden of tobacco-related illness and death is heaviest. Tobacco use contributes to poverty by diverting household spending from basic needs such as food and shelter to tobacco<sup>4</sup>.

“A tax increase that increases tobacco prices by 10% decreases tobacco consumption by about 4% in high-income countries and about 5% in low- and middle-income countries,” <sup>5</sup> according to the WHO.

“The total costs attributable to all smoking-related diseases and deaths in Pakistan for 2019 are Rs 615.07 billion (\$3.85 billion), and the indirect costs (morbidity and mortality)

<sup>4</sup> <https://www.who.int/news-room/fact-sheets/detail/tobacco>

<sup>5</sup> <https://www.who.int/news-room/fact-sheets/detail/tobacco>

make up 70 percent of the total cost. Rural residents bear 61 percent, males bear 77 percent and 35–64 age group bears 86% of the total cost,”<sup>6</sup> according to a study by Pakistan Institute of Development Economics (PIDE).

## High taxes hit consumption

In February, the International Monetary Fund (IMF) Technical Assistance Report - Tax Policy Diagnostic and Reform Option – noted that “FED rates on tobacco products were gradually increased between 2019 and 2022, and then saw a big increase by on average 146 percent in February 2023. Survey findings suggest that as a result of this increase, the consumption of cigarettes has declined by 20-25 percent.”

The IMF has recommended the government to introduce uniform taxation on tobacco in order to curb consumption and boost the revenue.

In addition, the global lender recommended to:

- Apply the same rate of excise on all locally manufactured cigarettes, regardless of whether the manufacturer is local or foreign.
- Tax e-cigarettes in a similar way to tobacco, given equivalent internality.

Pakistan, at present, is taxing cigarettes through a system of specific FED on cigarettes and the tax rate is applied to two price tiers: low-priced and high-priced.

But the multinational companies still find ways and means, provided to them by the loopholes in the tax system, to manipulate the as well as violate the rules.

The excise rules do not allow manufacturers or importer of cigarettes to introduce or sell a new variant of a cigarette brand at a price lower than the lowest actual price within the same brand family.

Despite this regulation, the Pakistan Tobacco Company (PTC) has launched a new brand, Capstan International, priced at Rs 164, substantially lower than its existing family brand, Capstan by Pall Mall, which is priced at Rs 212.

Similarly, a campaign has been launched by these companies seeking permission to introduce 10-stick cigarette pack, which the experts and health advocates, fear would increase consumption. It is feared that Pakistan would lose the hard-won gains, in terms of reduced consumption, if the permission is granted.

Though the taxes have been increased in recent past, cigarettes are more affordable and cheaper in Pakistan than elsewhere in the region and beyond.

In premium segment, a pack of Marlboro costs USD 1.69 in Pakistan but it in Bangladesh the price is USD 2.71, USD 4.20 in India, USD 6.05 in UAE, USD 6.11 in Sri Lanka, USD 6.23 in Bahrain and USD 7.46 in KSA.

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<sup>6</sup> <https://www.pide.org.pk/Research/The-Economic-Cost-of-Tobacco-Induced-Diseases.pdf>

The VFM exhibits a similar trend. The price for a pack of Pall Mall Capstan in Pakistan is USD 0.75 whereas it costs USD 3.18 in UAD, USD 3.98 in Sri Lanka, USD 4.80 in KSA and USD 6.23 in Bahrain<sup>7</sup>.

## Methodology

### **(a) Process**

Total of 1,500 General Interviews were conducted with people who regularly smoke. General interviews were conducted randomly with smokers in different areas of Pakistan's second largest city of Lahore. The interviews were planned in January 2024 and were executed in March 2024.

### **(b) Challenges**

Throughout the General Interviews phase, our teams encountered minimal difficulties. Out of 1,500 general interviews conducted, we successfully validated 1,425. The primary hurdle we encountered was interviewing individuals who were underage smokers.

### **Findings of the Survey:**

The *first section* of the study explains demographic profile of the survey respondents and the *second section* of the study aims to examine the changing behavior regarding inflation and deflation of tobacco prices.

Descriptive analysis of the study has been carried out via statistical package for social sciences (SPSS v.20) to check the standard deviation and mean of the variables. Variance is investigated through gender, age groups, experience and education regarding changing behavior of consumption with respect to price.

## **SECTION-I**

### **(a) Gender**

Table 1 summarizes gender distribution of the survey according to percentages and frequency in total number of responses. To describe it specifically in total of 1,425 questionnaire respondents, close to 92% (1,311) were male and 8% (114) were female.

Therefore, we can deduct from the above data that male responses are comparatively higher than the female responses.

Moreover, mean value is 1.08 which indicates that most of the survey respondents are males; S.D is 2.75 and value of Kurtosis 1.5 lies in acceptable range of normal distribution (George and Mallery, 2010).

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Table 1. Frequency Distribution of Gender of Survey Respondents

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	Frequency	Precent	Mean	S.D	Kurtosis
Male	1,311	92	1.8	2.75	1.5
Female	114	8			
Total	1,425	100			

### (b)Age

Table 2, elaborates age distribution of the sample size. Out of total sample size 1,425, respondents in age group 21-25 years are reported to be 32.5%, and age group 26-30 years consisted of 23%. Thus overwhelming majority of the survey respondents comprises of young adults. Similarly, age group 15-20 years is 16.7% and 31-35 years 17.1 % respectively. Respondents of age group 36-40 years comprised of 10.7% of the total sample. Our sample mean is 2.7 (32.5%), which suggests that most of our respondents are in 21-25 years' age group. S.D value is 1.23. Kurtosis value (-0.872) lies in acceptable range +2 and -2 (George and Mallery, 2010).

Table 2. Frequency Distribution of Age of Survey Respondents

Age Group	Frequency	Percentage	Mean	S.D	Kurtosis
15-20	238	16.7	32.5	1.23	-0.872
21-25	463	32.5			
26-30	328	23			
31-35	243	17.1			
36-40	153	10.7			
Total	1,425	100			

### (c)Experience

Table 3. Frequency distribution and descriptive statistics of experience of survey respondents.



	Frequency	Percentage	Mean	S.D	Kurtosis
None	356	25	2.19	0.903	-.783
1-5 Years	541	38			
6-10 Years	415	29.1			
11-15 Years	113	7.9			
Total	1,425	100			

Table 3, demonstrates the frequency distribution and descriptive results of experience of survey respondents. Mean value is 2.19 with 38.4%, this depicts most of our respondents lies in experience group of 1-5 years. S.D is .903 and kurtosis value -.783 (acceptable range of normal distribution). 28.7% of our total respondents were from age group of 6-10 years of experience, whereas, 11-15 years' experience group has 7.9% respondents. Those who didn't possess any experience were 25%. Value from frequency distribution suggests those who smoke tobacco are experienced entry-level professionals.

#### (d) Education:

*Table 4. Frequency and descriptive statistics of Education of Survey respondents*

	Frequency	Percentage	Mean	S.D	Kurtosis
PhD	21	1.5	2.6	1.3	0.477
MS/Mphil	231	16.2			
Masters	327	23			
Bachelors	526	36.9			
Diploma	247	17.3			
Other	73	5.1			
Total	1,425	100			

The above table demonstrates educational level of survey respondents who smoke cigarettes. Survey respondents were given six choices to choose among their own education level.

Mean value of our sample is 2.6 whereas 36.9% respondents have Bachelors education level.

The values in table suggest that people at early higher education level consume tobacco. Kurtosis value 0.477 explains the sample size is normal distributed.

Respondents have MS/MPhil education were reported to be 16.2 %. Moreover, Master level education of respondents is 23%.

Those having diplomas were 17.3% of total sample size. And 5% respondents didn't mention their qualification.

## SECTION-II

### (a) Smoking Frequency

Table 5. Frequency of smoking/tobacco consumption

	Frequency	Percentage	Mean	S.D	Kurtosis
Regular	741	52	2.3	0.8	-1.11
Medium	399	28			
Occasional	285	20			
Total	1,425	100			

Table 5. Represents frequency distribution of survey respondents in terms of smoking degree. S.D 0.8 and kurtosis value is within acceptable normal distribution range (-1.11). Mean value is 2.3 and most of the survey respondents (i.e. 52%) smoked tobacco on regular basis. Whereas 28 % survey respondents smoked tobacco at medium degree, whereas 20% respondents occasionally smoked tobacco.

### (c) Daily Consumption

Table 6 categorized the survey respondents in terms of tobacco consumed. Most of the survey respondents (40%) consumes 6-10 sticks per day. Whereas 29 % respondents consume 11-15 sticks per day. And 21.5% survey respondents consume 1-5 sticks per day.

There were 7% respondents who consume 16-20 sticks, the least number of respondents (2.5%) consumes 21 plus sticks per day.

Table 6. Frequency distribution of tobacco consumed by survey respondents

	Frequency	Percentage	Mean	S.D	Kurtosis
1-5 cig	306	21.5	2.2	1.0	-0.09
6-10 cig	570	40			
11-15 cig	413	29			
16-20 cig	100	7			
21 and more	36	2.5			
Total	1,425	100			

#### (d) Price vs Consumption:

Table 7. Increase in price decreases their daily consumption

	Frequency	Percentage	Mean	S.D	Kurtosis
Yes	901	63.2	1.2	0.9	-1.12
No	170	11.9			
Neutral	354	24.8			
Total	1425	100			

Table 7 elaborates the opinion of the survey respondents against a statement; ***“increase in price will decrease my consumption of tobacco per day”***.

The findings show 63% of respondents opted for “Yes” for the above-mentioned statement; therefore, we can suggest that increase in price has negative effect on consumption of tobacco.

Moreover, organizational policy of increasing prices is to discourage smoking of tobacco can be fulfillment of social responsibility in improving health indicators.

It was found that 25% of respondents couldn't decide and had neutral opinion whether increase in price has negative effect on their daily consumption. 12% respondents didn't care about the increase in prices of tobacco would decrease their daily consumption of tobacco.

#### (e) Impact of recent increase in Cigarette prices over consumption

Table 8. Increase in the price of tobacco has impact on daily consumption

	Frequency	Percentage
Quit	257	18
Switch	85	6
Reduced	214	15
Neutral	869	61
Total	1425	100

The above table 8, summarizes the responses against the argument, ***“Decrease in daily consumption of cigarettes due to the increase in prices resulting from the rise in FED.”***

The survey found as much as 18 % respondents have quit smoking after the cigarettes prices went up and become less affordable.

Another 6 % of the respondents said they have switched brands and gone for low priced cigarettes as they could not afford to continue with their old brands.

From the values we can suggest that increase in price of Cigarettes recently has positive impact on people leading them to quit smoking.

## Conclusion

Cigarette taxation proved, like elsewhere in the world, in Pakistan as the most crucial element of the policy to control and reduce consumption of cigarettes. Several research studies and surveys have substantiated that the tax hike promises a clear “win-win” situation for both public and government revenue.

The IMF has recommended the government to introduce single-tier tax structure. Whereas the World Bank has pointed out “A significant revenue gain of 0.4 percent of GDP (PKR 505.26 billion) could be achieved by applying the current rate on premium cigarettes (Rs. 16.50 per cigarette) to standard cigarettes as well.”

The survey results show that price increase is inversely proportional to the consumption of cigarettes which is in line with WHO FCTC. Survey findings reveal that over 63% of the total respondents believe that increase in prices of Tobacco products decreases its consumption.

The survey findings suggest a strong co-relation between prices of the products and tobacco consumption and in order to control consumption the government needs to increase taxes on Tobacco products.

In this regard, 18% respondents have reported that they quit smoking due to increase in prices of cigarettes. The number is huge and shows a contrast with past practice when the number of new smokers would go up with the dip in prices of cigarettes.

Findings of the study suggested that consumption of cigarettes declined by more than 11 billion sticks with 18% quitting smoking following introduction of high FED rates. Similarly, some 15 % reduced the number of cigarettes they would consume due to high prices. The overall impact of consumption is estimated to be around 20 billion sticks per year.

In 2022, the total consumption of cigarettes was estimated between 72 to 80 billion sticks. This number encompasses officially declared production, smuggled cigarettes, counterfeit products, and cigarettes for which duties have not been paid.

The government needs to shift its approach to the cigarette industry, prioritizing public health over revenue generation, embrace global practice of using high cigarette taxes as a tool to reduce consumption and health bill.

Therefore, taking into account the response of cigarette demand to high taxes, this study advocates for the adoption of more robust taxation policies. These policies should be designed to effectively lower tobacco consumption, thereby promoting public health and mitigating the negative impacts of smoking on public health.

## **BIBLIOGRAPHY**