

Under the Finance Act 2022, passed on June 30, 2022, in the National Assembly of Pakistan, the government revised the Federal Excise Duty (FED) rates on domestically-produced cigarettes. Keeping the two-tier system intact, the FED rates increased by 13.5 percent and 12.1 percent for high-priced and low-priced brands, respectively. The weighted average increase in FED rate is estimated to be 12.5 percent. This is a long-awaited increase since the rates were last revised in July 2019. Though much lower than the widely advocated increase of at least 30 percent, it is a positive step that has broken the stagnation in cigarette tax rates. However, more significant tax increases are needed to offset the damage done by the lax cigarette tax policy of the past three years. Key messages from SPDC's analysis are presented below.

The average excise tax share in the retail price is expected to decline from 45.9 percent to 40.9 percent despite the increase in the tax rate. This is due to the fact that the producer prices have increased more than the tax rate increase (Figure 1).

Cigarettes will be more affordable than two years ago.

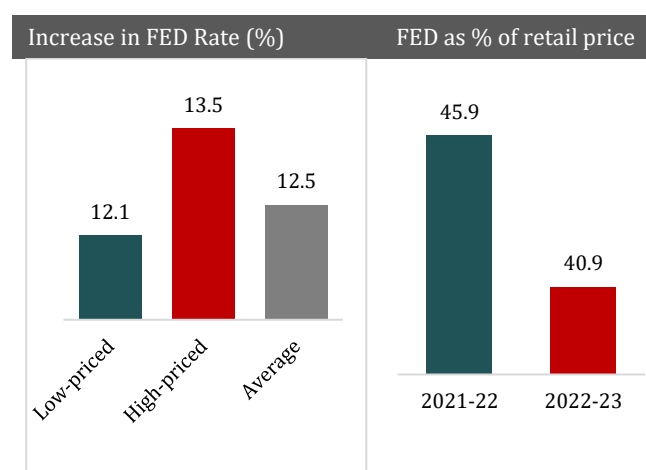
Cigarette affordability, also known as the relative income price ratio, is defined as the percentage of per capita GDP required to purchase 2000 cigarettes. The estimates show that even after the FED increase, cigarettes are expected to be more affordable in 2022-23 compared to 2020-21 (Figure 2).

Consumption of cigarettes will decline by 4.5 percent due to a 10.5 percent increase in the FED rate. However, a 30 percent increase in the FED would have resulted in a 7.6 percent decrease in total consumption.

Revenue and public health benefits will be less profound. The tax increase is expected to generate additional revenue of PKR 13.5 billion (including FED and GST). It would likely encourage more than 380,000 smokers to quit smoking and discourage about 413,000 future smokers from initiating. On the other hand, the estimates show that a 30 percent increase in the FED would result in additional revenue generation of PKR 27.2 billion and 641,000 fewer smokers. Moreover, it would discourage about 696,000 future smokers.

Figure 1: Structure of FED on cigarettes

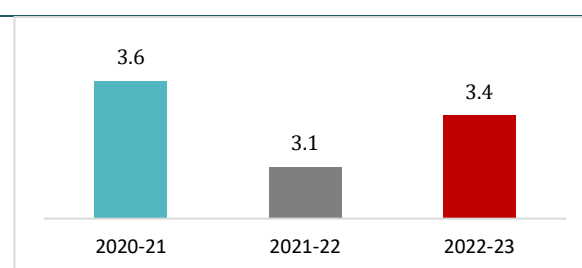
2021-22		2022-23	
Tier/Price*	FED Rate*	Tier/Price*	FED Rate*
≤ PKR 5,960	PKR 1,650	≤ PKR 6,660	PKR 1,850
> PKR 5,960	PKR 5,200	> PKR 6,660	PKR 5,900



* PKR per thousand sticks.

Source: Finance Bill 2022

Figure 2: Cigarette affordability



Source: Pakistan Economic Survey 2021-22; Price estimates by SPDC

Conclusion: The 12.5 percent increase in tax rate is a welcome policy measure but falls short of increasing the share of excise tax in the retail price of cigarettes and making cigarettes less affordable.