

Budget 2022-23

A Welcome but Insufficient Reform: Excise Tax Increase on Cigarettes

Under the Finance Bill 2022, presented on June 10, 2022, in the National Assembly of Pakistan, the government proposed to revise the Federal Excise Duty (FED) rates on domestically-produced cigarettes. Keeping the two-tier system intact, the FED rates increased by 7.7 percent and 12.1 percent for high-priced and low-priced brands, respectively. 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, larger tax increases are needed to offset the damage done by the lax cigarette tax policy of the past three years. This policy brief assesses the expected impact of tax and price increases on cigarette consumption, tax revenues, and health outcomes using a tax simulation model.¹

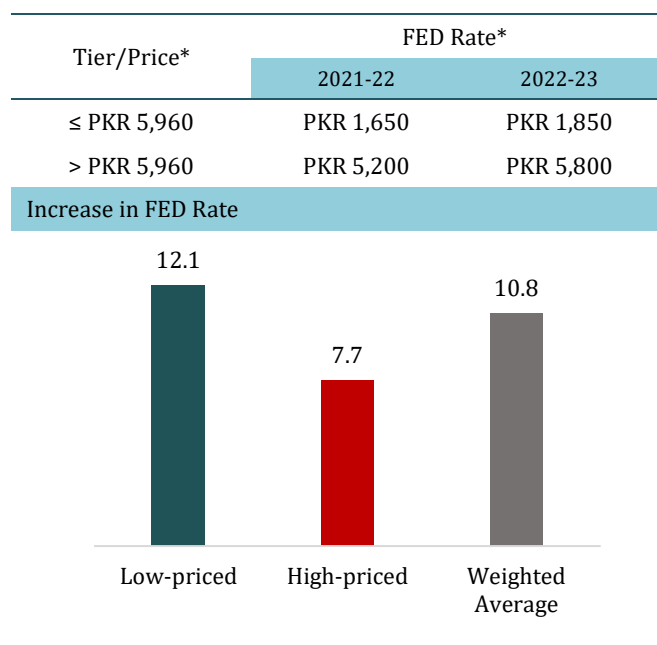
Excise tax share in the retail price would decline despite the increase in the tax rate.

The FED and the General Sales Tax (GST) are the two major taxes on cigarettes in Pakistan, where the FED accounts for almost 80% of the revenue from the sector. Under the FED, cigarettes are categorized by price tiers: low-priced (Tier 1) where the on-pack printed retail price is less than PKR 5,960 per thousand sticks, and high-priced for those above this price (Tier 2). The Finance Bill 2022 proposed an increase in the FED from PKR 1,650 to PKR 1,850 per thousand sticks for Tier 1 and from PKR 5,200 to PKR 5,800 for Tier 2. This way, the excise tax on a 20-cigarette pack has increased by PKR 4 and PKR 8 for Tier 1 and Tier 2, respectively. Tier 1 (low-priced) accounted for 87.8 percent of the market in 2020-21.² Given this market structure, the weighted average of excise tax would increase by PKR 4.5 per pack—from PKR 41.7 in 2021-22 to PKR 46.2 in 2022-23.

KEY MESSAGES

- The average increase of 10.8 percent in excise tax would reduce consumption by 4.3 percent.
- The proposed increase is not enough to achieve significant revenue and health benefits:
 - Excise tax share in the retail price is estimated to decline from 44.7 percent to 39.4 percent.
 - Cigarettes are expected to be more affordable than two years ago.

Figure 1: Structure of FED on cigarettes



* PKR per thousand sticks.
Source: Finance Bill 2022

Figure 2: Consumer prices of cigarettes, PKR per pack of 20 cigarettes

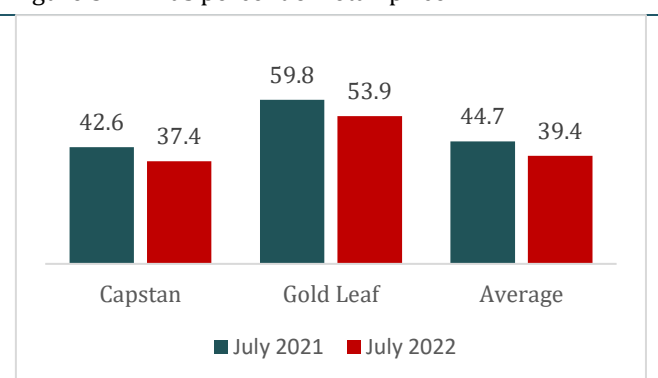
	2021 - 22		2022-23 (Estimated)	Change
	July 2021	May 2022*	Full Passthrough of FED	July 2021 to July 2022
Price of a pack of Gold Leaf	174.00	195.00	207.93	33.93
Change		12.1%	6.6%	19.5%
Price of a pack of Capstan	77.50	91.90	99.03	21.93
Change		18.6%	7.8%	27.8%
Weighted average price	89.27	104.48	112.31	23.04
Change		17.0%	7.5%	25.8%

* Prices of Gold Leaf is estimated through a brief survey of three cities while prices of Capstan are obtained from Pakistan Bureau of Statistics.

It is important to note that a significant increase in the market price of cigarettes was observed a couple of months before the budget (April 2022)³, which was due to an increase in producers' prices.⁴ Since the cigarette prices remained almost stagnant during the first ten months of the fiscal year 2021-22, the comparison of prices is made between July 2021 and July 2022 (Figure 2). Assuming a 100-percent pass-through of tax increase, it is estimated that the price of a high-priced brand (Gold Leaf) and a low-priced brand (Capstan) would increase by 19.5 percent and 27.8 percent, respectively. The average weighted price would increase by 25.8 percent. The increase attributable to tax change is only 7.5 percent. Therefore, the change in the average price is mainly due to increases in producer prices plus retailer/wholesaler margins.

Since the increase in producers' prices is more than the increase in FED, the average excise tax share as a percent of the (final) retail price would decline from 44.7 percent to 39.4 percent (Figure 3).

Figure 3: FED as percent of retail price

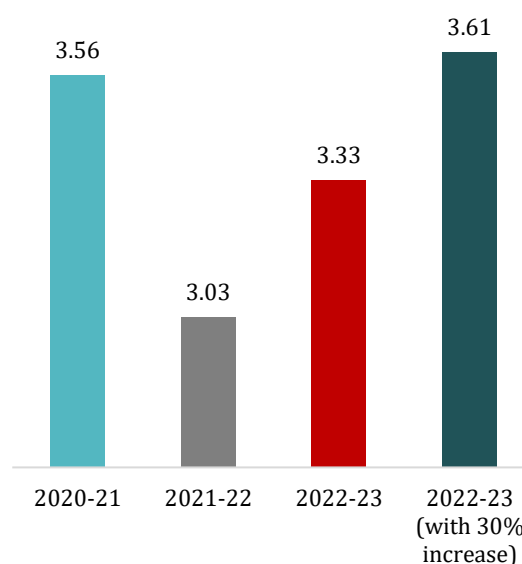


Source: Finance Bill 2022; Prices estimated by SPDC

Cigarettes would 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. This indicates that affordability is determined by per capita income (GDP per capita), general price level, and cigarette prices. In 2021-22, Pakistan's nominal per capita income increased by 17.2 while the inflation was 13.3 percent.⁵ Considering these macroeconomic indicators and the cigarette prices, the estimates show that even after the proposed FED increase, cigarettes would be more affordable in 2022-23 compared to 2020-21 (Figure 4). On the other hand, a 30-percent increase would have made cigarettes less affordable than in 2020-2021.

Figure 4: Cigarette affordability



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

Revenue and public health benefits would be less profound.

The analysis shows that due to the price increase, the total consumption of cigarettes would decline by 4.3 percent, from 3,582 million packs to 3,428 packs. However, due to the tax rate increase, additional revenue of PKR 11.7 billion would be generated (a rise of 7.0 percent)—including PKR 4.7 billion from FED (3.7 percent increase) and PKR 7.0 billion from GST (17.8 percent increase) (Figure 5).

The simulated health implications estimate that the price increase would likely encourage more than 365,000 smokers to quit smoking and would discourage about 397,300 future smokers.

Even so, a 30-percent increase in FED would have achieved better outcomes—a 7.7-percent decline in cigarette consumption, more than 550,000 fewer smokers, a decrease of more than 700,000 in the number of future smokers, and additional tax revenue of PKR 26.6 billion.

Conclusion

The proposed increase in the rate of FED on cigarettes is a welcome policy measure but falls short of the minimum level of increase required to keep cigarette affordability unchanged. Moreover, the average excise tax as a percent of the retail price would remain far below the widely accepted benchmark of 70 percent.

Figure 5: Simulated impacts on revenue and public health due to changes in cigarette prices

	10.8% increase (Finance Bill)	30% increase
Change in cigarettes consumption (million packs)	-154	-272
Percent change in consumption	-4.3	-7.7
Additional FED (Rs billion)	4.7	18.6
Additional GST (Rs billion)	7.0	8.0
Total Additional Revenue (Rs billion)	11.7	26.6
Change in the number of adult smokers	-365,400	-656,700
Change in the number of future smokers	-396,900	-713,400

¹ Modelling the Revenue and Health Implications of Tobacco Tax Policy in Pakistan: Options for the Federal Budget 2021-22, Policy Brief, Social Policy and Development Centre (SPDC), 2021.

² Pakistan: Tobacco Fact Sheet 2022. <https://spdc.org.pk/publications/pakistan-tobacco-fact-sheet-2022>

³ Monthly Price Indices, April 22, Pakistan Bureau of Statistics. https://www.pbs.gov.pk/sites/default/files/price_statistics/cpi/SPI_Annex_April_2022.pdf

⁴ The final consumer price (or final price) of locally produced cigarettes in Pakistan have three elements, which are categorized in two components. The first component is termed as 'printed retail price' that includes producer's price (including producer's profits and wholesaler and retailer's margins) and FED, while the second component is GST (applied at rate of 17 percent of the 'printed retail price'). Therefore, if the producer's price is increased to the extent that it does not cause the 'printed retail price' to exceed the tier limit, final consumer price will increase without any increase in the applicable tax.

⁵ Pakistan Economic Survey 2021-22, Government of Pakistan.

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