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Using taxation to control Tobacco consumption in Uganda

Executive Statement

This brief explores the trends in tobacco taxation in Uganda and highlights the importance of addressing factors that contribute to affordability when using taxation as a tobacco control tool. Drawn from a recent study by EPRC which simulates the potential impact of different tax changes on tobacco consumption, the brief underscores the need to make regular, consistent and uniform adjustments to the tobacco tax structure.

In 2017, the World Health Organization (WHO) estimated that tobacco use kills up to 7 million people each year and nearly 80 percent of the world's smokers are from low and middle-income countries. Tobacco use is globally recognized as a major risk factor for non-communicable diseases like heart disease as well as lung and related cancers¹. Tobacco taxation has been found to greatly influence cigarette prices² and thereby influence consumption. As a result, increases in tobacco excise taxes have been shown to be the most effective policy instrument for reducing smoking in other developing countries³. Uganda like most sub-Saharan African countries is still in the infancy of the tobacco use epidemic, but consumption among vulnerable groups such as the youth is on the rise and therefore requires evidence to inform and drive tobacco control policies.

Having signed and ratified the World Health Organization Framework Convention on Tobacco Control (WHO FCTC) in June 2007; Uganda has taken a strong anti-tobacco stance although more must be done with regard to taxation as a tobacco control tool. The existing taxes are still below the WHO recommended thresholds whereby tobacco excise taxes should make up to 70 percent of the retail price. In Uganda, excise taxes currently make up 31 percent⁴ of the retail price for regular cigarettes.⁵

Expenditure on cigarettes: Research⁶ shows that in 2016 an average tobacco user in Uganda spent up to UGX 949,000 (US\$ 365) annually on cigarettes. This amounts to over half of the 2016 per capita GNI which stood at US\$630.⁷ Results from the 2013 Global Adult Tobacco Survey for Uganda showed that tobacco products are low priced in comparison to other basic household items. Although the percentage of tobacco use has reduced over the past 5 years from 10.5 percent in 2012/13 to 5.4 percent in 2016/17 (UNHS), smoking prevalence among the youth has remained higher than the national rate. The Uganda Global Youth Tobacco Survey Report (2008) found that up to 15.6 percent of the students had ever smoked cigarettes while the national rate from the 2009/10 UNHS was 8.5 percent. This is a worrying trend because reducing the numbers of new smokers is one of the key tenements of tobacco control.

Tobacco Taxation in Uganda

Over the past 15 years, the tobacco tax structure has changed significantly. Until July 2004, Uganda applied an *Ad Valorem* tax to tobacco products which was changed to a more complex multi-tiered structure that imposed different rates based on the brand and characteristics of cigarettes and tobacco products. The tiered structure comprised of three tiers for cigarettes based on packaging characteristics and origin while other tobacco

1 Ezzati and Lopez, 2003; Islam *et.al.*, 2014

2 Chaloupka and Warner, 2000; van Hasselt *et al.*, 2015

3 e.g. Van Kinh *et.al.*, 2006, Shang *et.al.*, 2014 and IARC 2011

4 MoFPED and URA, 2017

5 The current share of total tobacco taxes (excise and VAT) in the cigarette retail price is 42%..

6 CTCA 2017

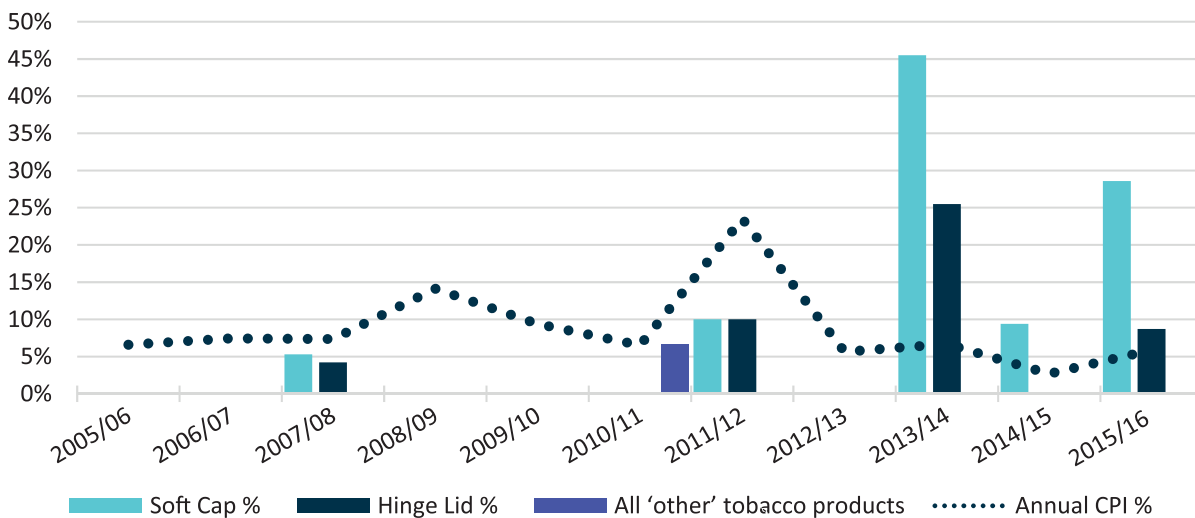
7 World Bank

products remained under an *Ad Valorem* tax. This three-tiered structure was reduced to two tiers in FY 2015/16 with other tobacco products maintaining the *Ad Valorem* tax. Overall, the tax changes have been driven by the need to raise additional tax revenues rather than by health concerns. However, there are proposals to institute a uniform tax on all cigarette types over the three financial years followed by increments in the new harmonised specific tax for proceeding financial years.

The current tax structure – a tiered system- easily lends itself to manipulation and is generally recognized as a less effective tax structure model for tobacco control⁸. In addition, imported cigarettes are currently taxed at a different rate from that levied on domestically produced ones. It has been argued that lower taxes on domestically produced tobacco products would “promote growth and encourage more companies to invest in the country”.⁹ This however presents a challenge because the separation of foreign and domestically produced cigarettes in tax schemes essentially creates an additional tier. From a public health perspective, both types of tobacco products are equally harmful.

Changes in Excise Tax: Although the excise tax rate has been increasing since 2011/12, this has not been at a regular or predictable rate as illustrated in Figure 1. Of the three major tobacco tax heads, the change in tax rate for soft cap cigarettes is consistently highest (although the rate is lower in actual terms), and has fluctuated in the last ten years. The 2017 excise tax diagnostic study by the World Bank showed that in the past 25 years, for every 1 percent increase in GDP the excise tax on cigarettes and other tobacco products has only increased by a meagre 0.18 percent and as such excise tax revenues on tobacco products are highly inelastic.¹⁰ It is not clear the extent to which the tax changes are pegged to inflation and tax rates and revenues from tobacco products (particularly cigarettes) have not kept pace with the growth of the economy. Since FY 2005/6, the 2013/14 tax increment was the first to rise by more than the inflation rate. This suggests that the current tax regime is not responding to affordability of tobacco products- one of the key factors affecting consumption.

Figure 1: % change in excise tax rate



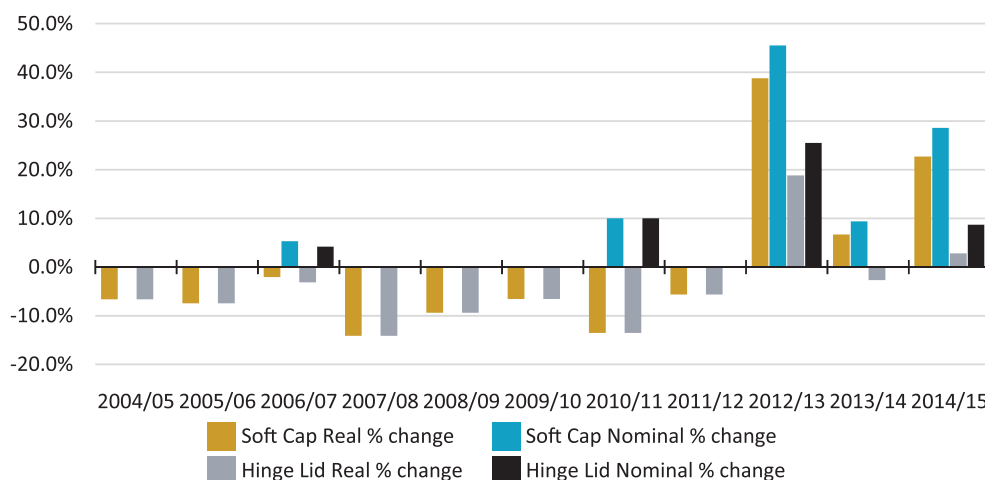
Source: Authors calculations from URA and BoU.

8 Shang et al., 2014

9 Report of the committee on finance planning and economic development on the excise duty amendment bill, 2017

10 World Bank (2017)

Figure 2: Nominal Vs Real tax changes



Source: Authors calculations from URA and BoU

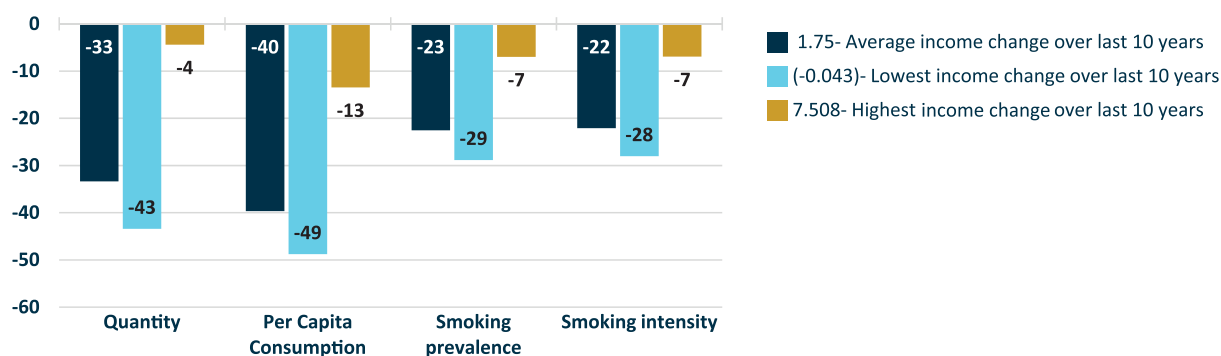
In fact, a comparison of the total changes in tax vis-à-vis the total change in the consumer price index (CPI)—the traditional measure of inflation—shows that from 2005/6 to 2015/16 taxes went up by 137 percent for soft cap cigarettes, 56 percent for hinge lid cigarettes and only 7 percent for all ‘other’ tobacco products. In the same time the CPI went up by 147 percent. Figure 2 which compares the real and nominal changes in tax shows that in real terms, taxes have not been increasing by much.

Why is this an issue?

The inelastic response of tobacco excise taxes to inflation or growth in GDP undermines efforts to curb consumption. Using the TETSIM¹¹ from the Economics of Tobacco Control Project

to assess the impact of a series of potential tax changes on consumption in Uganda. Simulations were done to take into account the long-term impacts of changes in income on consumption variables. The simulations¹² demonstrate that higher incomes and therefore GDP unresponsive taxes stifle tobacco control efforts. Using 2017 as the base year, Figure 3 illustrates how maintaining the current average¹³ tax rate change of 17 percent affects consumption as incomes change. Over the last ten years the average per capita income growth has been 1.75 percent. This level of income growth in tandem with the average tax rate increase of 17 percent would yield a 40 percent reduction in per capita consumption and a 33 percent reduction in the quantity of cigarettes smoked over the next ten years. Similarly at the lowest (-0.043) level of income growth there would be significant reductions in per capita consumption and overall smoking prevalence.

Figure 3: % change in consumption at different income growth levels



11 A comprehensive appendix of the mathematical derivation of the model is available at TETSIM website.

12 Analysis from the simulations concentrates exclusively on cigarettes (sticks) and does not make a distinction between soft-cap and hinge-lid because there is insufficient disaggregated data to input in the model.

13 Average over last ten years

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About the Authors

Anita Ntale is a Research Analyst at the Economic Policy Research Centre, Kampala, Uganda.

Dr. Ibrahim Kasirye is a Principal Research Fellow at the Economic Policy Research Centre, Kampala, Uganda.

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Figure 3 clearly illustrates that at the highest income growth, reduction in per capita consumption is 3 times less than at the average recorded income growth level, and the change in smoking prevalence is also significantly lower.

Policy implications

Taxation as a tool for tobacco control is underpinned by two competing objectives for governments. The first is to optimise revenue by imposing higher taxes and the second is to use the higher prices borne out of those higher taxes as a deterrent to suppress consumption and reduce the resultant negative externalities. To achieve both these objectives, excise tax changes must take into account GDP growth and inflation. Failure to do so affects real revenue for the first objective, and makes tobacco products more affordable thereby undermining the second objective.

Beyond pegging the tax changes to inflation, there is a need to unify the tiers in the tax structure and remove preferential tax rates for domestically produced cigarettes¹⁴. In addition new focus must also be directed at ‘other’ tobacco products whose consumption is likely to increase in the face of less affordable cigarettes.

¹⁴ This has already raised complications as it contravenes EAC laws and British American Tobacco has subsequently taken Uganda to court over this matter. In January, the East African Court of Justice issued an injunction stopping URA from collecting Tax from BAT pending hearing and determination of the case.

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