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The tobacco industry recognises the effectiveness of tax increases in decreasing smoking and therefore sales volumes. Internal documents released as part of settlement of litigation by US attorneys-general against Philip Morris and British American Tobacco include the following statements:

“Of all the concerns there is one—taxation—that alarms us the most. While marketing restrictions and public and passive smoking do depress volume, in our experience taxation depresses it much more severely. Our concern for taxation is therefore central to our thinking about smoking and health.¹ Increases in taxation, which reduce consumption, may mean the destruction of the vitality of the tobacco industry.²”

Given such concerns it is not surprising that the industry has in many instances vehemently opposed large increases in taxes. Opposition to tax increases historically—such as in submissions to government inquiries during the early 1980s to mid-1990s^{3,4}—invariably included one or more of the following arguments.

- First, that the tobacco industry was important to Australia's economy, and that increases in taxes on tobacco (and other tobacco-control measures) would lead to an increase in unemployment.
- Second, that increases in the price of tobacco products were inflationary—that they would result in unwelcome increases in the Consumer Price Index (CPI), which would be in conflict with the inflation-control policies set by central banks and international lending agencies.
- Third, that increases would be likely to have unintended consequences, forcing consumers to switch to more dangerous alternatives such as higher-tar and higher-nicotine cigarettes.
- Fourth, that very large tax increases would lead to such significant declines in smoking that government revenue will be put under threat.^{5,6}
- Fifth, that taxes were paternalistic and that governments should 'stay out of people's lives'.^{7,8}
- Sixth, that increases in tobacco taxes were regressive—that they impact most severely on the poor and underprivileged.^{8,9–11}

None of these arguments has been openly articulated by tobacco companies in recent years, the first four most likely because they have clearly been at odds with governments' experience with tax increases over three decades since the 1980s; the fifth and sixth perhaps because the self-interest would be too apparent. Persons employed by organisations that have received tobacco industry funding⁸ or who have done consulting work for tobacco companies⁷ however *have* produced articles exploring the issue of paternalism and questioning the theoretical rationale for tobacco taxes. Each of the first five arguments is examined in the following five sections.¹ The issue of regressivity is discussed in detail in [Section 13.11](#).

The major current argument against tax increases is:

- Finally, that they will lead to an increase in illicit trade—that the resulting price differences between countries will lead to incentives to smuggle, and that high prices will increase incentives for counterfeiters.¹³

This argument is discussed in detail in [Section 13.7.4](#).

13.10.1 Do increases in tobacco taxes threaten Australia's economy?

Tobacco is no longer grown in Australia and very few people are employed by importers and the major manufacturers. The number of people involved in selling tobacco products at the retail level is difficult to estimate, but almost all would be involved in businesses that sell products in addition to tobacco. Collins and Lapsley have demonstrated that the flow-on effects of employment in the tobacco industry are dwarfed by the social costs in Australia.¹⁴ And as they point out (as has been pointed out before by economist Ken Warner¹⁵) any reductions in tobacco-dependent employment following increases in tobacco taxes or other tobacco-control measures would be offset by increases in employment in other sectors as spending on tobacco products is replaced by spending on other goods and services.

13.10.2 Are increases in taxes on tobacco products inflationary?

Very large increases in the price of tobacco products could affect a country's CPI, particularly if a large proportion of the country's population smokes and daily consumption is high. This issue, and the falling proportion of many populations who smoke, has led many in tobacco control to suggest removal of tobacco from the basket of goods used to calculate the CPI. Indeed, in 1992, Tasmanian Democrat Senator Robert Bell presented a Bill that proposed just such an approach in Australia.¹⁶ The proposal was never supported, mostly because of concerns about the integrity of the index. Modern economic management puts great store by a country's official CPI. It is regarded as a key indicator of economic performance and is taken into account when establishing international credit ratings. CPIs are also often used to determine increases in pensions and benefits. The Australian Bureau of Statistics and most economists have opposed the exclusion of tobacco from the CPI on technical grounds. The integrity of the index relies on a very high degree of consistency over time and with other jurisdictions internationally.

A way around the problems of the inflationary impact of increases in tobacco prices would be to use an adjusted form of CPI that excludes tobacco and alcohol as the index used for wage increases and indexation of pension and benefits. This has been done in Luxembourg, France and Belgium since the early 1990s.¹⁷ This way, increases in the price of cigarettes are not offset by increases in those wages, benefits and pensions that are regularly increased in line with the CPI.

Concerns about the inflationary effects of tobacco price increases have waned over time in an era of much lower rate of inflation and as the cigarettes and tobacco sub-group has come to make up a progressively smaller component of the overall CPI. In Australia, the CPI is reviewed regularly to take account of changing patterns of consumer spending,ⁱⁱ and the sub-indices are re-weighted accordingly after each review.¹⁸ The changing weightings of the cigarettes and tobacco sub-group are set out in Table 13.10.1.

Table 13.10.1

Weighting of cigarettes and tobacco sub-group in overall CPI, 1948–2011, Australia

CPI series	Percentage
1 September 1948	6.000
2 June 1952	4.200
3 June 1956	4.200
4 March 1960	3.900
5 December 1963	3.900
6 December 1968	3.600
7 December 1973	3.560

8 September 1974	3.500
9 September 1976	3.246
10 March 1982	2.385
11 December 1986	2.218
12 September 1992	2.410
13 June 1998	3.080
14 June 2000	2.270
15 June 2005	2.410
16 June 2011	2.320

Source: Australian Bureau of Statistics 2011¹⁹

At the latest weighting,²⁰ the price of cigarettes and other tobacco products would have to increase by at least 20% in order to cause the overall Australian CPI to increase from the March 2012 rate of 1.6%²¹ to 2.0%.

13.10.3 Do tax increases have unintended consequences?

Opponents of tax increases often cite a study by Evans and Farrelly,²² which found that smokers in high-taxing states in the US were more likely to switch to high-tar cigarettes to maintain nicotine intake. There is no evidence of such a phenomenon having ever occurred in Australia, where the move away from high-tar brands began in the 1970s.^{23–27} Euromonitor International reported continuing declines over the 2000s, including a decline of 9% in 2010.²⁸ Machine-measured tar levels are no longer reported on cigarette packaging in Australia.

Harrison points to the example of people putting on weight when they quit smoking and suggests an apparent rise in obesity associated with increases in taxes on tobacco.⁷ This proposition is not supported in a much more sophisticated analysis by Courtmanche, which shows the opposite effect.²⁹ Obesity is a serious problem in Australia, but the contribution of smoking cessation to this is minor^{30,31} and the health risk of putting on a few kilos pales into insignificance compared with the risks of continuing smoking (see [Chapter 3, Section 3.29](#)).

All policies have 'downsides' or costs as well as benefits. While increases in taxes have been associated with some smokers making product-related changes in preference to behaviour-related changes (see [Chapter 3, Section 13.5](#)), not all such changes result in any greater harm for continuing smokers. For example, while use of roll-your-own tobacco may have increased in Australia following increases in taxes on tobacco products,²⁸ this kind of tobacco is not necessarily more harmful to smokers than smoking manufactured cigarettes provided that filters are used (see [Chapter 3, Section 3.27.1](#)).

13.10.4 Do very high taxes threaten government revenue?

It is sometimes argued that, by raising tobacco taxes too sharply, governments risk decreasing tobacco consumption so much that they will actually begin to lose taxation revenue. This proposition is often tied to the work of Laffer, who proposed a curve of diminishing revenue if incentives to work decrease with increasing taxes on incomes.³² Could a large increase in tobacco taxes *kill the goose that lays the golden egg*?

The answer is no, at least not immediately, for a number of reasons.

Because taxes contribute a proportion but do not constitute the whole of the price of tobacco products, prices do not increase in direct proportion to tax increases.¹⁵ As discussed in [Section 13.1](#), because demand is only moderately responsive to prices increases, overall consumption only drops at about half the rate of price increases—not enough to offset the increased revenue gained from increases in the rate of duty. There does not appear to be any documented case internationally of reduced tax revenues when tobacco taxes were increased, even where increases were high and problems with smuggling documented.¹⁵

However, the combined impact of tobacco tax and other tobacco-control policies in the community *will* reduce tobacco consumption and hence revenue from taxes on tobacco over time. This is to be welcomed as evidence of the success of public health policies, and should be planned for in the longer term. It was partly in recognition of the likely decline in excise revenue that the Australian Coalition government in 1998 decided to introduce a goods and services tax.³³

It should be remembered that people who do not consume tobacco products will consume other goods and services. This will result in revenue to government from the goods and services tax they pay on these products and services, and revenue from tax on the profits of companies that sell them. Lower tobacco consumption will also reduce costs to business, thereby increasing revenue to governments from taxes on company profits.

13.10.5 Are tobacco taxes paternalistic and overly coercive?

Increasing tobacco tax has been just one part of the comprehensive strategy for reducing harm caused by tobacco adopted by Australian governments over time.^{34,35} These strategies have also included progressive elimination of all forms of promotion of tobacco products, mandating of clear and comprehensive consumer information, substantial funding of education campaigns, services to quitters and subsidy of pharmaceuticals to help quitters cope with withdrawal symptoms. While all these strategies are valuable, tax increases are by far the most reliable and effective way of reducing consumption, with effects far stronger than for other tobacco-control interventions.^{36,37}

The idea that governments shouldn't interfere in people's lives is attractive in theory. But in Australia more than three million people still smoke, almost 90% of them regretting they ever started.³⁸ Smoking imposes a cost to taxpayers, but this pales into insignificance compared with the costs to business and to the households of smokers themselves.³⁹

Death of a breadwinner in middle age has disastrous consequences in any family—it can cause middle-income families to become financially insecure, and can propel lower-income families into poverty and welfare dependency. Reducing smoking helps people live more productive and healthier lives, which the government will be able to 'stay out of' for much longer!

The evidence that increasing excise and customs duty on tobacco products would increase prices, reduce consumption and increase the number of Australians who give up smoking is incontestable.^{40,41} Failing to act on such a clearly effective policy could be seen as a failure to prevent avoidable premature deaths.

Relevant news and research

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i In its technical manual published in 2010,¹² the World Health Organization includes the following as best practice principles for administration of tobacco taxes:

- Do not allow concerns about employment impact to prevent tobacco tax increase.
- Do not allow concerns about the inflationary impact of higher tobacco taxes to deter tax increases.
- Do not view low taxes and prices for some tobacco products as a 'pro-poor' policy.
- Do not allow concerns about the regressivity of higher tobacco taxes to prevent tobacco tax increases.

ii As determined by household expenditure surveys, and limited to spending patterns of a reference group comprising employed households living in capital cities.

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