

HAZARDS OF HIGH TAXES ON TOBACCO

The wise Minister of a Mauryan King had advised that since all undertakings depend on finance, the king should pay foremost attention to the treasury. The efficacy of this advice has not changed. Even today, the governments make sincere efforts to collect the needed tax revenue from the people. Often, the need and anxiety to collect more revenue makes it difficult to maintain the right balance among different considerations which, at times, are mutually conflicting.

Taxation of tobacco products is an example where this delicate balance gets disturbed. It is an accepted fact that tobacco products are injurious to health. But the economic factors are among the least important reasons for reduction of addiction to this harmful product. The factor that has been found to reduce the habit is enhanced awareness about concerns of personal health together with deterrence created by severe penal provisions in anti-tobacco laws and their effective enforcement. The impact of publicity campaign carried so far in our country has been such that over 50% of tobacco consumers are unaware about the ill-effects they invite, and anti-tobacco laws have not been able to make the desired dent. The gap created by these two factors is sought to be breached through the easily visible measure of higher taxation on this item.

In the Finance Act, 2014, excise duty on cigarettes has been increased by 72% on year-to-year basis for most of the popular brands. Tax rates have also been raised on other tobacco products. Over and above central excise, state governments also levy VAT on tobacco products which vary in the range of 12.5% to 65% from state-to-state. This wide variance in rates has a serious implication and has led to a surge in inter-state smuggling at an unmanageable level. It is logical to think that if the price of tobacco products is high, its sale will reduce resulting in less consumption and hence, less harm to the health of consumers. However, this otherwise sound principle does not always hold good, particularly, where other factors like basic human nature play a more dominant role. We find many people do prefer spending money on alcohol even if their families have to struggle for essential items of livelihood such as food, clothing, and house.

One noteworthy effect of very high rates of taxation on any item, be it gold or tobacco, is less compliance to tax laws, increase in evasion, and consequently, a reduction in the estimated revenue. This is why income-tax, customs and excise duties rates have substantially been reduced over the years especially since 1991. The resultant enhanced compliance level led to buoyancy in revenue collection. On items like tobacco products and alcoholic beverages, since tax rates are kept high; there is lesser compliance and higher evasion. According to an expert committee report in association with FICCI in the year 2012, the share of grey market was 15.7% in tobacco products resulting in sales loss to the tune of Rs. 8,965 crore to the genuine industry, and revenue loss of Rs. 6,240

crore to the central and state governments. The major source of supply in the grey market is counterfeited and smuggled goods which are increasing with the passage of time. The share of grey market in tobacco products is reported to have increased from 15.7% to over 20% in just two years.

The illegal activities of counterfeiting and smuggling are flooding the market with substandard fake goods which are produced without following quality norms at unhygienic places, and are sold without issuing bills, thus contributing towards increase in unaccounted money. The government gets less revenue, and the consumers whom the government wishes to protect get exposed to much greater health risks. No one would deny that consumption of good quality products even in respect of items like alcohol and tobacco is much less harmful than their counterfeited substandard substitutes. Among different tobacco products, cigarette is an item which is manufactured at comparatively cleaner places ensuring the good quality of tobacco and other ingredients. However, under the burden of high taxes, its share in total consumption of all tobacco products has reduced substantially over the years from 23% in 1971-72 to 11.9% in 2013-14 while the consumption level of more harmful tobacco products including fake cigarettes has proportionately increased. According to credible reports 20.8 billion cigarette sticks are smuggled into India every year, making it the fifth highest consumer of smuggled cigarettes in the world. Industry estimates further reveal that an estimated 60 million cigarette sticks are smuggled every month in Mumbai followed by 35 million sticks in Delhi and 20 million sticks per month in Pune, Bangalore and Hyderabad.

The other scaring point is that smuggling of cigarettes has posed a major security concern for many countries as it is financing terrorist activities. "Terrorist financing through cigarette smuggling is huge" says Louise Shelly, a transnational crime expert at George Mason University, and an adviser to the World Economic Forum on Illicit Trade. She further adds, "No one thinks cigarette smuggling is too serious, so law enforcement doesn't spend resources to go after it". The U.S. Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) has investigated a number of cigarette smuggling cases that were linked to terrorism. It is estimated that one in every three cigarettes exported worldwide is sold on the black market. The menace of cigarette smuggling has its roots in high rates of taxation. Counterfeiting and smuggling of cigarettes and drugs have been found to be one of the key sources of funding of extremist groups like Hezbollah, Taliban, Al-Qaeda, Boko Haram among others. Since, in respect to tobacco products, the percentage of grey market is on the rise and definite linkage has been established between their unchecked sale and the subsequent danger on health and security of people, it is desirable to take a serious note of this aspect while looking into the taxation of this sensitive item.

Health concerns can be effectively addressed by launching awareness campaigns and giving more teeth to anti-tobacco laws. It does not seem feasible that the habits of

drinking and smoking can be stopped altogether. There is not a single example in the world where by increasing taxation, the consumption has either waned or has been eliminated. Over the years there has been an increase in the illicit trade in cigarettes which forms nearly 20% of the total cigarette market in India. There has also been a steep rise in the cigarettes manufactured by small manufacturers in the unorganised segment. What additional taxation often does is that it opens the channels for smugglers and counterfeiters to enter and thrive in this rather low risk and high rewards business.

(P C Jha, Advisor FICCI CASCADE
and former Chairman, Central
Board of Excise and Customs)