

Excessive Taxation Harming Jobs, Health & Economy

The recent announcement by the government to increase levies on cigarettes in the form of National Calamity Contingent Duty (NCCD) has created significant uncertainty and anxiety for the legal cigarette industry. This decision comes at a time when the legal domestic cigarette industry is already facing a huge challenge from illicit and smuggled cigarettes. In-addition, this action will in all probability put additional pressure on the already serious job scenario in the country, and the tobacco industry which generates huge livelihood, and is highly labour intensive, especially the farming end of it, is bound to be adversely impacted by this step.

Already, job creation in India is a matter of great concern and a huge challenge. Job losses because of increase in smuggling and counterfeiting is not even on the radar of the policy makers of the country. In this context, FICCI CASCADE (Committee Against Smuggling and Counterfeiting Activities Destroying the Economy) for the first time in 2019 commissioned a study to identify the potential that lies in the containment of illicit trade in the country. In just five sectors, namely, Textiles, Tobacco Products (Cigarettes), Readymade Garments, Capital Goods (Machinery and Parts), and Consumer (Electronic) Durables, there is a potential to create over 16 lakh additional jobs which are currently being lost because of smuggling of these items after taking into consideration backward linkages and multiplier effects of these sectors in the economy as a whole.

The impact of tax hikes on farmers' livelihood can simply not be overstated. Any increase in tax on cigarettes is damaging for the domestic industry. Already, the livelihood of 2.6 crore Indian farmers and farm labourers which include women and tribal people is under severe pressure due to high taxation. Their cumulative drop in earnings has been estimated at over Rs. 5,000 crore during 2013-14 to 2018-19. In fact, smuggled and illicit cigarettes are estimated to use 17 million kgs of unaccounted tobacco which ends up stealing precious Indian jobs to the farmers of other tobacco growing countries such as Malawi, Zimbabwe, Tanzania and many more.

The level of taxation on a commodity like tobacco products has also got direct bearing on the health of the people. Somehow, the government holds the view that by increasing tax rates on cigarettes, its consumption can be reduced and thus the health hazard to the people can be minimized. However, on the basis of available statistics from the government sources itself, it is clear that with the increase in tax rates on cigarettes, there is a commensurate rise in the share of grey market, i.e., increase in availability of unaccounted, untaxed, smuggled, counterfeit and other types of illicit products in the market which are made in unhygienic and unhealthy environment with no concern for quality. There is also no doubt that such products of proven inferior quality are much more

injurious to health than the genuine tax paid products. It is an accepted fact that tobacco products are injurious to health, and hence, there is a need to curb their consumption. Subjecting a health injurious product to an excessive unrealistic tax rate is an unwise policy of the government, since it does not result in meeting the stated objective of protecting health of the people, and on the contrary, it results in huge tax evasion and also causing more harm to public health by pushing the people to consume sub-standard cheap substitutes which are marketed openly without carrying the statutory health warnings.

The NCCD increase will further the incidence of cigarette smuggling in India. The rampant sale of smuggled and illicit cigarettes has a long list of ill effects which include the opening of the hawala route to transfer money, generation of black money which is a direct result of money laundering, and serious security concerns as there is a direct and established link between illicit trade and smuggling with terrorism. Top terror groups like Al Qaeda, Taliban, ISIS, Hezbollah and many more over the years have been using proceeds from smuggling and illicit trade to fund their nefarious agendas.

It is a matter of grave concern that the domestic tobacco industry is facing a huge challenge from illicit and smuggled goods. Estimates by the FICCI CASCADE study of smuggling based on consumption approach shows that smuggling of cigarettes has increased from Rs. 7,183 crore in 2015-16 to Rs. 7,729 Crore in 2016-17 and further to Rs. 8,750 crore in 2017-18, which results in 14 to 20 percent of output loss to domestic tobacco manufacturers. These statistics are based on data obtained either from government sources or international agencies such as UN COMTRADE. The tax burden on cigarettes (cumulative growth in rates of tax, after cognizing for the increase in rates of GST Compensation Cess) has trebled between 2012-13 and 2017-18, in addition to successive year on year increases in excise duty rates between 2012-13 to 2016-17 amounted to a compounded CAGR of 15.7 percent. Tax collections, however, increased only by 4.7 percent CAGR, clearly indicating sub-optimisation of revenue collections resulting from excessively high duty rate increases. In 2017-18, the GST rate, contrary to the Revenue Neutral principle, as promised by the government, significantly increased the tax burden on legal cigarettes by 19 percent.

Taxation has a very critical impact on volumes of both legal and illicit cigarettes. Policy makers often lose sight of the obvious fact that higher the rate of taxes, higher is the illegal profit in evasion. There has to be a perfect compatibility between higher rates of taxation and higher efficiency level of enforcement agencies to check evasion effectively. Therefore, striking a right balance in fixing tax rate is critical. While taxation on legal cigarettes was increasing, illicit and smuggled trade in cigarettes increased from 21.8 billion sticks in 2013 to 26.4 billion sticks in 2018, a disturbing

increase of 21 percent. Here it is important to state that stability in tax rates ensured that the illicit cigarette market grew, albeit at a relatively slower pace.

In India, unlike the west, cigarettes are only 9 percent of the total tobacco consumed, and 91 percent of the tobacco consumption is in non-cigarette as also illicit products. It is important to note that the tax burden on this overwhelming majority is almost negligible. In this context, it is critical to understand and underscore the tobacco consumption pattern in India. While the overall tobacco consumption in India has increased from 320 million Kg in 1981-82 to 544 million kg in 2017-18, it is essential to state that the share of legal cigarettes has come down from 86 million kg in 1981-82 to 52 million kg in 2017-18. This makes it clear that while tobacco continues to thrive, it is the legal cigarettes that continue to bear the brunt. International studies have shown that taxes on cigarettes in India are the second highest in the world and its prices in India are much more than of our neighbours and of many developed countries.

It would therefore be important to reconsider the decision to hike the taxes on cigarettes. This would serve in the best interest of the nation on multiple fronts, as this would result in increased revenue, greater job creation, addressing the health concerns, reigning-in anti-social elements and curtailing the generation of black money.

(P. C Jha

Former Chairman, Central Board of Indirect taxes and Customs (CBIC) and

Advisor, FICCI CASCADE)