Tobacco Control in Practice

Article 6:
Price and tax measures to reduce the demand for tobacco

Case studies of implementation of the WHO Framework Convention on Tobacco Control in the WHO European Region
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Increases in tobacco taxes are known to reduce tobacco consumption quicker than any other single measure – although a combination of measures, such as those featured in the overall WHO Framework Convention on Tobacco Control (WHO FCTC) menu, provides the most effective approach of all. Regular tax increases especially affect the spending power of young people and may therefore help to deter the onset of tobacco use. They also have a secondary added value, in that they increase government revenue.

Article 6 requires parties to introduce fiscal policies that steadily increase the selling price of tobacco products, including possible prohibitions or restrictions on tax- or duty-free sales.

**Article 6 guidelines?** In preparation

**Timetable for implementation?** Not specified, but parties are required to provide periodic reports (see Article 21), such as on rates of taxation for tobacco products and trends in tobacco consumption.

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**Implementation progress within the WHO European Region**

Most countries (42) in the Region now ensure that at least 50% of the retail price is tax. Several of these countries (22) have achieved a tax rate of 75% or more – an increase of 7 countries in this higher bracket since 2008.

**Ukraine**

- **Population**: 45.4 million
- **Prevalence (adults, age-standardized)**
  - Male: 50%
  - Female: 13%
  - Total: 32%
- **Selling price (per pack, 20 cigarettes)**
  - Most sold: US$ 0.90
  - Cheapest: US$ 0.48
- **Date ratifying WHO FCTC**: 6 June 2006
The story of Ukraine

In 1993–1994, transnational tobacco companies lobbied the Government of Ukraine heavily and succeeded in lowering the tobacco tax. However, this did not result in an increase in revenue, as had been promised by the companies. The tide turned from 2008 to 2011, when the total excise increased by more than six-fold. The Ukraine experience shows that the synergy of various actors within the country can break through to reverse the situation and overcome long-standing resistance.

By Konstantin Krasovsky

Case study questions
What were the lessons learned from both the successful and unsuccessful attempts?
How did they decide how much to raise the taxes?
Who were the important actors that made this case study a success?
Why was great effort put into raising taxes and not prices?

Country context
After Ukraine became independent in 1991 and began its transition to a market economy, the transnational tobacco companies gradually took over almost all cigarette production in the country. In the early 2000s, Ukraine experienced an increase in smoking prevalence rates. In 2005, the prevalence of current smoking reached 67% among men (the highest rate in the European Region that year) and 20% among women.

Beating the odds
Even before entering the market in Ukraine, transnational tobacco companies made efforts to change the tax system in the country. In 1993–1994, transnational tobacco companies lobbied the Government of Ukraine and succeeded in reducing the tobacco excise tax. This, however, did not result in the revenue increase that they had promised to the government. Because of lobbying activities by the transnational tobacco companies between 1999 and 2007, the tax increases were very moderate, which resulted in increased tobacco consumption. The second important component of the revenue growth was a sharp increase in cigarette smuggling out of Ukraine. Production increased from 70 billion cigarettes in 2001 to 129 billion in 2007 (Fig. 1), but only 85–95 billion cigarettes were consumed within the country.

The remaining 30–40 billion cigarettes were smuggled primarily to the European Union (EU) countries. This was smuggling of excise-paid cigarettes, and this...
smuggling accounted for 25% of Ukrainian tobacco excise revenues. The authorities were satisfied with such a taxation policy, as nominal tobacco excise revenue increased from Hrv 726 million in 2001 to Hrv 2.5 billion in 2007. However, the inflation-adjusted revenue increase was parallel with the cigarette production increase (4).

**Tobacco industry lobbying in Ukraine caused a change in the tax system in their favour in 1993–1994 and only moderate tax increases in 1999–2007.**

Real prices declined as the general consumer price index increased by 131% in 1999–2007, whereas the price of tobacco products increased a mere 25%. In other words, between 1999 and mid-2008, the inflation-adjusted price of a cigarette pack decreased by almost 50%.

**From challenge to success**

In response to the tobacco epidemic, national authorities undertook several measures. In 2005, the Ukrainian parliament approved a law to prevent and reduce tobacco consumption and its harmful effects on human health. In 2006, Ukraine ratified the WHO FCTC. In 2009, the Cabinet of Ministers approved the state targeted social programmes to reduce the harmful effects of tobacco until 2012. Tobacco advertising was banned on television and radio (since 1996), on public transport (since 2003), outdoors (since 2009) and in print media (since 2010).

The above-mentioned tobacco control law prohibited such descriptors as “lights” on cigarette packs and introduced partial smoking bans, 30% text health warnings and other measures (5).

The tobacco control policies implemented in Ukraine since 2005 have greatly reduced the smoking prevalence. Although all tobacco control policies are important, the main factor accounting for the observed smoking reduction in Ukraine was obviously the increase in tobacco taxes and prices. Between September 2008 and January 2011, the prices of cigarettes rose three-fold by raising the average excise tax rates seven-fold (Box 2). The increases gave a dual positive result, reducing cigarette consumption and increasing tax revenue (Fig. 1).

**Although all tobacco control policies are important, the main factor accounting for the smoking reduction in Ukraine since 2005 was the tobacco tax increases.**

**Box 2: Timeline highlights**

- 2005 Tobacco control law enacted
- 2006 WHO FCTC ratified
- 2009 Government programme developed to reduce the harmful effects of tobacco
- 2008–2011 Excise taxes increased seven-fold and the price of cigarettes rose three-fold

**Getting it on the agenda**

In 2007, both the government and opposition parties submitted several proposals on tobacco excise taxes, but all of them proposed very moderate tax increases to keep the prices of tobacco from increasing to keep pace with inflation. Tobacco excise taxes were not on the mass-media agenda. To raise mass-media awareness of excise taxes on tobacco, the Coalition for a Tobacco Free Ukraine held a press conference in February 2008 to propose a substantial tobacco tax increase, with four key messages. The press conference was widely publicized in the mass media, and the public started to understand the abnormal and dangerous situation with low excise taxes on tobacco.

**The discussion on smuggling backfired on the tobacco industry**

**Key messages**

- Smoking rates in Ukraine are very high.
- Prices for healthy products are rising rapidly, whereas the prices of deadly cigarettes have almost not changed.
- Cigarette prices in Ukraine are much lower than in the neighbouring Russian Federation.
- Tobacco revenues are very low: the Government of Ukraine gets the same amount of revenue from one pack as Poland gets from one cigarette.
Later, when the tobacco industry proclaimed their usual smuggling arguments against the tax increase, the Coalition presented the evidence that many more cigarettes are smuggled out of Ukraine than into Ukraine, and that a tax increase in Ukraine could prevent cigarette smuggling into the EU countries.

Thus, the discussion on smuggling in the mass media backfired on the tobacco industry. Government officials had to respond, and although they initially mainly reproduced the tobacco industry rhetoric, the Coalition convinced them of the arguments in favour of tax increases. All arguments against tax increases were studied, and publicly responded to with facts and figures, as the Coalition produced a series of professional papers published in government newspapers, professional journals and popular political web sites. The arguments were also presented on television and radio, and representatives of the Coalition attended and spoke at the meetings of the Parliamentary Committee on Tax Policy and at other events.

The Coalition members used press conferences with top leaders in Ukraine to draw attention to the tobacco taxation. The pivotal meeting was conducted in early July 2008 with the Prime Minister, after her press conference. She got the message that cigarettes in Ukraine are much less expensive than in the neighbouring countries and that public opinion favours tax increases. She then became one of the main proponents of increasing the tobacco excise taxes, and in her public speeches she emphasized that the primary aim of such increases is health, although fiscal reasons are also important.

In retrospect, the proposed rates were probably too high to be supported at the initial stage.

Success 1
In July 2008, the Prime Minister became a proponent of a tax increase. She used the urgent need for additional revenue to ameliorate the consequences of floods in western Ukraine and persuaded the Parliament to adopt the bill on tax increase prepared by the head of the Committee on Tax Policy. The bill increased excise rates about twofold on 1 September 2008 (Fig. 2). Although the rates were lower than what the previous bill proposed, they were quite good. The adoption of the bill demonstrated that the opponents in the tobacco industry could be defeated. It also showed that new rates generated considerable money for the state budget, which was especially important, since the global economic recession hit Ukraine in late 2008. Although the Prime Minister’s support was a key trigger, the success was also due to the supportive political and media climate created by the Coalition efforts.

Increase in tobacco tax earmarked for relief for flooding in western Ukraine

Attempt 2
The Prime Minister publicly promised that the September tax increase was not going to be the last one. The Ministry of Finance was asked to submit a new bill, which proposed rather moderate tax increases. Similar rates were proposed in another bill submitted by the head of the Committee on Tax Policy.

The Coalition publicly called these bills “imitation tax increases” and asked 12 members of Parliament to submit the bill proposing to increase rates twofold. When the Parliament discussed the three bills during the first reading on 16 December 2008, most members of Parliament from both the government and opposition parties supported the bill of the 12 members of Parliament, while both the government and the Committee bills were rejected.

The head of the Committee on Tax Policy, who was responsible for preparing the bill for the second reading, included his rejected provisions on tobacco excise taxes into the draft law on alcohol excise taxes. The Parliament supported this bill in the sec-

Between 2008 and 2010, the tobacco control advocates in Ukraine had three futile attempts and three successes in trying to increase the tobacco taxes.

Attempt 1
In spring 2008, the Coalition prepared a bill to raise the excise rates approximately fourfold. Three members of Parliament submitted the bill to the Parliament, and the Committee on Tax Policy then blocked it. The Ministry of Finance opposed the bill, and the tobacco industry attacked the bill in the mass media. Although the Coalition published responses in the mass media, the officials ignored them and the bill was eventually buried. Lack of political support was the main cause of this failure. In retrospect, the proposed rates were probably too high to be supported at the initial stage.

Having the Prime Minister of Ukraine publicly endorse rising excise taxes on tobacco was key in generating political support for this policy change.
second reading, which meant that the bill of 12 members of Parliament was dismissed for formal reasons. Although the Coalition issued a press release about this deception, the law was adopted and signed by the President and the new rates came into effect on 1 February 2009. This failure paradoxically revealed the strength of the Coalition, as the opponents were not able to win an open battle.

Allies are needed among the people who prepare tax bills for second readings in Parliament

Success 2
In March 2009, the First Deputy Head of the Parliamentary Budget Committee asked the Coalition to prepare a draft bill, which was in turn submitted by seven members of Parliament. The bill proposed the same rates as the rejected bill of the 12 members of Parliament.

In just a few days, the Parliament passed the bill in the first reading, as it gained strong support from the Prime Minister. It was critical that the updated bill was prepared by the Budget Committee for the second reading and not by the Committee on Tax Policy, where the tobacco industry had strong allies.

The Ministry of Finance initially opposed the bill for formal reasons, but then they came to an agreement that the bill could significantly increase revenue. The Deputy Minister of Finance asked for a slight decrease in the proposed ad valorem (based on value) tax rate, and with this small compromise the Ministry supported the bill during the second reading. The tobacco industry arranged vigorous attacks against the bill both in the Parliament and the mass media. The Coalition effectively responded to their arguments with facts and figures. For example, when a former Prime Minister stated that he was against the bill since it could reduce employment in the tobacco industry, the Coalition presented official statistics demonstrating that cigarette production in Ukraine increased between 2001 and 2007 while employment at tobacco factories decreased.

The parliament supported the bill at the second reading on March 31, and it entered into force on 1 May 2009. Excise rates were increased twofold (Fig. 2), and the bill also included provisions on annual inflation for specific excise rates, and since January 2010 the rates have been raised by 15%.

The tobacco industry made many public statements that the bill would only increase smuggling and would not increase revenue. In early 2010, when statistics for 2009 were available, the Coalition publicly presented the forecasts of proponents and opponents to show that none of the industry forecasts came true, while the tobacco control experts’ forecasts were very close to the real figures. The Coalition also analysed cigarette prices, which revealed that tobacco manufacturers raised their own (non-tax) prices to maintain profits. The Coalition made this information public for two reasons: 1) to educate consumers that they should blame the tobacco industry when consumers pay more for their cigarettes and not the government and tobacco control advocates; and 2) to stimulate attempts to quit by increasing smokers’ perceptions that cigarette prices are increasing because, for potential quitters, the perceived price increase is...
known to be more important than the actual one. The general message was: “Foreign tobacco stakeholders want more from your pocket. Don’t pay them, you had better quit smoking”. By using this message, the Coalition underlined that the main justification for high tobacco taxes is health and not revenue.

The main success factor of this story was the strong support by the government, including the Ministry of Finance. The President also supported the bill mainly because the International Monetary Fund advised increasing excise rates as a prerequisite for a loan.

Moreover, tax proponents controlled the process of preparing the bill for the second reading. Finally, the Coalition managed to organize strong public support for the bill, including messages from physicians, and effectively responded to the tobacco industry arguments.

The rates introduced were even higher than those proposed in the bill in 2008.

**Attempt 3**

The government was not able to stop the economic recession from hitting Ukraine and needed to generate more money before the presidential elections in early 2010. In October 2009, after consultations with Coalition experts, the Ministry of Finance proposed a new bill that aimed to increase mainly ad valorem tax rates.

The tobacco industry used their routine arguments on smuggling to stop the bill, and in early October, a high-level official from the Customs Service stated that the volume of the cigarettes smuggled out of Ukraine far exceeds that smuggled into the country. The Coalition publicly stated that smuggling 30 billion cigarettes annually that were legally sold in Ukraine by the tobacco industry cannot be done without the tobacco industry being aware of it. At the end of October, the Parliament supported the government bill on the tax increase, and the tobacco companies significantly increased cigarette production that same month to pay excise taxes according to the old rates and not the new higher rates.

The industry also decided to exploit the political tensions between the President and the Prime Minister just before the elections. Eventually the President vetoed the law ostensibly to prevent smuggling, while the mass media commented that the veto was in fact to prevent additional income for the government.

Although this attempt failed, it revealed the changing position of the Ministry of Finance, which at first opposed a tax increase (Attempts 1 and 2, Success 1) and then became neutral (Success 2), and now it was one of the main proponents of the tax increase. The attempt also revealed the need to have allies at all stages of bill passage, not only in the government and key parliament committees, but also in the presidential office.

**The position of the Ministry of Finance was changing from opposing to advocating tax increase**

**Success 3**

In February 2010, a new President was elected in Ukraine and a new government was appointed. They needed additional revenue, and at that time the Ministry of Finance proposed the bill without consulting the Coalition experts. Some lobbyists managed to persuade not to increase taxes for non-filter cigarettes (where prices had increased fourfold in two years and which are smoked mainly by low-income older people). The tobacco industry remained publicly silent on this occasion. First, they understood they were no longer trustworthy after their previous forecasts failed. They also suggested that extensive mass-media discussions on taxes raised smokers’ awareness and perception of price increases, making them more willing to quit.

The tobacco industry was silent. They realized that they were no longer trustworthy.

The government submitted the bill in April, the Parliament approved it in May, the President signed it in June and it entered into force in July 2010. The tobacco industry used the time before July to increase cigarette production and wholesale sales to pay excise taxes according to old rates. From April to June they sold 32 billion cigarettes versus only 17 billion from January to March and 21 billion from July to September. This resulted in a report that estimated revenue losses of Hrv 0.3 billion. This phenomenon is called forestalling, and it should be addressed when considering subsequent tax increases.

**Forestalling: releasing large volumes of tobacco for consumption immediately before a tax increase**

This time the strong position of the Ministry of Finance was the main factor. The new Prime Minister when being Member of Parliament in 2008-2009...
was one of the main opponents of the tax increases. However, in 2010 the Ministry of Finance managed to change his standpoint by presenting facts and figures on previous successes.

**The battle was not over**

It was important not only to put tobacco taxes on the agenda but also to keep them on the agenda over many years. Tobacco taxes were kept on the agenda with the use of press releases and other media activities, which emphasized such issues as revenue increases, consumption decrease, industry price policy, smuggling and others. The tobacco industry media activities were monitored and responded to. It proved to be very valuable to keep records of previous industry statements and forecasts and to show that they turned out to be wrong and misleading and that the industry cannot be trusted in taxation issues.

In 2011–2012, however, tobacco-control advocates changed the focus of their control measures. Instead of concentrating on tobacco taxes, they took steps to improve the ban on tobacco advertising (effective 16 September 2012), introduce pictorial health warnings (effective 4 October 2012) and implement a completely smoke-free environment in most public places (effective 16 December 2012).

In the first half of 2011, cigarette prices increased by 2.6% but subsequently fell towards the middle of the year as a result of “price wars” between the tobacco companies that lowered the prices of some of their cigarettes to keep a competitive edge. In 2011, the Consumer Price Index (CPI) for tobacco products in Ukraine was 102.4% while CPI in general was 104.6%, which resulted in a fall in real (inflation-adjusted) cigarette prices that year despite an increase in tobacco excise rates.

As of 1 January 2012, the Government increased the specific excise rates for tobacco products by 15.0% (to adjust for inflation). In spite of a 6% increase in tobacco prices in the period January–August 2012, 56 billion cigarettes were sold, corresponding to the amount sold during the same period in 2011. The decline in cigarette sales observed in 2009–2011 had ended.

**Favourable conditions**

The keys to the success of the Ukraine story were the momentum that arose from ratifying the WHO FCTC in 2006, in addition to the expertise on tobacco taxation and history in the country and in neighbouring countries. Answers were provided to all of the main arguments against tax increases, which reduced trust in the tobacco industry. In addition, the government urgently needed additional revenue, especially during the economic recession, and the International Monetary Fund advised increasing excise taxes on tobacco as a condition for a substantial loan.

In Ukraine, the successes were achieved only when all six types of actors worked together as a body in the Coalition for Tobacco Free Ukraine.

**Economic experts (the brain)**

People who have readily available data on tobacco economics (prices, revenue, etc.) are fundamental factors for success. Initially the authorities were rather sceptical about tobacco control advocates, and only economic arguments could change their minds.

**Lobbyists (legs)**

These are people who managed to pass proposals, initially developed by the experts to the decision-makers (officials of ministries, members of parliament and ministers). The higher the political level they can reach the better.

**Media agents (eyes and ears)**

Mass-media campaigns about tobacco tax increases were needed not only to pass the proposal but to make the public aware of price increases, which could be a good trigger for smokers’ attempts to quit.

**Politicians and officials (arms)**

Strong political allies are needed at all stages of the process to pass the tax proposals.

**Public health advocates (heart)**

They help to highlight that the primary goal of tobacco excise increase is health and not just revenue.

**Financial donors (backbone)**

The resources gathered allowed for an extensive media campaign and qualified expertise. In Ukraine, the successes were achieved only when all six kinds of actors representing the body parts worked together in the Coalition for a Tobacco Free Ukraine, which united several nongovernmental organizations and committed individuals from various government, academic and political bodies.

**Evaluation**

Economic data should be evaluated before and after tax increases to clearly conclude about the effects of the tax increase and not depend on the tobacco industry, which always has better access to the data and could manipulate them. The following main data categories should be monitored and evaluated.
How was it decided how much to raise the taxes?

There are no blueprints for decisions on the amount the tax should be raised. However, it is known that tobacco consumption will decrease only if the real (inflation-adjusted and, even better, also income-adjusted) price increases. So the key is that the new rate should ensure a price increase above inflation.

For example, if the average price of a cigarette pack in a country is 3 units, including excise tax 1 unit, value-added tax (VAT) 0.5 units and pre-tax price 1.5 units, and the expected inflation rate is 10%, the excise increase should make the cigarette price exceed 3.3 units. If the excise tax rate is increased by 10% to 1.1 units and industry keeps its non-tax price, the resulting price will be 3.12 units (excise 1.1 units, VAT 0.52 units and non-tax price 1.5 units). To ensure that the price increase keeps up with the inflation level, the excise tax should be increased to at least 1.25 to make the price 3.3 units (excise tax 1.25 units, VAT 0.55 units and pre-tax price 1.5 units). In this situation, the minimum tax increase recommended by tobacco control advocates would be 25%.

As to the upper limits for countries with moderate tax rates, it could be recommended to consider the option when the excise tax reaches 70% of retail price (the level recommended by WHO (6)). In the example above, this means that the excise tax should increase almost eight-fold: to make the price 11 units (excise 7.7 units, VAT 1.8 units and pre-tax price 1.5 units). Such a tax rise increases a cigarette pack price almost 4-fold in a very short time, which is not politically acceptable in most countries. So the decision should be somewhere between merely keeping up with the inflation level and immediate growth to about 70%.

Ukraine’s experience reveals that, in a country without significant tax increases in previous years, a moderate rise such as 50% using the calculations from the above example could be proposed as the first step. The first success can persuade officials to propose new tax increases that could be higher, which in fact took place in Ukraine.

Estimating the revenue resulting from the proposed tax rates is also sensible. For such estimates, information is required about the tobacco excise tax revenue and the number of taxed cigarettes for the previous year with current excise tax rates. Then the number of taxed cigarettes after the proposed tax increase needs to be estimated, taking into account that this number will decline for three reasons: reduced tobacco consumption, reduced smuggling out of the country (if it takes place) and increased smuggling into the country. If price elasticity figures are available from experts, estimating the decline in consumption is easy. Smuggling cannot be precisely estimated, but it is recommended to calculate the number of taxed cigarettes with high (but realistic) estimates of smuggling. Then the new tax rates should be multiplied by the estimated number of taxed cigarettes to estimate the revenue. Usually such calculations reveal that, even with high smuggling levels, the tax rate increase will generate revenue growth in any case.

Why raise taxes and not prices?

Although only increasing tobacco prices (above inflation) is effective in reducing tobacco consumption, governments usually raise taxes and not prices. There are two main reasons for this: in a market economy, authorities should not regulate market prices but have to establish and collect taxes for public needs; and for most governments, fiscal interests outweigh health interests, and regulating taxes is a more reliable fiscal instrument than regulating prices. Increasing tobacco excise tax rates should increase prices as well; however, the price increase is less than the increase in excise taxes since these are only part of the price. The lower this part, the lower the effect of increasing excise tax on the price.

Revenue

For most governments, revenue is the main reason for increasing tobacco taxes. Evaluation of the Ukrainian experience demonstrates that sizable tax increases (in some cases rates were doubled) provide substantial money for the government. Annual revenue from tobacco excise taxes increased from Hrv 2.44 billion in 2007 to Hrv 3.58 billion in 2008 and Hrv 9.06 billion in 2009. For 2010, the revenue exceeded Hrv 13.06 billion. Despite the decline in average monthly sales by 26% in 2008–2010, average monthly revenue increased almost fivefold (Fig. 2).

The tobacco industry argues that if the tax increase is “too high”, the revenue could decline, such as in Georgia and the Baltic countries, which experienced a short-term revenue decrease directly after tax rates increased. The explanation is forestalling. As a result, during the first few months tax revenue can be lower than before the tax increase. For example, in Ukraine in 2010, the tax increase effective from July 1 was announced in April. The revenues and release for consumption took place in the first quarter – Hrv 2.25 billion and 17 billion cigarettes; second quarter – Hrv 4 billion and 32 billion cigarettes (just before the tax...
increase); third quarter – HRV 3.3 billion and 21 billion cigarettes; fourth quarter – HRV 4 billion and 25 billion cigarettes. If the third quarter is compared to the second quarter, the revenue apparently decreased. But considering the data for the entire year, revenue started to increase before the new rates were effective. The tobacco industry often manipulates information to the mass media and the government, comparing revenue exclusively at two time points: just before and after the tax increase.

In 2011, despite only nominal increases in cigarette prices and a reduction in sales, tobacco revenue amounted to HRV 15.3 billion, 17% more than in 2010. This increase resulted mainly from excise rates in the first half of 2011, which were significantly higher than in the same period of 2010, large increases in these rates having been introduced on 1 July 2010. During the period January–September 2012, stable cigarette sales and increased excise rates saw an increase of HRV 1.3 billion in tobacco revenue when compared with the same nine months of the previous year. In contrast, since the sales decline that occurred in October–December 2012 (after implementation of the above-mentioned tobacco control policies) was not compensated for by higher excise rates, the tobacco revenue for that period amounted to HRV 0.03 billion less than for the same period of 2011.

### Tobacco consumption

According to the State Statistics Committee household surveys, daily smoking prevalence for adults 18 years and older in 2010 was 24.0% versus 25.5% in 2009 and 27.5% in 2008. The survey also indicated a decrease in the average number of cigarettes smoked on a daily basis by the average smoker. In general, the tobacco consumption decrease in Ukraine in 2008–2010 could be estimated as at least 15%.

### Prices

In Ukraine, the average excise for filtered cigarettes increased seven-fold within three years from HRV 0.5 to HRV 3.5 per pack, while the nominal average price increased three-fold. In early 2008, the average price of cigarettes was about HRV 3, comprising: excise tax HRV 0.5, VAT HRV 0.5 and pre-tax price HRV 2. In late 2010, the price was about HRV 8: excise tax HRV 3.5, VAT HRV 1.3 and pre-tax price HRV 3.2. This shows that the industry increased the pre-tax price by 60%. Tobacco manufacturers raised their own (pre-tax) prices to maintain profits in the face of falling consumption. This reveals the hypocrisy of their statements that higher taxes and prices are incentives for smuggling into the country. If they really had wished to reduce smuggling, they would have maintained the pre-tax portions of the price.

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The tobacco industry increased its pre-tax price by 60% between 2008 and 2010 to maintain profits as consumption fell.

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<th>Cigarettes on which taxes are paid are smuggled to other countries. Is this good for revenue?</th>
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| Out-of-the-country smuggling seems to benefit country tax and production revenue, and hence one can hypothesize that low taxes and high price differences should be maintained. However, this opinion is misleading.

In 2007, the average excise tax in Ukraine was about HRV 0.4 per package, and the number of taxable cigarettes was about 120 billion or 6 billion packs including about 40 billion (2 billion packs) smuggled out of Ukraine. The excise tax revenue was about HRV 2.5 billion, including HRV 0.8 billion paid by smugglers. In 2010, the average excise tax was about HRV 2.7 per package, and the number of taxable cigarettes decreased to 96 billion (4.8 billion packs), including about 30 billion (1.5 billion packs) smuggled out of Ukraine. The excise tax revenue was HRV 13 billion, including HRV 4 billion paid by smugglers. Thus, because of the tax hike in the late 2000s, Ukraine managed to reduce the volume of out-of-the-country smuggling and to increase revenue from both domestic smokers and out-of-the-country smugglers. If the tax rates increased further, eventually out-of-the-country smuggling could disappear. However, with the increased rates, the additional revenue from domestic consumption will be higher than the loss of revenue paid by smugglers.

Importantly, the reduction of cigarette sales in Ukraine during 2008–2010 was mainly caused by declining cigarette consumption within the country and to a lesser extent by declining smuggling out of the country. Smuggling into the country did increase but at a much lower rate than the industry claims: in 2010, 1.5% of the cigarettes consumed were smuggled. |
Smuggling

After the tax rate increases, tobacco sales usually fall in the short term. The tobacco industry claims that this decline in sales is caused by an increase in smuggling into the country, when three processes contribute to declining tobacco sales after a tax increase: decreased consumption, decreased smuggling out of the country and increased smuggling into the country. Although an exact measure of each contribution is not possible, close estimates can be determined. In Ukraine, 124 billion cigarettes (including legally imported) were sold in 2008 and 96 billion in 2010. The decline in sales during this time was 23% and tobacco consumption decreased by 15%. Tax increases in Ukraine could have contributed to a decrease of smuggling out of the country, not only because the price difference decreased (the difference with the EU countries is still high), but also because smugglers have changed their preferences and smuggled even less expensive cigarettes from Belarus and the Russian Federation to the EU.

In 2011, sales of tax-paid cigarettes fell to 88 billion versus 96 billion in 2010, which was most probably caused by a decline in cigarette smuggling out of Ukraine. The currency exchange rate in neighbouring Belarus fell three-fold in 2011, resulting in much lower cigarette prices and it became common practice to smuggle Belorussian cigarettes first to Ukraine and then to Poland and other EU countries. It was estimated that the amount of cigarettes that were taxed in Ukraine but smoked in other countries decreased from about 30 billion in 2010 to about 20 billion in 2011 and 2012. Despite this decline, the numbers of cigarettes smuggled out of Ukraine remained much higher than the numbers smuggled into the country.

According to the World Customs Organization report (8), the number of cigarettes smuggled out of Ukraine decreased in 2009; nevertheless, Ukraine is still the top country in the number of large cigarette seizures. Tax and price increases in Ukraine probably contributed to this smuggling decrease. As to the cigarette smuggling into Ukraine, the Global Adult Tobacco Survey conducted in 2010 (9) revealed that only 1.5% of smokers presented packs without Ukrainian health warnings.

Experts in the tobacco industry have estimated that 3.0–4.4% of the total number of cigarettes consumed in Ukraine in 2011–2012 were illicit. However, since the method used to arrive at this estimation was not disclosed, it might not be a true reflection of the proportion of illicit cigarettes on the market, which means that smuggling into the country may not necessarily play a major role in sales’ decline.

Large tax increases should continue in order to reduce the amounts of products smuggled outside the country.

Conclusion

The Ukraine experience has shown that the synergy of nongovernmental organizations and public institutions, the mass media and international organizations can achieve the critical mass needed to make a breakthrough and overcome the long-standing resistance of cigarette manufacturers to increase tobacco taxes.

A few lessons can be learned from the experienced successes and unsuccessful attempts.

- Writing and introducing a bill increasing taxes on tobacco is easy. However, enacting such a bill requires strong allies at all stages of consideration.
- Finance ministry officials and politicians can become proponents of tax increases when well-tailored arguments are presented to them. The main argument for the next tax increase is the well-evaluated success of the previous tax increase.
- Politicians can easily change their positions on taxation in either direction, so do not label any of them your enemy and do not rely on any of them all the time.
- The tobacco industry manipulates facts and figures on revenue, smuggling and consumption. Economic data and industry statements therefore need to be permanent monitored to provide an accurate picture.
- Although revenue growth is portrayed as the main success of tobacco tax increases, smokers and not the industry pay tobacco taxes. Every opportunity to increase smokers’ awareness and perception of rises in the price of tobacco should be used to encourage smokers to quit.
- To reduce tobacco consumption it is not sufficient to adjust specific excise rates to meet inflation; it is necessary to increase excise rates on an annual basis and to a much greater extent than that required to counteract inflation.
- Non-price measures, as outlined in WHO FCTC, can effectively reduce tobacco consumption. Policies relating to such measures should be supported by an increase in tobacco excise rates to avoid a decline in tobacco revenue.

Unfinished business Despite a sevenfold increase in the excise tax and a threefold increase in prices, there are still ample opportunities in Ukraine to reduce tobacco consumption through taxation policies.
Although excise tax rates in Ukraine exceed rates in the neighbouring Russian Federation, Republic of Moldova and Belarus, they are still much lower than in neighbouring EU countries.

On 2 December 2010, the Parliament adopted the new tax code, which increased specific excise rates by 6.9%. Thus, since January 2011 the minimum excise tax rate for filtered cigarettes grew from Hrv 150 to Hrv 160.35. Such a tax increase did not raise cigarette prices with inflation.

Ukrainian tobacco-taxation policy in 2011–2012 can be considered beneficial from a fiscal point of view as tobacco revenues increased from Hrv 13.06 billion in 2010 to Hrv 16.6 billion in 2012. However, to achieve further increases in 2013, excise rates need to be raised significantly more than they were in 2011 and 2012.

References


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The World Health Organization (WHO) is a specialized agency of the United Nations created in 1948 with the primary responsibility for international health matters and public health. The WHO Regional Office for Europe is one of six regional offices throughout the world, each with its own programme geared to the particular health conditions of the countries it serves.

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