Supporting policies for
Raising taxes on tobacco products in Lebanon

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EXECUTIVE SUMMARY

Introduction and Background:

Tobacco use is a major public health problem in Lebanon. Over half of adults smoke, with prevalence among women only slightly lower than men. The 2005 Global Youth Tobacco Survey conducted in Lebanon revealed that 60% of 13-15-year olds smoked some form of tobacco at least once in the previous month. Despite Lebanon’s ratification of the Framework Convention in Tobacco Control in February 2005, there is yet no national policy that requires increase in tobacco taxation as stipulated by the convention. Price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, young persons in particular. World Bank studies have found that on average, a 10% increase in price is likely to reduce consumption by 8% for middle-income and by 4% for high income countries. Evidence to show how raising taxes lowers consumption and increases government revenue in Lebanon would be valuable to inform such a policy. Revenues from a tax increase can be subsequently earmarked towards national tobacco control prevention and cessation programs, so as to minimize the short term negative welfare effects on consumers.

To date in Lebanon, there have been no studies that address the welfare and public finance effects of raising taxes on tobacco products. Our study focused on the household consumption of tobacco products, comprising mainly imported cigarettes, local cigarettes and waterpipe tobacco. Total spending on these products reached 553 million USD in 2010, with 512 million USD spent on 307 million packs of imported cigarettes.

Government revenue from tobacco taxation comes mainly from ad-valorem excise, customs and value added taxes. Taxes currently constitute 30 to 50% of retail prices, much below the shares in upper middle income countries (70-80%). Given that average imported cigarette prices are quite low in Lebanon (1.6$/pack, compared to 2.5$/pack in upper middle income and 5$/pack in high income countries), there is substantial room for increasing the price of tobacco products as part of a national tobacco control strategy, aiming to protect the lives of the Lebanese people.

Study objectives:

1) To estimate the elasticity of demand for tobacco products in order to simulate, for a variety of tax rates, the burden of the tax and the expected revenue from the tax; and (2) To estimate the effectiveness of taxation at limiting consumption.
Findings:

Within the context of high smoking prevalence in the country, the Lebanese Government is currently able to derive around 230 million USD per year in tobacco tax revenue. This excludes profits accrued by the national public tobacco production and trade monopoly (the Regie), and is affected by cross-border smuggling which is estimated at 15% of revenues.

To simulate the impact of raising tobacco products’ prices on national consumption and public revenue, we have estimated the relevant own and cross price demand elasticities for the above-mentioned products. These elasticities are central in mapping the impact of higher prices on the quantities of packs consumed, and in incorporating the substitution possibilities that consumers might engage in across tobacco products. Our elasticity estimates are in line with international findings, as we find that the own price elasticity for imported cigarettes is -0.22 (i.e., for every 10% increase in imported cigarette prices, quantity consumed would drop by 2.2%, which shows an inelastic relationship). Incorporating these elasticities, we simulate the impact on tobacco consumption and government revenues of raising taxes on tobacco products. Based on the above, policymakers can chose a number of different potential reforms. For the purpose of illustration one example is illustrated below

So that the average raise on tobacco taxation will reach up to 140%

- Raise ad-valorem excise tax by 50%
- Enact a new per pack excise tax, which could be earmarked for public health projects, with the following schedule: 250LBP/pack on local cigarettes, 1500LBP/pack on imported cigarettes, and 500LBP/pack on water-pipe tobacco packs.

Given that raising taxes would increase prices, we simulate the likelihood that this would increase smuggling in the country, and incorporate an extreme scenario of smuggling increasing by 200% (from 15% to 45% of revenues).

Our simulation results show that enacting the above tax reforms would:

1- Lower local cigarette consumption by 92%, imported cigarette consumption by 7%, and water-pipe tobacco consumption by 26%.
2- Prices of imported cigarettes would increase from an average 2500LBP/pack to 4750LBP/pack, to be more in line with international ones, with tax shares increasing from the current 50% to 73% of retail prices for imported cigarettes.

Given that prices increase more than the drop in consumption, the net revenue impact on Government finances is positive: increasing tobacco taxes would generate 127 million USD in additional public revenues, about 52% more than current ones. This is despite the extreme scenario of a presumed tripling in smuggling activity as a result of higher prices.

Higher tobacco taxes would therefore lower consumption, thus curbing smoking prevalence, and at the same time generate additional income for the government. This comes on top of long run health spending savings achieved through lower public spending on tobacco-related diseases. Adopting such a measure will be in line with Lebanon’s International commitment to the Framework Convention on Tobacco Control. It’s a “win-win” situation in both saving lives and increasing government revenue.