Tobacco Taxation and Evasion in Bangladesh

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Outline

• Socio-economic context of Bangladesh
• Prevalence of tobacco use in Bangladesh
• Tobacco prices and taxes across countries
• Responsiveness of tobacco consumption to price changes
• Tobacco taxation and government revenue
• Tax evasion
• Concluding Remarks
1. Socio-economic context of Bangladesh

Table 1: Socio-economic context of Bangladesh

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Area</td>
<td>147570 sq. km</td>
</tr>
<tr>
<td>Population</td>
<td>146.10 million</td>
</tr>
<tr>
<td>Adults (&gt;15 years)</td>
<td>53.7 million</td>
</tr>
<tr>
<td>Real GDP growth rate (%)</td>
<td>6.0</td>
</tr>
<tr>
<td>GNI per capita (at current prices)</td>
<td>US $ 750</td>
</tr>
<tr>
<td>Population below property line (%)</td>
<td>40.0</td>
</tr>
<tr>
<td>Literacy rate (%)</td>
<td>54.8</td>
</tr>
</tbody>
</table>

Source: Bangladesh Economic Review 2010
Bangladesh was the first country to sign the WHO Framework Convention on Tobacco Control (FCTC)

It is among the first 40 countries to become a party to the FCTC.

In 2005, Bangladesh enacted the Tobacco Control Act (TCA)

Despite the enactment of the TCA, Bangladesh has experienced an alarming increase in tobacco use over the past five years.
Currently, there are 41.1 million people who use tobacco, including 20.9 million who smoke either cigarettes or bidis or both (ITC Bangladesh Survey, 2009)

Overall smoking prevalence increased from 20.9% in 2004-05 to 22.0% in 2009.

42.0% of males and 1.3% of females smoke some form of tobacco.

Compared to 2004-05, there are 8.7 million more people who use tobacco, including 2.5 million more smokers.
• The use of smokeless tobacco among men and women increased from 14.8% in 2004-05 to 27.6% in 2009 among men and 24.4% to 32.0% among women.

• Overall, the users of smoked tobacco, smokeless tobacco or both, increased from 36.8% in 2004-05 to 43.2% in 2009.

• High rates of tobacco use in tribal (49% males and 16.8% females and the slum areas (54.8%) threaten lives of people in these areas.
Average consumer price of cigarettes in Bangladesh is one of the lowest in the world (Figure 1).

Source: WHO data
## Table 2: Cigarette Prices and Taxation in South Asia

<table>
<thead>
<tr>
<th>Country</th>
<th>Price of a 20 cigarette pack of widely used brand (US $ at PPP, 2006)</th>
<th>Tobacco tax as % of retail price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>1.38</td>
<td>50</td>
</tr>
<tr>
<td>India</td>
<td>7.04</td>
<td>58</td>
</tr>
<tr>
<td>Nepal</td>
<td>1.66</td>
<td>70</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>7.89</td>
<td>54</td>
</tr>
</tbody>
</table>

**Source:** The WHO Report on the Global Tobacco Epidemic, 2008.

The affordability index of WHO shows that cigarettes have become more affordable relative to 1995 in Bangladesh (WHO, 2010).
4. Responsiveness of tobacco consumption to price changes

- For estimating the responsiveness of tobacco consumption to changes in the price of tobacco, three parameters have been calculated:
  - Price elasticity of smoking participation
  - Conditional price elasticity
  - Total price elasticity, which is the sum of the first two parameters.
- Table 3 shows the price inelastic demand for cigarettes and bidi in Bangladesh.
- This suggests that a given increase in tobacco prices would lead to a less than proportionate decrease in consumption.
- This would lead to an increase in tobacco expenditure of smokers and thereby generate greater tax revenue.
Table 3: Price elasticity of demand for cigarettes and bidis in Bangladesh, 2009

<table>
<thead>
<tr>
<th></th>
<th>Cigarette</th>
<th>Bidi</th>
</tr>
</thead>
<tbody>
<tr>
<td>Smoking prevalence (%) (exclusive and dual users)</td>
<td>18.7</td>
<td>12.4</td>
</tr>
<tr>
<td>Elasticity of smoking participation</td>
<td>-0.29</td>
<td>-0.46</td>
</tr>
<tr>
<td>Price elasticity of tobacco demand conditional on smoking participation</td>
<td>-0.14*** (0.04)</td>
<td>-0.18 (0.12)</td>
</tr>
<tr>
<td>Total price elasticity</td>
<td>-0.43</td>
<td>-0.64</td>
</tr>
</tbody>
</table>

4.1. Tobacco taxation and the poor

- The poorer people are more sensitive to price changes than the richer because the opportunity cost of a given increase in expenditure is greater for the poor.
- Bidi smokers are more price sensitive than cigarette smokers. The difference is explained by the large price differential between cigarettes and bidis.
- Low socio-economic status (SES) demand for bidis is price elastic which is mostly explained by their high probability of quitting or abstention from smoking in the face of a price increase.
- Available evidence shows greater sensitivity of low SES people with respect to increases in prices as reflected in total price elasticity (Table 4).
Table 4: Price elasticity of demand for cigarettes and bidis in Bangladesh by socio-economic status, 2009

<table>
<thead>
<tr>
<th></th>
<th>Cigarette</th>
<th>Bidi</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
<td>Moderate</td>
</tr>
<tr>
<td>Smoking prevalence (%) (exclusive and dual users)</td>
<td>45.6</td>
<td>38.1</td>
</tr>
<tr>
<td>Elasticity of smoking participation</td>
<td>-0.33</td>
<td>-0.27</td>
</tr>
<tr>
<td>Price elasticity of tobacco demand conditional on smoking participation</td>
<td>-0.10 (0.08)</td>
<td>-0.12** (0.05)</td>
</tr>
<tr>
<td>Total price elasticity</td>
<td>-0.43</td>
<td>-0.39</td>
</tr>
</tbody>
</table>

Source: ITC Bangladesh Enumeration and Survey, 2009
5. Tobacco taxation and government revenue

- The taxation of tobacco products is governed by the Value Added Tax (VAT) Act, 1991.

- In FY 2009-10, VAT and SD collected from cigarettes, bidis and smokeless tobacco amounted to US $ 960 million (about 11% of total government revenue).

- For bidi, VAT is 15% and SD is 20%. Both these taxes are collected on a tariff value of Taka 3.1579 per pack of 25 sticks, although the average selling price of a pack is taka 6.20. With this tariff value level, the effective tax rate is 19.5% (VAT 9% + SD 10.5%).

- In the budget for FY 2010-11, VAT at the rate of 15% and SD at 20% has been imposed on a tariff value of taka 3.43 for handmade filter bidi.
• For imports, 25% customs duty and 15% VAT are imposed on all forms of tobacco products. The SD on imports, however, varies from 20% on raw tobacco to 100% on handmade cigarettes, bidis, cigars, cheroots, etc.

• In the budget for FY 2010-11, export duty at the rate of 10% has been imposed on export of unmanufactured tobacco.

• The current cigarette taxation is composed of two components: VAT at the rate of 15% and SD ranging from 33% at the lowest price tier to 58% at the highest price segment.

• Out of the four price slabs, the majority (71.8%) purchase cigarettes in the second lowest price tier followed by the lowest price tier (13.4%).

• Currently, the total tax incidence of cigarettes per pack of 10 sticks ranges from 48% to 73% (Table 5).
Table 5: Price slabs and taxes on cigarettes

<table>
<thead>
<tr>
<th>Price Slabs (Taka)</th>
<th>FY 2009-10</th>
<th>FY 2010-2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price Slabs (Taka)</td>
<td>VAT (%)</td>
<td>SD (%)</td>
</tr>
<tr>
<td>Low segment 7.30-8.80</td>
<td>15</td>
<td>32</td>
</tr>
<tr>
<td>Medium segment 16.40-17.40</td>
<td>15</td>
<td>52</td>
</tr>
<tr>
<td>High segment 23.36-29.36</td>
<td>15</td>
<td>55</td>
</tr>
<tr>
<td>Premium segment 46.50 and above</td>
<td>15</td>
<td>57</td>
</tr>
</tbody>
</table>

Source: National Board of Revenue
6. Tax evasion

6.1. Factors responsible for tax evasion

- Tax evasion is a part of the underground economy, which constitutes about 40% of GDP.

- False declaration of brand by taking advantage of same colour tax stamp/ banderole in the low segment.

- Smuggled and counterfeit cigarettes due to weak border management.

- The extent of tax evasion due to misdeclaration by using the same tax stamps and banderole on two price points in the low segment price slab is estimated to be 5% of the total cigarette market. This amounts to the revenue loss of Tk. 300 crore (US $ 43 million).
6.2. Steps taken to combat tax evasion in cigarette

• In 2002 tax stamp and banderole system was introduced by the National Board of Revenue (NBR) to combat tax evasion.

• Vigilant monitoring of the ports of entry and domestic manufactures by the NBR.

• Anti-smuggling drive by the government.

• As a result, illicit trade in cigarette reduced from 20% in 2000 to 1.2% in 2009 (Figure 2).
Figure 2: Reduction in illicit trade in cigarette

Source: National Board of Revenue
7. Concluding Remarks

• The inelastic demand for cigarettes and bidis suggests that greater revenue can be generated by increasing taxes.

• Very low retail price of tobacco products makes them affordable.

• Therefore, measures need to undertaken to
  - increase tobacco prices and harmonize tax rates across different forms of tobacco, so that no switching takes place;
  - switch from ad valorem tax to specific tax as the latter is found to be more effective;
  - introduce two-colour banderole to eliminate tax evasion in the lowest segment;
  - strengthen intelligence activities to combat tax evasion; and
  - undertake comprehensive motivation programs to create awareness among people.
Thank you