# TAXING HEALTH RISKS





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# A Policy Paper on Tobacco Excise Tax and Health Promotion

This policy paper is the result of a professional collaboration between the University of the Philippines – College of Law and HealthJustice.

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#### LIST OF ACRONYMS

Acquired Immune Deficiency Syndrome (AIDS) Actual Net Retail Price (ANRP) Administrative Order (AO) Association of Southeast Asian Nations (ASEAN) Barangay Health Unit (BHU) British American Tobacco (BAT) Bureau of Internal Revenue (BIR) Bureau of Local Health Development (BLHD) Center for Health Development (CHD) Central Office (CO) Cerebro-Vascular Disease (CVD) Chronic Obstructive Pulmonary Disease (COPD) Civil Service Commission (CSC) Common Effective Preferential Tariff (CEPT) Conference of the Parties (COP) Consumer Price Index (CPI) Coronary Artery Disease (CAD) Corporate Social Responsibility (CSR) Department of Budget and Management (DBM) Department of Finance (DOF) Department of Health (DOH) Department of the Interior and Local Government (DILG) Executive Order (EO)

Family Income and Expenditure Survey (FIES) Fortune Tobacco Corporation (FTC) Framework Convention on Tobacco Control (FCTC) Global Adult Tobacco Survey (GATS) Global Youth Tobacco Survey (GYTS) Green Tobacco Sickness (GTS) Gross Domestic Product (GDP) Gross Retail Price (GRP) Health Executive Agenda for Legislation (HEAL) Health Promotion Foundation (HPF) Human Immunodeficiency Virus (HIV) Implementing Rules and Regulations (IRR) Information, Education, Communication (IEC) Inter-Agency Committee – Tobacco (IAC-T) Inter-Local Health (ILH) International Monetary Fund (IMF) Interngovernmental Negotiating Body (INB) Local Government Unit (LGU) Millennium Development Goals (MDG) National Capital Region (NCR) National Center for Health Promotion (NCHP) National Internal Revenue Code (NIRC), also referred to as "Tax Code" National Statistics Office (NSO)

vi Taxing Health Risks ..... National Tobacco Administration (NTA) Net Retail Price (NRP) Non-Government Organization (NGO) People's Organization (PO) Philip Morris Fortune Tobacco Corporation (PMFTC) Philip Morris Philippines Manufacturing Incorporated (PMPMI) Philippine Health Insurance Corporation (PhilHealth) Philippine Peso (PhP) Philippine Tobacco Institute (PTI) Purchasing Power Parity (PPP) Republic Act (RA) Revenue Regulation (RR) Rural Health Unit (RHU) Short Message Service (SMS) Simplified Net Income Taxation System (SNITS) Smoking-Attributable Mortality, Morbidity, and Economic Costs (SAMMEC) Southeast Asia Tobacco Control Alliance (SEATCA) Tariff Reform Program (TRP) Thai Health Promotion Foundation (ThaiHealth) Tobacco Free Initiative (TFI) United Nations (UN) United States Department of Agriculture (USDA) United States Dollar (USD)

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#### FOREWORD

The health debate on tobacco has long been over. Tobacco products kill, maim, stunt, punish, torture, and tax the health of individuals and entire societies. Tobacco companies no longer even dispute the fact that they peddle all forms of cancer, cardiovascular diseases, and countless forms of suffering for families worldwide.

The question of how to deal with tobacco products and industries, and how to guard our health against them, therefore, is no longer discussed on the level of science. It is now pursued on the level of laws and political will.

The Philippines, for example, is a party and signatory to the World Health Organization Framework Convention on Tobacco Control. Under the FCTC, our government has committed to a range of reforms whose ultimate objective is to curb tobacco use. We are committed to advertising and promotion bans on tobacco products, for example; to instituting smoking cessation programs; to banning smoking in public places. And among a range of other reforms, we are committed to exploring and implementing a more progressive taxation system on tobacco products.

Why taxation? Because the WHO and the World Bank themselves have documented worldwide how pricing and tax measures comprise the most effective action against tobacco use.

Article 6 of the FCTC plainly states that "price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons." Thus does the FCTC encourage us to implement tax and pricing policies on tobacco products "so as to contribute to the health objectives aimed at x Taxing Health Risks ······

reducing tobacco consumption."

Studies show that every ten percent (10%) increase in tobacco prices can lead to a decline of approximately eight percent (8%) in the demand for tobacco products, particularly among the poor and the young, who are most sensitive to price changes.

Moreover, done right, a more progressive tax program on tobacco products will reduce smoking and public health costs while also still maintaining and perhaps even improving revenues collected from tobacco taxes. The social and economic dividends from a less sickly population and workforce, meanwhile, can only further magnify the wisdom and benefits of this cause.

Consider the alternative. Consider the reality of the status quo: Because of a poor and compromised tobacco tax system, the Philippines has some of the cheapest cigarettes in the world, and therefore one of the highest number of smokers globally. From the tobacco industry the government gains approximately PhP25 billion in excise tax per year but the estimated health and productivity loss in the economy has been placed at around PhP200 billion per year.

Clearly, therefore, the Philippines must improve and strengthen its taxation of the tobacco industry with a clear health-based agenda.

To reiterate and be clear, none of these directions are up for debate. We all stand in consensus on the science that tobacco kills, and the strategy is prescribed by a global convention to which our government is party. It now boils down to political will and sincerity. The impetus and pressure to move is no longer just a matter of saving lives, it is a matter of standing by our word. This policy paper therefore goes beyond reminding why we must act. It outlines how we must act, even as it reassures that everything not only makes sense, everything is do-able. Immediately.

There can be no excuses. The science is solid and no longer up for debate, the promises have been made, the commitments have been spelled out and signed, and now the policies fleshed out. As with most things in life, pursuing the right thing and the right way boils down not only to commitment, but also to character and sincerity.

I congratulate the lawmakers, health advocates, researchers, and health officials who have brought us this far. We hope to be congratulating our government leaders in the near future should they simply execute and implement these recommendations with the health of our people in mind.

Jan Marier

**Juan Martin Flavier, MD, MPH** Secretary of Health (1992-1995) Philippine Senator (1995-2007)

#### **EXECUTIVE SUMMARY**

The Philippines, with 17.3 million adult smokers, has one of the highest smoking prevalence rates in the world. The country ranks ninth in the male adult smoking population and 16th in the female adult smoking population. Use of tobacco products among the Filipino youth is also on the rise, with smoking prevalence increasing by almost 40 percent within a span of four years.

Tobacco consumption costs many lives and resources. It is estimated that 35,000 Filipinos die every year due to tobacco-related diseases. Secondhand smoke causes a wide range of immediate and long-term adverse health effects, including cancer, serious respiratory diseases, and cardiovascular diseases. The economic costs, including expenses for health care and cost of productivity losses, of only four of these diseases range from PhP218 billion to PhP461 billion.

Studies have established a direct link between low prices of tobacco products and the high prevalence of smoking and incidence of tobacco-related diseases. Corollary to this, a higher tobacco price, often due to increase in excise taxes, has been proven to reduce tobacco consumption. Tobacco price and tax measures are the most effective measures to reduce tobacco use, as recognized under the World Health Organization Framework Convention on Tobacco Control (WHO FCTC).

Thus, the Philippines, known as one of the countries with the cheapest cigarettes in the world and the highest number of consumers, has much to gain from increasing tobacco excise taxes in terms of achieving health objectives. Inasmuch as the youth and the poor are more price sensitive, increasing tobacco taxes will also be instrumental in preventing the youth from being addicted to smoking and discouraging the poor from smoking.

Moreover, due to the relative inelasticity of demand for tobacco, the government can expect to generate more revenues from increasing excise taxes. Implementing the increase in tobacco excise taxes becomes all the more important and urgent in light of a looming fiscal crisis in the country.

Unlike in the past when the importance of tobacco excise tax was measured in terms of the revenues it may generate, the tobacco excise tax should be viewed as a means of both achieving health objectives and gaining additional revenues.

Because a sound tax administration is complementary to a good tax policy, there must be a concomitant aim to fix the tax administration and curb tobacco smuggling.

Consultations with various stakeholders resulted in a clear understanding that tobacco tax increases should take into consideration both the health and revenue goals, and, where feasible, even prioritizing public health interests.

Tobacco taxes can directly contribute to health promotion through a dedicated tax system to ensure that a portion of the excise taxes is channeled towards health promotion initiatives. The World Health Organization has commended many countries' practice of utilizing dedicated tobacco taxes to finance health promotion activities. "Health Promotion Funds" in many countries invariably involve funds from tobacco and/or alcohol, sourced from taxes, surcharges or other levies. Considering that seven out of the ten leading causes of mortality in the Philippines are smoking-related, it is only logical that funds for health promotion be sourced from tobacco. xiv Taxing Health Risks ······

## TAX LEVELS AND REFORM

How tobacco tax should be increased greatly depends on the objectives set by the policy makers. We present scenarios for the short and long terms based on the government's health and revenue objectives. These objectives take into account the Philippines' current tobacco consumption and tax levels as well as those in other countries. We also take into consideration the key features of tobacco taxation in countries recognized for their best practices in tobacco taxation policies. Our recommendation also takes into account the practicality and feasibility of the increase in terms of its possible impact on revenues.

Our review of the current tax structure revealed inequities and loopholes that need to be addressed immediately. This entails reforming the current Philippine excise tax system, which includes the removal of the price classification freeze, indexation of taxes to inflation, shifting from a multi-level to a single level tax structure, and then setting regular and frequent increases in excise tax in order to sustain the reduction in tobacco consumption in the medium and long term.

Thus, we recommend the following approach to facilitate a smooth transition from the current to the new tax system:

- 1. The first and immediate step involves removing the price classification freeze and reducing the number of tiers from four to three.
- 2. The second step further reduces the number of tiers from three to two and ensures that cigarette prices will be less affordable to the youth. The tax will be adjusted from PhP12 to PhP16 for the medium- and high-priced brands and from PhP28.30 to PhP29.40 for the premium-priced brands.

- 3. The third step will be the final stage of shifting to a single level tax structure. The uniform specific rate will be PhP30 for all brands to compensate for inflation and increases in income and hence, further reduce cigarette consumption. After attaining the single level tax structure, taxes will be annually increased to adjust to inflation.
- 4. For the long term, taxes must be regularly increased by at least a rate that is greater than inflation in order to compensate for increases in income and remove the effect of being desensitized to prices. Regular increase in tax needs to be flexible and must be adjusted depending on the health and revenue objectives of the policy makers.

Assuming that price elasticity of demand for cigarettes in the Philippines is between -0.235 and -0.5, implementing this excise tax increase proposal will reduce smoking prevalence to 23-25 percent by 2014. This will also generate additional revenues of PhP18 billion to PhP26 billion in the first year alone.

## DEDICATED TAX

A review of earmarked funds from tobacco taxes shows that tobacco taxes dedicated to promoting tobacco farming greatly exceed earmarked tobacco taxes allocated for health purposes. Financing tobacco promotion also goes against FCTC commitments to promote alternative livelihood for tobacco farmers. To resolve the inconsistency with international obligations, funds distributed to tobacco-producing provinces should instead be utilized to promote alternative livelihood for farmers.

Republic Act 9334 (RA 9334) earmarks a percentage of the incremental tax for the Philippine Health Insurance Corporation (PhilHealth) and disease prevention programs instead of "health promotion." A distinction must be made. Unlike "disease prevention," "health promotion" involves enabling people to increase control over their xvi Taxing Health Risks ······

health and its determinants. This occurs through health education, advocacy, and social mobilization or engaging the participation of all segments of society in putting health promotion to action. This unique aspect of "health promotion" highlights the need for community involvement, specifically of the local government and civil society groups.

We find that existing institutions have the capacity and mandate to undertake health promotion activities: the Department of Health (DOH) and the Department of Interior and Local Government (DILG) at the national level and the local government officials (LGU) officials, including local health officials and/or the local health boards. In both cases, the participation of civil society actors is essential.

## 1. Introduction

The new administration faces the challenge of increasing taxes in light of a low revenue effort. The new Congress is confronted not only with the task of deliberating the DOF's proposal for excise tax reform to improve tax administration and correct imbalances, but also to update RA 9334 or the Sin Tax Law of 2004, as the prescribed tax schedule runs out by 2011.

The year 2011 ushers in the last set of tobacco excise tax increases under RA 9334. But even as early as 2008, the DOF began calling for an increase in excise taxes as a revenue-generating measure to address the increasing budget deficit. The efforts to increase tobacco taxes were also meant to address the need to reconcile the low incremental tax rates vis-à-vis the rising inflation rates, to improve tax administration by removing the multiple tiers of price classification, and to correct the discriminatory impact of allowing identified brands to enjoy lower tax rates.

Where tobacco excise taxes are concerned, there is an implicit recognition of the fact that the Philippines' current rates are very low, and in fact, one of the lowest in the world.

Various bills proposing increases on excise tobacco tax rates were filed during the 14<sup>th</sup> Congress. These proposals met much resistance in Congress, especially in the Committee of Ways and Means of the House of Representatives. This reflects the typical struggle between Congress and DOF that was evident even during the proceedings that led to the current law, RA 9334. A pair of investigative journalists<sup>1</sup> reported that this is attributable to the opposition by Members of Congress favoring vested interests in the tobacco industry and tobacco companies.

<sup>&</sup>lt;sup>1</sup>L. Balane, and J. Llanto, *Well-entrenched Interest,* Newsbreak, March-April 2010, pp. 16-17.

However, global trends and an international treaty are poised to change the rules of the game in the Philippines. For the first time, the health objectives of tobacco excise taxes must be considered in developing excise tax policies. Excise tax needs to be measured not only in terms of revenues it may generate but more importantly, in terms of the number of lives it can save.

Since the Philippines ratified the FCTC, the government has committed "to adopt or maintain... measures like implementing tax policies and price policies... on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption." This reflects the international community's recognition that increasing taxes on tobacco products is the single most effective means to curb tobacco consumption. For the Philippines, this means an effective solution to the tobacco epidemic that kills 35,000 Filipinos annually and plagues almost a third of the population. This also presents a significant solution to the youth smoking problem, wherein 27 percent of school children are found to be smoking.<sup>2</sup>

In relation to tobacco taxation, the economic objective is not simply limited to revenue generation. A 2006 study analyzing the relationship between tobacco and poverty concluded that the tobacco industry contributed more losses than gains to the economy. Government revenue gains were less than PhP30 billion, but the devastating harm that the product causes resulted in economic costs of PhP218 - 461 billion.<sup>3</sup>

<sup>&</sup>lt;sup>2</sup> Department of Health, National Statistics Office, World Health Organization and U.S. Centers for Disease Control and Prevention. *Global Youth Tobacco Survey* (2007).

<sup>&</sup>lt;sup>3</sup> Figure based on 2010 inflation-adjusted projection of the 2006 Tobacco and Poverty study estimates of the health/economic costs of four smoking-related diseases. World Health Organization, Department of Health, University of the Philippines-Manila, and Philippine College of Medical Researchers Foundation, Inc. (2006). *Tobacco and poverty in the Philippines*. Manila: Authors (2006).

Contribution of the tobacco industry to employment has progressively decreased. Employment in the tobacco industry is less than one percent of the country's total employment because of the decreasing number of farmers, rising imports, and sophistication of the retail industry.

Unlike revenue measures, public health measures attract wider public interest and support. Because of the FCTC mandate, the DOH and public health advocates now have a stake in the excise tobacco tax policy. This has become more pronounced in light of funding for health promotion through tobacco taxes as recommended by the WHO and done in many countries where a percent of tobacco taxes has long been earmarked for health promotion.<sup>4</sup>

This paper recognizes the challenges that the stakeholders, DOF, DOH, civil society, and the academe face due to their different views and disciplines, specifically between the economic and the health concepts. Consultations with these groups resulted in a clear understanding that tobacco tax increases should take into consideration both the public health and revenue goals, and, where feasible, even prioritizing public health interests. Further, any tobacco tax increase proposals to Congress should be acceptable to both government agencies as well as civil society in order to have a strong, unified position to overpower tobacco industry interests.

To achieve this unified stance, however, basic questions need to be resolved:

• How can the current tobacco tax system be improved?

<sup>&</sup>lt;sup>4</sup> Countries that have earmarked tobacco taxes for health promotion: Australia, South Korea, Finland, Iceland, Malaysia, Poland, Slovenia, Qatar, Taiwan, Thailand, USA (California, Arizona).

Regional Strategy for Health Promotion, Follow-up of the Sixth Global Conference on Health Promotion, Health Promotion and Dedicated Taxes, 10 (2006).

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- How should tobacco tax be increased to meet health objectives while increasing revenues?
- How can tobacco taxes contribute to sustainable funding for health promotion and other purposes as done in many countries?

## Limitations

Among the different types of tobacco products, the dominant type is cigarette packed by machine (in 20s). Specifically, over 90 percent of tobacco products consumed in the country are in the form of cigarettes. Hence, for purposes of simplifying the discussion, the projections in this paper will focus on cigarettes.

The paper will also be limited to a review of excise taxes. The excise taxes may be imposed not only to generate revenues but also to address a regulatory function, in this case, serving health objectives.<sup>5</sup>

## 2. Objectives

The first part of this paper attempts to explain the relevance to public health of tobacco tax increases, define health and revenue targets, identify options and proposals, and provide a framework that enables stakeholders to analyze the public health as well as revenue impacts of

<sup>&</sup>lt;sup>5</sup> Caltex Phils. vs. Commissioner on Audit, G.R. No. 92585 (May 8, 1992) citing Lutz vs. Araneta, 98 Phil. 148 (1955); Gaston vs. Republic Planters Bank, 158 SCRA 626 (1988).

<sup>&</sup>quot;Taxation is no longer envisioned as a measure merely to raise revenue to support the existence of government; taxes may be levied with a regulatory purpose to provide means for rehabilitation and stabilization of a threatened industry which is affected with public interest as to be within the police power of the state."

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each option or proposal. It will also discuss the political economy and possible tobacco industry arguments and lead to the identification of the specific features of a robust tobacco tax policy.

The subsequent part of the paper discusses the prospects of tobacco tax funding for health promotion in the Philippines.

To achieve this, the policy paper will:

- 1. Provide background and data about the standards and the ideal situation in taxing tobacco products.
- 2. Develop projections based on the recommended tax increase proposal with the objectives of lowering tobacco consumption and increasing revenue.
- 3. Discuss background and recommendation for sustainable funding for health promotion and other purposes.

The policy paper was drafted in consultation with representatives and experts from the DOF, DOH, WHO, civil society, and the academe. The research team collected additional data and information from the experts and provided technical support during the working group meetings.

# 3. Background

# 3.1 Magnitude of the Tobacco Epidemic

Smoking is deemed to be the single largest preventable cause of death in the world. In 2010, tobacco will kill six million people, and if the current trends continue, it will kill seven million annually by 2020, and 6 Taxing Health Risks ······

eight million people annually by 2030.<sup>6</sup>

The global trend on tobacco use shows that while smoking is decreasing in developed countries, the number is steadily increasing in the developing nations.<sup>7</sup> As a matter of fact, the Philippines has one of the highest prevalence rates in the world<sup>8</sup> as it ranks ninth in the adult male smoking population and 16th in the adult female smoking population.<sup>9</sup>

The 2009 GATS estimates that adult smoking prevalence in the Philippines is 28.3 percent. This is equivalent to 17.3 million Filipinos (aged 15 years old and over) who currently use tobacco products.<sup>10</sup> This prevalence rate is high compared to Thailand's prevalence rate of 23.7 percent.<sup>11</sup>

Meanwhile, use of tobacco products among the youth is increasing. The latest GYTS showed that 27.3 percent of school children aged 13 – 15 years old are tobacco users -- an increase of almost 40 percent within a span of four years.<sup>12</sup> It is said that children as young as five to seven years old are starting to smoke.

## 3.2 Health Impact of Tobacco

Tobacco use is causing over five million deaths each year. In the Philippines, it is estimated that 35,000 die every year due to tobacco-

<sup>&</sup>lt;sup>6</sup> The American Cancer Society, THE TOBACCO ATLAS, 38 (3<sup>rd</sup> ed. 2009).

<sup>&</sup>lt;sup>7</sup> It is estimated that 80 percent of the world's smokers currently live in low- to middle-income countries.

World Health Organization, Geneva, Switzerland, Tobacco or Health: a Global Status Report (1997).

<sup>&</sup>lt;sup>8</sup>As a result of the high prevalence of tobacco use, almost 90,000 Filipinos every year or 10 Filipinos every hour die from smoking-related diseases.

<sup>&</sup>lt;sup>9</sup> S*upra* note 6, at 23-25.

<sup>&</sup>lt;sup>10</sup> Department of Health, National Statistics Office, World Health Organization and U.S. Centers for Disease Control and Prevention, *Global Adult Tobacco Survey* (GATS) (2009).

<sup>&</sup>lt;sup>11</sup> U.S. Centers for Disease Control and Prevention, "GATS Fact Sheets and Reports." Accessed October 15, 2010. http://www.cdc.gov/tobacco/global/gats/countries/index.htm.

<sup>&</sup>lt;sup>12</sup> The 2003 Global Youth Tobacco Survey shows that there were only 19.6 percent tobacco users among youth aged 13-15 years, thus, a percentage increase of 39.3 percent. See Department of Health, *supra* note 2.

related diseases.<sup>13</sup> Scientific evidence confirms that smokers suffer from significantly elevated risks of death from numerous cancers, respiratory diseases, cardiovascular diseases, and other conditions.<sup>14</sup> Majority of the deaths attributable to smoking come from chronic obstructive pulmonary diseases and cerebro-vascular diseases.<sup>15</sup>

Secondhand smoke causes hundreds of thousands of deaths among non-smokers<sup>16</sup> and adversely affects half of the world's children.<sup>17</sup> In the Philippines, it has been reported that almost 60 percent of the youth aged 13-15 years are exposed to secondhand smoke in their own homes.<sup>18</sup> Secondhand smoke, composed of sidestream smoke from the burning tip of the cigarette and mainstream smoke exhaled by the smoker, causes a wide range of immediate and long-term adverse health effects, including cancer, and serious respiratory and cardiovascular diseases.<sup>19</sup> Brief exposure can trigger respiratory symptoms, including cough, phlegm, wheezing and breathlessness, and asthma attack in children with asthma.

<sup>&</sup>lt;sup>13</sup> Each year, close to 36,000 Filipinos die from four smoking-related diseases (lung cancer, CVD, CAD, and COPD), according to 2003 estimates using the SAMMEC method (which includes current and former smokers). World Health Organization Western Pacific Office, *Tobacco Control in the Philippines Comprehensive Report*, Chap.4.

<sup>&</sup>lt;sup>14</sup> Tobacco is responsible for over 90 percent of all cases of lung cancer, 75 percent of chronic bronchitis and emphysema cases and nearly 25 percent of ischaemic heart diseases.

World Health Organization, "Tobacco." Accessed October 15, 2010. http://www.wpro.who.int/NR/ exeres/978BE0FD-AE30-46C6-8F75-1F40AE7B57BC.htm.

<sup>&</sup>lt;sup>15</sup> World Health Organization, Department of Health, University of the Philippines - Manila, and Philippine College of Medical Researchers Foundation, Inc. (2006). *Tobacco and poverty in the Philippines*. Manila: Authors (2006). <sup>16</sup> It is estimated that occupational exposure to secondhand smoke kills 200,000 workers every year.

The American Cancer Society, supra note 6.

<sup>&</sup>lt;sup>17</sup> Children are most vulnerable to exposure to secondhand smoke. Almost half of the world's children, or around 700 million, breathe air polluted by tobacco smoke, particularly at home.

World Health Organization, "Why is smoking an issue for non-smokers?" Online Q&A, August 26, 2010. Accessed October 18, 2010. http://www.who.int/features/qa/60/en/index.html.

<sup>&</sup>lt;sup>18</sup> Supra note 2.

<sup>&</sup>lt;sup>19</sup> The US Surgeon General's Report, pointed out that "Breathing secondhand smoke for even a short time can have immediate adverse effects on the cardiovascular system, interfering with the normal functioning of the heart, blood, and vascular systems in ways that increase the risk of heart attack....Even a short time in a smoky room can cause your blood platelets to become stickier, damage the lining of blood vessels, decrease coronary flow velocity reserves, and reduce heart rate variability." U.S. Department of Health and Human Services, "The Health Consequences of Involuntary Exposure to Tobacco Smoke: A Report of the Surgeon General (2006)." Accessed October 16, 2010. http://www.surgeongeneral.gov/library/secondhandsmoke/factsheets/ factsheet7. htm.

## 3.3 Economic Burden of Tobacco

In 2006, a study found that four smoking-related diseases account for six to eight percent of all deaths. The economic costs, including expenses for health care and costs of productivity losses from these diseases, range from PhP218 billion to PhP461 billion.<sup>20</sup> The study measured the costs, arising from cerebro-vascular diseases (CVD),<sup>21</sup> coronary artery diseases (CAD), <sup>22</sup> chronic obstructive pulmonary diseases (COPD),<sup>23</sup> and lung cancer.

The government shoulders part of the costs in caring for people who cannot afford medical expenses of tobacco-related diseases. These costs represent an economic burden. The annual health care costs and the fraction borne by the public sector represent real resources that could have been used to finance other public goods.

A larger fraction of the health care costs borne by the private sector, on the other hand, represents opportunity costs and income losses. This is aggravated by productivity losses due to sickness resulting from tobacco consumption.

<sup>&</sup>lt;sup>20</sup> Supra note 3, at 125.

<sup>&</sup>lt;sup>21</sup>Autopsy studies have demonstrated a significant positive relationship between smoking and atherosclerosis. Atherosclerosis, the main underlying process of CVD, is characterized by the accumulation of lipid in the intima of large elastic arteries (aorta) and medium-sized muscular arteries (coronary, femoral, carotid, and others).

U.S. Centers for Disease Control and Prevention, "Perspectives in Disease Prevention and Health Promotion Smoking and Cardiovascular Disease," *Morbidity and Mortality Weekly Report,* January 6, 1984. Accessed October 22, 2010. http://www.cdc.gov/mmwr/preview/mmwrhtml/00000252.htm.

<sup>&</sup>lt;sup>22</sup> On the other hand, a report of the U.S Department of Health and Human Services reveals that smoking can be associated with coronary heart disease and estimates that up to 30 percent of deaths from CHD can be caused by smoking. *Id.* 

<sup>&</sup>lt;sup>23</sup> The study justified choosing these diseases because they are closely linked with smoking. The US Surgeon General found that smoking causes approximately 90 percent of all lung cancer deaths in men, 80 percent of all lung cancer deaths in women, and 90 percent of deaths from COPD.

U.S. Department of Health and Human Services, U.S. Centers for Disease Control and Prevention, National Center for Chronic Disease Prevention and Health Promotion, *The Health Consequences of Smoking: A Report of the Surgeon General.Office on Smoking and Health* (2004).

#### 3.3.1 Impact on the Poor

The poor spend scarce resources on tobacco products instead of other basic necessities. Studies from different countries conclude that tobacco consumption as a percentage of household expenditure is higher among the poorest relative to the richer households. This is true for the Philippines, where the ratio of tobacco expenditure to total income is highest in the lowest income level.<sup>24</sup> Because a greater percentage of Filipinos do not earn enough to satisfy their family's basic needs, more money being spent on tobacco means sacrificing clothing, shelter, education, or health.

## 3.4 Role of Tobacco Tax and Price in Public Health

**Treaty Application** 

The WHO FCTC is the first public health treaty negotiated under the auspices of the WHO. It was developed in recognition of the need to address the tobacco epidemic, a global problem with serious consequences.

The FCTC enumerates a range of public health measures to curb the tobacco epidemic. These include smoke-free environments, comprehensive advertising bans, regulation of packaging and labelling of tobacco products, public education, product regulation, tax and price measures, measures to curb illicit trade, and the provision of alternative livelihoods. Some of these measures such as the smoking bans, advertising bans, textual health warnings, education and alternative livelihood programs have been addressed in part by RA 9211 or the Tobacco Regulation Act of 2003.

<sup>24</sup> Supra note 15, at 11.

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Article 6 of the FCTC recognizes that price and tax measures are effective and important means of reducing tobacco consumption among various segments of the population, in particular, among the youth. It states that "each Party should take account of its national health objectives concerning tobacco control and adopt or maintain, as appropriate, measures which may include implementing tax policies and, where appropriate, price policies, on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption."<sup>25</sup>

The FCTC was signed by the Philippines<sup>26</sup> on September 23, 2003, the Senate's concurrence to the treaty was obtained on April 25, 2005, and the instrument was deposited on June 6, 2005.

Conventional international law becomes part of the law of the land through transformation pursuant to Article VII, Section 21 of the 1987 Constitution, which provides that "no treaty or international agreement shall be valid and effective unless concurred in by at least two-thirds of all the members of the Senate." Said agreement must go through a process prescribed by the Constitution for it to be transformed into local law that can be applied to domestic conflicts.<sup>27</sup> Accordingly, treaties signed by the executive branch may be ratified by the Senate. Ratification is the formal act by which a State confirms and accepts the provisions of a treaty concluded by its representatives.<sup>28</sup> By virtue of the ratification on April 25, 2005, the FCTC is now part of domestic or municipal law and is binding on the Philippines.

<sup>&</sup>lt;sup>25</sup> WHO FCTC, Article 6, Par. 2 (a).

<sup>&</sup>lt;sup>26</sup> Under Philippine laws, international law may become part of local laws either through incorporation or through transformation. The doctrine of incorporation is found under Section 2, Article II of the 1987 Constitution, thus: "The Philippines renounces war as an instrument of policy, adopts the generally accepted principles of international law as part of the law of the land, and adheres to the policy of peace, equality, justice, freedom, cooperation and amity with all nations." Under the doctrine of incorporation, generally accepted principles of international law are automatically incorporated into local law. See Kuroda v. Jalandoni, 83 Phil 171 (1949).

<sup>&</sup>lt;sup>27</sup> Pharmaceutical and Health Care Association of the Phil. v. Duque, G.R. No. 173034 (2007) *citing* J.G. Bernas, S.J., AN INTRODUCTION TO PUBLIC INTERNATIONAL LAW 57 (2002).

<sup>&</sup>lt;sup>28</sup> Pimentel, et al. v. Romulo, G.R. No. 158088, July 6, 2005 citing Cruz, International Law (1998).

Applying the principle of *pacta sunt servanda* or good faith compliance with the treaty, the Philippine government, in the next round of review of the tax system, should implement Article 6 of the FCTC and take national health objectives into account when shaping tobacco tax measures. The government must ensure that tobacco taxes contribute to health objectives, and not just revenue targets.

It bears stressing that the current tobacco excise tax law, RA 9334, was passed in 2004, after the signing of the treaty but prior to its ratification. It was passed purely as a revenue measure and was not intended to reduce tobacco consumption.

## Evidence

Studies invariably show that increase in tobacco prices has resulted in a significant reduction of tobacco use. It was estimated that a ten percent increase in price will reduce demand by about four percent in high-income countries and eight percent in low- to middle-income countries.<sup>29</sup>

In high-income countries, tobacco taxation is an increasingly important measure to advance public health, and through the increase in tobacco taxes and the resultant increase in prices, the consumption of tobacco has consistently decreased.<sup>30</sup> On the other hand, econometric studies for low- to middle-income countries show that higher taxes on cigarette prices lead to significant reduction in cigarette smoking and other tobacco uses.

<sup>&</sup>lt;sup>29</sup> Chaloupka et al., *Tobacco Control in Developing Countries*, Chapter 10 The Taxation of Tobacco Products, 244, 267 (2000).

<sup>&</sup>lt;sup>30</sup> World Health Organization, Health Promotion and Dedicated Taxes, Regional Strategy for Health Promotion, *Follow up on the Sixth Global Conference on Health Promotion*, 5-6 (2006).

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Evidence also shows that increasing tobacco taxes is instrumental in preventing the youth from smoking. Studies from Grossman and his colleagues have suggested that younger persons will be more sensitive than older persons to changes in cigarette prices for several reasons.<sup>31</sup> First, the addictive nature of cigarette smoking makes it much easier for the youth to quit as compared to addicted adults since the former has been smoking for a relatively short time. Second, peer smoking has a much greater impact on youth smoking than on adult smoking. Thus, if one stops smoking because the vice has become unaffordable, other members of the group are likely to follow. Third, the youth have less disposable income than adults and will be more affected by price increases.

Finally, economic experts project that an increase in tobacco taxes will significantly lower tobacco consumption of the poor because they are more responsive to price changes.<sup>32</sup> As the poor reduce their consumption of tobacco products, their income can be reallocated to spend for other basic resources. The "Tobacco and Poverty Study in the Philippines" found that if a person reallocated his tobacco expenditure on rice, he would have an additional 466 calories daily from rice alone.<sup>33</sup> The average monthly expense for tobacco, if reallocated to food, could add around 750 calories to the daily family diet. Thus, if the extra resources were utilized properly, it could alleviate malnutrition, especially among children.

The study of tobacco economics also shows that countries with low prices of tobacco products are likely to have higher tobacco consumption.<sup>34</sup> This proves true in the Philippines, which has one of the highest

<sup>&</sup>lt;sup>31</sup> Supra note 29, at 251-252 citing studies by Lewit et al. (1981); Grossman and Chaloupka (1997).

<sup>&</sup>lt;sup>32</sup> Jha and Chaloupka, *Curbing the Tobacco Epidemic: Governments and the Economics of Tobacco Control, Global Trends in Tobacco Use*, The International Bank for Reconstruction and Development/ The World Bank 74 (1999).

<sup>&</sup>lt;sup>33</sup> Supra note 15, at 13.

<sup>&</sup>lt;sup>34</sup> Studies conducted in the United Kingdom and South Africa show that price has an effect on the consumption of tobacco products. *Supra* note 29 at 242-244.
numbers of smokers in the world but has the lowest cigarette prices. Cigarette prices in the Philippines are said to be the second lowest in Southeast Asia.<sup>35</sup>

In sum, various studies have shown that an increase in price resulting from excise taxes leads to a significant reduction of demand for tobacco products, and that the poor and the young are the most likely to give up smoking or to smoke less because of the change in price. Tax increases can lead to a significant number of lives saved, diseases prevented, and youth prevented from taking up smoking.

#### **Illustration**

Tobacco taxes have been utilized in many jurisdictions to serve as a tobacco control measure to reduce smoking prevalence. There are many varied examples of best practices in different parts of the world where taxes have been increased in order to deter smoking.

For instance, in New York City, the cigarette tax level was constantly increased for health purposes but has consistently yielded revenues. The increases in tax, along with other tobacco control measures, contributed to reducing smoking prevalence by four percent from 2002 to 2006, thereby saving around 240,000 lives in New York City alone.<sup>36</sup> The tax for a pack of cigarettes is currently equal to USD4.25 or PhP104.64, if the PPP rate<sup>37</sup> is used for conversion.<sup>38</sup> The total

<sup>&</sup>lt;sup>35</sup> Southeast Asia Tobacco Control Alliance, Tobacco Tax in ASEAN Countries, 4 (2008).

<sup>&</sup>lt;sup>36</sup> U.S. Centers for Disease Control and Prevention, "Decline in Smoking Prevalence – New York City (2002 – 2006)," *Morbidity and Mortality Weekly Report*, June 27, 2007. Accessed October 18, 2010. http://www.cdc.gov/mmwr/preview/mmwrhtml/mm5624a4.htm.

<sup>&</sup>lt;sup>37</sup> The purchasing power parity (PPP) exchange rate determines the real exchange rate (as against the nominal exchange rate), taking into consideration the inflation rates in countries being compared. It conforms to the principle that there is one price for all goods and services, outside of the transaction costs.

<sup>&</sup>lt;sup>38</sup> PPP conversion rate is PhP24.62 per USD. The rate is from the World Economic Outlook 2010 by the IMF.

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price of one cigarette pack is approximately USD9 or PhP220, with the excise tax composing 60-80 percent of the total retail price.

For many countries, such as Thailand, Australia, Singapore, and Malaysia, increasing the excise tax on cigarettes has succeeded in decreasing consumption and smoking prevalence. These countries experience continued increase in excise tax revenues even with decreasing consumption and smoking prevalence, implying that demand for cigarettes is relatively inelastic.

#### 4. Tobacco Tax

4.1 Tobacco Tax in the Philippines

## 4.1.1 Different Types of Taxes on Tobacco Products

In the Philippines, the types of taxes imposed on tobacco products are:<sup>39</sup>

- a. Value-added tax (VAT)<sup>40</sup> levied on tobacco products after all other taxes have been applied. The current VAT rate is 12 percent.
- b. Import Tariff<sup>41</sup>– levied on all imported tobacco products based on dutiable value. Under the Tariff Reform Program (TRP), the tariff rate is five percent in 2003. However, the tariff rate under the Common Effective Preferential Tariff (CEPT) scheme of the ASEAN Free Trade Area is lower than the rate

<sup>&</sup>lt;sup>39</sup> SEATCA Report Card, *Tobacco Tax in ASEAN Countries,* 11 (2008).

<sup>40</sup> Rep. Act No. 9337, Sec. 4 (2005).

<sup>&</sup>lt;sup>41</sup> Pres. Decree No. 1464, Sec. 100, as amended by Rep. Act No. 9135 (2001).

under the TRP.<sup>42</sup> But starting 2010, tariff rates are zero percent for importations from ASEAN countries.

c. Excise tax<sup>43</sup>– levied on all tobacco products at different rates depending on the type of product. For machine-packed cigarettes, which account for 97 percent of the market,<sup>44</sup> a four-tier tax system (premium, high-priced, medium-priced and low-priced) that depends on the net retail price per pack of cigarettes is currently applied.

The projections in this paper will focus on excise taxes, for they are the subject of the proposed bills and they serve regulatory objectives. Among the many types of tobacco products, the projections will be limited to cigarettes packed by machine as this is the most widely-used form of tobacco product and dominates over 90 percent of the market for all tobacco products.<sup>45</sup> However, policy implications here apply to all types of cigarettes as these are viewed as possible substitutes and are equally harmful.

## 4.1.2 Problems in the Tobacco Excise Tax System

## 4.1.2.1 Price Classification Freeze

Section 145 of RA 8240, as amended by RA 9334, made a classification between old brands of cigarettes and those registered after January 1, 1997. Existing or old brands of cigarettes, or leading brands that form over 90 percent of the total market, are taxed based on their net retail price as of October 1, 1996. In 1997, the brands that were classified belong only to the low-priced, medium-priced, and high-priced

<sup>&</sup>lt;sup>42</sup> CEPT rates vary for different products: tobacco leaves (3.6%), cigar and cigarettes (5%), and tobacco manufacturers (4%) in 2003.

<sup>&</sup>lt;sup>43</sup> Rep. Act No. 9334, Sec. 5 (2004).

<sup>&</sup>lt;sup>44</sup> Family Income and Expenditure Survey (2003).

<sup>&</sup>lt;sup>45</sup> Id.

classifications. There were no premium price brands identified and classified as such.<sup>46</sup> This is what is commonly referred to as the "price classification freeze," and sometimes referred to as the "protection clause" because it effectively protects certain brands from being placed in higher tax brackets. Section 5 of RA 9334 states:

The classification of each brand of cigarettes based on its average net retail price as of October 1, 1996, as set forth in Annex 'D', including the classification of brands for the same products which, although not set forth in said Annex 'D', were registered and were being commercially produced and marketed on or after October 1, 1996, and which continue to be commercially produced and marketed after the effectivity of this Act, shall remain in force until revised by Congress. [Emphases supplied.]

Those that are listed in "Annex D," which include majority of the topselling brands, remain in specific price classifications established in 1996, while the others are classified according to their actual or current net retail price (NRP). For instance, Marlboro, which was classified as "high-priced" in 1996, enjoys a specific rate at around PhP12, and has never been classified as "premium" or taxed at around PhP28 even if its NRP has actually increased. Thus, the so-called tax increase in RA 9334 did little to increase the price and did nothing to discourage smoking.

The price classification freeze is advantageous to old brands but disadvantageous to new entrants because old brands are taxed based on their *1996* NRPs, while new brands are taxed based on their *current* NRPs.

<sup>&</sup>lt;sup>46</sup> Rep. Act No. 8424, Annex D. (1997).

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The freeze has also led to lower collection of taxes from tobacco products because their price classification of over a decade ago, in 1996, remains the same even if the ANRP of the product has doubled. Table 1 illustrates how excise taxes imposed on popular brands do not correspond to the current NRP and tax schedule shown in RA 9334.

#### Table 1: Net Retail Price of Cigarette Brands

		GIVEN		NRP DERIVATION		
BRAND	Gross Retail Price (PhP)	Excise Tax (PhP)	Value- Added Tax (%)	Net Retail Price (PhP)	Remarks	
Marlboro (Most Popular High- Priced Brand)	29.27	11.43	12%	14.70	For NRP of above <i>PhP10</i> per pack (premium- priced), excise tax should be <b>PhP27.16.</b>	
Fortune (Most Popular Low-Priced Brand)	12.77	2.47	12%	8.93	For NRP above <i>PhP6.50 to</i> <i>PhP10</i> per pack (high- priced), excise tax should be <b>PhP11.43.</b>	

## Where: **Net Retail Price** = [Gross Retail Price ÷ (1 + Value-Added Tax)] - Excise Tax

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Table 2 shows the comparison of the peso values of NRP of cigarettes. Without the price classification freeze, the illustrated low-priced to high-priced brands would have been reclassified to premium brands. The variance of up to PhP24 in taxes per pack represents a significant revenue loss to the government.

	Net Retail Price of Cigarettes in 1997	Price Class Fixed by Law (Sec. 145)	Actual Net Retail Price* as of 2010 <sup>47</sup>	New Price Class Should be	Excise Tax Currently Paid per Pack (Due to Sec. 145)	Excise Tax Should be (per Pack)	Variance per Pack**
Brand X	PhP 4.71	Low	PhP 13.6	Premium	PhP 2.47	PhP 27.16	24.69
Brand Y	PhP 5.50	Medium	PhP 13.32	Premium	PhP 7.14	PhP 27.16	20.02
Brand Z	PhP 6.81	High	PhP 14.70	Premium	PhP 11.43	PhP 27.16	15.73

# Table 2: Actual Net Retail Price of Cigarettes andCorresponding Taxes

\* Computed using the following formula:

2010 NRP = [2010 GRP ÷ (1 + VAT Rate)] – 1997 Price Class Excise Tax.

\*\* This represents savings for the tobacco companies and losses for the government.

A conservative estimate below shows that each year for the past five years, the government has lost at least PhP25 billion to PhP29 billion in revenues, or a total of PhP130 billion annually (Table 3). Note that the estimate is deemed conservative because it only assumes that price

<sup>&</sup>lt;sup>47</sup> National Statistics Office (NSO), Price Survey for the Months of January to March (2010).

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classes will move one notch from low- to medium-priced, mediumto high-priced, or high- to premium-priced. However, price surveys reveal that many of the popular brands are classified as low-priced or medium-priced when they should belong to a higher classification, either as high-priced or premium-priced brands.

Current	Price Class	Government Revenue Losses (PhP) in billions <sup>49</sup>					
Price Class	if Freeze Removed	2005	2006	2007	2008	2009	<b>2010</b> <sup>50</sup>
Low	Middle	6.23	7.96	8.03	9.04	8.74	10.04
Middle	High	2.71	2.55	2.40	2.39	1.85	2.12
High	Premium	15.75	17.76	14.04	18.01	14.99	17.26
TOTAL		24.69	28.62	24.47	29.44	25.58	29.42

## Table 3: Government Revenue Losses Due to PriceClassification Freeze48

The potential impact of the removal of the price classification freeze on revenue is projected in Table 4. The estimates refer only to a little more than 60 percent of the market for cigarettes, but it gives us an idea of the billions in revenues forgone due to the price classification freeze. Where computations are done based on brand-specific data on prices and market share, removing the price classification freeze alone without increasing cigarette excise taxes has the impact of increasing government revenue by PhP31.67 billion, using the price elasticity employed by DOF.

<sup>&</sup>lt;sup>48</sup> All brands currently classified as low-, middle- and high-priced are expected to be classified as middle-, highand premium-priced, respectively, if the price classification freeze is removed based on the derived NRP of cigarettes from the NSO price surveys of 2005 to 2010.

<sup>&</sup>lt;sup>49</sup> In computing for change in consumption due to removal of price class freeze, the DOF price elasticity estimate is applied to actual volumes of consumption for the included years except for year 2010.

<sup>&</sup>lt;sup>50</sup> For 2010, computations are based on projected volume of cigarettes sold for 2010 that are derived from BIR removals data due to lack of removals data for 2010.

Brand	Current Price Class	Suggested Price Class	% Change in Retail Price	Market Share (%) <sup>52</sup>	New Smoking Prevalence	Potential Lives Saved <sup>53</sup> (K=,000)	Revenue Increase (PhP) in Billions
А	High	Premium	60	18	28.04	56 K	10.10 B
В	High	Premium	57	10	28.17	27 K	5.48 B
С	Medium	Premium	98	14	27.98	69 K	9.13 B
D	Medium	High	27	3	28.28	4 K	0.47 B
Е	Low	Premium	153	1	28.26	8 K	0.70 B
F	Low	High	79	18	27.97	71 K	5.79 B
IN AGGREGATE			64	27.46	179 K	32 B	

## Table 4: Potential Impact of Removal of PriceClassification Freeze51

Removal of the price class freeze can also help decrease cigarette consumption and save lives because it will effectively classify most brands as premium-priced, hence a tax rate of PhP27. A few will be classified as high-priced, which would be taxed at PhP12, and fewer will be classified medium-priced, which would be taxed at PhP7. Even taking into account only 60 percent of the market (as estimated in Table 4), the removal of price classification freeze has the potential of decreasing smoking prevalence from 28.3 percent to 27.5 percent and saving 180,000 lives.

<sup>&</sup>lt;sup>51</sup> Price elasticity used in computations is the DOF estimate equal to -0.235.

<sup>&</sup>lt;sup>52</sup> Market shares are based on the ERC Group, World Cigarettes p. 17, (2007).

<sup>&</sup>lt;sup>53</sup> Based on the finding that lives equivalent to 35 percent of those who will quit smoking will be saved (Van Walbeek, 2010). A simulation model to predict the fiscal and public health impact of a change in cigarette excise taxes. Tobacco Control, 19 (1), 31–36.

This alone, however, presents a partial solution, because other issues regarding the current tax structure still remain. These include, among others, the difficulty in administering taxes due to the multi-tiered price classification, the lack of indexation, and the presence of lowpriced cigarettes.

## 4.1.2.1.1 Barriers to Removing the Price Classification Freeze

The two main players in the cigarette industry, Fortune Tobacco Corporation (FTC) and Philip Morris Philippines Manufacturing Incorporation (PMPMI), have flourished under the current excise tax structure because of their long-standing presence in the market that qualified them to be "protected" under the price classification freeze (Annex D). It is estimated that leading brands, comprising over 90 percent of the total market, are enjoying an artificially low tax rate because of the price classification freeze. Practically all of FTC's brands and the most popular PMPMI's brand, Marlboro, enjoy this privilege.

Because its Lucky Strike brand was not included in Annex D and was classified as a premium cigarette, British American Tobacco (BAT) filed a case in court arguing that the price classification freeze violates the equal protection clause of the Constitution. The Supreme Court ruled, contrary to BAT's assertions, that the equal protection clause is not violated because there is a rational basis for the price classification.<sup>54</sup> The Court also held that the DOF and BIR do not have the power to adjust the classification of tobacco products because Congress did not intend to grant such power to those agencies. It addressed the apprehension that delegating too much authority to them might open the tax system to potential areas for abuse and corruption.<sup>55</sup>

In what seemed to be a practice of judicial economy, the Court stated that it cannot make judgment as to whether the provision on the price classification freeze is the best means to achieve State interests because that is delving into the wisdom of the law, which the court cannot inquire into, much less overrule. For as long as the price classification freeze provision has not been put into law to unduly favor older brands over newer brands, the court must reasonably assume that the aforementioned provision was put in place to improve the efficiency and effectivity of the tax administration.<sup>56</sup>

<sup>&</sup>lt;sup>54</sup> British American Tobacco vs. Camacho, G.R. No. 163583, August 20, 2008 *citing* Government Service Insurance System v. Montesclaros, G.R. No. 146494, July 14, 2004, 434 SCRA 441, 451-452. A legislative classification that is reasonable does not offend the constitutional guaranty of the equal protection of the laws. The classification is considered valid and reasonable provided that: (1) it rests on substantial distinctions; (2) it is germane to the purpose of the law; (3) it applies, all things being equal, to both present and future conditions; and (4) it applies equally to all those belonging to the same class.

The first, third, and fourth requisites are satisfied. The classification freeze provision was inserted in the law for reasons of practicality and expediency. That is, since a new brand was not yet in existence at the time of the passage of RA 8240, then Congress needed a uniform mechanism to fix the tax bracket of a new brand. The current net retail price, similar to what was used to classify the brands under Annex "D" as of October 1, 1996, was thus the logical and practical choice. Further, with the amendments introduced by RA 9334, the freezing of the tax classifications now expressly applies not just to Annex "D" brands but to newer brands introduced after the effectivity of RA 8240 on January 1, 1997 and any new brand that will be introduced in the future.

British American Tobacco argued that the classification freeze, placed in lieu of the periodic adjustment and reclassification provision, would foster anti-competitive environment. But, the Court held that the classification freeze provision was the main result of the Congress' earnest efforts to improve efficiency and effectivity of the tax administration over sin products while trying to balance the same with other state interests.

<sup>&</sup>lt;sup>55</sup> British American Tobacco vs. Camacho, G.R. No. 163583, August 20, 2008.
<sup>56</sup> *Id.* 

The law also prohibits downward classification. BAT attempted to penetrate the mid-price market segment by seeking reclassification of Pall Mall, from being premium-priced under RA 8240 to a mid-priced brand. In 2007, the DOF, reversing a BIR position, ruled that Pall Mall should be taxed at a lower rate of PhP6.74. After much debate,<sup>57</sup> DOF subsequently reversed its own ruling and classified Pall Mall as a premium brand and subjected it to the highest tax rate per pack. <sup>58</sup>

In late 2009, sources reported an attempt by Congress to address the price classification freeze issue through a Joint Resolution of the Senate and the House of Representatives. Apparently, senior members of Congress premised that a revision by Congress through a Joint Resolution would be an alternative procedure to "revise" price classifications in accordance with the RA 9334 provision requiring the price classification of existing brands as of October 1, 1996 to "remain in force until revised by Congress."<sup>59</sup> This initiative was abandoned as the 14<sup>th</sup> Session of Congress came to an end.

#### 4.1.2.2 Multi-level Tax Structure

The current tax structure comprises four tiers with different specific tax rates depending on their price classification as premium, high-priced, medium-priced, and low-priced. The specific tax rate depends upon the price classification, thus cigarettes that are classified at a lower bracket pay a lower rate.

<sup>&</sup>lt;sup>57</sup> See various online news reports illustrating this debate:

Michelle Remo, "Fortune urges DOF to amend Pall Mall Decision," *Philippine Daily Inquirer,* September 16, 2007. Accessed October 15, 2010. http://business.inquirer.net/money/breakingnews/view/20070916-88927/ Fortune\_urges\_DoF\_to\_amend\_Pall\_Mall\_decision.

Conrado Banal III, "Mystery of Pall Mall prices," *Philippine Daily Inquirer*, November 22, 2007. Accessed October 15, 2010. http://business.inquirer.net/money/columns/view/20071122-102396/Mystery\_of\_Pall\_Mall\_prices.

Ben Rosario, "House panel tackles cigarette excise tax issue," *The Manila Bulletin,* November 14, 2007. Accessed October 15, 2010. http://mb.com.ph/node/45727.

 <sup>&</sup>lt;sup>58</sup> The Daily Tribune, "Former BIR Chief, DOF execs to face off in House probe," October 4, 2007. Accessed October 15, 2010. http://www.tribuneonline.org/business/20071004bus1.html.
 <sup>59</sup> Sec. 145 of Rep. Act No. 8424 provides:

<sup>&</sup>quot;The classification of each brand of cigarettes based on its average net retail price as of October 1, 1996, as set forth in Annex 'D', shall remain in force until revised by Congress."

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This system keeps low-priced cigarettes low and widens the gap between high-priced and low- priced cigarettes. The DOF noted that the wide gap between low-, middle-, and high-priced cigarettes has encouraged a trend of shifting from high-priced brands to low-priced brands, with a clear indication that consumption of low-priced cigarettes is rising, while those of the medium-priced and high-priced cigarettes show a downward trend.<sup>60</sup>

Segment	2009 Tax	Average Price (NSO Survey)	Market Share of Popular Brands (ERC 2007)		
			2004	2005	
Low	PhP2.47	PhP12.77	14.5%	18.1%	
Medium	PhP7.14	PhP22.92	15.4%	14.2%	
High	PhP11.43	PhP29.26	17.1%	18.2%	
Premium	PhP27.16				

Table 5: Average Price in Each Segment and the IncreasingMarket Share of Low-Priced Cigarettes

Table 6 shows that 99 percent of the cigarettes are taxed between PhP2 and PhP12. Very few cigarettes are categorized as premium. The figures from 2004-2005 also reflect the increase in market share of low-priced cigarettes among the popular brands.

<sup>&</sup>lt;sup>60</sup> Information from the DOF, through a PowerPoint Presentation shared at a recent Tobacco Tax Forum held in Manila, December 2009.

Market Segment	Market Share estimate (%) <sup>61</sup>	2009 Tax Rate (PhP)	
Low	48.3	2.47	
Medium	20.4	7.14	
High	30.2	11.43	
Premium	1.2	27.16	

#### Table 6: Market Segment, Market Share, and Tax Rate

The multi-tier system does not contribute to lowering the consumption of cigarettes because of the possibility of downward shifting or shifting to lower-priced brands. In addition, according to DOF, under a multi-tiered system, the rules for classifying products leave too much discretion for classifying the net retail price such as validation and revalidation rules.<sup>62</sup> It thus opens the system to possible misclassification.

#### 4.1.2.2.1 Ad Valorem Nature<sup>63</sup> of Excise Tax

Technically speaking, RA 9334 employs "specific excise tax," which is added as a fixed amount to the price of cigarettes. However, there are several specific taxes involved and tobacco products' specific tax rates vary according to the tax tier,<sup>64</sup> thus mimicking an ad valorem system, where taxes and prices of products with a low tax base remain low.

- 1. Premium PhP10 up, excise tax = PhP27.16 per pack.
- 2. High-priced PhP6.50 -10, excise tax = PhP11.43 per pack.
- 3. Medium-priced PhP5 6.50, excise tax = PhP7.14 per pack.
- 4. Low-priced below PhP5, excise tax = PhP2.47 per pack.

<sup>&</sup>lt;sup>61</sup> Data based on the 2007 ERC Group publication on the tobacco industry in Asia and the Far East, World Cigarettes p. 10.

<sup>&</sup>lt;sup>62</sup> Supra note 60.

<sup>&</sup>lt;sup>63</sup> In general, there are two types of excise taxes:

Specific excise tax, which is imposed based on weight or volume, capacity, or any other physical unit of measurement.

<sup>•</sup> Ad valorem excise tax, which is imposed based on selling price or other specified value of the good. <sup>64</sup> If Net Retail Price is:

Net Retail Price is defined as the gross retail price (or average supermarket price) less applicable excise and value-added taxes.

Issues	Specific	Ad Valorem
Government Administration	Easier to administer relative to ad valorem tax according to World Bank, WHO, and DOF, as it only requires determining the physical quantity of goods.	Prone to undervaluation of products, which makes government administration more difficult.
<i>Change in Real Value of Tax due to Inflation</i>	Real value eroded by inflation unless tax is indexed.	Real value not eroded by inflation.
Equity	Uniform across all price classes.	More equitable than specific tax; increases as price increases.
Impact on Price	If taxed higher than the inflation rate, increases prices of goods more than the ad valorem tax.	Needs to be high enough to increase price significantly.
Impact on Consumption	Reduces consumption by significantly increasing prices and eliminating possibility of shifting to lower-priced goods.	Reduces consumption by discouraging quality improvement of products.

## Table 7: Comparison of Specific and Ad Valorem Taxes

#### 4.1.2.2.2 Advantages of Specific Tax over Ad Valorem Tax

Between specific and ad valorem taxes, a specific tax rate (as opposed to one that mimics ad valorem or a mixed type) is preferred because, according to the World Bank, it allows the greatest flexibility and allows governments to raise the tax while lowering the risk that the industry will respond with actions that will keep prices low.<sup>65</sup> Studies have shown that specific taxes increase the prices of goods more than ad valorem taxes. Ad valorem taxes induce firms to increase production to lower prices and in effect lower the taxes they would have to pay for.<sup>66 67</sup>

On the other hand, the specific tax, because of its greater positive effect on prices, can reduce consumption to a larger extent when compared to the ad valorem tax. Hence, if the main objective is to reduce tobacco consumption, the specific type of tobacco excise tax is more appropriate.

Aside from its greater effect on prices, the specific tax is more effective in reducing tobacco consumption because it significantly eliminates the possibility of consumers shifting from high-priced to low-priced cigarettes when it is implemented uniformly across all types and brands of cigarettes.

Unlike the ad valorem system where prices of inexpensive brands remain low relative to prices of expensive brands, the specific tax system, when applied to the current tax system,<sup>68</sup> will minimize price differentials among the various price categories, making it less likely for consumers to "trade down" in favor of low-priced brands and in effect would diminish the health benefit of reducing consumption.<sup>69</sup>

<sup>&</sup>lt;sup>65</sup> Jha and Chaloupka, *supra* note 32, at 38.

<sup>&</sup>lt;sup>66</sup> Delipalla and Keen. *The Comparison between Ad Valorem and Specific Taxation under Imperfect Competition,* 49 JOURNAL OF PUBLIC ECONOMICS, 351-367(1992).

 <sup>&</sup>lt;sup>67</sup> Delipalla and O'Donnell, *Estimating Tax Incidence, Market Power and Market Conduct: The European Cigarette Industry*, 19 INTERNATIONAL JOURNAL OF INDUSTRIAL ORGANISATION, 885-908(2001).
 <sup>68</sup> Subra note 60.

<sup>&</sup>lt;sup>69</sup> World Health Organization, *WHO Technical Manual on Tobacco Tax Administration, Regional Training Workshop on Tobacco Taxation* (2010).

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Moreover, the World Bank, WHO, and DOF agree that the specific tax is easier to administer than ad valorem tax because the former requires only the determination of the physical quantity of the product without the need to determine its value. Tax revenue can be collected at any point, whether at the manufacturer, wholesaler, or importation stage, as long as the unit of basis has already been defined. The specific tax system is also less prone to undervaluation of products.<sup>70 71 72</sup>

As early as the 1990s when RA 8240 was enacted, the DOF had recommended a shift from ad valorem to the specific tax system. The agency noted that an ad valorem system was a source of massive tax leakage because the taxpayer was able to evade taxes by undervaluing cigarette prices through the use of various marketing arms and dummy corporations.<sup>73</sup> As a case in point, in a highly publicized case, the BIR charged FTC and its owner, Lucio Tan, to have fraudulently avoided paying the correct ad valorem and value-added taxes by setting up fictitious marketing arms and dealers nationwide to defraud the government.<sup>74</sup>

## 4.1.2.2.3 Advantages of Ad Valorem Tax over Specific Tax

On the other hand, the ad valorem tax system is credited for being more equitable than the specific type since those who can afford more expensive cigarette brands pay more taxes while those who can afford less, pay less.<sup>75</sup>

<sup>&</sup>lt;sup>70</sup> Jha and Chaloupka, *supra* note 32, at 87-88.

<sup>&</sup>lt;sup>71</sup> *Supra* note 60.

<sup>&</sup>lt;sup>72</sup> Supra note 69.

<sup>&</sup>lt;sup>73</sup> Supra note 55.

<sup>&</sup>lt;sup>74</sup> Roy Sinfuego, "Hearing on P25B Lucio Tan tax evasion case cancelled," *The Manila Bulletin*, April 30, 2005. Accessed October 15, 2010. http://www.mb.com.ph/node/121433.

<sup>&</sup>lt;sup>75</sup> Information from Felipe Medalla, through a round table discussion at a Technical Working Group meeting on Tobacco Tax Increase, April 2010.

In an ad valorem tax system, any additional costs related to demandenhancing improvements of the product will add on to the price of the product and will increase the tax for that product; thus discouraging investments in enhancing quality.

In contrast, specific taxes create incentives for firms to improve the quality<sup>76</sup> of their products in terms of packaging, branding, and variety while ad valorem taxes discourage investments in quality. <sup>77 78 79</sup> Since price differentials are reduced with a specific tax, firms are encouraged to differentiate their product and improve the quality of their product to induce demand.<sup>80</sup>

Given that improvements in quality can increase demand for tobacco, the ad valorem system has the effect of decreasing demand for tobacco as it discourages investments in quality.<sup>81 82</sup>

Theory also suggests that in the long run, specific taxation will lead to increased industry profits and market power of a few players. The specific tax system, relative to the ad valorem tax system, tends to be in favor of higher-priced products so that small players in the market may not be able to survive and the few big players will gain more market power. International economic experts suggest that with specific taxation, the governments may need to work on additional policies to

<sup>&</sup>lt;sup>76</sup> Quality refers to demand-enhancing improvements on products. In the case of tobacco, the improvements may come in the form of packaging, adding variety, advertising, or promotion.

<sup>&</sup>lt;sup>77</sup> Barzel, An Alternative Approach to the Analysis of Taxation, 84 Journal of Political Economy, 1177-1197 (1976). 1976.

<sup>&</sup>lt;sup>78</sup> Kay and Keen, *Product Quality under Specific and Ad Valorem Taxation*, 19Public Finance Quarterly, 238-247 (1991).

<sup>&</sup>lt;sup>79</sup> Keen, The Balance between Specific and Ad Valorem Taxation, 19(1) FISCAL STUDIES 1-37 (1998).

<sup>&</sup>lt;sup>80</sup> Cremer and Thisse, *Commodity Taxation in a Differentiated Oligopoly*, 35 International Economic Review 613-633 (1994).

<sup>&</sup>lt;sup>81</sup> World Health Organization, *supra* note 69.

<sup>&</sup>lt;sup>82</sup> Cnossen, Theory and Practice of Excise Taxation: Smoking, Drinking, Gambling, Polluting, and Driving, Oxford University Press (2005).

offset the tobacco industry's increased influence.<sup>83</sup> This aptly applies to the Philippine setting where the tobacco industry's influence is already pronounced even in the absence of any tax reform, because 92 percent of the market is dominated by a single entity.

Another advantage of the ad valorem tax system is that the real value of the tax is not eroded over time as the tax usually follows the movement of prices.<sup>84</sup> However, the DOF pointed out that this is not true in the Philippines,<sup>85</sup> where in the past ad valorem system, collections did not actually follow the tobacco price index as a result of under-declaration and transfer pricing.<sup>86</sup>

## 4.1.2.2.4 Choosing between Specific and Ad Valorem Taxes

Based on the advantages and disadvantages, the choice between specific and ad valorem taxes ultimately depends on the goals of policymakers for increasing the tobacco tax, the market structure of the tobacco industry, the administrative capacity of taxing authorities, and the political economy of the country. There is no one size that fits all, so the excise tax system must be tailored according to the needs and limitations of the country.

In the Philippines, an important consideration is the low tax levels that provide a low tax base. Ad valorem taxes tend to keep prices of cigarettes low and easily affordable, particularly to the young. This goes against the recognition that price and tax measures are effective and

<sup>86</sup> Supra note 60.

<sup>&</sup>lt;sup>83</sup> World Health Organization, *supra* note 69.

<sup>&</sup>lt;sup>84</sup> Id.

<sup>&</sup>lt;sup>85</sup> Transfer pricing refers to the pricing of contributions transferred within an organization. This is a major concern for fiscal authorities since there is a possibility that multinational entities may set transfer prices on cross-border transactions to reduce taxable profits.

important means of reducing to bacco consumption among the youth as embodied in the FCTC.  $^{\rm 87}$ 

Another major consideration in choosing the type of tax is the ease of tax administration. The huge tax leakage from cigarettes, which amounted to at least PhP18 billion in 2006,<sup>88</sup> is reflective of the weak tax administration of the country. Hence, it is recommended that the Philippines adopt the simplest tax system for tobacco taxes.

The DOF's experience with large tobacco companies under an ad valorem system of taxation influenced the government agency to switch from an ad valorem type in 1986 to a specific type of taxation in 1997. The latter is easier to implement and is less prone to tax avoidance and evasion ploys by tobacco companies. Thus, the ad valorem tax may be an option for the Philippines only if the BIR would be able to surmount the problem of undervaluation of cigarettes. But for now until tax administration has demonstrated capacity to correct underpricing and other sources of leakage, the specific excise tax appears to be the more viable option for the country.

A combination of the specific and ad valorem systems can also be done to capture the strengths of both types of taxes. Then again, a mixed system will require strong tax administration. Hence, this is not a practical option for the Philippines, at least in the short term.

Moreover, as the main goals for increasing tobacco tax are to reduce tobacco consumption and achieve health objectives, the specific tax when implemented uniformly across all brands emerges as the better option relative to an ad valorem or any tax that mimics an ad valorem

<sup>87</sup> Art 6.1 of the WHO FCTC provides:

The Parties recognize that price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons.

<sup>&</sup>lt;sup>88</sup> Antonio, *Philippine Tobacco Industry and Estimation on Tax Leakage* (2008).

type. The specific tax raises the price of cigarettes more than the ad valorem tax and, in addition to making cigarettes less affordable to the youth, reduces the probability of enticing consumers to shift from higher-priced to lower-priced cigarettes.

## 4.1.2.3 Lack of Price Indexation

Unlike other specific tax systems, the specific rates under RA 9334 are not pegged to any price index that takes inflation rates into consideration (e.g., CPI). Hence, the rates set in 2004 have since been eroded by price inflation.<sup>89</sup> Real taxes (or taxes measured in real terms by taking inflation into account) have not increased as much. Notwithstanding tax increases provided by law, the effective tax burden has declined. In 2008, the effective tax burden shrank to eight percent to 37 percent from 14 percent to 40 percent, depending on the classification of the cigarette brands<sup>90</sup> (Annex E).

RA 9334 provides for an increase on excise tax rates on cigarette products every two years from 2005 until 2011, but the rate of increase is marginal, i.e., by four percent to 10 percent, depending on the price classification, and does not even match inflation rates that are on the average 5.3 percent per year.<sup>91</sup>

Hence, increases in tax rates of around five percent per year are merely an adjustment to inflation but do not necessarily increase tax rates to affect consumer behavior.

<sup>&</sup>lt;sup>89</sup> DOF presentation, supra note 60.

<sup>&</sup>lt;sup>90</sup> Id.

<sup>&</sup>lt;sup>91</sup> Average inflation rate for the past 10 years from the NSO.

Table 8 illustrates the marginal increase for the 2009 and 2011 excise tax rates.

Cigarettes packed by machine (each pack with 20 pieces)	2011 Rates	2009 Rates	% Increase
NRP below PhP5 per pack (low- priced)	PhP2.72	PhP2.47	10%
NRP of PhP5 to PhP6.50 per pack (medium-priced)	PhP7.56	PhP7.14	4.5%
NRP above PhP6.50 to PhP10 per pack (high-priced)	PhP12.00	PhP11.43	5.8%
NRP of above PhP10 per pack (premium-priced)	PhP28.30	PhP27.16	4.2%

Table 8: Change in Excise Taxes on Cigarettes in 2011

Because the current tax rates do not automatically adjust to inflation, the stipulated tax increases have lagged behind inflation rates. This is one of the weaknesses of the law that can easily be addressed by appropriate legislation.

In the case of BAT vs. Camacho,<sup>92</sup> the Supreme Court looked into the deliberation of the bills that resulted in RA 9334. The proposal of the DOF contained a provision that allowed the Secretary of Finance to periodically adjust the excise tax rate and tax bracket taking into account the movement of CPI. The House of Representatives rejected the proposal and argued that it is an undue delegation of legislative power. The proposal was also criticized in the Senate using the same justification and that the power given might

<sup>&</sup>lt;sup>92</sup>G.R. No. 163583 (2008). See supra note 55.

invite corruption and arbitrariness. Based on the deliberations, the Court held that the legislative intent was clearly not to delegate the power of readjusting the tax rates and tax brackets in the hands of the Secretary of Finance.

Contrary to the assertions of the legislators, a tax law that provides the executive or implementing agency the power to index the rates to inflation does not amount to an undue delegation of power to the executive branch. In testing whether a statute constitutes an undue delegation of legislative power, it is usual to inquire whether a statute was complete in all its terms and provisions when it left the hands of the legislature so that nothing was left to the judgment of the appointee or delegate of the legislature.<sup>93</sup> The parameters in implementing the adjustment, such as using the CPI as basis and providing the years when the adjustment will be implemented, will be provided by law, such that all that is required from the Secretary of Finance is the actual computation of the tax rate that will be imposed.

This is currently being practiced by the DOF. In the Tax Code, the value of certain transactions exempt from VAT can be adjusted yearly using CPI.<sup>94</sup> This power does not require additional law as the NIRC already provides the parameters to implement the provision. Another example is Section 244 in relation to Section 128 of the NIRC, under which the Commissioner of Internal Revenue has the power to adjust the minimum amount of gross receipts of domestic land carriers and keepers of garages for purposes of computing the percentage tax provided under Section 117 of the NIRC. Revenue Regulation No. 9-2007 was issued for this purpose. The BIR used CPI in updating the value of the minimum gross receipts of domestic land carriers and keepers of garages for purposes of computing the percentage.

<sup>&</sup>lt;sup>93</sup> People vs. Vera, G.R. No. L-45685 (November 16, 1937).

 $<sup>^{94}\,</sup>National$  Internal Revenue Code, Sec. 109 (w), (x)

Due to lack of price indexation, it is estimated that the government has forgone over PhP20 billion worth of revenues in the last five years. Table 9 below shows the estimated revenue loss for each year.

Year	Estimated Revenue Loss <sup>95</sup> (PhP) in Billions (B)		
2006	2.24 B		
2007	3.33 B		
2008	4.42 B		
2009	5.22 B		
201096	7.45 B		
TOTAL	22.66 B		

Table 9: Government Revenue Loss Due to Lack of Indexation

Proper indexation of excise taxes alone has the potential of increasing government revenue by PhP7 billion in the first year of implementation and reducing tobacco consumption by three percent. Table 10 illustrates how a simple measure such as indexation to inflation rates can save thousands of lives and generate billions in government revenues.

<sup>&</sup>lt;sup>95</sup> In computing for change in consumption due to indexation, the DOF price elasticity estimate is applied to the actual average excise tax and volume for removals per year except for year 2010.

<sup>&</sup>lt;sup>96</sup> Computations based on projected volume of cigarettes sold for 2010 are derived from BIR removals data due to lack of removals data for 2010.

Year	2011	2012	2013	2014	2015	2016
Incremental Increase (Decrease) in Revenue (PhP) Base Year = 2011 Excise (RA 9334) <sup>97</sup>	7.47 B	9.09 B	10.77 B	12.52 B	14.35 B	16.24 B
Estimated New Smoking Prevalence (%)	27.38	27.19	27.01	26.81	26.62	26.41
Potential Number of Lives Saved (K=,000)	197 K	39 K	40 K	41 K	42 K	43 K

#### Table 10: Potential Impact of Price Indexation to Inflation

#### 4.1.2.4 Low Incremental Change in Tax and Price

The law provides for the incremental increase of cigarette tax every two years. Table 11 shows the incremental increase in excise tax of cigarettes packed by machine.

<sup>&</sup>lt;sup>97</sup> Price elasticity used in computations is the DOF estimate equal to -0.235. Computations are also based on the average excise tax in the past years and projected volume for removals for 2010.

Chart of Tax Rates	2005	2007	2009	2011
If net retail price (excluding the excise tax and the value-added tax) is below PhP5 per pack	PhP2 per pack	PhP2.23 per pack	PhP2.47 per pack	PhP2.72 per pack
If net retail price (excluding the excise tax and the value-added tax) is PhP5 but does not exceed PhP6.50 per pack	PhP6.35 per pack	PhP6.47 per pack	PhP7.14 per pack	PhP7.56 per pack
If net retail price (excluding the excise tax and the value-added tax) exceeds PhP6.50 but does not exceed PhP10 per pack	PhP10.35 per pack	PhP10.88 per pack	PhP11.43 per pack	PhP12 per pack
If net retail price (excluding the excise tax and the value-added tax) is above PhP10 per pack	PhP25 per pack	PhP26.06 per pack	PhP27.16 per pack	PhP28.30 per pack

## Table 11: Incremental Increase of Excise Tax of Cigarettes

Table 11 documents the marginal increase in excise taxes prescribed under RA 9334. The increases are so low that they are overtaken by inflation. Such marginal increases do not promote the public health objectives at all and this is evident in the rising smoking prevalence rates in the past five years, especially among the youth. 38 Taxing Health Risks ······

## 4.1.3 Impact of Current Tobacco Excise Tax System on Revenues

### 4.1.3.1 Declining revenues

Government records show a declining trend in the contribution of tobacco taxes to government revenue for the past ten years. It reached the highest percentage of about four percent of the total government revenue collection in 2001-2002 but significantly dropped in 2007.

## Figure 1: Government Revenue from Taxes on Tobacco Products (in PhP Billion)



## Figure 2: Declining Contribution of Tobacco Tax to Government Coffers



## 4.1.3.2 Decreasing Tax Burden

The tax burden of cigarette products has decreased remarkably over the past decade. Based on 2010 cigarette prices, the cigarette excise tax as a percentage of GRP ranges from 19 percent to 48 percent, with most of the cigarettes taxed as low to high, whereas in 1997, it was between 30 percent and 60 percent. The current tax burden on cigarettes is currently half of the same a decade ago. The tax burden is also way below the recommended rate by the WHO equivalent to 70 percent of the retail price.

Figures 3 and 4 illustrate the decrease in tax burden. The uppermost bars represent the excise tax as a percentage of ANRP on the one hand, and fixed NRP on the other. The NRP of cigarettes, which determines the amount of tax to be imposed, is fixed by law. This is indicated in RA 8240, as amended by RA 8424 and RA 9334, and with reference to Annex D of RA 9334. On the other hand, ANRP is market-determined and estimated based on the selling price of the tobacco product. Over time, as ANRPs increased, NRPs remained the same. The share of the excise tax to actual net retail price has decreased, thus reducing the effective tax burden.

## Figure 3: Composition of the Gross Retail Price of Cigarettes in 1997

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Figure 4: Composition of the Gross Retail Price of Cigarettes in 2010

## 4.2 Political Economy

## 4.2.1 Historical Background of the Tobacco Excise Tax System

Prior to the current system, the tobacco excise tax in the Philippines varied from specific to ad valorem or a mixture of both systems. Under the Ferdinand Marcos regime, both specific and ad valorem taxes were imposed on tobacco products. A multi-level specific tax was imposed based on price, and a distinction was made between locally manufactured cigarettes and imported cigarettes. An additional ad valorem tax was imposed based on the gross selling price of the manufacturer or importer, with varying rates depending on whether the cigarettes were packed in 20s or in 30s.<sup>98</sup>

On July 1, 1986, during Corazon Aquino's administration, the government changed the system to purely ad valorem.<sup>99</sup> It imposed different rates based on whether the cigarettes were packed in 30s, packed in 20s, or imported. Cigarettes packed in 20s were further classified into locally manufactured or locally manufactured but bearing a foreign brand. The rates were increased during President Aquino's administration, but the ad valorem system was retained.<sup>100</sup>

RA 8240, passed in January 1997, provided a four-tiered system for taxes on machine-packed cigarettes. The system mimicked an ad valorem system in that the tax schedule had higher specific taxes for cigarettes with higher net retail prices and lower taxes for cigarettes with lower net retail prices.

RA 9334 was enacted in December 2004 and took effect in January 2005. It amended certain provisions of the NIRC, which incorporated RA 8240 provisions relating to excise tax rates for alcohol and tobacco products. The law introduced new rates marginally every two years for cigarette prices for the period 2005-2011. However, it retained the four-tiered system based on prices of tobacco products – low-priced,

<sup>&</sup>lt;sup>98</sup> Exec. Order No. 978 Imposing an ad valorem tax and revising specific tax rates and maximum retail prices of cigarettes (1984).

<sup>&</sup>lt;sup>99</sup> Exec. Order No. 22 Further amending certain provisions of the National Internal Revenue Code, as amended. (1986) The law provided that an ad valorem tax shall be imposed on tobacco products.

<sup>&</sup>lt;sup>100</sup> Exec. Order No. 273, Adopting a Value-Added Tax, Amending for this Purpose Certain Provisions of the National Internal Revenue Code, and for Other Purposes (1987); Rep. Act No. 6956, An Act Modifying the Excise Tax on Distilled Spirits, Wines, Fermented Liquor and Cigarettes, Amending for the Purpose Sections 138(a) and (b), 139, 140 and 142(c) and (d) of the National Internal Revenue Code, As Amended (1990).

medium-priced, high-priced, and premium-priced. Interestingly, although the law was passed in 2003, it tied the tax base to the 1996 prices of the tobacco products as was done under its predecessor, RA 8240, which took effect in 1997.

#### 4.2.2 Key Actors

#### 4.2.2.1 Tobacco Industry

Key players of the tobacco industry in the Philippines comprise a select few, following the merger of top companies dominating the market for cigarettes. The recent joint venture between PMPMI and FTC will consolidate the market share of the new corporation, Philip Morris Fortune Tobacco Corporation (PMFTC), estimated at about 92 percent of the cigarette market. The market share for cigars, on the other hand, remains under the control of the following players: La Flor de la Isabela, Tabaqueria de Filipinas Inc., and La Suerte Cigar and Cigarette Factory.

According to a study based on tobacco industry documents, the tobacco industry in the Philippines has been dubbed the "Strongest Tobacco Lobby in Asia."<sup>101</sup> It revealed that the tobacco industry thrived in the Philippine political environment, notorious for its corrupt practices, by taking advantage of political donations in exchange for favorable economic policies. Through this strategy, the industry has time and again succeeded in blocking the passage of effective tobacco control policies and in pushing for the enactment of laws favorable to its interests.<sup>102</sup>

 <sup>&</sup>lt;sup>101</sup> K Alechnowicz and S Chapman, "The Philippine tobacco industry: 'The Strongest Tobacco Lobby in Asia'," *Tob Control* (2004);13:ii71-ii78, accessed October 15, 2010, doi:10.1136/tc.2004.009324.
 <sup>102</sup> *Id.*

The tobacco companies have assigned a group to do their lobbying.<sup>103</sup> The PTI is an association representing local cigarette manufacturers, FTC, PMPMI, La Suerte Cigar and Cigarette Factory, Mighty Corporation, and Associated Anglo-American Tobacco. According to *Newsbreak*,<sup>104</sup> these companies contribute to PTI, with the contributions being primarily used as "lobby money." The contribution of each tobacco company is based on its market share.

Aside from the PTI, the tobacco companies use front groups to push for their interests, such as tobacco farmer groups. Aligning themselves with tobacco farmers is an astute move on the part of the tobacco industry to generate public sympathy. It enables the industry to focus on livelihood issues of the farmers, rather than on the health consequences of the tobacco products.<sup>105</sup>

The tobacco industry, through tobacco companies, its association, front groups, or Members of Congress who represent their interests, have long peddled myths about tax increases. Listed below are the arguments used by the tobacco industry to oppose excise tax increases and the corresponding counterarguments to such myths.

## • Higher tobacco taxes will reduce government revenues.

In the short and medium term, higher taxes will not reduce government revenues. In fact, tax revenues can be expected to rise despite the price increase, because the demand for cigarettes is relatively inelastic.<sup>106</sup> Evidence in other countries shows that although smokers are affected

<sup>104</sup> *Id*.

<sup>&</sup>lt;sup>103</sup> L. Balane, and J. Llanto, *Well-entrenched Interest, Newsbreak*, March- April 2010, at 16.

<sup>&</sup>lt;sup>105</sup> *The Cost of Tobacco Farming*, Golden Leaf Barren Harvest (2001) at 29.

<sup>&</sup>lt;sup>106</sup> Jha and Chaloupka, supra note 32 at 72.

by cigarette price increases, they respond relatively slowly to the increase due to their addiction to tobacco. $^{107}$ 

• Increase in taxes will result in massive job losses and will hurt the economy.

Tobacco industry presence in the economy does not necessarily mean that the economy is dependent on the tobacco industry.<sup>108</sup> The Philippine economy does not depend on the rise and fall of the tobacco industry. In fact, employment in the tobacco industry constitutes less than one percent of the total employment of the country.<sup>109</sup> This figure includes farmers involved in tobacco production and employees involved in the trading and buying of tobacco leaves, manufacturing, local marketing and distribution, and the government sector. Furthermore, employment will increase in other industries because money will be spent on other goods.<sup>110</sup>

In addition, the impact of any tobacco control policy to the economy will be gradual. The World Bank estimates that the decrease in employment arising from decreased consumption will be gradual, hence, allowing farmers to shift to other crops.

#### • Increase in tobacco taxes will hurt the poor.

Although the excise tax is regressive in the sense that it imposes a disproportionately heavy financial burden on the poor, it has a progressive impact from a health perspective. Because majority of the smokers belong to the lower income groups, which are more responsive

<sup>&</sup>lt;sup>107</sup> Id. at 39- 41.

<sup>&</sup>lt;sup>108</sup> Kenneth E. Warner, "The economics of tobacco: myths and realities," *Tob Control* (2000);9:78-89, accessed October 15, 2010, doi:10.1136/tc.9.1.78.

<sup>&</sup>lt;sup>109</sup> Austria and Asuncion, *Measuring Employment in the Tobacco Industry: The Case of the Philippines* (2008) at 10.

<sup>&</sup>lt;sup>110</sup> The World Bank Group, "Chapter 6: The Costs and Consequences of Tobacco Control," *in Curbing the Epidemic: Governments and the Economics of Tobacco Control*, accessed October 15, 2010. http://www1. worldbank.org/tobacco/book/html/chapter6.htm.

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to price changes than the rich,<sup>111</sup> increasing tobacco taxes will significantly lower their consumption and help them quit smoking.

Improvement in health and having more money to spend for other basic needs are the consequential benefits of quitting smoking. This is more pronounced in the Philippines where the poorest households spend more on tobacco than clothing, shelter, education, or health.<sup>112</sup>

## • Increase in taxes will encourage smuggling.

The presence of smuggling constrains the government from implementing taxes as an effective tobacco control policy because it reduces the revenues that can be raised by tobacco tax. It also puts a dent on the resources of the government's law enforcement units and presents opportunities for corruption.<sup>113</sup>

Smuggling has often been used as an argument against a tobacco tax increase. The argument goes that increasing the tax will not reduce consumption and will reduce revenue because of the availability of cheaper smuggled cigarettes.

In reality, however, there is no evidence that tax increases or high taxes *per se* lead to an increase in large-scale smuggling. Determinants of smuggling depend on many factors other than the retail price. Based on a study by the World Bank, indicators such as the degree of corruption in a country contribute to the increase in smuggling.<sup>114</sup>

<sup>&</sup>lt;sup>111</sup> Studies from different countries conclude that tobacco consumption is higher among the poorest households. See Baquilod et al. *supra* note 2.

<sup>&</sup>lt;sup>112</sup> *Id*.

<sup>&</sup>lt;sup>113</sup> Merriman, D, Yurekli, A., and Chaloupka, F.J, How big is the worldwide cigarette smuggling problem? In

Jha, P and Chaloupka, F.J. TOBACCO CONTROL IN DEVELOPING COUNTRIES, 366 (Oxford University Press 2000). <sup>114</sup> Supra 113 at 385.

Moreover, studies in high-income countries show that even in the face of high rates of smuggling, tax increases bring additional revenues and reduce consumption.<sup>115</sup> Thus, the solution is not to forgo the increase of taxes but to strictly implement laws against smuggling. As discussed by various experts in the field of tobacco economics, "the appropriate response to smuggling is to adopt policies that make it less profitable, more difficult, and more costly to engage in smuggling.<sup>116</sup>"

Increasing excise taxes of tobacco is a good policy from both the health and finance aspects. It should not be rejected based on difficulties that might be encountered in its implementation. Instead, what the government must do is to strengthen its anti-smuggling efforts as a complementary effort to increase revenue collection.

## 4.2.2.2 Congress

The role of Congress, specifically the Ways and Means Committee of the Lower House, cannot be underestimated. Based on the origination clause of the Constitution, all revenue and appropriation bills must originate exclusively from the House of Representatives (or the Lower House).<sup>117</sup> It cannot originate from the Senate, although the Senate can concur or propose amendments, or even file a substitute bill.<sup>118</sup>

<sup>&</sup>lt;sup>115</sup> Jha and Chaloupka, *supra* note 32, at 73.

<sup>&</sup>lt;sup>116</sup> Luk Joossens, et al., "Chapter 16: Issues in the smugging of tobacco products," in *Tobacco Control for Developing Countries*, edited by Prabhat Jha and Frank Chaloupka. (Oxford University Press for the World Bank and World Health Organization, 2000), 404.

<sup>&</sup>lt;sup>117</sup> CONST. (1987) Art XI, Section 24. All appropriation, revenue or tariff bills, bills authorizing increase of the public debt, bills of local application, and private bills, shall originate exclusively in the House of Representatives, but the Senate may propose or concur with amendments.

<sup>&</sup>lt;sup>118</sup> Tolentino vs. Secretary of Finance, G.R. No. 115455, August 25, 1994.

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However, there may be new roles for the Committee of Health in both Houses of Congress because the FCTC mandate to consider taxes and prices as a priority health measure brings a possibility that a bill, say, to "Curb Tobacco Consumption by Price Measures and Establish a Health Promotion Mechanism" may actually be filed in the Health Committee, and referred to the Ways and Means and Appropriations Committee for the latter to comment on the revenue and appropriations aspect. Bills are defined by their subject, and the committee that acquires original jurisdiction over such a measure is the one that is principally responsible for such a bill.<sup>119</sup>

Whether or not a bill that is intended to reduce tobacco consumption through price and tax measures will be considered one over which the Committee on Health can acquire original jurisdiction is a novel question for the House, especially in light of the mandate of the WHO FCTC, but the referral to the Ways and Means and Appropriations Committee will be unavoidable due to the revenue and budgetary impact.

RA 9334 further ensured that no discretion is left to the implementing authority when it comes to the excise tax rates to be imposed on cigarette brands. Section 145 of the NIRC provides that the price classification of specific protected brands named in the Annex "shall remain in force

<sup>&</sup>lt;sup>119</sup> Section 43 of the House Rules provides:

<sup>&</sup>quot;Referral to Committee. As a general rule, a bill or resolution shall be referred to only one (1) committee. Whenever a bill or resolution covers a subject matter that relates to the jurisdiction of more than one (1) committee, it shall be referred to the committee within whose jurisdiction the subject matter directly and principally relates to: Provided, That if it entails appropriation of public funds or contains tax or revenue proposals, it shall also be referred to the Committee on Appropriations and/or the Committee on Ways and Means, as the case may be, for comments relative to the appropriation, tax or revenue aspects only. The committee that acquires original jurisdiction over a measure that is recommended for adoption or approval, shall be principally responsible for submitting a report to the House. It may incorporate therein, if it deems necessary, the recommendations of the Committee on Appropriations and/or the Committee on Ways and Means, as the case may be."
until revised by Congress." It bears stressing that the word "Congress" is used instead of "House of Representatives." It is not clear whether Congress intended for the revision to be done through a revenue bill which can only originate from the House of Representatives, or if Congress contemplates any other Congressional act to revise the price classification in Annex D.

What is clear is that any measure that does not favor the tobacco industry emanating from the House of Representatives will face certain opposition from the Northern Alliance. This is a group of 39 wellpositioned Members of Congress who hail from northern provinces of Luzon where tobacco farming is concentrated.<sup>120</sup> They vote as a solid bloc, thereby increasing their influence. They populate and even head the Ways and Means Committee, to which revenue bills are assigned. Customarily, the number of Members of Congress in a Committee is around 60, a majority of whom do not regularly attend hearings or sessions. When an excise tobacco tax bill is to be taken up in a Committee, the Northern Alliance members of the Committee will invariably be present to oppose the bill.

Public health advocates claim that it was through the strong lobby of the tobacco industry in Congress that RA 9211 was immediately enacted into law before the Philippines ratified the FCTC. RA 9211 contained provisions favorable to the industry.<sup>121</sup> For instance, it included a statement recognizing a "balanced interest" between the tobacco interest and health in the implementation of the Tobacco Regulation Act. It also created the Inter-Agency Committee - Tobacco (IAC-T), where the tobacco industry is represented through the PTI. Essentially, the law that is supposed to provide regulatory restrictions

120 Supra note 103.

<sup>&</sup>lt;sup>121</sup> *Id*.

on the tobacco industry provided the tobacco industry with a seat at the table.

#### 4.2.2.3 Department of Health

The DOH is the competent national authority primarily responsible for the implementation of tobacco control measures and the FCTC. It has been actively involved in the tobacco control advocacy and has released policies to implement the articles of the FCTC. At the international level, through the Conference of the Parties (COP) in its 3<sup>rd</sup> Session, the Philippines, as represented by delegates from the DOH, raised the need to initiate technical work on Article 6 of the FCTC considering that price and tax measure is the single most effective measure to reduce tobacco consumption.

Ironically, the House Committee of Ways and Means of the previous Congress did not recognize the DOH as a stakeholder of an excise tobacco tax policy. This was particularly evident in the 14<sup>th</sup> Congress where despite specific requests to be invited to hearings on the proposed tax bills, the DOH was not notified in advance of the hearings. Thus far, the DOH has not actively ventured into using the tobacco tax or price as a public health measure. However, it has been advocating the earmarking of a portion of the increase in tobacco taxes to finance tobacco control measures.

Recently, the DOH initiated plans to implement a more comprehensive tobacco control strategy by including tax and price measures. It announced that it targets to decrease smoking prevalence to 25 percent in the short to medium term, which corresponds to about 10 percent reduction of the current smoking prevalence rate.<sup>122</sup> It hopes to achieve this through the implementation of policies on graphic health information, smoking bans, advertising bans, and tobacco tax and price increases; among which, the last is expected to have the most impact.

To reach the targeted reduction in smoking prevalence, the DOH also actively promoted the implementation of the FCTC by issuing the Administrative Order No. 2010-0013, providing Graphic Health Information and a Ban on Misleading Descriptors. However, the tobacco industry filed suits in various courts to ensure that the administrative order is stayed. A similar initiative also met the same tobacco industry opposition during the last session of the previous Congress. This leaves the DOH with very few effective and powerful interventions to utilize for purposes of reducing tobacco consumption, hence, there is now much reliance on the power of taxes to contribute to this health objective.

#### 4.2.2.4 Department of Finance

The DOF recognizes an urgent need to address the increasing budget deficit. To meet revenue targets, the DOF recommends key measures such as the Simplified Net Income Taxation System (SNITS) for professionals and self-employed individuals, rationalization of fiscal incentives, and increasing excise taxes (on tobacco, alcohol, and petroleum).

Moreover, the DOF is alarmed by the steadily decreasing revenues from excise taxes, especially tobacco taxes, due to the lack of indexation and the price classification freeze. Hence, it has been actively pushing for

<sup>&</sup>lt;sup>122</sup> Information shared by a DOH official at a Tobacco Tax Forum held in April 2010.

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the amendment of the tobacco excise tax system <sup>123</sup> since 2008.<sup>124</sup>

In the 14<sup>th</sup> Congress, the DOF recommended several bills to increase and reform the tobacco excise tax. The Committee on Ways and Means refused to consider the DOF proposals and opted to explore other sources of revenue such as a tax on Short Message Service (SMS). The Committee also put the DOF to task by asking it to focus on efficient and effective collection of taxes instead.

In an effort to improve tax collection and avoid tobacco tax leakages, the DOF attempted to impose the requirement of unique tax markings on cigarette packs as provided for under the Tax Code.<sup>125</sup> It endorsed the initiative of the BIR to explore means to build technical capacity to require the tobacco companies to place secure tax marks on the cigarette packs to reduce the estimated PhP30-50 billion in leakage. When the BIR was considering SICPA's proposal relating to the tax stamp measure, the Lower House (specifically the Northern Alliance Members of Congress) vehemently opposed the BIR's negotiations with SICPA, claiming that the measure infringes on the right of Congress to raise revenues. They also claimed that the proposed project had major legal infirmities.<sup>126</sup>

<sup>&</sup>lt;sup>123</sup> Chino Leyco, "DoF lists priority tax reforms for incoming administration", *The Manila Bulletin*, May 14, 2010. Accessed June 7, 2010. http://www.mb.com.ph/node/257324/dof-li.

<sup>&</sup>lt;sup>124</sup> Michelle Remo, "IMF prods government on single tobacco tax rate," *Philippine Daily Inquirer*, August 12, 2008. Accessed October 13, 2010. http://business.inquirer.net/money/breakingnews/view/20080812-154066/ IMF-prods-govt-on-single-tobacco-tax-rate.

<sup>&</sup>lt;sup>125</sup> National Internal Revenue Code, Sec. 8 (1997)

<sup>&</sup>lt;sup>126</sup> Dennis Gadil, Malaya Business Insight, '*llocos solons buck SICPA*' (May 4, 2010) Available http://www. malaya.com.ph/05042010/busi4.html. Accessed: November 8, 2010.

#### 4.2.3 Legislative Proposals (14th Congress)

During the 14<sup>th</sup> Congress, several bills on tobacco excise tax were submitted to the Committee of Ways and Means but none survived the committee hearings due to the influence of well-placed Members of Congress representing the interests of the tobacco industry.

The bills filed manifest the views of some stakeholders as to the direction of the tax reform pertinent to the analysis of this paper. The apparent objectives of some of these bills were to raise more revenue for the government and to "level the playing field" by removing the price classification freeze. Other bills were not meant to reform the tax system but were intended to provide incremental increases while adopting the existing system, including its flaws. Because the latter types of bills do not represent real reforms and are not taken seriously even by stakeholders, including the DOF, they will not be included in this discussion. What will be discussed are two bills that the DOF considered supporting during the 14<sup>th</sup> Session of Congress. These refer to the Suarez Bill and the Lacson Bill.

This paper notes that the tax reform bills have been filed in the new 15<sup>th</sup> Congress under the administration of President Benigno Aquino III. As of this writing, the new Congress has begun deliberations on sin tax bills similar to those filed in the 14<sup>th</sup> Congress.

#### 4.2.3.1 Suarez Bill

The Suarez Bill, filed by Quezon Representative Danilo E. Suarez, proposed a single uniform excise tax for all cigarettes equal to PhP14 per pack that will be effective beginning of the first year of implementation, where the excise tax rate will be automatically adjusted based on inflation. The IMF declared that this proposal could yield

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approximately PhP34 billion in revenue for the government.<sup>127</sup>

Then Head of the Ways and Means of the House of Representatives, Representative Exequiel Javier noted that the increase to PhP14 could result in as much as 527 percent increase because the tax rate for the low-priced cigarettes was only PhP2.23 per pack. Representative Rufus Rodriguez remarked that the bill would "kill the industry" and would lead to loss of jobs.<sup>128</sup>

It bears stressing that a PhP14 increase across the board would result in a PhP34 retail price per pack for the most popular brand (Marlboro) or a mere PhP4 price increase, the excise tax being 41 percent of gross retail price -- a far cry from the WHO recommendation. Notably, the *sari-sari* stores (small neighborhood stores), where most cigarettes are sold, currently sell up to PhP40 per pack (Marlboro) or PhP2 per stick. The fact that stores can sell up to that price level shows that as far as retailers are concerned, PhP40 is still an affordable price for the popular brand. Furthermore, most cigarettes are sold by the stick at a price that ranges from PhP0.50 to PhP2. Hence, the 527 percent increase claimed by Representative Javier will not have the impact he fears.

#### 4.2.3.2 Lacson Bill

The bill filed by Senator Panfilo Lacson proposed moving to a twotiered excise tax system in the first year of implementation and to a unitary excise tax system in the second year of implementation and onward. In the first year, the excise tax would be equal to PhP8 for low-

 <sup>&</sup>lt;sup>127</sup> GMA News '*IMF: Amendments on 'sin' products could bring 34B for govt'* Available http://www9.gmanews.tv/ story/113002/imf-tax-amendments-on-sin-products-could-get-extra-p34b-for-govt. Accessed: October 15, 2010.
 <sup>128</sup> C. Fonbuena, '*Sin tax amendment bill hits snag*," (2009) Available http://www.abs-cbnnews.com/ business/05/26/09/sin-tax-amendment-bill-hits-snag.

and medium-priced cigarettes, and PhP14 for high- and premiumpriced cigarettes. In the second year and onward, excise tax would be a single uniform rate of PhP14 for all cigarette price categories, and an automatic inflation adjustment for the excise tax would also be put in place.

The move from a two-tier system in the first year to a one-tier system in the second year is meant to soften the blow of a one-step transition from four tiers to one tier. It is also meant to mitigate the impact of sudden increases in the low-price segment (e.g., PhP2 to PhP14 increase). Hence, for the low-price segment, the tax would increase from PhP2 to PhP8 in the first year, then from PhP8 to PhP14 in the second year.

# 4.2.3.3 Problem with the Legislative Proposals

The problem with the bills discussed above is that they do not fully address health objectives, contrary to Article 6 of the FCTC. While indexation to inflation is necessary, it may not be enough to substantially bring down smoking prevalence. Without providing for a frequent and regular increase on top of indexation, the health impact cannot be sustained.

Increasing the tax to PhP14 may have a short-term health impact. Yet, the tax of PhP14 also means a significant reduction in taxes for some brands that are currently taxed at the premium rate of approximately PhP28 per pack. This is contrary to Section 5 of RA 9334, which states that:

"Any downward reclassification of present categories, for tax purposes, of existing brands of cigars and cigarettes duly registered at the time of the effectivity of this Act which will reduce the tax imposed herein, or the payment thereof, shall be prohibited." *[Emphases supplied.]*  There is no question that the above provision can easily be repealed by Congress in favor of lower taxes for premium cigarettes currently taxed at PhP28. However, it goes against the spirit of the law, which is to push taxes upward. It would also amount to a form of privilege or benefit granted to the tobacco companies and would go against the recommendations under the Guidelines for Implementation of Article 5.3 of the FCTC.<sup>129</sup>

# 4.3 World's Best Practices in Tobacco Taxation

Key features of the world's best practices in tobacco taxation are based on policies that have worked in countries with comprehensive tobacco control programs. Some of these, such as indexation to inflation and implementation of a uniform specific tax, were already discussed in the previous sections. Hence, the focus of this section is to discuss the other important features of effective tobacco taxation.

The WHO recommends a standard to determine the right tax level for cigarettes. According to the WHO, tobacco excise tax must be at least 70 percent of the tobacco retail prices. The rate is based on the tax levels in countries where consumption of cigarettes has successfully declined. <sup>130</sup>

The tax increase must also significantly increase the cigarette retail price to reduce the affordability of cigarettes. Especially in many lowto middle-income countries where increasing incomes encourage tobacco use, it is recommended that tax increases should compensate for increases in disposable income and result in increases in real price that are greater than the growth in real income.

<sup>&</sup>lt;sup>129</sup> Recommendation 7.1, Guidelines for Implementation of Article 5.3 of the WHO FCTC provides:

<sup>&</sup>quot;Parties should not grant incentives, privileges or benefits to the tobacco industry to establish or run their businesses."

<sup>&</sup>lt;sup>130</sup> World Health Organization, *supra* note 69.

Tax increases must be frequent and regular. Inasmuch as income is usually increasing continuously over time, tax increases must also be frequent to effectively reduce tobacco consumption. The government must have a clear statement of implementation of frequent tobacco tax increases to enable consumers to plan for future increases by quitting or not starting to smoke.<sup>131 132</sup>

Tobacco tax policies must also be linked to a comprehensive tobacco control program. Other non-price interventions such as smoke-free policies, graphic health warnings, support for quitting of current users, and education campaigns must be implemented along with higher tobacco taxes to successfully curb the epidemic.<sup>133 134</sup> As illustrated earlier with the Graphic Health Information AO, the tobacco industry lobby has made it difficult and costly for the Philippines to implement tobacco control policies, hence there is much reliance on the role of tobacco taxes as a primary cost-effective mode of intervention to encourage quitting and reduce the increasing prevalence of youth smoking.

In some countries, duty-free sales to and import by international travelers have been banned as a complementary measure to tobacco tax increases. A few jurisdictions have reported an intention to ban duty-free sales to international travelers. This is in recognition of the fact that many duty-free cigarettes are being diverted to illicit trade channels such that the ban is being contemplated by governments at the Intergovernmental Negotiating Body (INB) for the Protocol on the

<sup>131</sup> *Id*.

<sup>&</sup>lt;sup>132</sup> M. Laugesen, M, Scollo, D. Sweanor, S. Shiffman, J. Gitchell, K. Barnsley, and J. Difranza, J.. *World's Best Practice In Tobacco Control.* 9 TOBACCO CONTROL, , 228-236 (2000).

<sup>&</sup>lt;sup>133</sup> World Health Organization, *supra* note 69.

<sup>&</sup>lt;sup>134</sup>Supra note 132.

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Illicit Trade of Tobacco.<sup>135</sup>

Other measures to curb smuggling and illicit trade of tobacco must also complement the tobacco tax policies. As discussed previously, the presence of smuggling hinders the government from implementing taxes as an effective tobacco control policy. Hence, the administrative capacity of the BIR must be strengthened by means of adopting advanced technologies that will ease the tracking and tracing of tobacco products and make it difficult for tobacco companies to avoid and evade taxes. <sup>136 137</sup>

Finally, WHO considers using dedicated tobacco taxes for financing health promotion mechanisms as one of the best practices in tobacco taxation. This is to allow tobacco taxes to further contribute to health objectives. Dedicated tax for health promotion financing will be discussed in the latter part of this paper.

#### 4.4 Setting Targets for Increasing Tobacco Tax

Ideally, the world's best practices in tobacco taxation are a starting point in setting general targets and objectives for increasing the tobacco tax. However, due to varying conditions among countries, policy makers

<sup>&</sup>lt;sup>135</sup>Article6.2(b) of the WHO FCTC provides:

Without prejudice to the sovereign right of the Parties to determine and establish their taxation policies, each Party should take account of its national health objectives concerning tobacco control and adopt or maintain, as appropriate, measures which may include:

<sup>(</sup>a) implementing tax policies and, where appropriate, price policies, on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption; and

<sup>(</sup>b) prohibiting or restricting, as appropriate, sales to and/or importations by international travellers of tax- and duty-free tobacco products.

<sup>&</sup>lt;sup>136</sup> World Health Organization, *supra* note 69.

<sup>&</sup>lt;sup>137</sup> Supra note 132.

must tailor the specific details of the tax increase according to the current situation, needs, and limitations of the country in focus. Hence, this section tackles the possible targets for increasing the tax for the Philippines in the short and long terms.

#### 4.4.1 Short-Term Targets (Five years)

The DOH is aiming to reduce the current smoking prevalence rate by 10 percent, from 28 percent to 25 percent. It hopes to achieve this target by 2014 in adherence to the Regional Action Plan for the Tobacco Free Initiative in the Western Pacific, which embodies plans to promote full implementation of the FCTC.

On the other hand, in light of the declining tax effort (from 17 percent of the GDP in 1997 to 12.8 percent of the GDP in 2009)<sup>138</sup> and the emerging fiscal crisis in the Philippines, the DOF has proposed to earn additional revenue of PhP95 billion in 2011<sup>139</sup> from VAT, excise taxes, and the SNITS. Increasing the VAT from 12 percent to 15 percent, however, will exacerbate the regressivity of the tax burden in the Philippines.<sup>140</sup> Hence, addressing the deficit by increasing excise taxes on sin products is a more equitable option. Accordingly, the World Bank views excise taxes on tobacco and alcohol as one of the most significant among possible equitable sources of tax revenue.

<sup>&</sup>lt;sup>138</sup> Dennis Gadil, "Ilocos solons buck SICPA," *Malaya Business Insight*, May 4, 2010. Accessed November 8, 2010. http://www.malaya.com.ph/05042010/busi4.html.

<sup>&</sup>lt;sup>139</sup> Rhea Sandique-Carlos, "Philippine 2011 Budget Deficit to Widen Without New Taxes – Finance Chief," *Dow Jones Newswires*, May 25, 2010. Accessed October 18, 2010. http:// http://www.nasdaq.com/aspx/stock-market-news-story.aspx?storyid=201005250446dowjonesdjonline000107&title=philippine-2011-budget-deficit-to-widen-without-new-taxes-finance-chief.

<sup>&</sup>lt;sup>140</sup> Cai Ordinario, "15% VAT to cut consumption, imperil MDGs," *Business Mirror,* June 1, 2010. Accessed October 19, 2010. http://www.tucp.org.ph/news/index.php/2010/06/15-vat-to-cut-consumption-imperil-mdgs.

In preparation for achieving the long-term objectives, addressing the problems with the current excise tax system is critical in the short term. Reforming the current system entails addressing the problem of price classification freeze, moving to a uniform specific tax structure, increasing the rates, and taking into account the inflation rates and real income growth.

Assuming that the level of tax will be based on the revenue requirements of the government, the revenue targets must be set at a level where optimal revenues can be gained. However, if the rationale for increasing the excise tax is geared towards primarily meeting health objectives, generating additional revenues becomes a supplementary reason for increasing the excise tax.

At the minimum, proposals to increase the cigarette excise tax in the short term must satisfy the DOH target of reducing the smoking prevalence rate by 10 percent by 2014, at the same time bringing in additional revenues for the government.

# 4.4.2 Long-Term Targets (Over ten years)

The DOH has not set targets for the long term. However, due to reasons that will be discussed in the succeeding paragraphs, it is only logical to set a strategic target—at the minimum, a rate that will enable the country to reach the cigarette price levels in neighboring countries like Thailand, Malaysia, and Singapore.

Thailand and Singapore are two of the ASEAN countries that are closest to achieving the WHO recommendation on the appropriate tax level for cigarettes. Total tax for cigarettes as a percentage of the cigarette retail price is approximately 70 percent in Thailand and 69 percent in Singapore.<sup>141</sup> A pack of Marlboro is approximately PhP100 in Thailand and PhP300 in Singapore, while it is only around PhP30 in the Philippines.

Table 12 below shows a global trend to bring the cigarette tax incidence up to 70 percent of the price as recommended by the WHO. The tobacco tax levels are subject to monitoring as part of the Philippines' commitment to comply with Article 6 in relation to Article 20 of the FCTC.<sup>142</sup> Governments are required to submit periodic reports of their tobacco tax rates to the Conference of the Parties to the FCTC. In the Philippines, reports are submitted through the DOH.

Reports submitted reflect that the Philippines has one of the cheapest cigarettes in the world.

<sup>142</sup> Article 6.3 of the WHO FCTC provides:

Article 20.4 of the WHO FCTC provides:

Each Party shall endeavour to:

<sup>&</sup>lt;sup>141</sup> Data came from Prakit Vathesatogkit's presentation in the April 2010 Southeast Asia Initiative on Tobacco Tax seminar.

The Parties shall provide rates of taxation for tobacco products and trends in tobacco consumption in their periodic reports to the Conference of the Parties, in accordance with Article 21.

The Parties shall, subject to national law, promote and facilitate the exchange of publicly available scientific, technical, socioeconomic, commercial and legal information, as well as information regarding practices of the tobacco industry and the cultivation of tobacco, which is relevant to this Convention, and in so doing shall take into account and address the special needs of developing country Parties and Parties with economies in transition.

<sup>(</sup>a) progressively establish and maintain an updated database of laws and regulations on tobacco control and, as appropriate, information about their enforcement, as well as pertinent jurisprudence, and cooperate in the development of programmes for regional and global tobacco control;

<sup>(</sup>b) progressively establish and maintain updated data from national surveillance programmes in accordance with paragraph 3(a) of this Article; and

<sup>(</sup>c) cooperate with competent international organizations to progressively establish and maintain a global system to regularly collect and disseminate information on tobacco production, manufacture and the activities of the tobacco industry which have an impact on the Convention or national tobacco control activities.

Countries	Tax Incidence (%)	Price in Local Currency	Implied PPP Rate <sup>144</sup> in Local Currency	Price in PhP	Data Year
Australia	68	9.60	1.492	150.22	2008
Brazil	63	4.26	1.561	64.46	2009
Canada	69	7.94	1.23	150.71	2008
Indonesia	52	10,625.20	5,442.12	45.58	2008
Malaysia	48	9.00	1.922	109.32	2008
Philippines	48	30.69	23.346	30.69	2008
Singapore	69	11.60	1.082	263.95	2010
Thailand	73	75.15	16.759	105.92	2009
UK	80	5.24	0.651	187.92	2008
USA (New York)	79	6.50	1.00	151.75	2008

# Table 12: Table of Tax Incidence and Price of Cigarettes inDifferent Countries143

\*Converted to Philippine Peso using the Purchasing Power Parity (PPP) conversion rate<sup>145</sup>

The average price of Marlboro, the most popular cigarette brand in the Philippines, is PhP29.26.<sup>146</sup> For cigarette taxes, inclusive of excise and value-added tax, to be at least 70 percent of the retail price of the most popular brand in the Philippines, excise tax must be raised to PhP30. If taxes on Marlboro are raised to PhP30 per pack, the price will be approximately PhP50, assuming that the tax burden is passed on to the consumers. Interestingly, it will still be cheaper than the Marlboro brand in Thailand, Singapore, or Malaysia.

<sup>&</sup>lt;sup>143</sup> Data on tax incidence and price obtained from the Southeast Asia Tobacco Control Alliance.

<sup>&</sup>lt;sup>144</sup> PPP rates are from the World Economic Outlook 2010 by the International Monetary Fund.

<sup>&</sup>lt;sup>145</sup> *Id*.

<sup>&</sup>lt;sup>146</sup> Based on NSO's 2010 price survey from January to March.

This implies that even if the Philippines adheres to the WHO recommendation, the country's cigarette prices will still be lower than those of its neighboring countries.<sup>147</sup> This may be explained by the possibility that the cost of production is very low in the Philippines, or that the tobacco industry can afford to lower the prices of cigarettes due to the "savings" of up to PhP24 of taxes per pack (see Table 3 under Price Classification Freeze), resulting from the price classification freeze.

From the standpoint of international trade, aligning price levels to those of neighboring countries is expected to discourage the Philippines, where cigarette prices are low, from being a source of smuggled cigarettes. Being a supplier of smuggled cigarettes is contrary to the basic Philippine commitment through the FCTC to cooperate with other countries in fighting the tobacco epidemic.

Pegging rates that are at par with neighboring countries will force the tobacco industry in the Philippines (monopolized by the transnational Philip Morris) to be treated the same way as those in other countries. This is consistent with the spirit of the FCTC not to give special or preferential treatment to the tobacco industry, as outlined in the Guidelines for the Implementation of Article 5.3 of the FCTC.<sup>148</sup>

Imposing the level of tax in Thailand across all brands in the Philippines will increase the excise tax to PhP48 to PhP50 per pack and significantly increase the cost of cigarettes to approximately PhP60 to PhP70 per pack. If the prices of cigarettes in Thailand and similar neighboring countries do not increase in the long term, then the prices of cigarettes

<sup>&</sup>lt;sup>147</sup> To illustrate this point, increasing the tax to PhP30 will increase the retail price of Marlboro to PhP50.06, but this is still below the retail price of the most popular brand in Thailand, which is equal to ThB58 or PhP83.06 using the exchange rate or PhP83.58 using the purchasing power parity (PPP) conversion rate. The price of the most popular brand in Thailand was obtained from Prakit Vathesatogkit's presentation in the April 2010 Southeast Asia Initiative on Tobacco Tax seminar.

<sup>&</sup>lt;sup>148</sup> Recommendation 7.1, Guidelines for Implementation of Article 5.3 of the WHO FCTC.

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and smoking prevalence in the Philippines will catch up with theirs. However, this is unlikely to happen, since the Thai government has committed to increase its tax rates frequently in order to ensure that tobacco consumption is reduced steadily. Hence, the Philippines will need more time to catch up with the excise tax levels of cigarettes in neighboring countries and may not be able to do so in the short run unless a more drastic measure, beyond those recommended in this paper, is done.

If purely health objectives were to be considered in increasing tobacco tax, the major consideration would be decreasing the smoking prevalence to the lowest possible level achievable. The Philippines should begin looking at neighboring countries with the lowest smoking prevalence rates and apply lessons learned by developing measures to achieve the health goals.

For the Philippines, it is reasonable to begin with the lowest smoking prevalence in Southeast Asia as basis for an achievable target. In the said region, Singapore has the lowest smoking prevalence rate equal to 14 percent, which is also among the lowest in the world.

To reach the 14 percent smoking prevalence rate in the short term, a drastic tax increase, which will significantly reduce cigarette consumption but can also create huge revenue losses for the government, must be implemented in the Philippines. This cannot be an option for a country currently experiencing a fiscal problem. Hence, the purely health objective may only be contemplated in the long term when economic circumstances change.

This clearly implies that the Philippines should continue to increase tobacco taxes to at least keep pace with the neighboring countries in the long term. While the ideal strategic objective is to be at par with the higher cigarette prices and lower smoking prevalence rates of neighboring countries, the realistic scenario is to moderately and regularly increase the current level of taxes in the Philippines so as to catch up with the continually increasing rates of neighboring countries.

#### 4.5 Excise Tax Increase Proposal

In crafting the tobacco excise tax increase proposal, priority is given to reforming the current excise tax system to address the myriad problems associated with it. All reforms are considered necessary in the short run. These include the removal of the price classification freeze, indexation of taxes to inflation, shifting from a multi-level to a single level tax structure, and increases in excise tax that significantly increase cigarette price.

In addition to reforming the current system, a key feature of the world's best practice in tobacco taxation, that is, frequent and regular increases in tax rates, is adopted for the proposal. Increasing the tax regularly is important to compensate for inflation and increases in income, especially for developing countries. This strategy can also be used to gradually reach the long-term health objectives.

Aside from the needed reforms and adoption of best practice features, an important consideration in crafting the proposal is the practicality of the tax increase. Especially now that a fiscal crisis is emerging, the Philippines cannot afford tax measures that contribute to losses for the government in order to reach the tax levels of neighboring countries in an instant. Hence, gradual tax increases, which do not adversely affect government revenues, must be done regularly, in order to catch up with countries that have the best tobacco control policies. In implementing the features of the proposal, an approach with several stages can be adopted to facilitate a smooth transition from the current to the new tax system. This may be done through the following steps:

- 1. The first step is to remedy the patent discrepancy caused by the price classification freeze, i.e. removal of the price classification freeze. In effect, the lowest price classification will cease to exist so that the four tiers will be reduced to three, and the excise taxes of cigarettes will start at PhP7.56, then PhP12, then PhP28.30, which will be the excise taxes for the medium-, high-, and premium-priced brands in 2011.
- 2. The second step aims to further reduce the number of tiers from three to two, lessen the gap between the excise taxes for the price classes, and to ensure that cigarette prices will be less affordable to the youth. The medium- and high-priced brands will be taxed uniformly at PhP16. On the other hand, following the previous pattern of increase in the premium-priced brands (four percent increase between 2009 and 2011), the tax for the highest price classification will be increased by four percent from PhP28.30 to PhP29.40.
- 3. The third step will be the final stage of shifting to a single-level tax structure. The uniform specific rate will be PhP30 for all brands to compensate for inflation and increases in income<sup>149</sup> and to further reduce consumption for cigarettes. In addition, once the single-level tax structure is in place, the price indexation to inflation will apply, resulting in automatic upward adjustment of taxes annually.

<sup>&</sup>lt;sup>149</sup> The average inflation rate and real GDP per capita growth rate in the Philippines for the past 10 years is five percent and two percent, respectively.

4. For the long-term, increasing tobacco taxes on top of price indexation to inflation must be done to satisfy the health objectives in general and to compensate for increases in income and remove the effect of being desensitized to prices in particular. The regular increase in tax needs to be flexible and must be adjusted depending on the health and revenue objectives of the policy makers.

#### 5. Projecting the Impact of Tobacco Tax Increases

The recent proposals on the tobacco excise tax increase and the trends worldwide broaden the array of alternatives that policy makers can explore and choose from. The succeeding discussion presents one of such alternatives. This attempts to achieve the short-term objectives and incorporates the key features of a robust tax system.

The model can provide a basis for ultimately deciding on the possible options for a tax increase. Many options are available as there is an infinite number of possibilities, in a manner of speaking, but the succeeding projections isolate some of the pragmatic or feasible alternatives that are necessary to reach health and revenue objectives.

For this section, readers are urged to focus more on the general principles than the specific numbers resulting from projected estimates, which are sensitive to changes in parameters employed and limited by the data available. Supplementary discussion on the model utilized in this section is available as an annex to this paper (Annex A). 68 Taxing Health Risks ·····

# 5.1 Data

A summary of the data used for the projections is presented in Table 13. A detailed description of the data and data sources is found in Annex B.

Data	Data Source		
2011 Projected Cigarette Consumption by Removals (Packs of 20s)	PhP4.1 billion	BIR Removals	
2011 Projected Average Retail Price	PhP18.08 per pack	2010 NSO Price Survey (weighted average based on 2009 volume share)	
2011 Projected Average Excise Tax	PhP6.18 per pack	BIR Removals (weighted average based on 2009 volume share)	
2011 Average Net Retail Price	PhP9.96 per pack	Derived from 2011 Projected Average Retail Price	
2011 Projected Excise Tax Revenue	PhP25.1 billion	BIR Removals & RA 8424 (based on 2009 volume share)	
2009 Smoking Prevalence (%)	28.3	2009 Global Adult Tobacco	
2009 Smoking Population	17.3 million	Survey (GATS)	
Price Elasticity of Demand for Cigarettes	-0.235	DOF	

# Table 13: Summary of Data Used for Projections

# 5.2 Limitations and Assumptions

The model for estimating the impact of the tax alternatives has several limitations due to limited data and literature. These are the following:

a. Price Elasticity: The DOF estimate for the price elasticity of demand for cigarettes equal to -0.235<sup>150</sup> is adopted in projecting the impact of tax increase alternatives. It is the most updated time series estimate for the Philippines. However, there are a few caveats in using this elasticity.

The first limitation involves the data for consumption of cigarettes used in estimating the elasticity. Due to lack of more accurate data, the DOF employs the BIR removals data for cigarettes as proxy for consumption. The removals data only take into account volumes of cigarettes that have been appropriately taxed. Smuggled cigarettes that have been consumed are not captured by the data. Hence, the volume of cigarettes consumed and consequently, the absolute price elasticity estimate and the resulting estimated change in consumption due to increase in price are underestimated. However, the DOF elasticity provides a relatively reliable estimate of impact on government revenue because it captures only the changes in consumption of taxed cigarettes.

Another caveat of the DOF estimate is that it does not take into account varying price elasticities for cigarettes belonging to different price categories. Studies have shown that low-priced cigarettes are more price elastic than high-priced cigarettes. The DOF estimate assumes that on average, the price elasticity of demand for cigarettes is equal to -0.235.

<sup>&</sup>lt;sup>150</sup> For simulations on the impact of tax increases, the authors used the price elasticity equal to - 0.235 as estimated by the DOF as it is closest to the price elasticity estimates of majority of the Southeast Asian countries and is consistent with what the DOF uses in projecting increases in revenue. The estimate of -0.235 is also near the low range of price elasticity figures estimated from the Tobacco and Poverty Study in the Philippines in 2006.

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- b. Point Elasticity Method: In estimating the change in consumption due to change in price, the point elasticity method is utilized. This is consistent with most studies that estimate the impact of tax increases. It bears stressing that this method yields more accurate results for estimating changes in consumption due to small changes in price. Hence, proposals presented here are limited to those resulting in changes in price of cigarettes by no more than 60 percent.
- c. Covered Period: Projections presented are only up to year 2014 since the price elasticity of demand for cigarettes is expected to change after a few years as consumer behavior correspondingly adjusts to price changes over time.
- d. Specific Taxes: All excise tax increase proposals considered are of the specific type for reasons previously discussed.
- e. Other Factors: In estimating the impact on revenue, it must also be noted that other factors that are likely to come into play are very difficult to predict. These include the extent of brand substitution or downward shifting, shifting to other types of cigarettes, or increased bootlegging or contraband cigarettes. Despite these factors, studies have shown that due to the increasing population, increasing number of potential smokers, and addiction of smokers to cigarettes, upward adjustments in taxes still result in net increase in revenues.

The following assumptions are applied for the projections:

a. In the short run, it is less likely for a smoker to shift to a brand that belongs to a different price class other than the price class of the currently consumed brand, e.g. from a currently consumed medium-priced brand to a low-priced brand. However, a smoker may shift between brands that belong to the same price class. (Several studies show that smokers have specific quality preferences and would more likely smoke less than immediately shift to a low-priced category.)

- b. Tobacco companies are assumed to pass on 100 percent of the increase in excise tax to the consumers. The assumption is arbitrary, given the absence of information. It is nevertheless possible that a monopoly, where 92 percent of the market is dominated by a single tobacco company, can increase the retail price by more than the excise tax increase or absorb a portion of the tax increase, depending on their price strategy.
- c. Variables other than the price of cigarettes are assumed constant. The price change is assumed to take effect immediately, therefore projections do not account for the stockpiling.
- d. The price elasticity of cigarettes is assumed to be constant over the time period covered by the projection.
- e. Smuggling activity is assumed to remain constant. This assumption is supported by studies that show that smuggling levels or illicit trade and resultant tax leakages will not increase simply as a result of tax increase, because smuggling is not a function of cigarette tax but a function of the degree of corruption in a country.<sup>151</sup> It is also assumed that reasonable measures to curb smuggling are in place.
- f. The government is assumed to undertake the same level of tax collection as it is doing now.
- g. Base year is assumed to be 2011.
- h. Inflation is assumed to remain constant at five percent per year.

<sup>&</sup>lt;sup>151</sup> World Health Organization, Geneva: Tobacco Free Initiative, *Building Blocks for Tobacco Control: A Handbook* (2004).

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#### 5.3 Models

#### 5.3.1 Change in Consumption

In determining the change in consumption due to a change in tax, the following equations are used for the computations.

- (1) Gross Retail Price = (Net Retail Price + Excise Tax) × (1 + VAT Rate)
- (2) Net Retail Price = [Gross Retail Price ÷ (1 + VAT Rate)] Excise Tax
- (3) % Change in Consumption = Price Elasticity × Percent Change in Price
- (4) % Change in Smoking Prevalence = % Change in Consumption  $\times 0.35^{152}$
- (5) Number of Lives Saved = Number of Quitters  $\times 0.35^{153}$

#### 5.3.2 Change in Revenue

The following equations are used in estimating the impact of tax increases on government revenue.

<sup>&</sup>lt;sup>152</sup> This is based on past studies that suggest that 40 percent to 50 percent of the change in consumption is from changes in smoking prevalence. F.J Chaloupka, T. Hu, K.E. Warner, R. Jacobs, and A. Yurekli, *The Taxation Of Tobacco Products* (2000) *in* P. Jha and F.J. Chaloupka (Eds.), TOBACCO CONTROL IN DEVELOPING COUNTRIES 237 – 272 (New York: Oxford University Press 2000).; Van Walbeek, C. (2010). A simulation model to predict the fiscal and public health impact of a change in cigarette excise taxes. *Tobacco Control*). However, to generate more conservative estimates, the authors chose the figure of 35 percent change in consumption due to changes in smoking prevalence.

<sup>&</sup>lt;sup>153</sup> This is based on the study of Van Walbeek (2010), which estimated that lives equivalent to 35 percent of the number of smokers who quit will be saved.

- (1) Government Revenue = Number of Packs Consumed × Excise Tax
- (2) % Change in Government Revenue =
  (Government Revenue<sub>OLD</sub> Government Revenue) ÷
  Government Revenue<sub>OLD</sub>

#### 5.4 Results

The impact of the proposal cited above is projected to illustrate how the tax increase affects cigarette consumption, smoking prevalence, and government revenues. The following table presents the results of the estimations.

Voor	Base	1	2	3	
1641	2011	2012	2013	2014	
Excise Tax (PhP)	2.72, 7.56, 12, 28.30	7.56, 12, 28.30	16, 29.40	30	
Ave. Price per Stick (High-Priced)	1.52	2.43	2.49	2.52	
Ave. Price per Stick (Low-Priced)	0.56	0.83	1.30	2.09	
Retail Price Increase Relative to Previous Year (%)	2-3	25-60	3-57	1-60	
Estimated Smoking Prevalence (%)	28.3	27.08	26.29	25.43	
Reduction in Number of Smokers (K=,000)		747 K	480 K	528 K	
Potential Number of Lives Saved (K=,000)		261 K	168 K	185 K	
Increase in Excise Tax Revenue with 2011 as Base Year (PhP) in Billions (B)		26 B	42 B	64 B	

Table 14: Projected Impact of the Excise Tax Increase Proposal, using DOF's Price Elasticity

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The removal of the price classification freeze in the initial year will gradually decrease smoking prevalence and immediately generate additional revenues for the government. Moving to a uniform specific tax in Year 3 will significantly close the price gap between high-priced and low-priced cigarettes and will help the Philippines reach the DOH short-term smoking prevalence target of 25 percent (three percentage points less than the current rate or 10 percent reduction in prevalence) by 2014 without adversely affecting government revenues.

The estimations show that, in the short to medium run, increasing excise cigarette tax can help reach health targets and raise additional revenues. Since the current cigarette excise taxes and prices in the Philippines are very low, proposed tax increases that do not increase retail price of cigarettes by more than 60 percent will not adversely affect government revenues and can even help reduce the fiscal deficit. Hence, in the short and medium terms, the goals for public health and fiscal balance are met at the same time.

Theory suggests that in the distant future, as consumers are able to adjust their consumption according to future expectations in cigarette prices and as cigarette demand becomes more price elastic, higher increases in excise tax may create losses for the government. If this were true, then the government should begin looking at alternative sources of revenue so that it may continue pursuing the health objective of curbing the tobacco epidemic in the long term. However, contrary to theory so far, frequent increases in cigarette excise tax have always generated additional revenues for governments, as experienced by the majority of countries around the world.

## 5.4.1 Employing a Higher Price Elasticity

An important caveat of the projections is that they were based on the DOF price elasticity, which, due to its limitations, is critiqued by many as an underestimation of the true value of the absolute price elasticity of demand for cigarettes. Underestimation of price elasticity implies that projections based on this elasticity may underestimate the impact on consumption, on the one hand, and overestimate the impact on revenues, on the other. Hence, this section attempts to address the abovementioned weakness by presenting impact projections based on a higher price elasticity for cigarette demand.

Verse	Base	1	2	3
rear	2011	2012	2013	2014
Estimated Smoking Prevalence (%)	28.3	25.80	24.20	22.56
Reduction in Number of Smokers (K=,000)		1,529 K	980 K	1,001 K
Potential Number of Lives Saved		535 K	343 K	350 K
Increase in Excise Tax Revenue with 2011 as Base Year (PhP)		18 B	26 B	35 B

Table 15: Projected Impact of the Excise Tax Increase Proposalwith Price Elasticity Equal to -0.5

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The excise tax increase proposal continues to generate positive government revenues even when a higher price elasticity equal to -0.5 is employed. Hence, it can be expected that the recommended tax increase scheme will be effective in reducing consumption of cigarettes without incurring revenue loss.

Despite utilizing a -0.5 elasticity, the proposed increase still comes out with a significantly positive revenue yield. Moreover, the proposal addresses the problems of the current tax system and meets the minimum health objective of reducing smoking prevalence by 10 percent in the short run.

#### 5.5 Recommendations

In increasing the tobacco excise tax, it is obvious that policymakers should prioritize addressing the pitfalls of the current tax system. The removal of the price classification freeze will immediately decrease the smoking prevalence as well as increase excise tax revenues. Shifting from a multi-level to a single level tax structure will ease tax administration and significantly reduce the price gap between low- and high-priced cigarettes, thereby further reducing cigarette consumption.

Beyond 2014, regularly increasing the excise tax based on inflation and income growth will ensure that revenues are not eroded and will facilitate continued gradual decreases in smoking prevalence over time. In the long run, the proposed four-stage approach will slowly but surely bring the Philippines' tax and smoking prevalence to levels at par with countries with the best tobacco control policies. The specific details of the recommended regular increase in excise tax beyond 2014 are left for policymakers to decide on. However, in devising the increase for 2015 onwards, they must bear in mind the need to index taxes to inflation, at the least, to prevent erosion of taxes and maintain the excise tax burden. Emphasis must also be given to increasing the excise tax at a rate higher than inflation to effectively address long-term health objectives and be at par with neighboring countries.

Ultimately, determining the appropriate tax increase option still depends on the objectives that will be set by policymakers. The aim of this paper is to provide plausible or workable options for consideration and a model that can be used to project the impact of tax increase proposals. Policymakers are encouraged to adjust the specific details of the tax increase proposals presented, such as the amount of excise tax, the regular percentage increase, or schedule of increases, according to what will be deemed necessary in relation to varying objectives and strategies, keeping in mind the national health objectives as indicated in the FCTC.

It is worthy of note that increasing tobacco taxes has the potential of meeting health objectives without adversely affecting government excise revenues. Increasing tobacco taxes will even significantly contribute to improving the fiscal position of the country in the medium term.

Note that all estimations are as good as the data and parameters used in the model. Hence, future studies that will make use of more accurate data and generate more robust parameters are highly encouraged.

Employing complete data on brand-specific, age-specific, or incomespecific cigarette consumption, which are based on demand, will greatly improve the accuracy of the estimates. Determining the real price elasticity of demand for cigarettes and variations in the price elasticity based on age, income-class, or time duration (short- vs. longterm price elasticity) is also an important area of study. Inclusion of other factors, such as smoking population growth and income growth, in the impact projection of tax increases will also bring the estimates closer to actual values.

Studies that will employ pre-intervention and post-intervention data may also generate more accurate estimates of changes in consumer behavior due to changes in tax. Therefore, it is highly recommended that data collection prior to and after the implementation of the proposed tax increase be undertaken to determine more accurately the health and revenue impact of a tax increase and the appropriate regular tax increase on top of indexation to inflation.

# 6. Complementary Measures

A sound tax policy should include complementary measures to fix tax administration. Tobacco consumption will not be reduced despite tobacco tax increases if serious efforts to curb smuggling are not implemented. Tobacco smuggling undermines tobacco tax policies and will ensure availability of cheap, tax–free cigarettes. Tobacco smuggling also reduces government revenue. It is estimated that illicit trade in cigarettes costs governments USD40 billion in lost revenue every year, with losses falling disproportionately in low- and middle-income countries.<sup>154</sup>

<sup>&</sup>lt;sup>154</sup> Framework Convention Alliance, "Latest research: Stakes get higher in tobacco smuggling," June 28, 2009. Accessed November 9, 2010. http:// http://www.fctc.org/index.php?option=com\_content&view=article&id=294:I atest-research-stakes-get-higher-tobacco-smuggling&catid=99:illicit-trade&Itemid=209.

A measure that will aid efforts to curb smuggling is the full implementation of Section 8 (A)<sup>155</sup> of the NIRC, which provides for the printing of "internal revenue stamps, strip stamps and labels... with adequate security features." The language of this provision of law is mandatory as it uses the word "shall" in imposing the duty on the Commissioner of Internal Revenue to "prescribe, provide, and distribute to proper officials the requisite licenses, internal revenues stamps, labels, all other forms, etc." that will aid the BIR in its tax administration efforts.

Since 2009, there have been three unsolicited proposals to the BIR to provide a tax stamp system, namely: (1) Swiss company SICPA Holding, (2) Philip Morris – Fortune Tobacco Corp (PMFTC), and (3) Chinese firm Huagong Tech Co., Ltd. To achieve the objective of having an adequate and secure tax stamp system, the BIR will bid out the contract for the procurement of this system. It is noteworthy that the current BIR Commissioner Kim Henares has deemed PMFTC's 95 percent hold on the cigarette industry as a relevant factor in the development of its terms of reference for the bid, particularly in the light of PMFTC's proposal for the BIR to adopt its Codentify system.<sup>156</sup> Ironically, the

Internal revenue stamps, whether of a bar code or fuson design, shall be firmly and conspicuously affixed on each pack of cigars and cigarettes subject to excise tax in the manner and form as prescribed by the Commissioner, upon approval of the Secretary of Finance. "

<sup>&</sup>lt;sup>155</sup> Full text of National Internal Revenue Code, Section 8 (A):

<sup>&</sup>quot;SEC. 8. Duty of the Commissioner to Ensure the Provision and Distribution of forms, Receipts, Certificates, and Appliances, and the Acknowledgment of Payment of Taxes.-

<sup>(</sup>A) Provision and Distribution to Proper Officials. - It shall be the duty of the Commissioner, among other things, to prescribe, provide, and distribute to the proper officials the requisite licenses internal revenue stamps, labels all other forms, certificates, bonds, records, invoices, books, receipts, instruments, appliances and apparatus used in administering the laws falling within the jurisdiction of the Bureau. For this purpose, internal revenue stamps, strip stamps and labels shall be caused by the Commissioner to be printed with adequate security features.

<sup>&</sup>lt;sup>156</sup> VG Cabuag, "BIR to bid out excise-tax stamp on cigarettes," *Business Mirror* for ABS-CBN News, October 28, 2010. Accessed November 8, 2010. http://www.abs-cbnnews.com/business/10/27/10/bir-bid-out-excise-tax-stamp-cigarettes.

PMFTC, through its president Chris Nelson, has issued statements to the press prior to his company's proposal to the BIR, claiming that "tax stamps will have a negative effect on the demand of cigarettes which will have a direct effect on local tobacco farmers."<sup>157</sup>

Parties to the FCTC are currently developing the Draft Protocol to Eliminate Illicit Trade in Tobacco Products (Draft Protocol). The Draft Protocol requires "unique, secure and non-removable identification markings" on tobacco products within a period of 10 years after entry of force of the Protocol.<sup>158</sup> A tracking and tracing system will help enable the government monitor tobacco products, which is necessary to prevent its diversion into illegal markets.

The Draft Protocol recognizes that the tobacco industry should have limited participation in the implementation of curbing anti-smuggling of tobacco products. It emphasizes that the obligations of the Party to the Protocol should not be performed by or delegated to the tobacco industry.<sup>159</sup> Consistent with Article 5.3 of the FCTC, each Party must ensure that any interaction with the tobacco industry and those representing the interests of the tobacco industry should only be to the extent necessary in the implementation of the provisions of the Protocol related to tracking and tracing of tobacco products.<sup>160</sup>

# 7. Sustainable Funding for Health Promotion

# 7.1 Dedicated Tax System

A subsequent policy on tobacco excise taxes will inevitably deal with

<sup>&</sup>lt;sup>157</sup> Ma. Elisa P. Osorio, "Tax stamps to hike cigarette prices by PhP 0.52 per pack," *Philippine Star*, January 26, 2010. Accessed November 8, 2010. http://www.philstar.com/Article.aspx?articleId=543857&publicationSubCa tegoryId=66.

<sup>&</sup>lt;sup>158</sup> Draft Protocol to Eliminate Illicit Trade in Tobacco Products, Article 7.3.

<sup>&</sup>lt;sup>159</sup> Draft Protocol to Eliminate Illicit Trade in Tobacco Products, Article 7.12.

<sup>&</sup>lt;sup>160</sup> Draft Protocol to Eliminate Illicit Trade in Tobacco Products, Article 7.13.

the question of dedicated tax. The current law on tobacco excise tax, RA 9334, dedicates a portion of the revenues from excise taxes on tobacco products to tobacco-producing provinces, as well as a smaller portion of the revenues from excise taxes on alcohol and tobacco products to DOH and PhilHealth.

In addition, Article 6 of the FCTC recognizes the implementation of tobacco tax polices to contribute to health objectives,<sup>161</sup> and the WHO has advocated the use of dedicated tax from tobacco for health promotion.<sup>162</sup>

The discussion below provides a critique of the current system, discusses best practices in other countries, and presents recommendations on ways forward.

#### 7.1.1 Dedicated Taxes for Tobacco-Growing Provinces

RA 7171 sets aside 15 percent of the total excise taxes collected on locally manufactured Virginia-type cigarettes to Virginiaproducing provinces. This is estimated by the NTA and released by the DBM, which is mandated by law to remit

<sup>&</sup>lt;sup>161</sup>Article 6.2, WHO FCTC provides:

Without prejudice to the sovereign right of the Parties to determine and establish their taxation policies, each Party should take account of its national health objectives concerning tobacco control and adopt or maintain, as appropriate, measures which may include:

<sup>(</sup>a) implementing tax policies and, where appropriate, price policies, on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption; xxx.

<sup>&</sup>lt;sup>162</sup> Regional Strategy for Health Promotion, Follow-up of the Sixth Global Conference on Health Promotion, 3 (2006).

said funds to the beneficiary provinces<sup>163</sup>:

"The financial support given by the National Government for the beneficiary provinces shall be constituted and collected from the proceeds of fifteen percent (15%) of the existence taxes on locally manufactured Virginia-type of cigarettes."

Virginia tobacco constitutes 58 percent of the total tobacco area.<sup>164</sup> The Virginia tobacco production is estimated to average a little less than PhP1 billion a year.

Provinces producing burley and native tobacco are also given their share of the revenue from excise tax. RA 9334 allocates 15 percent of the incremental revenue collected from excise tax of tobacco products to the LGUs of these provinces:

"Fifteen percent (15%) of the incremental revenue collected from the excise tax on tobacco products under RA No. 8240 shall be allocated and divided among the provinces producing burley and native tobacco in accordance with the volume of tobacco leaf production."

The Secretary of Budget and Management is hereby directed to retain annually the said funds equivalent to fifteen percent (15%) of excise taxes on locally manufactured Virginia-type cigarettes to be remitted to the beneficiary provinces qualified under this Act.

<sup>&</sup>lt;sup>163</sup> Sec. 3. Financing and Remittance.

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Provinces producing Virginia tobacco shall be the beneficiary provinces under this Act: Provided, however, That, to qualify as beneficiary under this Act, a province must have an average annual production of Virginia leaf tobacco in an amount not less than one million kilos: Provided, further, That the Department of Budget and Management (DBM) shall each year determine the beneficiary provinces and their computed share of the funds under this Act, referring to the National Tobacco Administration (NTA) records of tobacco acceptances, at the tobacco trading centers for the immediate past year.

<sup>&</sup>lt;sup>164</sup> National Tobacco Administration, '*The Philippine Tobacco Industry, Tobacco Types and Particulars*' Available http://nta.da.gov.ph/moretobacco.html. Accessed: October 15, 2010.

In total, it is estimated that tobacco-producing provinces receive PhP1.6 billion annually from excise taxes on tobacco products. In 2009, Gloria Macapagal Arroyo signed EOs 843 and 846, ordering the release of the share in the excise taxes of beneficiary LGUs that are producing burley, native, and Virginia tobacco.<sup>165</sup>

# 7.1.2 Dedicated Taxes for Health

Similarly, RA 9334 provides a portion of the revenue from excise taxes for health purposes. According to the law, for a period of five years, 2.5 percent of the incremental revenues from the excise tax on alcohol and tobacco products shall be remitted directly to PhilHealth for the purpose of meeting and sustaining the goal of universal coverage of the National Health Insurance Program, while another 2.5 percent of the incremental revenue from the excise tax on alcohol and tobacco products shall be credited to the account of the DOH and constituted as a trust fund for its disease prevention program.

"(1) Two and a half percent (2.5%) of the incremental revenue from the excise tax on alcohol and tobacco products starting January 2005 shall be remitted directly to the Philippine Health Insurance Corporation for the purpose of meeting and sustaining the goal of universal coverage of the National Health Insurance Program; and

<sup>&</sup>lt;sup>165</sup> Exec. Order No. 843 (2009) Release of the fifteen percent (15%) share of beneficiary Local Government Units (LGUs) consisting of provinces, cities and municipalities producing burley and native tobacco in the total incremental revenue collected from the excise tax on tobacco products accumulated from 1997 to 2007 amounting to PhP6,370,708,183,73.

Exec. Order No. 846 (2009) Monetization of the unappropriated and unreleased share of the Local Government Units producing Virginia Tobacco from the 15% excise tax collection on locally manufactured Virginia-type cigarettes for the calendar years 2002-2009 amounting to PhP5,810,192,796.00.

"(2) Two and a half percent (2.5%) of the incremental revenue from the excise tax on alcohol and tobacco products starting January 2005 shall be credited to the account of the Department of Health and constituted as a trust fund for its disease prevention program.

"The earmarking provided under this provision shall be observed for five (5) years starting from January 2005."

Through this provision, it is estimated that health will receive approximately PhP100 million annually for five consecutive years, from 2005-2010. In contrast, RA 7171's dedicated tax for Virginia Tobacco Producing Provinces and RA 9334's dedicated tax for native and burley tobacco are intended to remain for as long as the provinces produce tobacco.

#### 7.2 Critique of Current Dedicated Tax System

There are two key problems with the current earmarked taxes from tobacco. First, there is an imbalance in the support given to promote tobacco versus health and other tobacco control measures. Second, there are issues surrounding their implementation.

#### 7.2.1 Inequity

#### 7.2.1.1 Amount

The amount allocated for health on the one hand and for tobacco growers on the other is grossly disproportionate. Funds allocated for health consist of a total of five percent of incremental excise tax or an approximately of PhP100 million a year for five years, with PhP50 million due to the trust fund for disease prevention and
PhP50 million due PhilHealth. On the other hand, funds allocated for tobacco interests that are credited directly to LGUs of tobaccoproducing provinces amount to roughly PhP1.6 billion per year for as long as tobacco is produced in these provinces.

From another perspective, the fund allocated from tobacco taxes for health is disproportionately low, considering that economic costs (health costs and productivity losses) resulting from tobacco-related diseases range from PhP218 billion to PhP461 billion a year.<sup>166</sup> On the other hand, the funds that are allocated for tobacco are relatively large. The tobacco industry's contribution to the economy in terms of excise taxes is approximately PhP26 billion yearly.<sup>167</sup> Hence, around six percent of the total excise tobacco tax goes back to the tobacco industry and can be viewed as a form of subsidy for tobacco farming.

## Table 16: List of the Beneficiaries of Earmarked Tobacco Excise Tax and the Amount of Earmarked Taxes

Tobacco-growing provinces in the Philippines <sup>168</sup>	Type of tobacco	Percent of Total Production <sup>169</sup>	Earmarked Taxes	Average AMOUNT per year
Ilocos Norte Ilocos Sur La Union Abra	Virginia Tobacco	58%	15% of taxes from Virginia Tobacco producing provinces (estimated at PhP5.81 billion, representing their share in the excise tax from 2002- 2009 <sup>170</sup> )	PhP828 million per year to 4 provinces

<sup>&</sup>lt;sup>166</sup> Figure based on 2010 inflation-adjusted projection of the 2006 Tobacco and Poverty study estimates of the health and economic costs of four smoking-related diseases. <sup>167</sup> E. Antonio, *Philippine Tobacco Industry and Estimation on Tax Leakages* (2008)

<sup>168</sup> Supra note 164.

<sup>&</sup>lt;sup>169</sup> *Id*.

<sup>&</sup>lt;sup>170</sup> Exec. Order No. 846 (2009) Monetization of the Unappropriated and Unreleased Share of Local Government Units Producing Virginia Tobacco from the 15% Excise Tax Collection on Locally Manufactured Virginia-Type Cigarettes for the Calendar Years 2002 to 2009 amounting to PhP5,810,192,796.00.

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Pangasinan Tarlac Nueva Ejica Occidental Mindoro	Burley Tobacco	18%	15% of incremental tobacco excise tax (aggregate of PhP6.37 billion from 1997- 2007) <sup>171</sup>	PhP787million per year to 22 provinces
Cagayan Isabela Nueva Viscaya Quirino Ifugao Mountain Province Iloilo Leyte Negros Oriental Capiz Cebu Misamis Oriental Zamboanga del Sur North Cotabato Maguindanao Sarangani Bukidnon Davao del Sur	Native Tobacco	24%	Shared with above (15% incremental excise tax)	
Beneficiary Agency				
Department of Health			2.5% of incremental tax (approximately PhP52 million per year or PhP260 million from 2005 - 2009) <sup>172</sup>	PhP52 million per year to DOH
PhilHealth			2.5% of incremental tax (approximately PhP52 million per year or PhP260 million from 2005 - 2009) <sup>173</sup>	PhP52 million per year to PhilHealth

<sup>&</sup>lt;sup>171</sup> Exec. Order No. 846 (2009) Release of the Fifteen Percent (15%) Share of Beneficiary Local Government Units (LGUs) Consisting of Provinces, Cities, and Municipalities Producing Burley and Native Tobacco in the Total Incremental Revenue Collected from the Excise Tax on Tobacco Products Accumulated from 1997 to 2007 Amounting to PhP6,370,708,183.73.

<sup>&</sup>lt;sup>172</sup> Computed using incremental revenue from RA 9334 (PhP2.094 billion in 2005).

<sup>&</sup>lt;sup>173</sup> Computed using incremental revenue from RA 9334 (PhP2.094 billion in 2005).

#### 7.2.1.2 Period of Implementation

RA 9334 specified a deadline for the implementation of earmarking of funds for health, limiting its implementation to five years. The relevant provision of the law is quoted as follows:

"The earmarking provided under this provision shall be observed for five (5) years starting from January 2005."

Any health program initiated cannot be sustained if the budget allocated for health is limited to five years. This puts to question the sustainability of the program.

In contrast, the earmarking provisions for tobacco-growing provinces, under both RA 7171 and RA 9334, do not have that limitation and will continue until the laws are amended or repealed.

The apparent inequitable treatment in favor of tobacco results in a situation where for an indefinite period of time, the tobacco industry through the tobacco-producing provinces will receive what is effectively a subsidy to improve tobacco growing. Subsidizing the tobacco sector flags the need to review the current dedicated tax system in light of the government's commitment as a Party to the FCTC, specifically, the provisions on Articles 17<sup>174</sup> and 18<sup>175</sup> on promoting economically viable alternatives to tobacco and Article 5.3 in relation to its Guidelines on prohibiting the granting of privileges and benefits to the tobacco industry.<sup>176</sup>

<sup>&</sup>lt;sup>174</sup>Parties shall, in cooperation with each other and with competent international and regional intergovernmental organizations, promote, as appropriate, economically viable alternatives for tobacco workers, growers and, as the case may be, individual sellers.

<sup>&</sup>lt;sup>175</sup> In carrying out their obligations under this Convention, the Parties agree to have due regard to the protection of the environment and the health of persons in relation to the environment in respect of tobacco cultivation and manufacture within their respective territories.

<sup>&</sup>lt;sup>176</sup> Recommendation 7.1, Guidelines Implementing Article 5.3 of the WHO FCTC provides:

<sup>&</sup>quot;Parties should not grant incentives, privileges or benefits to the tobacco industry to establish or run their businesses."

To promote transparency and accountability, there is a need to look into the projects that have been implemented using money allocated to tobacco-producing provinces and to review whether it has been used to promote the purposes stated under the law. However, this is a topic of a separate research and is beyond the scope of this paper.

## 7.2.1.3 Inconsistency of policies

### 7.2.1.3.1 Promotion of Tobacco Products vs. Promotion of Alternative Livelihood for Tobacco Farmers

The efforts of the tobacco industry in encouraging countries to plant more tobacco have resulted in its overproduction and consequently, lower market prices.<sup>177</sup> While this is advantageous to the tobacco industry, this means that farmers have been receiving lower income from planting tobacco despite the backbreaking labor that the crop requires.

Planting tobacco also brings a host of different health and environmental problems. Handling tobacco itself can be toxic. Nicotine in tobacco can cause Green Tobacco Sickness (GTS), an occupational illness found among workers harvesting tobacco. It is caused by dermal (skin) absorption of nicotine from contact with wet tobacco leaves. GTS is characterized by symptoms that may include nausea, vomiting, weakness, headache, dizziness, abdominal cramps, and difficulty in breathing, as well as fluctuations in blood pressure and heart rates.<sup>178</sup>

<sup>&</sup>lt;sup>177</sup>*The Costs of Tobacco Farming,* Campaign for Tobacco Free Kids, Golden Leaf Barren Harvest 4-8 (2001). <sup>178</sup>*Id.* at 25.

Tobacco also requires the use of massive amounts of pesticides to keep it free from insects and disease, exposing the farmers to risks of pesticide-related ailments and even death.<sup>179</sup>

Moreover, tobacco cultivation causes negative effects on the environment, including depletion of soil nutrients, pollution from pesticides and fertilizers, and serious deforestation (due to land clearance for tobacco cultivation and use of wood to cure tobacco leaves), contributing to adverse climate change.<sup>180</sup>

Acknowledging these issues, Parties to the FCTC deemed it proper to include measures that deal with the supply side as part of the comprehensive tobacco control policy. As a signatory to the FCTC, the Philippines is bound to promote "economically viable alternatives for tobacco workers, growers and, as the case may be, individual sellers"<sup>181</sup> and to protect "the environment and the health of the persons in relation to the environment in respect of tobacco cultivation and manufacture."<sup>182</sup>

In pushing for tobacco control measures, the Parties to the FCTC foresee a drop in tobacco consumption and consequently in tobacco production. Although it is expected that the decrease in employment will be gradual, prudence dictates necessary preparation through development of programs that will encourage shifting to alternative crops.

<sup>179</sup> *Id*. at 24.

<sup>&</sup>lt;sup>180</sup> Framework Convention Alliance, "Alternative Livelihoods and Environments: The Facts," citing HJ Geist, "Global Assessment of Deforestation Related to Tobacco Farming," 8 *Tobacco Control* 18-28 (1999); World Health Organization, "Tobacco and Poverty: A Vicious Circle (2004)." Accessed October 24, 2010. http://www. fctc.org/index.php?option=com\_content&view=article&id=117&Itemid=130.

<sup>&</sup>lt;sup>181</sup> Art. 17, WHO FCTC (2005).

<sup>&</sup>lt;sup>182</sup> Art. 18, WHO FCTC (2005).

Consistent with Articles 17 and 18 of the FCTC, RA 9211 creates programs to assist farmers in shifting to alternative crops. The Tobacco Grower's Assistance Program, which aims to financially support tobacco farmers who may be displaced due to the implementation of the law and the Tobacco Growers Cooperative aims to assist farmers in developing alternative farming systems and in planting alternative crops.<sup>183</sup>

However, RA 9211 did not provide for a specific sustainable funding allocation that will enable the implementation of the said programs. Moreover, these programs already expired in 2008<sup>184</sup> since the law provided only a five-year period for their implementation.<sup>185</sup>

The provisions of RA 9334 and RA 7171 are in direct conflict with the measures under the FCTC and RA 9211, considering that the funds for tobacco-producing provinces are intended for the provision of special support through cooperative projects that will enhance better quality of tobacco products, increase productivity, guarantee the market, and increase participation of tobacco farmers in the tobacco agro-industrial projects.<sup>186</sup>

The law provides:

"The fund shall be exclusively utilized for programs in pursuit of the following objectives:

"(1) Cooperative projects that will enhance better quality of agricultural products and increase income and productivity of farmers;

<sup>&</sup>lt;sup>183</sup> Rep. Act No. 9211, Section 33 (2003).

<sup>&</sup>lt;sup>184</sup> Rep. Act No. 9211 was approved on June 23, 2003 and took effect fifteen (15) days after its publication.

<sup>&</sup>lt;sup>185</sup> Rep. Act No. 9211, Section 33.

<sup>&</sup>lt;sup>186</sup> Sec. 2, Rep. Act No. 7171(1992); Sec. 7(B), Rep. No. 9334 (2004).

"(2) Livelihood projects, particularly the development of alternative farming system to enhance farmer's income; and

"(3) Agro-industrial projects that will enable tobacco farmers to be involved in the management and subsequent ownership of projects, such as post-harvest and secondary processing like cigarette manufacturing and by-product utilization."

Under its charter, the NTA is tasked to improve the economic and living conditions of the tobacco farmers and those who depend upon the tobacco industry for their livelihood and to promote the balanced and integrated growth and development of the tobacco industry to help make agriculture a solid basis for industrialization.<sup>187</sup>

In sum, the current state of laws reflects contradictory policies. The government promotes tobacco-growing on the one hand, while on the other, it is duty-bound to promote alternative livelihood for farmers and protect the environment and farmers' health. Evidently, the current dedicated tax system and the funding and appropriation policies prioritize tobacco over health.

#### 7.2.1.3.2 Prohibiting Incentives to the Tobacco Industry

Providing funding to promote tobacco defies the government's commitment under the FCTC to protect public health policies "from the commercial and other vested interests of the tobacco industry."<sup>188</sup>

<sup>&</sup>lt;sup>187</sup> Exec. Order No. 245 (1987).

<sup>&</sup>lt;sup>188</sup> Article 5.3 of the WHO FCTC provides: "In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law."

The Guidelines for the Implementation of Article 5.3 expound on the General Obligation under the FCTC to protect public health policies from the vested and commercial interests of the tobacco industry. One of the firm recommendations for governments is to avoid giving preferential treatment or incentives to the tobacco industry for doing business.<sup>189</sup>

Although the portion of the excise tax is given to the LGUs of tobaccoproducing provinces and not directly to the tobacco industry, the latter undeniably is the ultimate beneficiary of the promotion of tobacco agriculture. Hence, said provisions are directly opposed to the implementation of Article 5.3 of the FCTC.

### 7.2.2 Problems in implementation

## 7.2.2.1 Failure to remit the earmarked funds

The 2.5 percent incremental tax that was supposed to be remitted to the DOH Trust Fund remains unremitted. The DBM acknowledged during a Congressional inquiry in 2009 that the provision has not yet been implemented. It explained that it would not be able to release the said amount until it receives the IRR from the DOF on the computation of the fund.<sup>190</sup> Subsequently, the BIR issued RR No. 4-2009, released only on April 3, 2009, amending the previously issued RR No.3-2006. However, as of August 2010, the funds have not yet been remitted. The fact of non-remittance to the specified trust fund technically characterizes this provision as

<sup>&</sup>lt;sup>189</sup> Recommendation 7.1, Guidelines Implementing Article 5.3 of the WHO FCTC provides:

<sup>&</sup>quot;Parties should not grant incentives, privileges or benefits to the tobacco industry to establish or run their businesses."

<sup>&</sup>lt;sup>190</sup> Letter presented to Congress and Representative Paul Daza by the Department of Budget and Management.

unimplemented. The fund earmarked for the DOH, being in the form of a "trust fund," may not be incorporated in the general budget of the agency.<sup>191</sup> The law provides:

"Two and a half percent (2.5%) of the incremental revenue from the excise tax on alcohol and tobacco products starting January 2005 shall be credited to the account of the Department of Health and **constituted as a trust fund for its disease prevention program.**"<sup>192</sup> [Emphasis supplied.]

PhilHealth is differently situated because the law provides that the fund allocated should be directly remitted to the agency. Hence, the fund can be incorporated into its general budget.

"Two and a half percent (2.5%) of the incremental revenue from the excise tax on alcohol and tobacco products starting January 2005 shall be **remitted directly to the Philippine Health Insurance Corporation** for the purpose of meeting and sustaining the goal of universal coverage of the National Health Insurance Program."<sup>193</sup> [*Emphasis supplied.*]

## 7.2.2.2 Distinction between Disease Prevention Program and Health Promotion

The failure to define Disease Prevention Program poses a problem. RA 9334 provides that the dedicated tax is to be constituted as a trust fund

<sup>&</sup>lt;sup>191</sup> CONST. (1987), Art. VII, Sec. 29 par. (3).

All money collected on any tax levied for a special purpose shall be treated as a special fund and paid out for such purpose only. If the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government.

<sup>&</sup>lt;sup>192</sup> Rep. Act No. 9334, Section 7(C) (2) (2004).

<sup>&</sup>lt;sup>193</sup> Rep. Act No. 9334, Section 7(C) (1) (2004).

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for the "disease prevention program" of the DOH when the intention, based on legislative history, is to provide funding for health promotion. But a health promotion mechanism goes beyond a "disease prevention program." In health promotion, a substantial sum is also spent on **social mobilization** in order to encourage the participation of communities to achieve health goals. Health Promotion activities also include health education, **research**, and other **social welfare programs**.

This confusion between "health promotion" and "disease prevention" manifests an apparent need to be specific about the purpose of the fund. In other countries, the purpose for the fund is stated in legislation, and health promotion is defined to cover myriad activities often employing preventive rather than curative measures such as promotion of a healthier lifestyle, tobacco control, safety, health education, etc.

# 7.2.2.3 Failure to identify the proper body that will administer the fund

RA 9334 fails to express clearly not only the purpose of the fund but also the specific body meant to administer it. The legislative history and agency actions show, however, that the intention is for the NCHP to utilize the funds for its health promotion activities. The NCHP<sup>194</sup> was established under Administrative Order No. 58 in 2001 to push the action areas provided under the Ottawa Charter, which in turn defines health promotion as the process of enabling people to increase control over their health. The Ottawa Charter was also the basis for the creation of ThaiHealth, the model Health Promotion Funding Structure in the ASEAN that has been recognized by the WHO.<sup>195</sup>

In 2006, the DOH, through the NCHP, initiated a series of planning workshops aimed at tapping the 2.5 percent incremental tax meant for "disease prevention programs" for health promotion activities. Should the 2.5 percent incremental tax be released through the trust fund, it can be used to augment NCHP's budget to implement specific tobacco control activities. This represents a substantial amount because the NCHP's budget in 2006 was only PhP41.1 million. In 2010, NCHP budget received a substantial increase amounting to PhP172 million. However, in view of the multifarious tasks required to implement health promotion strategies, PhP172 million would still be relatively small to achieve the purpose of accomplishing the herculean task of "enabling people to reach a state of complete physical, mental and social well-being, an individual or group must be able to identify and to realize aspirations, to satisfy needs and to change or cope with the environment."<sup>196</sup>

- Develop and evaluate national campaign
- Develop, produce and provide prototype IEC materials to CO, CHDs, retained hospitals and partners
- Establish network with partners, especially those involved in addressing the prerequisites to health
- Provide capacity building opportunities on health promotion for health workers at the CO, CHDs, retained hospitals and LGUs
- Establish monitoring and evaluation networks and services
- Clear all IEC materials developed and produced by other government organizations, NGOs, commercial/business agencies that carry the program/logo of the DOH.

<sup>&</sup>lt;sup>194</sup> DOH Administrative Order No. 58 (2001):

National Center for Health Promotion is tasked to perform the following:

<sup>•</sup> Formulate policies, standards and guidelines pertaining to health promotion,

<sup>•</sup> Provide of technical assistance to the Central Office (CO), Centers for Health Development (CHD) and retained hospitals on health promotion

<sup>&</sup>lt;sup>195</sup> Thailand Health Promotion Foundation, "Showcases." Accessed October 15, 2010. http://en.thaihealth. or.th/about/showcases.

<sup>&</sup>lt;sup>196</sup> First International Conference on Health Promotion Ottawa, "Definition of Health Promotion, Ottawa Charter for Health Promotion," November 21, 1986. Accessed October 15, 2010. http://www.who.int/healthpromotion/ conferences/previous/ottawa/en/index.html.

It must also be noted that NCHP is a government institution that is not independent of political influence and bureaucracy, and has limited capacity to provide support to other sectors such as community-based organizations.

The 2009 Health Executive Agenda for Legislation (HEAL) of the DOH recognized the shortcomings of the NCHP through a proposal for an independent health promotion institution. The DOH reflected a view that a central agency for health promotion may be necessary to provide technical guidance for implementing health promotion programs.

In 2010, the DOH initiated processes to review the HEAL to recognize the role of other actors or beneficiaries who can contribute to broadening the reach of the health promotion objectives.

Specifically, it was recognized that in light of the principle of devolution and the existing mechanism to provide earmarked funds directly to LGUs, sustaining community-level health promotion through the LGUs can be a viable option. Ideally, there should be an independent body free from political influence, to administer health promotion at the local level.<sup>197</sup>

#### 8. Health Promotion

Health promotion involves enabling people to increase control over their health and its determinants. This occurs through health education, advocacy, and social mobilization or engaging the participation of all segments of society in putting health promotion to action. It covers diverse actions such as modifying or changing the environment, giving

<sup>&</sup>lt;sup>197</sup> Interview with Leizel Lagrada, MD, Health Policy Development and Planning Bureau, DOH, August 2010.

support to obtain health, mobilizing people to take action, and advocating change of rules or laws. The core areas of action have focused on capacity building, health promotion leadership, health promotion infrastructure and financing, strategic partnerships for education, strategic partnerships for governance, health communication, and health promotion effectiveness.<sup>198</sup>

### 8.1 Health Promotion in Other Countries

For at least two decades, countries around the world have established different types of institutions conducting health promotion and funded by different sources, mostly from sin taxes. These institutions conduct a wide range of activities to fulfill the mandate of health promotion. Various areas where the funding from sin taxes have been used are as follows:

- a. Community health programs,
- b. Social welfare,
- c. Research,
- d. Sponsorship of sports, recreation, and culture,
- e. Health education programs,
- f. Smoking cessation,
- g. Healthcare premiums,
- h. Anti-smuggling programs,
- i. Policy advocacy to reduce tobacco use, and
- j. Campaigns to limit tobacco advertising.

<sup>&</sup>lt;sup>198</sup> World Health Organization Western Pacific Regional Office, "Health Promotion." Accessed October 15, 2010. http://www.wpro.who.int/health\_topics/health\_promotion.

In other countries, tobacco taxes have been earmarked primarily for health promotion and neither for tobacco farming nor for the tobacco industry. The USA and some European and East Asian countries have adopted different forms of earmarked or dedicated taxes, to be realized from a certain proportion of general tax revenue, usually from the taxes levied on tobacco, alcohol, and/or gambling. For instance, in some countries, sin taxes are earmarked for purposes of reducing or eliminating the consumption of a particular consumer product, including tobacco and alcohol, and in some cases, the revenue collected is spent on social welfare or community activities aimed at the improvement of health and wellness of the public.<sup>199</sup> In Australia, VicHealth, a health promotion organization that was established through the use of earmarked tobacco taxes, provides financing for sports and other activities that customarily relied on tobacco sponsorships.<sup>200</sup> This has helped in the enforcement of tobacco advertising and sponsorship bans, and removed the reliance on tobacco companies for sponsorships and dole-outs.

Much of the health promotion funding includes funding for research on health promotion strategies. This is essential for continuous improvement of the program and in identifying key areas that need support, and complements the development of the Health Promotion Program. Other forms of research are also funded. VicHealth, for example, funds various research projects that range from the epidemiological data on the health, development, and well-being of children in Victoria to the identification of perpetuating cycles of depression, alcoholism, and violence.<sup>201</sup> Healthway in Western Australia

<sup>&</sup>lt;sup>199</sup>World Health Organization, *Health Promotion and Dedicated Taxes, Regional Strategy for Health Promotion*, Follow up on the Sixth Global Conference on Health Promotion, 2 (2006).

<sup>&</sup>lt;sup>200</sup> Victorian Health Promotion Foundation. Fact Sheet, VicHealth Funding Model (February 2006),

<sup>&</sup>lt;sup>201</sup> *Inspiring Health,* Victorian Health Promotion Foundation Annual and Financial Report 2008-2009 (2009) at 14-16.

provides grants for research that aims to promote good health and prevention of illness in the community.<sup>202</sup>

The network of HPFs recommended using the dedicated tax from harmful products such as tobacco as a tool to build the resources of the HPF.<sup>203</sup> The group noted that this strategy will increase the price of tobacco products resulting in lower consumption and at the same time will not reduce the revenue of the government following tobacco tax increase.

The tobacco excise tax serves a special and distinct purpose related to health. Increase of taxes and the subsequent increase in price serve to deter tobacco consumption. Using a portion of the revenue from earmarked funds for health purposes, such as health promotion, provides a complementary approach in dealing with lowering consumption of tobacco products as well as with promoting of the wellness of the population in general.

It is also consistent with Article 6 of the FCTC, which urges governments to ensure that tobacco tax policies should contribute to health objectives.<sup>204</sup>

Table 17 illustrates how various countries are "making the tobacco companies pay" by allocating funds from tobacco for health promotion activities through dedicated taxes or a separate levy.

<sup>&</sup>lt;sup>202</sup> Healthway Health Promotion Research Grants. Accessed October 15, 2010. http://www.healthway.wa.gov. au/default.aspx?MenuID=464.

<sup>&</sup>lt;sup>203</sup> Statement from the Second Meeting of the International Network of Health Promotion Foundations, Bangkok, March 4-6, 2002.

<sup>&</sup>lt;sup>204</sup> Article 6 of the WHO FCTC provides:

<sup>2.</sup> Without prejudice to the sovereign right of the Parties to determine and establish their taxation policies, each Party should take account of its national health objectives concerning tobacco control and adopt or maintain, as appropriate, measures which may include:

<sup>(</sup>a) implementing tax policies and, where appropriate, price policies, on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption;

XXX.

Country	Funding	Type of Health Promotion Mechanism/ Purpose	
Australia (Victoria) <sup>205</sup>	5% dedicated tax on sales of tobacco products	VicHealth: Provides funds for sports sponsorship, school and community health, and research	
Australia (Western Australia) <sup>206</sup>	15% of incremental tax on tobacco	Healthway: Provides funds for sports sponsorship, school and community health, research, and arts	
Korea <sup>207</sup>	Tobacco tax (USD 0.15 per pack collected from tobacco sales), 3%, given to National Health Promotion Fund, and 97% to National Health Insurance	Korea Institute for Health and Social Affairs (KISHA): Uses funds for health education, anti- smoking campaigns, and limiting tobacco and alcohol advertisements	
Finland <sup>208</sup>	0.45% per annum from tobacco tax	Ministry of Social Affairs and Health Health promotion, including tobacco control	
Iceland <sup>209</sup>	0.9% from tobacco tax	Tobacco Control Board: Tobacco control	

#### Table 17: Health Promotion Fund Through Dedicated Tax

<sup>&</sup>lt;sup>205</sup> Tobacco Control Act (1987).

<sup>&</sup>lt;sup>206</sup>Tobacco Control Act (1990).

<sup>&</sup>lt;sup>207</sup> National Health Promotion Act (1995).

<sup>&</sup>lt;sup>208</sup> Act on the Measures for Recreation of Tobacco Smoking Statute, (1976 amended in 1999).

<sup>&</sup>lt;sup>209</sup> Tobacco Control Act (1996).

Malaysia <sup>210</sup>	Sums allocated annually by the Government Moneys earned or arising from property, charges, or interest All grants, donations, gifts, contributions, bequests or any other sums received by the Board	Malaysia Health Promotion Board: Implements health promotion programs and activities and funds research, sporting, recreational, and cultural organizations that promote healthy lifestyles and healthy environments
Poland <sup>211</sup>	0.5% from tobacco tax <sup>212</sup>	Council of Ministers: Implements a program outlining health, economic, and social policies aimed at reducing tobacco use
Slovenia <sup>213</sup>	Earmarked from the National Budget	Health Council: Promotes public health initiatives against the harmful effects of tobacco products
Qatar <sup>214</sup>	2% of overall Tobacco Sales Act	Ministry of Health: Health Promotion

<sup>&</sup>lt;sup>210</sup> Act of Parliament (Act 651).

<sup>&</sup>lt;sup>211</sup> Tobacco Control and Health Protection Act. (1995).

<sup>&</sup>lt;sup>212</sup> World Health Organization, Western Pacific Regional Office, *Regional Strategy for Health Promotion, Health Promotion and Dedicated Taxes*, 11 (2006).

<sup>&</sup>lt;sup>213</sup> Restriction on the Use of Tobacco Products (2002).

<sup>&</sup>lt;sup>214</sup> The Law of Tobacco Control (2002).

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Taiwan <sup>215</sup>	30% of tobacco tax surcharge	Bureau of Health Promotion: Funds various health promotion activities Examples: 6% of tobacco tax is allocated to cancer control, 3percent to tobacco control, 1percent to combat tobacco smuggling and counterfeit cigarettes, 20percent to support programs that subsidize health care premiums for disadvantaged citizens and other health and social welfare programs	
Thailand <sup>216</sup>	2% surcharge on tobacco and alcohol	Thai Health Promotion Foundation: Undertakes campaigns to reduce consumption of alcohol, tobacco, and other harmful substances; implements health promotion projects and research	
USA (California) <sup>217</sup>	USD0.25 per pack	California Tobacco Programme: Funds tobacco-related school and community health education programs and research	
USA (Arizona) <sup>218</sup>	USD0.23 per pack	Health Department: Funds programs for the reduction of tobacco use such as public education, cessation, and evaluation	

<sup>&</sup>lt;sup>215</sup> Bureau of Health Promotion, Department of Health, Taiwan, China, "Taiwan's new tobacco tax allocated to tobacco and cancer control, and other health and social programs." Accessed October 15, 2010. http://www.bhp. doh.gov.tw/bhpnet/English/NewsShow.aspx?No=200907140003.<sup>216</sup> Health Promotion Foundation Act, (2001).
<sup>217</sup> California Revenue and Taxation Code (1998).

<sup>&</sup>lt;sup>218</sup> Tobacco Tax and Health Care Act.

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The WHO Regional Office for South-East Asia recognized ThaiHealth as a model health promotion foundation. It encouraged other memberstates to consider the possibility of establishing a Health Promotion Foundation along the lines of ThaiHealth,<sup>219</sup> an autonomous body utilized to provide sustainable funding for health promotion

#### 8.2 Health Promotion in the Philippines

#### 8.2.1 Programs

#### 8.2.1.1 Preventive Measures

Health promotion activities generally focus on wellness or preventive measures, rather than curative measures. It is recognized that investing in preventive measures is a cost-effective way to improve public health.

In countries in the Western Pacific Region, prevention and health promotion are receiving insignificant funding. 91 percent of the health fund is spent on curative care, only eight percent is spent on prevention

<sup>&</sup>lt;sup>219</sup> World Health Organization Regional Office for South-East Asia *Regional Strategy for Health Promotion for South-East Asia* (2006).

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of illness, and one percent is spent on health promotion.<sup>220</sup> In the Philippines, only 12.3 percent of public health spending went to preventive health care in 2003; majority of the expenses were spent on curative care.<sup>221</sup>

Among the top 10 causes of death in the Philippines are diseases of the heart, diseases of the vascular system, cancer, and diabetes. The onset of these lifestyle-related diseases depends on factors that can be influenced by socio-economic and physical environment, by the state of the health care system, and the behavior and practices of the individual.<sup>222</sup> Prevention and control of these diseases should be a priority of the government, and participation of the public in the effort of the government is essential.

#### 8.2.1.2 Social Mobilization

There are three key elements to health promotion - education, social mobilization, and advocacy.

Social mobilization is defined as a broad-scale movement to engage people's participation in achieving a specific development goal through self-reliant efforts.<sup>223</sup> In other countries like Thailand and Australia, health promotion foundations conduct social mobilization as a critical component of health promotion. ThaiHealth's experience emphasizes the importance of public participation in policy advocacy.<sup>224</sup> It mobilizes

<sup>&</sup>lt;sup>220</sup> Presented by Dr. Susan Mercado *Health Promotion Foundations funded through Tobacco Taxes*, Tobacco Tax Strategizing Forum, (April 22, 2010).

<sup>&</sup>lt;sup>221</sup> Department of Health National Objectives for Health Philippines 2005-2010 (2005).

<sup>&</sup>lt;sup>222</sup> Id.

<sup>&</sup>lt;sup>223</sup> N .McKee, E Manoncourt, C . Yoon, R. Carnegie, *Involving people, evolving behaviour*. Penang: Southbound (2000).

<sup>&</sup>lt;sup>224</sup> P. Sivaraksa, "Origin of ThaiHealth"." Accessed October 15, 2010. http://en.thaihealth.or.th/resource-center/ reports.

ThaiHealth, "Fact Sheet." Accessed October 15, 2010. http://en.thaihealth.or.th.

Campaign for Tobacco-Free Kids, "Country Case Studies: Thailand," 1999. Accessed November 5, 2010. http://www.tobaccofreekids.org/campaign/global/casestudies/.

communities to participate in road safety training and in advocacy for reduction of sugar in infant formula.

On the other hand, VicHealth supports community activities like sports that otherwise would have been sponsored by the tobacco industry. Through the health promotion funding, VicHealth has managed to solicit the support of the community for the ban on tobacco sponsorships.

Novel approaches need to be explored to ensure that health promotion funding incorporates social mobilization as a key component. In the Philippine setting, social mobilization can be done through the programs of the DOH BLHD or the DILG. In practice, due to the devolution of health services, social mobilization and community health initiatives are best done through the LGUs.

An example of effective implementation of health promotion activities through the LGU is the Social Health Insurance Indigency Program of Bindoy, Dumaguete, Negros Oriental. The program provides primary health care and encourages community participation as the members contribute a counterpart to the over-all resources for health care, thus enabling health services to become affordable and accessible to the poor.<sup>225</sup> Health service delivery in the municipality has improved and the community participation in the program has provided the constituents of Bindoy with a sense of ownership and has empowered them to be more responsible for their health care.<sup>226</sup>

<sup>&</sup>lt;sup>225</sup> "Improving LGU Performance through Local Capacity Innovations and Incentive Mechanisms," Galing Pook Foundation published in cooperation with the United Nations Development Program and SNV Netherlands Development Organization 13- 15 (2010).
<sup>226</sup> Id at 16-18.

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Another example is the Fight Against AIDS, Fight Against Poverty Program of Zamboanga City, which is a collaborative effort of the LGU and the community through the Zamboanga City Multi-Sectoral AIDS Council (ZCMSAC) for the prevention and control of Sexually Transmitted Diseases (STD) and HIV/AIDS. The ZCMSAC focuses on advocacy and information and education campaign. It aims to effect a behavioral change in high-risk groups, and increase awareness among the population.<sup>227</sup> As a result of the program, the HIV prevalence in the community has been reduced to less than one percent, while STD prevalence among high-risk population has been reduced to 12 percent to 15 percent.

It must be noted that government funding for social mobilization and advocacy is a new area. But evidence shows that LGUs and communitybased organizations have had some success in this arena.

## 8.2.2 Structures

In various countries, as illustrated in Table 17, separate structures are responsible for health promotion. Some institutions have been created for this purpose, while in others, an existing unit in government is tapped to do health promotion. The set-up of a politically independent institution that can work closely with the communities and civil society organizations is ideal. But in the Philippine setting, policy makers have a general aversion to establishing new institutions because it is viewed as contrary to rationalizing and streamlining the functions of the government. Taxing Health Risks 107

EO 366, enacted by Gloria Macapagal Arroyo in 2004, implemented the government's Rationalization Program. The policy aims to transform the executive branch into a more effective and efficient government by focusing on its vital functions and channeling government resources to these core public services; and improving the efficiency of government services and delivery by eliminating or minimizing overlaps and duplications in government and improving agency performance through rationalization of service delivery and support systems, and organizational structure.<sup>228</sup>

Health Promotion experts recommend the creation of autonomous independent institutions to undertake Health Promotion activities.<sup>229</sup> However, it is unlikely that such a creation would gain support in Congress in light of the existence of the NCHP under the DOH.

For practical reasons, this paper will focus on existing institutions or mechanisms that have the capacity or mandate to implement activities related to health promotion. At the national level, there are two possible agencies that may be tapped, the DOH and the DILG. At the local level, health promotion may also be undertaken through the LGU officials including local health officials and/or the local health boards.

#### 8.2.2.1 Structures at the National Level

The DOH has several bureaus and centers that may be assigned to undertake health promotion activities:

• The first is the NCHP, which implements health promotion, albeit at a limited scale. The NCHP<sup>230</sup> develops directions, policies, standards

<sup>&</sup>lt;sup>228</sup> Exec..Order No. 366 (2004).

<sup>&</sup>lt;sup>229</sup> Regional Strategy for Health Promotion, *Follow-up of the Sixth Global Conference on Health Promotion*, 6 (2006).

<sup>&</sup>lt;sup>230</sup> Adm. Order No. 58 (2001).

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and guidelines pertaining to health promotion, and provides technical assistance and health promotion data to the CO, CHDs, and other partners. It develops IEC materials, builds capacity of health workers, and monitors and evaluates systems to ensure evidence-based health promotion.

- The second is the DOH's BLHD, which provides technical support in the development of policies, programs, and projects to support the decentralization of health services at the local level. It has a program called "Inter-Local Health (ILH) Zone," which is a nationally endorsed unit for local health service management and delivery in the Philippines. The overall concept is the creation of an ILH System by clustering municipalities into ILH zones. Each ILH zone has a defined population within a defined geographical area and comprises a central (or "core") referral hospital and a number of primary level facilities such as RHUs and BHUs. In addition to government health services, ILH zones are inclusive of all other stakeholders and sectors involved in the delivery of health services or the promotion of health, including community-based NGOs and the private sector.<sup>231</sup>
- The third are the regional offices of the DOH or the CHDs. The CHDs are tasked with promoting programs at the LGU level.

<sup>&</sup>lt;sup>231</sup> Department of Health, A Handbook on Inter-Local Health Zones, District Health System in a Devolved Setting 4 (2002).

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The DILG, an agency assigned to exercise general supervision over the LGUs, can also be tapped if the intention is to allow LGUs to have a bigger role in health promotion. The DILG is proposing a "Performance Challenge Fund" that aims to encourage good performance of LGUs through an incentive fund to support capital investments in improving social services, providing public infrastructure, enhancing economic services, adapting to climate change and preparing for disasters, and promoting good governance. However, the DILG does not possess the technical expertise to conduct programs related to health promotion.

#### 8.2.2.2 Local and Community Level

The principle of devolution embodied in the Local Government Code requires the national agencies to work closely with the local governments in the implementation of policies and programs. Hence, the role of the LGUs and the communities in health promotion cannot be underestimated.

Due to the devolution of health services,<sup>232</sup> the LGUs are given the responsibility of managing the health of their own constituents. Most of the health investments at the LGU level are health costs to treat illnesses or to establish health facilities. Little is invested in health promotion that has the potential to prevent diseases and reduce health costs.

<sup>&</sup>lt;sup>232</sup> Local Government Code, Book, I, Title One, Chapter 1, Sec. 17 (e) National agencies or offices concerned shall devolve to local government units the responsibility for the provision of basic services and facilities enumerated in this section within six (6) months after the effectivity of this Code.

As used in this Code, the term "devolution" refers to the act by which the national government confers power and authority upon the various local government units to perform specific functions and responsibilities.

Local Government Code, Book, I, Title One, Chapter 1, Sec. 17 (g) The basic services and facilities herein above enumerated shall be funded from the share of local government units in the proceeds of national taxes and other local revenues and funding support from the national government, its instrumentalities and government-owned or -controlled corporations which are tasked by law to establish and maintain such services or facilities. Any fund or resource available for the use of local government units shall be first allocated for the provision of basic services or facilities enumerated in subsection (b) hereof before applying the same for other purposes, unless otherwise provided in this Code.

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Available health promotion funding creates an opportunity for LGUs to undertake activities within their own jurisdictions with the guidance of health promotion experts. There is value in tapping the Local Health Boards if the aim is to encourage increased participation of LGUs in conducting health promotion activities. The Local Health Board is composed of the local Chief Executive, the Health Officer, the Chairperson of the Committee on Health of the *Sanggunian*, a representative from the private sector or non-governmental organization involved in health services, and a representative of the DOH.

It bears stressing that the cooperation of the national government, local government and the community-based organizations has resulted in many success stories in the implementation of laws and programs. This collaboration must be utilized in undertaking health promotion activities. Needless to say, these three sectors need to be capacitated to participate in health promotion activities.

## 8.2.3 Funding

In many countries, earmarked funds for health promotion have come from tobacco taxes or charges but though various channels such as:

- a. local or state tax or charge on tobacco,
- b. surcharge or tobacco and alcohol,
- c. sales tax (VAT) on tobacco, and
- d. excise tax of tobacco and/or alcohol.

In the Philippines, out of the 10 leading causes of mortality, at least seven are smoking-related (Annex F). It is only logical that the fund for health promotion be sourced from tobacco funds.

Among the various modes of utilizing funds from tobacco, earmarking from excise taxes is the most popular. In the Philippines where there are many limitations surrounding the imposition of local taxes and sales tax, earmarking from tobacco excise taxes is easily the top choice.

This does not imply that additional or alternative means to obtain tobacco funds for health promotion are not feasible. These should also be explored; however, they go beyond the scope of this paper.

# 8.3 Dedicated Taxes for Purposes Complementary to Health Promotion

In addition to funding health promotion, dedicated taxes can be used to support the activities that are otherwise funded by the "corporate social responsibility" programs of the tobacco industry. Article 5.3 of the FCTC calls for explicit measures to prevent tobacco industry interference that conflicts with public health goals. In addition, the WHO asserts that CSR and the tobacco industry are "an inherent contradiction" (as cited in Spotlight on the Framework Convention on Tobacco Control: Article 5.3, Tobacco Industry Interference, July 2008).

This is relevant because the Philippines, as party to the FCTC, had a deadline to implement a comprehensive advertising ban by September 2010. Based on the Guidelines Implementing Article 13 of the FCTC, a comprehensive advertising ban on tobacco includes the ban on the tobacco industry's so-called Corporate Social Responsibility.

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CSR of the tobacco industry includes donation of money to LGUs and other organizations.<sup>233</sup> The tobacco industry often engages in providing calamity funds<sup>234</sup> and funding education programs directly (through partnership with public schools<sup>235 236</sup> or the youth smoking prevention program<sup>237</sup>) or indirectly (donations to the Knowledge Channel<sup>238</sup>).

The so-called CSR exposes the government agencies and personnel to a possible violation of the government's commitment under Article 5.3 of the FCTC<sup>239</sup> and Joint Memorandum Circular 2010-01 issued by the CSC and DOH, whereby government agencies and personnel are prohibited from partnering with or receiving contributions from the tobacco industry.

The CSR ban is expected to have an adverse impact on organizations and LGUs that benefit from the tobacco industry's so-called CSR. Dedicated tobacco taxes can be made to replace these contributions or donations in the same way that in Australia, a portion of the tobacco taxes was allocated to pay for sports sponsorship.

<sup>&</sup>lt;sup>233</sup> Philippine Information Agency, "Donations boost quality of education in Basey town," November 10, 2008. Accessed October 15, 2010. http://www.pia.gov.ph/?m=12&sec=reader&rp=4&fi=p081110. htm&no=33&date=11/10/2008.

 <sup>&</sup>lt;sup>234</sup> "Relief packs readied," *The Daily Tribune*, October 15, 2009. Accessed October 15, 2010. http://www.tribuneonline.org/business/20091015bus8.html.

<sup>&</sup>lt;sup>235</sup> "Embrace-ing schools", *Philippine Star*, July 4, 2010. Accessed October 15, 2010. http://www.philstar.com/ Article.aspx?articleid=590105.

<sup>&</sup>lt;sup>236</sup> Ninfa B. Quirante, "Oras High School get new classrooms", *Philippine Information Agency for Samar News*, July 18, 2007. Accessed October 15, 2010. http://www.samarnews.com/news\_clips7/news136.htm.

<sup>&</sup>lt;sup>237</sup> Philip Morris International, "Youth Smoking Prevention." Accessed October 15, 2010. http://www.pmi.com/ eng/about\_us/how\_we\_operate/pages/youth\_smoking\_prevention.aspx.

Tobacco Industry Interference in Health Policy in ASEAN Countries, Southeast Asia Tobacco Control Alliance 11 (2009).

<sup>&</sup>lt;sup>238</sup> KCFI Public Relations Team, "Knowledge Channel and Philip Morris Philippines Partner in Environmental Clean-up," *Knowledge Channel*, January 29, 2008. Accessed October 15, 2010. http://www.knowledgechannel.org/pressdetails.php?id=16.

<sup>&</sup>lt;sup>239</sup> Paragraph 17.6, Guidelines Implementing Article 5.3 of the WHO FCTC provides:

Denormalize and, to the extent possible, regulate activities described as "socially responsible" by the tobacco industry, including but not limited to activities described as "corporate social responsibility".

It is interesting to note that in 2009, Philip Morris alone spent over a billion dollars in so-called CSR activities,<sup>240</sup> more than the amount of money it pays in taxes. If these were paid to the government in the form of taxes and a portion is allocated to cover the CSR activities such as calamity fund, education, and environment fund, then the risks of tobacco industry interference would decline, the risks of violating the advertising ban would also be reduced, and the government would have more control of how the money would be spent.

Other pertinent activities to promote the implementation of diverse tobacco control measures may also be funded through the dedicated tax system. This can include efforts to promote alternative livelihood, to monitor tobacco industry interference, and others. However, these will be subject of subsequent research.

#### 8.4 Recommendations

To remove the imbalance in the currently earmarked funds, the funding for health should be increased. There is an immediate need to review the earmarked funds for tobacco-producing LGUs in line with the objective of reducing tobacco consumption and would not be contrary to the other policies of the government.

The funding to promote tobacco can instead be reallocated to promote alternative livelihood for farmers and to establish a health fund or ensure that the farmers are enrolled in the health care coverage of PhilHealth. These actions will be in line with the Philippine

<sup>&</sup>lt;sup>240</sup> In 2008, PMPMI donated over USD 1.5 billion to different charitable groups in the Philippines, Philip Morris International Inc. Accessed October 15, 2010. http://www.tobaccofreecenter.org/files/pdfs/en/IW\_facts\_ casestudies\_pmi\_philippines.pdf.

commitment to the FCTC not to promote tobacco growing, but to promote health and, where necessary, provide alternative livelihood sources for tobacco farmers. Review or audit of funds allocated to tobacco-producing provinces is also recommended to ensure transparency and accountability.

In addition to increased funding for health, a distinction must be made between disease prevention and health promotion. It is also recommended that health information, social mobilization and advocacy, and research be incorporated into health promotion programs

The priority given to health promotion emphasizes the need to involve community-based organizations and LGUs in the social mobilization activities. Hence, LGUs should be provided with sufficient funds to take advantage of their capacity to undertake health promotion and mobilize social partners to support, advocate, and monitor health promotion in the community. The DOH should be able to provide guidance to the LGUs in conducting health promotion through the development of the appropriate standard and evaluation guidelines.

On the other hand, the DOH must be capacitated to provide the appropriate technical assistance to the LGUs through its various offices. DOH funds should be augmented so that:

- 1. The NCHP will be able to conduct extensive health information campaigns, including taking advantage of effective media, such as television, to connect to a wider base;
- 2. The BLHD will be able to continue its work with the LGUs in providing the latter with the technical support they need to fulfill their role in the devolution of health services; and

3. The capacity of the CHD will be developed in promoting and assisting the LGUs in health promotion programs.

In order to encourage public support and participation, national government, either through DOH or a multi-sectoral or interagency body, will find good value in investing in nationwide health information through use of mass media to inform people about health promotion programs. ThaiHealth considers effective use of media as crucial for health promotion and takes advantage of working with popular and alternative media in disseminating its message.

To further support LGU initiatives, the DILG, with its mandate to monitor and supervise LGUs, may also be enticed to support in implementing health promotion activities.

## 9. Conclusion

From a public health standpoint, increasing tobacco taxes is considered the single most effective means of reducing tobacco-related deaths and diseases. It also serves as a deterrent for young persons because they are most sensitive to increases in tobacco prices brought about by the increase in taxes.

To correct the apparent imbalance and injustice of giving undue advantage to the tobacco monopoly, there is an immediate need to remove the protective clause in RA 9334 that freezes the price classification of the popular brands at 1997 levels. The removal of the price classification freeze itself is expected to immediately yield more than PhP20 billion in additional revenues.

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Indexing future excise taxes to inflation must also be included in the design of a tax increase proposal. This is important so that the real value of the excise tax and the intended effective tax burden for cigarettes are preserved.

In addition, a new law needs to be enacted in order to reach the public health targets of reducing tobacco consumption by 10 percent in the short term and attaining the cigarette price and smoking prevalence levels of neighboring countries with best tobacco control policies in the long term. It is possible to consider the law a health measure primarily, although it incidentally raises revenue for the government. This will have an impact on the participating Committees in Congress, where the Committee on Health will take the lead in promoting the health objective, even as the Committee on Ways and Means remains mainly responsible in meeting the revenue goal.

Based on short- and long-term targets and best tobacco tax practices, the new law must impose a tax increase using the following approach to facilitate a smooth transition from the current to the new tax system:

- 1. The first and immediate step involves removing the price classification freeze, effectively reducing the number of tiers from four to three.
- 2. The second step further reduces the number of tiers from three to two and ensures that cigarette prices will be less affordable to the youth. The tax will be adjusted from PhP12 to PhP16 for the medium- and high-priced brands and from PhP28.30 to PhP29.40 for the premium-priced brands.
- 3. The third step will be the final stage of shifting to a single level tax structure. The uniform specific rate will be PhP30 for all brands to compensate for inflation and increases in income and to further

reduce consumption for cigarettes. The uniform specific rate will likewise be subject to annual increases on the basis of prices indexed to inflation.

4. The final step involves increasing taxes regularly on top of the price indexation to inflation to meet long-term health objectives. The frequent increase in tax needs to be flexible and must be adjusted depending on the health and revenue objectives of the policy makers.

The proposed tax increase will gradually increase the excise tax and at the same time fix the pitfalls of the current tax structure. Health objectives will be achieved, and the Philippines will be able to catch up with the neighboring countries with best tobacco control practices without sacrificing the fiscal position of the country. This move will also be consistent with the WHO recommended standard to impose excise taxes at 70 percent of the gross retail price.

Incidentally, this also provides additional government revenues. Hence, this will reduce the need to increase taxes that are unpopular and regressive.

It bears stressing that these increases will lead to an increase in earmarked funding under RA 7171 and RA 9334. The amount will double and triple in the next few years if excise tobacco taxes are increased to meet health objectives to reduce consumption. There may be a need to seriously reconsider how the additional earmarked funds will be used in light of these projections.

It is recommended that the existing earmarking provisions be improved to ensure that the incremental proceeds are used for tobacco controlrelated purposes. For instance, the additional proceeds from tobacco118 Taxing Health Risks ······

producing LGUs can be used to promote alternative livelihoods for tobacco farmers in accordance with WHO FCTC Articles 17 and 18 and RA 9211. Funding cost-effective programs, such as health promotion, is significant in achieving health objectives. Existing institutions, such as the DOH, DILG, and LGUs, have the capacity and mandate to undertake health promotion activities.

The tobacco industry will find ways and means to water down any effective measures related to the tobacco tax policy. As in the past, Members of Congress in the Ways and Means Committee representing tobacco industry interests will shoot down any efforts to increase taxes by resisting increases in tobacco taxes by claiming that they are antipoor or that they will ruin the tobacco industry. But the fact is no similarly situated country in the world that increased tobacco taxes had ever caused the downfall of the tobacco industry, nor made the poor worse off.

They are also likely to insist on retaining the multi-tiered price classification or propose ad valorem types of taxes to ensure that prices of brands in the low-priced segment remain low, thus giving access to the youth and the poor. However, this runs contrary to the health objective of the tax policy and will only retain the tax administration problem of misclassification. Neither the DOH nor the DOF endorses the ad valorem tax or a mixture of ad valorem tax and specific tax for the reasons cited.

The evidence is clear: Tobacco taxes can save lives by reducing the number of smokers while providing the much-needed revenue to address deficits and provide funds for health promotion. But proponents of tobacco excise tax reform must be vigilant about the tobacco industry's attempts to water down effective tobacco control policies.

## ANNEX A

## Estimating the Impact of Tax Increase on Consumption and Government Revenue

This section is divided into two subsections. The first gives a brief background on studies that measure the price elasticity of demand for cigarettes. The second describes how the impact of tax increases on cigarette consumption, smoking prevalence, and government revenue is estimated.

## 1. Price Elasticity of Demand for Cigarettes

An important parameter in estimating the impact of tax increases on cigarette consumption and smoking prevalence, economic costs due to smoking-related diseases, and government revenue is the price elasticity of demand for cigarettes. Price elasticity of a certain good measures the responsiveness of demand for that good to a change in price. To illustrate, a price elasticity of cigarette equal to -0.8 means that a 10 percent increase in cigarette price will translate to an eight percent decrease in demand for or consumption of cigarettes, holding other variables constant.

A brief discussion of cigarette price elasticity results from other countries is undertaken. After this, Philippine studies estimating the price elasticity of cigarettes are presented.

## 1.1 Evidence from Neighboring Countries

While there are many studies that estimate the price elasticity of demand for cigarettes, particular focus is given to studies done in the neighboring, developing Southeast Asian countries for purposes of comparability to the Philippines. The following table shows that various studies in various countries yield consistent data that point to the fact that prices of tobacco products or cigarettes are relatively inelastic.

Country	Estimated Price Elasticity	Type of Data Used	Year of Publication	Specifics
Indonesia <sup>241</sup>	-0.43	1970 to 1994 Annual Aggregate	1999	<ul> <li>accounts for non-stationary price and income data</li> <li>includes dummy variables for policy changes (i.e. mechanization of <i>kretek</i> production, ban lift on TV advertising of tobacco)</li> </ul>
	-0.51	1980 to 1995 Annual Aggregate	2000	• analysis limited to <i>kreteks</i> only
	-0.33 to -0.47	1970 to 2001 Annual Aggregate	2005	<ul> <li>includes dummy variables for introduction of health warnings on cigarette packs, economic crisis and a time trend</li> </ul>
	-0.32 to -0.43	1996 to 2001 Monthly Aggregate	2005	<ul> <li>includes dummy variables for introduction of health warnings on cigarette packs, economic crisis and a time trend</li> <li>price data includes both tobacco and alcohol</li> </ul>
	-0.32	1970 to 2000 Annual Aggregate	2003	<ul> <li>uses a myopic addiction model with lagged consumption variable</li> </ul>
	-0.59 to -0.67	1999 to 2002 Aggregate	2003	<ul> <li>accounts for population and income growth and substitution between cigarette products</li> </ul>
	-0.82 to -2.11	1999 to 2002 Aggregate	2003	<ul> <li>accounts for population and income growth and substitution between cigarette products</li> <li>price elasticity estimation by type of cigarette (i.e. hand-made <i>kreteks</i>, machine-made <i>kreteks</i> and white cigarettes)</li> </ul>

#### Table 18: Estimated Price Elasticities for Selected Southeast Asian Countries

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<sup>241</sup>S. Barber, A. Ahsan, S. Adioetomo, and D. Setyonaluri, *Tobacco Economics in Indonesia*. Paris: International Union Against Tuberculosis and Lung Disease (2008).
	-1.0	1999 Cross-sectional Household	2002	• using an Almost Ideal Demand System (AIDS)
	-0.6	1999 Cross-sectional Household	2005	<ul> <li>includes         variables on         household         expenditures,         excise tax         dummies, area,         large islands,         residence,         sex, age, and         education         price elasticity         for households         with smokers         only</li> </ul>
	-0.8	1997 and 2000 Household Panel	2005	<ul> <li>dependent variable is household budget shares of tobacco</li> </ul>
	-0.666	Aggregate	1995	
Thailand <sup>242</sup>	-0.0926	1988 Cross-sectional Household	1995	
	-0.979	Cross-sectional Household	1995	<ul> <li>beverages and tobacco products aggregated in the same category</li> </ul>
	-0.39	2000 Cross-sectional Household	2003	

<sup>&</sup>lt;sup>242</sup> I. Sarntisart,. *An economic analysis of tobacco control in Thailand*. HNP Discussion Paper Economics of Tobacco Control Paper No. 15. The World Bank: Washington (2003).

<b>Vietnam</b> 243 244 245	-0.94	1998 Cross-sectional Household	2006	<ul> <li>includes variables on annual per capita income, individual, household, geographic and commune characteristics</li> <li>price elasticity of male participation in smoking (includes both smokers and non-smokers)</li> </ul>
	-0.50	1998 Cross-sectional Household	2006	<ul> <li>includes variables on annual per capita income, individual, household, geographic and commune characteristics</li> <li>price elasticity of male smokers only</li> </ul>
	-0.59 (low quintiles; -0.40 (high quintiles)	1998 Cross-sectional Household	2006	<ul> <li>includes variables on annual per capita income, individual, household, geographic, and commune characteristics</li> <li>price elasticity of male smokers only according to income group</li> </ul>
	-0.53	1998 Cross-sectional Household	2007	<ul> <li>uses an Almost Ideal Demand System (AIDS)</li> </ul>

<sup>&</sup>lt;sup>243</sup> H. Kinh, H., Ross, D. Levy, N. Minh, , and B. Ngoc, *The effect of imposing a higher, uniform tobacco tax in Vietnam.* Health Research Policy and Systems, *4*(6) (2006).

<sup>&</sup>lt;sup>244</sup> G. Guindon, H. Nguyen-Thi-Thu, K. Hoang-Van, E. McGirr, T. Dang-Vu, and L. Nguyen-Tuan *Tobacco Taxation in Vietnam*. Paris: International Union Against Tuberculosis and Lung Disease(2010).

<sup>&</sup>lt;sup>245</sup> P. Eozenou, and B. Fishburn, *Price elasticity estimates for cigarette demand in Vietnam.* MPRA Paper No. 12779 (2007).

Myanmar <sup>246</sup>	-1.633	2001 Cross-sectional Household	2003	<ul> <li>focuses only on consumption of cheroots, cigarettes and <i>phet kyan</i></li> <li>includes variables on income, age, education and literacy, gender, marital status, urban/rural residence, and addiction</li> <li>price elasticity of smoking participation (includes smoker and non-smokers)</li> </ul>
	-0.342	2001 Cross-sectional Household	2003	<ul> <li>focuses only on consumption of cheroots, cigarettes and <i>phet kyan</i></li> <li>includes variables on income, age, education and literacy, gender, marital status, urban/rural residence, and addiction</li> <li>price elasticity of smokers only</li> </ul>

Most of these studies confirm that as prices go up, the demand does not go down as much as the increase in price. Hence, increasing prices through tax increases does not necessarily lead to a reduction in government revenue.

#### 1.2 Philippine Studies

Two different studies that measure the price elasticity of cigarettes in the Philippines are available. The following table summarizes the details of these studies.

 <sup>&</sup>lt;sup>246</sup> N.Kyaing, *Tobacco economics in Myanmar*. HNP Discussion Paper Economics of Tobacco Control Paper No.
 14. The World Bank: Washington (2003).

Models	Estimated Price Elasticity	Type of Data Used	Year of Publication	Specifics
MODEL 1 <sup>247</sup>	-0.149	1970 to 2004 Annual Aggregate	2006	<ul> <li>uses USDA data on cigarette production, imports and exports for consumption</li> <li>includes dummy variable for the issuance of warning on tobacco products</li> </ul>
	-0.200	1970 to 2004 Annual Aggregate	2006	<ul> <li>uses USDA data on cigarette production, imports and exports for consumption</li> <li>includes variable for lagged consumption</li> </ul>

#### Table 19: Estimated Price Elasticities for the Philippines

<sup>247</sup> The Tobacco and Poverty Project is a collaborative effort of the National Tobacco Control Team of Department of Health (DOH), the College of Public Health of UP Manila, the Philippine College of Medical Researchers Foundation, Inc. and the Tobacco Free Initiative of the World Health Organization (TFI-WHO). It aims "to establish evidence concerning the existence of a vicious cycle of tobacco and poverty in the country with intention of designing effective measures to break that cycle" (National Tobacco Control Team-DOH, College of Public Health-UP Manila, Philippine College of Medical Researchers Foundation, Inc., and Tobacco Free Initiative-WHO, 2006, p. 11). Chapter 4 of this study focuses on the analysis of the demand for tobacco in the Philippines and has a section on estimating the price elasticity of demand for cigarettes.

This study uses time series data from 1970 to 2004. It estimates the elasticity using the following regression models:

(1)	$\ln(\text{Cigarettes2}_i) = \beta_0 + \beta_1 \ln(\text{Price2}_i) + \beta_2 \ln(\text{Income2}_i) + \omega$
(2)	$\ln(\text{Cigarettes2}_i) = \lambda_0 + \lambda_1 \ln(\text{Price2}_i) + \lambda_2 \ln(\text{Income2}_i) + \lambda_3 \text{Policy}_i + \rho$
(3)	$\ln(\text{Cigarettes2}) = \delta_0 + \delta_1 \ln(\text{Price2}) + \delta_2 \ln(\text{Income2}) + \delta_3 \ln(\text{Cigarettes2}) + \sigma$
where	In(Cigarettes2), consumption of cigarettes per capita (in log)
	In(Price2), tobacco price (in log)
	In(Income2), real GDP per capita (in log)
	Policy, dummy variable for issuance of warning on tobacco products (2001-2004)
	In(Cigarettes2,1,1), lagged consumption of cigarettes per capita (in log)
	$\omega$ , $\rho$ and $\sigma$ , error terms.

The data on cigarette consumption based on the USDA database on cigarette production, imports and exports of all countries. Consumption is computed by subtracting exports from the sum of domestic production and imports while consumption per capita is equal to consumption divided by the population of individuals aged 15 years old and above, which is derived from the UN population estimates. Cigarette prices are estimated for 2003 and adjusted for the other years using the tobacco CPI for the NCR. The real GDP per capita is used to measure the income elasticity of cigarettes while the lagged consumption of cigarettes per capita takes into account addiction to cigarettes. The policy variable indicates the period since the warning, "Cigarette smoking is dangerous to your health", has been required for printing on cigarette packs, which began in 2001 (National Tobacco Control Team-DOH, et. al., 2006).

The Tobacco and Poverty Project study estimates the price elasticity of cigarette consumption equal to -0.149 for equations (1) and (2) and -0.200 for equation (3). This means that cigarette consumption is price inelastic or does not change much in response to changes in price.

MODEL 2 <sup>248</sup>	-0.235	1988 to 2008 Annual Aggregate	2009	<ul> <li>uses DOF model</li> <li>uses BIR removals data for consumption</li> </ul>
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The estimation results for the two Philippine studies are quite similar both in direction and magnitude, with cigarette price elasticity estimates ranging from -0.235 to -0.149. This is because both studies use aggregate time series data and models that are almost the same. Although the data sets employed are different, the similarity of the estimation results implies that the BIR data on removals and the USDA database are similar sources of data on aggregate cigarette consumption.

Results in the Philippines, like in other Southeast Asian countries, support the relative inelasticity of demand for cigarettes. It can be expected that increases in cigarette prices due to increases in tax will decrease consumption and at the same time potentially increase government revenue.

For simulations on the impact of tax increase, the authors choose the price elasticity equal to -0.235 as estimated by the DOF as it is closest to the price elasticity estimates of majority of the Southeast Asian countries, and it is consistent with what the DOF uses in drafting proposals for policy makers. It is also the most updated time series estimation for the Philippines.

<sup>&</sup>lt;sup>248</sup> In the Tobacco Tax Forum organized by HealthJustice in December 2009, Stela Montejo, the DOF representative, presented the DOF study on excise tax reform. The study uses time series data from 1988 to 2008 with the following regression model:

(4)	$\ln(\text{Cigarettes1}_i) = \alpha_0 + \alpha_1 \ln(\text{Price1}_i) + \alpha_2 \ln(\text{Income1}_i) + \epsilon$
where	In(Cigarettes1), consumption of cigarettes per capita (in log)
	In(Price1), tobacco CPI (in log)
	In(Income1), real GDP per capita (in log)
	ε, error term.

For the data on consumption of cigarettes, the DOF uses the BIR data on removals for cigarettes. The tobacco CPI, real GDP and population are taken from the NSO. Population used in computing for consumption per capita is the population of individuals aged 15 years old and above while population used in computing for income per capita is the total population.

Using the above-mentioned model, the DOF study estimates the price elasticity of demand for cigarettes equal to -0.235. Similar to the results of the DOH study, this means that cigarette consumption is relatively not responsive to changes in price.

# 2. Model

This subsection discusses the model used to project the possible impact of excise tax increases on cigarette consumption, smoking prevalence and government revenue. The first describes the parameters used in estimating the impact of tax increase on consumption and smoking prevalence. The second presents the model used to estimating changes in government revenue due to changes in cigarette excise tax.

# 2.1 Impact of Tax Increase on Consumption and Smoking Prevalence

To compute for change in consumption due to a change in tax, the change in gross retail price due to a change in tax is determined first. The following equation shows how the gross retail price of cigarettes is computed in the Philippines.

(1) Gross Retail Price = (Net Retail Price + Excise Tax) × (1 + VAT Rate)

Hence, there should be information on the net retail price (NRP) of cigarettes, amount of excise tax, and VAT rate. Excise tax is equal to the proposed excise tax while VAT rate is equal to 12 percent in the Philippines. Data on the current NRP of cigarettes are derived by using equation (1) and solving for NRP.

(2) Net Retail Price = [Gross Retail Price ÷ (1 + VAT Rate)] – Excise Tax Once the percentage change in GRP has been computed, the point elasticity method is applied to estimate the change in consumption due to a change in price caused by a change in excise tax. The following equation shows the computation for the change in consumption.

(3) % Change in Consumption = Price Elasticity × % Change in Price

Computations for the change in GRP and consumption are done by cigarette price classification. Hence, GRP refers to the average GRP per price classification. See Annex B for data on consumption levels and average GRP per price classification.

To compute for the change in smoking prevalence, the following equation is applied.

(4) % Change in Smoking Prevalence = % Change in Consumption × 0.35

This is based on past studies that suggest that 40 to 50 percent of the change in consumption is from changes in smoking prevalence<sup>249</sup>. However, to generate more conservative estimates, the authors choose to settle with a 35 percent change in consumption due to changes in smoking prevalence.

The potential number of lives saved as a result of smokers quitting is computed using the following equation.

(5) Number of Lives Saved = Number of Quitters  $\times$  0.35

This is based on the study that estimated that lives equivalent to 35 percent of the number of smokers who quit will be saved.<sup>250</sup>

<sup>&</sup>lt;sup>249</sup> F.J Chaloupka, T. Hu, K.E. Warner, R. Jacobs, and A. Yurekli, *The Taxation Of Tobacco Products* (2000) *in* P. Jha and F.J. Chaloupka (Eds.), TOBACCO CONTROL IN DEVELOPING COUNTRIES 237 – 272 (New York: Oxford University Press 2000).

<sup>&</sup>lt;sup>250</sup> C. Van Walbeek, A Simulation Model To Predict The Fiscal and Public Health Impact of a Change in Cigarette Excise Taxes. 19 (1) <u>TOBACCO CONTROL</u>, 31–36 (2010).

# 2.2 Impact of Tax Increases on Government Revenue

In estimating the impact of tax increases on government revenue, the projected change in consumption is employed in estimating the new level of cigarette consumption after the tax increase. Government revenue is then computed by multiplying the new level of consumption per price classification by the corresponding new excise tax.

#### ANNEX B Data and Data Sources for Impact Projection

A brief discussion on the data employed for projecting the impact of tax increases is presented here. This begins with the projection of aggregate cigarette consumption and the derivation of cigarette prices. Data on smoking prevalence and projection of revenue from excise taxes in the Philippines are also discussed here.

#### 1. Consumption

Data on cigarette consumption are based on the BIR data on removals for cigarettes from 1993 to 2009. Since data on cigarette consumption for 2010 and 2011 are not available, the authors made projections for cigarette consumption for the said years based on the historical growth of cigarette consumption. Figure 1 shows the trend for consumption of cigarettes in the Philippines based on the BIR data on removals.

# Figure 5: Annual Number of Cigarette Packs (in 20s) Consumed Based on BIR Removals Data



From 2004 to 2009, a distinct trend for cigarette consumption can be seen, which can be matched directly to the years when RA 9334 took effect. This trend clearly shows how consumption based on removals responds to increases in taxes. The trend consistently shows that an increase in consumption and a drop in consumption occurs prior to and during the years when excise tax is increased (2005, 2007 and 2009), respectively. According to the DOF, as mentioned during the Tobacco Tax Forum organized by HealthJustice in December 2009, this indicates that front-loading is being done by tobacco companies in years prior to a cigarette tax increase.

In order to account for the variance and front-loading based on the 2004 to 2009 trend for cigarette consumption, the authors estimate consumption for 2010<sup>251</sup> by averaging the positive growth rates<sup>252</sup> leading to all the peaks and applying this average to the actual 2009 consumption based on removals. In estimating consumption for 2011<sup>253</sup>, the average negative growth rate<sup>254</sup> for the years leading to all the troughs is obtained and applied to the projected consumption for 2010.

In estimating cigarette consumption per price class for 2011, the 2009 actual volume shares of each price classification are applied to the projected 2011 aggregate cigarette consumption based on removals. See Table 18 for the 2009 volume shares and projected volumes per price classification.

<sup>&</sup>lt;sup>251</sup>Cigarette consumption for 2010 is estimated at 4.67 billion packs of cigarettes.

<sup>&</sup>lt;sup>252</sup> The average positive growth rate is 14.26 percent.

<sup>&</sup>lt;sup>253</sup> Cigarette consumption for 2011 is estimated at 4.06 billion packs of cigarettes.

<sup>&</sup>lt;sup>254</sup> The average negative growth rate is 13.13 percent.

# Table 20: Volume Share and Projected Consumption perPrice Classification

Price Classification	2009 Volume Share (%)	2011 Projected Consumption (Packs)
Low	55.64	2,257,127,103
Medium	12.53	508,405,019
High	30.96	1,255,899,388
TOTAL	100	4,056,694,255

Note that the premium-priced classification is not included in the estimations due to unavailability of data. Nevertheless, this will not significantly alter the results of the projections since the premium-priced brands only compose 1.2 percent<sup>255</sup> of the total market for cigarettes.

# 2. Cigarette Prices

Retail prices of cigarettes for 2011 are estimated from the 2010 prices, which are obtained from the NSO's monthly price survey from January to March 2010. The NSO monitors prices of goods from 88 provinces and key cities on a monthly basis for the computation of the CPI. Sample outlets, where prices are collected, are chosen based on their popularity, consistency and completeness of stock, permanency, and accessibility.

In estimating the retail prices of cigarettes for 2011, the average price of cigarette per price classification in 2010 is computed to get the current

<sup>&</sup>lt;sup>255</sup> ERC Group, World Cigarettes. London: p. 10 (2007).

NRP of cigarettes. The average price is derived by averaging the retail prices of brands<sup>256</sup> per price class from all provinces and key cities included in the survey, excluding packs in thirties. The NRP is computed using equation (2) of Annex A while the 2011 GRP is computed using the derived NRP and the excise tax amount for 2011. See Table 19 for data used in estimating the average price of cigarettes for 2011.

Price Classification	2010 Average GRP (PhP)	2010 Excise Tax (PhP)	2010 Average NRP (PhP)	2011 Excise Tax (PhP)	2011 Estimated Average GRP (PhP)
Low	10.90	2.47	7.26	2.72	11.18
Medium	19.29	7.14	10.08	7.56	19.76
High	29.68	11.43	15.07	12.00	30.32

# Table 21: Data Used in Estimating the 2011 Average Price of Cigarettes

# 3. Smoking Prevalence

Based on the 2009 GATS in the Philippines, 17.3 million Filipinos aged 15 years old and above are smoking. That is equivalent to a smoking prevalence rate of 28.3 percent. Simulations for changes in smoking prevalence are based on this most recent smoking prevalence rate.

<sup>&</sup>lt;sup>256</sup> Brands for which the price and price class data are available are the following in alphabetical order: Boss, Camel, Champion, Evergreen, Fortune, Hope, Liberty, LA Menthol, Mark, Marlboro, Miller, More, Peak, Philip Morris, Plaza, West Point, Winston, and Winter. Eighteen (18) brands are included all in all. For price classification of brands, see Annex D of RA 8424.

# 4. Excise Tax and Government Revenue

The estimation for government revenue is based on the projected cigarette consumption for 2011. To compute for excise tax revenue for each price classification, the projected cigarette consumption per price classification is multiplied by the corresponding excise tax as stipulated in RA 9334. See Table 19 for the schedule of 2011 excise taxes and Table 20 for the projected government revenues from cigarette excise tax.

Price Classification	2011 Projected Excise Tax Revenue (PhP)
Low	6,139,385,720.01
Medium	3,843,541,940.42
High	15,070,792,657.88
TOTAL	25,053,720,318.31

Table 22: 2011 Projected Excise Tax Revenues

Addressing the imbalance between earmarked taxes for health and those for tobacco growing LGUs is crucial. It is clear that health funding needs to be increased. In the same vein, finding the best way to utilize the funds for health promotion and to ensure that these are not misused is critical. Corollary to this is a need to determine the amount required to achieve the desired objectives and identify the proper institution that will conduct health promotion in the country.

# ANNEX C Background of Health Promotion

In 1986, the first international health promotion conference was held in Ottawa, Canada. The Ottawa Charter for Health Promotion defined health promotion as the process of "enabling people to increase control over and improve their health." It also explained that in order for individuals to reach a state of complete physical, mental, and social well-being, they must be able to identify and to realize aspirations, to satisfy needs, and to change or cope with the environment."

The Ottawa Charter identified five action areas:

- 1) Development of a health public policy,
- 2) Creation of a supportive environments for health,
- 3) Strengthening community action,
- 4) Development of personal skills, and
- 5) Reorientation of health services.

The participants in the Ottawa Conference pledged a commitment to health promotion through the following actions:

- To move into the arena of healthy public policy, and to advocate a clear political commitment to health and equity in all sectors;
- To counteract the pressures towards harmful products, resource depletion, unhealthy living conditions and environments, and bad nutrition; and to focus attention on public health issues such as pollution, occupational hazards, housing, and settlements;
- To respond to the health gap within and between societies, and to tackle the inequities in health produced by the rules and practices of these societies;

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- To acknowledge people as the main health resource; to support and enable them to keep themselves, their families, and friends healthy through financial and other means, and to accept the community as the essential voice in matters of its health, living conditions, and well-being;
- To reorient health services and their resources towards the promotion of health; and to share power with other sectors, other disciplines and, most importantly, with people themselves;
- To recognize health and its maintenance as a major social investment and challenge; and
- To address the overall ecological issue of our ways of living.

The World Health Assembly recognized that comprehensive approaches that combine the five strategies identified by the Ottawa Charter are the most effective and that health promotion is a "key investment" and an essential element in health development.<sup>257</sup>

Succeeding Conferences in Health Promotion were essential in defining the key focus areas of health promotion. In Adelaide (1988), the concept of "healthy public policy" was introduced. "Healthy public policy" is characterized by an explicit concern for health and equity in all areas of policy and by accountability for health impact. The main aim of healthypublic policy in health is to create a supportive environment to enable people to lead healthy lives.<sup>258</sup> In Sundsvall, Sweden (1991), participants in the conference established the importance of supportive environments for health, referring to both the physical and the social

<sup>&</sup>lt;sup>257</sup> WHA Resolution 51.12 (Health Promotion).

<sup>&</sup>lt;sup>258</sup> Adelaide Recommendations on Healthy Public Policy, Second International Conference on Health Promotion, Adelaide, Australia (1988).

aspects of our surroundings.<sup>259</sup> In Jakarta (1997), participants recognized that health promotion has a marked impact on the determinants of health so as to create the greatest health gain for people, to contribute significantly to the reduction of inequities in health, to further human rights, and to build social capital. Thus, participants committed to draw upon the widest possible range of resources to tackle health determinants in the 21<sup>st</sup> century.<sup>260</sup> In Mexico (2000), placing health promotion was recognized as a fundamental component of all public policies and programs in all countries in the pursuit of equity and better health for all. Lastly, in Bangkok (2005), participants drafted the Bangkok Charter for Health Promotion, which identified actions, commitments, and pledges required to address the determinants of health in a globalized world through health promotion. The Bangkok Charter identified four key commitments for the promotion of health, to wit:

- 1. Make the promotion of health central to the global development agenda.
- 2. Make the promotion of health a core responsibility for all government.
- 3. Make the promotion of health a key focus of communities and civil society.
- 4. Make the promotion of health a requirement for good corporate practice.

<sup>&</sup>lt;sup>259</sup> Sundsvall Statement on Supportive Environment for Health (1991).

<sup>&</sup>lt;sup>260</sup> Jakarta Declaration on Leading Health Promotion into the 21st Century [1997].

#### ANNEX D

Annex D of RA 8424 (Tax Reform Act of 1997) showing the brands covered by Fortune Tobacco. Philip Morris brands were previously manufactured by La Suerte under a license.

Manufacturer	Brands	Current AVT /Pack (Php)	Net Retail of VAT & EXT per pack (Php)
GRAND TOTAL	50		1.00
	55%		
Fortune Tobacco	Camel KS	5.34	4.71
Fortune Tobacco	Salem M 100	6.96	4.67
Fortune Tobacco	Salem M King	5.34	4.82
Fortune Tobacco	Winston Lts. KS	5.85	5.44
Fortune Tobacco	Winston Red KS	5.85	5.55
La Suerte	Marlboro Lts. KS	6.51	6.82
La Suerte	Marlboro Lts. M KS	6.51	6.84
La Suerte	Marboro Red KS	6.51	6.78
La Suerte	Phillip Morris KS	6.26	7.39
La Suerte	Phillip Morris M 100's	7.45	7.48
No. of Brands	No. of Brands 10		
	Subtotal	6.24	6.05
	45%		
Fortune Tobacco	Champion Int'l.	3.49	5.51
Fortune Tobacco	Champion M 100	3.25	4.56
Fortune Tobacco	Hope Lux. M 100's	4.85	7.37
Fortune Tobacco	Hope Lux. M KS	3.69	5.86
Fortune Tobacco	Mark M 100's	3.49	5.66
Fortune Tobacco	Mark M King	3.21	6.33
Fortune Tobacco	More Premium Int'l.	3.25	5.37
Fortune Tobacco	More Premium M 100's	3.25	5.29
Fortune Tobacco	Montreal F King	3.25	6.29
Sterling Tobacco	Bowling Green M 100's	2.54	7.00
No. of Brands	10		
	Subtotal	3.40	5.92
	20%		

Fouture Takesee	Decc VC	0.00	4.10
Fortune Tobacco	DUSS KS	0.90	4.10
Fortune Tobacco	Champion Lts. KS	0.90	4.45
Fortune lobacco		0.95	4.//
Fortune lobacco	Evergreen M 100 s	0.84	3.93
Fortune lobacco	Fortune Int I. M KS	0.76	4.46
Fortune Tobacco	Jackpot M 100's	0.78	3.99
Fortune Tobacco	Liberty M 100's	0.78	4.47
Fortune Tobacco	Peak M 100's	0.90	4.03
Fortune Tobacco	Plaza M 100's	0.84	4.89
Fortune Tobacco	Westpoint KS	0.84	4.89
Fortune Tobacco	Winter M 100's	0.78	3.99
La Suerte	Cannon M 100's	0.93	6.15
La Suerte	Cannon M KS	0.90	5.01
La Suerte	Forbes KS	0.90	5.14
Sterling Tobacco	Miller Int'l. M 100's	0.64	4.58
Sterling Tobacco	Morgan Int'l. M 100's	0.89	7.43
Sterling Tobacco	Stork Int'l. M 100's	0.72	4.28
Sterling Tobacco	Stork Special Lts. M 100's	0.64	4.61
Sterling Tobacco	Union American Blend	1.09	4.64
Sterling Tobacco	Union KS	0.92	4.80
Anglo American	Asia Boston KS	0.41	3.80
Anglo American	Canadian Club M 100's	0.41	3.91
Anglo American	Navy Club KS	0.41	4.25
Anglo American	Rambo M 100's	0.63	3.46
Anglo American	Spotlight M 100's	0.46	2.89
Anglo American	Triple A Freedom M 100's	0.51	3.28
Mighty Corp	Blue Seal M 100's	0.46	3.41
Mighty Corp	Gallo KS	0.44	2.60
Mighty Corp	L.A. Special M 100's	0.45	2.81
Mighty Corp	Marvel M 100's	0.46	3.02
Mighty Corp	Marvel Red KS	0.50	3.11
Mighty Corp	Right M 100's	0.47	3.39
No. of Brands	32		
	Subtotal	0.69	4.20

#### ANNEX E

# The table illustrating the decreasing effective tax burden of cigarettes

Brand	2004 Retail Price	2004 Tax Rate	Effective Burden (Tax/ Price)	2008 Retail Price	2008 Tax Rate	Effective Burden (Tax/ Price)
А	PhP8.32	1.12	14%	PhP30.00	2.23	8%
В	PhP18.21	5.85	33%	PhP39.50	6.79	18%
С	PhP16.52	5.60	34%	PhP30.75	6.74	22%
D	PhP13.93	5.60	41%	PhP17.65	6.74	39%
E	PhP18.77	8.96	48%	PhP31.00	10.88	35%
F	PhP22.15	8.96	41%	PhP30.00	10.88	37%
G	PhP22.71	8.96	40%	PhP30.00	10.88	37%

#### ANNEX F

#### Table 25. Mortality: Ten (10) Leading Causes

#### (Department of Health)

# Number and rate/100,000 Population Philippines 5-Year Average (2000-2004) and 2005

Cause	5 Year A (2000-	verage 2004)	2005*	
	Number	Rate	No.	Rate
1. Diseases of the Heart	66,412	83.3	77,060	90.4
2. Diseases of the Vascular system	50,886	63.9	54,372	63.8
3. Malignant Neoplasm	38,578	48.4	41,697	48.9
4. Pneumonia	32,989	41.4	36,510	42.8
5. Accidents	33,455	42.0	33,327	39.1
6. Tuberculosis, all forms	27,211	34.2	26,588	31.2
7. Chronic lower respiratory diseases	18,015	22.6	20,951	24.6
8.Diabetes Mellitus	13,584	17.0	18,441	21.6
9. Certain conditions originating in the perinatal period	14,477	18.2	12,368	14.5
10. Nephritis, nephrotic syndrome and nephrosis	9.166	11.5	11,056	3.6

Note: Excludes ill-defined and unknown causes of mortality (R00-R99) n=23,235

\* reference year

\*\* External Causes of Mortality

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