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CIGARETTE EXCISE TAX IN KENYA – THE WAY FORWARD

POLICY BRIEF
TOBACCO TAX

Summary statement

The objective of this Brief is to examine the effects of tobacco excise taxes on cigarette excise revenue in Kenya through its impacts on prices and consumption of cigarettes. We examine the current tiered specific excise tax structure in comparison to a uniform specific tax structure (see Box 1). The uniform tax is considered a best-practice tobacco tax policy globally.

Governments across the globe face adverse consequences of tobacco use and over 7 million people die annually from tobacco-caused diseases. In Kenya, more than 8,100 individuals die annually. As a result, there are both global and domestic initiatives to control the use of tobacco. Local initiatives include the Tobacco Control Act of 2007 and the National Tobacco Control Action Plan 2010-2015. These initiatives require sufficient financial resources for their effective implementation and domestic revenue mobilization becomes an important avenue to address financing gaps in the envisaged interventions.

Although taxation is the most effective tool to not only control tobacco use but also to generate revenue to the government, the choice of a tax structure presents difficult options for governments. From our review and findings, a uniform specific tax structure for tobacco is superior to a tiered tax structure. A uniform tax:

- Enhances effectiveness of tax administration since it is a more simplified tax system.
- Limits incentives for reducing non-compliance by producers and for substitution by users.
- Restricts incentives for introduction of pricing strategies that reduce tax liability – by producers. Further, the simulation results of this study indicate that:
- The uniform tax would result in relatively higher prices for the low-end products and would thus be more effective in reducing tobacco use among the most vulnerable groups such as the youth and lower income households. Thus, a uniform tax is more likely to curtail initiation of smoking by the youth.
- Movement from the current tiered specific tax to a uniform structure shall be potent if the uniform tax rate exceeds Ksh. 2,470 per 1000 cigarettes (or Ksh. 2.47 per cigarette).
- Cigarette excise tax revenue would increase even if the uniform rate is increased to a 75 percent share of the retail price of cigarettes which is estimated at Ksh. 18.5 per cigarette. As an example, a uniform tax rate of Ksh. 3,500 per 1000 cigarettes (or Ksh. 3.5 per cigarette) would increase cigarette excise tax revenue from about Ksh. 12.1 billion (in 2019/20) to Ksh. 16.5 billion annually.

The uniform tax rate has the potential of reducing cigarette use especially among the poor and at the same time increase excise revenue for the government. The reduced consumption will ultimately reduce the tobacco-caused diseases and other negative socio-economic and environmental impacts.

Box 1: Tobacco tax systems and structures

Tobacco taxes can be specific taxes, ad valorem taxes, or some combination of the two (mixed systems). Specific excise is charged per unit sold and an example is a tax of Ksh. 1,200 per 1,000 cigarettes (or Ksh. 1.2 per cigarette). These taxes can either be uniform or tiered (differentiated). An excise tax is uniform if the same rate or value apply to all product types regardless of different characteristics such as filtered or non-filtered cigarettes. An excise tax is said to be tiered if a differentiated value or rate applies to different product types. Ad valorem is Latin for "according to value" and as the name suggests is levied on a fixed percentage of the value of a good or service – such as 35% rate.

Introduction

Tobacco use and the effects of exposure to second-hand smoke are now known to have adverse health, social, environmental and economic consequences on humanity. Tobacco use is linked to non-communicable diseases (NCDs) and is the single most preventable cause of death in the world today. It is estimated that global deaths exceed 7 million annually while more than 8,100 die in Kenya as a result of tobacco-caused diseases.

From a policy perspective, the control of tobacco use is important for achieving the Sustainable Development Goals (SDGs) adopted by Kenya and other United Nations member states in 2015. As examples, tobacco control is important for reduction of extreme poverty (SDG Goal 1) and promotion of good health and wellbeing (SDG Goal 3) – through reducing premature mortality from NCDs by one third (SDG target 3.4). Tobacco taxation is also important in generating resources for achieving universal health coverage by 2030 (SDG target 3.8).

Issues

The government of Kenya has over time put in place institutions, policies and reforms for controlling use of tobacco. A key institution is the Tobacco Control Board established under section 5 of the Tobacco Control Act of 2007 with a key mandate of advising the government. The main policies put in place are guided by the WHO FCTC which Kenya ratified in 2005. These policy tools include the Tobacco Control Act of 2007; the Tobacco Control Regulations, 2014; the National Policy on Tobacco Control; and the National Action Plan on Tobacco Control.

However, amidst these tools, Kenya is still one of the highest consumers of tobacco in sub-Saharan Africa (SSA) in per person terms. In addition, insufficient financial resources for tobacco control is one of the most frequently reported constraints affecting operations of established institutions and the implementation of interventions on tobacco control. This implies the need to enhance domestic resource mobilization – among other interventions. Numerous studies indicate that tax policy is a key avenue for resource mobilization. Specifically, higher taxes on tobacco products is the most effective tool in reducing tobacco consumption and consequently improving public health while also increasing government revenues that can be used to fund priority national investments and programmes. Studies also show that not all taxes are equal – necessitating the need to carefully design the most appropriate taxes.

Evidence suggests that Kenya is still grappling for answers regarding an improved tax structure for cigarettes that ensures achievement of public health objectives without compromising tax revenues. Although a uniform specific tax rate is known to be superior to a tiered tax (see Box 2), Kenya still applies a tiered or differentiated excise tax for cigarettes. The choice of the most appropriate tax can lead to the desired result of reducing consumption of tobacco, curtailing non-communicable diseases and promoting public health in general (WHO, 2011). Effective taxation may also provide the needed resources to reduce the estimated Ksh. 200 billion gap in financing universal health coverage and covering the societal costs of tobacco use estimated at Ksh. 2.978 billion annually. ,

Other pertinent issues to stakeholders including government are the impacts of taxes on employment, health and smuggling. These issues are also briefly discussed in this brief.

Box 2: Merits of a uniform specific tax over a tiered tax

- Enhances effectiveness of tax administration since it is a more simplified tax system.
- Limits incentives for reducing non-compliance by producers and for substitution by users.
- Restricts incentives for introduction of pricing strategies that reduce tax liability – by producers.

Methodology

The study applies a simulation approach using the WHO Tobacco Tax Simulation Model (TaXSiM). Simulations are the standard approaches available to answer "what if" questions regarding changes in tax structure. The tax structure for the year 2019 is used as the benchmark over which changes are assessed (see Box 3).

Simulation Scenarios and Results

The effects of the type of excise taxes on cigarettes are analyzed by two broad simulation scenarios. The simulations assume that:

1. The benchmark scenario is the tiered tax that prevailed for most of the year 2019, which was an excise tax of Ksh. 1,895 for cigarettes without filters and Ksh. 2,630 for cigarettes with filters.
2. In scenario 1, we assume that the tax authority introduces a uniform specific tax of Ksh. 2,446 per 1,000 cigarettes (or Ksh. 48 per pack of cigarettes) rather than maintaining a specific tiered tax. The Ksh. 2,446 is a weighted average of the tiers.
3. In scenario 2, we assume the tax authority introduces a uniform tax of Ksh. 3,500 per 1,000 cigarettes (or Ksh. 70 per pack of cigarettes) in place of the tiered tax. We also examine the effects of higher uniform rates. All the tax rates examined are within the recommended 75 percent share of excise tax on cigarettes retail price.

Box 3: Recent Tax Structure in Kenya

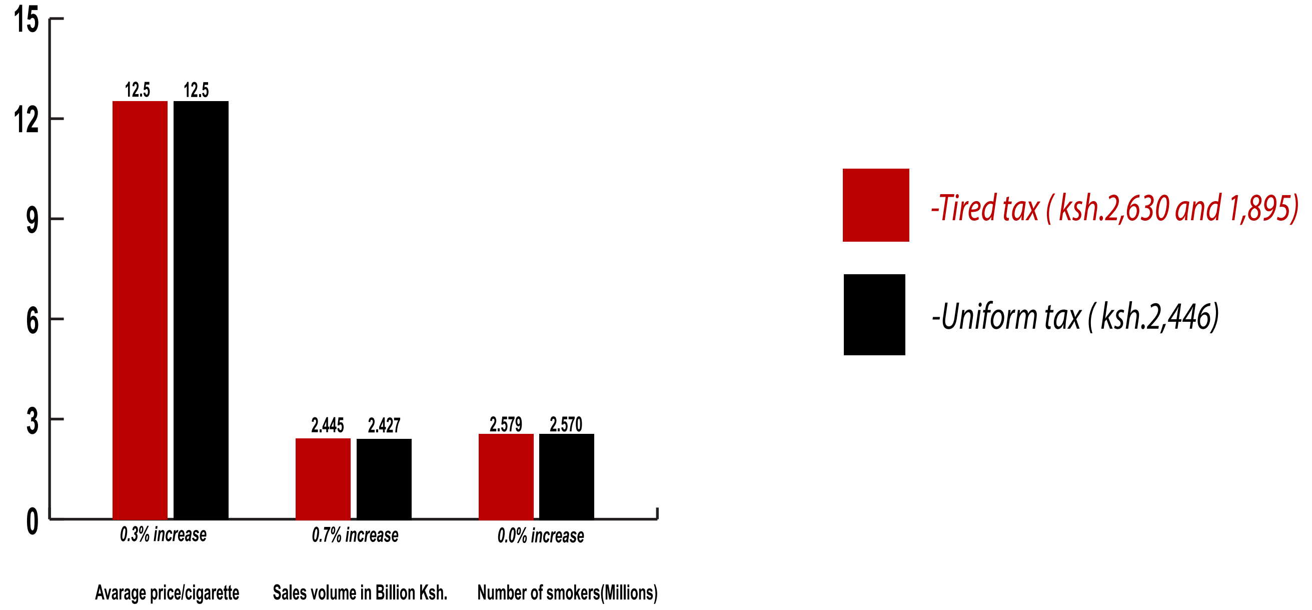
The tax structure that prevailed for most of 2019 can be traced back to 2017 when cigarettes with filters (hinge lid and soft cap) were taxed at a rate of Ksh. 2,500 per thousand cigarettes (or 2.5 per cigarette). This rate was adjusted upward following the Legal Notice No. 164 of 2018 to Ksh. 2,630 in August 2018. On the other hand, the same Legal Notice adjusted excise rates for cigarettes without filters (plain cigarettes) from Ksh. 1,800 per thousand cigarettes in 2017 to Ksh. 1,895 in 2018. These 2018 rates were applicable until 1st July 2019 before Legal Notice No. 109 of 2019 came into effect.

Benchmark scenario: In the baseline scenario (i.e. 2019) the excise tax was Ksh 1,895 for cigarettes without filters and Ksh. 2,630 for cigarettes with filters. The average retail price of the most common brand was Ksh. 250 per pack. Cigarette consumption is estimated at 2.445 million packs. Cigarette Excise revenue was Ksh. 12.081 billion from the simulation (and was comparable to the Ksh. 12.236 billion reported in the Economic Survey, 2020). Excise tax was 35.6 percent share of the retail price of cigarettes against a WHO recommended minimum benchmark of 75 per cent.

Scenario 1:

Introducing a uniform tax rate of Ksh. 2,446 per thousand cigarettes or Ksh. 48.9 per pack: If the government introduces a uniform specific tax of approximately Ksh. 50 per pack (or US$0.50 per pack), the retail price of the most common brand will increase to Ksh. 250.75 per pack (or by 0.3 percent). The tax share in the retail price will remain about the same (at 35.5%). Cigarette consumption will reduce by 0.7 percent (or by 18.3 million packs). Excise tax revenue is expected to decrease by 0.7 percent (or by Ksh. 89.2 million) (Figure 1).

Figure 1: Effects of introducing a uniform tax of Ksh. 2,446



The number of smokers will reduce only slightly (by 9,642). These results are expected since although the uniform tax of Ksh. 2,446 increased the tax burden for the poorest consumers it reduced the burden for the premium segment of smokers. The simulations indicated that for the excise revenue to increase from the base scenario of the tiered tax, the uniform specific tax rate must exceed about Ksh. 2,470 per 1,000 cigarettes.

Scenario 2:

Introducing a uniform tax of Ksh. 3,500 per thousand cigarettes or Ksh. 70 per cigarettte pack

The rationale of applying this higher tax is to move closer to the WHO recommended benchmark of a minimum of 75 percent share of excise tax on retail price. In this scenario, the average retail price of cigarettes is expected to increase by 12.2 percent. The excise tax share of the retail price is 42.1 percent. Cigarette consumption is estimated to decrease by 5 percent (or by about 112.0 million packs). The smoking prevalence for the population reduces from 8.3 percent to 8.1 percent while the number of smokers reduces by 59,056 (or by 2.3 percent). Excise revenue is expected to increase by 37 percent (or by about Ksh 4.4 billion) (Figure 2). The tax burden increases for all categories of smokers but increasingly so for the the lower end of the market.

Figure 2: Effects of introducing a uniform tax of Ksh. 3,500

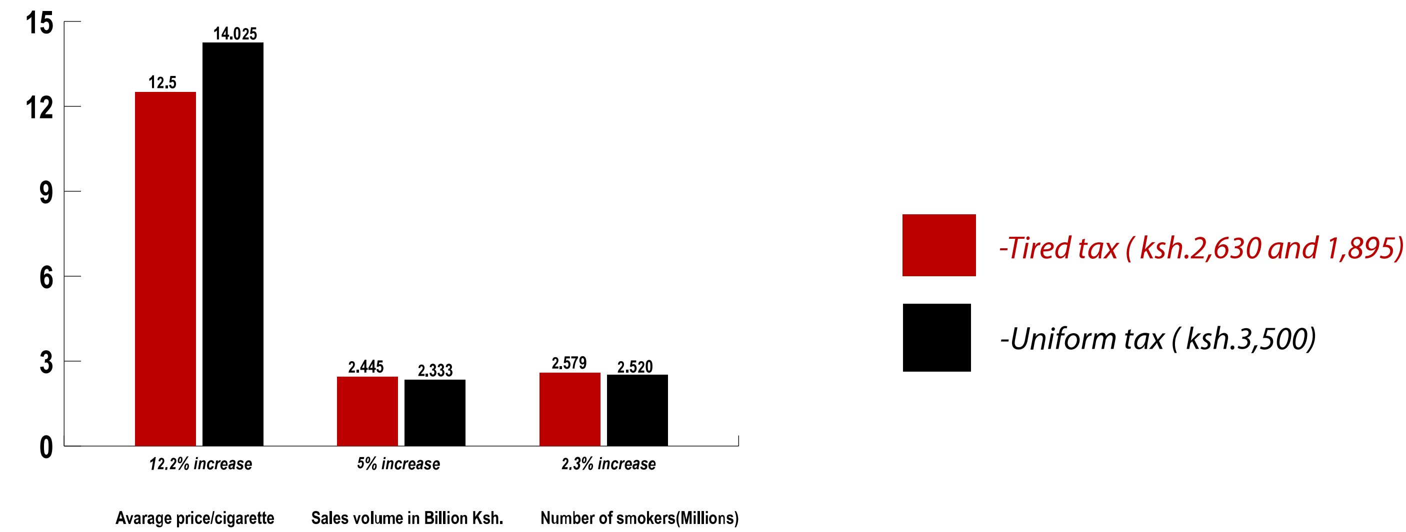
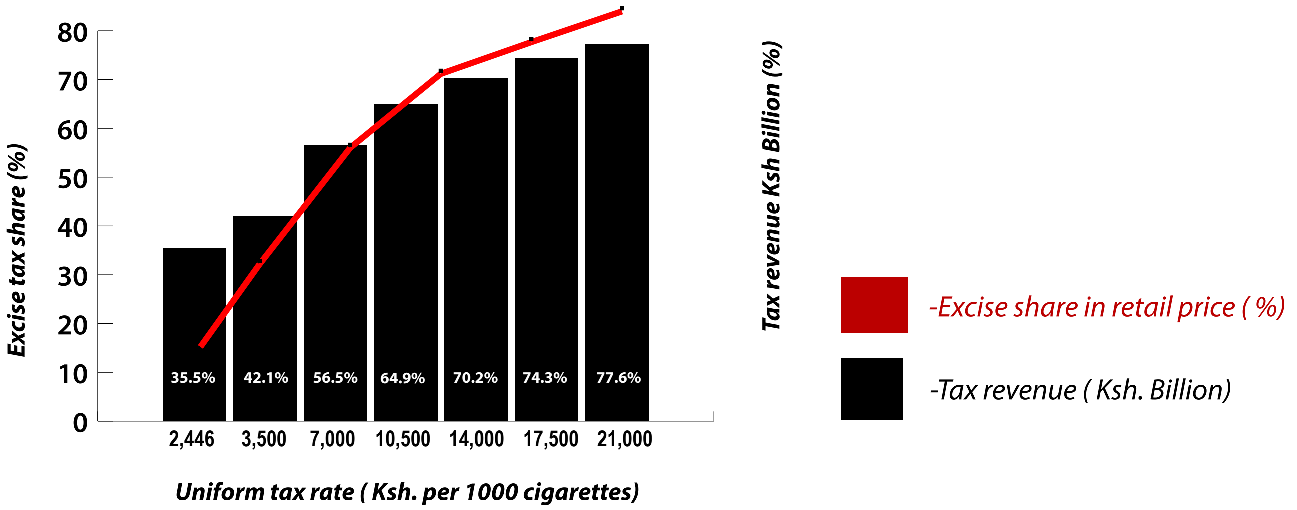


Figure 3

examines the effect of higher uniform taxes on: (i) the share on tax to the retail price of cigarettes; and (ii) impacts on excise revenue. Increasing the uniform tax from Ksh. 2,446 to Ksh. 21,000 per 1,000 cigarettes increases the share of tax unambiguosly. The recommended minimum of 75 percent share of tax in retail price of cigarettes is achieved for a uniform tax rate just above Ksh. 10,500 per thousand (or 10.5 per cigarette) (Figure 3). This suggests that there is room to increase the excise tax on cigarettes and still accrue larger excise revenues.



Employment and health issues in tobacco control

Questions usually arise among policy makers regarding health and employment effects of taxation in the tobacco value chain. It is important to note that the negative impacts of tobacco production and use are known to outweigh any potential employment benefits.

- There is no evidence from existing literature that suggest that tobacco growing benefit tobacco farmers. Indeed, both farmers and consumers are victims rather than beneficiaries of the sector.
- Employment in manufacture of tobacco products is negligible in Kenya. Between 2015 and 2019 it accounted for an average of 0.43 percent of the total employment in the manufacturing sector in Kenya. This averaged 1,474 persons annually.

- The global community, in law and practice, is encouraging crop substitution away from tobacco. Indeed, the WHO Framework Convention on Tobacco Control (for which Kenya is a signatory) in Article 17 provides that countries 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 individual sellers. This is a protective measure against effects of tobacco on global health and wellbeing.

As for health impacts, it is estimated that the economic cost of smoking in Kenya amounts to Ksh. 2.98 billion annually (Drope et al, 2018).i This includes direct costs related to healthcare expenditures and indirect costs related to lost productivity due to early mortality and morbidity. The health cost is a fundamental reason used to justify relatively high taxation of tobacco products. The advantage of the uniform tax is that it increases the relative price of tobacco among the low-income households thus reducing consumption among those who are less likely to afford medical care.

Conclusion and recommendation

It is evident that the current cigarette prices can be increased with the added advantages of increasing excise revenue and reducing consumption. The share of excise tax on total price of cigarettes is about half the recommended 75 percent share suggesting significant room to increase excise taxes.

There is need for the national treasury and planning to reform the tax structure to conform to best practice in tobacco control – by introducing a uniform tax rate. To have an impact on excise tax revenue the uniform tax rate should exceed Ksh. 2,470 per thousand cigarettes. The simulations indicate that Kenya would have an additional 4.4 billion by applying a uniform tax of Ksh 3.5 per cigarette. This tax will supplement other regulations currently in place to reduce tobacco use such as; smoke free-zones, prohibition in advertising and promotion of tobacco products, graphic health warnings, and sale restrictions.

But there are genuine concerns about regional effects of a large tax increase. We recommend that a relatively large increase in tax be implemented in a regional context/approach. The potency of the new tax structure will hinge on international cooperation between Kenya and its neighbours within the East African Community (EAC) and the Common Market for Eastern and Southern Africa (COMESA) trading blocs. Although the share of excise tax varies across the countries, there is need to carefully analyze other important parameters including relative affordability of cigarettes given the varying per capita incomes.

The advocacy work by local stakeholders should therefore embrace a regional approach that is extended to the EAC and COMESA regions to curtail arguments of the industry against such a move.

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