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Tobacco taxation in West Africa : Overview issues and options for tobacco control

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Tobacco taxation in West Africa:
Overview, issues and options for tobacco control

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Abstract:

Background: Since the World Health Organization Framework Convention on Tobacco Control (WHO FCTC), tobacco taxation has emerged at the heart of effective tobacco control. The Article 6 of the Convention recommends that Parties should "implement tax policies (…) on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption". A large volume of literature now concurs that raising taxes to increase the price of tobacco products is one of the most effective means to curb tobacco consumption.

Objective: We review the current state of tobacco taxation in the West Africa region against the objective of Article 6 of the WHO FCTC. The scope of our review is threefold. First, we provide an overview of both *de jure* and *de facto* tobacco taxation in West Africa. Second, we point out and critically analyses policy changes that policy makers should adopt in raising taxes to increase the price of tobacco products. Finally, we draw attention to and discuss policy options that may help in achieving a more effective taxation of tobacco products in the region.

Method: We used data from the "Tobacco Taxation Country Profiles" produced recently by the *Consortium pour la Recherche Economique et Sociale* (CRES). We summarize and synthesize these data, and we build on existing literature to guide our assessment of the current tobacco taxation policies and practices in the West Africa Region.

Key findings and policy recommendations: Consistent with economic integration agreements, policies for the taxation of tobacco products in West Africa are governed by Community Directives. But these Directives provide for flexibility in their application by Member countries, which implies that the current policies and practices in the taxation of tobacco products are the result of both regional and national legislation. Our review highlighted three features that threaten the objectives of tobacco control: the ad valorem basis of levying excise duty as pursuant to the Community Directives; the differentiated rates for the excise duty in many countries; and the relatively low levels of excise tax rates in most of the countries.

We argue that the Community Directives on tobacco excise tax should evolve towards allowing a mixed excise tax structure, whereby Member countries must levy a specific excise tax calculated per unit of the product, in addition to an ad valorem excise tax calculated as a proportion of an adequate tax base. Also, Member countries should apply uniform excise rate on all tobacco products, and should increase the rates of excise duty so that the share of tobacco taxes account for at least 70 percent of retail prices, as recommended by the WHO. We note that Community Directives can help this happen by requiring explicitly that Member countries must apply uniform rates of the excises; and by raising the minimum of and removing the "upper limit" on the applicable excise duty rates. Finally, we emphasize the need to find ways of ensuring that all national tobacco taxation policies comply with the relevant regional Directives.

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Introduction

Raising taxes to increase the price of tobacco products is largely viewed as one of the most effective and cost-effective way to reduce tobacco consumption. Yet, as noted by the 2013 WHO Report on the Global Tobacco Epidemic, this measure remains the least likely to be established. This study seeks to provide information that may help in promoting the implementation of effective tobacco tax measures in the West Africa region. Yet, some of the issues addressed in this study are relevant to other developing countries as well.

The countries of West Africa have a population of about 300 million people. It comprises fifteen countries that made up the Economic Community of the West African States (ECOWAS). Eight of these countries share a common currency and form another regional economic bloc: the West African Economic and Monetary Union (WAEMU). Among the missions of ECOWAS and WAEMU is the harmonization of domestic tax systems including tobacco taxation. Accordingly, domestic tobacco taxation policies are largely subjected to Community Directives or regulations.

We review the current state of tobacco taxation in West Africa against the objective of Article 6 of the World Health Organization Framework Convention on Tobacco Control (WHO FCTC): "implementing tax policies (…) on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption". The scope of this study is threefold. First, it provides an overview of both *de jure* and *de facto* tobacco taxation in West Africa. Second, it points out and critically analyses policy changes that policy makers should adopt in raising taxes to increase the price of tobacco products. Third, it draws conclusion on the challenges in implementing the Article 6 of the WHO FCTC in West Africa.

Methods

Data used in this paper have been collected for the research and advocacy project on tobacco taxation in West Africa, led by the *Consortium pour la Recherche Economique et Sociale* (CRES) with the support of the International Development Research Centre (IDRC), and in collaboration with the Economic Commission for the West African States (ECOWAS).

The project involved a multinational team composed of specialists in taxation, customs, statistics and economic analysis. National teams gathered data and produced country reports -" Tobacco taxation country profiles"- for their respective countries. Building on these country reports, a regional synthesis reports was produced.

The regional report as well as the country reports were presented and discussed during high-level policy workshops, which offered the opportunity to validate the data and then discuss the policy recommendations with key decision-makers at national and at the ECOWAS and the WAEMU levels.

What follows is a summary of the main points of the final draft of the regional synthesis report. Also included – in the concluding section- is a paragraph on the main outputs of the discussions with policy makers.

Overview of tobacco taxation in West Africa

Excises, customs duties and value-added tax (VAT) are the most common taxes imposed on tobacco products in the West African countries. In addition to these taxes, which are subjected to community Directives, some of the countries also impose "special" taxes on tobacco products within their jurisdictions.

Excises duties: A Directive on excises was introduced in the WAEMU since 2000, and in the ECOWAS since 2009. Both Directives provide for a common mean of taxation (tax base and type of excises) as well as minimum and maximum rate levels within which member countries are free to set their national rates by considering their own circumstances. According to the Directives, excises on tobacco products should be levied on an ad valorem basis; and the excise duty rates should be in the range of 15% to 45% in the WAEMU, and 15% to 100% in the ECOWAS. The tax base is the manufacturer's price for locally produced tobacco; and for imported tobacco, it is the customs value of the products plus the customs duty and other entry charges.

With the exception of Guinea Bissau, which applies a 10% excise tax rate on tobacco products, all of the member countries of the WAEMU fully comply with the WAEMU Directive on excises. In the ECOWAS, compliance with respect to the ECOWAS Directive is relatively weak. In this regard, five cases are worth noting. The first is Gambia, where the excises on tobacco products are levied on a specific basis. The second is Cap-Verde, where the excise rate on all tobacco products is 10%, below the minimum standard rate fixed by the Community Directive. A third outlier is Ghana where the excise rate is 150%, above the maximum standard rate fixed by the ECOWAS Directive. Fourth is Sierra-Leone, where, surprisingly, excise duties are no longer imposed on tobacco products since 2006. The last case is Nigeria where excise duties are imposed only on imported tobacco products while, as the ECOWAS Directive currently stands, excise duties must be imposed on all tobacco products, be they manufactured locally or imported from third countries.

Beyond these peculiarities, there are substantial cross-country differences in excise rates applied on tobacco products within the West Africa region: the excise rates vary widely, from 0% in Sierra-Leone to 150% in Ghana; and in most of the countries, these rates are at levels below 30%. In addition, eight of the fourteen countries that levy excises on tobacco products apply a uniform rate on all types of tobacco products, while the other six apply differential tax rates depending on the prices, types or degree of transformation of tobacco products (raw versus manufactured tobacco).

Customs duties: Since 2000, customs duties in the WAEMU should be based on the WAEMU common external tariff (CET). This CET provides for three rates of customs duty on tobacco products: 5% for raw products, 10% for intermediate products, and 20% for final products such as cigarettes; these duties are imposed only on imports from third countries. The customs duties that the WAEMU member countries actually imposed on tobacco products are wholly compliant with the WAEMU CET, with the exception of Guinea-Bissau, where customs duties on cigarettes is 15% in place of 20% as fixed by the CET.

In 2006, the ECOWAS decided to establish a CET, which draws on the basic WAEMU CET. But a number of concerns arose and made it difficult to fully implement the ECOWAS CET by 2014. As a result, customs duties applied on tobacco products in most of the non-WAEMU countries are not compliant with the ECOWAS CET; further, they differ markedly from one country to another depending on national legislations. For example, customs duty on cigarettes is 5% in Liberia, 10% in Sierra Leone, 20% in Ghana, and 35% in Nigeria. In all cases, however, customs duties are levied only when tobacco products are imported into the ECOWAS.

Value added taxes (VAT): A Directive on VAT was introduced in the WAEMU in 1998, and in the ECOWAS in 2009. As with the excises taxes, both VAT Directives provide for common rules relating to the calculation of the tax base, and the range of applicable rates for the VAT on tobacco products. Member countries can set their VAT rate between 15% and 20%, according to the WAEMU Directive; and between 5% and 20% according to the ECOWAS Directive.

Actually, almost all the West African countries applied VAT on tobacco products: the only exceptions are Guinea-Bissau and Liberia where the sales tax is yet to be replaced by the VAT as recommended by the regional regulations.

The rates of VAT (or sales tax) vary by countries. For example: 5% in Nigeria, 15% in Ghana, and 18% in Togo. In general, the VAT (or sales tax) rates are higher in WAEMU than in non-WAEMU countries, probably because the ECOWAS Directive allows for smaller VAT rates.

Other taxes: In several countries, national legislations established supplementary taxes on tobacco products. Some act as excises since they applied only to tobacco products or to a limited range of goods (e.g.: the "Eco tax" in Benin or the environmental tax in Gambia). Most other are additional taxes on a wide range of goods including tobacco products, to finance specific programmes through earmarking (e.g.: the National Health Insurance Levy in Ghana).

In general, the rates of these additional taxes are relatively low, less than 5%. But two exceptions worth noting: Nigeria and Senegal. In both countries, national legislations established a special levy on tobacco products imported from countries outside the ECOWAS. The rate of this levy is 20% in Senegal; in Nigeria it varies between 50% and 100% depending on the type tobacco products. Since Nigeria and Senegal are the two most important producers of tobacco in West Africa, the special levies applied on imported tobacco can be seen as part of a strategy to protect local tobacco growers and/or manufacturers.

Issues and options in the taxation of tobacco products in West Africa

Having presented an overview of tobacco taxation, we now highlight and discuss a number of issues that arise if we ask: how effective are the current tobacco taxation policies and practices in promoting public health by reducing the consumption of tobacco products in West Africa? What concrete policy changes are needed to be more effective?

In what follows we examine the issues of excise tax structure and rate levels, of dedicated tobacco taxes or earmarking, and of compliance of national policies with regional Directives. We do not address issues related to VAT and customs duties because these taxes are less adequate and effective for achieving tobacco control objectives via tobacco tax increases.

Excise tobacco tax structure: Basically, excise taxes can be either specific (based on quantity) or ad valorem (based on value). A combination of the two (mixed excises) is possible as well.[1]

The issue of which excise tax method is better might seem simple, at least for developing countries. Consider for example the following quote from a World Bank (1999, p.87) report: "If a primary purpose of the excise is to discourage tobacco consumption, a strong case can be made for specific excises that would impose the same tax per stick. Specific taxes also are easier to administer because it is only necessary to determine the

[1] A WHO survey of excise systems in 182 countries reveals that 60 countries rely on ad valorem excises only, while 55 countries impose only a specific excise; and 48 countries levy a mixture of both specific and ad valorem excises (WHO, 2010, p. 35).

physical quantity of the product taxed, and not necessary to determine its value." Sunley et al. (2000) take this point further: they consider various advantages and disadvantages of both types of excises, specific versus ad valorem, and conclude that "on balance, given the weak tax administrations in most developing and transition countries, specific excises on cigarettes automatically adjusted for inflation should be preferred to *ad valorem* excises."

However, the matter is not that straightforward in reality. For one thing, a common point in the theoretical literature (see for e.g., Delipalla and Keen, 1991; Keen, 1998) is that the socially optimal balance between specific and ad valorem taxation is likely to depend on the characteristics of the market at issue.[2] Therefore, since developing countries are heterogeneous in their individual situations, at least regarding the characteristics of their national tobacco industry, the single one-size recommendation for specific excises may not fit all.

Furthermore, it is worth recalling this remark from the WHO (2010, p.51): "in general, governments want to improve public health without compromising tax revenues." To put it differently: political economy considerations are important; that is, policy recommendations justified chiefly as responses to public health issues might have little prospects for adoption and implementation, should the achievement of other key government goals be compromised.

Against this background, we suggest that the Community excise tax Directives in West Africa should evolve towards allowing a mixed excise tax structure, whereby countries must levy a specific excise tax calculated per unit of the product, in addition to an ad valorem excise tax calculated as a proportion of an adequate tax base. This suggestion, it should be emphasized, is not to challenge the broad result suggested by existing theoretical and empirical literature - that specific taxation tends to lead to relatively high levels of price as compared to ad valorem taxation and thus is more appropriate for achieving tobacco control objectives. We just do not want to ignore that this broad result is often followed by the remark that "there is no general prescription as to the appropriate balance between the two taxes, which indeed is likely to differ quite markedly over distinct contexts" (see Keen, 1998; WHO, 2010). Thus, we view the mixed excise tax system as a good compromise to accommodate all countries within the Community.

[2] The point here is that the relative merits of excise versus ad valorem excise tax have been discussed only under restricted assumptions. For example, Delipalla and Keen (1991) show that ad valorem taxation implies a relatively low consumer price. But their analytical framework refers to an industry consisting of identical firms –i.e., with same cost functions - producing a single homogenous good. This is obviously far from what most tobacco industries are in the real world. Indeed, Delipalla and Keen (1991) do acknowledge, in their conclusion, that the results laid out in their paper may not be robust to changes in the characterisation of the framework.

Uniform vs. differentiated excise tobacco tax rate: A common point in the literature is that levying excise taxes at the same rate on all tobacco products is more appropriate for reducing tobacco use while at the same time leading to a more effective tax administration and higher tax revenues (WHO, 2010). The main point here, as the WHO (2010) report put it, is that a "unit-rate excise tax system would reduce incentives for substitution among different brands (…), and eliminate incentives for various pricing strategies by manufacturers to reduce their tax liability."

Tiered tax system is often motivated by equity concerns, whereby higher-priced brands products are taxed more heavily than lower-priced brands products as a means of promoting "fairness", or of helping the poorer people as they spend more of their money on lower-priced brands products than rich people. Yet, while such a tax policy may be appropriate in the case of essential products, it is inappropriate in the case of tobacco products; particularly because tobacco use exacerbates poverty. So, the case for differentiating excise taxes on tobacco products as a way to achieve pro-poor goals is a weak one.

Excise tobacco tax levels: In view of the levels of excise tax currently applied on tobacco products in West African countries, it is clear that there is enough room for increases. "Studies show that choosing an excise tax that represents at least 70% of the retail price will make a difference with respect to lives saved" (WHO, 2010; p. 53). Yet, the average excise tax share of the most popular brand is less than 70% in all West African countries.

One constraint that may prevent tax increases is the imposition of an "upper limit" on excise tax rates. In fact, as noted before, the ad valorem excise tax rates on tobacco products cannot be more than 45% in the WAEMU, and 100% in ECOWAS. This practice automatically restricts the ability of member countries to be more aggressive in increasing tax on tobacco products; thus, it should be removed.

Dedicated tobacco taxes or earmarking: This practice can be seen as a way to correct for the negative health consequences of tobacco use, and to raise public support to tax increases on tobacco products (WHO, 2010; Vardavas, 2012). Moreover, dedicated tobacco taxes for much needed expenditure on health. However, there are also some arguments against the practice. For example, earmarking may be seen as an additional constraint in the management of fiscal policy, impeding the optimal allocation of resources and hence reducing social welfare (WHO, 2010; p. 99). On balance, there is a consensus in the literature that whether tax earmarking is a good policy is a context-specific issue (see for e.g.: Marsiliani and Renström, 2000). A number of governments do earmarked tobacco taxes (see WHO, 2010), and it might be useful for West African countries to build on their experience to make the best of the practice of dedicated tobacco taxes.

Compliance of national policies with regional Directives: Non-compliance by some Member States with regional Directives on tobacco taxation is a bane that threatens tobacco control efforts in the region. Addressing this issue is not straightforward, given the lack of, or the difficulty to establish a regional mechanism with the authority to enforce regional laws, including sanctions in case of non-compliance. Yet, it is possible to find ways of improving the compliance rate of Member States by studying factors that lead to compliance and non-compliance with the regional Directives. This may be the subject of future research.

Conclusion and final remarks

How tobacco products are taxed in West African countries is the result of both national and regional legislations. Our review highlighted four important features in the current policies and practices that are not in step with the objectives of tobacco control, namely the practice of levying excise duty on an ad valorem basis as pursuant to the Community Directives on tobacco excise tax; the differentiated rates for excise duty in many countries; the relatively low levels of excise tax rates which are applied on tobacco products in most of the countries; and the application by some Member States of less stringent tobacco taxation policies than what is required by the relevant regional Directives.

We argued that the community Directives on tobacco excise tax should evolve towards allowing a mixed excise tax structure, whereby Member countries <u>must</u> levy a specific excise tax calculated per unit of the product, in addition to an ad valorem excise tax calculated as a proportion of an adequate tax base. We also argued that Member countries should apply uniform excise rate on all tobacco products, and should increase the rates of excise duty so that the share of tobacco taxes account for at least 70 percent of retail prices, as recommended by the WHO. Community Directives on tobacco excise tax can help this happen by requiring explicitly that Member countries <u>must</u> apply uniform rates of the excises; and by raising the minimum of and removing the "upper limit" on the applicable excise duty rates.

The positive effects of such changes for tobacco control would however be limited if some Member States do not comply with regional Directives in designing their national tobacco taxation policies. We argued that the issue of non-compliance should be addressed, and that this requires in-depth studies to determine how to create favourable conditions to ensure full compliance.

In closing, we would like to emphasize that the above recommendations have been discussed with high-level policy makers from national governments as well as from the ECOWAS and WAEMU. As the main outcome of discussions, a new ECOWAS's Directive on tobacco taxation in West Africa has been drafted. The new draft Directive basically endorsed some of the recommendations outlined above. Specifically, it provides for a mixed excise tax system, for an increase in the minimum applicable ad-valorem excise duty rates, and for a target of 70 percent for the share of all taxes in the retail prices of cigarettes.

The way towards effective adoption of this new Directive, however, is not easy; especially given the active lobbying of the tobacco industry, which would like to stop any policy changes aimed at reducing tobacco consumption. Thus, much more efforts are needed on the advocacy side to push for the adoption of the new ECOWAS Directive on tobacco taxation.

What this paper adds:

- We review the current policies and practices in the taxation of tobacco products in the West Africa region;
- We highlight key features that threat the achievement of tobacco control objectives;
- We suggest few options that may help in achieving a more effective taxation of tobacco products in the region.

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