

Tobacco Taxes in China

Based on *Tobacco Taxation and Its Potential Impact in China* by Teh-wei Hu, Zhengzhong Mao, Jian Shi, and Wendong Chen

Raising the tobacco tax in China by 1 RMB per pack can save more than 3 million lives and generate an additional RMB 64.9 billion.

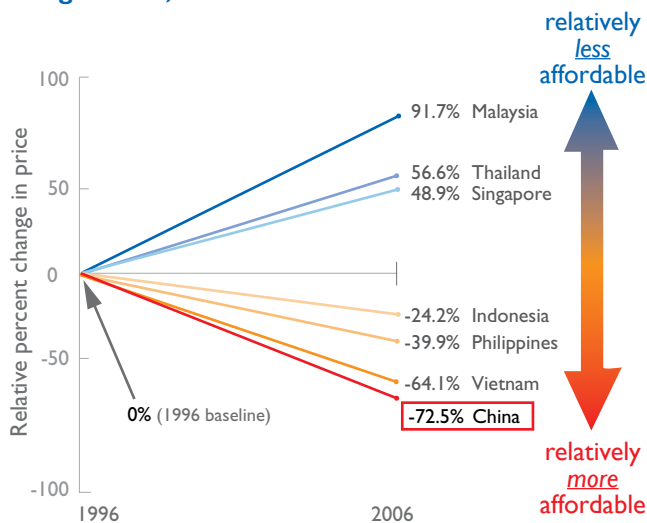
The low cost of tobacco products in China contributes to very high levels of cigarette smoking, especially among males. China's high smoking rate causes alarming health and economic costs. The most effective way to reduce tobacco use in China is to raise the price of tobacco through excise tax increases.

Tobacco Use in China¹

China is the largest producer and consumer of tobacco in the world.

- China grows one third of the world's tobacco crop. It produces and consumes one third (1.7 trillion) of the world's cigarettes.
- 300 million Chinese smoke — 36% of China's population over age 15.
- 57% of men and 3% of women over age 15 are current smokers.
- Taking into account both inflation and purchasing power, cigarettes have become more than twice as affordable in China since 1990. Smoking in China is much less costly than in Thailand, Malaysia, and Singapore.

Figure 1: Relative Change in Affordability of Cigarettes, 1996 – 2006²



Tobacco Industry in China

- The State Tobacco Monopoly Administration (STMA) and the China National Tobacco Corporation (CNTC) control the production of tobacco leaf and the manufacturing and advertising of cigarettes.

- The Monopoly produced 1.7 trillion cigarettes in 2005, generating tax and profit of RMB 240 billion (\$30 billion USD)*, equivalent to 7.6% of central government revenue. The combination of tobacco tax and profit as a percentage of government revenue is declining over time due to rapid growth in other economic sectors.
- The tobacco industry employs about a half million people, 0.06% of total employment in all sectors.

Impact of Tobacco Use in China

High smoking rates contribute to a significant number of early deaths, high healthcare costs and lost productivity.

- China has the world's highest number of smoking-attributable deaths. One million Chinese die each year from tobacco-related diseases;³ these deaths are expected to rise to 2 million by the year 2020.⁴
- Smoking costs Chinese society RMB 186 billion (\$22.7 billion USD) each year, or 1.9% of China's GDP. Direct medical costs of smoking are RMB 14 billion (\$1.7 billion USD), which accounts for 3.1% of China's national health expenditures annually. Annual indirect costs of smoking reach RMB 172 billion (\$21 billion USD).
- Direct spending on cigarettes has an impoverishing effect. Households with smokers spend less on food, education, clothing and housing than households of nonsmokers. Poor households in China spend 8 to 11% of total household expenditures on cigarettes. Medical spending related to smoking impoverished 30.5 million urban residents and 23.7 million rural residents in China in 1998 alone.

Higher Taxes Reduce Smoking

The most effective way to reduce tobacco use is to raise the price of tobacco through tax increases and ensure that the increases are reflected in prices. Higher prices discourage youth from initiating cigarette smoking and encourage current smokers to quit.

*This document uses the 2000 exchange rate of 1 RMB = \$0.12 USD.

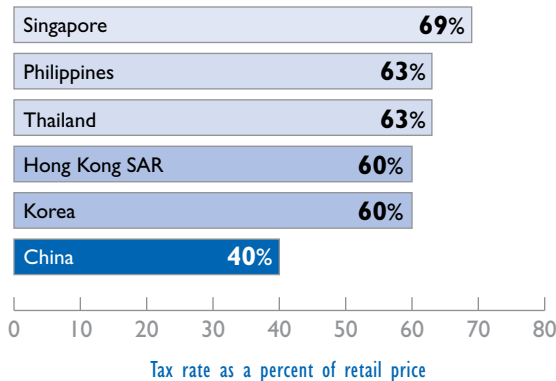
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Tobacco Taxes in China are Low and Inefficient

There are several types of tax on tobacco in China.

- **Cigarette tax:** The cigarette tax combines an *ad valorem* tax and a specific excise tax. The *ad valorem* tax is currently two tiered, allowing producers to adjust brand prices to pay lower tax rates. The total cigarette tax rate in China is approximately 40%* at the retail price level, far below the median range of tax rates of the international community, which is between 65 and 70%.

Figure 2: Tax Rates in China and Neighboring Jurisdictions



- **Tobacco leaf tax:** As the only legitimate buyer of tobacco leaf, CNTC provides a 20% tobacco leaf tax to local governments as tax revenue. CNTC sets quotas on production of tobacco leaf. The current tax revenue sharing mechanism between central and local governments acts as an incentive to encourage local governments to over-produce tobacco leaf.

The Case for Excise Tax Increase

A specific excise tax, by limiting brand switching to cheaper cigarettes, is effective in reducing smoking prevalence. In contrast, *ad valorem* excise taxes lead to a greater spread in prices between cheaper and higher-priced cigarettes, increasing the potential for switching to cheaper cigarettes when excise rates are increased and undermining the public health benefit of tobacco taxation. Specific excise taxes are easier to administer because it is only necessary to determine the physical quantity of the product taxed and not its value.

Tobacco Taxes Save Lives and Increase Government Revenue

If China raised their tax rate from its current rate to 51% of retail price (via a 1 RMB increase in the specific excise tax per pack), the number of smokers would decrease and health would improve. Tobacco tax revenue would increase to RMB 235.1 billion (\$28.7 billion USD) — an increase of RMB 64.9 billion.

Table 1: Impact of Cigarette Tax Increase of 1 RMB (-.5 elasticity)

Reduction in number of smokers	13.7 million
Lives saved	3.4 million
Medical cost savings	RMB 2.68 billion
Increase in tobacco tax revenue	RMB 64.9 billion

- **Productivity losses would decrease**, generating an additional 9.92 billion (\$1.2 billion USD) in the Chinese economy.
- Projected industry losses of 1.63 billion RMB would be negligible compared to the **gain in government tax revenue**.
- **Employment losses**, at approximately 5,500 employees, **would be minimal** compared with the loss of 59,000 employees due to mergers and efficiencies in the Chinese tobacco industry.
- Tobacco farmers could lose 6% of their total revenue, or RMB 873 million. However, farmers could use the land to produce other more profitable crops and thus **potentially increase earnings**.
- The local governments could lose RMB 174.53 million. However, these local government revenue losses could be easily compensated for by the **increased central government tax revenue**.

*The precise total tax rate as a percent of retail price is uncertain, but is estimated to be between 32 and 40 percent.

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Recommendations

- **Increase the cigarette excise tax** by at least RMB 1 per pack, and gradually increase it to 4 RMB per pack, while maintaining the *ad valorem* tax. China should increase the overall tax rate beyond 60% of retail price over time.
- **Simplify the current two-tier *ad valorem* tax** into one single rate to prevent producers from adjusting brand prices to pay lower tax rates.
- **Adjust the specific excise tax automatically** to account for inflation and consumer purchasing power.
- **Remove the tobacco leaf tax.** To mitigate revenue and employment losses at the local level, the central government could increase the cigarette specific excise tax and transfer some of the additional revenue to local governments.
- **Reform revenue sharing between the central and local government.** Use the transfer mechanism between central and local government to support local fiscal needs.
- **Pursue a more aggressive tobacco control strategy,** consistent with the Framework Convention on Tobacco Control provision on implementing tax policies to reduce tobacco use.
- **Earmark the additional tax revenue** for tobacco control activities such as anti-smoking media campaigns, enforcement of smoke-free legislation, staffing of tobacco control units, and for coverage of health care expenses for the uninsured low-income population.

A tax increase on cigarettes in China will save lives, reduce medical care costs, increase productivity and increase government revenue.

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