

This policy brief is based on a study titled "Effect of Introducing a New Low-Tier Cigarette Brand on Cigarette Tax Revenue in Bangladesh: Evidence from cigarette sales by British American Tobacco (BAT) in Bangladesh, 2019–2020" conducted by ARK Foundation, Bangladesh

THE COMPLICATED CIGARETTE TAX STRUCTURE IN BANGLADESH IS CAUSING EXPANSION OF THE LOW-TIER CIGARETTE MARKET AND LOWER TAX REVENUE

BACKGROUND

A substantial body of evidence demonstrates that significant increases in cigarette taxes resulting in higher cigarette prices are the most effective way to control cigarette smoking and increase tax revenue. In Bangladesh, the complicated tiered ad valorem cigarette tax structure, with a low base price for each tier, has made tobacco tax a less effective instrument to control cigarette smoking and created an opportunity for cigarette manufacturers to avoid taxes. Adding to these existing challenges, in fiscal year (FY) 2019-20 the Bangladesh government increased the difference between low- and medium-tier base prices, making low-tier cigarettes even more affordable. This price change, together with a significantly lower ad valorem excise tax for low-tier cigarettes, created a window of opportunity for manufacturers—which they seized—to expand the market for low-tier cigarettes, resulting in lower tax revenues for the government.

Brand repositioning: Evidence from cigarette sales by British American Tobacco (BAT)

In FY 2019-20, BAT introduced a new cigarette brand (named Royals) in the low tier and decreased the supply of a cigarette brand (named Star) in the medium tier. As a result, BAT's market share of low-tier brands grew to 69.0 percent—a considerable increase from FY 2018-19's low-tier share of 36.8 percent (Figure 1).

Objective of the study

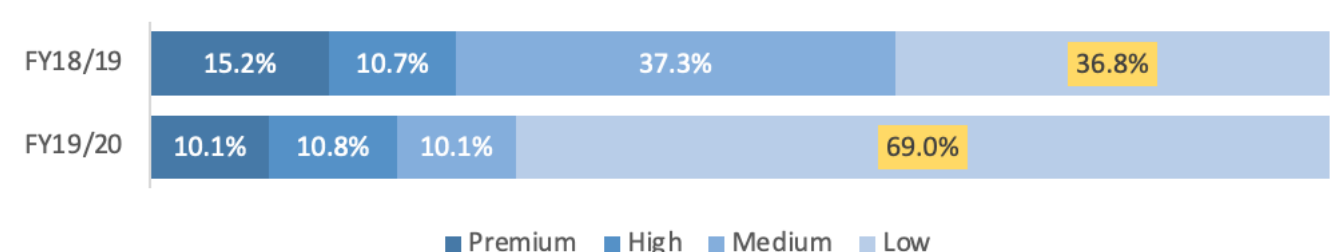
The study estimates the tax revenue gap^[1] resulting from BAT's introduction of a new brand in the low tier and reduction of supply of a medium-tier brand in FY 2019-20. The study also analyzes the impact of different tax policies to identify policy recommendations that would prevent cigarette companies from repositioning brands to avoid taxes and instead increase government tax revenue. To conduct these analyses, this study utilizes the WHO Tobacco Tax Simulation Model (TaXSiM).

[1] Revenue gap = Potential revenue - Actual revenue

KEY FINDINGS

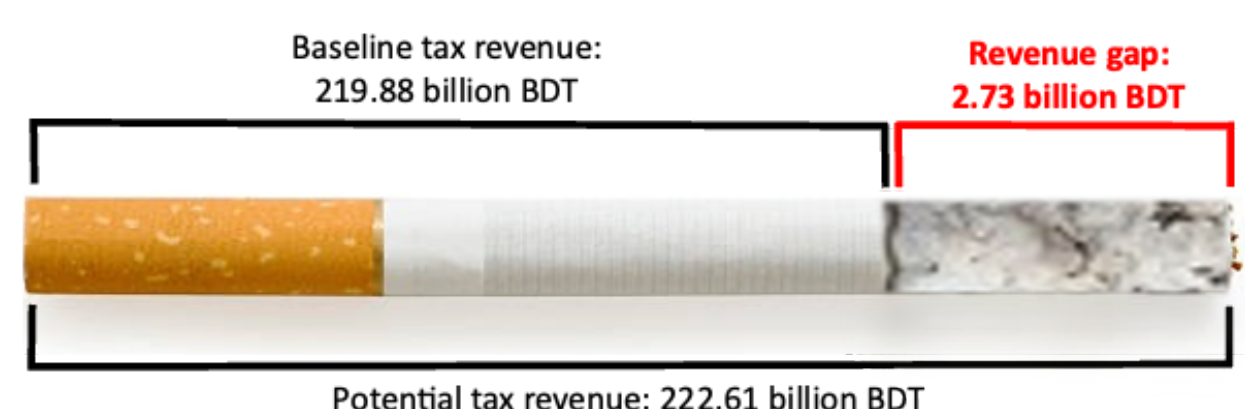
- The lower excise tax rate and lower base price of the low-tier cigarettes encourage manufacturers to expand their low-tier cigarette brands, which results in lower tax revenues for the government.
- Imposing uniform excise tax is an effective way to control low-tier cigarette brand expansion while at the same time ensuring higher tax revenue.
- An increase in the base price of low-tier cigarettes - while keeping a substantial excise tax rate gap between the low and medium tiers - would encourage manufacturers to expand the low-tier cigarette market, resulting in lower tax revenue.

Figure 1: Sales volume share of British American Tobacco (BAT) in Bangladesh, by tier



Source: Authors' calculations from data obtained from the National Board of Revenue (NBR), Ministry of Finance, Bangladesh

Figure 2: Estimated revenue gap in FY 2019-20 due to BAT's expansion of low-tier cigarette market

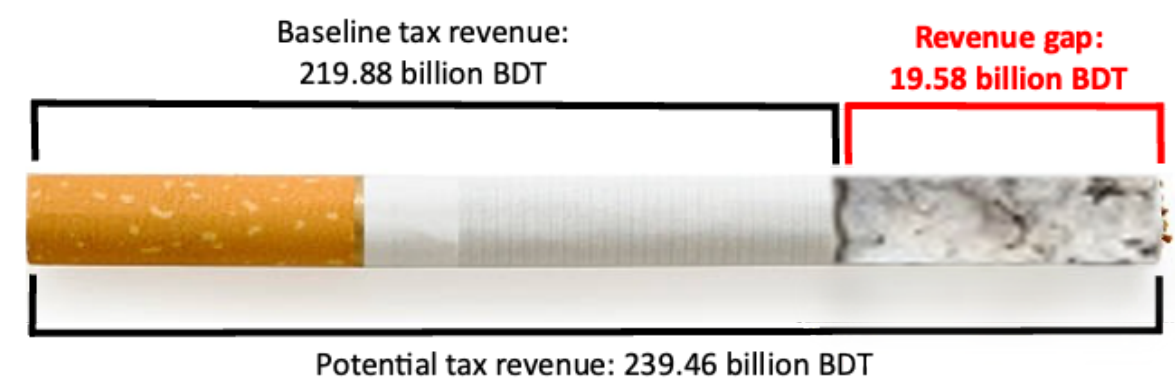


Source: Author's calculation from data obtained from the National Board of Revenue (NBR), Ministry of Finance, Bangladesh

RESEARCH FINDINGS

- BAT's brand repositioning—introducing a new low-tier cigarette brand and decreasing supply of its medium-tier brand—caused a significant government revenue gap.* This study estimates that the revenue gap, in FY 2019-20, is around 2.73 billion taka (Figure 2). To put this in perspective, the government could have covered about 7.2 percent of the yearly cost of the Padma Multipurpose Bridge Project from the revenues it would have earned if BAT had not repositioned its brands.
- An increase in the base price of low-tier cigarettes without changing the excise tax rate for the low tier would induce cigarette manufacturers to expand their low-tier cigarette brands and consequently cause a higher tax revenue gap.* Assuming, in FY 2019-20, the government imposed a policy where the low-tier cigarette price had been set at 45 taka instead of 37 taka without changing the excise tax rate for low-tier cigarettes, this study estimates that the revenue gap would be around 5.20 billion taka. The study also finds that this policy intervention would actually result in a large increase in revenue for the manufacturer, about 2.13 billion taka. This implies that the manufacturer would be induced to expand its low-tier market share, which in turn would result in a higher tax revenue gap.
- An increase in the base price along with an increase in the excise tax rate for low-tier cigarettes would result in less incentive for cigarette manufacturers to expand the low-tier market and more tax revenue for the government.* Assuming, in FY 2019-20, the government imposed a policy combining a higher base price of low-tier cigarettes at 45 taka instead of 37 taka, with a higher excise tax rate for low-tier cigarettes (65 percent instead of 55 percent), this study estimates that the government tax revenue would be 19.58 billion taka higher than the baseline tax revenue of 219.88 billion taka (Figure 3). This policy intervention would also result in lower earnings (by 12.26 billion taka) for cigarette manufacturer BAT. So, cigarette manufacturers would be less motivated to expand the low-tier cigarette market, which in turn would ensure higher tax revenue for the government.

Figure 3: Estimated revenue gap in FY 2019-20 government increase low-tier cigarette price and impose uniform ad valorem excise tax



Source: Author's calculation from data obtained from the National Board of Revenue (NBR), Ministry of Finance, Bangladesh

POLICY RECOMMENDATIONS

- The government should simplify the cigarette tax structure by imposing a uniform excise tax rate for all tiers of cigarettes. This will ensure higher tax revenues for the government.
- Along with establishing a uniform excise tax rate, the government should also increase the tax base of cigarettes (base price) with the ultimate target of moving from four tiers to two tiers. This will demotivate cigarette manufacturers from expanding the low-tier cigarette market while also ensuring a significant increase in government tax revenue.
- For controlling low-tier cigarette market expansion by the manufacturers, the government should substantially increase low-tier cigarette base price along with substantial increase in the excise tax rate of low-tier cigarettes. Increasing only the base price of the low tier would encourage manufacturers to expand low-tier cigarette brands, resulting in less tax revenue for the government.

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