

The potential impact of tobacco tax increase on tobacco use in Viet Nam

Key Findings

- Raising taxes is the most effective and cost-effective tobacco control policy for curbing tobacco consumption and increasing revenues.
- A 10% increase in the price of cigarettes would result in a reduction of daily smoking prevalence among men from 30.7% to 29.9%, reducing 270,000 male smokers in Vietnam.
- To effectively reduce tobacco consumption, tax increases must reduce cigarette affordability. That means tax increases need to outpace both inflation and income growth.
- The tax reform bill in discussion in 2024 proposes to move from the current pure ad valorem tax to a mixed structure including a specific component. If the tax significantly increases cigarette prices, this will reduce tobacco consumption as well as reduce brand price dispersion.

Background

Despite the implementation of a number of tobacco control measures in accordance with the Framework Convention on Tobacco Control (FCTC), to which Vietnam is a signatory, tobacco consumption remains a major public health problem in the country. With a population of more than 15 million smokers, the annual number of smoking-related deaths exceeds 40,000. In addition to the health costs incurred, tobacco expenditure often coincides with expenditure on alcoholic beverages, creating a "crowding out" effect that reduces household investment in education.ⁱ Overall, tobacco use is detrimental to household welfare and to the physical and mental development of children and youth.

Recent rapid economic growth has inadvertently facilitated an escalation in tobacco consumption in Vietnam. An analysis of cigarette price fluctuations and the concurrent rise in per capita income between 1994 and 2017 reveals a notable shift in the affordability of cigarettes for the Vietnamese population. In 1994, purchasing 100 packets of cigarettes required the equivalent to 31% of annual per capita GDP. By 2017, however, this share had fallen to 5.2%. Furthermore, an alternative statistical assessment by the World Health Organization (WHO) shows that between 2005 and 2016, while nominal per capita income increased by 4.7 times, retail prices of the most common

tobacco products in Vietnam increased by only 2.2 times.ⁱⁱ Due to the high affordability of cigarettes, Vietnam received a score of zero for this component in the most recent Tobacconomics Cigarette Tax Scorecard (third edition) that used data from 2022.ⁱⁱⁱ

Given the overall negative impact of tobacco consumption on household welfare and the observed increase in consumption due to rapid economic growth, it is important to assess the potential impact of tobacco tax increases on tobacco consumption in Vietnam. This policy note presents the latest evidence on the price responsiveness of cigarette consumption in Vietnam and the potential impact of implementing higher tobacco taxes and is part of a series which provides evidence showing the advantages of tobacco tax increases in Viet Nam.

Findings

Increasing taxes remains the most effective measure to reduce tobacco consumption and its associated harms

Global evidence shows that increasing cigarette prices through a higher tobacco tax is the single most effective and cost-effective policy to reduce cigarette consumption.^{iv,v,vi} These global findings

are consistent with research on consumer behaviors in Vietnam, affirming that elevating tax rates results in increased retail prices and tax revenues, and thus with a decrease in consumption, smoking prevalence, and tobacco-related morbidity and mortality rates.^{vii} Specifically focusing on Vietnamese men, Nguyen Viet et al. (2021)^{viii} pointed out that a 1% increase in the price of cigarettes would correspond to a decrease in the likelihood of smoking among males by 0.08 percentage points, equivalent to a price elasticity of -0.26. A 10% increase in the price of cigarettes would result in a reduction of daily smoking prevalence among men from 30.7% to 29.9%, leading to a decrease in the number of male smokers by 270,000 individuals.

Given the low-cost of cigarettes in Vietnam, regular and significant increases in tobacco taxes that lead to substantial increases in prices are necessary to gradually reduce consumption and the prevalence of tobacco use.

The 2017 proposed tobacco tax framework suggested implementing a fixed tax component of VND 1000. However, assessments by the World Health Organization (WHO) and other international bodies have found this amount to be insufficient. According to their recommendations, the minimum tax threshold should be set at VND 2,000 or higher to effect significant change, with the ideal target being VND 5,000. However, this tax reform was not implemented. On June 2024, Viet Nam proposed a tax reform to move from a system based on only an ad valorem tax to a hybrid that would add a uniform (i.e., the same on all cigarettes) specific tax. If implemented, this will almost certainly have the benefit of shrinking price dispersion, particularly by driving the price of the cheapest cigarettes up, closer to the price of more expensive ones. It would also be straightforward to administer since it will be assessed per pack of 20 cigarettes.

There are two options proposed for consideration:

Since	Option 1:	Option 2:
2026	VND 2,000 /pack	VND 5,000 /pack
2027	VND 4,000 /pack	VND 6,000 /pack
2028	VND 6,000 /pack	VND 7,000 /pack
2029	VND 8,000 /pack	VND 8,000 /pack
2030	VND 10,000 /pack	VND 10,000 /pack

Considering the existing low price of cigarettes in Vietnam, where the price of the most sold brand was VND 22,900 in 2022, equivalent to 3.19 international dollars (purchasing power parity adjusted) noted above or USD 0.99 at the official exchange rate,^{ix} this tax reform is an opportunity to effectively increase cigarette prices in line with best practices of tobacco taxation. Indeed, the pure ad valorem structure aggravates the price gap between cigarette brands. As of July 31, 2022, the price of the cheapest brand of cigarettes was VND 7,000, while the premium brand cost VND 39,800 (that is 0.98 and 5.55 international dollars, respectively). The price dispersion, indicating the share of the cheapest brand’s price in the premium brand’s price, was 17.59%, reflecting a significant gap between the cheapest and premium brands.

Tobacco tax systems, price gaps and vulnerable groups

When faced with tax or price increases, some smokers would quit smoking, others would reduce their consumption (i.e. smoke fewer cigarettes), and others would trade down, i.e. switch from a higher-priced brand to a lower-priced brand.^x While higher taxes do lead to more expensive cigarettes, the degree to which consumption decreases depends, in part, on whether smokers have opportunities to trade down to a lesser priced brand.

In the case of pure ad valorem taxes, large price gaps between high- and low-priced brands also produce large gaps in the taxes collected on these brands.^{xi}

Large price gaps between different tobacco brands create opportunities for smokers to switch to cheaper brands when taxes rise, undermining the public health benefit (i.e., fewer tobacco users) of a tax increase. The proposals for tobacco tax increases in Vietnam were preceded by concerns about the potential impact of tax increases and the move to a mixed tax system. Concerns were voiced over the potential diminishment of domestic tobacco companies' competitiveness, the fostering of illicit tobacco trade, and the purported ineffectiveness of such measures in reducing overall tobacco consumption.

To address these concerns and furnish pertinent data for policy deliberations pertaining to tobacco harm mitigation, Nguyen et al. (2022)^{xii} analyzed the behavioral transitions in tobacco brand consumption consequent to tax increments.

Evidence shows that the main primary driver of the preference for cheaper domestic brands among individuals with lower incomes is the constrained financial resources of these consumers. As cigarette prices increase, individuals with a preference for more expensive foreign brands, typically associated with higher income levels, may choose to transition towards domestically manufactured alternatives, which offer lower price points, thereby maintaining their consumption patterns. On the other hand, people who buy cheaper domestic brands are limited by their budget. A considerable proportion of these individuals are financially unable to smoke more expensive cigarettes, so they look for cheaper alternatives or try to stop smoking. Many previous studies have shown that individuals from low-income households, as well as youth, show higher responsiveness to price fluctuations of tobacco products. Tax hikes are also likely to prevent initiation altogether or to delay the start of smoking among younger and/or lower-income individuals.^{xiii,xiv,xv} It is well documented that the longer the delay in starting to smoke, the less likely the individual will be a lifelong smoker. All of this means that increasing tobacco taxes will reduce the overall consumption, including among those who usually prefer cheaper domestic tobacco brands, and the reduction will be even higher for vulnerable groups, like young and poor smokers. The decline in smoking-related healthcare expenditures will increase available resources that could be allocated to food, education, and health. At the same time, the reduction in diseases will result in more productive workers, improving household productivity. This will have huge impact on Viet Nam's output.^{xvi,xvii}

It's unlikely that a small tax increase will have a substantial impact on tobacco consumption or smoking rates.

Cigarettes manufactured in Vietnam are subject to three distinct taxes: an ad valorem excise tax, compulsory contributions to the Tobacco Control Fund (TCF), and a value-added tax (VAT). The combined effect of these taxations results in a tax rate of 84.7% of the factory price. Despite this rate appearing substantial, upon closer examination, the 84.7% tax rate based on the factory price translates to only a 36.7% tax rate when computed against the retail price. That falls significantly below the WHO's recommended minimum rate of 75%.

Dao and Le (2018) have highlighted that the tax policies implemented in Vietnam have not effectively increased the cost of cigarettes. Instead, they proposed the adoption of a lump-sum tax of VND 5,000 per packet, which they argue would augment revenue and diminish smoking rates to align with national objectives.^{xviii}

In line with this perspective, Barker et al. (2023)^{xix} conducted an analysis of smoking cessation behavior among Vietnamese smokers, considering various packaging and pricing scenarios. They found that Vietnam requires a substantial increase in cigarette prices to achieve significant increases in quitting rates. According to the authors, cigarette prices would need to double (from the reference price of VND 15,000 to 30,000) to observe a noteworthy rise intentions to quit. Increasing cigarette prices to VND 40,000 would result in a 38% higher likelihood of intentions to quit smoking.

Barker et al. (2023)^{xix} also found that other measures increase the intention to quit smoking. For example, they found that plain packaging featuring a 50% health warning label (HWL) coverage resulted in a 34% higher likelihood of expressing intentions to quit (compared to branded packaging with the same HWL coverage). Additionally, branded packaging with an 85% HWL coverage led to a 29% increase in the likelihood of quitting intentions compared to branded packaging with a 50% HWL coverage.

Recently, Vo et al. (2023)^{xx} have generated evidence showing that under the current ad valorem tax structure, tax hikes disproportionately affects consumers of low-priced cigarette brands compared to those opting for premium brands. This disproportionality stems from two primary factors: first, the restricted escalation in prices under a pure ad valorem tax system, and second, the manner in which the Vietnamese translation for cigarettes are mostly in cash (that means that rounded prices make it easier for both retailers and consumers to conduct transactions, especially in cases when changes are not available due to the lack of small denomination notes).

Additionally, Barker et al. (2023) identified that the tobacco industry tends to undershift the tax increase first, and over-shift the tax increases in a second stage. That is the tax increase is not immediately and not completely transferred to retail prices, to reduce the price shocks on consumers. The tobacco industry lowers the tax

base, absorbing cost or reducing profits, so that there is less ad valorem tax per pack, and the impact on the retail price is diminished. Real prices were observed to incrementally rise over a one-year period following the introduction of tax revisions, indicating efforts of tobacco industry to gradually reflect the impact of tax adjustments on consumers. This kind of mitigating effects that implies the absorption of the tax increase, can only be implemented when the tax increase is small. When implementing large tax increases, the tobacco industry cannot absorb the tax increase and tax increase would be fully translated to price increases immediately.

Conclusion and policy recommendations

The most effective tobacco control tool is to significantly increase excise taxes on tobacco products. It is also a cost-effective policy because it does not take governments much, if any, additional resources beyond the regular resources applied to a standard review of tax structure and rates. The principle is simple: a sufficiently large tax increase

will raise tobacco prices, making tobacco products less affordable, thus driving down tobacco initiation, prevalence and consumption.

Because tobacco demand is relatively inelastic, higher taxes generate increases in fiscal revenues. Despite the indisputable effectiveness of increasing taxes on tobacco products as a means of reducing tobacco consumption, this powerful policy tool remains underutilized in Vietnam. To reduce tobacco use, the government must implement a more assertive increase in taxes, ensuring that the minimum tobacco prices rise at a rate exceeding inflation and economic growth.

The tax reform bill in discussion in 2024 proposes to move from the current pure ad valorem tax to a mixed structure including a specific component. If the tax significantly increases cigarette prices, this will reduce tobacco consumption as well as reduce brand price dispersion by driving the price of the cheapest cigarettes up closer to the prices of more expensive ones. This reform will be simple to implement as it will be based on a tax per pack of 20 cigarettes.

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Notes

This Policy Note is based on the Vietnam Evidence Matrix^{xx} by Tobacconomics. This Policy Note is part of a set of documents includes “The impact of tobacco consumption on employment and productivity in Viet Nam”^{xx} and “Evidence on illicit trade of tobacco products in Vietnam”^{xx} produced by Development and Policies Research Center (DEPOCEN) and the Tobacconomics team. The narratives summarize existing evidence on the economics of tobacco and tobacco control in Vietnam, with a focus on tobacco taxation. The studies are organized by Tobacconomics research core competency, which respond to the industry's arguments against effective tobacco control policies.

Citation

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