Tobacco tax increases in the Philippines: more revenue and better health

Key Messages

1. Republic Act No. 10351 (Sin Tax Reform Act 2012) stands as a global milestone in terms of tobacco taxation, delivering significant benefits to both public health and public finance.
2. Revenue collection from tobacco taxes has declined since 2022, and this is likely partly due to inefficiencies in the tax administration.
3. Evidence strongly suggests that tobacco companies are over-shifting the yearly tax increase (i.e., raising prices more than the tax increase) and taking advantage of higher prices to maximize profit at the expense of public finance.
4. Available evidence of exports suggests discrepancies which requires further research.
5. Significant tax increases to tobacco products would have a triple benefit:
   a. reduce consumption,
   b. reduce the burden of disease caused by tobacco, and
   c. increase (recover) revenue collection for the Philippines public finance, in particular, for the Department of Health and the universal healthcare program.

Background

Republic Act No. 10351 (RA 10351), also known as the Sin Tax Reform Act of 2012, has been a global milestone for tobacco taxation. Its aim was to address the harmful burden caused by tobacco in the Philippines, while raising significantly more revenue for public finance, reaching 6.3% of the total revenue collected in 2021. This, in turn, has allowed the government to allocate valuable resources for public healthcare. The Republic Act 10351 provided a significant price increase and an automatic annual adjustment, as well as a simplification of the previously inefficient tiered tax structure. In July 2019, Republic Act 11346[1] was passed to increase the tobacco tax rates and contained a similar stipulation of annual increases in tax rates by 5%. However, the recently proposed House Bill 11360 included the following provision:

"The rate of tax imposed shall be increased by 2% every even-numbered year effective on Jan. 1, 2026, and 4% every odd-numbered year, effective on Jan. 1, 2027."

This implies a reduction in the tax rates. To support the proposed bill, proponents of the legislation are putting forward evidence showing the decline of revenue collection, claiming that this was caused by high tax rates on tobacco products. The aim of this policy note is to explore elements that could more accurately explain the reduction in revenue collection from tobacco products; to examine additional, seemingly contradictory contextual data that indicate the need for further and deeper investigation; and suggest measures to reverse this situation from a public health and public finance perspective.

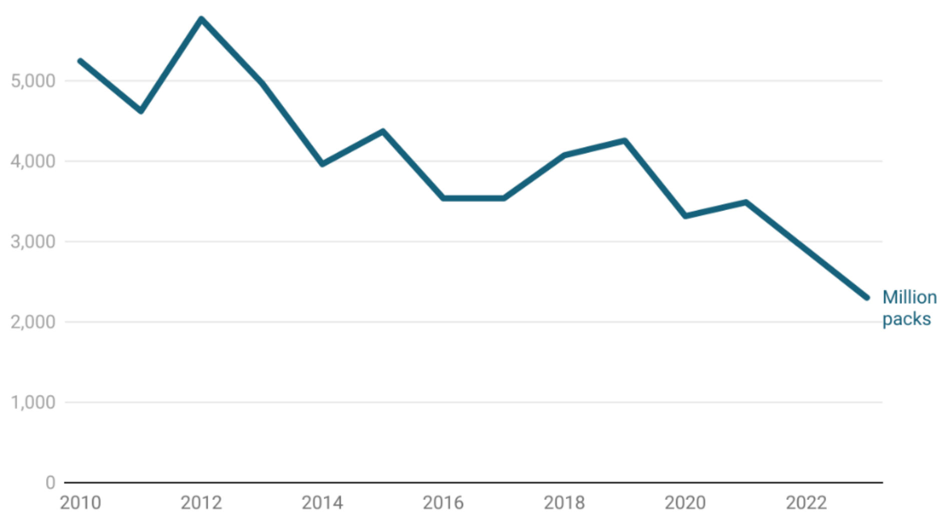
Consumption of cigarettes in the Philippines

After the Sin Tax Reform took effect, the prevalence of current smoking among adolescents and adults decreased significantly compared to the years before RA 10351. According to the Global Tobacco Youth Survey (GYTS), the prevalence of current use of tobacco among students ages 13-15 dropped from 15.9% in 2004 to 12.5% in 2019 (WHO, 2004, 2019). The Global Adult Tobacco Survey (GATS) showed a reduction in the prevalence from 28.3% in 2009 to 19.5% in 2021 in the adult population (15+ years old) (WHO, 2009, 2021a). The National Nutrition Survey also shows a steady decline of the prevalence of current smoking. While the latest round in 2023, shows that the prevalence of smoking has slightly increased, this survey combines both electronic and manufactured cigarettes. If disaggregated by type of product, the prevalence of use of electronic cigarettes has increased both among adolescents and adults, while the prevalence of manufactured cigarettes has decreased. In addition, sales of cigarettes have progressively decreased since 2010 (**Figure 1**), which suggests that both cigarette use, and intensity have been dropping.

[1] https://lawphil.net/statutes/repacts/ra2019/ra_11346_2019.html

Figure 1. Sales of cigarettes. Philippines, 2010-2024

Sales of cigarettes have steadily decreased since 2010



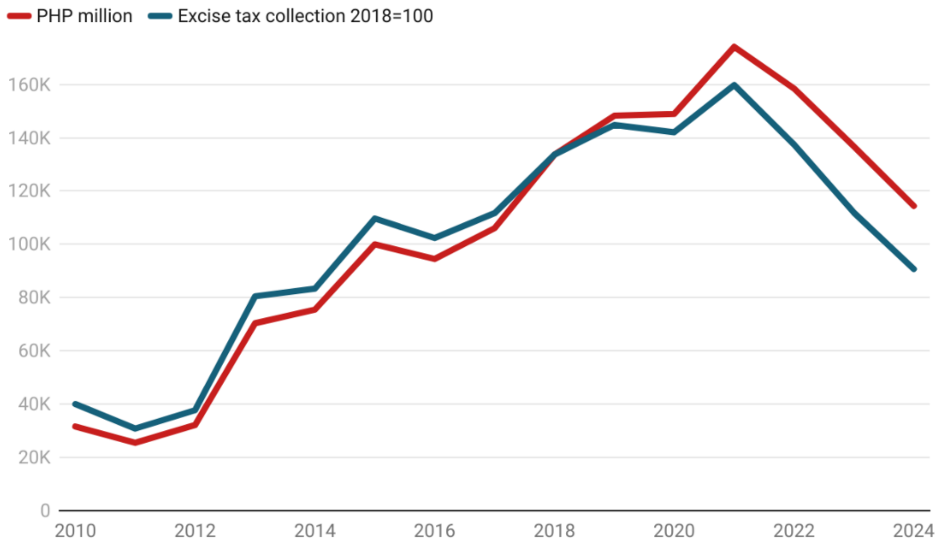
Source: Bureau of Internal Revenue excise tax collections based on removals report.

Decline of revenue collection

Compared to 2010, revenue collection from tobacco taxes has increased. The 2016-2021 period was characterized by a rapid increase in revenue collection from tobacco taxes in nominal prices (red line in **Figure 2**) and in 2018 prices (blue line). However, after 2021, the revenue collection from these taxes has declined. In 2021, the collection from cigarettes represented 6.3% of the total tax revenue (the maximum year after consistently increasing importance relative to other tax revenue streams), and then this proportion dropped: 4.9% in 2022, 4.0% in 2023, and 3.2% in 2024. Nevertheless, the decreasing relative importance of revenue from tobacco taxes may also be due to an increase in revenue from other sources.

Figure 2. Excise tax collection from cigarrettes. Philippines, 2010-2024

Since 2021, revenue collection began to decline



2024 includes only January-November

Source: Bureau of Internal Revenue.

Prices of cigarettes

Republic Acts 10351 and 11346 had a provision of yearly 5% increases in the specific tax. Available evidence, however, suggests that the prices of cigarettes have been increasing rapidly, faster than general inflation and the expected price increases[2] after the annual 5% adjustment (**Figure 3**).

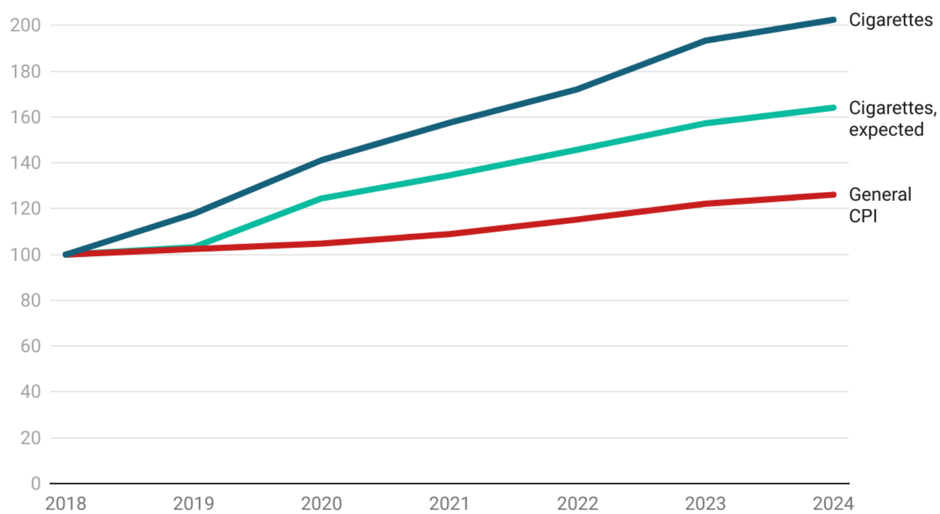
[2] We used the unit value of cigarettes in 2018 from Euromonitor as the base. Unit values are defined as the quotient of the value of the market in monetary units divided by the quantity of cigarettes, and thus unit values are a proxy or an estimate of the average prices. We assumed that the final market price of a pack of 20 cigarettes is defined by the following formula:

Market price= ((pre-tax price + specific tax per pack)*(1+retail margin))*(1+VAT).

Starting from the prices (unit values) for 2018 and the formula for market price defined above, we constructed the expected prices adjusting the specific tax per pack according to the Republic Acts 10351 and 11346 for each year from 2018 to 2024, assuming that the tobacco industry adjusted the specific tax according to the Republic Acts, that the retail margin is 5.5%, the VAT rate is 12% and that the pre-tax price has increased as the same pace as general inflation.

Figure 3. General and cigarettes price indices (2018=100). Philippines, 2018-2024

The prices of cigarettes are increasing considerably faster than the general prices



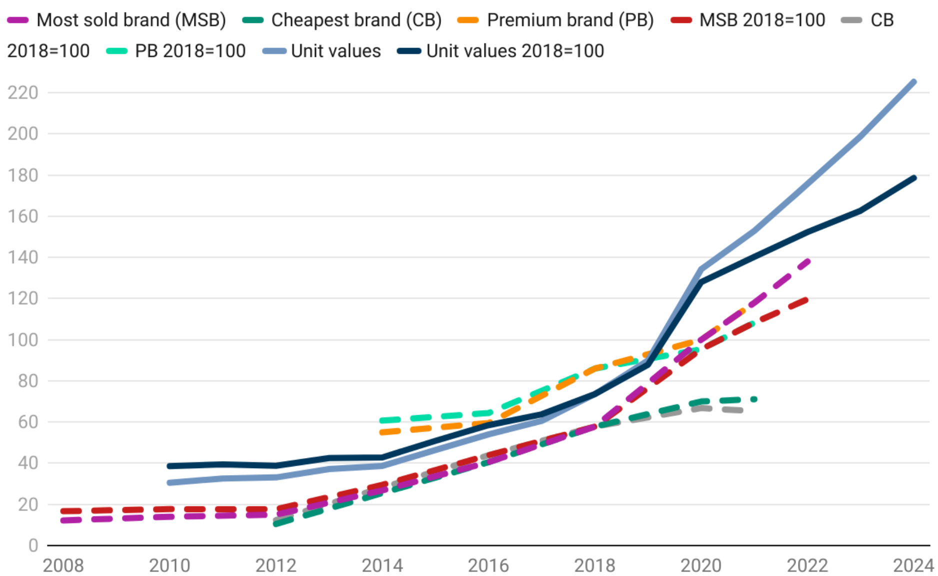
Source: Own elaboration with data from Philippine Statistics Authority and Euromonitor data.

The available data also demonstrate that the increases in prices are common to the most sold brand, cheapest brand, and premium brands, not only in nominal terms but in constant PHP (i.e., taking inflation into consideration). We observed that the prices in constant PHP increased, which implies that the prices have increased even faster than general inflation, explained because the price increases were much greater than the expected after the 5% annual adjustment (**Figure 4**) outlined in RA 10351 and 11346. This evidence strongly suggests that tobacco industry has almost certainly been over shifting the tax, getting more profit per stick in the last few years. Over shifting means that the industry increases the prices more than expected according to the adjustments in the specific tax provided in the legislation. Over shifting has been observed in other countries after tax increases and is a common pricing strategy by the tobacco industry to ensure more profits. This industry-generated price increase push sales down, thus reducing the government tax revenue collection, with the additional revenue from the price increase going to the tobacco industry and not to the public finance. By over shifting, the tobacco industry is likely aiming to push the price to higher levels to reduce what is commonly known as the consumer surplus, defined as the difference between the market's willingness to pay and price effectively paid in the market. Of course, at these higher price levels, there is a reduction in the demand for tobacco products, as seen in

Figure 1. This demonstrates that there is considerable room for government to increase taxes, with the additional revenues from higher prices going to the government rather than the industry.

Figure 4. Unit values and prices of cigarettes, current and constant, PHP. Philippines, 2018-2024

Unit values and prices have increased in real terms



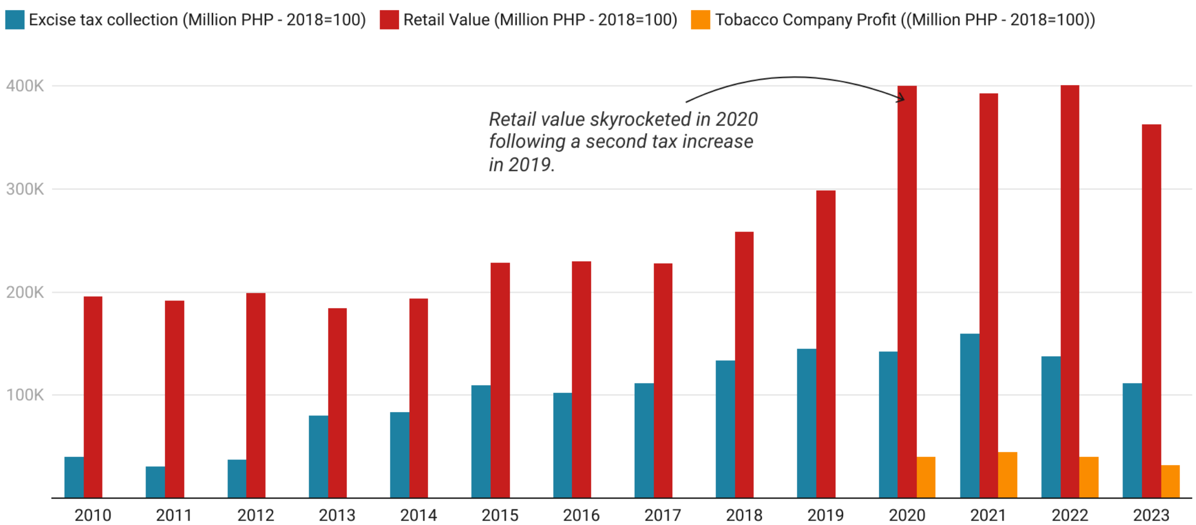
Source: Own elaboration based on WHO and Euromonitor.

Tobacco company profits

As observed in Figure 2, excise tax collection increased until 2020, followed by a downward trend through 2023. **Figure 5** illustrates the trend in retail value (total retail sales value) from 2010 to 2023, together with the trend in excise tax collection. In 2013, although excise tax revenue rose sharply due to a substantial tax increase in January 2013, the retail value did not show a proportional increase, with the public finance receiving a greater proportion of this through taxes. However, retail value steadily increased until 2019. In 2020, following a second tax hike, the pattern shifted, showing that retail value rose sharply with greater magnitude than the increase in excise tax revenue, suggesting that the tobacco industry has been capturing most of this additional value through their pricing strategy. Since then, retail values have remained relatively stable, while excise tax revenues have declined. Tobacco company profits had a similar trend to the excise tax revenue since 2020. Although retail values have been increasing, cigarette sales have consistently declined since 2012 as shown in Figure 1.

Figure 5. Total retail values, excise tax revenues and tobacco company profits. Philippines, 2010-2023

Retail value (total retail sales value) has steadily increased since 2014, following a tax increase in 2012. The value skyrocketed in 2020 after a second tax hike in 2019 and remained relatively stable afterward. Tobacco company profits mirrored the trend in excise tax revenue, which has declined since 2020.



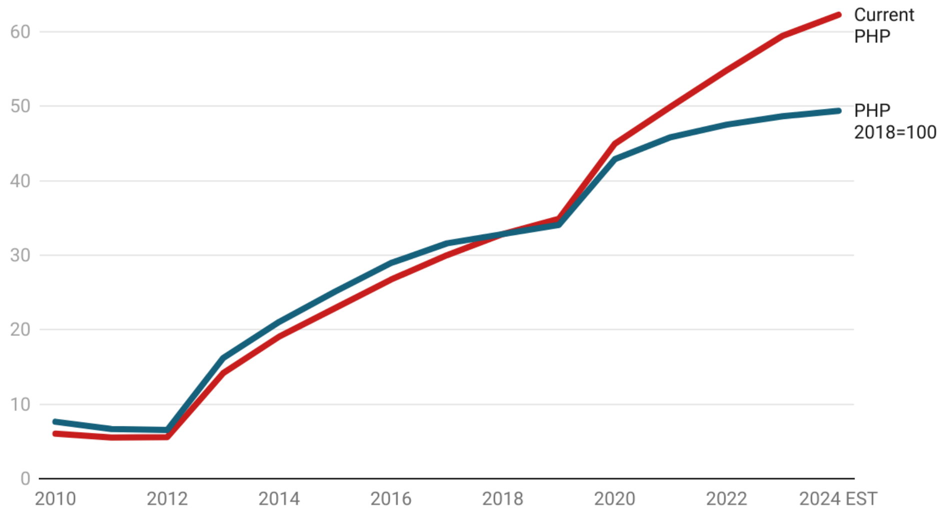
Tobacco company profit data were not available before 2020.

Source: Excise tax revenue from Philippine Statistics Authority, retail value from Euromonitor and tobacco company profits from SEC financial statements.

We analyzed the average excise tax collection per pack according to the Bureau of Internal Revenue (BIR) (**Figure 6**). Evidence suggests that the revenue collection per pack increased steadily over time, following the expected trend according to the provisions in the Republic Acts mentioned previously. We also explored the sales by price band (**Figure 7**) and the constant distribution from 2020 to 2023 (inclusive), and we found that despite the price increases, there was not a shift to lower-priced brands.

Figure 6. Average excise tax collection per pack, PHP. Philippines, 2010-2024

The excise tax collection per pack has increased since 2012 and did not fall after 2021

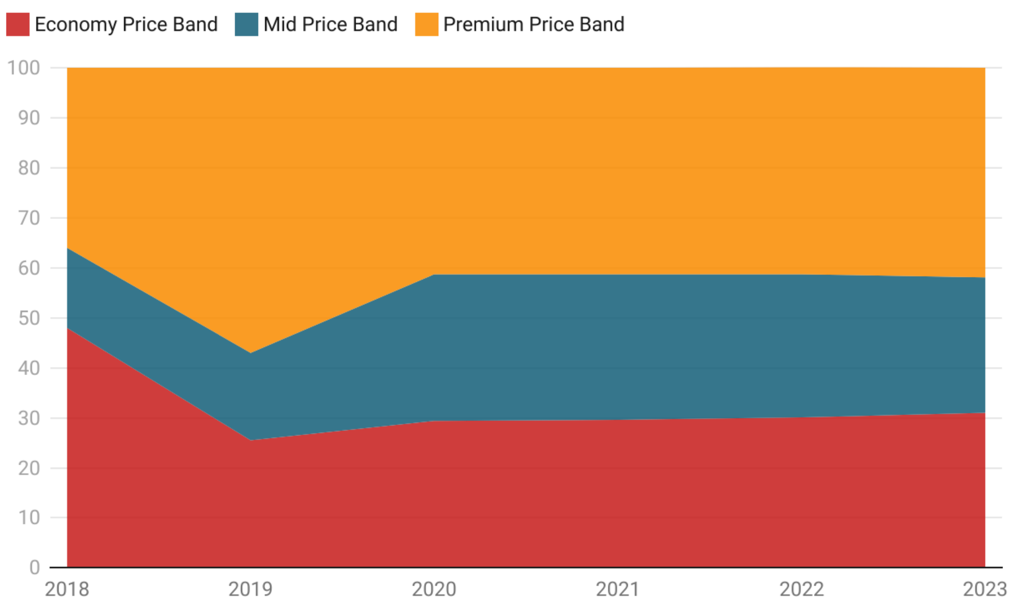


2024 includes only January-November

Source: Own elaboration based on Bureau of Internal Revenue data.

Figure 7. Sales of cigarettes by price band, % volume. Philippines, 2018-2023

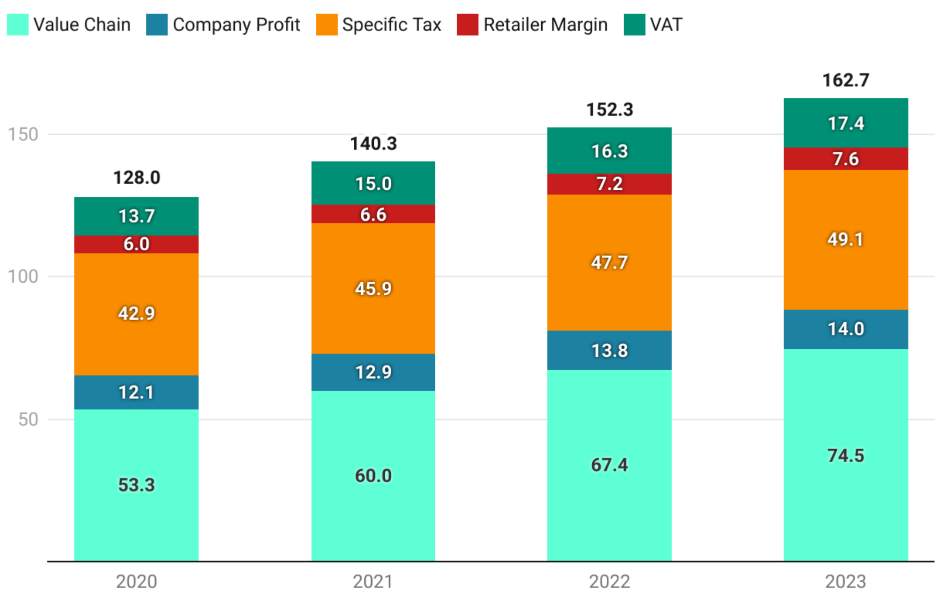
The distribution of volume by price brand has been unaltered since 2020



Source: Own elaboration with data from Euromonitor.

We decomposed the prices to assess who is receiving the extra revenues from higher prices. **Figure 8** illustrates the average price of a cigarette pack, broken down into its components in constant PHP: value chain or production costs,[3] company profits,[4] excise tax, retailer margin,[5] and VAT. The value chain was calculated as the portion of the total price excluding VAT, excise tax, company profits, and retail margin. The company profits category has shown a steady rise. In addition, the value chain or production costs categories has also increased. The sum of the value chain and company profits categories has increased 35.3% from 2020 to 2023. Moreover, it is critical to consider that companies report their own profits, which are also relatively easy to manipulate, for example, by moving profits to associated distributors and other similar entities in the supply chain, necessitating further research. Nevertheless, Figure 8 shows that the tobacco industry is getting more money through the value chain and profit categories.

Figure 8. Price structure of a pack of cigarettes, constant PHP, 2018=100. Philippines, 2020-2023



Source: Own elaboration with data from Euromonitor, Republic Acts 10351 and 113646, and Tobacco Company Financial Statements

[3] This includes the costs of all inputs to produce cigarettes: raw materials, facilities, labor, tobacco leaf, etc.
[4] Using company financial statements.
[5] Under the same assumption of retail margin of 5.5% as for Figure 3.

Illicit trade

A recent study[6] performed by Action for Economic Reforms (AER) aimed to examine the illicit cigarette trade particularly assessing the distribution across local "sari-sari"[7] stores and characteristics of these products in eight cities in the Philippines. AER found that the illicit trade in cigarettes varies significantly across cities. For instance, unregistered brands are sold in sari-sari stores in 6 out of 8 cities, with the percentage of stores selling these products varying from 1% in Navotas City to 61% in General Santos City. Also, forensic analysis of tax stamps on cigarette packs showed that 7.4% of collected cigarette packs had tax stamps that were missing or not legitimate (2.7% with no stamps and 4.7% with fake tax stamps). Illicit trade poses a demonstrable threat to public health and undermines fiscal measures to reduce consumption of cigarettes, and revenue collection. However, the lack of relevant longitudinal data on illicit trade prevents us from assessing if the illicit trade penetration has increased over the years, which may also help to explain part of the decline in revenue collection. On this, it is necessary to emphasize that there is no association between tax rates and illicit trade penetration in many countries around the globe, as illicit trade depends on law enforcement and good tax administration (WHO, 2021b). Considering this, the Philippines government is only now considering the implementation of a number of key, well-proven measures that would help to secure the cigarette supply chain such as an effective system to track and trace all products, including those manufactured domestically for domestic consumption and export, and imports. Other countries' experiences like Kenya and the United Kingdom suggest strongly that such measures are extremely effective in addressing current issues with missing or fake tax stamps.

Production and foreign trade

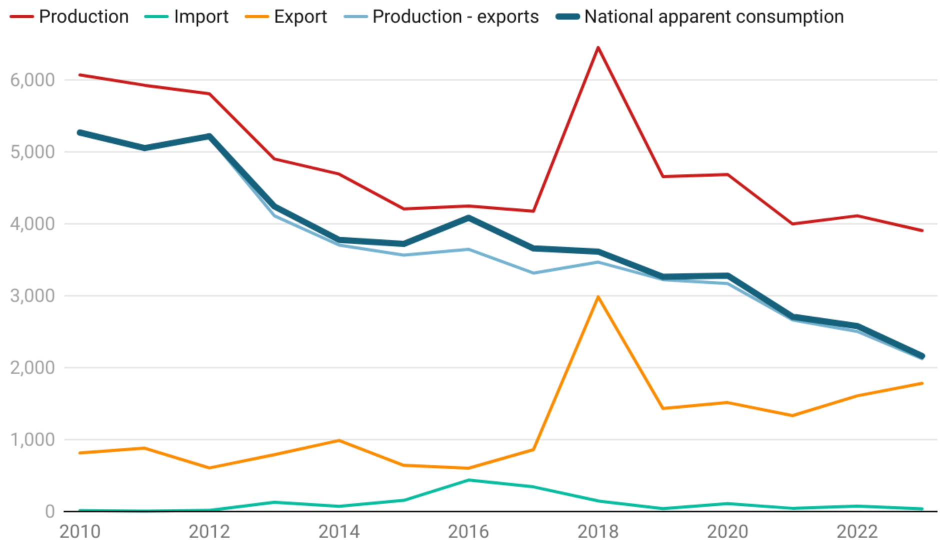
Production shows a negative trend in the period of 2010-2023 (**Figure 9**). Regarding foreign trade, reported imports have been historically low when compared to the national apparent consumption[8] (NAC), with relative importance as low as 0.1% of the market in

[6] These results are preliminary and are not published yet.
[7] Small, usually family-owned stores that sell a variety of daily use products in neighborhoods.
[8] National apparent consumption = production – exports + imports.

2011, reaching its maximum in 2016 at 10.7%. Exports show a positive trend, with an outlier observed in 2018, when exports increased by 247% compared to 2017.[9]

Figure 9. Production, imports, and exports of cigarettes (million packs). Philippines, 2010-2023

The category of production minus exports shows a very similar trend to the reported by BIR



Source: Own elaboration with data from Euromonitor.

Considering the increase in exports and the level of illicit trade, further examination is necessary to judge the hypothesis that exports are returning to the country illegally (or not leaving at all and producers are simply putting these products into the domestic market without paying appropriate taxes), since there could be some discrepancies in the amounts and trends of exports[10] when analyzing UN Comtrade data (2014-2024) (**Figure 10**).

[9] Note that exports are subject to payment of a bond equivalent to the amount of the excise tax, as provided in the tax code and Republic Act 11346:

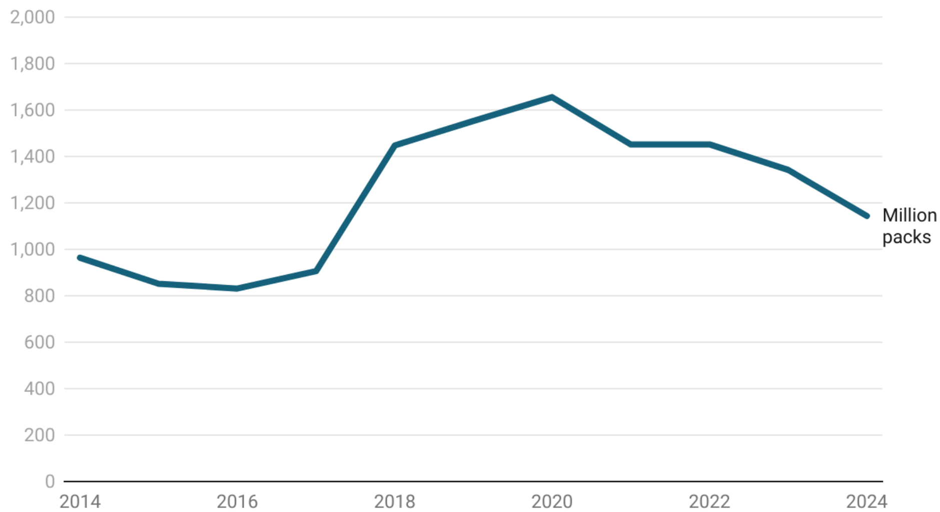
"No tobacco products manufactured in the Philippines and produced for export shall be removed from their place of manufacture or exported without posting of an export bond equivalent to the amount of the excise tax due thereon if sold domestically: Provided, however, That tobacco products for export may be transferred from the place of manufacture to a bonded facility, upon posting of a transfer bond, prior to export."
Source: https://www.bir.gov.ph/tax-code

[10] We gathered the imports data of all countries from Philippines of product code 240220 (cigarettes; containing tobacco) and assumed that one pack is of 20 cigarettes of 0.75 grams each.

The national apparent consumption has steadily decreased over the last two decades and does not show a breaking point as observed in 2021 for revenue collection and its levels and trends are very similar to the reported by the Bureau of Internal Revenue in Figure 1.

Figure 10. World's imports of cigarettes from Philippines, 2014-2024

Contrary to Euromonitor data, Comtrade shows a declining trend in exports from Philippines after 2020



Source: Own elaboration with data from UN Comtrade

Potential new rates

Since evidence shows that the tobacco industry has increased its prices at a higher pace than expected according to the tax increases stipulated in the Republic Acts, there is room for setting higher rates of taxes on tobacco products above the forecasted inflation rate of 3.5%.[11] Simulations conducted by Economics for Health at Johns Hopkins University find that an increase in tax would result in further reduction in consumption and increase in revenue (Table 1). This would mean a win for public health and a win for public finance, which in turn would yield to additional resources for the Department of Health.

[11] https://www.bsp.gov.ph/SitePages/MediaAndResearch/MediaDisp.aspx?ItemId=7424

Table 1. Tobacco excise tax collection at different tax rates on cigarettes in the Philippines

If the tax rate is increased, consumption would be reduced as excise tax collection would increase

Tax rate (PHP per stick)	Consumption (million packs)	Excise collection (million PHP)
62.3 (current)	2703.1	124,804
70.0	2535.1	150,302
80.0	2317.5	157,031

Source: Own elaboration with data from the Bureau of Internal Revenue and assumping a price-elasticity of -0.3 and an adjustment factor defined as the ratio between potential revenue collection and observed revenue collection in the period 2022-2024.

Conclusions and recommendations

Republic Act 10351 and subsequent updates have been globally acknowledged as one of the most important tobacco taxation milestones. The Sin Tax Reform has been associated with a steady reduction in tobacco consumption and significant increases in financial resources for healthcare in the Philippines. However, revenue collection from tobacco taxes has declined in the recent years. Evidence shows that the tobacco industry has over shifted the taxes on tobacco products, which means that they have raised prices far beyond the expected after the 5% annual increase in the specific component. This is reflected in a more than 35% increase in the combined categories of value chain (production costs) and company profits. Under a strengthened fiscal policy on these products—i.e., higher excise taxes—this revenue could be collected by the Philippines government instead of the industry. It is necessary to explore tax administration efficiency, to assess the hypothesis that there have been inefficiencies in that task and further analyze exports, since there are some discrepancies that suggest that "exported" cigarettes are being reintroduced to the country. Several key implications emerge:

- If passed, the House Bill 11360 would potentially cause tobacco prices to decrease and consumption to increase, especially among youth, with less revenue collection and/or increased benefits for the tobacco industry (i.e., higher profits), all at the expense of the broader Philippines population. Alternatively, it is possible that prices do not decrease, which would also mean more profit for the tobacco industry and a significant loss of revenue for public finance. Both possibilities would imply that the Department of Health would have less resources for the universal healthcare initiative and other programs, negatively affecting healthcare for the poor and ultimately economic growth and development for the country.

- Raising the excise tax on cigarettes would help curb cigarette consumption, while boosting government revenue.
- Strengthening tax administration would minimize tax evasion and combat illicit trade, including ensuring that some domestic producers are not cheating the tax system.
- Additional revenues could be directed partly toward tax administration changes such as a track-and-trace system to secure the tobacco supply chain and enhance public healthcare.

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