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Increasing the Tobacco Tax Rate in Vietnam is Not Enough: Tobacco Tax Structures Need Reforms Too

Introduction

Tobacco use is the world's leading cause of preventable deaths, killing more than 7 million people each year, with 80% of deaths in low- and middle-income countries.[i] Significantly increasing tobacco taxes is the single most effective way to reduce the health and economic devastation caused by tobacco. Evidence from around the world shows that higher taxes and prices reduce tobacco use.[ii]

In Vietnam, the retail price of cigarettes and cigars include a special consumption tax based on the price of those tobacco products as they leave the factory. This is called the pre-tax ex-factory price. The current special consumption tax rate for cigars and cigarettes in Vietnam is 70%. Vietnam adds a 10% valued-added tax (VAT) levied on the total of the ex-factory price. Tobacco manufacturers and importers also have to pay an additional 1.5 to 2% of the pre-tax ex-factory price toward The Fund for Prevention and Control of Tobacco Harms.[iii]

All these taxes might seem high, but they can be manipulated by undervaluing the ex-factory price, which is exactly what is happening in Vietnam.

There are various ways to tax tobacco products. This policy brief explains the different tax structures, how they vary, and, most importantly, how they affect affordability of cigarettes and cigars in Vietnam.

The conclusion that can be drawn from the data in this policy brief is that cigarettes and cigars have become increasingly affordable in Vietnam during the 2006-2016 period. However, available evidence and international guidelines recommend that tobacco products need to become increasingly expensive (less affordable) to reduce their demand.

Different Types of Tax Structures

There are two types of excise taxes that are often applied to all goods or products that are sold: specific excise taxes and ad valorem excise taxes. Specific excise taxes are levied as a specific value per quantity, such as per pack of cigarettes, per 20 cigarettes, or per gram of tobacco. Ad valorem excise taxes are levied as a percentage of some value or base, such as 70% of ex-factory price or retail price.

Specific taxes are significantly easier to administer than ad valorem taxes since it is easier to count the physical quantity of product than it is to determine the value. The base on which the ad valorem tax is calculated can be manipulated by undervaluing, for example, the ex-factory price. Even if the ad valorem tax goes up, the price to the consumer may not change if the ex-factory price is lowered by the manufacturer.

Thus, ad valorem taxes often result in lower average retail prices than specific taxes. With tobacco products, this creates greater opportunities for consumers to continue to smoke their current brand or trade down to cheaper brands. Since tobacco consumption is strongly related to price, an increase in ad valorem tobacco taxes, in this case, would in all likelihood not reduce consumption. Conversely, specific taxes lead to higher average prices, particularly at the lower end of the price spectrum, thereby reducing consumption and generating a greater health benefit from tax increases.

One challenge with specific taxes is that the value of the tax can be eroded by inflation. However, this is relatively easy to overcome through automatic increases or other types of adjustments to the specific tax.

Tobacco Taxes in Vietnam

Vietnam demonstrates one of the most prominent weaknesses of ad valorem taxes because it uses a poorly defined tax base such as the pre-tax ex-factory price. Table 1 shows the breakdown of a pack of the most-sold brand of cigarettes which cost 20,000 Vietnamese Dong (VND) at the retail level in 2016. While the ad valorem tax rate of 70% seems significant, applying it to a base very early in the supply chain only accounts for 28.1% of the retail price which is much less than the recommended 70% by the World Bank and the World Health Organization (WHO).[iv]

Table 1

Breaking down the price of a pack of the most sold brand of cigarettes in Vietnam in 2016

		VND per pack	Percentage of retail
a	Pre-tax ex-factory price	8,028	40.1%
b	Excise tax (70% of a)	5,620	28.1%
c	VAT (10% of a + b)	1,394	7.0%
d	Compulsory levy (1.5% of a)	120	0.6%
e	Wholesale and retail margin	4,838	24.2%
f	Retail price	20,000	

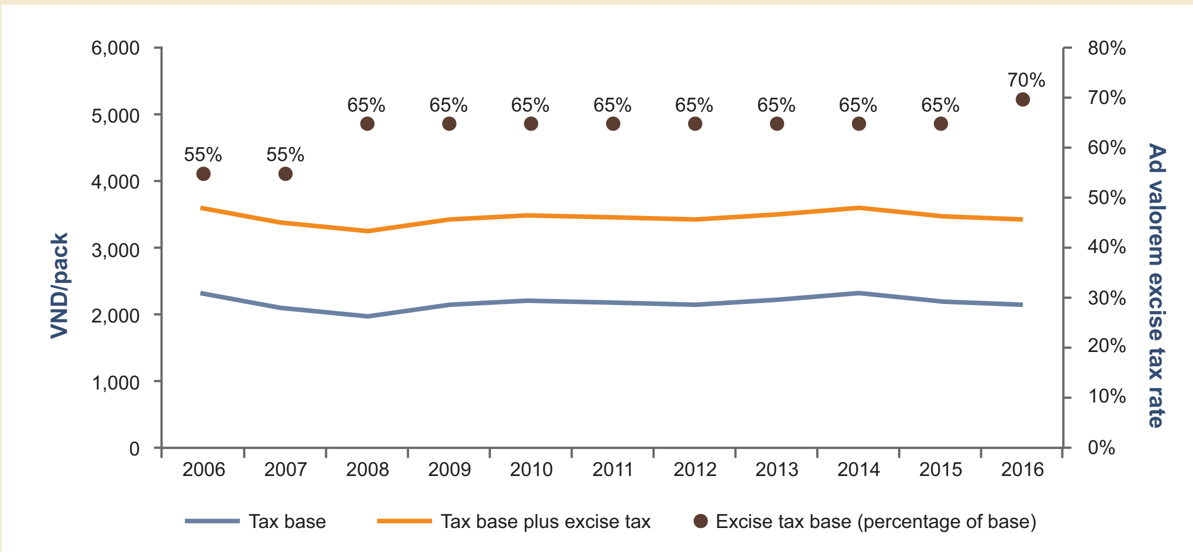
Source: WHO report on the global tobacco epidemic (2017)[v]
Note: Price represents the price of the most-sold brand. This price and hence the pre-tax ex-factory price and excise are significantly higher than the weighted average used elsewhere.

Similarly, the increases in the ad valorem excise tax rate, from 55% to 65% in 2008, and 65% to 70% in 2016 have had little impact on retail cigarette prices because the ex-factory price has remained relatively unchanged after inflation.

Figure 1 shows the average tax base per pack (pre-tax ex-factory price) and excise tax added to the base over the time period 2006 to 2016 in inflation adjusted terms (all values are converted into 2006 prices). While excise taxes have been going up, Figure 1 demonstrates how the industry can lower the tax base to lower the per pack price.

Figure 1

Average tax base and excise tax added to the base per pack of cigarettes in Vietnam (in inflation adjusted terms), 2006-2016



Source: General Statistics Office of Vietnam,[vi] Euromonitor International,[vii] Guindon et al. (2010),[viii] Vietnam Tobacco Tax Report Card (2017)[ix]

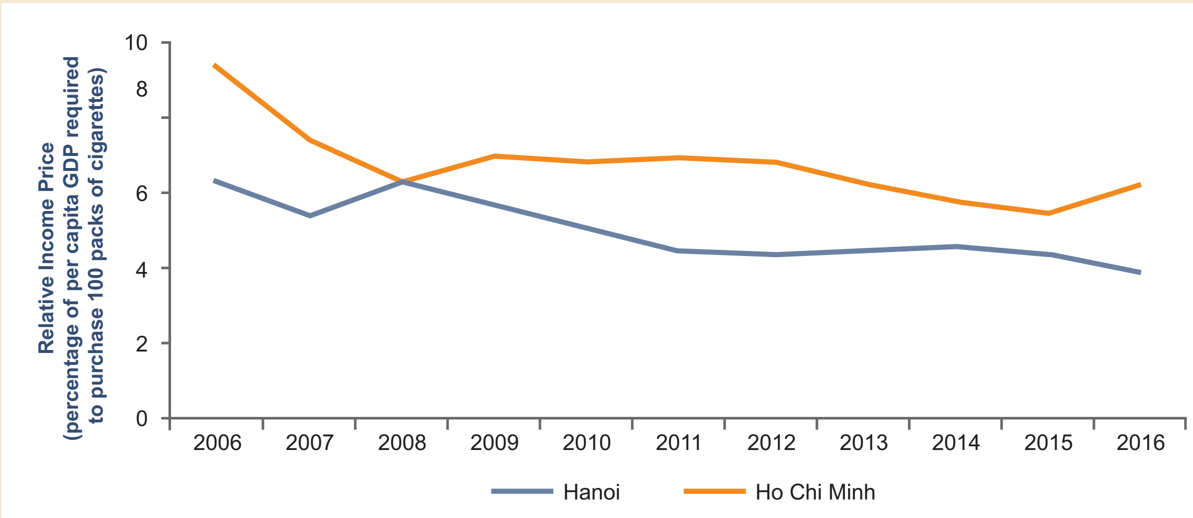
Impact of Ad Valorem Taxes on Tobacco Affordability

The ad valorem tax rate was increased twice during 2006-2016, but it had little impact because the tobacco industry lowered the ex-factory price during the same period. With inflation, the significantly smaller increases in the average excise tax per pack resulted in cigarettes becoming more affordable in Vietnam during this time.

Combined with the rapid economic growth that Vietnam has experienced, this increase in affordability has been very large. Figure 2 shows the affordability of cigarettes over the 2006-2016 time period in Vietnam as measured by the Relative Income Price (RIP), which is a percentage of per capita gross domestic product (GDP) required to purchase 100 packs of cigarettes. A declining RIP means that cigarettes are becoming more affordable over time. This was true in both Hanoi and Ho Chi Minh City, as measured by the price of a popular local brand purchased in local supermarkets. Figure 3 shows the same data as an index, relative to the 2006 level of affordability, which leads to the conclusion that by 2016, cigarettes became 38% more affordable in Hanoi and 34% more affordable in Ho Chi Minh City.

Figure 2

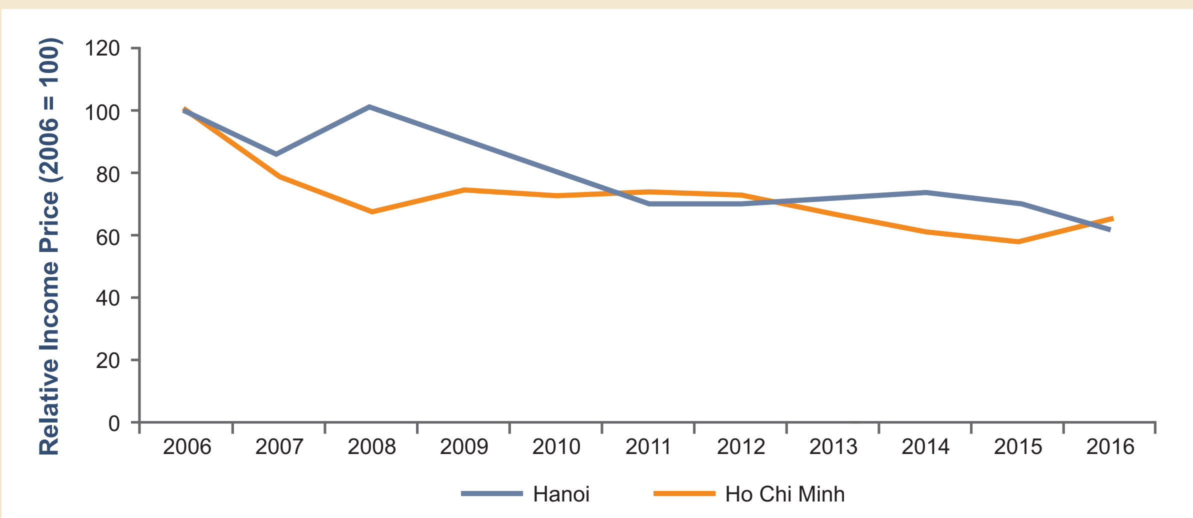
Affordability of cigarettes in Vietnam, 2006-2016



Note: Prices represent the price of a local brand in a supermarket sourced from the Economist Intelligence Unit Worldwide Cost of Living Survey. Per capita GDP is sourced from the World Bank's World Development Indicators database. Both prices and income are collected in local currency.

Figure 3

Affordability index of cigarettes in Vietnam from 2006 to 2016



Note: Prices represent the price of a local brand in a supermarket sourced from the Economist Intelligence Unit Worldwide Cost of Living Survey. Per capita GDP is sourced from the World Bank's World Development Indicators database. Both prices and income are collected in local currency.

Conclusions

While increases in the affordability of most goods and services are positive and sought after, increases in the affordability of cigarettes result in increased smoking and its negative health consequences. The World Health Organization (WHO) recommends that countries establish their tax policies in such a way as to ensure that tobacco products become less affordable over time. The WHO Guidelines also highlight the importance of tax structures, recommending that countries like Vietnam, which have agreed to the WHO Framework Convention, implement specific or mixed excise tax systems rather than purely ad valorem systems.

Given the weaknesses of an ad valorem tax system, and specifically, the way ad valorem taxes have been applied and administered, Vietnam would benefit from reforming its tobacco excise tax structure. These reforms would significantly improve the administration of excise taxes and ensure that future excise tax increases result in greater health benefits. The easiest and most efficient way to reform the tax structure would be to shift to a uniform specific excise tax. This could occur through an immediate shifting to a uniform specific excise tax or through a movement over time to a mixed system whereby a specific tax is added to the current ad valorem tax.

It is important to note that due to the presence of inflation and rapid economic growth, any specific excise tax should be regularly increased in order to maintain its health impact. Importantly, the specific excise tax should be increased annually by at least the combination of inflation and economic growth through an automatic adjustment process, ensuring that affordability will not increase.

Thus, there are three actions that are urgently needed to reduce tobacco consumption in Vietnam:

- Tobacco products are becoming increasingly affordable in Vietnam; this trend needs to be reversed.
- The weakness of the current tax structure, relying mostly on ad valorem taxes, needs to be changed to include specific excise taxes that are raised regularly to keep pace with inflation.
- Tobacco taxation as a share of retail price is low in Vietnam in comparison to other countries in the region and they need to be increased as recommended by the World Bank and WHO.

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About Tobacconomics

Tobacconomics is a collaboration of leading researchers who have been studying the economics of tobacco control policy for nearly 30 years. The team is dedicated to helping researchers, advocates and policymakers access the latest and best research about what's working—or not working—to curb tobacco consumption and the impact it has on our economy. As a program of the University of Illinois at Chicago, Tobacconomics is not affiliated with any tobacco manufacturer. Visit *www.tobacconomics.org* or follow us on Twitter *www.twitter.com/tobacconomics*.

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