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Case Studies in Illicit Tobacco Trade: The Philippines

Background

Beginning in 2013, the Philippines began imposing steep price increases on tobacco. This Fact Sheet describes the series of increases and the measures put in place by the government during this time to combat illicit trade. The Fact Sheet concludes by offering recommendations to further address illicit trade of tobacco products.

In the Philippines, the smuggling of a wide array of goods, including essential ones like rice and oil, is ubiquitous.[1] The revenue collection agencies, namely the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BoC) are viewed as corrupt by many in society, and even the judiciary is prone to bribes and regulatory capture.[2]

How then can illicit trade be dealt with in a situation when good governance and institutions are wanting? Strong governance and institutions cannot be realized in an instant, but delaying measures to reduce tobacco consumption, like the series of disruptive tax rates that the Philippines has imposed since 2012, is not an option in the face of the huge costs of tobacco-related illness and death on society and productivity. A viable way to tackle illicit trade even when institutions are lacking is to measure it, identify the sources of challenges, and execute the appropriate interventions.

Tobacco Tax Increases in the Philippines Since 2012

The Philippines has had three rounds of amendments to its tobacco excise tax law beginning in 2012 with the Republic Act 10351 (RA 10351), or the "sin tax law". RA 10351 was a major reform of the excise tax system on tobacco and alcohol products, after 15 years of a multi-tiered, specific excise tax system that did not adjust for inflation. The main features of the reform included a gradual shift from a four-tiered specific tax structure to a unitary system, significant increases in the tax, the removal of the "price classification freeze" that kept legacy brands from moving to higher price and tax categories, and an annual four-percent adjustment of the specific excise once the unitary system is in place.

Beginning in 2013, the four-tiered structure became two-tiered and excise tax on cigarettes increased by as much as 108 percent and 341 percent for high-priced and low-priced brands, respectively, between 2012 and 2013. In that same period, prices jumped by more than 40 to 60 percent for the most popular brands according to the data of the Philippine Statistics Authority. By the time the unitary tax structure came into effect in 2017, the price of the cheapest brands had already more than doubled, significantly narrowing the gap between the cheapest and the most expensive brands.

Before 2017 ended, another tobacco tax increase was passed under RA 10963, otherwise known as the Tax Reform for Acceleration and Inclusion Law (TRAIN), which instituted a 17-percent cigarette tax increase for the year 2018. TRAIN was then superseded by the third and most recent tobacco excise tax amendment in RA 11346, which passed in July 2019. Under RA 11346, the unitary specific tax on cigarettes increased by 29 percent at the start of 2020, which will be followed by eleven-, ten-, and nine-percent increases for the years 2021, 2022, and 2023, respectively. After 2023, a five-percent annual increase will take effect.

The impacts of the sin tax law have been significant—

- Total cigarette pack sales dropped by 32.5% in the first two years.
- Smoking prevalence declined substantially from 28.3% in 2009 to 22.7% in 2015.
- Government revenue nearly tripled from 32.9 bn PHP in 2009 to 106 bn PHP in 2016.
- Due to earmarking, the national health budget more than doubled, resulting in 8 million more low-income families receiving health care coverage under the National Health Insurance Program.

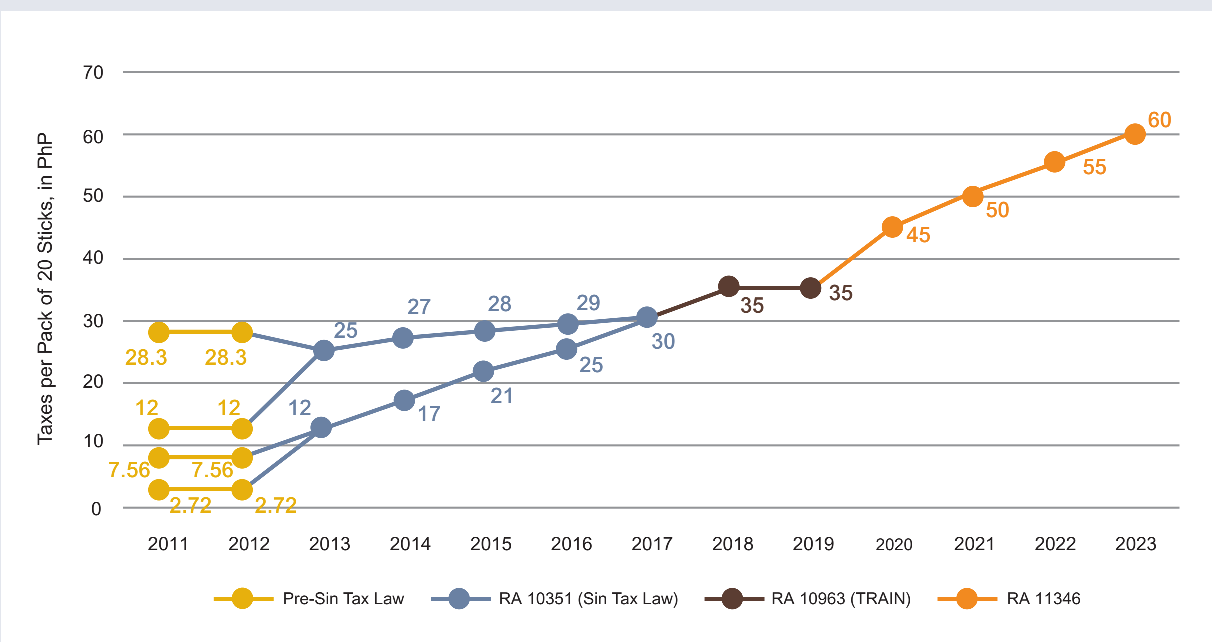
Efforts to Combat Illicit Trade

At the same time, BIR strengthened tax administration efforts to combat illicit trade. In July 2014, BIR issued a revenue regulation (RR No. 07-2014) to comply with the law's provision that locally manufactured packs of cigarettes shall have internal revenue stamps, and extended the regulation to imported cigarettes as well.

From January 2015 to mid-2016, the government, through a World Bank project, monitored tax-compliance effort at the political district level. For each month, more than

Figure 1

Cigarette Excise Tax Rates, Philippines, 2011-2023



Source: Government of the Philippines, Republic Act Numbers 10351, 10963, and 11346.

100,000 observations were recorded in more than 60 districts nationwide. The compliance rate (or the tax stamp prevalence) was 95.81 percent by May 2016.[3] This compliance rate stands in contrast to tobacco industry-sponsored estimates of an illicit market share of 18 percent, which have since been discredited.[4] At the same time, Euromonitor International (2019) estimates showed an increase in illicit trade with respect to the volume of cigarettes from 6.5 percent in 2012 to around 12 percent since the tobacco tax reform was implemented in 2013.[5]

In order to address counterfeit tax stamps and to further strengthen the stamp system, in June 2016 the BIR Commissioner issued a revenue memorandum order (RMO No. 30-2016) with guidelines for replacement of internal revenue stamps that were spoiled, had factory defects, or badly ordered, and procedures in monitoring tax stamps. She also issued a separate memorandum order (RMO No. 33-2016) that provides uniform procedures for the implementation of the Internal Revenue Stamp Integrated System (IRSIS). In addition, BIR upgraded the tax stamp with a new design and introduced a mobile stamp verifier application available to the public to authenticate tax stamps, but its use by the public remains limited.

Currently, illicit trade mainly consists of counterfeit brands, but it has also "evolved into sneaking unregistered cigarette-making machines into the country, with small factories producing fake cigarettes bearing famous brands."[6] Finance Secretary Dominguez has noted that the operators import surplus machines from China that produce cigarettes[7] and as a result, he has prioritized raiding these illicit factories, burning the contraband, destroying the machines, and has made the fight against illicit trade a priority alongside the ongoing comprehensive tax reforms.

Other recent measures that the government has undertaken include the following:

- Improved cooperation between the two revenue-collecting agencies, the BIR and BoC, manifested in the creation of a joint task force to coordinate enforcement activities.
- Coordination of BIR and BoC with counterparts in China to stop the entry of illegal cigarette-making machines.
- Cooperation with ASEAN members to curb their export of untaxed cigarettes to the Philippines.
- Stiffer penalties under RA 11346 on tobacco taxation for using fake tax stamps.
- Resistance to legislation that will hamper raids of illicit cigarette factories and warehouses.
- Coordination with the Department of Interior and Local Government in filing charges against local officials who fail to address illicit trade in their jurisdictions.[8]

Conclusion

The case of the Philippines shows that it is possible to implement a significant tax reform and large tax increases, while at the same time strengthening tax administration. This allowed for significant increases in revenues, reductions in tobacco use, and relatively effective control of illicit trade. Even with these measures, though, more could be done to combat illicit trade—

- The stamp verifier application should be used more throughout the country.
- The public should be given access to brand-specific data on retail prices of the different tobacco products, or at least BIR should conduct or commission a brand-specific retail price survey and make the survey result accessible to the public.

- Local government units should be involved as they are first to know the presence of illegal activities. Currently earmarked funds for the health facilities enhancement program at the local level can be supplemented with other incentive mechanisms tied to fighting illicit trade.
- BIR should measure illicit trade on an annual basis through gap analysis comparing tax-paid sales with consumption and/or primary surveys of smokers with pack inspections.
- BIR should put in place a tracing and tracking system, which records the movement of a cigarette pack through the supply chain.

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