

This policy brief is based on a research study entitled “**Cigarette Brand-Switching Behavior and Tobacco Taxation in Vietnam**” conducted by the Development and Policies Research Center (DEPOCEN)

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## Potential Impacts of Specific Tobacco Excise Tax on Illicit Trade in Cigarettes

Raising tax imposed on tobacco is the most effective measure to reduce smoking in many countries around the world. The Ministry of Finance of Vietnam is proposing to switch from the current purely ad valorem system to a mixed one by imposing a specific tax rate on top of the ad valorem tax. The value of the tax rate being discussed ranges from VND 1,000 to VND 2000 VND as currently being proposed by MOF and to 5,000 VND as suggested by WHO and other international organization<sup>1</sup>.

The threat of illicit trade is one of the main concerns against any tobacco tax proposal. It is argued that increases in prices induced by adding the specific tax component may encourage smokers of domestic brands to switch to illicit brands. This then would not only undermine the very objective of the tax reform, but also adversely affect the domestic industry. To address this concern, a discrete choice experiment is conducted to allow for simulating the potential impact of specific tax increases on smokers' cigarette brand choice. The experimented brands include popular domestic and foreign brands, as well as Jet and Hero, the two most popular illicit cigarette brands in Vietnam. Together, they account for over 80% of the cigarette market in the country.

The simulation results suggest that a larger share of current smokers opt out (that is, to buy none of the studied brands or quit smoking) and do not intend to switch to illegal cigarette brands in response to specific tax increases. To illustrate, two simulation scenarios are presented in Table 1: (i) the entire tax increases are transmitted to retail prices of licit cigarettes but the

price of the illicit brands remains unchanged (i.e. Scenario 1), and (ii) the entire tax increases are transmitted to retail prices and the price the illicit brand prices only go up by 50% of the tax increases (Scenario 2),

As shown in Table 1, under Scenario 1, if the VND 5,000 specific tax is imposed, it is estimated that nearly 15% of current smokers would not consume legal cigarette brands any longer. Among them, 8% (more than half) would rather opt out (that is, to choose none of the experimented brands), suggesting the possibility of quitting cigarette altogether.

There are two possible explanations for this finding. First, as observed in a recent study<sup>2</sup>, the illicit cigarettes are considerably more expensive than a majority of the legal cigarettes in Vietnam. Hence, many smokers of the legal cigarettes simply cannot afford to consume the illicit cigarettes, regardless of whether the specific excise tax is raised. Second, Jet and Hero, two predominant illicit cigarette brands, are distributed almost exclusively in the South where they are smuggled from Cambodia. Perhaps due to high transportation costs and risk of being caught, they are rarely found in the North and Central. Therefore, it is extremely unlikely that smokers in these two regions could switch to these two brands following the specific tax increase.

Simulation results under scenario 2 suggest that the magnitude of the substitution to the illicit brands tends to be negatively related to change in their prices as a result of the specific excise tax hike. As reported in Table 1, should the illicit brand prices go up by 50% of

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<sup>1</sup> WHO. Tobacco Taxes in Viet Nam Questions and Answers. Hanoi; 2018.

<sup>2</sup> Nguyen, Anh, and Hoang The Nguyen. 2020. “Tobacco

Excise Tax Increase and Illicit Cigarette Consumption: Evidence from Vietnam.” *Tobacco Control*: tobaccocontrol-2019-055301.

the VND 5,000 specific tax (VND 2,500), then their total market share would increase by only less than four percentage points, half of the figure in the Scenario 1 where their prices are assumed to be constant. Understandably, once the illicit cigarettes become

more expensive, not only do they appear less compelling as substitutes, some of their current smokers may also find them less affordable and would choose not to stay with them.

**Table 1: Impacts of Raising Specific Tobacco Excise Tax on Cigarette Market Share by Brand Segment**

Scenario	Assumptions	Price segment	Specific Tax Rate		
			1,000 VND	2,000 VND	5,000 VND
1	- All taxes on legal cigarettes are passed through to smokers	Low	-3.3	-6.1	-11.9
		High	-0.7	-1.4	-3.0
	- The prices of illicit cigarettes are not affected	Illicit SE555	0.1	0.3	0.7
		Jet and Hero	1.8	3.4	6.4
		<b>Optout</b>	<b>2.1</b>	<b>3.8</b>	<b>7.9</b>
2	- All taxes on legal cigarettes are passed through to smokers,	Low	-2.8	-5.1	-10.8
		High	-0.4	-0.8	-2.0
	- The price of the illicit cigarettes increases by 50% of the tax rate.	Illicit SE555	0.1	0.1	0.4
		Jet and Hero	0.9	1.7	3.3
		<b>Optout</b>	<b>2.2</b>	<b>4.1</b>	<b>9.2</b>

*Note: Each number indicates a percentage point change in market share of a cigarette brand segment in response to a corresponding specific excise tax rate. One percentage point represents one percent of current cigarette smokers. Low-priced brands consist of Thang Long and Tourism in the North, Prince and Batos in the Central, Hoa Binh and Khanh Hoi in the South, and Sai Gon in all three regions. High-priced brands comprise of Vinataba in the North, White Horse in the Central, Craven A in the South, and SE555 in all three regions. Optout refers to “none of these brands”, meaning that smokers choose not to smoke any of the listed brands.*

There are at least three reasons to expect the prices of the illicit cigarettes to increase. First, once legal cigarettes become more expensive, smugglers and retailers may find it more profitable to strategically price up the smuggled products even though this means that their market shares would be lower than in the case of holding their prices unchanged. Second, more effective market surveillance and border control can inflate the costs and risk of trading the illicit cigarettes, and thus their prices, as the national and provincial 389 Steering Committees, government agencies designated to fight smuggling appear to have done between 2016 and 2020<sup>3</sup>. Finally, costs incurred before Jet and Hero reach the Vietnamese border can jump due to higher

excise taxes or more stringent distribution restriction imposed by the Government of Cambodia.

In conclusion, the Government of Vietnam should impose the specific excise tax on tobacco products, and have a clear monitoring and evaluation plan to assess its effectiveness in reducing cigarette consumption. The threat of illicit trade in cigarettes should not be exaggerated since this misrepresentation may easily cause the well-established benefits of raising the specific tobacco excise tax to be overlooked. Moreover, by maintaining and improving market surveillance and border control, the Government could help raise the costs of sourcing

<sup>3</sup> Nguyen, Anh, and Hoang The Nguyen. 2020. “Tobacco Excise Tax Increase and Illicit Cigarette Consumption: Evidence from Vietnam.” *Tobacco Control*: tobaccocontrol-

and distributing the illicit cigarettes in the South,  
thereby discouraging legal brand smokers from

switching to the illegal brands as well as encouraging  
illegal brand smokers to give up smoking.

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