

# Increasing Tobacco Taxes Does Not Harm the Poor in Argentina

## KEY MESSAGES

**Tax increases reduce tobacco consumption and relatively more so among low-income households. This reduction should be the ultimate aim of the tobacco tax policy.** In Argentina, a 10 percent increase in cigarette prices would decrease consumption by 7.5 percent for the less affluent smoker and by 4.9 percent for the more affluent ones. As less well-off individuals reduce consumption relatively more, they bear relatively lower tax burden from higher taxes.

**Tobacco tax increases are not regressive.** In Argentina, those individuals with a higher price elasticity of demand for cigarettes are the less affluent ones. Thus, they will decrease consumption relatively more following price increases and will bear relatively less tax burden. Faced with a price increase of 18 percent, the poorest and the richest quintile would increase tobacco spending in a similar proportion as a share of income. Thus, tobacco tax increases tend to be more proportional than regressive.

**The trend toward more progressive tobacco taxes is heightened when considering the long-run effects of a tax increase.** Higher taxes discourage consumption and save on future medical expenses associated with smoking-related diseases. They also generate an increase in lifetime earnings due to a lower risk of premature death. When these factors are taken into account, increasing tobacco taxes is a progressive policy. Due to higher taxes the poorest quintile would experience savings of about 1 to 4 percentage points of their income due to lower medical expenses and higher labor income.

## WHY INCREASE TOBACCO TAXES?

The global health and economic burden of tobacco use is enormous and is increasingly borne by low- and middle-income countries (LMICs). Already, around 80 percent of smokers live in LMICs. While smoking prevalence is falling at the global level, the total number of smokers worldwide is still more than one billion, partly driven by population growth. Thus, there is a strong possibility that the global target of a 30 percent relative reduction in tobacco use by 2025 agreed to by World Health Organization (WHO) Member States will not be met. The number of tobacco-related deaths is more than 8 million annually. In this context, increasing tobacco excise taxes can help to save millions of lives as the scale of the epidemic demands continued attention and support.

Increasing tobacco taxes, however, often leads to criticism that they disproportionately affect the poorest sectors of society, given that low-income households often allocate a higher share of their income to tobacco consumption. This inaccurate narrative is strongly promoted by the tobacco industry and its allies, including some government officials. Yet, such claims stem from two flawed assumptions: i) that all individuals across the income distribution react similarly to an increase in the price of cigarettes (caused by tax increases); and ii) that changes in tobacco taxation affect households only through the expenditure on tobacco.

This Policy Brief analyzes these distributional aspects of potential tax reforms that propose to increase taxes on

cigarettes in Argentina. Specifically, CEDLAS developed an Extended Cost Benefit Analysis (ECBA) to evaluate whether increasing tobacco taxes could be a progressive policy.

## DISTRIBUTIONAL ASPECTS OF INCREASING TOBACCO TAXES

The trend toward more progressive tobacco taxes can be heightened by considering the long-run effects of a tax increase (Vulovic and Chaloupka, 2021). Tobacco taxes have a **direct effect** on cigarette expenditure (i.e., taxes modify retail prices and, consequently, household expenditure on cigarettes). But they also generate **indirect effects**. If higher taxes discourage consumption, households can expect to save on future medical expenses associated with smoking-related diseases, and they can also expect an increase in lifetime earnings due to a lower risk of tobacco-related morbidity and premature death. As lower-income households consume relatively more tobacco, savings in medical expenses and increases in future labor income will be relatively greater for them. Thus, the **total long-term effect** will depend on the changes in cigarette expenditure, medical expenses, and the income of individuals due to better health conditions (Fuchs and Meneses, 2017).

Combining this ECBA with recent simulations of tax reforms scenarios developed by CEDLAS (2022) this research evaluates whether increasing tobacco taxes could be progressive. Specifically, this research simulates two tax reform scenarios where higher tobacco taxes lead to higher

prices of cigarettes, and then evaluates how those price changes affect household cigarette expenditure, medical expenses, and labor incomes.

- **Tax Reform 1:** proposes to raise the ad valorem rate of the internal tax (II), resulting in an increase in the price of cigarettes of 18.3 percent, on average.
- **Tax Reform 2:** proposes to modify the structure of the II by establishing a unique specific tax (i.e., replacing the ad valorem rate by a fixed specific rate). The level of this specific tax is set according to the economic costs of smoking, in terms of direct medical care that tobacco use imposes. This scenario results in an increase in the price of cigarettes of approximately 41 percent on average.

The research also considers the implications of income group-specific elasticities for the distributional impacts of tobacco taxes.

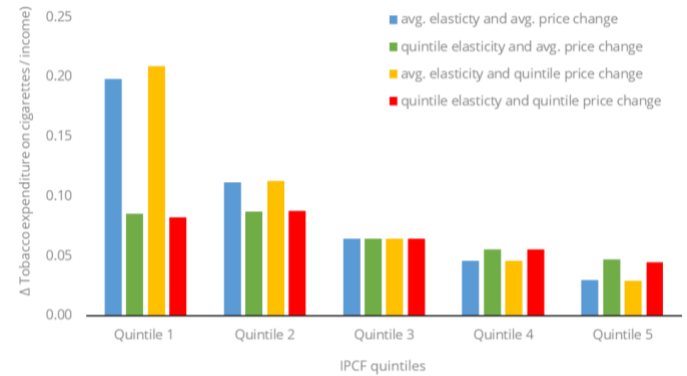
Figure 1 shows the proportional change in cigarette expenditure and the total effects for Tax Reform 1. The blue bars assume an average price elasticity of demand for cigarettes of 0.6, as estimated in Cruces et al. (2022). This elasticity is the same for all the smokers. Additionally, all the smokers face the same change in price (i.e., 18.3 percent price increase). In this case, an increase in the price of cigarettes—due to a tax hike—would be regressive as it disproportionately affects expenditures of less affluent smokers. The poorest (richest) quintile would increase its tobacco expenditures—as a share of income—by 0.20 (0.03) percentage points.

Alternatively, the green bars assume that price elasticities vary across income groups,<sup>1</sup> with the poorest as the most reactive, while all the smokers face the same change in price (i.e., 18.3 percent). Now, the poorest quintile would increase its share of tobacco expenditure in relation to income by 0.09 percentage points, while the richest quintile would increase it by 0.05. The second, third, and fourth quintile experience changes in tobacco expenditure relative to their income very similar in magnitude relative to quintile 1. Thus, **tobacco tax increases are more neutral when the differing price elasticities of demand for each income group is considered.**

The yellow bars and the red bars show the proportional change in cigarette expenditure, but assume that price changes are quintile specific.<sup>2</sup> In the first case, the poorest quintile would increase its share of tobacco expenditure in relation to income by 0.21 percentage points, while the richest quintile would increase it by 0.03. In the second case, the changes are 0.08 and 0.05, respectively. Again, results indicate that tobacco tax increases are more neutral when

income group-specific price elasticity of demand is considered. The results reveal that the assumption of the price elasticity of demand for tobacco products is crucial when analyzing the tax incidence of increasing tobacco taxes.

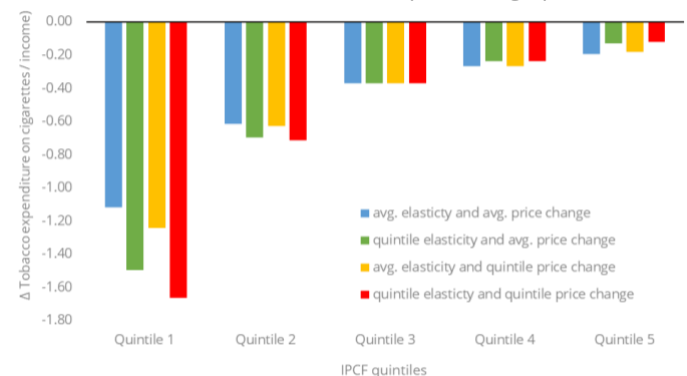
**FIGURE 1.** Extended Cost Benefit Analysis (ECBA) of a change on cigarette taxes in Argentina. **Direct Effect:** Change in expenditure on cigarettes as a share of income (in percentage points).



Source: Authors' elaboration based on Cruces et al. (2022) and the CEDLAS (2022) tobacco tax simulation. Note: quintiles of household per capita income.

Figure 2 shows that by incorporating indirect effects (on health expenditure and labor productivity), a change in the price of cigarettes is progressive and is beneficial for all the quintiles of the distribution. The poorest (richest) quintile would experience savings in the range of 1.1 to 1.7 (0.1 to 0.2) percentage points of their income due to lower medical expenses and higher labor income. These effects can be doubled if more aggressive changes in tobacco taxation, such as those proposed in Tax Reform 2, are carried out. Thus, **increasing tobacco taxes is a progressive policy.**

**FIGURE 2.** Extended Cost Benefit Analysis (ECBA) of a change on cigarette taxes in Argentina. **Total Effect:** changes in cigarette expenditure, medical expenses, and the income of individuals as a share of income (in percentage points).



Source: Authors' elaboration based on Cruces et al. (2022) and the CEDLAS (2022) tobacco tax simulation. Note: quintiles of household per capita income.

<sup>1</sup> As estimated in Cruces et al. (2022), the elasticity for each quintile is 0.75, 0.67, 0.62, 0.57, and 0.49, respectively.

<sup>2</sup> The change in prices that faces each quintile is 20.2%, 18.7%, 18.3%, 18.3%, 17.2%, respectively.

## CONCLUSION AND POLICY RECOMMENDATIONS

This research suggests that increasing tobacco excise taxes in Argentina would not harm welfare, especially for the poorest sectors. Reductions in tobacco consumption result in better health, lower medical expenses, increased life expectancy, and more time for income generating activities.

The results from this study reinforce a legislative agenda that promotes increases in tobacco excise taxes in Argentina. Tobacco taxation policy in Argentina should include a larger increase in the current ad valorem rate of the II.

The government could contribute to improved health and wellbeing of its citizens by increasing tobacco taxes, while generating significant and much needed additional tax revenues in a progressive manner. This can be done through alternative designs of the existing internal tax that defy arguments that commonly block the possibility of reforming the current tobacco tax structure, such as those on the

regressivity of increasing tobacco taxes.

## REFERENCES

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**This brief summarizes policy analysis outcomes from the report “ Distributional analysis considering long-run health benefits of increasing tobacco taxes in Argentina”, elaborated by CEDLAS.**