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The impact from the planned increase in the excise duty on tobacco products

Summary

Law 4389/2016 provides for the increase of the ad valorem excise duty rate on cigarettes from 20% to 26% and the specific excise duty rate on fine cut tobacco from €156.7 to €170 per tax unit, effective from January 2017. With this increase, additional tax revenues of €121.8 million are expected annually. The study examines the impact of the planned increase in the excise duty on tobacco products both on the tax revenues and the overall economic activity in Greece.

The tax increase on tobacco products will lead to a significant price increase (by 40-50 cents per 20 cigarettes and 50 cents per 30 grams of fine-cut (RYO) tobacco) and a large decline in the use of legal tobacco products, ultimately failing to achieve the intended effect on tax revenues. The fall in tax revenues due to the decrease in the demand for legal tobacco products is expected to offset the increase in tax revenues from the higher tax per unit. This result is mainly due to the impact on cigarettes, where tax revenues are actually expected to decline as a result of the increase in tax rates.

In particular, compared with the case of no change in excise duties on tobacco products, the increase in excise tax rates is expected to lead to more than €100 million shortfall relative to the budget's target in 2017. This result does not take into account any effect from a) the hoarding of tobacco products in anticipation of the tax hikes, which will alter the distribution of tax revenues over time by reducing them in the year of the application of the tax increase and b) the increase in the minimum RYO tobacco quantity per pouch size to 30 grams in 2017.

The increase in excise duties is also expected to boost the smuggling of tobacco products, provided that more effective mitigation measures are not implemented. It is estimated that the penetration of illegal cigarettes will increase by more than 5 percentage points (to 30% of total cigarette consumption), compared to the case of no change in the taxation of tobacco products.

The study also considers the wider impact on the Greek economy from the increased taxation of tobacco products, which is expected to be substantial. Compared with the scenario of no change in excise duties, the gross value added of the economy is expected to fall by €66 million annually, employment to contract by 1.700 full-time equivalent jobs and the tax revenues (other than from tobacco taxes) and social security contributions to decline by €19 million.

Therefore, if the loss of taxes and contributions from the reduction in economic activity and the rising unemployment is taken into account, the tobacco tax hike is expected to have a negative budgetary outcome.

Given the negative impact on public revenues and economic activity, the study examines an alternative tax scenario, based on the premise that planned and reasonable increases in the excise duty rates have a milder impact on the tobacco market equilibrium and tax revenues, as the consumers adapt better to small price increases.

The results of the alternative scenario show that a gradual increase in the excise duty rates on tobacco products is expected to have a better impact on tax revenues (although the budget target is still not achieved) and milder adverse effects on economic activity and employment.

Indicatively, the gradual increase in the excise duty rates over the next three years brings in cumulatively €133 million additional revenue and limits the losses in gross value added by €7-45 million per year and in employment by nearly 700-1,300 jobs.

The study also assesses the contribution of the tobacco industry (production and distribution of tobacco products) to the Greek economy. Taking into account the linkages of this sector with other sectors of the economy, the study estimates that a total of approximately €1.2 billion of gross value added and 28,500 jobs (in full-time equivalent terms) are directly or indirectly related to the production and trade of cigarettes and other tobacco products. In particular, according to the study estimates:

- For every euro of final consumption of tobacco products, €1.6 of gross value added are generated in the whole economy.
- Each job in the tobacco industry is associated with 4 jobs (in full-time equivalent terms) in the Greek economy.

The results of the study are available (in Greek) at the link below:

http://iobe.gr/docs/research/RES_04_28112016_PR%CE%95_GR.pdf