

## **Tax Working Group Public Submissions Information Release**

### **Release Document**

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# UP IN SMOKE:

THE SOCIAL COST  
OF TOBACCO  
EXCISE



# FOREWORD BY JORDAN WILLIAMS



Since the publication two years ago of our first report looking at the issue of tobacco taxes, our predictions (and warnings) about the negative costs associated with continuing to hike taxes on smokers have come true.

In the earlier report, we showed how smokers are being treated as cash cows — taxes then already covered three times of the health costs of the habit. We warned of the risks of a black market developing if tobacco excise continued to increase, and highlighted the Government's failure to legalise e-cigarettes for vaping.

Vaping is the first real alternative to traditional cigarettes, and are is considered to be at least 90 percent less harmful. They are the number one tool used in Britain to help smokers quit. Despite that, e-cigarette liquids containing nicotine are still technically illegal to sell in New

Zealand (though importing it for personal use is not prohibited).

Since our last report, New Zealanders have woken-up to the benefits of e-cigarettes, with vaping stores popping up around the country (and, technically, operating illegally). We say the Government should stop dragging the chain, and fully legalise the sale of e-cigarette liquids containing nicotine. That would allow New Zealanders to conveniently access international brands and products, and enable more smokers to make the switch.

The goal of excise tax — to reduce smoking rates and prevent smoking-related illness — is a noble one. But it's not enough to judge a policy by its intentions. This report evaluates tobacco excise tax based on its actual results, both intended and unintended.

Counterintuitively it is the poor that have been the least responsive to recent tax hikes. That means smokers, and their families, are going without.

Increasing taxes well in excess of the health costs of tobacco, knowing that they are being paid by those least able to afford it, is morally questionable, especially when the Government won't legalise the safer alternative.

Despite tobacco prices increasing by over 60 percent since 2012, only one in ten adult

smokers have quit. And amongst Maori and Pasifika, there has been no statistically significant reduction in smoking rates over the last decade. In other words, the much higher taxes have completely failed to achieve the goal of reducing smoking rates in those communities where they are the highest.

As detailed in this report, for someone on the average wage, smoking will see them pay 17.5 percent of their income on excise tax — about the same the same worker pays in PAYE.

The underground markets we warned about have taken hold. The Police now back us up on this claim, with dairy owners and other tobacco retailers all too aware that high tobacco excise sees them targeted by criminals, eager to get their hands on stolen tobacco for profitable resale.

The election of the Labour-led Government is an opportunity to halt the tobacco tax escalator and acknowledge that the current approach just isn't working.

*Jordan Williams is the Executive Director of the New Zealand Taxpayers' Union.*



# INTRODUCTION

Tobacco excise tax has increased by 10 percent a year since 2010. After adjusting for inflation, that's caused the price of tobacco to more than double. At Treasury's recommendation, tobacco excise will continue to increase by 10 percent a year for the next four years. Some health advocates have recommended 10 percent annual increases in excise through to 2025.

There are three primary considerations for the Government when it comes to future decisions on tobacco excise.

Firstly, the degree to which increases in excise reduces smoking prevalence.

Secondly, how increases in tobacco excise financially impact households.

Thirdly, any unintended consequences from higher taxes – specifically, does it incentivise (or is it already incentivising) crime?

This report will consider each of these in order.

Our analysis finds that excise increases have had mixed results on smoking prevalence.

In spite of the huge increase in prices, the Ministry of Health found no statistically significant difference in the rates of smoking amongst Maori and Pasifika between 2006/07 and 2015/16. In the general

population, only one in ten adults quit smoking between 2011/12 and 2015/16, during which period of time tobacco prices increased over 60 percent.

For the vast majority of smokers who haven't quit, in spite of the taxes, tobacco excise has significantly reduced their disposable income.

A pack-a-day smoker is nearly \$3,000 per year worse off in real terms than they were in 2010. Tobacco excise is legislated to increase by 10 percent annually (in real terms) until 2020, although with the 'SmokeFree 2025' goal in mind, public health officials advocate for tax increases many years beyond that.

The consequences for public safety have also been apparent.

The literature on the economics of crime notes that criminals act rationally in response to the expected returns from committing crime. This is exactly what appears to have happened in New Zealand - increasing tobacco prices has induced a wave of tobacco related burglaries and robberies because the potential illegal profits from doing so have skyrocketed.

Detailed information on tobacco related crime isn't recorded by Police, in spite of significant media coverage over tobacco

related crime. We do know, however, that robberies, aggravated and otherwise, have increased by 26.6 percent since 2014 and the Police, particularly in the Counties Manukau District, have said that tobacco is the primary driver.

While it is difficult to provide perfectly-informed policy advice in this area, given the lack of data, it is concerning then that there is a four-year plan in place to increase tobacco excise, without a good understanding of the associated costs.

**“A pack-a-day smoker is nearly \$3000 per year worse off in real terms than they were in 2010”**

# IMPACT ON SMOKING RATES

The aim of tobacco excise is to reduce the rate of smoking in society. The mechanism is simple – tax increases are passed on to consumers in the form of higher prices, which reduces consumer demand for tobacco. The degree smoking rates change in response to price increases is crucial, because it impacts the size of any social benefits from excise tax.

Economists measure price responsiveness by calculating the "price elasticity of demand".

Typically, tobacco is classed as price inelastic, which means even large price increases will elicit a small change in demand. Treasury modelling assumes a price elasticity of between -0.3 and -0.5, which implies a reduction of between 3 percent and 5 percent in tobacco consumption for every 10 percent increase in price. Evidence gathered overseas indicates that's a sensible estimate.

The price elasticity of daily smoking prevalence is estimated equal to -0.25 by Treasury. That

implies a 10 percent increase in price reduces smoking prevalence in society by 2.5 percent. That means very large tobacco excise increases will be required to have a significant impact on smoking rates.

Modelling from the University of Otago's Public Health department has estimated the national smoking rate under various tax scenarios (see table).

In the absence of any tax increases from 2015, they estimate the smoking rate will be 9.9 percent of the general population in 2025.

Annual 10 percent increases in tobacco excise from is estimated to only reduce that rate by 1.2 percentage points to 8.7 percent in 2025. Amongst Maori, the comparative improvement in smoking rates under the above scenario is only two percentage points for men and three percentage points for women.

This indicates that smoking prevalence in an environment without additional increases in excise tax still falls substantially.

Tobacco excise increases have

had mixed results over the last decade.

The Ministry of Health has found that between 2006/07 and 2015/16, smoking rates among Maori and Pasifika have not experienced a statistically significant change. Smoking rates in the general population have fallen 4 percentage points over this period, but it's unclear what proportion of this change can be attributed to increases in excise taxes. The University of Otago forecast smoking rates falling, even in the absence of price increases. Treasury assume that smoking prevalence will fall by 1 percent per annum even in the absence of tax increases. If we applied that assumption, then excise tax increases are responsible for a reduction in the smoking rate of only 1.9 percentage points.

Treasury notes in a Regulatory Impact Statement in 2016 that "ultimately some smokers will not cut back." There is an obvious trade off in harming the wellbeing of that group, and price increases leading others to quit.

Scenario	Non-Maori men (%)	Non-Maori women (%)	Maori men (%)	Maori women (%)	Total (%)	Year with <5% prevalence reached for adult population
No tax increase (0%)	9.3 (9.2 to 9.4)	6.9 (6.8 to 7)	20 (20 to 21)	21 (20 to 21)	9.9 (9.8 to 10)	2046
Annual 5% increase in excise	8.8 (8.7 to 9)	6.4 (6.4 to 6.7)	19 (19 to 20)	20 (19 to 20)	9.4 (9.3 to 9.5)	2043
Annual 10% increase in excise	8.2 (8.1 to 8.4)	6.1 (6 to 6.3)	18 (17 to 18)	18 (18 to 19)	8.7 (8.6 to 8.9)	2039
Annual 15% increase in excise	7.7 (7.5 to 7.8)	5.7 (5.6 to 5.9)	17 (16 to 17)	17 (17 to 18)	8.2 (8 to 8.3)	2036
Annual 20% increase in excise	7.2 (7 to 7.3)	5.4 (5.2 to 5.5)	15 (15 to 16)	16 (16 to 16)	7.6 (7.5 to 7.7)	2034

Mean and 95% uncertainty intervals presented. Source: Cobiac LJ, Ikeda T, Nghiem N, et al. (2014). Modelling the implications of regular increases in tobacco taxation in the tobacco endgame

# COST TO HOUSEHOLDS

The cost to smokers from higher tobacco excise has been substantial. The Government has increased the excise in real terms by 94.8 percent between 2010 and 2017. Currently, a 20-pack of cigarette costing the consumer around \$22, has taxes applied in excess of \$17.

In addition, the Government has legislated for an additional 10 percent annual increase (plus adjustments to reflect inflation) until 2020.

Increases in tobacco excise has made a pack-a-day smoker worse off today by nearly \$3,000 (in 2017 terms) a year compared to 2010. A smoker who buys a 50-gram pouch of tobacco a week is paying \$25 extra in excise on every transaction - that adds up to \$1,330 a year.

If excise taxes increase at their current rate through 2025, as has been proposed in order to meet the goal of 'SmokeFree 2025', pack-a-day smokers will be worse off by an additional \$7,024 a year – or \$135 a week. For someone on the median wage of \$959 a week, that represents approximately 17.5 percent of an individual's after-tax income. Given the average earner pays 17.5 percent tax on most of their income, this level of tobacco excise effectively sees a smoker paying twice the level

of tax in comparison to others on the average wage.

Note that \$135 is also the figure provided by New Zealand Immigration as an average spend on food and alcohol each week. Another way to consider increases in tobacco excise is the equivalent of making a pack-a-day smoker pay twice for all their groceries.

If you buy a 50-gram pouch each week, you should expect to be worse off by \$60 a week or over \$3000 a year. That represents approximately 11 percent of a minimum wage worker's after-tax income.

In New Zealand, low income households have higher smoking rates than high income households, and Maori and Pasifika have higher smoking rates than the rest of society.

In 2025, one in ten will still smoke, and one in five Maori will still smoke. If the current relationship between income and smoking status continues (which should be expected), smoking rates will be much higher than those numbers for low income households.

Obviously for those who choose to stop smoking altogether, increases in tobacco excise won't hurt their incomes, but many of those who choose to quit are still expected to quit

even in the absence of those tax increases. Meanwhile the majority of current smokers who are expected to continue even in the presence of higher prices, will have their disposable incomes significantly reduced.

Evidence from the United States confirms that cigarette taxes are regressive. Lower income households, although more sensitive to tobacco price changes, "*... spend a disproportionate share of their income on cigarette taxes compared to smokers with greater incomes.*"

In a report from 2016, Treasury recommended that annual real increases in tobacco excise of 10 percent a year stop in 2020.

*"While increases of this magnitude would not, on their own, achieve the Smokefree 2025 goal, we believe they strike an appropriate balance between the drive to make further reductions in smoking with the recognition that ultimately some smokers will not cut back."*

# TOBACCO EXCISE DRIVING CRIME

Increasing excise taxes on tobacco translates into higher prices. The aim is to reduce demand and therefore the prevalence of smoking in society, but higher prices have two important effects.

Firstly, addicted smokers who struggle to quit are more willing to purchase tobacco on the black market. Higher prices from legitimate retailers can (as demonstrated earlier) can demonstrably impact the finances of households that often already struggle to balance their budget.

The vast majority of society normally don't want to associate with criminals or risk sanction from the justice system. However, as cigarette prices skyrocket, these costs are outstripped by the comparative savings available to smokers by purchasing illegally distributed tobacco.

Higher prices therefore induce the willingness of smokers to purchase tobacco from the black market.

Secondly, increasing tobacco excise tax incentivises illegal supply. In foreign jurisdictions, this encourages smuggling tobacco across borders, from low tax environments to high tax environments. Given New Zealand's isolated location, smuggling tobacco illegally into

the country is more difficult. Criminals have therefore pursued alternative methods of supply: burglaries and robberies.

This result is predicted by substantial literature on the economics of crime. Gary Becker first wrote about how criminals rationally respond to changes in payoffs in 1968. The model presented in *Crime and Punishment: An Economic Approach* posits that the decision to commit crime depends on the pay-off from the crime; the risk of being caught; the punishment if caught; and the value of any alternative income.

The model would predict that, holding all other variables constant, if the proceeds of crime materially increased, we should expect to see more people choosing to commit that crime.

That claim has also been empirically tested.

Evidence from a 2015 paper points to changes in the price of "loot" as a significant factor in crime trends in the United Kingdom. The authors note that changes in the prices of jewelry, fuel, and metals impact the way criminals target their offending. This is exactly the story we've seen at home, where burglaries and robberies have reportedly increased in line with cigarette

prices.

The New Zealand Police do not officially record the goods targeted in relation to burglaries and robberies, although a report from September 2016, referenced to in the New Zealand Herald in October, indicated a minimum of 490 robberies were attributable to criminals targeting tobacco products over 13 months.

Police data also shows a significant increase in robberies, aggravated and otherwise, between 2014 and 2017. In 2014 there was an average of 180 robberies a month, whereas this has climbed to 229 robberies a month in 2017.

According to Sunny Kaushal of the Crime Prevention Group (an organisation focused on representing the interests of dairies and convenience stores):

*"The Criminals appear to have taken over suburbs. On an average, this year there have been more than ten serious robberies of shop owners per week in NZ."*

*"The Government is going to hike the tax on cigarettes again in January. We are afraid this will only add more to the problems and put more shop owners' and their workers' lives in danger."*

# REFERENCES:

The previous National-led Government acknowledged that tobacco taxes were a problem in driving burglaries.

In June 2017, then Minister of Police, Paula Bennett announced a total of \$1.8 million in subsidies for security systems to be made available to dairy owners around the country. In total, each dairy is expected to receive \$1,500 each. This only represents a tiny proportion of the revenue from tobacco excise: approximately 0.1% of the \$2 billion the Government earns from tobacco excise.

Responding to the policy, Mr Kaushal said:

*“\$1.8 million was a good start, but it isn’t enough to address the situation. \$1500 to a shop goes nowhere when the cost of installing effective measures like cigarette dispensers is approximately \$20,000. Moreover, there are questions about its distribution and eligibility criteria, which we asked the Police authorities about, but they haven’t responded as yet.”*

Increasing tobacco excise is often treated as a no-brainer, but there are obvious trade-offs as demonstrated above.

It’s important that the Police gather data on how tobacco may be related in burglaries and

robberies so we can measure the impact of any further increases in tobacco excise. Tobacco excise increases of 10% per annum are already scheduled until 2020, although there will be significant pressure to continue the increases through to 2025.

High quality data which measures the social costs of excise increases will enable a greater focus on evidence informed policy making.

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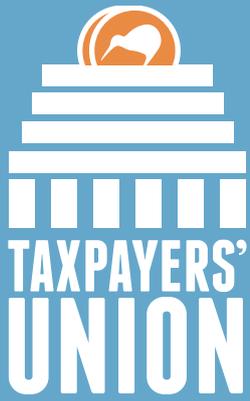
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