Tobacco tax increases and the Consumer Price Index

World Health Organization

The UN Statistics define the Consumer Price Index (CPI) as follows:

"The CPI is an index that measures the rate at which the prices of consumption goods and services are changing from month to month (or from quarter to quarter).

The prices are collected from shops or other retail outlets. CPIs are official statistics that are usually produced by national statistical offices, ministries of labour or central banks…

Tobacco products are one of the consumer goods that are included in the basket for the CPI.

Financial implications of higher taxes via CPI

- Consumer Price Index (CPI) is
  - regarded as a key indicator of economic performance
  - taken into account when establishing international credit ratings.
  - used as the appropriate measure of inflation for the purposes of adjusting payments, such as
    - wages, rents, interest and social security benefits

- Consequently, CPI can have substantial and wide-ranging financial implications for the governments as well as households

World Health Organization

Financial implications of higher taxes via CPI

- **There is a fear that increases in excise taxes on tobacco products, especially on cigarettes which can lead to increases in consumer prices, could increase the CPI.**

- This is a concern by the governments who employ strict <u>inflation-control policies</u> .

World Health Organization

What is the inflationary impact of excise tax increase?

This depends on

- the weight of tobacco in the basket of Consumer Goods that determines CPI, &
- The rate of taxes on consumer prices

Inflationary impact of tobacco tax increases:

Tax as a share of price			Tobacco weight in price index			Inflationary impact		
Low (<40%)	Medium (40-70%)	High (>70%)	Low (<2%)	Medium (2-4%)	High (4-8%)	Low (<1.0%)	Medium (1-2.5%)	High (>2.5%)
X			X			X		
	X		X			X		
		X	X			X		
X				X		X		
	X			X			X	
		X		X			X	
X					X		X	
	X				X		X	
		X			X			X

NOTE: Midpoints of ranges for tax and tobacco weight are used for computing inflationary impact.

Source: WHO

Remove or not to remove tobacco prices from the basket of CPI?

- **Many suggested removal of tobacco from the back of goods used to calculate the CPI**
  - Its inflationary factor and
  - Reducing prevalence rate the falling proportion of many populations who smoke,
- **Economists, on the other hand, oppose the exclusion of tobacco from the CPI on**
  - technical grounds including keeping the integrity of consistency of the index over time and
  - comparison with other countries.

Countries' solution for eliminating inflationary impact of higher taxes

A way around the problems:

"Use the CPI which excludes tobacco and alcohol as the index used for wage increases and indexation of pension and benefits which are increased in line with the CPI."

- This practice has been used by
  - Luxembourg (1 January 1991)
  - France (1 January 1992)
  - Belgium (1 January 1994)
    - the index is called “health index” and it excludes, more specifically alcohol, tobacco and fuel. Mainly used for the indexation of rents (pensions, social benefits and some salaries).
  - New Zealand (April 2010)
    - removed tobacco prices in April 2010 from the indexing formula for social assistance payments. This was part of the plan to regularly increases tobacco excise by 10% and make sure this would not affect the CPI.