



International Institute
for Legislative Affairs

Tobacco Taxes in Kenya

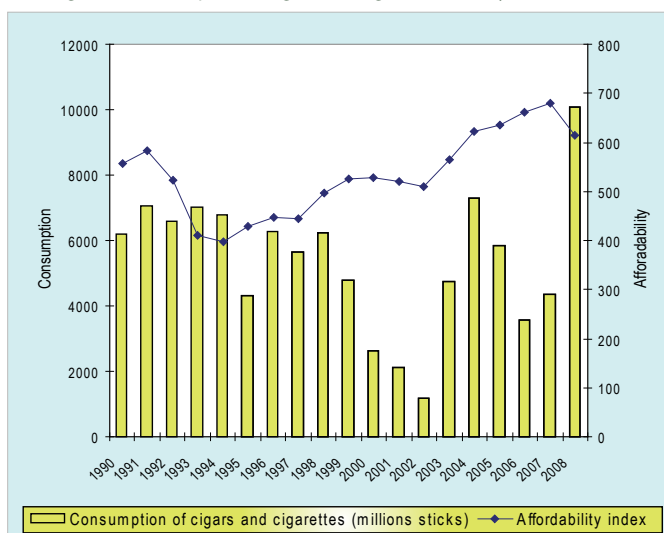
Increasing the price of tobacco through tax increases will decrease tobacco consumption, save lives and raise government revenue

Based on 'Economics of Tobacco Taxation in Kenya' (2011); a publication of the International Institute for Legislative Affairs

Current Status

- Approximately one-half of lifetime smokers die prematurely from tobacco use. Many of these deaths occur in a citizen's most productive years between the ages of 35 and 60 in developing countries.
- In Kenya, 1 in 5 men between the ages of 15 and 49 use tobacco (18-20%).
- 15% of students use some type of tobacco product. While only about 1% of adult women in Kenya report using tobacco, 15% of boys and 15% of girls report using tobacco, raising concern about the growing rate of use among young girls.
- Studies show that Cigarettes in Kenya are cheap and are becoming more affordable over time.
- Figure 1: Consumption of cigars and cigarettes in Kenya, 1990-2008

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Sources: Computations using data from GOK (various) Statistical Abstracts

Higher Tobacco Taxes Reduce Tobacco Use

The most effective way to decrease tobacco use is to increase the price of tobacco products through tax increases. Higher tobacco prices encourage smokers to quit and prevent youth from starting to smoke.

- Even though tobacco is addictive, increasing tobacco prices will reduce consumption. In Kenya, studies show that a 10% increase in price will reduce consumption by 4.2%.
- Higher taxes are particularly effective in reducing smoking among vulnerable populations, such as youth, pregnant women, and low-income smokers.

Higher Tobacco Taxes bring in more Government Revenue

Tobacco taxes can bring in significantly more revenue which could be used to correct for the negative impact of tobacco use -- the death and disease caused by tobacco and the loss in economic productivity from sick smokers. Cigarette taxes account for 30% of all excise tax revenue in Kenya (Approx. 7000 million Ksh in 2008)

- Tobacco production has increased in Kenya over time as BAT consolidated its manufacturing operation in Nairobi and Mastermind has increased its exporting. Increased production results in more use by Kenyans, thus increasing the health and production costs to the country.
- Tobacco growing is not among the 10 leading agricultural products in Kenya. Tobacco leaf marketing is highly variable over time, overall decreasing slightly since the 1990s.

The Kenyan Tobacco Tax Structure

- Tobacco excise tax imposition, control and collection is governed by the Customs and Excise Act. Tax policy originates from the Ministry of Finance (MOF) and administered by the Customs and Excise Department of the Kenya Revenue Authority.
- The structure of tobacco excise tax in Kenya has changed multiple times over the last decade fluctuating between specific and ad valorem types. Until June 2011, tobacco products were classified into 4 categories with different tax rates for each category.

Category	Post 2008 definition	Rate of excise duty Ksh per mille
A	Plain cigarettes or plain cigarettes RSP of up to Ksh 2,500 per mille	700
B	Soft Cap cigarettes of <72mm or soft cap cigarettes with RSP of Ksh 2501 – 3,500 per mille	1,000
C	Soft cap cigarettes of >72 mm or soft cap cigarettes with RSP of Ksh 3501 – Ksh 4,500 per mille	1,500
D	Hinge lid or RSP of more than Ksh 4,500 per mille	2,500

(RSP means Retail Selling Price, 1 mille equals 1000 sticks)
Sources: KRA website(www.kra.go.ke); Gerson et al (2010)

Table 1: Tax rates for cigarettes in Kenya

Category	Pre-2008 definition	Duty payable
A	Cigarettes – RSP up to Ksh 1,500 per 1,000 sticks	495
B	Cigarettes – RSP between Ksh 1,501 and Ksh 2,500 per 1,000 sticks	781
C	Cigarettes – RSP between Ksh 2,501 and Ksh 3,500 per 1,000 sticks	994
D	Cigarettes – RSP over Ksh 3,500 per 1,000 sticks	1696.20

Specific excise taxes are charged per quantity (e.g., Khs 90.00 per pack regardless of price). Ad valorem excise taxes are charged as a percentage of the value of the product (e.g., 30% of the price of a pack).

The changing tax regimes have not produced predictable impacts on consumption and revenue suggesting that the design and administration of the excise duties is problematic.

- A recent IMF study (2010) found the current structure for tobacco products is too complex and lacks in policy rationale. The system makes it difficult for the government to reduce consumption, predict revenue and control illicit trade.
- Official tobacco sales figures and government revenues show considerable variation over time, suggesting that the availability of non-duty paid cigarettes are impacting formal sales and tax collection. It is estimated that approximately 20% of the cigarette market is non-duty paid. This highlights the critical importance of developing a tax structure that is simple to administer and reduces tax evasion.

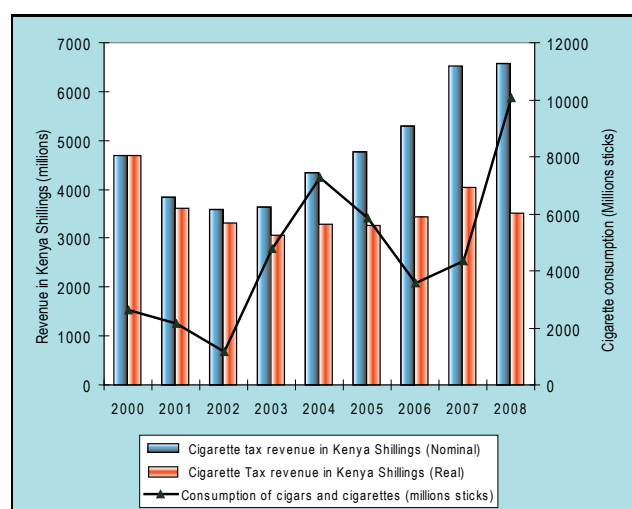
The global trend is for simplification of excise tax systems. Until June 2011 the excise tax structure for tobacco products was complex. The Finance Bill 2011 proposes to harmonize the excise duty regime for cigarettes at Ksh.1,200 per mille or 35 percent of the retail selling price (RSP), whichever is higher. The proposed regime will reduce incentives for substitution among different brands, which is in line with the public health objective of reducing tobacco consumption.

Table 2: The 2011 proposed tax structure for tobacco products

Description	Rate of Excise Duty
Cigarettes	Sh. 1200 per mille or 35% of retail selling price.

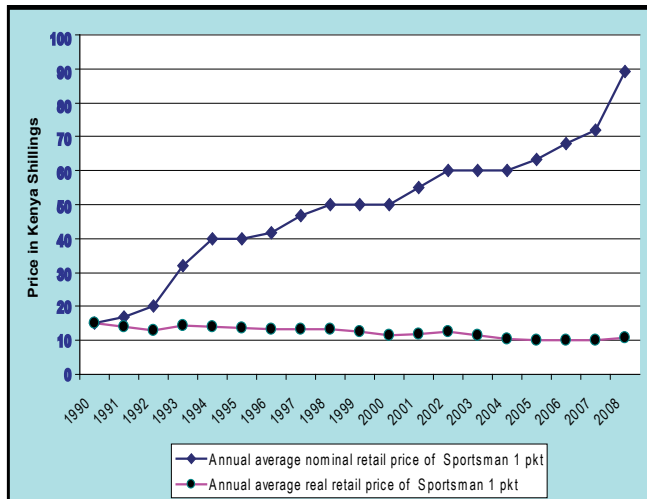
Source: Kenya Law Reports website (<http://www.kenyalaw.org/klr/index>)

Figure 2: Cigarette tax revenues



Source: Computations using data from GOK (various) Statistical Abstracts

Figure 3: Real and nominal prices of Sportsman (1990=100)



Source: Computations using data from GOK (various) Statistical Abstracts

Figure 3 reveals a wide gap in real and nominal prices of a packet of sportsman. The nominal price for a packet of sportsman first increased, primarily between 1990 and 1994, and then flattened out before resuming the growth momentum from 1997 to 2008. Overall, the nominal price for a packet of sportsman grew by 8% annually between 1990 and 2008. During the 1990 – 2008 period, the real price of one packet of sportsman grew by -2.2 per cent

annually. This implies that in real terms, the price of one packet of sportsman actually became cheaper in 2008 relative to 1990. It is notable that whereas there was an average annual increase of 8 per cent in the nominal price of a packet of sportsman, the real price shrunk by 2.2 per cent.

Table 3: Growth in prices of basic commodities vs. prices of cigarettes and beer

Item	Growth in nominal price (%)	Growth in real price (%)
Cabbage (1 kg)	5.7	-4.3
Bread, White (1/2 a loaf)	7.8	-2.3
Kerosene (1 litre)	11.9	+1.8
Maize flour (1kg)	7.4	-2.7
Kales-Sukumawiki (1kg)	7.5	-2.6
Cigarettes Sportsman (1 packet)	8.0	-2.2
Beer Tusker (0.5 litre)	9.2	-0.8

*Source: Computed from log trend estimates using both constant and nominal figures.

Table 3 shows average annual growth in prices of some selected basic commodities as well as the growth in the price of cigarettes and beer, which are luxury goods. The commodity with the fastest annual growth in nominal price is kerosene while the item with the least annual growth in price was the cabbage. Similarly, the average annual growth in the nominal price of a packet of sportsman is lower than the average annual growth in the price of kerosene, which is a basic commodity but very close to the increases in the price of bread, maize flour and kales. In real terms, it is only kerosene that became more expensive - all other items including beer and cigarettes became cheaper between 1990 and 2008 since their real prices shrunk. The commodity whose real price shrunk least was beer while the commodity whose price shrunk fastest was the cabbage.

It is surprising that public policy has extended similar treatment to cigarettes as is the case for basic commodities such as bread, maize flour and Sukuma Wiki yet these basic commodities constitute about 50 per cent of the consumers' budget and therefore are more important for poverty alleviation.

Reforming the Tax System: Key Recommendations

Kenya has complied with the FCTC by enacting the 2007 Tobacco Control Act, but much remains to be done in order to streamline the system and maximize tobacco control policy. The Kenya Tobacco Control Act:

- Obligates MOF to use price and tax measures to further the objectives of the Act; and
- Sets up a Tobacco Control Fund from public budget allocations.

Raising the price of tobacco through effective tax increases is the most effective policy available to reduce tobacco use and save lives. Increasing tobacco tax will bring in more government revenue.

For tobacco taxation in Kenya to be effective in reducing tobacco use and generating government revenue, the system must more closely mirror international best practices, including:

- Simplify the tax system to enable better tax administration, eliminating price categories.
- Rely on specific taxes. Specific tax regimes allow the government to better predict revenue as they are not affected by price changes.
- Establish regular adjustments for inflation and income growth.
- Increase tobacco taxes to at least 70% of retail price to ensure consumption declines.
- Tax all tobacco products equally to prevent users from switching brands and types due to price differences.

Such changes to the system along with effective monitoring of tax collection will ensure the industry cannot engage in price manipulations to avoid or evade paying taxes and will enable the government to better generate revenue from tobacco taxes.

Earmarking part of the tobacco revenue for Public Health programming will assist in garnering public support for tobacco tax increases and lead to better health for the country.



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