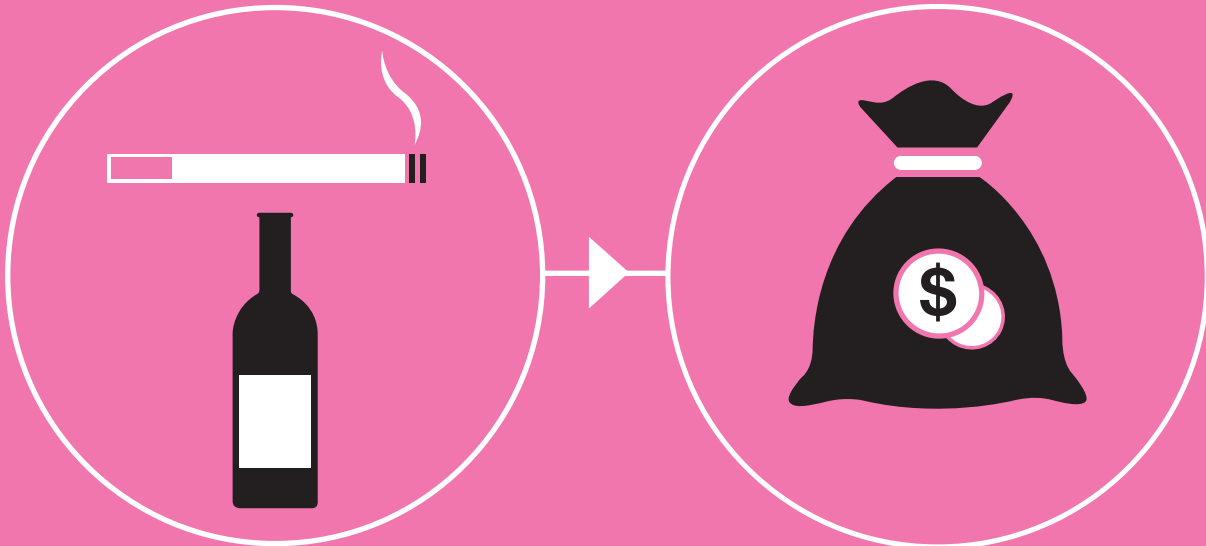


Excise taxes

Progressive Taxation Briefing



What is excise tax?

Excise taxes are taxes levied on specific goods such as alcohol, tobacco, fuel and luxury goods, and also on activities such as gambling. Hence they are sometimes colloquially known as ‘sin taxes’. They are indirect (collected by someone other than the government), often levied at the point of sale and included in the price of a product or activity. They can be applied to either domestically-produced or imported goods.

There are few detailed figures on revenue raised by excise taxes in developing countries, but they appear significant, although widely variable.¹ According to the IMF Fiscal Affairs Department, excise taxes are roughly 1-2% of GDP in low and middle income countries.² Their importance is greater in Asia and Latin America than in Africa (for example, tobacco excises alone raise 8% of government revenue in Indonesia, where smoking prevalence is very high). There is scope to

increase revenue from excises. For example, in 2011, sub-Saharan Africa could have increased its total revenue by 0.5% of GDP if it had raised the proportion of excises in total revenue to the world average.³

Most excise revenue in developing countries comes from widely used products such as tobacco, alcohol, fuel, cars and (increasingly) electronic communications. For example, in 2009 excise taxes on tobacco and alcohol raised 90% of non-fuel excise duty in Egypt and the Philippines, and around 80% in Senegal and the Central African Republic.⁴ It is possible that the revenue potential of this source will grow as incomes grow.

Excise taxes are also levied on luxury products such as perfume, jewellery, inputs for cars, planes and helicopters (and these things themselves), high-end brands and supplies for high-end services (such as pool cleaning). These raise relatively small amounts of revenue, because the volume of purchases of these items is small, but where income levels are rising they could contribute greater amounts of revenue. China, for instance, has recently levied a tax on luxury goods.⁵

As well as raising revenue, excise taxes, particularly on alcohol and tobacco, are used to attempt to influence behaviour and realise wider social objectives, on the grounds that higher prices tend to discourage consumption. This seems to be an effective strategy. The World Bank says that “raising taxes on tobacco products is one of the most cost-effective measures to reduce consumption of products that increase mortality, while also generating substantial domestic revenue for health and other essential programmes.”⁶

Taxes on fuel are key to the progressive taxation debate, as domestic fuel (e.g. kerosene) is essential for most poor people, and many poor people rely on public transportation, where fares rise when fuel taxes rise. They are also often politically important, with proposals to increase fuel taxes generating protests, for example in 2018 in South Africa, Haiti, and Kenya. Fuel taxes are most often applied to fuels used for transport, such as petrol and diesel. Because this raises the cost of transporting goods, it affects the whole economy. Fuels for domestic heating and lighting (such as kerosene), crucial to many low-income households, are often taxed at lower rates or exempted. Fuels for agricultural or industrial vehicles, and for electricity generation, are also usually taxed at lower rates.⁷ Fuel taxes range from as much as 70% of the retail price (e.g. in Turkey and the Netherlands) to zero. Fuel taxes also carry the policy objective of influencing behaviour, this time in order to reduce consumption of carbon-emitting products for environmental reasons.

How can excise tax be made more progressive?

Because they are indirect taxes borne by consumers and (usually) flat-rated, excise taxes are inherently likely to be regressive, in the same way as VAT. An IMF staff policy paper calls them ‘especially regressive’, even compared with other indirect taxes such as VAT.⁸ However, when the identity of the consumers of the taxed items, and the possibility of exemptions are taken into account, the progressivity of excise taxes becomes complex.

On luxury goods such as yachts, perfume and jewellery, excise taxes are likely to be *progressive*, as they are likely to

be bought only by the very well-off. It is the taxes on goods consumed in high volumes – such as cigarettes, alcohol and fuel – that are the regressive ones. As we have seen, the bulk of excise tax revenue is raised from these latter sources. Even here, there are complexities.

While excise taxes on tobacco and alcohol tend to fall more heavily on people with low incomes in developed countries, this is not so strongly the case in developing countries.⁹ Speculation would suggest that this might be because poorer people consume less of the taxed products because they cannot afford them; informal home-produced alternatives to tobacco and alcohol products are more widely available in developing countries, as smuggled products may be also.

There is a marked gender difference: far more men than women worldwide buy tobacco and alcohol. Therefore these excise taxes impact men more than women. However, this may sometimes simply mean men reserving a higher proportion of household income to buy the products, reducing the money available for things like school fees and food.

Fuel taxes are likely to be regressive, as fuel is essential for domestic use and for the transport of people and products, affecting everyone, however poor. Taxing fuel for private cars is likely not to be regressive in most low income countries, but may be hard to separate out from other transport fuels. Excise taxes on domestic fuel are likely to be gender- as well as income-regressive, as women are responsible for most cooking.

Excise taxes have their advantages and disadvantages, from the point of view of social justice. The advantages include:

- They have significant revenue potential.
- The revenue is relatively easy to collect.
- They can be used to generate behaviour change for wider social and environmental objectives, e.g. concerning public health.

The disadvantages include:

- They may be highly regressive.
- Excise taxes on fuel may increase the price of this essential item (and other items too, because of increased transport costs) beyond the reach of poor people, if there are no exemptions.
- Price differences may promote smuggling from neighbouring countries that do not levy these taxes. This risk is particularly cited for alcohol and cigarettes.

However, research shows that the risk is overstated, and indeed that in the case of cigarettes, tobacco companies themselves not only put forward the argument that smuggling is a risk as a justification for opposing the tax, but also may sometimes be complicit in the smuggling.¹⁰

on use of social media and money transactions by mobile phone (which has sparked a massive public backlash).¹³ In **Bangladesh**, bank deposits are taxed, with higher rates for larger deposits. Air tickets are also taxed, as are tobacco products and alcohol.¹⁴ The **Philippines** has recently levied a tax on sugary drinks.¹⁵

Examples of good and bad uses of excise tax

► Some examples of what is taxed through excises

In **Zimbabwe**, excise taxes are applied to tobacco, alcohol, fuel (petrol, diesel and illuminated kerosene), second-hand motor vehicles, and airtime (on mobile phone networks).¹¹ This last tax is gaining popularity in African countries but is very controversial because of its impact on the poor. In **Mozambique**, excises are levied on planes and boats, 'air vehicles without engines', and second-hand clothes, as well as tobacco and alcohol products.¹² **Uganda** imposed a tax

► Regressive and progressive fuel taxes

A 2009 study of the potential impact of a 10% fuel price hike in **Costa Rica** found that it would be progressive on petrol, and regressive on diesel (because many poor people relied on buses) and on other fuel products.¹⁶ In 2009 in **Kenya**, the top decile spent more than 10% of its income on private transport, the third richest 2% and all lower deciles much less – a tax on fuel for private transportation was therefore progressive. However public transport had a different pattern, with the highest usage by middle income classes. Even if fuel for private and public transport were both taxed at the same rate the result would still be slightly progressive.¹⁷ A study in **India** found that a fuel tax would be progressive, but a tax on kerosene would be regressive.¹⁸

Recommendations

►► Governments should:

- *Carry out impact assessments before levying excise taxes, with a particular focus on women and poor people, to ensure these groups are not disproportionately affected.*
- *Charge higher excise duties on luxury products, as these tend to be progressive, and lower ones on products that poor people buy, as these tend to be regressive.*
- *Ensure that there are exemptions for domestic fuel (such as kerosene); and other fuels if impact assessments suggest this is appropriate.*
- *Consider excise taxes' potential for achieving wider policy objectives, such as improving public health or reducing carbon emissions.*
- *Consider harmonisation of excise taxes between groups of neighbouring countries, to reduce incentives for smuggling.*

This is one of a series of briefings on Progressive Taxation published by ActionAid International in October 2018. You can find them at www.actionaid.org/taxpower

▶ Endnotes

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