



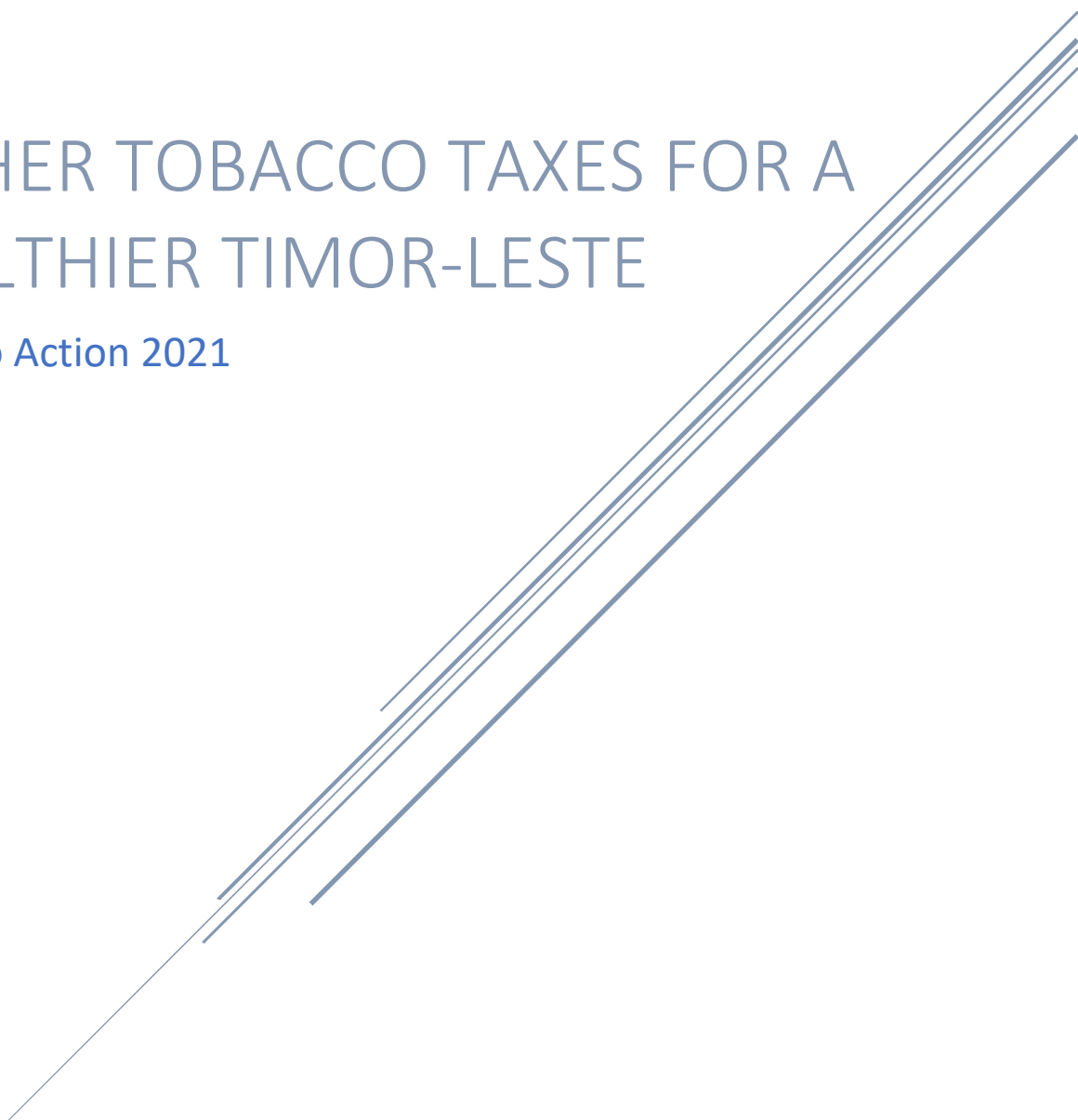
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# HIGHER TOBACCO TAXES FOR A HEALTHIER TIMOR-LESTE

Policy to Action 2021



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## Executive Summary

Timor-Leste has one of the highest smoking rates in the world. About 60.7% of adult males and 9.4% of adult females used tobacco in 2020. The tobacco prevalence among young people is similarly high: about 42% of boys and 21% of girls ages 13-15 also used tobacco in 2019.

Every year, more than 700 people in Timor-Leste are killed by tobacco-related diseases while the economic cost of smoking amounts annually to USD 64 million, or about 1.5% of its GDP.

Even though Timor-Leste has implemented some tobacco control measures, its tobacco tax policy is weak and limits the ability of the government to reduce tobacco use and to lower the health and economic damage caused by tobacco use.

The excise tax rate is very low, representing only 19% of the retail price in 2018, even though the best practice calls for the excise tax to represent at least 70% of the retail price. Due to the failure to increase the tax and to industry price increases, the share of tax in price is declining over time. There is also a problem with the tax structure that, even though specific, is levied as per kilogram (currently USD 19.00/kg), not per unit. This means that the industry can lower their tax payment by making cigarettes lighter (e.g., by decreasing the length). As a result of this weak tax policy, the tobacco industry in Timor-Leste collects twice as much profit compared to Indonesia, for example.

The cigarette market in Timor-Leste is not well secured against tax avoidance and tax evasion. The industry can easily reduce its tax liability by supplying shorter cigarettes and there are no tax stamps or fiscal marks on packs, making it easy to supply untaxed products. The sale of duty-free cigarettes is not banned, again opening a door for non-taxed products. In addition, the Customs Authority only collects quantity data based on the net weight as opposed to the number of units, in defiance of the World Customs Organization (WCO) recommendation.

As a result of poor tobacco tax policy, and possibly poor tax administration, excise revenue is low. In 2012, the government collected only USD15.6 mil from tobacco taxes, or about 3.4% of its total tax revenue in that year. A higher tax would lead to higher tobacco tax revenue that could support the achievement of the Sustainable Development Goals (SDGs), the Timor-Leste strategic development plan 2011- 2030, and fund preparedness for future epidemics and pandemics.

## Recommendations

1. Increase the specific excise tax so that it eventually reaches at least 70% of the retail price.
2. Levy the tax per unit (e.g., per stick) as opposed to per weight (kg).
3. Index the excise tax for inflation and for per capita income growth so that cigarettes become less affordable over time.
4. Invest in tax administration and enforcement (e.g., introduce tax stamps, collect data to aid customs with risk profiling)
5. Commit a portion of the revenue to invest in health, pandemic preparedness, and poverty alleviation.

## Background: Tobacco Use in Timor-Leste and its Consequences

Timor-Leste has one of the highest smoking rates in the world. World Health Organization (WHO) estimates that, in 2020, about 35.4% (60.7% of males and 9.4% of females) of Timor-Leste's population aged 15 years and older were current tobacco users (approximately 267,900 people). About 60% of these users, or 179 000 adults, use tobacco daily.<sup>2</sup> Cigarettes are the most common form of tobacco used, but smokeless tobacco is also popular with 19.8% of adults using it daily.<sup>3</sup>

The tobacco prevalence among young people is similarly high: about 42% of boys and 21% of girls ages 13-15 also use tobacco, according to the Global Youth Tobacco Survey conducted in 2019.<sup>4</sup> The overall smoking prevalence among this age group was 30.9%, the highest in the SEA Region. This is a significant increase in prevalence among this age group that was estimated at about 23.4% just few year back, in 2015.<sup>5</sup> The increase occurred among both genders.<sup>5</sup> The prevalence of current cigarette smoking was 20.4% while 13.9%, of students currently consumed smokeless tobacco products. The prevalence of smokeless tobacco use among youth increased drastically during the period 2013–2019, from 8.4% in 2013 to 13.9% in 2019, a staggering relative increase of more than 65% in a six year period. Notably, the current use of smokeless tobacco was higher among girls (14.8%) compared with boys (12.2%).<sup>4</sup>

The susceptibility to tobacco use among youth is worrisome. As many as 43.6% of students who never consumed tobacco were found to be susceptible to tobacco use in the future. A total of 13.2% students, who had ever smoked cigarettes, had tried their first cigarette before the age of 10 year.<sup>4</sup>

As many as 71% of students were exposed to SHS in enclosed public places and around 57.4% students were exposed to SHS inside their school building or outside on the school premises.<sup>4</sup>

If tobacco control efforts are not intensified, WHO projects that by 2025 around 32% of the population aged 15 years and older (approximately 265,600 people) will still be using tobacco (Table 1).<sup>1</sup> This means that Timor-Leste is unlikely to achieve the 30% reduction in tobacco use target by 2025.

Table 1. Fitted trends in current tobacco use among persons aged 15 years and older

Year	CURRENT TOBACCO USE (%)										Estimated no. of current tobacco users
	Men			Women			Both sexes				
	Lower 95% credible limit	Point estimate	Upper 95% credible limit	Lower 95% credible limit	Point estimate	Upper 95% credible limit	Lower 95% credible limit	Point estimate	Upper 95% credible limit		
2000	72.6	89.1	100.0	9.2	16.6	26.1	41.2	53.3	63.5	225,600	
2005	67.3	83.0	99.0	8.4	14.1	19.9	38.1	48.9	59.8	250,400	
2010	62.0	75.6	90.0	8.6	12.4	16.3	35.6	44.3	53.5	275,200	
2015	54.8	67.5	81.8	7.4	10.7	14.1	31.4	39.5	48.3	269,300	
2020	48.6	60.7	77.1	6.0	9.4	13.0	27.5	35.4	45.4	267,900	
2025	39.2	55.2	74.2	4.9	8.3	12.7	22.2	32.0	43.8	265,600	
30% relative reduction target	52.9			8.7			31.0				

Source: Timor-Leste Country Factsheet. WHO, 2019. [https://cdn.who.int/media/docs/default-source/searo/tobacco/country-fact-sheets/timor-leste-who-tobacco-prevalence-trend-estimates-2019.pdf?sfvrsn=4f8f7910\\_2](https://cdn.who.int/media/docs/default-source/searo/tobacco/country-fact-sheets/timor-leste-who-tobacco-prevalence-trend-estimates-2019.pdf?sfvrsn=4f8f7910_2)

Table 2 confirms that the initiation of tobacco use starts early in Timor-Leste and the majority of tobacco users initiate before the age of 25. Even though the prevalence is projected to decline over time, close to half of males in the age group 14 – 24 years old are projected to still smoke in 2025.

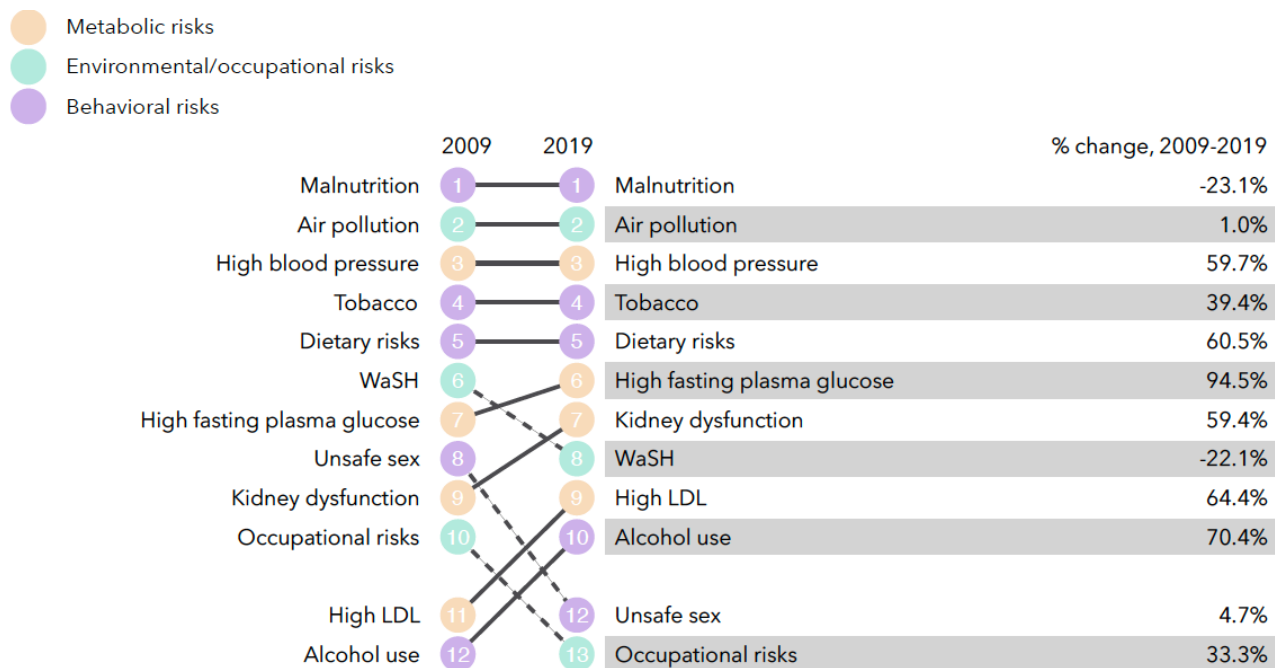
Table 2. Fitted age-specific rates of current tobacco use, 2000, 2010, 2018 and 2025

Age (years)	Men				Women				Both sexes			
	2000	2010	2018	2025	2000	2010	2018	2025	2000	2010	2018	2025
15–24	80.9	66.0	55.5	47.7	13.0	9.9	8.0	6.6	47.3	38.3	32.1	27.4
25–39	95.5	77.2	64.5	55.9	14.7	11.2	8.9	7.4	56.1	44.6	37.0	31.9
40–54	99.7	81.3	68.1	58.9	18.8	14.2	11.5	9.4	60.0	48.6	40.2	34.3
55–69	100.0	85.5	71.4	62.2	21.7	16.6	13.3	11.0	59.6	50.7	42.4	36.6
≥ 70	99.9	86.4	72.1	63.0	21.9	16.8	13.5	11.2	56.4	47.6	39.9	34.6

Source: Timor-Leste Country Factsheet. WHO, 2019. [https://cdn.who.int/media/docs/default-source/searo/tobacco/country-fact-sheets/timor-leste-who-tobacco-prevalence-trend-estimates-2019.pdf?sfvrsn=4f8f7910\\_2](https://cdn.who.int/media/docs/default-source/searo/tobacco/country-fact-sheets/timor-leste-who-tobacco-prevalence-trend-estimates-2019.pdf?sfvrsn=4f8f7910_2)

Figure 1 shows the top 10 risks factors that contribute to the total number of disability adjusted life years (DALYs) in 2019 and the % change from 2009 to 2019. Tobacco use is the 4<sup>th</sup> most important risk factor for the loss of healthy years of life, and its contribution to DALYs increased by almost 40% during the 10 years studied.

Figure 1: Risk Factors Driving the Most Deaths and Disability, Timor-Leste



Source: The Global Burden of Disease 2019, Institute for Health Metrics and Evaluation

Every year, more than 700 people in Timor-Leste are killed by tobacco-related diseases. About 18% of all male deaths and 9% of all female deaths in 2016 were caused by tobacco use.<sup>2</sup>

The economic cost of smoking amounts to USD 64 million per year, or about 1.5% of its GDP. This includes direct costs of healthcare expenditures and indirect costs related to lost productivity due to early mortality and morbidity.<sup>6</sup>

## The Government Response to Control Tobacco Use

Understanding the danger that tobacco use imposes on the society, Timor-Leste signed the Framework Convention for Tobacco Control (FCTC) 25 May 2004 and ratified it on 22 December 2004.<sup>5</sup> In 2016, the country passed strong tobacco control legislation. The law bans tobacco advertising and promotions and bans smoking in public spaces, public gatherings, offices, meeting venues and inside public transport such as taxis and microlets. The 2016 law also prohibits the sale of tobacco products to children under the age of 17 and the sale of tobacco products at educational facilities, playgrounds, stadiums, and healthcare institutions, as well as via vending machines and the internet.<sup>7</sup> Further, the law prohibits the sale, the import and advertising of e-cigarettes<sup>9</sup> while the use of e-cigarettes is prohibited in places where smoking is prohibited.<sup>8</sup> The sale of single cigarettes and small packets of cigarettes is also prohibited, even though about 21.3% of smokers 13 – 15 years old were able to purchase cigarettes as individual sticks in 2019.<sup>4</sup> As many as 49.2% of current cigarette smokers were not prevented from buying cigarettes in 2019 despite being underaged.<sup>4</sup> In terms of cessation assistance, it launched a quit line for those who want to stop smoking.<sup>5</sup> Timor-Leste ranks number one in the world for having implemented the largest graphic health warning on cigarettes, covering 92.5% of the package on average; 85% of the front and 100% of the back of all tobacco product packages.<sup>5</sup>

## Tobacco Tax Policy and Its Implication for Tobacco Control

Timor-Leste lags behind when it comes to applying best practices in tobacco tax policy, even though it is well established that tobacco taxation is the most effective tool to reduce the high prevalence, and to lower the health and economic damage caused by tobacco use.

Timor-Leste applies a uniform specific tax, which is the best practice as far as the tax structure, but the total and the excise taxes are so low that they represented only 21.8% and 19% of the retail price of the most widely sold brand of cigarettes in 2018, respectively (Table 3).<sup>5</sup> The best practice calls for the excise tax to represent at least 70% of retail price.<sup>10</sup> VAT and import duty are 2.4% and 0.35% of retail price, respectively.<sup>5</sup>

It is evident that the share of tax in price is declining over time (Table 3). This is due to tobacco industry increases in the retail price even though there were no tax changes,<sup>5</sup> and due to the failure of the specific tax to adjust for inflation, which means that the real value of tax declines every year. Despite low inflation in 2017 (0.52%<sup>11</sup>) and reasonable inflation in 2018 (2.29%<sup>11</sup>), the industry increased the price of cigarettes by 33% (Table 3).

Another problem with the tax structure is that the tax is levied as per kilogram (currently USD 19.00/kg<sup>12</sup>), not per unit. This means that the industry can lower their tax payment by making cigarettes lighter (e.g., by decreasing the length).

Table 3: Price, Tax and Affordability of Most Sold Cigarette Brand (a Pack of 20 cigarettes)

	2008	2010	2012	2014	2016	2018
Price (USD)	1.00	1.25	1.25	1.25	1.50	2.00
Total tax as % retail price			33.51	33.51	28.01	21.79
Specific excise tax as % retail price			30.40	30.40	25.33	19.00
VAT as % retail price			2.44	2.44	2.44	2.44
Import duties as % retail price			0.67	0.67	0.23	0.35
Affordability (% of GDP per capita)	2.35	3.30	2.07	3.58	7.21	8.05

Notes: A uniform specific tax is applied. Affordability is calculated as % of GDP per capita required to purchase 2000 cigarettes of the most sold brand.

Source: WHO Report on The Global Tobacco Epidemic, 2019. The 2016 and 2018 affordability values calculated using the average price and the GDP per capita from the World Bank.

The tobacco industry in Timor-Leste is collecting a hefty profit, as indicated by the calculation presented in Table 4. It shows that the net-of-tax price in Timor-Leste, which mostly consist of industry profit, is about USD 1.56. (According to the industry source,<sup>13</sup> per pack operating costs of one of the major multinational company in 2019 was about USD 0.36 per pack. These costs are likely lower in LMIC. For example, a pack of cigarettes in South Africa can be manufactured for as little as R2.50 (USD 0.17) a pack.<sup>14</sup>) The net-of-tax price in Timor-Leste contrasts sharply with the net-of-tax price in Indonesia, which is less than half of the net-of-tax price in Timor-Leste.

Table 4: Cigarette prices and taxes in Timor-Leste and Indonesia, 2018

Country	Price of a 20-cigarette pack of the most sold brand			Taxes as a % of price of the most sold brand	Net-of-tax part of the price, US\$
	In reported currency	Reported currency	In USD	TOTAL TAX	
Indonesia	26 250	IDR	1.82	58.55%	0.75
Timor-Leste	2.00	USD	2.00	21.79%	1.56

Note: The net-of-tax price of the most popular cigarette brand was calculated as:  $[Price\ in\ USD \times (1 - Total\ tax\ share)]$ .

Source: WHO Report on The Global Tobacco Epidemic, 2019.

A recent publication evaluating the cigarette tax policy in 170+ countries according to best practices rated Timor-Leste quite poorly.<sup>15</sup> Out of the maximum five points reflecting cigarette prices, changes in the affordability of cigarettes over time, the share of taxes in retail cigarette prices, and the structure of cigarette taxes, Timor-Leste received an overall score of 1.13 in 2014, 1.25 in 2016, and 1.75 in 2018.

The score has been improving primarily thanks to the reduction in cigarette affordability over time. However, the data shows that this reduction is attributable to industry pricing policy rather than excise tax policy, because the share of tax in retail price remains low and is declining (received the score of 0 out of 5). The tax structure is relatively good and received the score of 4 out of 5 during the whole time of observation (2014 – 2018),<sup>15</sup> most likely due to the absence of an inflation adjustment. The 2018 overall score of 1.75 is below the world average of 2.07 as well as below the regional (SEAR) average of 1.82.<sup>15</sup>

The cigarette market is not well secured against tax avoidance and tax evasion. The industry can reduce its tax liability by supplying shorter cigarettes, since the tax is based on the weight. There are no tax stamps or fiscal marks on packs, making it easy to supply untaxed products. The sale of duty-free cigarettes is not banned,<sup>5</sup> again opening a door for non-taxed products. Cognizant of the issue, Timor-Leste introduced a new electronic clearance system, ASYCUDA World, and established a new Customs Authority in 2017 to better protect its tax revenue. This resulted in less under-reporting of import values of all products, including tobacco. As a result, tobacco import values grew by 35% year-on-year in 2017.<sup>16</sup>



Despite these changes, the Customs Authority data collection is not adequate to enforce proper tax collection on all cigarettes, because it only collects quantity data based on the net weight as opposed to the number of units, in defiance of the World Customs Organization (WCO) recommendation.<sup>17</sup>

As a result of poor tobacco tax policy, and possibly poor tax administration, excise revenue is low. In 2012, the government collected only USD15.6 million from tobacco taxes,<sup>5</sup> or about 3.4% of its total tax revenue in that year.<sup>18</sup>

## Conclusion

Pro-health tobacco tax policy is the most effective measure to reduce the persistently high tobacco use prevalence in Timor-Leste. Studies conducted in South East Asia and elsewhere document the effectiveness of higher tobacco taxes, particularly in reducing tobacco use among youth and the poor.

Evidence-based tobacco tax policy would result in a healthier workforce, which is vital for economic growth. In 2020, the Human Capital Index in Timor-Leste stood at 0.45, as compared to the East Asia and the Pacific's regional average of 0.59.<sup>19</sup> Timor-Leste needs to improve this Index in order to recover quickly from the 7 percent GDP contraction in 2020 due to the Covid pandemic.<sup>19</sup>

The Human Capital Index can be improved by reducing tobacco use, but more investment in health is also necessary. In 2014 the share of health in aggregate government expenditure in Timor-Leste was only 2.4%, the lowest among 190 countries evaluated.<sup>20</sup> Higher tobacco taxes can generate additional revenue that could be invested in health.

Tobacco tax revenue could also fund the preparedness for future epidemics and pandemics. Timor-Leste ranked as 166<sup>th</sup> out of 195 countries in the Health Security Index, reaching a score of 26.0 while the average global score was 40.2.<sup>21</sup> The Index measures the capability to address infectious disease outbreaks that can lead to international epidemics.

Higher tobacco taxes would help to address the extremely high poverty level in Timor-Leste where about 42% of the population is classified as poor.<sup>19</sup> This is because the economic burden of tobacco use disproportionately impacts the poor by making them extremely vulnerable when they have to deal with the dire financial consequences of tobacco-related diseases (e.g., the cost of treatments and the loss of income). Tobacco use is indirectly responsible for slowing progress in poverty alleviation.<sup>22</sup>

Evidence-based tobacco tax policy belongs to the Sustainable Development Goals (SDGs) toolkit. The National Parliament of Timor-Leste is committed to the SDGs as reflected in its 2015 resolution. In addition, health features prominently in the Timor-Leste strategic development plan 2011- 2030.<sup>23</sup> The time to implement the best practices in tobacco taxation is now.

## Recommendations

1. Increase the specific excise tax so that it eventually reaches at least 70% of the retail price.
2. Levy the tax per unit (e.g., per stick) as opposed to per weight (kg).
3. Index the excise tax for inflation and for per capita income growth so that cigarettes become less affordable over time.
4. Invest in tax administration and enforcement (e.g., introduce tax stamps, collect data to aid customs with risk profiling)
5. Commit a portion of the revenue to invest in health, pandemic preparedness, and poverty alleviation.

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