

**Submission to present a paper at the International Jubilee Conference of the Economic Society of South Africa**

Request to submit an oral paper by

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**Proposed title: The distributional impact of tobacco excise tax increases**

Since 1993 the South African government has followed a consistent and aggressive tobacco control policy. Although anti-tobacco legislation (the Tobacco Products Control Act of 1993 and the subsequent Amendment Act of 1999) has generated much attention and controversy, the most potent tobacco control instrument has been sharp increases in the excise tax. Econometric evidence suggests that excise-induced price increases<sup>1</sup> are largely responsible for the 20 per cent reduction in aggregate cigarette consumption between 1993 and 2000.

However, even though rapid tax increases have had good tobacco control and fiscal consequences<sup>2</sup>, some economists argue that the burden of the tax falls disproportionately heavily on the poor. The reasoning is based on two observations: (1) smoking prevalence, in most countries, is higher among the poor than among the rich, and (2) poor households generally spend a higher proportion of their income on tobacco products. On the basis that regressive taxes are “bad”, an argument could thus be put forward that the government should decrease tobacco excise taxes.

Tobacco control advocates do not hold this view. While not denying that, at a particular time period, tobacco taxes are regressive, they argue that, because lower-income groups have a more price elastic demand, tax-induced price increases are likely to decrease their consumption by a greater percentage than that of more affluent groups. On the basis of this assertion, they argue that increases in the excise tax are likely to reduce the regressiveness of the excise tax.

The aim of the proposed paper is to estimate the price elasticities of demand for various income and racial groups. The study is part of a larger study into the economics of tobacco control in South Africa. It is funded by Research for International Tobacco Control, a secretariat housed at the International Research Development Centre, and the World Bank. The study is based on the 1990 and 1995 Income and Expenditure Surveys.

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<sup>1</sup> The real price of cigarettes has doubled between 1993 and 2000.

<sup>2</sup> Real government revenue from cigarette excise taxes has doubled since 1993.

For any particular survey, one would expect large variations in income and tobacco expenditure. However, the unfortunate aspect of a cross-section survey is that there is little or no price variation. Thus, even though one can estimate income elasticities, one cannot say anything about the impact of price differences on people's tobacco demand, simply because there are no price differences at a given point in time<sup>3</sup>. However, by comparing two cross-section surveys, one can investigate the changes in tobacco demand that is not explained by changes in income and hopefully tie this to changes in the price of cigarettes. The strong assumption is that the demand for cigarettes is determined by two factors only: income and price. However, based on time-series data, this does not appear to be too extreme an assumption.

At the time of writing of this submission, the study is in a relatively advanced phase and the results seem believable.

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An exception would be where there are significant changes in cigarette prices, as is the case in a large number of developing countries, and where the prices paid by the respondents are recorded in the survey. In South Africa's case, neither of these two conditions apply.