IMPACT OF TAXATION ON THE ILLICIT TRADE OF TOBACCO
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1. Effecting national, regional, and international policy change or support

2. Fostering strategic ideas based on cooperation and innovative thinking

3. Providing a regional venue for collaboration and cooperation in dealing with critical issues in East Asia; and

4. Actively participating in regional debates and global conversations

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As SRI sought solutions, East Asia’s affairs frequently inserted themselves into the equation. There was and is a clear relation between domestic and regional affairs; movement in one reverberates in the other.
IMPACT OF TAXATION ON THE ILLICIT TRADE OF TOBACCO

WRITTEN BY
STRATBASE ADRI RESEARCH

Manila, Philippines
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ABSTRACT

By exploring existing literature and reports about tobacco smuggling and generating its own estimates of smuggling and revenue losses, ADRI suggests measures how this clear and present danger can be controlled in order to increase public revenues while controlling resources that, otherwise, go to smugglers and other criminal groups engaged in tobacco smuggling. The illicit trade of tobacco products in the Philippines is a perennial problem. The following sections of this paper will show that the illicit tobacco trade results in estimated tax losses for the government from PhP 20 billion to PhP 80 billion a year. Estimates on the illicit tobacco trade are made and government initiatives in fighting the illicit trade are discussed. Under an ideal situation, the national debt could have been controlled through the following tracks: (1) large-scale privatization of state-owned corporations, financial institutions, real properties, and other assets; (2) cutting subsidies, government spending and borrowings; and (3) increased taxation. As tax rates rise, revenues rise but there is a point whereas tax rates further rise, revenues start to fall or decline as people reduce consumption of the taxed commodity or service. Ultimately, they shift to the nearest substitutes, which in this case are the illicit, illegal, smuggled tobacco. The sums of money from the illicit tobacco trade do not go to the government in the form of tax revenues but to the criminal groups and their protectors in government at the national and local levels. There is also an optimal tax rate where government optimizes revenues while reducing incentives for illicit trade that favor the smugglers. In essence, this paper presents implementational and operational recommendations to government agencies and departments such as the NTA, DILG, DTI, DOF, PEZA, BIR, BOC, and the DFA, in terms of increasing its international collaboration with tobacco exporting and importing countries.
The illicit trade of tobacco products in the Philippines has remained a perennial problem. The succeeding sections of this paper will show that the illicit tobacco trade results in estimated tax losses for the government from PhP 20 billion to PhP 80 billion a year.

In view of the huge fiscal deficits of the government in funding various projects, there is a strong pressure to raise taxes from different sectors of the economy. Prior to the COVID-19 pandemic, the Philippine government’s average borrowings amounted to PhP 65 billion per month in 2018 and PhP 73 billion per month in 2019. By 2020 and 2021, this jumped to PhP 208 billion per month.

When the new administration starts on June 30, 2022, among its major challenges is to manage the enormous national debt. In 2016, when President Rodrigo Duterte took office, the national government’s outstanding debt stood at PhP 6.09 trillion. However, when the COVID-19 pandemic hit in 2020, the national debt rose to PhP 9.80 trillion from PhP 7.73 trillion in 2019. As the government resorted to borrowings to augment its COVID-19 response measures, the national debt ballooned to a new record high of PhP 12.73 trillion as of end-April 2022, based on the latest data from the Bureau of the Treasury (BTr). The debt at the end of the first quarter of 2022, amounting to
PhP 12.70 trillion, was equivalent to 63.5% of the GDP, far from the pre-pandemic level of 39.6% in 2019.

Under an ideal situation, the national debt could have been controlled through the following tracks: (1) large-scale privatization of state-owned corporations, financial institutions, real properties, and other assets; (2) cutting subsidies, government spending and borrowings; and (3) increased taxation.

In the first track, the proceeds of the sale of public assets may be used to retire some existing debt. Meanwhile, if the new administration chooses to increase taxation, among the “candidate” sectors is the tobacco industry. In fact, over the past few years, this industry has been subjected to a series of dramatic tax hikes to finance the Universal Health Care (UHC) program and other priority programs of the government. Under the Duterte administration alone, three laws increasing sin taxes were enacted, which led to the rise in tobacco tax by 83%, from PhP 30 per pack in 2017 to PhP 55 per pack in 2022.

But as the succeeding sections will show, increases in tobacco taxes are always followed by expanded tobacco smuggling and illicit trade of cigarettes. The more expensive legal tobacco gets, the more attractive illegal tobacco becomes. The latter’s attraction is that it is cheap because it is smuggled to begin with. While taxation of tobacco is necessary, one must consider increased taxation in the context of its possible consequences – namely, increased illicit tobacco trading. Reflecting on the appropriate level of taxation, Congressman Jericho “Koko” Nograles of the Technical Working Group on Illicit Tobacco and Agricultural Smuggling of the Ways and Means Committee, questions, “Is there such a thing as over-taxation to the point where we are actually rewarding smugglers because of the size of the taxation?” The government must find ways to strike a careful balance between increased taxation and increased illicit activity.
This paper will explore some existing literature and reports about tobacco smuggling, generate its own estimates of smuggling and revenue losses, and suggest measures how this clear and present danger can be controlled in order to increase public revenues while controlling resources that, otherwise, go to smugglers and other criminal groups engaged in tobacco smuggling.

Incidence of Illicit Tobacco Trade in the Philippines

Cigarette smuggling is often reported in the news because of its frequent occurrence and the high value of products that escape public coffers despite government initiatives to curb smuggling and increase revenue sources. Annex 1 shows a compilation of news reports of cigarettes and tobacco smuggling from 2020 to 2022. It was observed that in the first quarter of 2022, seizures included not just cigarettes, but also e-cigarettes or heated tobacco products (HTPs).

Estimates on Illicit Tobacco Trade

The exact extent and magnitude of illicit tobacco trade can be difficult to determine due to its covert nature and, therefore, discrepancies in data.

Data from Euromonitor (2022), as seen in Table 1, suggests a noticeable decline in the sale of cigarettes in the Philippines between 2016 and 2021, regardless of whether the cigarettes were legal or illegal. The retail volume of cigarettes sold decreased from 78.55 billion sticks in 2016 to 50.81 billion sticks in 2021. Similarly, the illicit trade volume of cigarettes fell from 9.77 billion sticks in 2016 to 8.82 billion sticks in
2021. It should be noted, however, that the amount of illegal cigarettes sold fell at a much slower pace than the amount of legal cigarettes.

### Table 1. Euromonitor Data Set On Retail and Illicit Cigarette Trade Volume In The Philippines

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Volume</td>
<td>78,548.5</td>
<td>71,470.1</td>
<td>70,179.4</td>
<td>67,986.6</td>
<td>58,319.9</td>
<td>50,809.0</td>
</tr>
<tr>
<td>Illicit Trade Volume</td>
<td>9,774.0</td>
<td>8,976.0</td>
<td>8,527.2</td>
<td>7,930.3</td>
<td>8,088.9</td>
<td>8,816.9</td>
</tr>
<tr>
<td>Retail plus Illicit Trade</td>
<td>88,322.5</td>
<td>80,446.1</td>
<td>78,706.6</td>
<td>75,916.9</td>
<td>66,408.8</td>
<td>59,625.9</td>
</tr>
</tbody>
</table>

*Sources: Euromonitor From Trade Sources/National Statistics*

Moreover, according to the Asia Illicit Tobacco Indicator 2017 by Oxford Economics (2018), total cigarette consumption in the Philippines was estimated at 80.8 billion cigarettes in 2017. Of this figure, 75.5 billion was legal domestic consumption, while 5.3 billion was illicit consumption. Illicit cigarettes that were consumed in the Philippines consisted primarily of domestic non-tax paid cigarettes. It is worthy of note that in 2017, around PhP 9.4 billion (USD 186 million) in tax revenues was lost to illicit cigarette consumption, which was 46.3% lower than the PhP 17.4 billion (USD 367 million) estimated in 2016. Based on Table 2 below, the estimated illicit consumption in 2013 saw a significant increase from the 2012 level, following the sin tax reforms introduced by the government.

Oxford Economics’ estimate of illicit tobacco at 13.5% of total consumption in 2015 is close to Austria and Villanueva’s (2021) 14% in 2016 at 20% illicit penetration rate.

Austria and Villanueva (2021) provided estimates of illicit tobacco at 20% under-reporting in number of cigarette sticks, with 9.4 billion in 2014, 8.5 billion in 2016, 14.2 billion in 2017. On the other hand, at 40% under-reporting, 23.6 billion were estimated in 2014, 20.7 billion
Table 2. Oxford Economics Estimated Illicit Cigarette in the Philippines (% of Total Consumption)

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal Domestic Consumption</td>
<td>94.0</td>
<td>81.8</td>
<td>80.4</td>
<td>86.2</td>
<td>86.9</td>
<td>93.4</td>
</tr>
<tr>
<td>Non-Domestic Legal</td>
<td>0.1</td>
<td>0.1</td>
<td>0.1</td>
<td>0.4</td>
<td>0.1</td>
<td>0.1</td>
</tr>
<tr>
<td>Domestic Illicit</td>
<td>5.6</td>
<td>16.3</td>
<td>18.6</td>
<td>12.0</td>
<td>11.8</td>
<td>4.4</td>
</tr>
<tr>
<td>Non-Domestic Illicit</td>
<td>0.3</td>
<td>1.8</td>
<td>0.9</td>
<td>1.5</td>
<td>1.2</td>
<td>2.1</td>
</tr>
<tr>
<td>Total</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Sources: Oxford Economics (2018). "Asia: Illicit Tobacco Indicators 2017"

in 2016, and 26.7 billion in 2017. Even at 20% penetration rate of illicit tobacco, 14% of consumption in 2016 and 22.8% of consumption in 2017 were illicit products (Table 3).

Table 3. Austria And Villanueva’s Estimate Of Illicit Cigarette (2013-2017)

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Estimate Cigarette Consumption (Billion Sticks)</td>
<td>69.21</td>
<td>70.78</td>
<td>60.63</td>
<td>61.06</td>
<td>62.32</td>
</tr>
<tr>
<td>Illicit cigarette trade, at 10% under-reporting (Billion Sticks)</td>
<td>2.32</td>
<td>2.39</td>
<td>1.97</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 20% under-reporting</td>
<td>9.40</td>
<td>8.49</td>
<td>14.21</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 30% under-reporting</td>
<td>16.47</td>
<td>14.60</td>
<td>20.44</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 40% under-reporting</td>
<td>5.87</td>
<td>23.55</td>
<td>2.05</td>
<td>20.70</td>
<td>26.67</td>
</tr>
<tr>
<td>At 10% penetration of illicit (% of consumption)</td>
<td>3.3%</td>
<td>3.9%</td>
<td>12.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 20% penetration</td>
<td>13.3%</td>
<td>13.9%</td>
<td>22.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 30% penetration</td>
<td>23.3%</td>
<td>23.9%</td>
<td>32.8%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>At 40% penetration</td>
<td>8.5%</td>
<td>33.3%</td>
<td>3.4%</td>
<td>33.9%</td>
<td>42.8%</td>
</tr>
</tbody>
</table>

Sources: Oxford Economics (2018). "Asia: Illicit Tobacco Indicators 2017"
However, Lavares et al (2020) offers contrasting estimates of the illicit tobacco trade. In a separate study, the authors, who did not believe in high smuggling incidence, used low under-reporting numbers of 8%, 12% and 16%. They noted:

“According to the lower bound estimates, the illicit cigarette market in the Philippines was negligible in 2008, 2013 and 2015 and it only reached 8.7% in 2018…. the share of illicit cigarette market had increased again to a prevalence comparable with its 1998 level, even though the tax rate more than tripled in real values during that time.”

In 2021, Congressman Joey Salceda, who chairs the House Committee on Ways and Means that is in charge of tax legislation, estimated cigarette smuggling at PhP 30 billion to PhP 60 billion per year. However, it is unclear if this figure referred to the total market value of illicit tobacco or lost government revenues. Furthermore, according to the EU-ASEAN Business Council, cigarette smuggling in the Philippines is estimated at PhP 10.7 billion per year.

The Center for Research and Communications (CRC) of the University of Asia and the Pacific (UAP) (2017) estimated an amount
of PhP 1 billion a year in foregone tax revenues in 2014 and 2015 due to smuggling.

Based on his own computations and estimates of tax leakage by illicit tobacco from 2020, which amounted to PhP 18 billion to PhP 80 billion a year (Annex 2), Oplas (2022) concluded that:

“Government concern for public health is inconsistent if it focuses only on more regulations and taxation of alcohol, tobacco and sugary products and drinks. If it is consistent, government should also regulate sugary food like chocolates and ice cream, risky sports like rock climbing and downhill cycling, financially-addicting activities like online and casino gambling, cockfighting, and many other activities. Either government should regulate and heavily-tax all of these stated activities – which will further increase government corruption – or it should relax regulations and taxation of all of these activities. So another round of higher sin taxes is not justified until smuggling issues discussed above are resolved. Instead, legislators and executive agencies should focus on strictly implementing the existing laws and plug loopholes, like controlling the proliferation of smuggled, illicit products.”

Government Initiatives in Fighting Illicit Tobacco Trade

The Bureau of Internal Revenue’s (BIR) total collection of excise tax from locally-manufactured and imported cigarettes in 2016 amounted to PhP 94.5 billion. Adding this to the Bureau of Customs’ (BOC) estimate of PhP 16 billion losses from cigarette smuggling, potential tax revenues in 2016 might have been PhP 110.5 billion. Lost revenue from smuggling was 14.5% of potential total tobacco tax revenue in 2016.

In a virtual event organized by the National Tobacco Administration (NTA) in April 2022 regarding the government’s efforts in combatting illicit tobacco trade, the agency presented data on tobacco trade from
2018 to 2021 (Table 4). Based on the author’s computations of the trade balance (i.e., exports minus imports), the following were observed: (1) there is persistent trade deficit in unmanufactured tobacco; (2) there is also persistent trade surplus in manufactured tobacco; and (3) trade surpluses were recorded except in 2020.

Table 4. Philippines Tobacco Trade

<table>
<thead>
<tr>
<th>Tobacco Type</th>
<th>Imports, USD Million</th>
<th>Exports, USD Million</th>
<th>Trade Balance, USD Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unmanufactured</td>
<td>155.81</td>
<td>226.69</td>
<td>195.74</td>
</tr>
<tr>
<td>Manufactured</td>
<td>79.31</td>
<td>96.75</td>
<td>304.99</td>
</tr>
<tr>
<td>Total</td>
<td>235.12</td>
<td>323.44</td>
<td>500.73</td>
</tr>
</tbody>
</table>

Sources: NTA; Trade balance are author computations
One possible explanation for observations (2) and (3) is the high incidence of smuggled tobacco, since the imports are highly understated resulting in a substantial surplus. More smuggling happens when more taxes are imposed per case or per stick of tobacco products.

NTA also showed data on production—mostly Virginia and native tobacco—volume removals, and excise taxes paid. In 2020, production peaked at 49 million kilograms but volume removals crashed at 44.5 billion sticks from 75.7 billion sticks in 2019. Consequently, excise tax collection also crashed to PhP 100 billion from PhP 132 billion the year before.

The computed average tax per stick steadily rose from PhP 1.68 per stick in 2018 to PhP 2.50 stick in 2021. This is a result of a series of tobacco tax hikes.

During the same virtual forum, the BIR shared some of the key measures it has undertaken to combat illicit tobacco trade. One important initiative is the enhancement of the Internal Revenue Stamps Integrated System (IRSIS), which is a web-based application system for the ordering, distribution, and monitoring of stamps as well as the payment of excise taxes. Its major functionalities are as follows:

1. Enable APO Production Unit to accept online orders;
2. Online approval of the BIR strictly in accordance with the order placed by the taxpayer;
3. Release stamps to the taxpayer placing the order;
4. Enable the BIR to monitor the ordering, payment, and distribution of the released stamps to the correct taxpayers;
5. Make available real time data and generation of system reports such as the identification of importation, locally produced for domestic market and exportation on a per taxpayer basis;
6. Remove products within the Bureau of Customs’ (BOC) custody; and
7. Upgrade tools for tracking and tracing illicit cigarettes through the taggant readers and mobile device application.

The BIR has also conducted inter-agency meetings with the BOC, Philippine Economic Zone Authority (PEZA), Subic Bay Metropolitan Authority (SBMA) and other agencies to reconcile procedures or processes, as well as documentary requirements for the exportation of products. The BIR has likewise facilitated meetings with the National Bureau of Investigation (NBI) to coordinate enforcement activities related to registration and product validation, reporting requirements and destruction.

As shown in Tables 6 and 7, the 14 mission orders in 2018 yielded 35.52 million packs of cigarettes seized, with 10.6 million stamps volume and 17 machines seized. The COVID-19 lockdowns imposed in 2020 encouraged more smuggling as people had lesser income and shifted to smuggled cigarettes. The BIR countered with four mission orders that resulted in the seizures of 4.89 million packs of cigarettes plus 30.66 million stamps volume.

The BIR, however, has a lower estimate of PhP 123 million to PhP 1.6 billion a year in tax losses due to smuggling.
**Table 6. Summary of Raids Based on Mission Orders Issued**

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Mission Orders</th>
<th>Submitted to DOJ or Prosecutor's Office</th>
<th>Number of Cases Filed</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>14</td>
<td>7</td>
<td>3</td>
<td>For issuance of Notice, with Report for ongoing review, issuance of Letter of Authority</td>
</tr>
<tr>
<td>2019</td>
<td>11</td>
<td>4</td>
<td>6</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>12</td>
<td>3</td>
<td>3</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>10</td>
<td>-</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>TOTAL</td>
<td>51</td>
<td>17</td>
<td>16</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bureau of Internal Revenue (BIR)

**Table 7. Seized Products/Assets by the BIR**

<table>
<thead>
<tr>
<th>Year</th>
<th>Cigarettes (No. of Packs)</th>
<th>Stamps Volume</th>
<th>Machines</th>
<th>Raw Materials / Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>35,521,170</td>
<td>10,598,000</td>
<td>17</td>
<td>Assorted packs/boxes of raw materials such as filter rods, leaf tobacco, bobbins, cut fillers, plug wraps, filter tipping papers, packaging materials, etc.</td>
</tr>
<tr>
<td>2019</td>
<td>3,189,600</td>
<td>8,435,120</td>
<td>42</td>
<td>Assorted cigarette labels, ink chemical boxes and cardboard</td>
</tr>
<tr>
<td>2020</td>
<td>4,890,124</td>
<td>30,659,011</td>
<td>50</td>
<td>Sacks of tobacco raw materials, boxes and labels</td>
</tr>
<tr>
<td>2021</td>
<td>2,465,060</td>
<td>-</td>
<td>6</td>
<td>Tobacco raw materials, tapes and labels</td>
</tr>
<tr>
<td>TOTAL</td>
<td>46,065,954</td>
<td>49,692,131</td>
<td>121</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bureau of Internal Revenue (BIR)
Table 8. Summary of the BIR’s Estimated Revenue Losses (Excise Taxes) Due to Illicit Trade in Taxable Years (2018-2021, in PhP Million)

<table>
<thead>
<tr>
<th></th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Apprehended,</td>
<td>1,243,521</td>
<td>111,636</td>
<td>220,056</td>
<td>123,253</td>
<td>1,698,465</td>
</tr>
<tr>
<td>Million Packs of Cigarettes</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Confiscated</td>
<td>370,930</td>
<td>295,229</td>
<td>1,379,655</td>
<td>-</td>
<td>2,045,815</td>
</tr>
<tr>
<td>Fake Internal Revenue Stamps</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Revenue Losses for the Years 2018-2021</td>
<td>1,614,451</td>
<td>406,865</td>
<td>1,599,711</td>
<td>123,253</td>
<td>3,744,280</td>
</tr>
</tbody>
</table>

Source: Bureau of Internal Revenue (BIR)

The BOC also presented during the same forum the measures it is taking to fight illicit cigarette trade, as follows:

1. Issuance of Alert Orders based on profiling of shipments and derogatory information received;
2. Coordination and case study sharing with international partners, such as the ASEAN member states (through the Customs Enforcement and Compliance Working Group, CECWG) and the Australian Border Force and ASEAN (through Project Portcullis);
3. Coordination with the Philippine National Police (PNP) and the Philippine Coast Guard (PCG) for apprehensions through checkpoints that are subsequently turned over to the BOC; and
4. Coordination with the Department of Finance (DOF) and the BIR on the monitoring of apprehensions and filing of cases.

With these and other measures, the BOC saw a reduction in apprehended smuggled tobacco products, from PhP 4.77 billion estimated value in 2020 to only PhP 1.58 billion in 2021. Consequently, the estimated tax losses declined from PhP 1.51 billion in 2020 to PhP 1.08 billion in 2021.
Table 9. Summary of the BOC’s Apprehensions on Illicit Tobacco Products

<table>
<thead>
<tr>
<th>Year</th>
<th>Seizure Volume in Master Cases*</th>
<th>Estimated Value (PhP Million)</th>
<th>Excise Tax (PhP/pack)</th>
<th>Excise Foregone (PhP Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2019</td>
<td>16,982</td>
<td>1,598.856</td>
<td>35</td>
<td>297.185</td>
</tr>
<tr>
<td>2020</td>
<td>66,960</td>
<td>4,774.619</td>
<td>45</td>
<td>1,506.600</td>
</tr>
<tr>
<td>2021</td>
<td>43,301</td>
<td>1,581.117</td>
<td>50</td>
<td>1,082.525</td>
</tr>
<tr>
<td>2022</td>
<td>3,488</td>
<td>122.912</td>
<td>55</td>
<td>95.914</td>
</tr>
<tr>
<td>TOTAL</td>
<td>87,430</td>
<td>8,077.504</td>
<td></td>
<td>2,982.224</td>
</tr>
</tbody>
</table>

*One Master Case has 50 reams of cigarettes, 1 ream has 10 packs. A Master Case contains 10,000 sticks

As shown in Table 10, the summarized combined apprehensions of illegal cigarettes by the BIR and BOC were only between PhP 1 and PhP 2 billion.

Table 10. Estimated Revenue Losses by BIR and BOC from Smuggled Cigarettes

<table>
<thead>
<tr>
<th>Year</th>
<th>BIR (in PhP Million)</th>
<th>BOC (in PhP Million)</th>
<th>BIR + BOC, Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Packs</td>
<td>Value</td>
<td>Value</td>
</tr>
<tr>
<td>2018</td>
<td>1,243.52</td>
<td>1.614</td>
<td>0.704</td>
</tr>
<tr>
<td>2019</td>
<td>111.64</td>
<td>0.407</td>
<td>0.704</td>
</tr>
<tr>
<td>2020</td>
<td>220.06</td>
<td>1.600</td>
<td>3.107</td>
</tr>
<tr>
<td>2021</td>
<td>123.25</td>
<td>0.123</td>
<td>1.205</td>
</tr>
<tr>
<td>2022</td>
<td>0.123</td>
<td>0.095</td>
<td></td>
</tr>
</tbody>
</table>

Source: BIR and BOC

Speaking during the same NTA forum, Cong. Jericho “Koko” Nograles of Puwersa ng Bayang Atleta (PBA) party list presented the extent of illicit tobacco trade in the Philippines (Table 11).

Table 11. Estimates of Illicit Tobacco as Share of Total Supply

<table>
<thead>
<tr>
<th>Province</th>
<th>% Share</th>
<th>Province</th>
<th>% Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nationwide</td>
<td>13.0</td>
<td>Sultan Kudarat</td>
<td>35.6</td>
</tr>
<tr>
<td>Zambales</td>
<td>11.5</td>
<td>Zamboanga de Sibugay</td>
<td>50.6</td>
</tr>
<tr>
<td>Nueva Ecija</td>
<td>22.2</td>
<td>Misamis Occidental</td>
<td>57.2</td>
</tr>
<tr>
<td>Bataan</td>
<td>31.6</td>
<td>“Some areas Mindanao”</td>
<td>60.0</td>
</tr>
</tbody>
</table>

Source: Cong. Jericho "Koko" Nograles' presentation
According to Cong. Nograles, the average price of illicit tobacco is PhP 35 per pack, or PhP 2 per stick, which is half of the minimum price of the cheapest brands of legal tobacco, that sell at PhP 72 per pack. The tax on these cheap legit brands was already at PhP 45-50 per pack in 2020 and 2021.

Cong. Nograles stated that in a committee hearing at the House of Representatives last February 2022, the BOC identified the following as the “best-selling” illicit brands in Mindanao: Astro, Canon, Commando, Delta, Famous, Fort, Guiang Baru, New Berlin, Oxford, Premiex, San Marino, Two Moon, and Union. He questioned why the BOC did not mention other well-known illicit brands in Mindanao, such as Bros, Billionaire, Nelson, R&B, and Wilson. It is possible, then, that these brands could be the bulk of those smuggled cigarettes in Mindanao that “escape” the eyes and monitoring of the BOC. Cong. Nograles, who hails from Davao, presented his own estimate of foregone revenues from illicit tobacco nationwide amounting to PhP 26 billion per year, not far from the estimates of Cong. Joey Salceda of PhP 30 billion per year.

Using the assumptions of Cong. Nograles, Table 12 below shows this paper’s own estimates of lost taxes from tobacco smuggling. Assumption 1 uses 87% legal and 13% illegal of total supply (Euromonitor) estimate. On the other hand, Assumption 2 uses 80% legal and 20% illegal of total supply, even as Cong. Nograles claimed that in some parts of Mindanao illicit cigarettes comprise 60% of supply.

---

**Table 12. Estimated Tax Losses from Cigarette Smuggling 2021**

<table>
<thead>
<tr>
<th>Assumption: % Legal – % Illegal</th>
<th>Cigarette Removals (in Billion Sticks)</th>
<th>Estimated Illicit (in Billion Sticks)</th>
<th>Tax P55/pack, P2.75/stick</th>
<th>Tax Losses PhP 24.45 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) 87%-13%</td>
<td>59.5 B (87%)</td>
<td>(59.5 B) / 0.87 = X / 0.13</td>
<td>P2.75/stick</td>
<td>8.89 B x P2.75 = P24.45 B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>X = [(59.5 B) x (.13)]/0.87 = 8.89</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(2) 80%-20%</td>
<td>59.5 B (80%)</td>
<td>(59.5 B) / 0.80 = X / 0.20</td>
<td>P2.75/stick</td>
<td>14.88 B x P2.75 = P40.92 B</td>
</tr>
<tr>
<td></td>
<td></td>
<td>X = [(59.5 B) x (.20)]/0.80 = 14.88</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Source: Author estimates*
Moreover, in the legislative side, two bills were filed at the House of Representatives during the 18th Congress (2019-2022) that particularly focused on addressing the illicit trade of tobacco products: House Bill Nos. 6507 and 7272. However, these did not see any significant movement from 2020 as it remained pending with the House Committee on Ways and Means.

**Tobacco Taxation in the Philippines**

The prices of cigarettes have seen a significant increase over the past several years as the tobacco industry experienced a series of tax hikes starting 2013 (National Tax Research Center, 2018). In recent years, with the passage of Republic Act No. 10963, otherwise known as the Tax Reform for Acceleration and Inclusion (TRAIN) Law, followed by RA 11346 or the Tobacco Tax Law of 2019, the tax rate was raised from PhP 30 per pack in 2017 to PhP 35 per pack in 2019, PhP 45 in 2020, PhP 50 in 2021, PhP 55 in 2022, and PhP 60 projected for 2023 (Table 13). Aside from these, RA 11467 also imposed another round of tax increases on e-cigarettes beginning 2020.

### Table 13. Tobacco Excise Tax Rates Under RA 10963, RA 11346, and HTPs Tax Rates

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>RA 10963 (2017)</td>
<td>PhP/pack</td>
<td>32.5</td>
<td>35</td>
<td>35</td>
<td>37.5</td>
<td>37.5</td>
<td>40</td>
<td>40</td>
<td>+4%/year</td>
</tr>
<tr>
<td>RA 11346 (2019)</td>
<td>PhP/pack</td>
<td></td>
<td></td>
<td>45</td>
<td>50</td>
<td>55</td>
<td>60</td>
<td>60</td>
<td>+5%/year</td>
</tr>
<tr>
<td>HTPs, RA 11346</td>
<td>PhP/ml.</td>
<td>10-50</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+5%/year</td>
</tr>
<tr>
<td>RA 11467 (2020): HTPs</td>
<td>PhP/pack</td>
<td>25</td>
<td>27.5</td>
<td>30</td>
<td>32.5</td>
<td></td>
<td></td>
<td></td>
<td>+5%/year</td>
</tr>
<tr>
<td>Salt nicotine</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+5%/year</td>
</tr>
<tr>
<td>Classic nicotine</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>+5%/year</td>
</tr>
</tbody>
</table>

*These prices/tax rates are based on the laws*

*Source: Author’s own illustration*
Illicit trade appears to have increased when sin tax laws were passed into law. Based on data from Oxford Economics (2018) as shown in Table 2, the share of domestic illicit cigarettes to total consumption in the Philippines increased from 5.6% in 2012 to a whopping 16.3% in 2013. Likewise, consumption of non-domestic illicit cigarettes grew from 0.3% to 1.8% in the same period. On the other hand, the consumption of legal domestic cigarettes declined from 94.0% in 2012 to 81.8% the following year. Incidentally, RA 10351 or the Sin Tax Reform Law was enacted in December 2012, which led to the increase in the tax rates on sin products.

Tobacconomics Tax Scorecard

The Tobacconomics Cigarette Tax Scorecard is a collaborative research program of the University of Illinois Chicago (UIC), which aims to curb tobacco consumption worldwide and is funded by Bloomberg Philanthropies. The scorecard is composed of four components: Absolute Price, Affordability Change, Tax Share, and Tax Structure. The scoring is based on 0 to 5, with 5 being more anti (legal) tobacco. However, illegal tobacco is not covered by all those taxes since smugglers and criminal syndicates just pay bribes and give personal favors to some government personnel and officials in-charge of imposing and collecting high tobacco taxes so that they will turn a blind eye on the circumstances on the ground.

Hence, higher absolute tobacco prices, lower affordability change for smokers, higher tobacco tax share to total taxes, and more uniform or unitary tax rate with periodic increases will generate high scores.

The following are the highlights of the 2020 scorecard versus previous years’ data:
1. The Philippines seems to be the most taxed country in Asia for tobacco products. It scored 5 in terms of less affordability and 5 in tax structure. The taxes just keep rising: PhP 30 per pack in 2017, PhP 35 in 2019, PhP 45 in 2020, PhP 50 in 2021, PhP 55 in 2022, and PhP 60 in 2023.

2. The Philippines’ overall score of 3.63 in 2020 is the highest in Asia, even higher than Singapore and Malaysia. This score is also higher than those of Australia, Germany, Italy and US, and is in the top 20 out of 160 countries covered that year.

3. The increase in the Philippines’ score and ranking is rather fast within a short period of time. The overall score of the Philippines was

<table>
<thead>
<tr>
<th>Country</th>
<th>Components Score 2020</th>
<th>Overall Score 2020</th>
<th>Overall Score 2020</th>
<th>Overall Score 2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td>China</td>
<td>1</td>
<td>0</td>
<td>1.5</td>
<td>1</td>
</tr>
<tr>
<td>Myanmar</td>
<td>1</td>
<td>0</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Vietnam</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Japan</td>
<td>--</td>
<td>0</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Thailand</td>
<td>2</td>
<td>0</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Indonesia</td>
<td>3</td>
<td>3</td>
<td>2.5</td>
<td>1</td>
</tr>
<tr>
<td>South Korea</td>
<td>2</td>
<td>0</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>5</td>
<td>0</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Singapore</td>
<td>5</td>
<td>0</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Philippines</td>
<td>2</td>
<td>5</td>
<td>2.5</td>
<td>5</td>
</tr>
<tr>
<td>US</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>Italy</td>
<td>4</td>
<td>0</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Germany</td>
<td>4</td>
<td>2</td>
<td>2.5</td>
<td>4</td>
</tr>
<tr>
<td>Australia</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>France</td>
<td>5</td>
<td>4</td>
<td>4.5</td>
<td>3</td>
</tr>
<tr>
<td>Canada</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>UK</td>
<td>5</td>
<td>3</td>
<td>4.5</td>
<td>5</td>
</tr>
</tbody>
</table>

only 1.25 in 2014, which tripled to 3.75 in 2018, but slightly declined to 3.63 in 2020. Even then, the Philippines’ score in 2020 was still the highest in Asia, and was nearly double the score of the US.

4. In the Tobacconomics scorecard in 2018, the Philippines scored 3.75 and belonged to the top 10 out of 174 countries and jurisdictions covered.

5. While it would imply that more tobacco taxation in the Philippines should slow down, if not halt temporarily, because of the aforementioned reasons, lobbying for more tobacco taxation continues due to the availability of funding as the Philippines’ score goes up.

Analysis

The extent and incidence of illicit tobacco trade goes directly and lock-step with the increase in tobacco tax rates. As retail prices of legal tobacco go up due to higher taxes, the attractiveness of cheap, illicit and unregistered products also increases for smokers.

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**Chart 2 . Estimated Laffer Curve of Tobacco Taxation in the Philippines**
This study developed the “Philippines cigarette taxation Laffer curve” (Chart 2). The Laffer curve is a theory developed by economist Arthur Laffer that shows the relationship between tax rates and tax revenues by governments. As tax rates rise, revenues rise but there is a point where as tax rates further rise, revenues start to fall or decline as people reduce consumption of the taxed commodity or service. Ultimately, they shift to the nearest substitutes, which in this case are the illicit, illegal, smuggled tobacco.

From the NTA’s figures above, this paper argues that the optimal tax rate is PhP 55 per pack because the degree of smuggling seems to be rising or deteriorating, but at the same time government tax revenue keeps rising. Raising this rate to PhP 60 per pack or higher will greatly tilt the balance towards more smuggling and flatlining of tax revenues. This means that smugglers are actually rewarded at the expense of the people who rely on tax revenues for their public health and related needs.

Price Elasticity of Demand (PED)

“Elasticity” signifies responsiveness to changes, especially to increases, in prices of the volume or quantity of consumption. When the price goes up, consumption usually goes down. The question is by how much percentage decline in quantity given a certain percentage increase in the price.

Price Elasticity of Demand (PED) is defined and computed as:

\[
PED = \frac{\% \text{ change in quantity}}{\% \text{ change in prices}}
\]
When the quotient or result is above 1.0, then in this case, cigarette demand is “elastic” or responsive. A 10% increase in price leads to 11% or higher reduction in consumption, so many smokers either consume less legal tobacco or continue their average sticks per day by simply shifting to cheaper smuggled tobacco.

When the quotient or result is below 1.0, then it is classified as “inelastic” (i.e., less-responsive to price changes). A 10% increase in price leads to a 9% or lower reduction in consumption, so many smokers will just continue consuming more legal tobacco.

When the quotient is zero, the situation is “perfectly inelastic” or totally non-responsive to any changes in tax rates. When the quotient is 1.0, it is called “perfectly elastic” or totally responsive; a 1% rise in tax leads to 1% decline in consumption.

In Table 15, percentage changes in price and industry volume are computed and the PED is derived, as follows:

1. Price increases in the last three years were highest in the period 2018-2019, manifesting a 22.7% increase. The price increase in the periods 2019-2020 and 2020-2021 were muted by the pandemic-induced lockdowns as well as the lower income and spending capacity of the consumers. Price increase in 2020-2021 was only 4%.

2. Volume reduction in the last three years was largest in 2020-2021 with -8.5%. These are reduction in consumption of legal tobacco, clearly explained by higher taxes per pack or per stick, and hiddenly explained by the continued entry of smuggled and illicit tobacco.

3. PED was inelastic or less-responsive in 2019 and 2020 with 0.13 and 0.41, respectively, and elastic or price-responsive in 2021 with 1.91. The average for the last three years was 0.41 PED. Overall, the consumption of legal tobacco has remained inelastic.

It should be noted that the aforementioned prices of leading products of legal tobacco in 2021 at PhP 6 to PhP 7 per stick, carried
an excise tax of PhP 50 per pack alone (or PhP 2.50 per stick). This means that the gross share of manufacturers, wholesalers and retailers combined is actually only PhP 3.50 to PhP 4.50 per stick. Since they must also pay corporate taxes, and the cost of raw materials, overhead costs like electricity, water, salaries and so on, the manufacturers, wholesalers, and retailers would be lucky to have a combined net profit of PhP 1.50 to PhP 2.50 per stick. In sum, manufacturers, wholesalers and retailers are likely to share a profit of PhP 1.5 to PhP 2.5 per stick amongst themselves. Based on this analysis, it is clear that the government enjoys significant revenue from cigarette sales compared to other stakeholders.
Decline in Volume Removals as Taxes Rise

Based on the annual reports of the BIR, the quantity or volume removals (i.e., tax-paid) of domestic cigarettes has been declining. Some emerging trends from the official data are as follows:

1. There was big drop in volume in 2013 of 743 million packs compared to the 2012 level, when new tax rates were implemented that affected low-priced cigarettes. The average tax rate of PhP 5.77 per pack in 2012 nearly tripled to PhP 14.42 per pack in 2013. On this basis, it is safe to assume that the aforementioned 743 million packs were illicit tobacco, which suddenly became attractive when the tax rates increased.

2. Another big drop of 1 billion packs occurred in 2014 as the average tax rate increased to PhP 20.79 per pack versus PhP 14.42 per pack in 2013. It is possible that the gap created by the drop of 1 billion packs may have been filled by smuggled cigarettes and not really by “reduced consumption” as often assumed by tobacco control advocates.

3. While there was recovery in consumption of legal tobacco in 2015, there was another drop of 832 million packs from 2015 to 2016. However, this perceived drop might have been unlikely because 2016 was the national and local elections year when candidates distributed giveaways in the form of groceries, alcohol and even cigarettes to their supporters. At first, it might appear that consumption was higher. However, the opposite happened. This means that many political candidates actually purchased cheap illicit tobacco to be distributed as giveaway items.

4. A single tax rate for all types of cigarettes was introduced in 2017 under the TRAIN Law (RA 10963), in the form of PhP 30 tax per pack, and volume removals flat lined. The curious thing is that the effective tax rate in 2017 was actually PhP 35.61 per pack.
5. There was modest increase in consumption and removals in 2018 and 2019, a period when the economy was doing fine on a pre-pandemic level. But in 2020, another huge drop in removals occurred that involved 937 million packs, compared to the level in 2019. The most proximate explanation is that the big increase in tax from PhP 35 per pack in 2019 to PhP 45 per pack in 2020, when the pandemic-related lockdowns were imposed, affected many people’s income. But based on the reported tobacco smuggling, as presented in Annex 1, it appears that much of the reason was actually the widespread smuggling of tobacco.

Tax Elasticity of Demand (TED)

Tax elasticity of demand (TED) is not a formal or mainstream concept in economics, but will be tackled in this paper anyway, based on the concept of PED.

From the simple formula of PED, it can be extended to TED, which is defined and computed as:

\[
TED = \frac{\% \text{ change in quantity}}{\% \text{ change in tax}}
\]

Table 16 below shows that the TED of cigarettes are (1) inelastic or less responsive in six out of 10 years: 2011-2013, 2015, 2017 and 2019. In 2017, it actually showed a “perfectly inelastic” demand. And (2) elastic or responsive to tax hikes in four out of 10 years: 2014, 2016, 2018 and 2020. Overall, it may be said that the demand for cigarettes in the Philippines is generally inelastic and less-responsive to tax hikes. This is probably because of the country’s large adult population size.
Table 16. Cigarette Taxation and Removals (Tax-paid) and Tax Elasticity of Demand (TED)

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Volume Removals</td>
<td>Mill. Pack</td>
<td>4,618.6</td>
<td>5,709.7</td>
<td>4,966.3</td>
<td>3,959.7</td>
<td>4,366.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Excise Tax</td>
<td>P Billion</td>
<td>26.00</td>
<td>32.94</td>
<td>71.61</td>
<td>82.34</td>
<td>99.50</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. =2/1 Average Tax</td>
<td>P/Pack</td>
<td>5.63</td>
<td>5.77</td>
<td>14.42</td>
<td>20.79</td>
<td>22.79</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Volume Removals</td>
<td>% Change</td>
<td>(11.9)</td>
<td>23.6</td>
<td>(13.0)</td>
<td>(20.3)</td>
<td>10.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Excise Tax</td>
<td>% Change</td>
<td>(18.0)</td>
<td>26.7</td>
<td>117.4</td>
<td>15.0</td>
<td>20.9</td>
<td></td>
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</tr>
<tr>
<td>7. =5/6 Estimate TED</td>
<td></td>
<td>0.66</td>
<td>0.88</td>
<td>(0.11)</td>
<td>(1.35)</td>
<td>0.49</td>
<td></td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Volume Removals</td>
<td>Mill. Pack</td>
<td>3,535</td>
<td>3,535.9</td>
<td>4,070.4</td>
</tr>
<tr>
<td>2. Excise Tax</td>
<td>P Billion</td>
<td>95.05</td>
<td>125.9</td>
<td>136.0</td>
</tr>
<tr>
<td>3. =2/1 Average Tax</td>
<td>P/Pack</td>
<td>26.89</td>
<td>35.61</td>
<td>33.41</td>
</tr>
<tr>
<td>4. Legislated Tax *</td>
<td>P/Pack</td>
<td>21 -28</td>
<td>30</td>
<td>31.2</td>
</tr>
<tr>
<td>5. Volume Removals</td>
<td>% Change</td>
<td>(19.0)</td>
<td>0</td>
<td>15.1</td>
</tr>
<tr>
<td>6. Excise Tax</td>
<td>% Change</td>
<td>(4.5)</td>
<td>32.5</td>
<td>8.0</td>
</tr>
<tr>
<td>7. =5/6 Estimate TED</td>
<td></td>
<td>4.26</td>
<td>0.00</td>
<td>1.89</td>
</tr>
</tbody>
</table>

* Tax rates in 2011-2012 under RA 9334; 2013-2016 under RA 10351; 2017-2019 under RA 10963 where unitary tax rate was introduced; 2020 onwards under RA 11346, tax rates per pack: PhP 45 in 2020, PhP 50 in 2021, PhP 55 in 2022, PhP 60 in 2023

Sources: BIR Annual Reports, Table 3 (removals) and Table 4 (excise tax), various laws/RAs; % changes and TED are author computations.
Conclusion and Recommendations

This study presented four estimates of lost taxes due to cigarette smuggling, as follows:

1. PhP 18 billion to PhP 80 billion a year (Bienvenido Oplas, 2022, see Annex 2)
2. PhP 30 billion a year (Cong. Joey Salceda, 2021)
3. PhP 26 billion a year (Cong. Koko Nograles, 2022)
4. PhP 24 billion to PhP 41 billion a year (this paper, see Table 12).

Based on the preceding estimates and numbers about the size of foregone taxes due to high tobacco smuggling, it can be concluded that there is such a thing as over-taxation to the point where smugglers are actually being rewarded because of the size of the taxation. Whether the foregone taxes are PhP 26 billion per year (which is Cong. Nograles’ estimate) or PhP 30 billion per year (Cong. Salceda’s estimate) or PhP 41 billion per year (this paper’s estimate) or even up to PhP 80 billion per year (Oplas’ estimate), the amounts are enormous. Such amounts do not go to the government in the form of tax revenues but to the criminal groups and their protectors in government, both national and local. There is also an optimal tax rate where government optimizes revenues while reducing incentives for illicit trade that favor the smugglers.

With these significant amounts of lost taxes due to smuggling, it is important then that government should focus on controlling smuggling and allocate more resources and personnel to this endeavor, penalize publicly government personnel who are in cahoots with the smugglers and illicit traders. Government must resist temptations to further raise tobacco tax rates while smuggling incidence remains high.
The expanded recommendations of this paper start with the proposals by Cong. Nograles that this paper concurs with, plus the author’s own proposals.

Cong. Nograles proposed the following measures on how to combat illicit trade:

1. The NTA should be more involved in the fight against illicit trade. It should also ensure registration of manufacturers and importers, participate in the audit with BIR and BOC, and continue to be vigilant in the Inter-Agency Committee on Tobacco (IAC-Tobacco) for strict compliance against illicit trade.

2. The DILG should exercise power of supervision and direct local government units (LGUs) to be more vigilant against illicit trade, or be considered complicit. The same should be expected from National Police Commission (NAPOLCOM).

3. The Department of Trade and Industry (DTI) should educate retailers on the consequences of purchasing and re-selling illegal products.

4. The DOF must see to it that the BOC and BIR regulations are streamlined.

5. PEZA must have better freezone governance and enforcement so that investors will feel more secure.

Other measures that the government should take are the following:

1. The DOF and Congress should increase penalties for smuggling. Regulations should be simple and easily implemented by the PNP, LGUs, and industry players.

2. The DOF and DTI should not impose a floor price for tobacco, heated-tobacco products (HTPs) and vapor products from legal
producers and registered companies. Prohibitions should apply only to illegal products from illegal sources.

3. The sale of non-compliant packages for HTP and vapor products should be prohibited. Labels and packages should be consistent with Graphic Health Warning Law.

4. BIR tax stamps for HTP and vapor products should be affixed after enrollment with enhanced IRSIS. Currently, it has 10 colors, which is complex since cigarettes only have 3 colors. It would be an administrative burden and difficult to implement as vapor products come in different sizes and shapes unlike cigarettes and HTP packed in 20s.

5. Sworn statements should be submitted pertaining to the volume of sales and removals. This will increase transparency, visibility and checks on reasonability of declared tax paid volumes vs. sales (additional measure to mitigate risk of under-declaration).

6. The BIR should appoint a third party to monitor the production and removal process and volumes and exclusion of excisable goods from duty-free barter transactions. This will enhance monitoring and supervision.

7. The jurisdiction of the DOF, BIR and BOC in economic zones and freeport zones should be strengthened, consistent with the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act’s reassignment of Revenue Officers on Premise (ROOP’s) in scoping HTP and vapor products to include ecozones.

8. The DTI, DOF and the Department of Foreign Affairs (DFA) should increase its international collaboration with tobacco exporting and importing countries. Cigarettes and tobacco products leaving an exporting country should ideally bear the legal tax stamps of the Philippines as the importing country.
### ANNEX

#### ANNEX 1. Media Reports on Tobacco Smuggling, 2020-2022

**Tobacco Smuggling Reports in the Philippines (2021)**
*(Only PhP 70 million and above included)*

<table>
<thead>
<tr>
<th>Place</th>
<th>Estimate Value</th>
<th>Remarks</th>
<th>Source Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cabiao, Nueva Ecija</td>
<td>P1 B</td>
<td>Arrested 20 Chinese nationals</td>
<td>ABS-CBN, 1/18/2020</td>
</tr>
<tr>
<td>Zamboanga</td>
<td>P245.8 M</td>
<td>Destroyed</td>
<td>PDI, 5/22/2020</td>
</tr>
<tr>
<td>Zamboanga</td>
<td>P109 M, 21.8 M sticks destroyed</td>
<td>PhilStar, 5/28/2020</td>
<td></td>
</tr>
<tr>
<td>Nationwide</td>
<td></td>
<td>110 machines seized in Q1 2020</td>
<td></td>
</tr>
<tr>
<td>Subic Port</td>
<td>P93 M</td>
<td>Declared as LED lights</td>
<td>PDI, ABS-CBN 7/3/2020</td>
</tr>
<tr>
<td>Davao Port</td>
<td>P107 M</td>
<td>P235 M July alone</td>
<td>PDI, 7/21/2020</td>
</tr>
<tr>
<td>Manila Port</td>
<td>P128 M</td>
<td></td>
<td>Philstar, 7/27/2020</td>
</tr>
<tr>
<td>Naguilan, Isabela</td>
<td>P1.3 B</td>
<td>Equipment, fake tax stamps, etc.</td>
<td></td>
</tr>
<tr>
<td>Manila Port</td>
<td>P186.9 M</td>
<td></td>
<td>UNTVweb, 7/28/2020</td>
</tr>
<tr>
<td>Marilao, Bulacan</td>
<td>P80 M</td>
<td>Face masks, cigarettes</td>
<td>ABS-CBN, 8/6/2020</td>
</tr>
<tr>
<td>Nationwide (May 28 - July 15)</td>
<td>P2.2 B</td>
<td>Cigarette-making machines, cigarettes from China</td>
<td>DOF, BW, 8/17/2020</td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P76 M</td>
<td>June, from China</td>
<td>PNA, 8/22/2020</td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P92 M</td>
<td>From China</td>
<td>MB, 8/25/2020</td>
</tr>
<tr>
<td>Manila Port</td>
<td>P36 M</td>
<td>P221+ M</td>
<td>PNA, 8/29/2020</td>
</tr>
</tbody>
</table>
**Tobacco Smuggling Reports in the Philippines (2021)**
(Only PhP 70 million and above included)

<table>
<thead>
<tr>
<th>Place</th>
<th>Estimate Value</th>
<th>Remarks</th>
<th>Source Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Batangas Port</td>
<td>P64.4 M</td>
<td>From China</td>
<td>GMA 8/29; PDI 8/30; MS 8/31/2020</td>
</tr>
<tr>
<td>Subic Port</td>
<td>P121 M</td>
<td>From China</td>
<td></td>
</tr>
<tr>
<td>Nationwide</td>
<td>P3 B +</td>
<td>Jan-August</td>
<td>MT, 9/2/2020</td>
</tr>
<tr>
<td></td>
<td>P360 M</td>
<td>August alone</td>
<td></td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P88.1 M</td>
<td>From China</td>
<td>CDN 9/2; PDI 9/4/2020</td>
</tr>
<tr>
<td>Zamboanga Port, Basilan, Sulu, Tawi-Tawi</td>
<td>P350 M</td>
<td>Materials for cigarette making</td>
<td>GMA 9/12/2020</td>
</tr>
<tr>
<td></td>
<td>P1 B +</td>
<td>Fake tax stamps</td>
<td></td>
</tr>
<tr>
<td>Zamboanga Port</td>
<td>P200 M</td>
<td>From Malaysia, Indonesia PIA, 9/14/2020</td>
<td></td>
</tr>
<tr>
<td><em>Worldwide</em></td>
<td>$40-$50 B/yr</td>
<td>WB estimate</td>
<td>MB, 9/14/2020</td>
</tr>
<tr>
<td>Manila Port/MICP</td>
<td>P219.6 M</td>
<td>Jan-July</td>
<td>GMA, 9/16/2020</td>
</tr>
<tr>
<td></td>
<td>P186.9 M</td>
<td>July 24 alone</td>
<td></td>
</tr>
<tr>
<td>Porac, Pampanga</td>
<td>P70 M</td>
<td>BOC condemnation</td>
<td>GMA 10/10; MS 10/11/2020</td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P148 M</td>
<td>August alone</td>
<td>Sunstar, 10/20/2020</td>
</tr>
<tr>
<td></td>
<td>P 88.1 M</td>
<td>Sept. 1st week</td>
<td></td>
</tr>
<tr>
<td>Davao Port</td>
<td>P96.6 M</td>
<td>P50 M destroyed</td>
<td></td>
</tr>
<tr>
<td>Zamboanga Port</td>
<td>P1,500 M+</td>
<td>Value destroyed</td>
<td></td>
</tr>
<tr>
<td>Visayas - Mindanao</td>
<td>P2 B +</td>
<td>Sept 2019 to present</td>
<td>Iloilo News, 10/21/2020</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P 16-P18 B/yr</td>
<td>Foregone taxes</td>
<td>PhilStar, 10/29/2020</td>
</tr>
<tr>
<td>Subic</td>
<td>P215 M</td>
<td>Cigs, veggies</td>
<td>PDI, 11/02/2020</td>
</tr>
<tr>
<td>Tawi - Tawi</td>
<td>P150 M</td>
<td>From Indonesia</td>
<td>PNA, 11/7/2020; Philstar 11/09/2020</td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P374 M</td>
<td>July-Sept from China</td>
<td>Cebu Daily News -PDI, 11/10/2020</td>
</tr>
<tr>
<td>Tawi - Tawi</td>
<td>P120 M</td>
<td>From Indonesia</td>
<td>MB, 11/12/2020; MS, UNTV, 11/13/2020</td>
</tr>
<tr>
<td>Nationwide</td>
<td>$213.4 M</td>
<td>Taxes lost 2019</td>
<td>BM, 12/01/2020</td>
</tr>
<tr>
<td></td>
<td>P20.25 B</td>
<td>Fake cigs 2018</td>
<td></td>
</tr>
<tr>
<td>ASEAN wide</td>
<td>$3.3 B</td>
<td>Taxes lost 2019</td>
<td></td>
</tr>
<tr>
<td>Zamboanga, Basilan, P183 M</td>
<td>Sept -Nov</td>
<td></td>
<td>PNA, 12/07/2020; PDI 12/08/2020</td>
</tr>
<tr>
<td>Sulu and Tawi - Tawi (BASULTA)</td>
<td>P5.05 B</td>
<td>19 CCBWs closed</td>
<td>DOF, 12/17/2020</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P5.22 B</td>
<td>BOC seizures 2020</td>
<td>PDI 1/8, 1/19/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P5.77 B</td>
<td>Seizures 2020</td>
<td>MT, 2/17/2021</td>
</tr>
</tbody>
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### Tobacco Smuggling Reports in the Philippines (2021)
*(Only PhP 60 million and up included here)*

<table>
<thead>
<tr>
<th>Place</th>
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<th>Remarks</th>
<th>Source Report</th>
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<tbody>
<tr>
<td>Cavite PEZA</td>
<td>P60 M</td>
<td>From China to PEZA Cavite</td>
<td>PDI, PEZA 1/26/2021; MB 1/27/2021</td>
</tr>
<tr>
<td>CDO Port</td>
<td>P125 M</td>
<td>From China</td>
<td>PDI, 2/18/2021</td>
</tr>
<tr>
<td>Bataan</td>
<td>P260 M</td>
<td>Cigarettes and rice</td>
<td>PDI, 2/24/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P30 B/yr</td>
<td>Cong. Salceda (est.)</td>
<td>PDI, GMA, 3/1/2021</td>
</tr>
<tr>
<td>Subic Port</td>
<td>P66 M</td>
<td>Two shipments</td>
<td>PDI, 5/31/2021</td>
</tr>
<tr>
<td>Tagoloan, Misamis Oriental</td>
<td>P75 M</td>
<td>Destroyed in Bukidnon</td>
<td>ABS-CBN, 6/16/2021</td>
</tr>
<tr>
<td>Mabalacat, Pampanga</td>
<td>P300 M</td>
<td>Wendel criminal group</td>
<td>&quot;P1.3-B fake cigarettes, materials seized in Pampanga&quot;</td>
</tr>
<tr>
<td>San Simon, Pampanga</td>
<td>P1.0 B</td>
<td>Cigarette-making machines</td>
<td>PNA, 6/25/2021</td>
</tr>
<tr>
<td>Cebu Port</td>
<td>P90 M</td>
<td>From China</td>
<td>ABS-CBN, 7/09/2021</td>
</tr>
<tr>
<td>Subic Port</td>
<td>P78 M</td>
<td>2 container ships</td>
<td>ABS-CBN, 8/03/2021</td>
</tr>
<tr>
<td>Mindanao</td>
<td>About 60% illicit (P3/stick vs legal P8/stick)</td>
<td>Esp. Polomolok, Davao, Ozamis, Zamboanga, Cagayan de Oro</td>
<td>Same report, BM, 10/11/2021</td>
</tr>
<tr>
<td>Mindanao</td>
<td>Illicit 19% of cigarette supply</td>
<td>From Kantar Survey</td>
<td>‘Smuggling underworld’ PhilStar 10/19/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P1.23 B</td>
<td>Seized Jan-Aug 2021; illicit 7-10% of supply</td>
<td>“Cigarette smugglers tightly watched” MT, 11/02/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>Illicit 7-10%, previously 35%</td>
<td>DOF estimated illicit share to total cigarette supply</td>
<td>BW, 11/02/2021</td>
</tr>
<tr>
<td>30 EU countries</td>
<td>34.2 B cigs., 2020, 7.8% of total consumption</td>
<td>Tax loss about 68.5 B/yr or nearly P500 B</td>
<td>&quot;Global tobacco smugglers cash in on pandemic – JTI&quot;, PhilStar 10/17/2021</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Over $35.9 B</td>
<td>$3.3 B/yr tax revenue losses</td>
<td>&quot;Illicit cigarettes in PH, ever-increasing&quot; —JTI&quot;, MB, 10/17/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P123 M foregone taxes</td>
<td>Illicit cigarette market share 8.6% 2021 from about 5-5.5% in 2020</td>
<td>&quot;Illicit cigarette sales up as anti-smuggling drive slows&quot; PDI, 11/22/2021</td>
</tr>
<tr>
<td>Subic Port</td>
<td>P300 M</td>
<td>Seized cigarettes by BOC in 2021</td>
<td>&quot;BOC Subic is not vs tobacco transshipment&quot; BM 11/29/2021</td>
</tr>
<tr>
<td>Zamboanga</td>
<td>P258 M</td>
<td>8,167 cases, 2,184 reams, and 618 packs from Indonesia</td>
<td>&quot;BOC destroys P258 million worth of smuggled cigarettes in Zamboanga&quot; Rappler 12/15/2021</td>
</tr>
<tr>
<td>Zambonga, BaSuTa</td>
<td>P300 M</td>
<td>Destroyed confiscated cigarettes May-Nov 2021</td>
<td>PhilStar, 12/16/2021</td>
</tr>
<tr>
<td>Nationwide</td>
<td>Fake cigs 5.5% of market share 2020, 8.6% in 2021 -- PMFTI estimate</td>
<td>BIR seized 2.5 M packs in 2021, P123 M lost taxes. BOC apprehended 100 illicit cigarette traders, P1.3 B, lost taxes P971 M</td>
<td>&quot;2022 starts with tax, price hikes on cigarettes, alcohol&quot; PDI, 1/02/2022</td>
</tr>
</tbody>
</table>

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**IMPACT OF TAXATION ON THE ILLICIT TRADE OF TOBACCO**

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"BOC destroys P258 million worth of smuggled cigarettes in Zamboanga" Rappler 12/15/2021

"2022 starts with tax, price hikes on cigarettes, alcohol" PDI, 1/02/2022
### Tobacco Smuggling Reports in the Philippines (2022)

<table>
<thead>
<tr>
<th>Place</th>
<th>Estimate Value</th>
<th>Remarks</th>
<th>Source Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nationwide</td>
<td>illegal cigarette imports P897 M</td>
<td>BOC: 103 criminal cases filed at DOJ in 2021 against traders of illicit cigarettes</td>
<td>“BOC to give priority to destroying illegal cigarettes to prevent pilferage”, PDI, 1/26/2022</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P1.72 B in 2021, cigarettes and tobacco prods</td>
<td>From 131 seizures</td>
<td>“BOC seized P28.4B worth of smuggled goods in 2021” BM 1/27/2022</td>
</tr>
<tr>
<td>Zamboanga City</td>
<td>P36 M</td>
<td>Confiscated in an abandoned warehouse, Brgy. Kasanyangan</td>
<td>“BOC seizes P36-M worth of illegal cigarettes in Port of Zamboanga”, PDI, 1/30/2022</td>
</tr>
<tr>
<td>Subic Port</td>
<td>P90 M HTPs, P30 M last Dec 6, 2021</td>
<td>1,500 master cases of COO brand recently, 500 cases last Dec. Heated Tobacco Products (HTP)</td>
<td>“DOF, BOC hailed for efforts against cigarette smuggling” PTVNews 1/30/2022</td>
</tr>
<tr>
<td>Clark Port</td>
<td>BOC seizures P224.4 M 2020 P355.5 M 2021</td>
<td>Total smuggled P10.63 B in 2020 and P28.43 B in 2021</td>
<td>Same PhilStar report 2/02/2022</td>
</tr>
<tr>
<td>ASEAN</td>
<td>$3.32 B/yr lost taxes from smuggling</td>
<td>EU-ASEAN Business Council and Transnational Alliance to Combat Illicit Trade (Tracit.Org) est.</td>
<td>“Policymakers urged to go easy on taxing tobacco products”, PDI 2/12/2022</td>
</tr>
<tr>
<td>Philippines</td>
<td>P10.7 B/yr lost taxes from cigarette smuggling</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nationwide</td>
<td>10% rise in cigarette prices, illegal cigarettes rise by almost 7%</td>
<td>Alvarez &amp; Marshall, “Causes and Control of Illegal Tobacco” (2021)</td>
<td>Same PDI report 2/12/2022</td>
</tr>
<tr>
<td>Nationwide</td>
<td>P221.4 M tobacco alone</td>
<td>Total P769.7 M from Jan-Feb 11, 2022 raids by BOC</td>
<td>“BOC seizes P770-M ‘hot’ goods in 1st 6 weeks of 2022”, DOF, 3/07/2022</td>
</tr>
<tr>
<td>Davao Port</td>
<td>P20 M</td>
<td>BOC-PNP joint operation</td>
<td>“P20M worth of smuggled cigarettes seized by Customs in Port of Davao”, PDI, 3/29/2022</td>
</tr>
</tbody>
</table>
### ANNEX 2. Oplas’ Estimates of Revenue Leakage from Illicit Tobacco in the Philippines

1. **DOF est., previously up to 35% of total supply is illicit, down to 10% 2021**

   - **2019:**
     - Legal (65%): 4,251 B packs
     - Illicit (35%): 0.65X = 4.251 B x 0.35
     - X = 1.488 B / 0.65 = 2.289 B packs
     - Tax leakage: $2.289 B packs \times $35/pack tax = $80.11 B tax leakage

   - **2020:**
     - Legal (75%): 3,314 B packs
     - Illicit (25%): 0.75X = 3.314 B x 0.25
     - X = 0.828 B / 0.75 = 1.105 B packs
     - Tax leakage: $1.105 B packs \times $45/pack tax = $49.72 B tax leakage

   - **2021 proj:**
     - Legal (90%): 3.3 B packs
     - Illicit (10%): 0.90X = 3.3 B x 0.10
     - X = 0.33 B / 0.90 = 0.367 B packs
     - Tax leakage: $0.367 B packs \times $50/pack tax = $18.35 B tax leakage

2. **Cong. Joey Salceda estimate, P30 billion/year**

   - @ $100/pack, P30 B/100 = 300 M packs illicit
   - Tax leakage:
     - 2019: $321 M packs \times $35/pack tax = $11.23 B leakage
     - 2020: $243 M packs \times $45/pack tax = $10.94 B leakage
     - 2019: $428 M packs \times $35/pack tax = $14.98 B leakage
     - 2020: $324 M packs \times $45/pack tax = $14.58 B leakage

---

*Source: Oplas, February 2022*
ACKNOWLEDGMENTS

The Stratbase ADR Institute extends its deepest gratitude to all involved in developing this strategic agenda. This publication would not have been possible without your commitment, collaboration, and support.

The strength of this strategic agenda comes not from any single policy. Rather, it draws from the collective insight of our expert authors from the academe, public and private sectors, and civil society. Hence, we are grateful for our authors’ generous sharing of knowledge and experiences that make up this strategic agenda.

We would especially like to thank Prof. Victor Andres ‘Dindo’ Manhit, President of the Stratbase ADR Institute, for this initiative would never have come to fruition without his leadership, vision, and direction.

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The Stratbase ADR Institute is an independent international and strategic research organization with the principal goal of addressing the issues affecting the Philippines and East Asia through fostering national, regional and international policy change or support; fostering strategic ideas based on cooperation and innovative thinking; providing a regional venue for collaboration and cooperation in dealing with critical issues in East Asia; and actively participating in regional debates and global conversations.

The Stratbase ADRi Research team is led by Francesco Javier "Paco" Pangalangan and Venice Isabelle Rañosa.

Francesco Javier "Paco" Pangalangan

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