Case Study: Expanding Health Insurance Coverage in the Philippines by Reforming the Taxation of Tobacco and Alcohol Products

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Background

In June 2010, Benigno Aquino, a chain smoker, was elected President of the Philippines. President Aquino campaigned on a 16-point agenda for reform, which he called his "Social Contract with the Filipino People"[1]. This social contract promised to transform health from "just another area of political patronage" to a "measure of good governance." President Aquino also committed not to increase and reduce, where possible, taxation and tariffs impacting regular citizens. When he took office, Aquino was alarmed to learn that an estimated 30% of Filipinos died prematurely due to inadequate access to health care. Hence, the President appointed renowned surgeon Dr. Enrique Ona, Health Secretary, with the specific charge of alleviating the burden of disease in the Philippines by expanding the national health insurance program (PhilHealth) to all Filipinos.

Tobacco use was a major cause of morbidity and premature mortality in the Philippines. Historically, the Philippines has had one of the highest rates of smoking in the world. Low taxes on tobacco products made cigarette prices in the country among the lowest in the world. In 2007, more than a quarter of 13-15-year-olds were regular smokers,[2] and in 2008, more than half of men (53.2%) and 12.5% of women aged 20 or older smoked.[3]

To address tobacco-related deaths, in 2003, the WHO established the WHO Framework Convention on Tobacco Control (FCTC) with the goal of reducing smoking worldwide, including by promoting higher taxation on tobacco products.[4] The WHO FCTC was based on substantial research over many years demonstrating the effectiveness of higher tobacco taxes and prices in reducing the consumption of cigarettes and other tobacco products.[5-7]

The Philippines joined 167 other WHO Parties (member states) in signing the WHO FCTC in 2005.[8] Nonetheless, tobacco cultivation has also traditionally been a source of income for many Filipinos in the tobacco-producing provinces of the country, where multiple farmers planted tobacco in addition to other profitable crops.[9] In 2010, tobacco excise revenues accounted for 0.3% of the Philippines' GDP.[10] In 2010, tobacco farming accounted for 0.4% of total agricultural employment, and farmers produced more than 70 million kilograms of tobacco leaf valued at PhP 4.85 billion (USD 108.4 million)[11], and approximately 40 million kilograms were exported.[12]

Funding Expanded Universal Health Coverage

As Health Secretary, Dr. Enrique Ona had the mandate to reduce the burden of disease in the Philippines by expanding the national health insurance program (PhilHealth) to all Filipinos. However, given President Aquino's promise not to introduce new tax measures, Secretary Ona recognized that to fund the increase in PhilHealth coverage, he would have to leverage existing government revenue streams.

Secretary Ona was appointed at the beginning of President Aquino's presidency, and the Framework Convention on Tobacco Control Alliance, Philippines (FCAP) knew that with this new administration in office, a new legislative session would convene, and there would be new leadership in the Department of Finance (DoF) and Department of Budget and Management (DBM). This meant that many policies, including the tobacco and alcohol taxes, would likely be reviewed.

Therefore, the FCAP requested a meeting with Secretary Ona to advocate that the Department of Health (DoH) support dramatic Sin Tax Reform to fund the cost of extending PhilHealth coverage to all citizens. Based on his experience as a doctor who had seen many patients with tobacco-related diseases over the years, Dr. Ona agreed to work for an increase in taxes on tobacco products, though he was unsure how best to design the tax policy to ensure sufficient revenue. He was also not sure how to muster political support and counter the forceful political influence of tobacco growers and cigarette manufacturers.

After their meeting with Secretary Ona, FCAP invited Action for Economic Reforms, a Philippine NGO experienced in advocacy and economic policy research, to collaborate on promoting the Sin Tax Reform. "*We had a new President, so there was a breath of fresh air—the possibilities seemed endless,*" one advocate reflected. "*It was an opportune time for groups to re-strategize the approach to passing sin tax reforms.*"

Action for Economic Reforms received a grant from the US-based foundation Bloomberg Philanthropies to unite local and national tobacco control, health care, and economic reform groups. They called their collaboration 'the sintax coalition'. Representatives from the groups met to establish a shared goal: to improve public health by reducing smoking and, secondarily, to generate revenues for health by raising taxes on cigarettes and alcohol.

Despite being a smoker himself, President Aquino supported the idea of raising taxes on tobacco products to discourage smoking and raise revenues to expand healthcare access. He agreed after being convinced by his advisers that it did not violate his campaign promise of "no new taxes" as this was just a restructuring of existing taxes. In August 2011, he announced his official legislative agenda, which included increasing 'sin taxes' to fund the expansion of universal health coverage. He directed all his cabinet secretaries to join Secretary Ona in prioritizing Sin Tax legislation reform.

Civil society coalition members set up meetings with legislators allied with the Aquino administration to ask if they would "champion" a Sin Tax Reform measure. They focused initially on members of the Ways and Means Committee in the House of Representatives, where tax bills were filed first and where legislators with known connections to the tobacco industry typically dominated the Committee.

Proponents and Opponents of the Sin Tax Reform

One key strategy used by reform proponents involved presenting the Sin Tax not as a tool for generating revenue but rather as a health-focused instrument that would help attain Universal Health Care.[13] To gain more allies, Sin Tax advocates crafted messaging centered on the health objectives of the tax reforms. A government official explained:

> *"But when we said, "This is really a health measure, not a revenue measure," I mean, then you are able to create more allies, yeah? Because health resonates with more people than– I mean, if you say, "Revenue," people just said, "You're just greedy, you want more money for government to corrupt.""* [13]

Proponents included civil society organizations, international organizations, and government departments and offices such as the Office of the President, the Department of Budget and Management, the Department of Finance, the Bureau of Internal Revenue, the Department of Health, some legislators, and local government executives. Moreover, "political mapping was also undertaken continuously throughout the legislative process to identify supporters, fence-sitters and staunch opponents."[13]

Proponents anticipated strong opposition from opponents such as the National Tobacco Administration, the Philippines Tobacco Institute, the Philippines Tobacco Growers Association, as well as some legislators who were part of the Northern Alliance, an influential group composed of members of Congress from Northern Luzon.

Hence, before speaking publicly about the Sin Tax Reform, Secretary Ona, DoF Secretary Cesar Purisima, and DBM Secretary Florencio Abad met to align their messaging. The DoF convened meetings, inviting point persons from other government agencies and civil society to share updates and concerns and to coordinate actions in support of the Reform. Undersecretary of Finance Jeremias Paul emphasized the value of a *"whole of government approach,"* noting that *"If we're not united, powerful opposing lobbies will capitalize on that."*

The core group of proponents met regularly in what they called the *"war room"* to align strategies, share their perspectives, and have a unified response to issues raised by the tobacco industry and their allies. They also allowed members to enact their own strategies if they were geared towards a common goal. They also anticipated that the issue of burden sharing between the tobacco and alcohol industries would most likely be an issue raised in Congress. Discussions ensued, and consensus was reached that they needed to choose their battles. In the case of tobacco versus alcohol, they focused on tobacco.[13] In the case of alcohol, the government's key objective was to be compliant with WTO rules. The Philippines lost a case in the WTO as it was deemed that domestic alcohol products had a favorable tax treatment over imported ones. Moreover, tobacco use posed a bigger health challenge than alcohol at that time. As an NGO actor explained:

> *"The alcohol people threatened not to support the reform unless they were given some concession. So we didn't fight that battle, in order to get the tobacco reforms"* [13]

To be consistent with existing Sin Tax legislation and mitigate opposition, proponents also proposed allocating a portion of incremental revenues to encourage farmers in tobacco-growing provinces to shift to our crops or other economic activities. Secretary Ona consulted with the Department of Agriculture's National Tobacco Administration to understand how the Reform might impact tobacco farmers and cigarette manufacturing workers. Because of this, some were concerned Dr. Ona might favor more conservative tax increases. He countered, *"I was aware that five of our provinces depend on tobacco as a major industry,"* Ona explained. *"I wanted to ask them what their concerns were and to convince them that this was a health issue."*

Data Proves Critical

The tobacco industry and their allies raised a lot of issues about the wisdom of raising tobacco taxes significantly. They claimed that raising tobacco taxes increases smuggling and illicit trade, is anti-poor or regressive, that revenues will go down, and it will have a negative impact on employment. The alcohol industry was not vocal in its opposition.

To counter tobacco industry lobbying, civil society groups reached out to local chronic disease experts to estimate the economic costs of smoking and compare it to the tobacco revenues collected by the government. Dr. Antonio Dans, a Filipino epidemiologist, had been studying the economic and health costs of tobacco for more than a decade. His work had never been used for advocacy. One advocate explained:

> *"It had worked for the tobacco industry that nobody could connect these things. All of these data existed, so the work in 2011 was to connect the dots."*

Dr. Dans updated his previous studies using current data and found the cost of death and disease resulting from four tobacco-related illnesses (lung cancer, chronic obstructive pulmonary disease, coronary artery disease, and cerebrovascular disease) to be PhP 188.8 billion (USD 4.22 billion) — nearly 2% of GDP.[14] Costs included health care, productivity losses, and premature death losses.

Dr. Dans also modeled how many premature deaths could be prevented given various combinations of price elasticity of demand values and excise tax increase assumptions. He created a table showing how various combinations of price elasticity of demand and magnitude of tax increase assumptions would affect smoking prevalence and revenue generation. The exercise was meant to point out that regardless of the price elasticity of demand assumption, the net impact on revenues would be positive. Drawing on the data, the DoF and coalition members decided to advocate for the highest tax rate possible. Traditionally, DoF and DBM preferred not to earmark legislation because it restricted the government's flexibility. In this case, all government parties agreed that it will be an exception and that the incremental revenues from higher tobacco and alcohol taxes would be "soft-earmarked" with the DOF drafting the implementing regulations.

The DoF calculated the price elasticity of demand for cigarettes to be –0.5, meaning that a 10% increase in cigarette prices would yield, on average, a 5% reduction in cigarette consumption. Tobacco industry stakeholders argued that elasticity was closer to –0.8, suggesting that a tax increase would discourage smoking so much that the revenue-generating goals of the bill would be undermined. Lower consumption would have a negative economic impact; they warned, stifling business for local tobacco farmers and cigarette manufacturing companies. Some also cautioned that such a tax increase would disproportionately burden poor Filipinos.

In contrast, proponents of the tax increase cited studies showing that job and economic losses owing to higher tobacco taxes were usually more than offset by increased spending and employment in other sectors. Studies suggested money previously spent on tobacco was diverted to other goods and services.[15,16] In response to arguments that higher tobacco taxes would be regressive, the DoF countered that poor Filipinos had the most to gain because they would not otherwise be able to afford health care.

Traditionally, the DoF took the lead on submitting tax proposals to Congress. For the Sin Tax legislation, Paul reflected, *"What differentiated this from past efforts was that health and finance were working together."* Ona and Purisima entrusted day-to-day coordination and communications to their under-secretaries. DoF Undersecretary Paul and his team helped Secretary Ona determine how much revenue the DoH required to achieve its goals of universal health coverage, while DoH Undersecretary Herbosa worked with the DoF and civil society coalition to emphasize the legislation's health objectives.

With respect to the tax reform, an agreement was also reached with President Aquino on the negotiable and non-negotiable parameters so that discussions with the industry stakeholders would be transparent. The non-negotiable reform parameters were: (a) removal of the price/brand classification freeze, which gave legacy brands a tax advantage over new entrants; (b) indexation of tax rates to inflation; and (c) compliance to WTO rules with respect to alcohol. The negotiables were: (a) length of transition period from a four-tiered structure to a two-tiered or unitary tax structure; (b) rate of tax increases; and (c) period of time between tax rate increases.

Getting the Law Passed

Legislative power in the Philippines rests with Congress, which is made up of the House of Representatives and the Senate. The House, which has 250 members, and the Senate, which has 24 senators, are important for enacting tax legislation such as the Sin Tax. Under the Philippine Constitution, all revenue bills must emanate from the House of Representatives. The Senate has the power and responsibility to suggest changes or modifications to proposed Bills.[13] Historically, proponents had typically faced opposition in the Ways and Means Committee of the House, which was the first step in getting a revenue bill passed, and almost always, this Committee was dominated by the tobacco industry. Fortunately, the 2010 House elections elected a new chair of the House Ways and Means Committee who did not have ties with the tobacco industry.[13]

Even before the Sin Tax House Bill was published, the tobacco industry mobilized farmers and factory workers to protest with the aim of stopping or at least slowing the passage of the House Bill. Northern Alliance members proposed lower rates and a three-tiered tax structure. Faced with this political pressure, the House Bill's authors made some compromises, agreeing to a two-tiered structure and a phased transition. San Miguel Corporation, one of the largest corporations in the Philippines and the dominant beer player, with revenues equivalent to 5.4% of GDP, was a critical player in advancing this Bill. To secure their support, pro-Sin Tax legislators lowered the premium on fermented liquor brands to include its popular premium beer brand. Similar negotiations were made with representatives of the Distilled Spirits Association of the Philippines.

Despite organized opposition from the tobacco growers and manufacturers, the Filipino public, recognizing the potential health care benefits, was overwhelmingly supportive. An organization representing local government leaders appealed to a nationally known former governor from a tobacco-growing province to endorse the legislation by publicly denouncing the notion that higher Sin Taxes would lead to the demise of the Philippines' tobacco industry—a popular argument among opponents. The Governor supported the local government leaders and argued the tax would “level the playing field" for smaller domestic companies trying to compete with Philip Morris Fortune Tobacco Corporation (PMFTC), a joint venture between Fortune Tobacco Corporation and Philip Morris International. Secretary Ona believed the former Governor’s public support of the Bill convinced several politicians from northern tobacco-producing provinces to support it.

The coalition organized press conferences, testified before Congress, and worked closely with media outlets to broadcast data on the negative effects of smoking. Former Secretaries of Finance and Health who had participated in past Sin Tax Reform efforts spoke publicly in favor of the Bill. When Secretary Ona spoke publicly, he emphasized the Bill’s health aims. He noted:

> *“…[This] was probably the most important role I played: to make it very clear to everybody to forget about it being a tax measure and focus instead on it being a health measure."*

Dr. Dans and other coalition members presented the data showing how different tax rates would impact smoking and revenue generation during legislative hearings. Proponents began calling the Sin Tax Reform Bill an *“anti-cancer tax"* and rallied more than 50 medical associations to sign a petition in favor of it.

A government official observed, *“Anything coming from government is considered propaganda, and anything coming from legislators and other politicians is perceived as meant to enhance their political careers."* To put additional pressure on Congress, the coalition created a public webpage that tracked which legislators supported the bill and which opposed it. *“Elections were scheduled for May 2013, and people were checking how senators had voted,"* one advocate explained. *“We made it an election issue."*

International credit rating agencies were also watching the Bill’s trajectory carefully. They recognized its potential to broaden the Philippines’ fiscal base for higher spending on infrastructure, health, and education. In October 2013, Moody’s Investors Service joined Fitch Ratings and Standard & Poor’s Ratings Services in upgrading its assessment of the country’s debt quality to a level below investment grade.[17] The DOF hoped to achieve an investment grade rating—which would reduce some borrowing costs and attract more investment funds—by 2014.

The Sin Tax Bill, being a revenue bill, required House passage, and Congressman Sid Ungab, Chairman of the Ways and Means in the House of Representatives had to strategize how to get the bill out of the committee, mindful that a majority of members were allied with the tobacco industry. To address this hurdle, Secretary Purisima requested a meeting with the President, the House Speaker, and key members of the Ways and Means Committee, on the reform parameters.

They compromised on the House version, knowing they could work on a better Senate version, and it passed on June 6, 2012.[13]

After the House approval, the Sin Tax House Bill required Senate passage. The Senate could either propose its own version of the Sin Tax bill or just ratify the House bill version. However, Senator Ralph Recto, then chairman of the Ways and Means Committee, filed a Senate version of the Sin Tax Bill which, when passed, was very similar to Philip Morris' low-rate proposal.[13] Consequently, there was an outcry from civil society, with some coining the Senate bill as the "Recto-Morris Bill". Sin Tax proponents in the Philippines used various strategies, including lobbying, media advocacy, and daily rallies asking for Senator Recto's resignation. Under public pressure, Senator Recto resigned from his position as Chairman and was replaced by Senator Franklin Drilon, whose wife died of lung cancer. A government official explained:

> *"But what really moved the reform for us was that the chairman, [he] was behind us all the way. So, he used his powers and authority as the Chair to move the discussion and the approval in favor of the reform."*[13]

The Senate version of the bill proposed by Senator Drilon had a unitary tax structure, tax rates indexed to inflation, and a five-year transition period.

The House and Senate passed separate versions of the measure; the difference between the two Bills was subsequently resolved in a Bicameral Conference Committee.[13] This was another challenge as the tobacco and alcohol industries were able to put in their allies in the Bicameral Conference Committee. Both Senator Drilon and Congressman Ungab, while chairing the Senate and House negotiating panels, respectively, did not have full control of the membership of the Bicameral Conference Committee as it was the Speaker of the House and the Senate President (a known tobacco industry ally) who would finally make that determination. After long deliberations, consensus was reached in the Bicameral Conference Committee, and their version of the Bill had to be ratified by both Houses of Congress.

On December 11, 2012, the committee signed the report and sent the measure to the President for approval. Both Houses of Congress ratified the bicameral version of the Sin Tax Bill with a very narrow margin in the Senate – 10 votes for and 9 votes against. President Aquino signed the Bill (Republic Act 10351, more commonly referred to as "the Sin Tax Reform Act") into law on December 19, 2012, with the higher tax rates taking effect on January 1, 2013.

Initial Results

With the passage of the Sin Tax Reform Law, cigarette taxes increased by up to 340% in the first year of implementation,[18] and the average price per cigarette pack increased from PhP 21.12 in 2012 to PhP 31.26 in 2013.[19] Total Sin Tax revenue collections for tobacco and alcohol reached

Php 70.4 billion (US$1.57 billion) and Php 33 billion (US$737.7 million), respectively during 2013. The total tobacco excise tax collection in 2013 represented a 114% increase over 2012 collections, while total alcohol tax collections grew by 38%. The Sin Tax Reform Act resulted in an unprecedented year-over-year increase in the DOH's budget of 57%. 85% of incremental tobacco tax revenues and 100% of incremental alcohol tax revenues were earmarked for health. Of these combined revenues, 80% would be used to finance PhilHealth, the attainment of the Millennium Development Goals, and health awareness programs. The remaining 20% would be used for health infrastructure improvements and support for indigent patients. Incremental tobacco tax revenues not supporting health (15%) would fund economic development projects in tobacco-growing provinces.

Surveys conducted in 2014 found a marked decline in smoking across all demographics. The most dramatic declines were in the lowest income quintile (from 38% to 25%) and among adults 18–24 years of age (from 35% to 18%). Proponents of the Sin Tax believed the reduction in smoking was largely the result of fewer Filipinos starting the habit. Dr. Antonia Dans, who had presented the costs of tobacco-related diseases during the Sin Tax Reform debates and whose epidemiologic research spanned a variety of lifestyle-related diseases, attributed the change to the Sin Tax Reform effort. He said:

> *"Studies show that people don't exercise in the Philippines because there are no facilities for nonmotorized traffic. There's no place to walk or to bike. Filipinos don't eat vegetables because they're too expensive, and they smoke because tobacco is so cheap. So, we used this logic, and whereas for 30 years we were unable to reduce smoking by telling people it was bad for them, with just a small tax measure, the prevalence went down from 31% to less than 26%. This seems small, but it's the equivalent of 3 million fewer smokers in 2013. Our estimate is that about 32,000 premature deaths were averted."*

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