A Comprehensive Examination of the Demand and Supply of Heated Tobacco Products

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Abstract

Heated Tobacco Products (HTPs), or “Heat-Not-Burn” have been first launched in the tobacco market in 2014, by Phillip Morris International Inc (PMI), in Japan and Italy. Since then HTP have been marketed and sold in an increasing number of countries, and by other transnational tobacco corporations including Japan Tobacco Inc (JTI), British American Tobacco Plc (BAT), and at least 30 countries. HTP are close substitutes to combustible cigarettes because they function by heating electronically a tobacco stick equivalent to a conventional cigarette, with the main difference that the tobacco is not burned. For this reason, they are also called “hybrid products”, and marketed by tobacco companies as “reduced risk products”. Little is known about the long-term health effects of HTPs, and existing research finds that they are likely to be taken up not just by current smokers but also by non-smokers, including younger generations, and females. For this reason, most countries chose to either not tax HTPs products or tax them at a much lower rate than that of cigarettes, either by amending the current tax code and including them among other existing categories (e.g., “other smoked tobacco”) or by creating a new category subject to its own tax rules. As HTPs can be sold at similar, lower, or higher prices than cigarettes, companies are likely to reap higher profits by expanding their market of HTPs as compared to combustible cigarettes.

In this paper, we estimate the direct and cross-price elasticity of supply and demand of cigarettes and HTP products. We use detailed information on country and products taxation to identify price changes. We use the results to simulate the consumption and revenue impact of aligning the taxation of cigarettes and HTPs.