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# HEALTH TAXES EXPLORED

A series on  
**Fiscal Policy  
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**Knowledge Note**

**Saving Lives while Raising Revenue:**

Opportunities in Brazil's reform of indirect taxes to improve Tobacco, Alcohol, and Sugar-Sweetened Beverages Excise Taxes

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# Saving Lives while Raising Revenue: Opportunities in Brazil's reform of indirect taxes to improve Tobacco, Alcohol, and Sugar-Sweetened Beverages (SSBs) Excise Taxes

## *Health Taxes Knowledge Note #6*

October 2024

Health taxes are excise taxes on products that have a negative public health impact: tobacco, alcoholic beverages, and sugar-sweetened beverages. The **Health Taxes Knowledge Notes** is a series on fiscal policy and health. It responds to specific questions on health taxes and key issues raised during health tax reforms, based on global best practices, scientific evidence, and the World Bank's experience from working with countries on design and implementation of health tax reforms. The series is produced under the Global Tax Program Health Taxes Project. *Join us as we explore effective use of health taxes to improve population health and the fiscal environment.*

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The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors. They do not necessarily represent the views of the International Bank for Reconstruction and Development/World Bank and its affiliated organizations, or those of the Executive Directors of the World Bank or the governments they represent.

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## SUMMARY AND RECOMMENDATIONS

Taxes and prices of tobacco products, alcoholic beverages, and sugar-sweetened beverages (SSBs) in Brazil are low compared to international peers. The ongoing landmark reform of indirect taxes (PLP 68/2024 and forthcoming Ordinary Law) provides an excellent opportunity to put in place well-designed excise taxes on tobacco, alcohol and SSBs.

If well implemented, reforms of the tax structure and increases in tax rates can make them more effective at improving population health and raising additional tax revenue. Global evidence to support reforms is strong, supporting the use of well-designed and administered health taxes.

Following global best practices, it is recommended that health taxes are focused on specific taxes or, when applied in mixed systems, that the specific taxes comprise a larger component of the excise tax than the ad valorem component. Tax rates, particularly for specific taxes, need to be increased significantly to align Brazil with the prices of international peers, and indexed to inflation plus three percentage points to protect real values of tax over time, and to reduce the affordability of tobacco, alcohol, and SSBs. To achieve these goals, the following points are recommended to be included in the forthcoming Complementary Law (covering tax structure) and the Ordinary Law (covering tax rates):

### *Complementary law:*

- Tobacco: The proposed mixed system is in line with global best practices, however significant increases in tax will be needed to make the existing good design effective and ensure positive health and revenue outcomes.
- Alcohol: the proposed mixed system is also in line with global best practices, however the tax base for the ad valorem tax component is proposed to be applied early in the supply chain. Application of the tax base early in the chain will not have a significant impact on prices and achieve the intended results. It is recommended that the tax base be applied later in the supply chain (i.e., on retail prices) to ensure stronger health impact.
- SSBs: taxes should be applied broadly to all SSBs (including fruit juices, sugar-sweetened milk, and all beverage categories using sugar as a sweetener), but excluding healthier alternatives (e.g., water and milk). This will achieve the desired health impact encouraging substitution to healthier products.

### *Ordinary law:*

- Tobacco: adopt a uniform specific tax with high rates for cigarettes.
- Alcoholic beverages and SSBs: adopt high rates for the specific component, with the rates increasing with alcohol and sugar content.
- Magnitude of rates: International peers and benchmarks aligned with the country's characteristics can help in estimating the magnitude of feasibly high rates for the specific component of the three taxes.

- Indexation for specific taxes: Adjust regularly to protect their real values, ideally automatically, to prevent inflation undermining health impact and excise revenue. This means automatic indexation to consumer price index and additional adjustment for long-term income growth to ensure products do not become more affordable over time.

# 1. INTRODUCTION

**Consumption of tobacco, alcoholic beverages, and sugar-sweetened beverages (SSBs) are significant contributors to poor health and preventable deaths in Brazil.**<sup>1</sup> Consumption of these products generate significant negative externalities and internalities.<sup>2</sup> Health taxes are excise taxes targeting the consumption of these goods, and by raising their price, they are an effective policy instrument to correct negative externalities and internalities.

Increases in prices also reduce consumption of these products and their associated health harms by increasing cessation, reducing initiation of new consumers (especially young ones) and reducing consumption of continuing consumers (NCI and WHO 2016; Babor et al. 2023). Furthermore, increases in health taxes can generate much needed additional tax revenue (World Bank 2023b).

**The effectiveness of health taxes is dependent on their design and implementation, including appropriate tax structures and tax rates, and large and regular tax increases.** The ongoing tax reform in Brazil, enabled by constitutional amendment 132<sup>3</sup>, provides an opportunity to implement well-designed health taxes on tobacco, alcoholic beverages and SSBs.

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<sup>1</sup> There are multiple pathways of harm associated with the consumption of these products. Tobacco causes illnesses to both smokers and non-smokers (via second-hand smoke) including heart disease, chronic obstructive pulmonary disease, lung cancer (among at least 8 other cancers), and stroke (GBD 2019 Tobacco Collaborators 2021). Alcohol is complex because there are significant variations in health outcomes by age, gender, and socioeconomic status. Health problems include both illnesses (e.g., cirrhosis, chronic liver diseases, strokes, cancers (Griswold et al. 2018)) and injuries (e.g., self-harm and suicide, injuries from drunk-driving and interpersonal violence). SSBs are associated with health conditions such as overweight and obesity, diabetes, and heart disease.

<sup>2</sup> Negative externalities are the uninternalized costs of consumption that accrue to non-consumers. Negative internalities are the uninternalized costs borne by the user resulting from time-inconsistent preferences due to imperfect information, present-bias, and/or addiction (World Bank 2022).

<sup>3</sup> Text in Constitutional Amendment 132 (approved 20 December 2023), Art. 153, VIII which, inter alia, creates a new excise tax (Imposto Seletivo – IS) levied on the extraction, production, sale or import of goods and services considered harmful to human health and the environment.

## 2. NEGATIVE EFFECTS ON HEALTH FROM CONSUMPTION OF TOBACCO, ALCOHOL AND SSBs

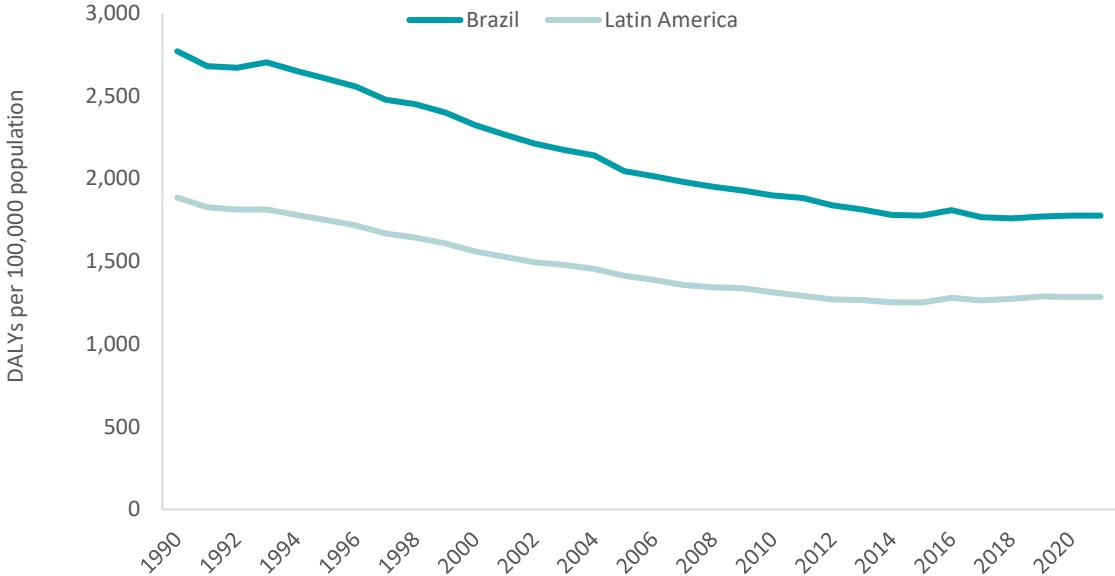
**Every year in Brazil, over 20 percent of deaths are linked to consumption of tobacco, alcoholic beverages and SSBs.** Currently, 10 percent of Brazil's adult population smoke daily (WHO 2023a), 58.1 percent of adult population are current drinkers and 8 percent are heavy continuous drinkers (WHO 2024). Tobacco use causes the most harm, with 2.5 times more deaths than alcohol use in Brazil. When weighted for premature mortality, tobacco use causes 1.4 times more Disability-Adjusted Life Years (DALYs) than alcohol use.<sup>4</sup> Tobacco use has declined in Brazil resulting in a decline in the DALYs attributable to tobacco use since 1990; however, this decline has stalled in the last decade (Figure 1). Moreover, DALYs due to tobacco use are 38 percent higher than the Latin American average. DALYs due to alcohol use have remained relatively unchanged over the last three decades and are 7 percent higher in Brazil compared to the Latin American average. Meanwhile, DALYs due to SSBs have more than doubled, increasing by 147 percent since 1990.

**Beyond health impacts, consumption of these products also causes adverse fiscal and developmental impacts.** The diseases caused by consumption of these products are chronic, and their treatment is expensive. This directly leads to increasing public costs for health systems and considerable out-of-pocket healthcare costs for households (Fuchs and Pierola 2022). In addition, there are indirect costs related to consumption. Destruction of human capital in adults results from premature death and disabilities (Cohen, Ferretti, and McIntosh 2015; World Bank 2021), and in children, from the life-long detrimental impacts of smoking (Avşar, McLeod, and Jackson 2021) as well as alcohol intake (Oei 2020) during pregnancy. The morbidity, mortality and disability attributable to this consumption is also an important source of lost macroeconomic productivity (Chaker et al. 2015). On income inequality, the highest consumption and subsequent burden of disease is concentrated in low-income populations, perpetuating the poverty cycle and increasing inequality (Niessen et al. 2018). The total cost caused by consumption of these products exceeds by far the health tax revenue collected: looking at tobacco alone, the total costs in Brazil in 2022 were R\$153.5 billion, representing 1.55% of GDP (CONICQ, IECS, and FIOCRUZ 2023).

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<sup>4</sup> Mortality is a crude measure and does not show the broader impact of illness and mortality. Disability-Adjusted Life Years (DALYs) provides a broader view by weighting mortality by the years of life prematurely lost to death, disability and lived in a state of less than full health.

Figure 1: Mortality and morbidity due to tobacco use in Brazil and Latin America, 1990-2021

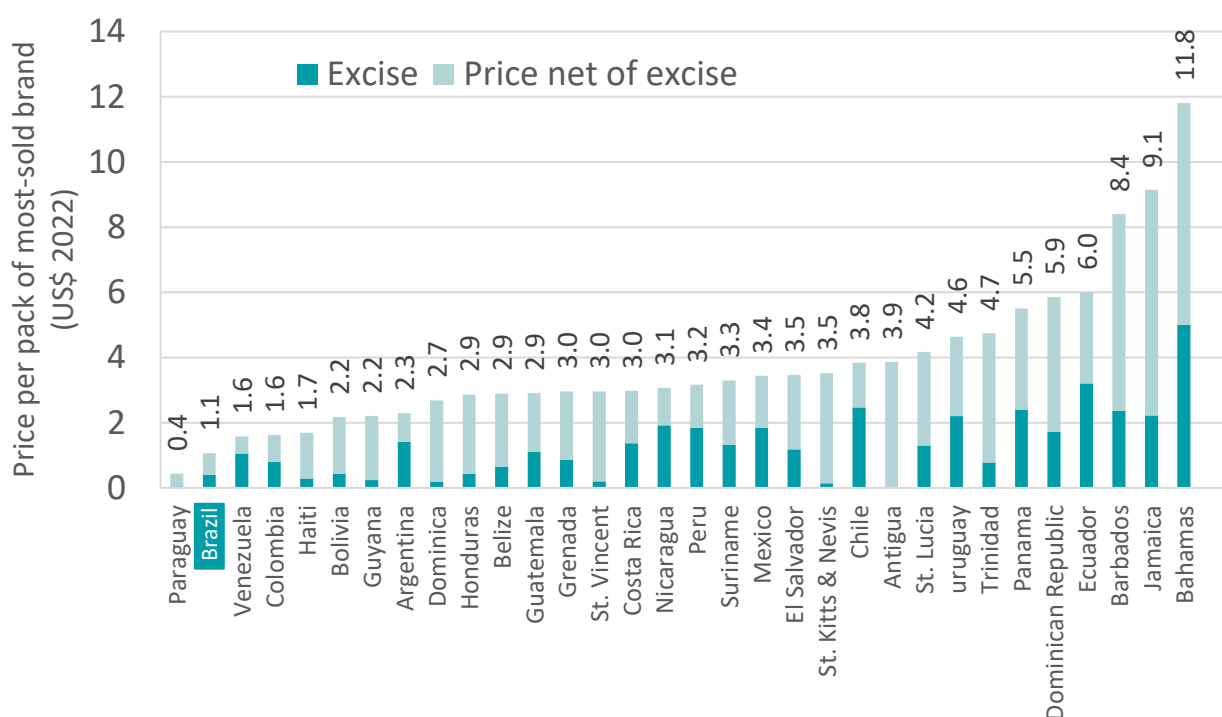


Source: Institute for Health Metrics - IHME (2024)

### 3. OPPORTUNITIES FOR TAXATION OF TOBACCO, ALCOHOL AND SSBs IN BRAZIL

In Latin America and the Caribbean (LAC), Brazil has one of the lowest sales prices and lowest tax rates for tobacco, alcohol, and SSBs, suggesting ample opportunity to raise taxes to reduce consumption. Compared to other countries in LAC, Brazil has the second lowest price of a pack of cigarettes (Figure 2) and the lowest price among G20 countries. At US\$1.07, cigarettes in Brazil are priced at just one third of the regional median (Peru, US\$3.16). For beer, Brazil has the fifth lowest price in LAC (Figure 3) and in the G20. For spirits, the country has the fourth lowest price in LAC (Figure 4) and the third lowest in the G20. For all three products, a key reason for low prices is low taxation (Powell and Chaloupka 2022). Further information on the level of taxation for each product is shown in Annex I.

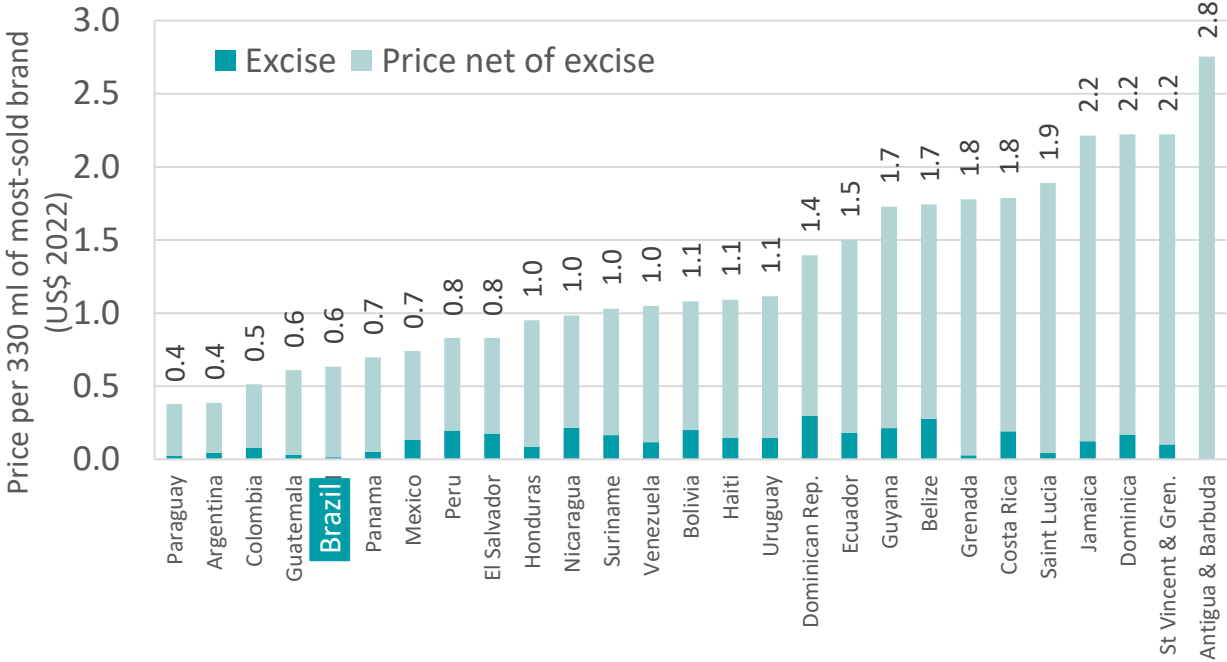
Figure 2: Country comparison of cigarette price and excise tax with regional peers in 2022



Source: World Bank staff estimates based on World Health Organization (WHO 2023d)

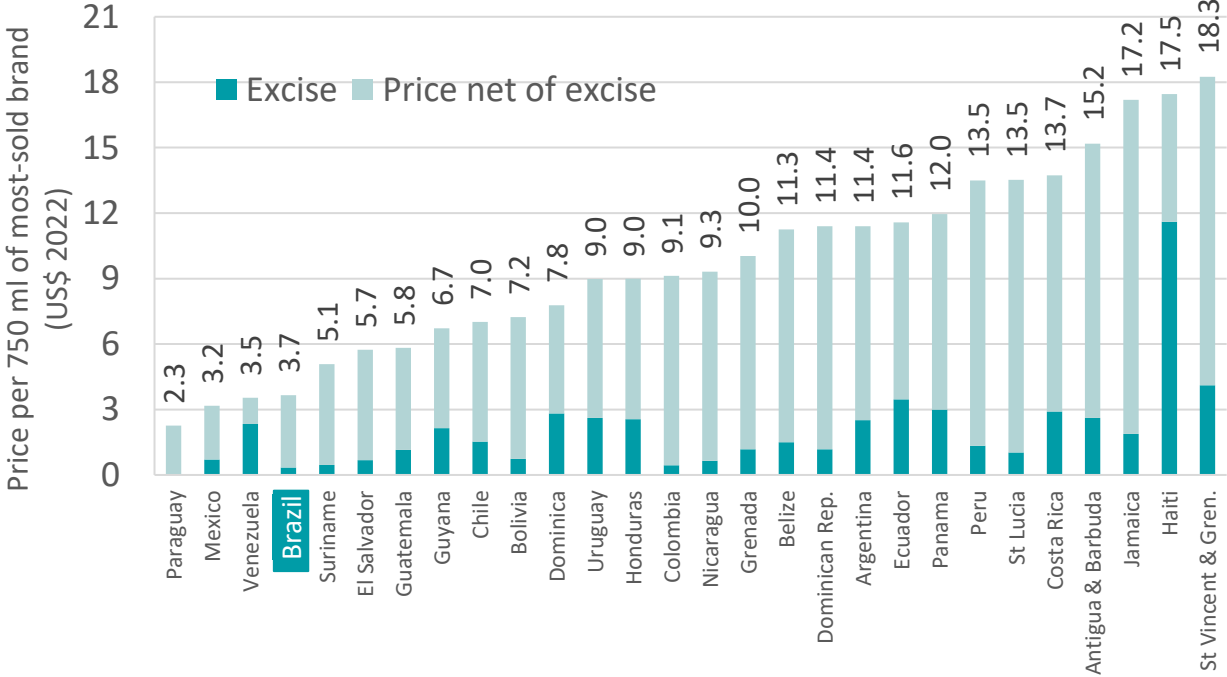


Figure 3: Country comparison of beer price and excise tax with regional peers in 2022



Source: World Bank staff estimates based on World Health Organization (WHO 2023b)

Figure 4: Country comparison of spirits price and excise tax with regional peers in 2022



Source: World Bank staff estimates based on World Health Organization (WHO 2023b)

## 4. WELL-DESIGNED HEALTH TAXES FOR BRAZIL: GENERAL CONSIDERATIONS

**The effectiveness of health taxes in reducing consumption and improving health depends on factors beyond the tax rate.** Tax design, specifically the tax structure is an important feature of health taxes. This includes the type of tax (i.e., specific or ad valorem), the tax base (i.e., the volume or value that the specific or ad valorem tax is based on), the scope of the tax (i.e., what products the tax applies to) and other design features that may affect the way the effective tax is calculated (e.g., thresholds and tiers) (World Bank 2023b). Well-designed taxes ensure that tax increases result in price increases, leading to a reduction in consumption and improvements in health, while simultaneously increasing tax revenue and generating progressive effects over the life course (Pereira and Araujo 2022). When taxes are not well-designed and/or tax administration is weak, tax increases may not lead to increases in prices and therefore consumption and health will not be affected.

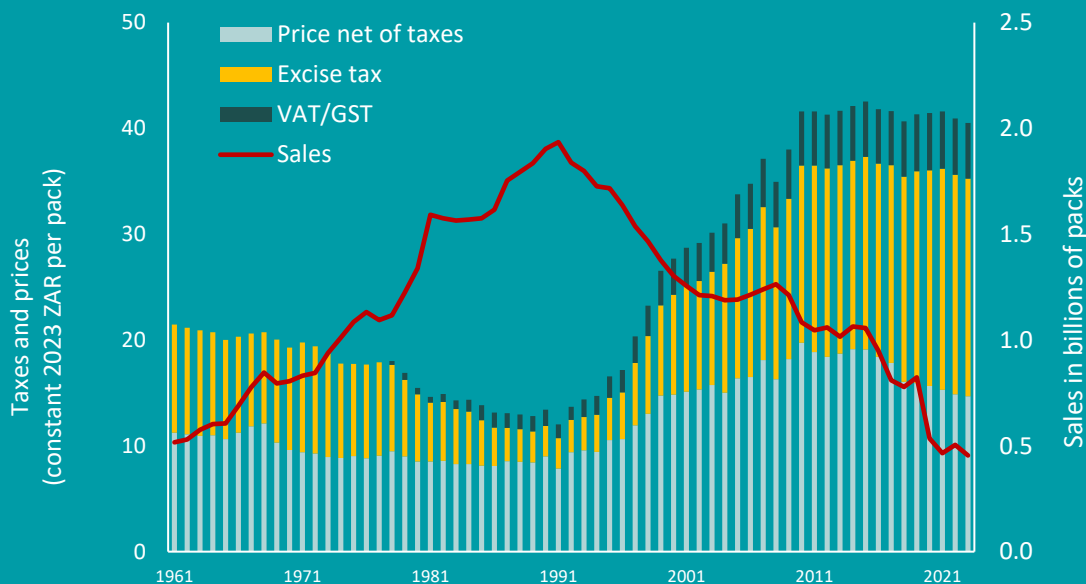
### Box 1: South Africa successfully implemented specific taxes on tobacco

The importance of the choice between specific and ad valorem taxes is supported by global evidence and examples. South Africa is an often-cited example of a country that has successfully increased uniform specific taxes to improve health. Between 1991 and 2010, cigarette excise taxes increased in real terms each year (except for 2008), totaling an increase of 487 percent in real terms, leading to prices increasing by 246 percent (Figure A).<sup>5</sup> Price increases coincided with a rapid decline in cigarette sales of 44 and 56 percent in aggregate and per capita terms, respectively. Tax increases were generally over shifted, resulting in larger price increases and declines in sales than would otherwise be the case.<sup>6</sup>

<sup>5</sup> Alcohol taxes in South Africa have increased considerably during the same period with similar results. Taxes on beer and distilled spirits increased by 71 and 138 percent in real terms between 1991 and 2023.

<sup>6</sup> Overshifting refers to a more than proportional price increase in response to a tax increase. Between 1991 and 2010 there was overshifting of the tax: the excise tax increased by ZAR 13.90 per pack but prices increased more than proportionally by ZAR 29.58 per pack (both in 2023 prices).

**Figure A: Cigarette taxes, prices and sales in South Africa (constant 2023 ZAR per pack; billions of packs)**



Source: World Bank GTP staff estimates using Research Unit on the Economics of Excisable Products, University of Cape Town; National Treasury and Statistics South Africa.

Between 2010 and 2023, excise taxes increased by only 23 percent and prices fell marginally (by 3 percent). Despite the lack of price increases, sales continued their rapid decline, falling by 58 and 64 percent in aggregate and per capita terms, respectively. Using a synthetic control as an econometric method (Chelwa, van Walbeek, and Blecher 2017), estimate that per capita consumption was 36 percent lower than would have been the case in the absence of tax increases (between 1994 and 2004). Since per capita sales declined by 39 percent during this period, nearly all of the decline in sales can be attributed to the price increases.

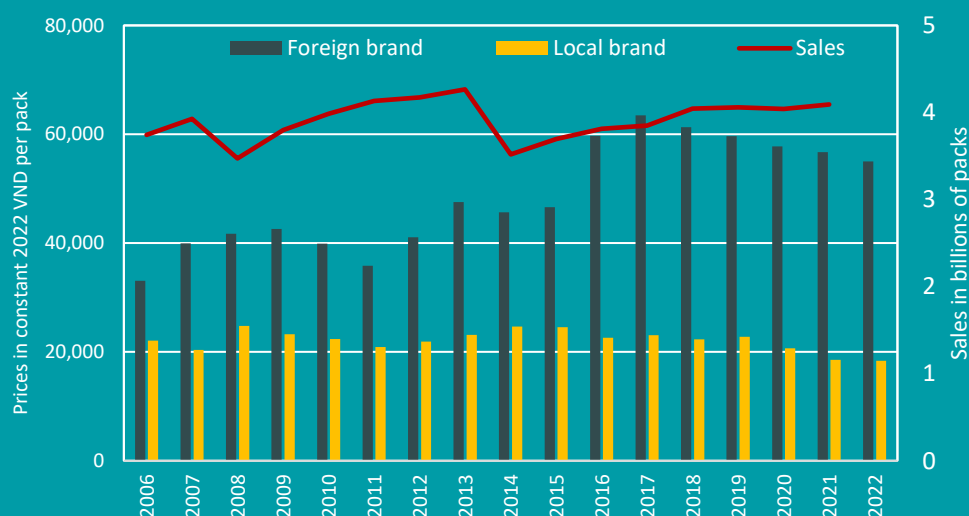
The decline in sales is corroborated by declines in smoking prevalence, mortality, and morbidity. Smoking prevalence declined from 33 to 20 percent between 1993 and 2017. The most recent estimate shows smoking prevalence at 17 percent in 2020 (van Walbeek, Hill, and Filby 2023). Declines in smoking prevalence resulted in significant reductions in smoking attributable mortality and morbidity. Between 1990 and 2019, deaths and DALYs per 100,000 declined by 27 and 37 percent, respectively (GBD, 2019); during the same period per capita cigarette sales decline by 70 percent. This compares to an increase of 9 percent in deaths per 100,000, and a decline of 7 percent in DALYs per 100,000 in upper-middle-income countries.

There is an opportunity to ensure that health taxes are well-designed in the forthcoming **Lei Complementar (Complementary Law, LC)** and the **Lei Ordinaria (Ordinary Law, LO)**. The proposed LC 68<sup>7</sup> on regulation of the new VAT and excise tax was approved by Brazil's Chamber of Deputies in July 2024<sup>8</sup>. On health taxes, the LC defines the type of tax, tax base, and scope of the new excise tax (*Imposto Seletivo*), leaving the setting of tax rates to a future LO. The LC will be debated in the Senate later in 2024, and the LO is expected to be debated in Congress in 2025. There is an opportunity to ensure that amendments to the LC in the Senate debates are aligned with global best practices, and to ensure that tax rates, other tax design features, and elements of tax administration in LO reflect best practices.

### Box 2: Vietnam and the use of ad valorem taxes on tobacco

Vietnam is an example that highlights how increasing ad valorem taxes, particularly those applied early in the supply chain, does not generate improvements in health outcomes.<sup>9</sup> The ad valorem excise tax rate on cigarettes increased in 2008, 2016 and 2019 but had a limited impact on prices (Figure B). Between 2006 and 2022, prices of the expensive foreign brand increased by 32 percent in real terms, while the price of the local brand fell by 26 percent. This highlights how ad valorem taxes result in larger effective tax increases on more expensive brands, increasing the price differential between expensive and cheap brands, and increasing incentives for consumers to avoid tax increases by trading down to cheaper brands. Instead of tax increases reducing sales, sales data show an increase of 9 percent between 2006 and 2021.

**Figure B: Cigarette prices and sales in Vietnam, 2006-2022 (constant 2022 VND per pack; billions of packs)**



Source: World Bank GTP staff estimates using WHO, Euromonitor, Economist Intelligence Unit and World Bank World Development Indicators data.

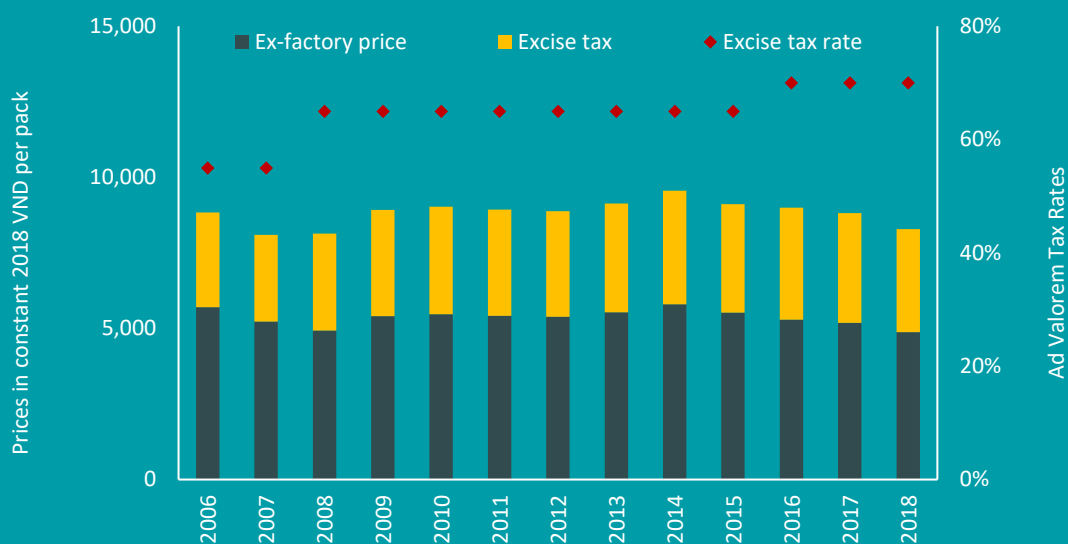
<sup>7</sup> In Brazilian law, a “Lei Complementar” is a law specifically called for in the constitution (it complements the constitutional text) and requires a higher approval threshold than an ordinary law.

<sup>8</sup> This policy note refers to the draft LC as the document titled “SENADO FEDERAL. PROJETO DE LEI COMPLEMENTAR N° 68, DE 2024” published on August 7th, 2024 in the Brazil’s Senate website <https://www25.senado.leg.br/web/atividade/materias/-/materia/164914>.

<sup>9</sup> The tax base is the ex-factory price for domestically produced brands or the CIF (customs, insurance, and freight) value for imported products.

Between 2006 and 2018, the average effective excise tax<sup>10</sup> increased by 9 percent in real terms despite the ad valorem rate itself increasing by 27 percent (from 55 to 70 percent), highlighting the 14 percent decline in the average ex-factory price (Figure C).<sup>11</sup> The example highlights how an increase in the statutory rate does not increase prices, or at least does so inconsistently, reflecting over shifting of taxes on higher priced brands and under shifting of taxes on cheaper brands.

**Figure C: Cigarette excise taxes in Vietnam (inflation adjusted), 2006-2018 (constant 2018 VND per pack; ad valorem tax rate)**



Source: (Blecher and Le 2018) updated by authors.

**Policy makers should consider three guiding principles as they embark on these reforms: understand and tailor reforms to country specific circumstances, target negative externalities and internalities by using specific taxes, and keep the tax design simple.** Understanding the country context means considering country-specific consumption patterns, markets, and prices. This will give policy makers the ability to design health taxes for maximum health and fiscal impact. Negative externalities and internalities vary by product; however, they are correlated with the volume of consumption rather than the value of the products. This means that specific taxes are preferable to ad valorem taxes for tobacco, alcoholic beverages and SSBs. Simply put: a cheaper cigarette or beer is not less harmful than a more expensive cigarette or beer. In some cases, a mixed system that includes both specific and ad valorem taxes can also be used to capture additional revenue from high priced products. Mixed taxes are effective when much more weight is given to the specific component.

<sup>10</sup> When ad valorem taxes are applied, the effective tax refers to the value of the tax per unit (e.g., if the statutory rate of 50 percent of the tax base and the tax base is \$1 per pack, the effective tax is \$0.50 per pack).

<sup>11</sup> In addition to under shifting on cheaper brands, this may also be due to reductions in input or manufacturing costs or down trading by consumers.

Finally, simple tax design facilitates the tax being fully passed to the consumer price, sending a clear signal to consumers and producers on the costs of consumption caused by the product and the incentives for behavioral response and for product reformulation/innovation by producers. At the same time, simple designs facilitate tax administration and enforcement.

**Tax design needs to consider consumption patterns and substitutes, as well as the incentives for the industry response in price.** For tobacco and alcohol, the ultimate policy goal is the reduction in the number of consumers, while for SSBs it is to substitute for healthy beverages (i.e. unprocessed or minimally processed beverages with no sugar, including safe drinking water). Based on these policy goals, tax design can benefit from understanding industry behavior, anticipating how they will likely respond in price, volume, marketing and product innovation, and product reformulation. On the demand side, evaluating the potential response in consumption patterns (initiation, frequency, and intensity) due to changes in prices is essential to determine how effective a particular tax design is in reducing consumption and generating tax revenue.

**When taxes are well-designed and tax rates are high, reforms will be most effective in triggering considerable price increases, substantial reductions in consumption and important increases in tax revenues.** There is overwhelming evidence supporting the fact that consumers of tobacco products respond to price hikes by quitting smoking, reducing smoking intensity, and potential smokers not trying cigarettes or not making smoking a regular habit (WHO 2021). Reductions in consumption in response to price increases have also been observed for alcoholic beverages (WHO 2023e) and SSBs (WHO 2022b). For similar reasons, low increases of rates and/or high increases split into small incremental increases over long periods of time can dilute the effect on price and on consumer behavior. This occurs because consumers perceive a negligible increase in prices in the short run and respond with no change in consumption.

### Box 3: Global practices and trends in tax structure

The World Health Organization reported an increasing number of countries implementing specific or mixed systems (WHO 2023d). Since 2008, there has been a 33 and 25 percent increase in the number of countries implementing specific or mixed systems, respectively. Furthermore, there has also been an increased proportion of countries with mixed systems favoring the specific component. In 2008, 44 percent of countries with mixed systems had a larger specific tax component, increasing to 60 percent in 2022. Furthermore, countries with specific taxes or mixed systems with a larger specific component have higher prices than those with ad valorem taxes and mixed systems with larger ad valorem components. In 2022, prices of cigarettes (in PPP terms) in countries with specific and mixed systems were 58 and 46 percent higher than ad valorem systems, while prices were 13 percent high in countries with mixed systems with larger specific components than mixed systems with smaller specific components.<sup>12</sup>

<sup>12</sup> World Bank GTP estimates using (WHO 2023d).

**While specific taxes linked to the amount of health harming content are considered best practice, they need to be adjusted regularly or automatically to avoid the tax being eroded over time.** The low and stable inflation that the world experienced for the two decades before the COVID-19 pandemic has been replaced by a period of higher inflation in almost all countries (World Bank 2023a). This has emerged as a significant challenge to health taxes. While specific taxes are universally preferred to ad valorem taxes, they are vulnerable to inflation erosion, exposing the lack of automatic adjustments in most countries and the difficulty in increasing taxes during times of high inflation.<sup>13</sup> To date, specific taxes in Brazil do not have an adjustment mechanism for inflation or income growth. The draft LC follows best practice as it includes a mechanism to update the rates for health taxes (World Bank 2023a). In particular, Article 435 establishes that specific tax rates will be adjusted annually; however, the terms to update the rates will be defined in the LO. Therefore, it is strongly recommended for the LO to keep ad valorem rates steady over time, and to update the rates of the specific tax every year by inflation plus three percentage points due to average long-term income growth<sup>14</sup>.

#### Box 4: Indexation of specific taxes

To avoid the specific tax being eroded over time by inflation and economic growth, many countries have designed systems with automatic inflationary adjustments of specific taxes. Chile benchmarks the specific tax component of cigarette excise taxes to inflation automatically every month (Paraje 2019). The adjustment is a legislative requirement and is administered by the tax authorities. Between the beginning of 2018 and February 2024, in the absence of the automatic adjustment, the real value of the tax would have declined by 27 percent<sup>15</sup>.

Australia has a similar mechanism, although the benchmarking is conducted twice yearly rather than monthly, also administered by the tax authorities. The benchmarking is applied to tobacco and alcohol taxes, and a range of other excises. However, the benchmarking is fixed to a measure of wages effectively benchmarking affordability rather than inflation. The automatic adjustment does not preclude the government raising excise independently as it did in September 2023, increasing the excise by 6.8 percent when the required increase was only 1.8 percent.

**Monitoring and evaluation of the tax design, prices, consumption, tax revenues and introduction of new products is essential to accurately inform policy dialogue around LC and LO.** The policy debate in the coming months will bring several proposals on structure and rates of health taxes to be considered for inclusion in the LC and LO. Monitoring and evaluation can be used to assess how these proposals follow global best practices, and to assess their potential fiscal and health impacts, providing guidance on which are better suited to support reaching the country's policy goals.

<sup>13</sup> For a more detailed discussion on the impact of inflation on health taxes and the various policy and administrative measures that authorities can implement to protect the value of health taxes, see (World Bank 2023a).

<sup>14</sup> Given the absence of adjustment for income growth in the past, these additional points recover lost ground on affordability. In addition, they adjust for long-run expected income growth: Brazil's 10-year (long-run) moving average of GDP growth is approximately 3%.

<sup>15</sup> World Bank Staff estimates using data from Servicio de Impuestos Interno, Chile.

**Illicit trade must not be a barrier to improve structures and increase rates of health taxes; progress on effective interventions to eliminate illicit trade of tobacco and alcohol products will boost impact of health taxes in the country.** The country has one of the highest proportions of illicit cigarette trade, estimated for 2019 at 38.6% of the market (Szklo and Drope 2024). International experience and evidence shows that illicit trade is mainly determined by non-price factors including governance capacity and enforcement, weak regulatory frameworks, social acceptance of illicit trade and availability of informal distribution networks (World Bank 2019). In addition to prices not being a main determinant of illicit trade, changes in prices of illicit cigarettes follow changes in legal cigarette prices (Paraje, Stoklosa, and Blecher 2022), reinforcing the need for progress on excise taxes to reduce affordability of both licit and illicit products. Interventions on supply chain control (e.g. licenses, due diligence, tracking and tracing, record keeping, security and preventive measures, effective control of free zones), on offences (e.g. conducts considered unlawful, liability of legal persons, prosecution and sanctions) and on international cooperation (e.g. information sharing, training and technical assistance, cooperation for prevention, detection investigation, prosecution and punishment) are effective in eliminating illicit cigarette trade (WHO 2013), and can be extended to alcoholic beverages. In addition, accurately monitoring of unrecorded alcohol (Rehm and Poznyak 2015) is useful to identify the need for additional complementary regulation on alcohol (WHO 2022a).

**Improving tax administration capacity is needed to ensure proper enforcement and compliance.** Best practices on tax administration have been identified for tobacco (WHO 2021), alcohol (WHO 2023e) and SSBs (WHO 2022b), covering institutional arrangements, the typical stages of the tax compliance cycle and control and enforcement. Progress on accurate implementation of these measures can give a better understanding of the dynamics of these markets to fiscal authorities, maximize collection of tax revenues from health taxes<sup>16</sup>, and identify opportunities for bilateral cooperation with neighboring countries.

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<sup>16</sup> For example, the observed tax revenue from licit cigarettes is currently much lower than what should be collected just by applying the current tax per pack at the minimum price (Tobacconomics, INCA, and WHO 2020); this is a major point to improve in the tax collection and administration around Brazil's tracking and tracing system (Scorpions).



## 5. TAX DESIGN CONSIDERATIONS FOR HEALTH TAXES IN BRAZIL IN 2025

### TOBACCO TAX

**Tax type.** The draft LC defines the type of tax as a mixed type with both specific and ad valorem components for cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes (HS 2402). It is recommended in the draft LC to make mandatory a mixed type for all other tobacco products (HS 2401,2403,2404). The tax rates are to be defined by LO; however, the relative tax rates will affect the balance between the specific and ad valorem components. It is strongly recommended that Brazil follow global best practices and set tax rates in a manner to ensure that the specific tax component is significantly larger than the ad valorem component (see Box 2). This will ensure that the mixed system in Brazil generates the most significant impact on health.

**Tax base.** The draft LC establishes that the tax base for the ad valorem component must consider the retail price.<sup>17</sup> Applying the tax to the retail prices follows global best practices and trends. The World Bank recommends defining the retail price as the tax base for the ad valorem component. The draft LC does not explicitly define the tax base of the specific component. However, cigarette packs in Brazil are standardized to 20 per pack under Article 355 of Decree 7212 of June 15, 2010, and consistency with this regulation would dictate this is used as the tax base for the specific tax to be set in the LO.

**Scope of tax.** The draft LC defines the scope of the tax to include all tobacco-related products under HS chapter 24, but it does not include HS 8543.40 (Electronic cigarettes and similar personal electric vaporizing devices). Inclusion of all products and substitutes and their devices, even if they are currently banned by regulation,<sup>18</sup> is needed from both health and fiscal perspectives. The World Bank supports inclusion of HS chapter 24 and recommends including HS 8543.40 in draft LC Annex XVII, as it will limit substitution between tobacco products that may undermine the health and fiscal impact of the tax.

**Tax rate.** In order for the good tax design provided for in the draft LC to be effective, high tax rates need to be set in the LO. Low tax rates will undermine the health and fiscal impact of the tax and result in a lost opportunity. The World Bank strongly recommends decisive action, implementing high excise tax rates to recover the lost ground over the last decade and to bring Brazil's tobacco taxes in line with its international peers. Based on regional benchmarks, an effective excise tax excise of R\$13.9 per pack would align Brazil to the median price in LAC, and R\$22.8 would match the country with the 75<sup>th</sup> percentile. Comparison with G20 peers suggest that, to reach the median price in this group, Brazil needs an excise of R\$15.60, and R\$42.6 to match the 75<sup>th</sup> percentile.

<sup>17</sup> Clarification is sought if retail prices are defined as including all indirect taxes as is the case in many other countries that apply such a tax base (e.g., Chile and the European Union).

<sup>18</sup> For instance, electronic cigarettes in the category "nicotine containing products intended for the intake of nicotine into the human body" (HS 2404) are currently part of the draft LC (Annex XVII) and are banned by ANVISA's (Brazilian Health Regulatory Agency) Resolution No. 855 of April 23.

Furthermore, it is recommended that taxes be uniformly applied to all cigarettes, regardless of product characteristics or brand.<sup>19</sup> Uniform rates limit the ability of consumers to trade down to cheaper products in response to tax increases which undermines the effectiveness of the tax. Specific rates should be adjusted annually by inflation plus three percentage points to ensure that the real value of the tax is protected over time and that cigarettes become less affordable over time.

## ALCOHOL TAX

**Tax type.** Similarly to tobacco, the draft LC defines the type of tax as a mixed system. As with tobacco, the World Bank recommends that the LO set tax rates such that the effective tax from the specific component is much larger than the one from the ad valorem component.

**Tax base (ad valorem).** The draft LC defines the ad valorem tax base as the sale value on commercialization (Article 412-I). This tax base is early in the supply chain and analogous to the ex-factory price applied in Vietnam (see Box 1). The World Bank recommends that this is reconsidered, as application of the tax base early in the supply chain results in low effective taxes and ineffective tax increases. When applied to such a low tax base even high tax rates will result in low effective taxes with negligible or null effects on consumer prices. It is recommended that the ad valorem taxes be applied to retail prices.<sup>20</sup>

**Tax base (specific).** Specific taxes on alcohol can be applied to the beverage volume or the alcohol content. The draft LC does not define the tax base on the specific component, however it does indicate that tax rates should vary by the alcohol content of beverages (Article 419-§1º-II). One mechanism of doing this is to apply specific taxes based on the alcohol content (i.e., per volume of the beverage – liters, and percentage of alcohol by volume - ABV). Given the heterogeneity of alcoholic beverages and the variation in alcohol content, World Bank recommends basing the tax on alcohol content (per liter per ABV), so higher alcohol products will be taxed more than lower alcohol products. This ensures that the tax targets the negative internalities and externalities of alcohol directly.

**Scope of tax.** The LC includes most but not all categories of alcoholic beverages, excluding HS category 2207 from the excise tax.<sup>21</sup> This category has undenatured distilled spirits with very high alcohol content (ABV>80%) that may be used as alcoholic beverages.<sup>22</sup> Most countries apply excise to these categories.<sup>23</sup> The World Bank recommends that all alcoholic beverages be subject to the excise tax to avoid loopholes and poor incentives that may generate incentives for consumers to substitute taxed alcohol for untaxed alcohol. Applying excise to HS 2207 is recommended.

<sup>19</sup> The CL implicitly defines the tax as being uniform as it does not mention variation of the tax rates. However, this is reinforced here to acknowledge the good design being in line with global best practices.

<sup>20</sup> This implies that the LC should include alcoholic beverages as part of the products (i.e., tobacco) that have the retail price as the tax base (Article 412-§3º). The variation in prices of alcoholic beverages for consumption on- and off-premises generates administrative complications; however, there are several examples of countries that have implemented systems to manage this (e.g., Colombia, the Philippines, and Thailand).

<sup>21</sup> *Álcool etílico não desnatado, com um teor alcoólico, em volume, igual ou superior a 80% vol.; álcool etílico e aguardentes, desnatados, com qualquer teor alcoólico.*

<sup>22</sup> 2207.10 (*Álcool etílico não desnatado, com um teor alcoólico, em volume, igual ou superior a 80 % vol.*).

<sup>23</sup> For example, in South Africa excise is applied to all alcoholic beverages including HS codes 2203 (beer), 2204 (wine), 2205 (vermouth and other wine), 2206 (other fermented beverages), 2207 (distilled spirits with ABV>80%) and 2208 (distilled spirits with ABV<80%) (Republic of South Africa 2023). Similarly, in the European Union excise is also applied to all alcoholic beverages including 2207 (Council of the European Communities 1992). Beverages with lower alcohol strength can be excluded on some products to generate incentives for firms and consumers to drink lower strength alcohol, both HS 2207 and 2208 are taxed.

**Tax rates.** It is strongly recommended to increase tax rates significantly to reduce alcohol per capita consumption. High specific and ad valorem tax rates will be required to benchmark taxes to international peers. Furthermore, this will be needed to ensure that the reform does not result in absolute nominal prices of any products declining as this will undermine the policy objectives and encourage consumers to trade down from high- to low-priced beverages. Based on regional benchmarks, an excise tax of R\$7.2 per liter of beer would align the country with the median price in LAC, while R\$18.1 would match prices in Brazil to the 75<sup>th</sup> percentile. For distilled spirits, Brazil would require an excise tax of R\$40 per liter to match the median price in LAC, or R\$70.1 per liter to match the 75<sup>th</sup> percentile. Furthermore, excise tax should vary by alcohol content and rates should be adjusted annually by inflation plus three percentage points to ensure that the real value of the tax is protected over time and that alcoholic beverages become less affordable over time.

## SSB TAX

**Tax type.** The draft LC does not explicitly define the type of tax for SSBs. In the absence of a specific component expressly mentioned, the general rule in the tax reform is to have only an ad valorem component. It is highly recommended to implement a specific excise tax for SSBs in the LO instead of an ad valorem tax. This recommendation is supported by global experience and trends: data from the World Bank SSB tax database (World Bank 2024) shows that of the 94 countries that apply national level excise taxes on SSBs, 58 apply specific or mixed systems with only 36 applying ad valorem.

**Tax base.** The draft LC does not define the tax base for SSBs. It is recommended to use one liter of SSB with the corresponding sugar content as the tax base for the specific component, and to vary the rate by sugar content.

**Scope of tax.** The draft LC follows best practices by excluding bottled water from the SSB tax. However, the LC also excludes several SSBs from the tax such as fruit juices (NCM 2009), sugar-sweetened milk (NCM 0402,0403) and categories that can be used for new beverages using sugar as a sweetener (e.g. NCM 2202.99.00 Outra). The World Bank recommends these to be included in the SSB tax as substitution to these SSBs would undermine the health impact of the tax because these beverages still contain high levels of sugar. Rather, the SSB tax should encourage substitution to healthy untaxed beverages (e.g. water, milk).

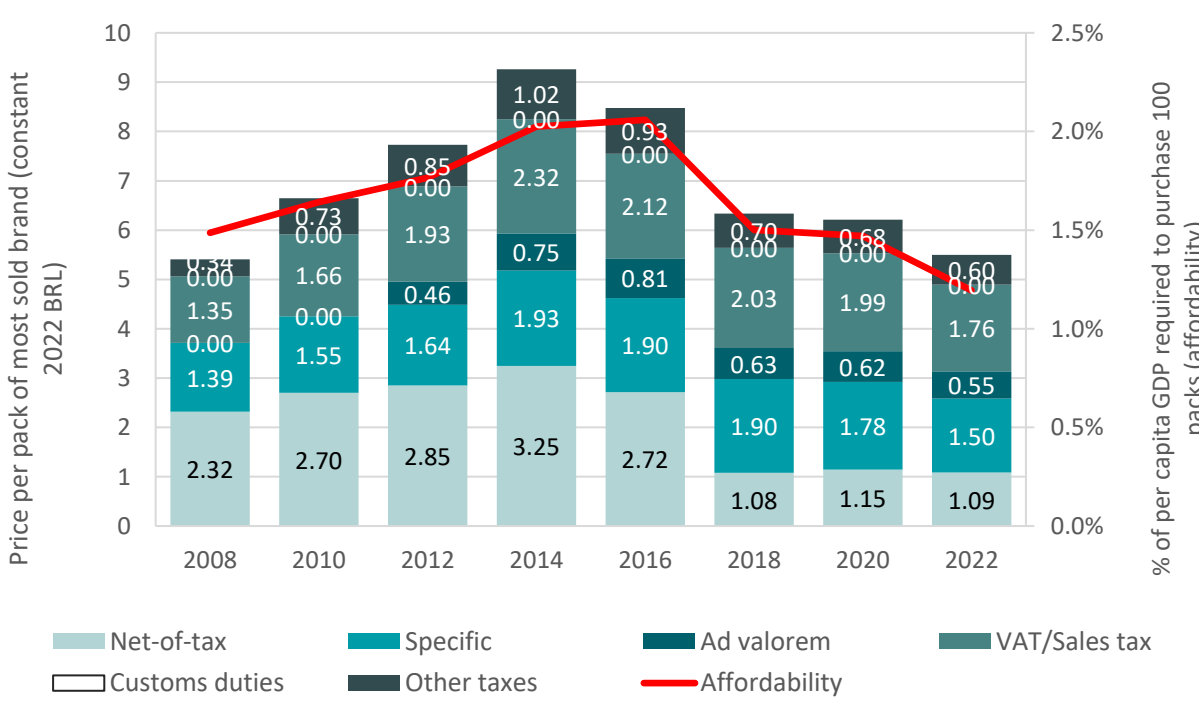
**Tax rate.** The World Bank recommends applying taxes in line with international benchmarks. Brazil would need an average excise of R\$3.9 per liter of SSB to be aligned with the median price in the region, and R\$6.4 per liter to align with the 75<sup>th</sup> percentile. Furthermore, rates should vary by sugar content to generate incentives for manufacturers to reduce the sugar content of beverages and for consumers to choose lower sugar beverages. Rates should be adjusted annually by inflation plus three percentage points to ensure that the real value of the tax is protected over time and that SSBs become less affordable over time.

# ANNEX 1

## CURRENT STATE OF TAXES ON CIGARETTES, ALCOHOL AND SSBs IN BRAZIL

1. **The effective tax rate of cigarettes in Brazil is low, leading to a low price and making tobacco consumption extremely affordable for the population.** The current price of a 20-cigarette pack of the most sold brand in 2022 was 5.5 Brazilian Reals (R\$) (Figure 1), and the excise mixed tax is R\$2.05. Over time, cigarettes' current real price is close to the one in 2008. The lack of indexation to inflation and of step increases in the rates has led to erosion of the effect of the excise tax, and lost progress in taxation that was achieved from 2008 to 2014. The trend reversal in prices has led to the same trend in affordability. By 2008, people in Brazil needed 1.5% of their per capita GDP to afford 100 packs of cigarettes, and cigarettes became less affordable over time (higher income needed to purchase 100 packs). However, since 2016, cigarettes have become cheaper relative to income, and today they are more affordable than they were in 2008. Through Decree 12.127 of July 31 2024, Brazil updated the minimum legal price from R\$5 to R\$6.50 starting at September 1<sup>st</sup>, and since November 1<sup>st</sup>, 2024 the specific component of the main excise tax will increase from R\$1.50 to R\$2.25. This is the first time these rates are updated since 2016. Even though this update goes in the right direction, it does not offset the effect for inflation. The 2016 minimum price updated using IPCA should be R\$ 7.22 in September 2023. Considering the 2012-2016 trend, the minimum price in September 2023 should be R\$12.76.

Figure 5: Decomposition of retail price of cigarette packs for the most sold brand: 2008-2022



Source: World Bank staff estimates based on World Health Organization (WHO 2023d)

2. **Alcoholic beverages and SSBs taxes also can be further strengthened for improved health outcomes.** For alcoholic beverages the price of one liter of beer is R\$9.97 and the price of cachaça, the most popular spirit, is R\$25.27; in SSBs, the price of one liter of an internationally comparable brand is R\$4.98 (Table 1). For all beverages, the ad valorem tax rates are low, while there is no specific tax in the excise tax, and the tax share in the retail price is low.

**Table 1: Price of beverages and tax share in Brazil, 2022**

Product	Price per liter (R\$ 2022)			Tax share in price (%)		
	SSB	Beer	Cachaça	SSB	Beer	Cachaça
Retail Price	4.98	9.97	25.27	100.0	100.0	100.0
VAT	0.90	2.19	4.55	18.0	22.0	18.0
Specific	0.00	0.00	0.00	0.0	0.0	0.0
Ad valorem	0.08	0.23	2.31	1.6	2.3	9.2
Other	0.29	0.54	1.32	5.8	5.4	5.2
Net-of-tax price	3.72	7.01	17.09	74.6	70.3	67.6

Source: World Bank staff estimates based on data from World Health Organization

## ANNEX 2

# RELEVANT PASSAGES ON HEALTH TAXES IN THE DRAFT LEI COMPLEMENTAR (PLP 68/2024)<sup>24</sup>

**Tax type.** Article 419 establishes a tax with an ad valorem cumulated with a specific component for all tobacco products and for the alcoholic beverages included as taxable products.

**Tax scope.** Article 406-§1-III and Annex XVII defines the set of smoking products to be subject to the excise tax; it includes 2401 (Tabaco não manufaturado; desperdícios de tabaco), 2402 (Charutos, cigarrilhas e cigarros, de tabaco ou dos seus sucedâneos), 2403 (Outros produtos de tabaco e seus sucedâneos, manufaturados; tabaco "homogeneizado" ou "reconstituído"; extratos e molhos de tabaco) and 2404 (Produtos que contenham tabaco, tabaco reconstituído, nicotina ou sucedâneos do tabaco ou da nicotina, destinados à inalação sem combustão; outros produtos que contenham nicotina destinados à absorção da nicotina pelo corpo humano).

Article 406-§1-IV and Annex XVII defines the set of alcoholic beverages to be subject to the excise tax; it includes 2203 (Cervejas de malte), 2204 (Vinhos de uvas frescas, incluindo os vinhos enriquecidos com álcool; mostos de uvas, excluindo os da posição), 2205 (Vermutes e outros vinhos de uvas frescas aromatizados por plantas ou substâncias aromáticas), 2206 (Outras bebidas fermentadas (por exemplo, sidra, perada, hidromel, saquê); misturas de bebidas fermentadas e misturas de bebidas fermentadas com bebidas não alcoólicas, não especificadas nem compreendidas noutras posições), and 2208 (22.08 Álcool etílico não desnaturado, com um teor alcoólico, em volume, inferior a 80% vol.; aguardentes, licores e outras bebidas espirituosas)

Article 406-§1-V establishes Sugar-Sweetened Beverages as one of the goods to be included for excise taxes. CL Annex XVII determines that the SSB taxable products are the ones in NCM 2202.10.000 (Águas, incluindo as águas minerais e as águas gaseificadas, adicionadas de açúcar ou de outros edulcorantes ou aromatizadas)

**Tax base.** Article 412-§3º defines the retail price as the tax base for the ad valorem component in tobacco products, and Article 412-I defines the sale value on commercialization as the tax base for the ad valorem component for Alcohol and SSB. Article 412-§1 defines "unidade de medida apropriada" as the tax base for specific components.

**Tax variation.** Article 419 specifies that the rates for alcoholic beverages in the specific component (419-§1-II) must vary with alcohol content per volume, and the ones for the ad valorem component (419-§4) could vary by type of product and alcohol content per volume.

<sup>24</sup> The full text of the draft LC can be found at <https://legis.senado.leg.br/sdleg-getter/documento?dm=9759614&ts=1726243479405&disposition=inline>

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