

THE COST OF INACTION: Tobacco Tax Freeze in Pakistan's Budget 2026-27

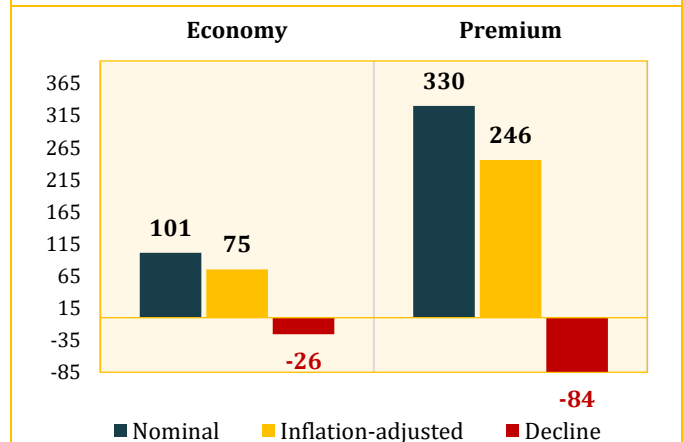
OVERVIEW

Over the past few years, Pakistan has followed a rigorous fiscal consolidation policy involving frequent tax hikes, removal of exemptions, and wide-ranging revenue-boosting measures. However, tobacco taxation has notably been excluded from these efforts. Despite fiscal challenges and clear public health reasons, the Federal Excise Duty (FED) on cigarettes remains completely unchanged for the third consecutive year, including in the Finance Bill 2026. As inflation has reduced the real value of this specific tax, cigarettes have become more affordable, weakening both tobacco control and revenue goals. This ongoing tax freeze diverges sharply from international best practices, which call for regular tobacco tax increases that surpass the combination of inflation and real income growth. This brief explores the economic and health impacts of Pakistan's three-year cigarette tax freeze, analyzing its effects on government revenue, cigarette prices, and health outcomes.

The FED serves as the primary tax on cigarettes in Pakistan and is levied under two price categories: low-priced (economy) and high-priced (premium) brands. The current excise tax rates are Rs 101 and Rs 330 per pack on economy and premium brands, respectively.¹

Since the FED rates have stayed the same since February 2023, real (inflation-adjusted) tax rates have declined. As shown in Figure 1, the real FED rate for economy brands has declined from Rs 101 to Rs 75 per pack (a Rs 26 reduction). Similarly, the tax rate on premium brands has declined by Rs 84 per pack.

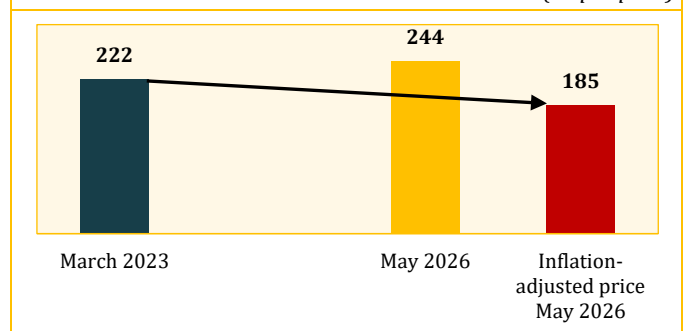
Figure 1: FED rates on cigarettes (Rs per pack)



Source: SPDC estimates based on the price data of the Pakistan Bureau of Statistics (<https://www.pbs.gov.pk/price-statistics>).

The freeze on taxes, along with rising nominal incomes and inflation, has made cigarettes more affordable over time (Figure 2). For example, price data from the Pakistan Bureau of Statistics (PBS) show that the market price per pack of the most popular brand, Capstan, rose from Rs 221.9 in March 2023 to Rs 243.8 in May 2026. However, the inflation-adjusted price has dropped to Rs 185 per pack (a reduction of Rs 37).

Figure 2: Market prices of the most sold cigarette brand (Rs per pack)



Source: Pakistan Bureau of Statistics (<https://www.pbs.gov.pk/price-statistics>).

¹In addition to FED, General Sales Tax (GST) is also applied at the rate of 18 percent on manufacturing and sales of tobacco products.

This policy of inaction has had and will continue to have profound negative implications for tax revenue and health outcomes as estimated by the Social Policy and Development Centre (SPDC) through a tax simulation model.

The estimates are based on three scenarios:

Scenario 1	Scenario 2	Scenario 3
No change in FED	8.2% Increase in FED rate (inflation adjustment for the past year)	21.1% Increase in FED rate (inflation adjustment of the past two years)

The results show that no change in FED would result in about 412,000 more smokers. On the other hand, in scenarios 2 and 3, there would be approximately 130,000 and 289,000 fewer smokers, respectively, relative to the *No Change* scenario. Similarly, the respective number of averted deaths due to smoking from these more ambitious scenarios is estimated to be about 109,300 and 133,600.

With regard to the revenue implications, the estimates show that there would be a marginal increase of Rs 17 billion (5.3 percent) in total revenue (including FED and GST) in the *No Change* scenario. In contrast, an increase of 8.2 percent and 21.1 percent in the FED would result in additional revenue of Rs 34 billion (10.8 percent) and Rs 61 billion (19.3 percent), respectively.

POLICY RECOMMENDATIONS

- The government should adopt a policy to automatically update tobacco taxes each year in line with inflation. This way, cigarettes will not become cheaper, and government revenue will be sustained. As Pakistan enters a period of economic recovery, with inflation and real income growth projected to hold steady, maintaining tax increases

Simulated impact of cigarette taxation				
	Baseline 2025-26	Change in FED rate		
		No change	8.2% increase	21.1% increase
Total Consumption (million packs)	3,044	3,135	3,085	3,024
Change in cigarette consumption (million packs)		91	41	-21
Total Revenue (FED+GST)	319	336	353	380
Total Additional Revenue (Rs billion)		17	34	61
Percent change in revenue		5.3	10.8	19.3
Number of adult smokers (million)	16.19	16.61	16.48	16.32
Change in the number of adult smokers		411,989	282,040	123,211
Change in the number of adult smokers^a			-129,949	-288,778
Number of future smokers (million)	11.05	11.33	11.24	11.13
Change in the number of future smokers		281,144	192,466	84,080
Change in the number of future smokers^a			-88,678	-108,386
Change in smoking-attributable adult deaths^a			-109,313	-133,608

^a Relative to the No Change scenario

that exceed the combined effect of inflation and income growth will yield much more positive fiscal and public health effects.

- The government should raise the FED on economy brands at a faster rate than the premium brands to close the gap between the two tiers. This way, smokers are less likely to switch to cheaper brands when prices go up, and the government can increase its revenue.
- The government should raise the FED rate by at least 21.1 percent in the Finance Act 2026 to make up for inflation over the past two years. This move would bring in an extra Rs 61 billion, help discourage smoking, and save lives.

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SOCIAL POLICY AND DEVELOPMENT CENTRE

G-22, B/2, Park Lane Clifton Block 05, Karachi | +92 316 1113113; +92 21 3587 3405 | www.spdc.org.pk | spdc@spdc.org.pk