
Exploring selective taxation in Southeast Asia



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The Southeast Asia Public Policy Institute has prepared this discussion paper, “Exploring Selective Taxation in Southeast Asia,” to form the foundation for policy roundtables in four markets in Southeast Asia: the Philippines, Malaysia, Thailand and Vietnam.

Drawing on country case studies, these roundtables will explore the design and administration of selective taxes and consider how tax systems can better balance fiscal requirements and broader policy objectives. The discussions and outputs from the roundtables will help identify best practices and policy lessons for the design of selective tax systems in the region.

This interim publication is the discussion piece at the center of these roundtables.

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Executive Summary

Selective taxes, usually in the form of excise taxes, are a policy tool widely used in Southeast Asia. Excise taxes are increasingly presented as both a policy instrument for addressing negative externalities associated with certain products and as a fiscal instrument for generating government revenue. This discussion paper lays out the argument that these two objectives are fundamentally in tension, which has implications for tax design and policy development.

If an excise tax implemented with the objective of reducing consumption of a good is successful, it erodes its own revenue base, while a tax that is intended to produce stable revenue may be impacted by changes in consumer behavior, including those driven by the tax itself. Failure to distinguish between revenue generation and non-revenue policy objectives can lead to poorly designed taxes that achieve neither objective in a sustainable way.

Key findings:

- **Economic pressure limits consumer tax tolerance.** Excise taxes exist alongside a series of broad-based taxes amid inflationary pressure. The accumulation of both burdens reduces disposable income, weakens purchasing power, and erodes public support for tax policy. Repeated rate increases can create a perception of unfairness, potentially encouraging consumers to seek untaxed or illicit markets.
- **The tax base should be tied to the proposed source of harm.** Taxes tied to a proposed source of harm (e.g., sugar content, pure ethanol, or carbon emissions) target negative externalities more directly than price-based (ad valorem) taxes. They are also simpler to administer and treat similar products neutrally. Notably, the WHO and World Bank both favor specific excise taxes over ad valorem taxes for public health policy-focused excise tax design.
- **Excise in the form of ‘health taxes’ poorly targets problematic behavior.** Excise taxes apply the same tax rate to every unit of a product category sold, regardless of who buys it. In some cases, such as alcohol, a small share of heavy users is responsible for a disproportionate share of harmful consumption. Yet tax paid rises in proportion to consumption, while the potential for harm rises sharply with heavier use. In this scenario, moderate drinkers who impose little to no societal cost bear much of the tax burden, while it may have limited impact on heavy drinkers.
- **Behavior and substitution can nullify non-revenue policy objectives.** Taxes that are too narrowly designed (e.g. focusing on a single sub-category of products) risk shifting consumption toward untaxed, cheaper, or illicit products. This can exacerbate the risk of harm. Thailand’s sugar-sweetened beverage tax is an example. It prompted beverage manufacturers to reformulate, but sugar consumption remains well above WHO-recommended levels, and sugar-containing products remain outside the tax’s scope.
- **High tax rates can exacerbate illicit trade.** Increases in the prices of legal products may drive consumers to unregulated and illicit markets, increasingly via e-commerce and social commerce. Unrecorded products can account for up to half of all consumption of excisable products in some markets. In addition to increasing consumption from illicit markets, illicit products may have higher potency and are likely lower quality.
- **‘Earmarking’ of excise tax revenues requires careful policy design and strict oversight.** Some revenue from excise taxation is ‘earmarked’ to fund specific activities or institutions. Earmarking is most effective when it functions as a user fee or directly mitigates the harms associated with the taxed activity. In addition, without robust transparency, monitoring, and accountability, earmarked programs may be vulnerable to inefficiencies or misallocation. In the

Philippines' Sin Tax Reform, a key concern is that government programs could become reliant on revenues from products whose consumption the policy is designed to reduce. This challenge becomes more pronounced when revenues from a narrow, shrinking tax base are used to fund broad, loosely defined, or unrelated programs.

Guiding principles for policymakers:

1. Set excise tax rates at sustainable levels that do not incentivize illicit trade or substitution with illicit products, which would counter the intended policy objectives.
2. Target a tax base that best helps achieve policy outcomes, such as sugar, pure ethanol by weight/volume or carbon emissions, rather than price (ad valorem).
3. Limit earmarking to expenditure programs that are appropriately paired with the tax, and ensure a high level of transparency, accountability and monitoring.

This interim publication is intended to be the foundation for a series of regional discussions with policy experts on current and future selective tax policy.

Introduction

Certain products can generate external harms or benefits depending on how they are used. Examples include pollution associated with some industrial activities, impaired driving resulting from alcohol misuse, traffic congestion, and positive public health benefits such as herd immunity from vaccination.

Excise taxes on products associated with negative externalities may be used to support public programs aimed at addressing the resulting societal costs. They can serve multiple policy objectives, including raising revenue for governments and, in some specific cases such as tobacco, encouraging changes in consumption patterns that policymakers associate with improved outcomes. Indeed, because its harms accumulate with consumption, policy aims to reduce use overall. This dual role makes excise taxes an attractive tool for policymakers, who often present them as both a health and fiscal tool.

However, these objectives can be in tension with one another and are not equally applicable to all types of products that policymakers might subject to ‘health taxes’. This is especially true when an excise tax intends to create better public outcomes by reducing or eliminating the consumption of a product. This logically reduces the available revenue from such a tax toward zero, though this will heavily depend on all consumers reacting to price increases in a similar way.

In theory, a true ‘health tax’ seeks to reduce consumption of a product by increasing its price, with success measured by declines in use and associated harms. A fiscal tool, by contrast, is designed to generate stable and predictable government revenue, with success measured by the amount of tax revenue collected. However, revenue targets and the reduction of negative externalities – pollution, harmful drinking, etc. – are distinct outcomes.

A long-term conflict of goals is evident. If a health tax is highly effective at reducing consumption, its revenue base will shrink over time. Conversely, a tax that consistently generates large and growing revenues may indicate that consumption remains widespread. Failure to distinguish between public health goals and revenue-raising objectives can lead to tax rates and structures that are poorly aligned with either purpose, undermining both policy effectiveness and public trust.

Furthermore, consumer behavior is unpredictable. The introduction of increased excise tax may itself have negative externalities. This includes the production and consumption of illicit goods from unregulated markets, which carries consumer and public health risks. Also, the intention to spend excise revenue on programs to mitigate negative externalities requires complex consideration to achieve meaningful results.

Health taxes have been implemented or discussed in a number of markets around Southeast Asia and applied to a range of consumer products including tobacco, alcohol and food and beverages containing sugar. The implementation of this form of taxation varies greatly across the region.

This interim discussion paper explores the theory behind selective taxation, and its use in Southeast Asia. It is intended to lay the foundation for discussion and scrutiny of current and future taxation policy.

Part I: Principles of Selective Tax Design

Part I sets out the principles that determine how selective taxes perform. Section 1 examines tax design: how the tax base is defined and how rates are set. Section 2 looks at how excise revenue is used, including the case for and against earmarking. Section 3 assesses outcomes, covering substitution, targeting, illicit trade and the limits of consumer tax tolerance. These principles form the framework for the country case studies in Part II.

1. Considering Tax Design

Excise taxes, like all policy instruments, carry unavoidable trade-offs. While a central purpose of taxation is to raise revenue, the effects of different tax bases vary considerably. Broad-based taxes on income or consumption tend to discourage productive activity, reducing work effort, output, and, ultimately, overall well-being.

By contrast, excise taxes are often applied to goods associated with negative externalities, depending on how they are used. In these cases, a decline in harmful consumption may yield social benefits rather than losses. However, when excise taxes are poorly structured, they can arbitrarily burden certain consumers, especially when harm is non-linear, or distort behavior in unintended ways, including discouraging shifts toward less harmful alternatives and moving economic activity toward illicit markets.

Ultimately, excise tax policy should aim to enhance societal well-being. Although the theoretical principles behind sound excise taxation are relatively straightforward, real-world constraints—such as limited information, administrative complexity, and criminality—make perfect implementation difficult. Even so, adherence to a set of guiding principles can help policymakers craft systems that reliably generate revenue while mitigating harm.

Defining the tax base

A foundational step in designing any tax is determining what activity or value will be subject to it—the tax base. This encompasses the total pool of income, assets, transactions, or consumption to which the tax applies.

When excise taxes function as user fees, the base should closely approximate actual usage. For example, fuel consumption serves as a practical stand-in for road use, since drivers who purchase more fuel tend to drive more. Alternative approaches, such as a vehicle miles traveled (VMT) system, may ultimately offer a more precise measure, though they raise legitimate concerns, including privacy. Even so, taxing fuel remains a more accurate proxy for road usage than flat vehicle registration fees which, if they were to raise anywhere near the same amount of revenue, would likely benefit frequent drivers and penalize infrequent drivers.

For excise taxes intended to address negative externalities, the base should be tied as directly as possible to the source of the harm. Doing so enables individuals and businesses to factor those external costs into their decisions. A tax on carbon emissions, for instance, embeds the environmental cost of pollution into energy production and consumption choices.

Taxes based on physical quantities—such as weight, volume, or units consumed—often align more closely with policy objectives than price-based (*ad valorem*) taxes. Gallons of fuel consumed provide a clearer signal of road wear and emissions than the price paid per gallon, just as the number of cigarettes smoked or drinks consumed more directly reflects potential harm than

retail prices. The ingredients or production processes of the product have no relation to the negative externalities associated with them. These quantity-based approaches also tend to be easier to administer, particularly in industries with vertically integrated structures where market prices may not be readily observable.

An effective tax base should also exclude activities or products that do not generate the targeted harm. For example, if the policy goal is to price carbon emissions, only emission-producing energy sources should be taxed, while non-emitting sources (such as renewables or electric vehicles) should remain outside the base. Clarity on this distinction is essential to ensure that excise taxes improve, rather than distort, market outcomes.

Directly taxing the source of harm also promotes neutrality by avoiding favoritism across similar products. Historical examples of differential tax treatment—such as lower rates for certain domestically produced alcohol—illustrate how poorly targeted bases can introduce bias. A more neutral framework would instead apply taxes uniformly based on measurable characteristics like alcohol content.

Finally, precise and consistent definitions are critical for implementation. Ambiguities in statutory language can lead to unintended disparities in how products are treated. In some cases, poorly drafted definitions have resulted in taxes applying only to bundled products while functionally identical standalone components escape taxation. Such inconsistencies highlight the importance of clearly defining the tax base to ensure equitable and effective policy.

Determining the tax rate

Once the tax base is established, policymakers must determine the appropriate rate. Ideally, excise tax rates should reflect the external costs associated with the taxed activity. Because these costs are difficult to measure at the individual level, policymakers typically rely on average estimates. As these estimates differ across categories of excisable goods, such as fuel and alcohol, rates should differ accordingly; within each category, however, they should apply uniformly to the relevant measurable characteristic, such as alcohol content, rather than vary by product type.

Linking consumption and cost

In some areas, these estimates are relatively accessible. For instance, the costs associated with road construction and maintenance are well documented, making it easier to approximate the social cost of driving. Even here, however, proxies like fuel consumption cannot fully capture all relevant factors, such as vehicle weight or road impact.

In other cases, the relationship between consumption and social cost is less straightforward. Moderate consumption of certain goods—like occasional alcohol use—may impose little to no societal cost, while excessive use can generate significant harm. Uniform excise rates based on averages would therefore overburden low-risk consumers, though heavier users will still face higher total tax payments due to greater consumption.

The structure of the tax also affects how it evolves over time. Value-based taxes naturally rise with inflation, as higher prices lead to higher tax collections. Quantity-based taxes lack this built-in adjustment and may need to be indexed to inflation—particularly when the associated social costs increase over time. However, if underlying harms decline due to technological or behavioral changes, there may be a case for reducing rates rather than increasing them.

Substitution effects

Setting appropriate rates also requires attention to market dynamics. In industries where legal products compete with illicit alternatives, excessive taxation can drive consumers toward unregulated markets and increase the incentive to produce and smuggle illicit products, undermining both revenue and policy goals.

Substitution with legal alternatives is another key consideration. Taxes that apply narrowly to specific products may simply shift consumption toward untaxed or less-taxed alternatives, limiting their effectiveness.

For example, taxes on sugar-sweetened beverages may reduce soda consumption without lowering overall calorie intake if consumers substitute with other high-calorie drinks or snacks. Similar patterns can emerge under outright bans of certain products.

Considering alcoholic beverages, increased taxation, especially price-based (*ad valorem*), can result in shifting consumption to lower-cost alternatives rather than reducing overall consumption. This would have no impact on overall consumption rates or public health policy pull-through. Conversely, fixed-rate taxes may disincentivize lower-quality purchases and shift the market toward higher-quality products.

Localizing approaches

Tax rates must also be calibrated to local economic and social contexts. A perfectly calibrated rate in one country will likely be a poorly calibrated rate for another country whose economic conditions and social norms are different. The World Health Organization summarizes this by saying, “There is no single optimal level of [...] taxes that applies to all countries because of differences in tax systems, in geographical and economic circumstances, and in national public health and fiscal objectives.”¹

The International Monetary Fund (IMF) echoes the position that tax increases are never a single solution (especially in emerging markets), but a comprehensive process that requires very thorough preparation by the government “to account for regional market dynamics. Large tax differences across borders can motivate consumers to seek out cheaper options next door, reducing both health impact and revenue.”²

Finally, excise taxes should be evaluated within the broader tax system. They are typically layered on top of general taxes on income, sales, and property. Because excise taxes apply to relatively narrow bases, they are not well suited to funding large portions of government spending. Moreover, excessively high excise burdens can have broader economic consequences, including reduced investment, slower job growth, and downward pressure on wages.

¹ WHO Framework Convention on Tobacco Control. (2017). *Guidelines for implementation of Article 6: Price and tax measures to reduce the demand for tobacco*. World Health Organization. <https://fctc.who.int/resources/publications/m/item/price-and-tax-measures-to-reduce-the-demand-for-tobacco>

² van Oordt, M., & Rosenberg, C. B. (2026, March). Taxing harmful habits. *Finance & Development*. International Monetary Fund. <https://www.imf.org/en/publications/fandd/issues/2026/03/taxing-harmful-habits-christoph-rosenberg>

2. Revenue

Revenue from excise taxes can be used in several different manners, some more effective than others. The best use for excise tax revenues depends on the reason the excise tax is levied in the first place. Using excise taxes as user fees to public services and to mitigate harm from negative externalities aligns the tax function with the expenditures. Other times excise tax revenues are completely disconnected from the spending of those funds.

The fraction of revenue dedicated or “earmarked” to an expenditure category varies widely by tax type and jurisdiction. In Europe, many environmental taxes are earmarked for environmental expenditures.

Globally, the World Bank reports that at least 80 countries earmark some portion of their revenue to health spending.³ The most common earmarks are income or payroll taxes to fund health care or pensions. The next most popular sources of earmarks are revenues from tobacco, alcohol, and specific foodstuffs or products.

Earmarking excise tax revenue is a common practice, but the efficiency of tying a revenue source to an expenditure program depends on the revenue source, the spending program, and why the excise tax was implemented in the first place. In addition, without robust transparency, monitoring, and accountability mechanisms, earmarked programs may be vulnerable to inefficiencies, misallocation of resources, or misuse of funds.

We outline three cases of earmarking below:

a. User Fees and Public Signaling

Earmarking is most logical when an excise tax functions as a user fee. In these cases, the connection between the taxed activity and the expenditure is clear and intuitive. As mentioned above, motor fuel taxes dedicated to road construction and maintenance are a classic example. Drivers who use public roads contribute toward the costs of building and maintaining that infrastructure, creating a direct relationship between payment and benefit received. Similar arrangements can be found in taxes that fund airport improvements, environmental cleanup programs, or regulatory oversight of specific industries.

Dedicated funding can also serve an important signaling function. Taxpayers are often more willing to accept a tax when they can clearly identify how the revenue will be used. Earmarking can therefore improve transparency and accountability by demonstrating that revenues are being directed toward a specific purpose rather than simply absorbed into a government's general fund.

Public transport (subways) and national park entrance fees both signal the amount of public usage and provide funds to maintain those services. Higher usage signals can suggest demand for more services. While earmarking does not guarantee efficient spending, it can strengthen public support for a tax and improve understanding of the policy rationale behind it.

b. Externality Alleviation

A second justification for earmarking excise tax revenue is to fund programs that directly reduce or mitigate the external costs associated with the taxed activity. When an excise tax is imposed to internalize social costs, dedicating revenue to addressing those costs can reinforce the policy's underlying objective. Examples include using tobacco and alcohol tax revenue to fund

³ Cashin, C., Sparkes, S., & Bloom, D. (2017). *Earmarking for health: From theory to practice* (Health Financing Working Paper No. 5) [Metadata]. World Health Organization. <https://iris.who.int/handle/10665/255004>

addiction treatment and public education programs; directing carbon tax revenue toward environmental remediation or pollution reduction efforts; or using taxes on gambling activities to support problem gambling services.

Unlike user fees, where the relationship between payment and benefit is direct, externality-alleviation spending seeks to reduce the broader societal harms associated with a taxed product or activity. In some cases, these expenditures may even reduce the need for future government spending by preventing costly social outcomes before they occur.

c. Unconnected Programs

The weakest justification for earmarking excise tax revenue is directing it toward expenditures that bear little or no relationship to either the taxed activity or the external costs used to justify the tax. While dedicating revenue to popular programs can help build political support for tax increases, doing so often undermines sound public finance principles and obscures the true purpose of the tax.

When revenues from tobacco, alcohol, sugar-sweetened beverages, or environmental taxes are diverted to unrelated spending programs, the tax increasingly resembles a general revenue measure rather than a targeted corrective tax. This can create confusion about the policy's objective. If a tax is justified as a public health intervention but the revenue is ultimately used to fund unrelated infrastructure projects, government payrolls, or general budget expenditures, taxpayers may reasonably question whether the primary goal is improving health or simply raising revenue.

A further challenge is that earmarking unrelated expenditures creates a dependency between a narrow and potentially declining tax base and a spending program that may require stable long-term funding. If the tax successfully reduces consumption—as policymakers often claim to desire—the revenue stream will shrink over time. This creates pressure either to increase tax rates, broaden the tax base, or seek alternative funding sources. In effect, the government can become financially dependent on the continued consumption of the very product it is attempting to discourage.

In the Philippines, tobacco and alcohol taxes have been used to finance broad health-care initiatives through the Sin Tax Reform Law. While expanding health coverage is a worthwhile policy goal, the connection between tobacco consumption and general healthcare financing is less direct than funding smoking cessation programs or disease prevention efforts. As health expenditures continue to grow, policymakers face the challenge of relying on a revenue source that public health policy seeks to reduce.

Similar dynamics have emerged elsewhere in the Southeast Asia region, where excise taxes have become important sources of general government revenue and funding for social programs that are only indirectly connected to the taxed products.

For these reasons, policymakers should be cautious when linking excise taxes to unrelated expenditures. The most effective earmarks are those that either function as user fees or directly mitigate the harms associated with the taxed activity. Beyond those cases, the benefits of earmarking become less clear, and the risks of fiscal distortion, reduced transparency, and conflicting policy objectives become more pronounced.

Assessing the use of earmarked revenue in Southeast Asia

The Philippines illustrates how difficult it can be to convert a statutory earmark into the spending it promises. Under the Sin Tax Reform Act of 2012 and its 2020 amendment, the bulk of alcohol and tobacco excise revenue was allocated to health spending, covering premium subsidies for low-income families under PhilHealth provided by the Universal Health Care Act and upgrades to public health facilities. Despite the allocation on paper, designated funds must still pass through the annual General Appropriations Act, and actual cash releases to recipient organizations depend on their demonstrated absorptive capacity.

Limited absorptive capacity has compounded the problem. PhilHealth, for instance, has persistently underspent on member benefits.⁴ Citing this underutilization, the Department of Finance ordered PhilHealth in 2024 to remit PHP 89.9 billion in ‘excess’ reserves to the National Treasury, and Congress subsequently zeroed out PhilHealth’s 2025 national government subsidy altogether. In December 2025, however, the Supreme Court declared the transfer void as contrary to the Universal Health Care Act and the sin tax laws, and ordered the PHP 60 billion already remitted to be returned to PhilHealth through the 2026 budget.⁵ The fiscal and administrative constraints surrounding its deployment have allowed the revenues to flow toward outcomes that bear an increasingly indirect relationship to the harm the tax was designed to address.

Thailand’s earmarking model, introduced with ThaiHealth in 2001 to give health promotion a degree of independence from the annual budget,⁶ has since drawn criticism over transparency and whether funds are used in line with the organizations’ core mandates.⁷ Thailand is now considering the removal of earmarked funding from alcohol and tobacco taxes. With a deficit of 3.9 percent of GDP and public debt projected at 69.36 percent of GDP against a 70 percent ceiling,⁸ Thailand held a public consultation from 30 September to 14 October 2026 on four draft amendments that would eliminate earmarked funding for Thai PBS, ThaiHealth, the Elderly Fund and the National Sports Development Fund. The bills argue that dedicated “sin tax” funding is inconsistent with the State Fiscal and Financial Disciplines Act, and that revenues should be managed through the normal government budget process.⁹

⁴ ABS-CBN News. (2024, December 5). COA: PhilHealth’s P89.9-B unutilized funds could have been used to expand benefits. <https://abs-cbn.com/news/nation/2024/12/5/coa-philhealth-s-p89-9-b-unutilized-funds-could-have-been-used-to-expand-benefits-1446>

⁵ DZRH News. (2025, December 5). SC orders return of P60 billion PhilHealth funds, upholds Universal Health Care law. <https://www.dzrh.com.ph/post/sc-orders-return-of-p60-billion-philhealth-funds-upholds-universal-health-care-law>

⁶ Pongutta, S., Suphanchaimat, R., Patcharanarumol, W., & Tangcharoensathien, V. (2019). Lessons from the Thai Health Promotion Foundation. *Bulletin of the World Health Organization*, 97(3), 213–220. <https://doi.org/10.2471/BLT.18.220277>

⁷ The Nation. (2015, October 12). Portion of funds cut over ‘irregularities’. <https://www.nationthailand.com/in-focus/30270676>

⁸ The Nation. (2026, April 23). GDP outlook cut as Thailand sets 3.78tn baht budget, debt nears ceiling. <https://www.nationthailand.com/news/policy/40065367>

⁹ The Nation. (2026, October 2). Bhumjaithai proposes four bills to redirect alcohol and tobacco taxes. <https://www.nationthailand.com/news/politics/40071799>

3. Outcomes and Impacts

Basic economics suggests that taxes on targeted products increase prices and result in less consumption. Does that mean these taxes automatically improve public health? Unfortunately, no. Even the best selective taxes face limitations when it comes to improving public health and other sought-after outcomes.

Behavior and substitution can nullify potential health effects

Taxes aimed at changing behavior can reduce consumption of specific products, but their broader health effects are often limited by substitution. When consumers cut back on a taxed good, they frequently replace it with other untaxed or less-taxed alternatives, leaving overall outcomes largely unchanged. Beverage taxes provide a clear example of this dynamic.

Research on sugar-sweetened beverage taxes generally finds that, while these policies do reduce purchases of the targeted drinks, they have not produced meaningful changes in obesity rates or average body weight.¹⁰ Without corresponding shifts in overall diet, physical activity, or lifestyle, the reduction in one category of consumption does not translate into improved population health.

This pattern underscores the importance of tax base design. Narrowly targeted taxes can distort choices without reducing total intake of the underlying harmful component. Just as uneven alcohol taxes can push consumers toward lower-taxed options, beverage-specific taxes encourage substitution into other sources of sugar or calories. A broader approach—such as taxing added sugar across all products—would more directly address total consumption and likely have a more pronounced effect on health outcomes.

Health taxes often poorly target problematic behavior

Taxes on products tied to health risks often miss the behaviors that generate the greatest harm. While they can nudge prices upward and slightly reduce consumption, they do little to address the root causes of addiction or the most serious consequences associated with misuse. In the case of alcohol, for instance, higher taxes may raise the cost of drinking but are unlikely to meaningfully curb alcoholism or prevent impaired driving on their own.

Another limitation is how broadly these taxes are applied. Everyone who consumes the product pays the tax, even though the risks are not evenly distributed across users. A relatively small share of heavy consumers accounts for a disproportionate amount of harmful alcohol consumption, while moderate users are far less likely to impose significant social costs. Because the potential for harm rises sharply with increased use, a uniform tax ends up placing much of the burden on individuals whose behavior is comparatively low-risk, while doing little to change the behavior of those most associated with negative outcomes.

a. Taxes Can Exacerbate Illicit Trade

Increasing tax levels and differentials make smuggling a lucrative criminal enterprise and create problems for many national governments. Higher tax rates incentivize smuggling.¹¹ As tax rates increase, consumers and suppliers search for ways around

¹⁰ Hoffer, A., & Macumber-Rosin, J. (2025, March 27). *Soda taxes won't fix global health*. Tax Foundation. <https://taxfoundation.org/research/all/global/sugar-tax-soda-tax-ssb/>

¹¹ Hoffer, A., & Macumber-Rosin, J. (2025, September 10). *Poor tax policy is worsening cigarette smuggling in the EU*. Tax Foundation. <https://taxfoundation.org/blog/eu-cigarette-smuggling-illicit-trade/>

these costs. Consumers tend to shop across borders where the tax rates are lower, and illicit market entrepreneurs develop black and gray markets to sell illegally to consumers, paying little or no tax at all.

Illicit trade undermines many of the objectives of excise taxation. Governments lose revenue when products are sold outside the tax system. Public health goals may also be weakened because illicit products are often sold without age restrictions, quality controls, or regulatory oversight. Consumers who purchase products in illicit markets are generally less responsive to future tax increases, reducing the effectiveness of excise taxes as a behavioral tool.

Southeast Asia provides several examples of these challenges. Up to 57 percent of total alcohol consumed in Vietnam is from unrecorded sources (illicit, smuggled, homebrewed), 56 percent in Indonesia, 43 percent in Cambodia and 39 percent in Malaysia.¹² Such large informal markets significantly limit the ability of excise taxes and regulations to influence consumer behavior. Instead of reducing harmful consumption, high taxes and weak enforcement can simply shift purchases into untaxed and unregulated channels.

Also, e-commerce and social commerce create viable channels that enable consumers to access illicit goods. Regulations are still evolving, but the sale of illicit goods and counterfeit products on online platforms is often missed by policymakers. As such, tax policy must also acknowledge that restricting access to legitimate products through increased taxation not only shifts purchases into untaxed and unregulated channels, but that these channels are: (a) increasingly more accessible to consumers through online channels; and (b) regulation for e-commerce and social commerce has not matured to a point where enforcement can capture and restrict illicit trade.

Importantly, the existence of illicit trade does not imply that excise taxes should be abandoned. Rather, it highlights the importance of balancing tax rates with enforcement capabilities, consumer demand, and regional market conditions. Excessive tax increases may generate diminishing returns if they accelerate the migration of consumers into illicit markets. Well-designed excise tax systems should therefore account for the risks of tax avoidance and smuggling, recognizing that the effectiveness of a tax depends not only on the statutory rate but also on the share of the market that remains within the legal system.

b. Higher Prices Can Incentivize More Problematic Behavior

Fixed-rate taxes can disincentivize lower-quality purchases and shift consumers toward higher-quality products, without necessarily impacting overall consumption or delivering the public health or environmental goals intended. Prohibitionist policies may produce similar shifts in consumer behavior to fixed-rate taxes, while unintentionally incentivizing changes in the products supplied through illicit markets.

The OECD report on illicit trade in high-risk sectors provides a useful explanation for this price-gap dynamic. At the core of this dynamic is the price differential between legal and illicit alcohol, which can increase incentives for illicit trade, particularly in markets where consumers are highly price-sensitive and established informal supply channels allow illicit products to reach them. Because taxes and tariffs contribute to the final price of legitimate products, sharp increases in the tax burden can widen this differential, strengthening both consumer demand for cheaper illicit alternatives and the potential margins available to illicit suppliers. This risk is particularly relevant where enforcement is weak or illicit distribution channels are already well established, highlighting the importance of accompanying tax policy with effective enforcement and measures that limit illicit market access.¹³

¹² WHO data compiled and referenced in Asia Pacific International Spirits and Wines Alliance, Alliance Against Counterfeit Spirits, EU-ASEAN Business Council, & Transnational Alliance to Combat Illicit Trade. (2023). *Towards an ASEAN community: Tackling illicit alcohol in Southeast Asia*. https://www.tracit.org/uploads/1/0/2/2/102238034/apiswa_illicit_alcohol_in_asean_report_2023_final.pdf

¹³ OECD. (2022). *Illicit Trade in High-Risk Sectors: Implications of Illicit Alcohol for Public Health and Criminal Networks*. OECD Publishing. <https://doi.org/10.1787/1334c634-en>

The academic research provides examples across many products. Per-unit gasoline taxes tend to lead to more consumption¹⁴ of premium-grade gasoline and proportionately less consumption of regular-grade gasoline. The market share of high-quality wine increases in response to unit taxes on wine, while *ad valorem* taxes have no significant effects.¹⁵ Beer drinkers move toward more premium beverages when fixed taxes and beer transportation costs increase.¹⁶ Illicit vaping products tend to be larger and contain more nicotine as consumers substitute in response to taxes on tobacco products.¹⁷ Considering consumer substitution in the face of tax and regulatory changes is important, particularly when excise taxes are intended to improve health.

Prohibitionist policies may work through a different mechanism from fixed-rate taxes. Rather than directly changing consumer choices through prices, they can create incentives for producers to alter the products they supply, which in turn affects consumers. This dynamic can be particularly pronounced in illicit markets, where production, transportation, and distribution carry high fixed costs and risks. To improve profitability and reduce the volume that must be smuggled, illicit producers may therefore have an incentive to concentrate more alcohol into smaller quantities.

During American alcohol prohibition, alcohol potency increased substantially.¹⁸ Illicit producers switched toward producing very high concentration spirits, prominently “moonshine,” that they sold to consumers. Illicit markets today are no different: highly concentrated products are ubiquitous.

c. Poorly targeted taxes can incentivize consumption of lower cost beverages

Conversely, the design of a tax can also incentivize the consumption of lower cost products. *Ad valorem*-based taxes, calculated as a percentage of the product’s value, make more expensive (and often higher quality) products relatively more expensive than lower cost products. From a public health standpoint, the cost or even relative quality of the product has minimal bearing. Hence, taxes should target the active substance, in the case of alcoholic beverages, the ethanol content, which can be done through specific excise taxes.

Notably, with regard to public health-focused taxes, both the World Bank and the World Health Organization support the use of specific excise taxes over *ad valorem* taxes for the taxation of alcoholic beverages. The WHO Technical Manual on Alcohol Tax Policy and Administration (2023)¹⁹ notes that specific excise taxes based on alcohol content (uniform taxes calculated on the volume of ethanol or pure alcohol in a beverage) have distinct advantages for public health. These taxes directly target the active component (ethanol), ensuring that beverages with higher alcohol content bear more tax. Applied at a single rate per unit of alcohol across beverage categories, such taxes also avoid distorting consumer choice between them. The manual concludes that, from a public health perspective, alcohol content-based specific taxes may be the most effective method to minimize the impact of harmful alcohol consumption.

The World Bank’s Health Taxes in Public Finance Reviews²⁰ supports this, writing that specific excise taxes are superior to *ad valorem* taxes as they more effectively target negative externalities and internalities, and, when levied as a fixed amount per unit, specific excises offer simpler administration and lower risk of tax avoidance. They are also more effective for public health,

¹⁴ Nesbit, T. M. (2007). Excise taxation and product quality: The gasoline market. *Economic Issues*, 12(2), 19–33. <https://ideas.repec.org/a/eis/article/207nesbit.html>

¹⁵ Ljunge, M. (2011). Do taxes produce better wine? *Journal of Agricultural & Food Industrial Organization*, 9(1), Article 12. <https://doi.org/10.2202/1542-0485.1359>

¹⁶ Rojas, C., & Shi, T. (2011). Tax incidence when quality matters: Evidence from the beer market. *Journal of Agricultural & Food Industrial Organization*, 9(1), 1–35. <https://doi.org/10.2202/1542-0485.1353>

¹⁷ Hoffer, A., & Macumber-Rosin, J. (2024, July 26). *Current vaping market challenges*. Tax Foundation. <https://taxfoundation.org/blog/vaping-market-challenges/>

¹⁸ Thornton, M. (1991). *The economics of prohibition*. University of Utah Press. https://cdn.mises.org/economics_of_prohibition_3.pdf

¹⁹ World Health Organization. (2023). *WHO technical manual on alcohol tax policy and administration*. <https://www.who.int/publications/i/item/9789240082793>

²⁰ World Bank. (2025). *PFR fundamentals series: How-to note - Health taxes in public finance reviews* (Report No. P506801) [Metadata]. <https://documents.worldbank.org/en/publication/documents-reports/documentdetail/099062325190093634/p506801-109763f9-2a10-4c37-aab8-ce0f3872e079>

as they raise prices uniformly and limit switching to cheaper alternatives. In addition, specific taxes generate larger, more stable tax increases relative to ad valorem taxes.

Economic Pressures and Consumer Tax Tolerance

Policymakers would do well to consider the aggregate pressure on taxpayers from increasing rates of taxation and broader economic headwinds. Excise taxes do not exist in isolation; they are imposed alongside other broad-based taxes and a range of other government levies.

At the same time, households across the globe continue to face inflationary pressures and market disruptors. Regional conflicts, fuel price volatility, and trade wars put upward pressure on prices and increase uncertainty. The cumulative effect of multiple tax burdens and inflation reduces disposable income, weakens consumer purchasing power, and erodes public support for tax policy.

This consideration is particularly relevant for excise taxes on consumer goods, where repeated rate increases can create perceptions of unfairness and encourage consumers to seek untaxed or illicit alternatives. At best, the increase in taxes has a limited impact on overall consumption as consumers may substitute with higher-quality or higher-strength alternatives in the case of poorly targeted fixed-rate taxes or with lower-cost and lower-quality alternatives in the case of poorly targeted ad valorem taxes. In both cases there would be limited pull-through for environmental, public health, or other intended policy objectives.

Sustainable tax policy requires balancing revenue and public health objectives against taxpayers' ability and willingness to absorb additional costs, especially during periods of economic uncertainty. With so many issues involved, designing the best possible tax can be challenging. Based on the above considerations, we have simplified three guiding principles for excise tax design best practices:

1. Set excise tax rates at a sustainable level to avoid incentivizing the creation of illicit markets or incentivizing consumers to substitute with illicit alternative products
2. Target a tax base that best helps achieve policy outcomes e.g. taxing specific substances such as sugar, pure ethanol by weight or volume, or carbon emissions, rather than price
3. Limit earmarking tax revenues to those with most appropriately paired expenditure programs

Part II: Selective Taxation in Asia

Selective taxation is a dynamic topic, with various approaches being implemented throughout Southeast Asia. Recent reforms and current policy proposals will have considerable impact on both the policy landscape and the marketplace for products being taxed.

Excise taxes, or selective taxes, are levied across all Southeast Asian countries, although their scope and structure vary considerably. The main excise categories across Southeast Asia typically include beer, wine, distilled spirits, cigarettes, and passenger vehicles, all of which are subject to excise tax in every country. Some countries also extend excise taxation to luxury goods, environmentally harmful products, gambling, and entertainment activities. The rationale behind these taxes usually combines revenue generation, public health deterrence, and, in some cases, environmental or social objectives.

Tax rates differ substantially across countries and product categories, generally ranging from 5 percent to over 200 percent ad valorem, or value-based, rates. Some countries also apply *ad quantum* or specific quantity-based levies. Among them, the Philippines and Thailand use a combination of specific and ad valorem rates, while others rely mainly on either specific rates or ad valorem rates.

In terms of earmarked taxation and the extension of selective taxes beyond traditional categories, Southeast Asia includes several countries that use earmarking. Vietnam and Lao PDR apply earmarking to tobacco products, Thailand applies it to tobacco and alcohol, and the Philippines applies earmarking to a range of products including alcohol and tobacco. These countries use revenue from taxes imposed on specific products to support or fund health promotion activities, health-related programs, and in some cases broadcasting, anti-smuggling, and agriculture support.

Beyond alcohol and tobacco, many countries also impose excise taxes on consumable products that affect public health. A clear example is the taxation of Sugar-Sweetened Beverages (SSBs) across the region. At least eight countries, including Brunei, Cambodia, Lao PDR, Malaysia, the Philippines, Thailand, Timor-Leste, and Vietnam, have adopted this approach. This reflects a more active role by Southeast Asian governments in using taxation as a policy tool to try to address health-related issues.

A framework for further discussion

As this paper has outlined, excise taxes can be structured with the intent to improve public health outcomes and generate revenue for governments, but there is an inherent tension between these two objectives. Public health policies should be assessed by their ability to reduce harmful consumption and related harms, while fiscal policies should be assessed by their ability to raise revenue efficiently and predictably.

Failure to distinguish between public health and revenue generation objectives can lead to poorly designed taxes that achieve neither objective in a sustainable way.

There are several key negative outcomes resulting from tax design choices:

1. **Illicit trade:** excise taxes can create illicit markets (smuggled or illegally produced goods) as consumers seek lower cost alternatives to highly taxed products.
2. **Consumer behavior:** taxes can create distortions in consumer behavior e.g. altering consumption patterns toward products that are taxed lower but are associated with the same negative externalities. This may happen especially with ad valorem taxes where taxes are calculated as a percentage of the product's value.

3. Use of tax revenue: tax revenue collected is not used effectively or used as intended. This may be the case for some earmarked taxation based on excise tax collection.

This paper is intended as the basis for a series of discussions with policy experts around the region. The following section provides case studies from around the Southeast Asia region, and Japan, exploring the different ways in which excise regimes are applied and raising some initial themes for consideration.

Case studies: Exploring Selective Tax Regimes in Asia

Malaysia's excise tax – considerations for illicit markets

Tax name	:	Excise Duty
Product applies to	:	Alcoholic beverage, tobacco & vape, motor vehicle, mahjong tiles, playing cards, sugar-sweetened beverages (SSB)

Malaysia imposes excise duty under the Excise Act 1976 on goods listed in the applicable Excise Duties Order when they are manufactured in Malaysia or imported. For alcohol, all alcoholic beverages are subject to excise duty, with rates differentiated by product category and generally expressed per liter at 100 percent alcohol by volume. Under the Excise Act 1976, the country applies rates ranging from RM 60 to RM 175 per liter of pure alcohol for products such as beer and spirits, or flat volume-based rates ranging from RM 175 to RM 450 per decaliter for products such as wine, depending on the beverage category.

Under Budget 2026 (considered in 2025), Prime Minister Anwar Ibrahim announced a 10 percent increase in excise duty on all alcoholic beverages, effective November 1, 2025, under the Excise Duties Order 2025. For example, the excise duty on beer increased from RM 175 to RM 192.50 per liter of pure alcohol.

A point for consideration is how further increases in an already high tax burden may affect the legal market, particularly where illicit alternatives are readily available. A further widening of the price gap between legal and illicit products may raise concerns about how excise increases interact with illicit-market conditions and, in turn, affect public health and revenue objectives.

Vietnam's special consumption tax – considerations for unrecorded alcohol

Tax name	:	Special Consumption Tax (SCT)
Product applies to	:	Alcoholic beverages, tobacco products, sugar-sweetened beverages, gasoline, luxury & non-essential goods, entertainment services, etc.

Under Vietnam's Law on Special Consumption Tax, organizations and individuals that manufacture, process, or import taxable goods, or provide taxable services, are liable for SCT. The most recent reform came through an amendment to the Law on Special Consumption Tax, or Law on Excise Tax No. 66/2025/QH15, which has been effective since January 1, 2026.

This reform also introduced a phased increase in excise tax on alcohol. Beverages below 20 percent ABV face an ad valorem rate of 35 percent through the end of 2026, rising by 5 percentage points annually until reaching 60 percent in 2031. Beverages above 20 percent ABV follow the same trajectory but from a higher starting point, beginning at 65 percent and climbing to 90 percent

by 2031. The stated aim of this escalation is to align Vietnam’s excise burden more closely with World Health Organization recommendations.

A point for consideration is how this phased tax increase may affect a market where unrecorded alcohol already represents a substantial share of consumption. As widening price differences between recorded and unrecorded products may influence consumer behavior, particularly among price-sensitive drinkers, some consumers may shift toward illicit channels, including homemade alcohol known locally as *rượu nấu* or *rượu đế*. Substitution between taxed and unrecorded products may need to be monitored closely.

Thailand’s ‘sin tax’ – considerations for earmarked revenue and policy alignment

Tax name	:	Excise tax levied on goods and services deemed harmful to health and society (a.k.a. Sin Tax)
Product applies to	:	Tobacco, alcoholic beverages, gambling, etc.

Thailand’s modern excise framework is consolidated under the Excise Tax Act B.E. 2560 (2017), under which manufacturers and importers are liable for excise tax. For alcohol specifically, the current tax structure is set out under Ministerial Regulation No. 39 B.E. 2567 (2024). Alcoholic beverages are subject to a two-tier excise structure comprising an ad valorem rate based on retail value and a specific rate based on alcohol volume. The applicable rates vary across beverage categories.

Beyond the base excise tax, two additional surcharges apply. A municipal tax of 10 percent of the excise tax supports local administration, while a further 7.5 percent surcharge, commonly referred to as the sin tax, is distributed among four beneficiaries: the Thai Health Promotion Foundation (2 percent), the National Sports Development Fund (2 percent), the Elderly Fund (2 percent), and Thai Public Broadcasting Service (1.5 percent). This structure of taxes and surcharges forms part of Thailand’s broader “sin tax” framework, under which revenues from targeted products are earmarked to support a wider health and social development ecosystem.

Under the current structure, local white liquor, or *Lao Khao*, is taxed at a low ad valorem rate of 2 percent and a specific rate of 155 baht per liter of pure alcohol. Other domestic spirits and imported spirits, by contrast, face a 20 percent ad valorem rate and a specific rate of 255 baht per liter of pure alcohol. In addition, imports face a 60 percent import tariff. When import duties, excise taxes, value-added tax of 7 percent, and local surcharges are combined, the total tax burden on many imported spirits can approach 400 percent of the CIF value.

Two related questions may be considered in the Thai case. First, consideration could be given to whether the current earmarking of revenues for health-promotion activities is generating the intended outputs and population-health outcomes consistent with the objectives of the tax. Second, the structure raises a broader policy question as to whether differences in tax treatment across alcoholic beverage categories are sufficiently aligned with the underlying health externalities being targeted.

Thailand's sugar-sweetened beverage tax – considerations for substitution

Tax name	:	Excise tax levied on sugar-sweetened beverages (a.k.a. Sugar tax)
Product applies to	:	Sugar-sweetened beverages

Thailand's sugar tax is a specific, sugar-content-based component of the excise tax on covered beverages. Introduced in 2017, it was phased in to allow manufacturers time to reformulate their products, beginning in 2019, with the final phase fully implemented in April 2025. The current sugar-content charge is zero for beverages containing 6 grams or less of sugar per 100 ml, THB 1 per liter for those containing more than 6 to 8 grams, THB 3 for more than 8 to 10 grams, and THB 5 for more than 10 grams. This charge applies alongside the relevant value-based beverage excise tax.

Following implementation, ThaiHealth reported that average daily sugar consumption declined from 27 teaspoons per person in 2017 to 23 teaspoons in 2021, while sales of lower-sugar alternatives increased by 35 percent over the same period.

Despite this improvement in consumer behavior, average sugar consumption remained substantially above the WHO-recommended level of 6 teaspoons per day. Considered alongside manufacturers' reformulation of beverage products, this raises the question of whether the tax is fully achieving its objective of reducing overall sugar consumption, particularly as consumers may continue to have access to other sugary products that fall outside the scope of the tax.

Philippines' excise tax – considerations for earmarked revenue

Tax name	:	Excise tax which is levied on goods and services deemed harmful to health and society (a.k.a. Sin tax)
Product applies to	:	Alcohol products, tobacco products, vapor products, sweetened beverages, etc.

In the Philippines, manufacturers and importers are responsible for paying excise taxes imposed under the National Internal Revenue Code. The term "sin tax" is commonly used to refer to excise taxes on alcohol, tobacco, heated tobacco, and vapor products, which form part of the broader excise tax system.

The Sin Tax Reform Act of 2012, or Republic Act No. 10351, restructured excise taxes on tobacco and alcohol. The law explicitly positioned sin taxes as a health measure aimed at reducing consumption while securing dedicated funding for public health. This was followed by a significant update under Republic Act No. 11467 in 2020, which increased tax rates across alcohol categories and restructured revenue allocation to support broader universal healthcare objectives. Under the revised framework, 60 percent of sin tax revenues were directed toward implementation of the Universal Health Care Act, 20 percent toward nationwide medical assistance and health programs, and 20 percent toward attainment of the Sustainable Development Goals. These funds are subsequently allocated through institutions such as the Department of Health and the Philippine Health Insurance Corporation to support health facilities, programs, and healthcare access for eligible populations.

The Philippine case raises questions about how effectively earmarked excise revenues can be translated into their intended public health outcomes once they interact with broader budgetary, administrative, and institutional processes. The effectiveness of the earmarking framework may therefore warrant further consideration, particularly with regard to the alignment between the use of revenues, the externalities associated with alcohol consumption, and the government's broader health financing arrangements.

Singapore's excise tax – considerations for tax design; base and rates

Tax name	:	Excise duty
Product applies to	:	Intoxicating liquors, tobacco products, motor vehicles, petroleum products and biodiesel blends

Singapore applies excise duty to four categories: intoxicating liquors, tobacco products, motor vehicles, and petroleum products and biodiesel blends. It covers goods manufactured in or imported into Singapore. Rates may be ad valorem, based on customs value, or specific, based on weight, quantity or volume. Customs duty applies separately to specified imports.

For alcohol, Singapore applies excise duty to intoxicating liquors manufactured in or imported into the country. It is calculated from beverage volume, alcoholic strength and the applicable rate per liter of alcohol. Beer, stout, cider, and shandy are generally taxed at S\$60 per liter of alcohol, while wine, sake, mead, spirits, liqueurs, and most other alcoholic beverages are taxed at S\$88 per liter of alcohol.

Domestic production may be exempt from GST and excise duty as long as the goods remain in a licensed excise warehouse. However, once the products leave the facility for local distribution or sale, they become subject to excise duty and GST. Imported liquor is subject to both 9 percent GST and customs duty. Under the standard tariff schedule, beer and stout are subject to customs duty of S\$16 per liter of alcohol, and samsu to S\$8 per liter of alcohol, while most wine and spirits tariff lines carry a nil rate.

Japan's product-specific indirect taxes – considerations for tax design

Tax name	:	National product-specific indirect taxes
Product applies to	:	Alcohol, tobacco, fuels, motor vehicles, aviation fuel and energy products

Japan's national consumption-tax framework includes general consumption tax and separate product-specific indirect taxes, including liquor and tobacco taxes, gasoline-related taxes, motor vehicle tonnage tax, aviation fuel tax, and petroleum and coal tax. Each has its own tax base and rate schedule.

For alcohol, Japan imposes a national liquor tax under the Liquor Tax Act. Volume-based rates are set per kiloliter across four classes and 17 product categories. Apart from liquor tax, alcohol also attracts 10 percent consumption tax.

The rates vary across categories: JPY 155,000 per kiloliter for beer and beer-type beverages, including happoshu; JPY 100,000 for sake and fruit wine; JPY 200,000 or more for shochu; and JPY 370,000 or more for whisky, brandy, and spirits. Until recently, low-malt beer (happoshu) and non-malt “new genre” substitutes were taxed at lower rates than traditional beer. A phased reform, implemented in October 2020, October 2023 and October 2026, removed that gap. Since October 1, 2026, beer and its substitutes have been taxed at a single rate of JPY 155,000 per kiloliter, down from JPY 181,000 for beer and up from JPY 134,250 for happoshu and “new genre” products.

Conclusion

Selective taxation is a tool. Depending on how that tool is used, it can be a valuable asset to policymakers tasked with generating revenue and minimizing social harm. Used well, selective taxes can both generate efficient tax revenue and marginally decrease harms from problem consumption. Poor tax design, however, not only makes excise taxes inefficient but also creates problems that can be more challenging than before any tax policy was implemented, including both financial and administrative issues and public health and tax collection challenges such as illicit products.

