

# Illicit trade in tobacco products

Presenters: Mpho Legote and Chris Axelson | 02 May 2018



**national treasury**

Department:  
National Treasury  
REPUBLIC OF SOUTH AFRICA

# The need to reduce tobacco consumption is clear

- According to the WHO FCTC, scientific evidence has unequivocally established that tobacco consumption and exposure to tobacco smoke cause death, disease and disability
- The WHO states that tobacco kills nearly 6 million people each year. More than five million of those deaths are the result of direct tobacco use while more than 600 000 are the result of non-smokers being exposed to second-hand smoke
- In order to deal with the negative consequences related to tobacco consumption, the Government has over the past decade introduced various policy measures (regulatory, taxation and expenditure)
- These measure range from banning tobacco advertising, restricting smoking in public places and increasing the targeted tax incidence for tobacco products

# Excise duties are a recommended measure to curb use

- South Africa's tax regime (excise) for tobacco products is based on international benchmarks
- Rates are adjusted on an annual basis to account for domestic price movements and to maintain the benchmarked targeted tax incidence,
- Globally there is pressure from the health fraternity to increase the tax burden on tobacco products to account for the full negative external cost associated with tobacco consumption,
- WHO proposes that countries set their tobacco tax incidence equal to at least 70% of the retail price of tobacco products.
  
- An increase in illicit trade in tobacco products not only impacts on the fiscus (excise tax revenue forgone), but also hampers Government's regulatory mandate as well as national public health policies.

# Excise duties follow a targeted tax incidence approach

- SA uses a targeted tax incidence approach which came into effect in 1994/95
- An initial tax incidence (excise tax plus VAT) was set at 50% of the retail selling price (RSP) of the most popular brand in each tobacco product category
- In Budget 2004, the tax burden benchmark increased to 52%
- In Budget 2015, shifted the focus on excise tax burden (i.e. removed the VAT component). As a result the current excise tax burden is set at 40%
- Excise taxes are adjusted annually to maintain the targeted tax incidence
- Real excise duties increased fivefold for a pack of 20 cigarettes between the period 1994/95 to 2014/15

# The current excise duty per pack of 20 cigarettes is R15.20

Product	Cigarettes (per pack 20)	Cigarette tobacco (50g)	Pipe tobacco (25g)	Cigars (23g)
1999/00	R 2.45	R 2.29	R 0.62	R 7.53
2000/01	R 2.83	R 3.21	R 0.97	R 13.11
2001/02	R 3.17	R 3.58	R 1.17	R 15.28
2002/03	R 3.51	R 5.15	R 1.31	R 17.63
2003/04	R 3.89	R 6.22	R 1.46	R 24.52
2004/05	R 4.53	R 6.95	R 1.71	R 28.36
2005/06	R 5.05	R 7.47	R 1.91	R 32.59
2006/07	R 5.56	R 7.82	R 2.07	R 34.16
2007/08	R 6.16	R 8.24	R 2.18	R 37.73
2008/09	R 6.82	R 8.67	R 2.30	R 39.72
2009/10	R 7.70	R 9.15	R 2.50	R 44.88
2010/11	R 8.94	R 9.73	R 2.70	R 47.66
2011/12	R 9.74	R 10.53	R 2.98	R 50.52
2012/13	R 10.32	R 11.05	R 3.22	R 53.05
2013/14	R 10.92	R 12.16	R 3.54	R 56.76
2014/15	R 11.60	R 13.03	R 3.63	R 61.87
2015/16	R 12.42	R 13.94	R 3.89	R 64.96
2016/17	R 13.24	R 14.88	R 4.16	R 69.28
2017/18	R 14.30	R 16.07	R 4.56	R 75.86
2018/19	R 15.20	R 17.44	R 4.94	R 82.31

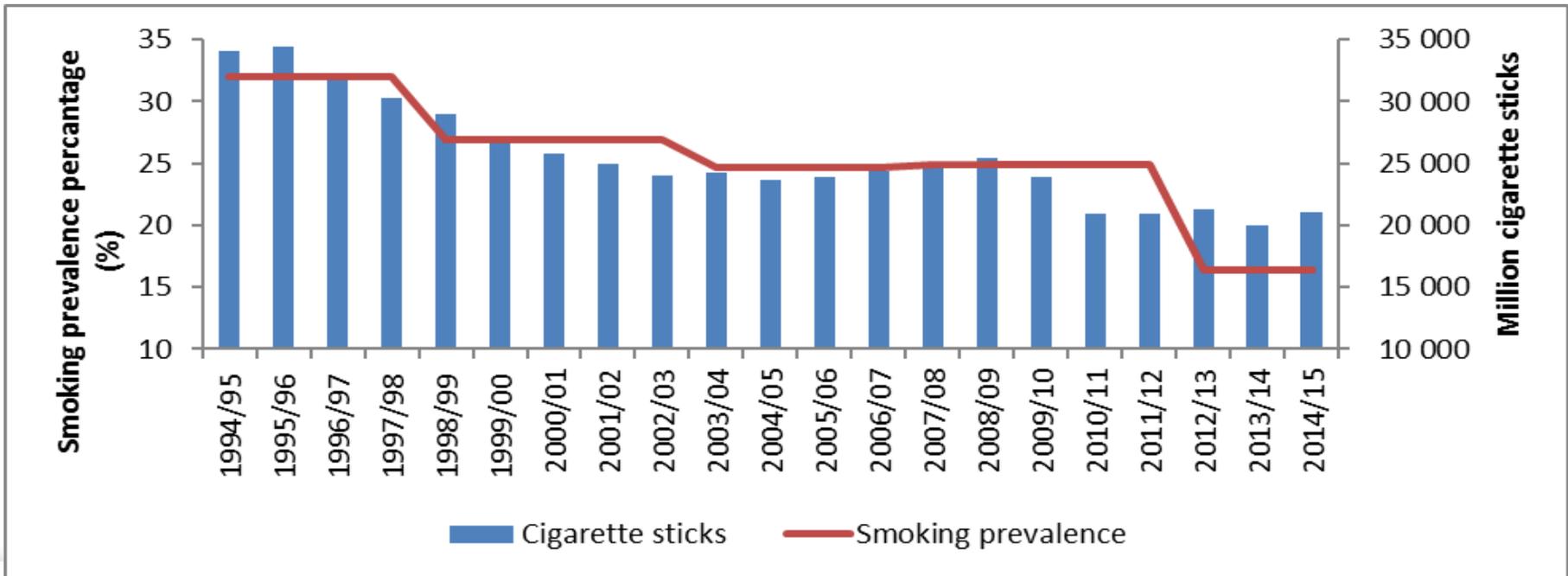
# Alongside a variety of non-tax interventions

- Meaningful tobacco regulations really started with the Tobacco Products Control Act of 1993,
- Government implemented complementary non-tax policy interventions:

Regulation	Description
Tobacco Products Control Act, 1993	<ul style="list-style-type: none"> <li>• Health hazard warnings and contents on advertisements and packages</li> <li>• Restrictions on vending machines</li> <li>• Prohibition of sales to people below age 16</li> </ul>
Regulations, 1994	<ul style="list-style-type: none"> <li>• Specifications on health warning and labelling requirements on packages</li> </ul>
Tobacco Products Control Amendment Act, 1999	<ul style="list-style-type: none"> <li>• Prohibition of smoking in public places except in designated areas</li> <li>• Bans on tobacco advertising and sponsorships</li> <li>• Bans on free distribution of tobacco products</li> <li>• Maximum content levels in cigarettes</li> </ul>
Tobacco Products Control Amendment Act, 2007	<ul style="list-style-type: none"> <li>• Bans smoking in selected outdoor areas.</li> <li>• Product regulation of imported and exported tobacco products</li> <li>• Standards for manufacturing and export of tobacco products</li> </ul>
Tobacco Products Control Amendment Act, 2008	<ul style="list-style-type: none"> <li>• Increase in age of sale from 16 to 18</li> <li>• Bans on one-to-one advertising</li> <li>• Bans on tobacco-like toys</li> <li>• Bans on tobacco sales at health and educational establishments</li> <li>• Tighter bans on free distribution</li> <li>• Tighter standards on:               <ul style="list-style-type: none"> <li>– Packaging and labelling with pictorial health warnings</li> <li>– Point of sales and display</li> </ul> </li> </ul>

# Smoking prevalence has been continually decreasing

- Smoking prevalence figures from South African National Health and Nutrition Examination Survey (SANHANES-1) suggests that there has been a steep drop in smoking prevalence numbers since implementation of the current excise regime in 1994.
- The prevalence rate was last estimated at 16.4%



# Estimates of illicit tobacco vary, but generally high

- Illicit tobacco has a negative effect on tobacco tax revenue
- An increase in illicit trade in tobacco products not only impacts on the fiscus (excise tax revenue forgone), but also hampers Government's regulatory mandate as well as national public health policies.
- Abundance of cheap cigarettes undermines our health policy
- Various estimates of extent of illicit trade in tobacco, and will vary over time as enforcement and general business conditions improve or worsen

	UCT – Corne van Walbeek	Stellenbosch – Craig Lemboe	Evan Blecher (Cancer Society)	TNS Global
<b>Model</b>	Price and income (GDP) sensitivity: legal consumption vs. total consumption	Gap method: legal market + illicit = total market	Gap method: legal market + illicit = total market	Retail level survey: purchase events
<b>Data</b>	Treasury & Stats SA	Treasury & AMPS	Treasury, AMPS, DHS, NIDS & SANHANES	Treasury, AC Nielsen & Survey data
<b>Period</b>	1999 – 2013	2001 – 2011	1997 – 2012	2007 – 2012
<b>Estimate</b>	<b>4 – 17.9 %</b> <b>20.4 % (2011/12)</b>	<b>≥ 20 %</b> <b>Average 24 %</b>	<b>8 – 12 % gap method</b> <b>17 % (2011)</b>	<b>11 - 30 %</b>

# Government involved in international measures to counter illicit trade

- SA signed to be a Party to the Convention in 2005 and has since begun to align its Tobacco Control legislation.
- Article 15 of the Convention provides for the elimination of all forms of illicit trade in tobacco products, including smuggling and illicit manufacturing
- Illicit trade increases the accessibility and affordability of tobacco products, fuelling the tobacco epidemic and undermining tobacco control policies.
- Also causes substantial losses in government revenues, and at the same time contributes to the funding of transnational criminal activities (WHO,2013)
- The WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products is the first protocol under the Convention (was adopted in November 2012)
- The Protocol requires of Parties to adopt and implement effective measures to control or regulate the supply chain to prevent, deter, detect, investigate and prosecute illicit trade
- NDoH is leading government process to ratify the Protocol

# And further measures are being implemented and explored

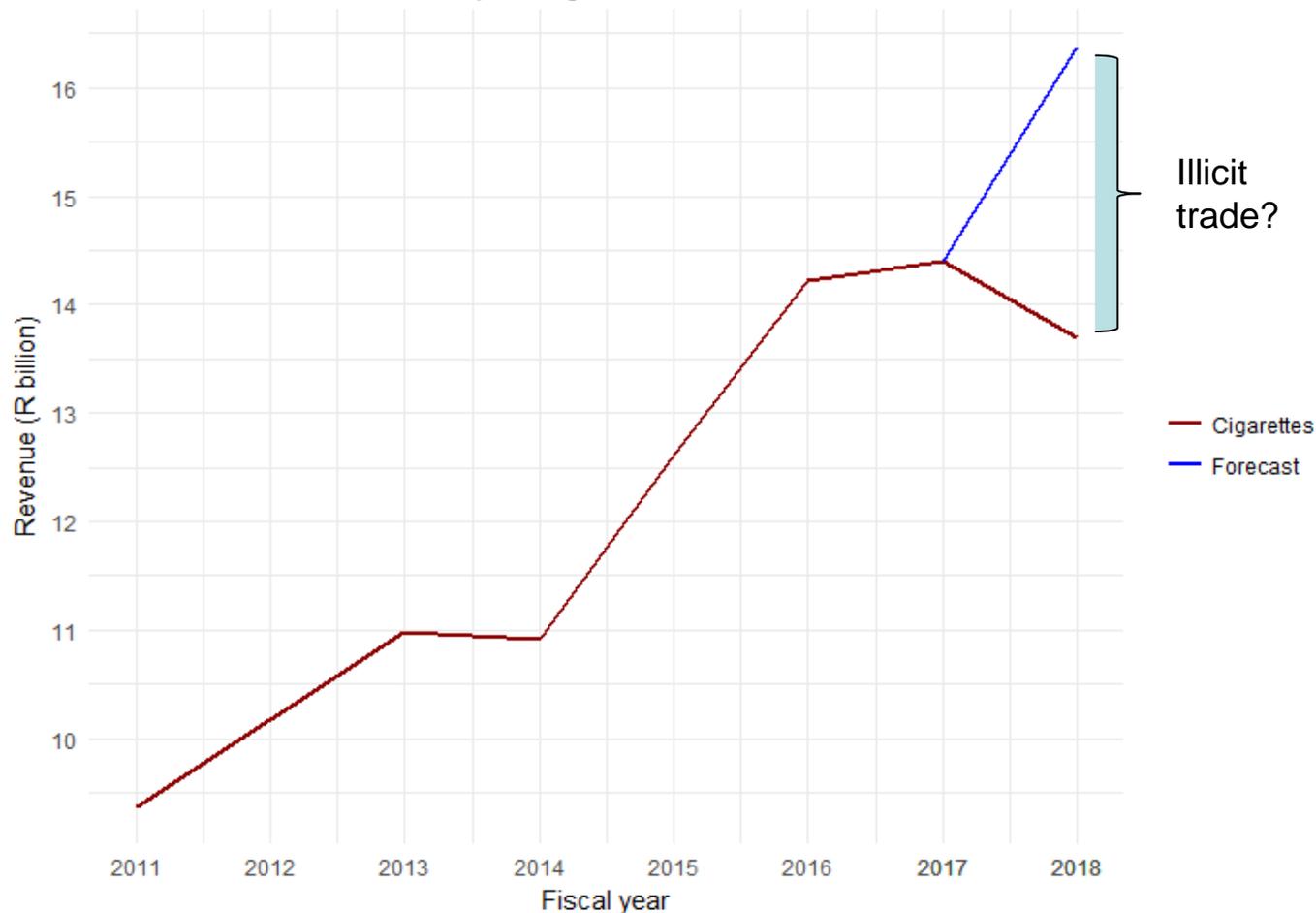
- Due to increased awareness of illicit tobacco trade, the National Treasury facilitated a workshop in 2013 to deliberate on the extent of illicit trade
- In 2017 Budget, it was announced that amendments will be considered for the provisions in the Tax Administration Laws Amendment Act (2016) for the marking, tracking and tracing of tobacco products
- The 2018 Budget announced that
  - “*The National Treasury and the Department of Health will explore additional measures to reduce consumption of tobacco products, including a minimum price and stronger enforcement.*”
- Should any retailer be selling a pack of cigarettes that is less than the R15.20 excise duty?
  - May be easier to enforce and clearer for the public to identify illicit products

# Last two years have been particularly worrying from a revenue perspective

- Budget 2017 estimated revenue from domestic excise on cigarettes was R15.04 billion
- Outcome was R11.07 billion (26% decrease)
- Partly due to large domestic manufacturer leaving SA
- But still **down close to R3 billion** when including imported cigarettes
- Appears to be due to increases in illicit trade (unless consumption has collapsed – note alcohol excise outperformed over same period)

Tax revenue from excise duties on cigarettes and cigarette tobacco

Revenues from both domestic and imported cigarettes



# Illicit tobacco closely linked to serious allegations made in media, needs to be investigated by Commission of Inquiry

- If revenues are falling due to lower consumption, that is a good thing (but no evidence that this is true and seems unlikely over such a short period)
- Does appear to be due to increases in illicit tobacco (which is a view echoed by some in the tobacco industry)
- NT does not believe a more accommodative excise policy is warranted or will assist in reducing illicit tobacco
- Is the increase in illicit tobacco trade due to declining resources, particularly a lack of intelligence capacity, at SARS?
- There may need to be greater co-operation with other authorities (SAPS, NPA) to target the problem
- There have been numerous media reports and books written on these issues and need to find out if there is any substance to these allegations
  - The Commission of Inquiry should investigate these matters
  - Industry itself face serious allegations, which may have ultimately contributed to undermining enforcement

THANK YOU



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# Annex: Tobacco Tax Review

Budget 2016 announced that a review of the current tobacco tax regime will be undertaken and the National Treasury is currently busy with this process.

Focus will be on

- Experience thus far,
- Other policy considerations such as:
  - √ The scope for potentially increasing tobacco taxes,
  - √ Possibility of a uniform tax across all categories,
  - √ Price points used for adjustments,
  - √ The role of minimum prices,
  - √ Tax treatment of non-combustible tobacco and tobacco substitutes,
  - √ The most desirable package of interventions needed in order to decrease tobacco use,
  - √ Other New developments,