



1 March 2021

The Standing and the Select Committees of Finance
Parliament
Republic of South Africa

Dear Members of the Standing and Select Committees of Finance

Comments on the tobacco excise tax increases in the 24 February 2021 Budget speech

Thank you for this opportunity to address the Standing and the Select Committees of Finance.

I am the Director of the Research Unit on the Economics of Excisable Products (REEP), based at the University of Cape Town. You can visit our website at www.reep.uct.ac.za. We are a group of researchers with extensive experience in tobacco taxation and the illicit trade of tobacco products. Our aim is to promote public health through objective and rigorous research. The unit is independent of the tobacco industry and is funded primarily by international organisations such as the Bill & Melinda Gates Foundation, the International Development Research Centre and Cancer Research UK.

It was particularly gratifying that the Minister increased the excise tax on tobacco products by 8%, substantially more than the predicted inflation rate of 4.2%. It was also gratifying that the Minister mentioned that people change their behaviour in response to changes in prices. While this comment was made within the context of an increase in the tax on alcohol, it applies to tobacco products as well. The comment is strongly supported by a large volume of research.

I would like to discuss some of the numbers, as they appeared in the Budget Review. I first start with the 2019/2020 financial year, then the current financial year (2020/21), and then the next financial year (2021/22).

In the 2019/20 financial year actual revenue from cigarettes was R13.97 billion, up 15.5% from 2018/19 revenue (see Table 3 (pages 210-211) of the full Budget Review). The quantity of legal, tax-paid cigarettes in the 2019/20 financial year was 7.6% higher than in the previous year. It is not possible that *total* cigarette consumption can increase by such a large percentage in a single year, so the only conclusion is that the quantity of illicit cigarettes was decreasing. This means that in 2019 SARS was turning the tide against illicit cigarettes.

The numbers for the 2020/21 financial year are very disturbing. National Treasury estimates that it will only collect R5.78 billion from cigarette excise taxation in the 2020/21 financial year, 60% down from the budgeted figure of R14.46 billion. The 20-week sales ban is responsible for about R6 billion of the decrease, but even if one takes account of this extraordinary decrease, the excise tax revenue is more than R2.5 billion below budget.

National Treasury is budgeting to receive R13.09 billion in cigarette excise taxes in 2021/22, on 697 million packs. In the 2019/20 financial year, 839 million packs were declared for excise tax purposes to SARS.

It is disturbing to see that National Treasury is expecting legal sales to decrease by 17% from its level of two years ago. According to NIDS-CRAM figures, the market for cigarettes has decreased by less than 5%, because of the sales ban. A decrease of 17% in legal cigarettes in a market that has decreased by only 5% implies that National Treasury is budgeting for a large increase in illicit sales. This is cause for concern.

Research by colleagues in REEP has shown that the illicit market has been problematic since 2010. See the diagram at the end of this letter. After some respite in 2014, driven by a focused campaign by SARS to curb the illicit trade in cigarettes at source, it went out of control between 2015 and 2017, when the specialised units at SARS were dismantled by the then-Commissioner, Tom Moyane. In 2018 the illicit market stabilised at very high level of around 35% of the total market, while in 2019 it decreased somewhat, probably to between 25% and 30% (illicit trade estimates are not shown beyond 2017 in the diagram).

The primary cause of illicit trade in South Africa is not the increase in the excise tax, as this committee has indicated previously, but poor enforcement. The illicit market boomed between 2014 and 2017 because SARS's enforcement units were removed, and the tobacco industry had free reign.

The Budget Review notes that "An additional spending allocation of R3 billion will be provided to SARS to modernise its technology infrastructure and systems, expand and improve the use of data analytics and artificial intelligence capabilities, and participate meaningfully in global tax compliance initiatives". This is to be welcomed. It is hoped that a part of this allocation will be used to install the appropriate technologies to reduce the illicit trade in tobacco products.

The Protocol to Eliminate the Illicit Trade in Tobacco Products has been ratified by 62 countries to date. Sadly, South Africa is not one of them. Should we ratify the protocol, the country would have access to international expertise and best practices in curbing illicit trade. The country would also commit itself to implement effective counter-measures, including a track and trace system (independent of the tobacco industry), licencing requirements, know-your-customer agreements, etc. The situation in South Africa is currently so desperate that effective counter-measures will easily pay for themselves.

While the tobacco industry might position themselves as partners of the government in the fight against tobacco, we urge National Treasury and SARS to not include them in any such discussions. Article 5.3 of the World Health Organization Framework Convention on Tobacco

Control, of which South Africa is a Party, states that when implementing their public health policies with respect to tobacco control (this would include measure to curb illicit trade), Parties should act to protect these policies from commercial and other vested interests of the tobacco industry. Although industry players might accuse other companies of involvement in illicit trade, the fact of the matter is that they are all, to some extent, involved in illicit trade. They have an incentive to be.

We would like to make a presentation to the two committees on 3 March 2021.

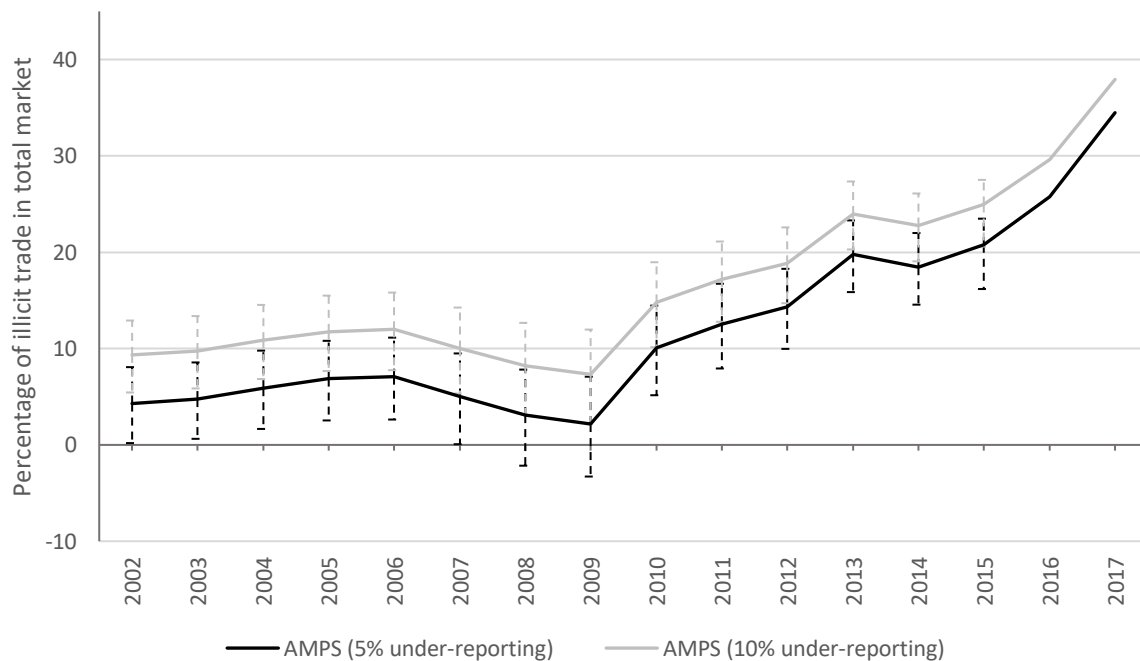
Best regards



Corné van Walbeek

Director: Research Unit on the Economics of Excisable Products (REEP)

Estimate of the size of South Africa's illicit cigarette market, 2002 to 2017



Source: Vellios, et al., 2019,

https://tobaccocontrol.bmj.com/content/tobaccocontrol/29/Suppl_4/s234.full.pdf.