

11 November 2022

Dr Yunus Carrim
The Select Committee of Finance
Parliament
Republic of South Africa

Dear Dr Carrim

Comments on tobacco excise taxes, the illicit trade in cigarettes and the taxation of electronic nicotine and non-nicotine delivery systems

As an independent research unit with a public health focus, the Research Unit on the Economics of Excisable Products (REEP) would like to comment on (1) the tobacco landscape in South Africa, with a special focus on the fiscal aspects and (2) the taxation of electronic nicotine and non-nicotine delivery systems (ENDS/ENNDS). We would like to address the Select Committee on Finance at the public workshop to be hosted on 15 November 2022, where we will elaborate on the points made in the letter below.

(1) Tobacco taxes and illicit trade

As you will recall, the government imposed a 20-week ban on the sale of tobacco products between 27 March 2020 and 17 August 2020. We conducted two online surveys during the sales ban, which resulted in the publication of four reports^[1-4] and two peer-reviewed journal articles^[5-6]. Our findings indicated that, while a small percentage of smokers quit during the sales ban, most smokers were able to purchase cigarettes during the sales ban period, albeit at very high prices. All cigarettes sold during the sales ban were illicit. Sadly, the sales ban entrenched an already large illicit cigarette market in South Africa.

While some degree of normality returned to the market after the sales ban was eventually lifted, the illicit market remained unacceptably large. Using gap analysis (a method in which one estimates the difference between total cigarette consumption and tax-paid cigarette consumption, and expresses it as a percentage of the total market), REEP estimates that the illicit market comprised more than 50% of the total market in 2020 and stayed at this high level in 2021.

[1] http://www.reep.uct.ac.za/sites/default/files/image_tool/images/405/Publications/reports/Lockdown%20Survey%20Final.pdf

[2] http://www.reep.uct.ac.za/sites/default/files/image_tool/images/405/News/REEP2ndreport.pdf

[3] http://www.reep.uct.ac.za/sites/default/files/image_tool/images/405/News/Report%20December%202020.pdf

[4] <https://cramsurvey.org/wp-content/uploads/2021/02/11.-Van-Walbeek-C.-Hill-R.-Filby-S.-Van-der-Zee-K.-2021-Market-impact-of-the-COVID-19-national-cigarette-sales-ban-in-South-Africa.pdf>

[5] <https://tobaccocontrol.bmj.com/content/31/6/694>

[6] <https://pubmed.ncbi.nlm.nih.gov/35511202/>

Within the context of a large illicit market, we saw that the tobacco industry placed pressure on National Treasury to not increase the excise tax on tobacco products. We appreciate that it took courage on the part of National Treasury to increase the excise tax on tobacco products by 8% in the 2021 budget and by 5.5% in the 2022 budget, though we believe that the National Treasury could have been bolder. Illicit trade in South Africa is, first and foremost a criminal issue. It is not primarily an excise tax issue.

The South African government has not ratified the Protocol to Eliminate Illicit Trade in Tobacco Products, despite multiple requests by civil society organisations to do so. REEP has made similar appeals to this Select Committee in the past. Should South Africa ratify the Protocol, the country will commit itself to implement measures that have been proven to reduce the illicit trade in cigarettes. Amongst other things, this entails securing the tobacco supply chain through the use of track and trace technology that is independent of the tobacco industry. We were disappointed that SARS's 2019 call for tenders to develop a track and trace system in South Africa, was withdrawn in 2021.

Because it leads to lower tobacco prices, illicit trade directly increases tobacco consumption by increasing the affordability of tobacco products. It also undermines non-tax policies to reduce tobacco use. Cabinet has recently approved the Tobacco Products and Electronic Delivery Systems Control Bill of 2018. Amongst other things, the Bill seeks to introduce plain packaging and graphic health warnings for all tobacco and nicotine products. While these policies have been proven effective in decreasing smoking initiation and increasing smoking cessation, their effectiveness will be significantly undermined if cheap, illicit cigarettes are widely available.

Illicit trade also significantly reduces government revenue. The tobacco sales ban provided an extreme example of how dramatic these revenue losses can be. We estimate that during the 20-week sales ban government lost approximately R6 billion from cigarette sales alone. The divergence of excise tax revenues to criminals undermines the social fabric of our country and limits the state's ability to allocate spending toward activities that support South Africa's developmental objectives as outlined in the country's *National Development Plan 2030*. It is therefore of the utmost importance that government ratifies the Protocol to Eliminate Illicit Trade in Tobacco Products and implements its provisions.

We were delighted to hear of the SARS's investigation of Gold Leaf Tobacco Corporation (GLTC). From our understanding, this concerns activities that took place between 2016 and 2018. Our research during the sales ban period in 2020 indicates that GLTC was at the forefront of selling illicit cigarettes. We would like to encourage SARS to expand its investigation to include the sales ban period as well (if SARS is not already doing this).

While British American Tobacco recently commissioned research to estimate the size of the illicit market in South Africa, no independent studies have undertaken this exercise in the past year. We do not trust the tobacco industry's studies on the size of the illicit market because they have a well-documented tendency (and a financial incentive) to exaggerate the size of the illicit market. This is not to deny that illicit trade is a problem in South Africa, but we urge the Committee to exercise extreme caution when engaging with the tobacco industry on the matter of illicit trade. The tobacco industry will use the high levels of illicit trade in South Africa as a reason why excise taxes on tobacco products should not be increased in the upcoming budget. This argument is self-serving and detrimental to public health and government revenue. South Africa's own tobacco taxation record from the mid-1990s to 2009/2010 shows that excise taxes can be increased aggressively,

without exacerbating the illicit market. Illicit trade concerns criminals and money. It can only be addressed through effective enforcement mechanisms to secure the tobacco supply chain.

The action taken against GLTC is a good first step in this direction because it incentivizes tax compliance among other tobacco companies who may fear that they will be targeted next. Our data indicates that most, if not all, tobacco companies were selling cigarettes during the tobacco sales ban. We hope that this action against GLTC will reduce some of the most brazen illicit activities by other tobacco companies.

We would also like to draw your attention to the findings of the most recent Global Adult Tobacco Survey (GATS) which was conducted in South Africa in 2021. GATS is a nationally representative household survey that monitors tobacco use among adults aged 15 years and older across countries, using a standardised protocol. According to the results from South Africa's survey, 25.8% of the South African population (11.1 million adults) currently smoke tobacco.⁷ This is significantly higher than the 19.9% estimated in the most recent wave of the National Income Dynamics Study that was conducted in 2017. It is well-documented that tobacco use imposes a significant health and economic burden on countries, and that consistent, year-on-year, increases in tobacco excise taxes reduce tobacco use. We estimate that the cost of smoking in South Africa amounted to 0.97% of the South African GDP in 2016.⁸ These costs are likely to have increased as a result of the observed rise in smoking prevalence over the past five years.

Within this context, we urge National Treasury to substantially increase the excise tax on tobacco products next year. We believe that a substantial excise tax increase (e.g. 10% above the inflation rate) should reflect a broader move by Treasury to a multi-year taxation approach in which, each year, tobacco excise taxes are increased by the inflation rate, plus a pre-announced additional percentage. This will ensure that tobacco products become less affordable over time. It would also align South Africa's tobacco taxation strategy with the recommendations of the World Health Organisation's Framework Convention on Tobacco Control, an international treaty that requires ratifying countries to implement policies to reduce the demand and supply of tobacco products. South Africa ratified the treaty in 2005.

For many years, countries like the UK, Australia and the Philippines have annually increased the excise tax on tobacco products by the sum of the inflation rate and a pre-announced additional percentage. For example, for eight consecutive years (2013-2020), Australia increased the excise tax by 12.5% above the inflation. Through this multi-year approach, these countries' tax authorities increased the predictability of the tax increases and have achieved significant revenue and public health gains. We urge Treasury to adopt a multi-year approach to tobacco taxation and to accompany these systematic excise tax increases with efforts to strengthen the fight against illicit cigarettes.

(2) Taxation of electronic nicotine and non-nicotine delivery systems

The government proposes to apply a flat excise duty rate of at least R2.90 per ml to both nicotine and non-nicotine solutions. The ENDS industry is likely to argue that they are providing a less harmful product to smokers who are unable to quit smoking, and that these products should therefore not be taxed. They may also argue that e-cigarettes can be used as a quitting device. The evidence for either of these two arguments is very thin. ENDS are becoming increasingly popular. In particular, disposable e-cigarettes have become extremely popular

⁷ https://www.health.gov.za/wp-content/uploads/2022/05/Global-Adult-Tobacco-Survey-GATS-SA_FS-Populated__28-April-2022.pdf

⁸ <https://pubmed.ncbi.nlm.nih.gov/32832993/>

amongst teenagers. These are not teenagers switching from combustible cigarettes to e-cigarettes, but rather teenagers that are initiating a potentially lifelong addiction to nicotine through e-cigarettes. This is not surprising, because e-cigarettes are accessible and cheap. These e-cigarettes are closed systems, thrown away once the liquid is finished. For example, Airscream, a UK company, has captured a large part of the South African market with a disposable e-cigarette called AirsPops. Pick ‘n Pay sells a 3ml AirsPops for R95. Each 3ml AirsPops provide 600–800 puffs. AirsPops are also sold on Takealot, together with many other brands of disposable e-cigarettes.

We recommend that Treasury sets the excise tax at R5.00 per ml, rather than at the proposed rate of R2.90 per ml and sets a floor of R50 per unit. While equivalence with tobacco taxation is a controversial topic, the current proposal of R2.90 per ml yields tax burdens that are consistently below the tobacco tax burdens. A tax of R5 per ml tries to partially address this. In Table 1, the blue cells shows Treasury’s current proposal. Under the current proposal of R2.90 per ml, a 3ml AirsPops would be subject to an excise tax of R8.70, increasing the price of a unit from R95 to R103.70. The excise tax incidence would be only 8.4%. Similarly, the excise tax incidence of Nevoks disposable e-cigarettes would be 13.1% and Vuse e-pods 9.9%. The pink cells show the tax incidences if Treasury increases the price from R2.90 to R5 per ml of e-liquid. The tax incidence for AirsPops increases to 13.6%, and for Vuse e-pods to 16%. However, increasing the excise tax to R5 is still insufficient to substantially impact the prices of these products. To address this issue, we recommend that Treasury sets a floor of R50 per unit of e-liquid (green cells). By doing so, the tax incidence would increase to 34.5% for AirsPops and 50% for Vuse e-pods.

Table 1: Treasury’s current proposal and REEP’s proposal, using two brands of disposable cigarettes and three brands of e-liquids as examples

Product (producer)	ml of e-liquid	Current retail price (24 August 2022)*	Treasury's current proposal			Increasing tax from R2.90 to R5			REEP's proposal		
			Specific excise tax (R2.90 per 1ml)	Retail price with specific excise	Specific excise tax share of retail price (%)	Specific excise tax (R5 per 1ml)	Retail price with specific excise	Excise tax share of retail price (%)	Specific excise tax (R5 per 1ml, floor of R50 per unit)	Retail price with specific excise and floor	Excise tax share of retail price (%)
Disposable AirsPops (Airscream)	3	R95.00	R8.70	R103.70	8.4	R15.00	R110.00	13.6	R50.00	R145.00	34.5
Disposable Vape (Nevoks)	12	R230.00	R34.80	R264.80	13.1	R60.00	R290.00	20.7	R60.00	R290.00	20.7
Vuse e-pods (BAT)	1.9	R50.00	R5.51	R55.50	9.9	R9.50	R59.50	16.0	R50.00	R100.00	50.0
Vuse e-liquid (BAT)	20	R125.00	R58.00	R183.00	31.7	R100.00	R225.00	44.4	R100.00	R225.00	44.4
Twisp e-liquid (BAT)	20	R200.00	R58.00	R258.00	22.5	R100.00	R300.00	33.3	R100.00	R300.00	33.3

* Airscream AirsPops Classic Toba (flavour) sold at PnP Rondebosch for R95 on 24 Aug 2022. Looks like all flavours are same price. See Airscream AirPops website: <https://global.aircreamuk.com/collections/one-use-3ml>. Nevoks: <https://www.takealot.com/nevoks-bar-disposable-vape-4000-puffs-rechargeable-rainbow-candy/PLID91156243>, Vuse e-liquid: <https://www.vuse.com/za/en/new-vuse-20ml>, Vuse epods: <https://www.vuse.com/za/en/flavours/vuse-epod/vuse-epod-mandarin-cinnamon> (2 epods costs R100. 1.9ml comes from the information about the device: <https://www.vuse.com/za/en/e-cigarette-devices/vuse/vuse-epod-starterpack>), Twisp e-liquid: <https://www.vuse.com/za/en/flavours/twisp>.

Once the baseline is established, National Treasury should, each year, increase the excise tax on ENDS/ENNDS by the inflation rate, plus a pre-announced additional percentage, to ensure that ENDS/ENNDS become less affordable over time. Through this multi-year approach, Treasury will increase the predictability of the tax increases. This will discourage possible e-cigarette users from starting, since they can assume that their habit is becoming more expensive over time.

Thank you for the opportunity to pass comment on these matters. Please contact me if you have any questions. For more information on our research unit, please visit: www.reep.uct.ac.za.

A handwritten signature in black ink, appearing to read 'C. van Walbeek', with a horizontal line underneath.

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