



Cigarette Taxation and Illicit Trade in South Africa: A Cautionary Tale

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The History of Tobacco Control in South Africa

Background of Tobacco Control in South Africa

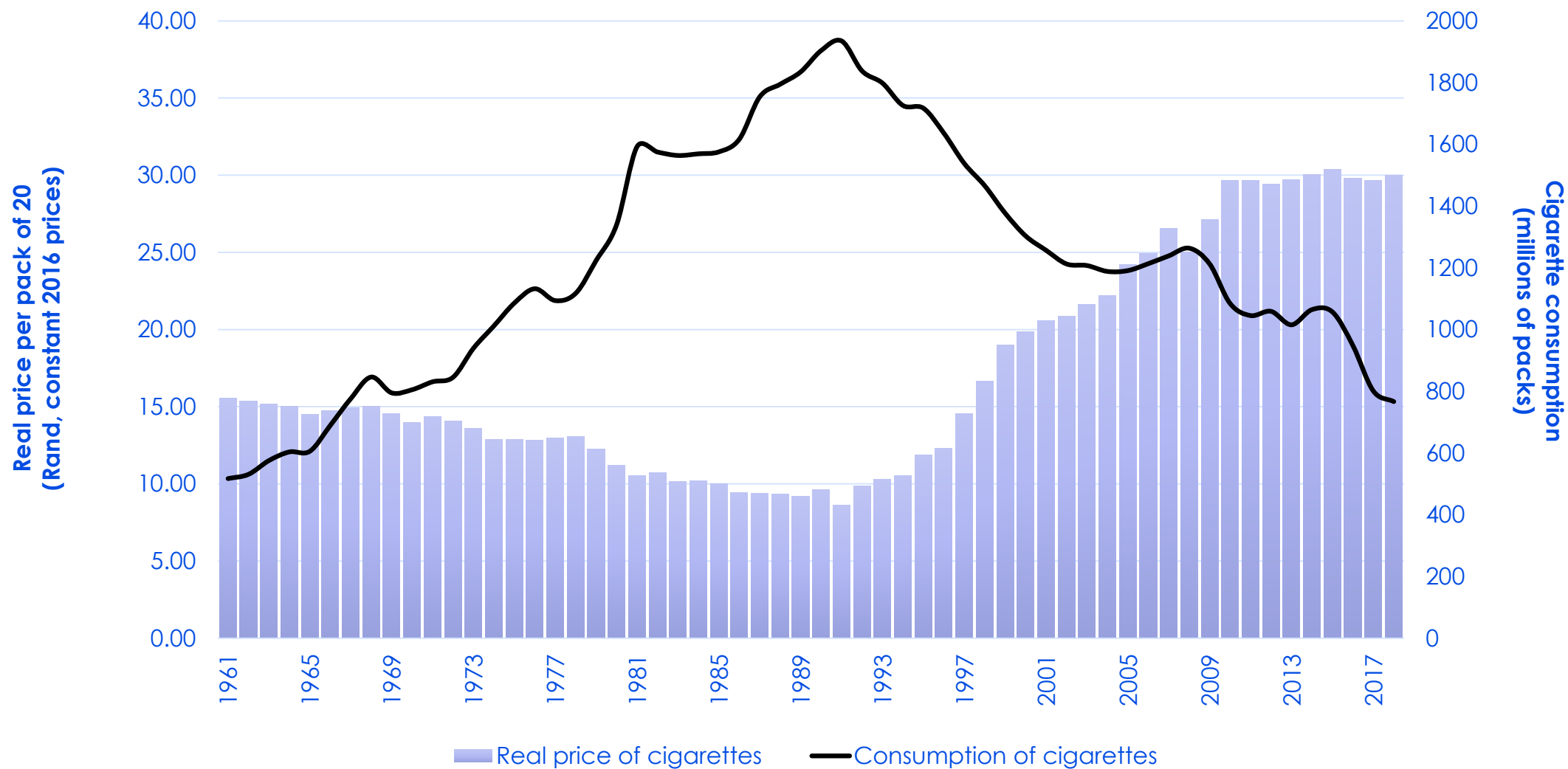
- Pre-1990: steady growth in cigarette consumption, modest increases in excise taxes and consequent reduction in the real price of cigarettes.
- Early 1990's: the government took a strong position on tobacco control policy.
 - Tobacco Products Control Act – warnings on labels and ban of smoking on public transport.
- 1994: ANC government announced goal to reach a 50% tax burden on the retail price of tobacco. Followed by sharp excise tax increases to achieve this.
- Tax burden target increased to 52% in 2004.
- Real retail price of cigarettes has increased significantly since 1990 and consumption has dropped significantly.

Model for Tobacco Control in Developing Countries

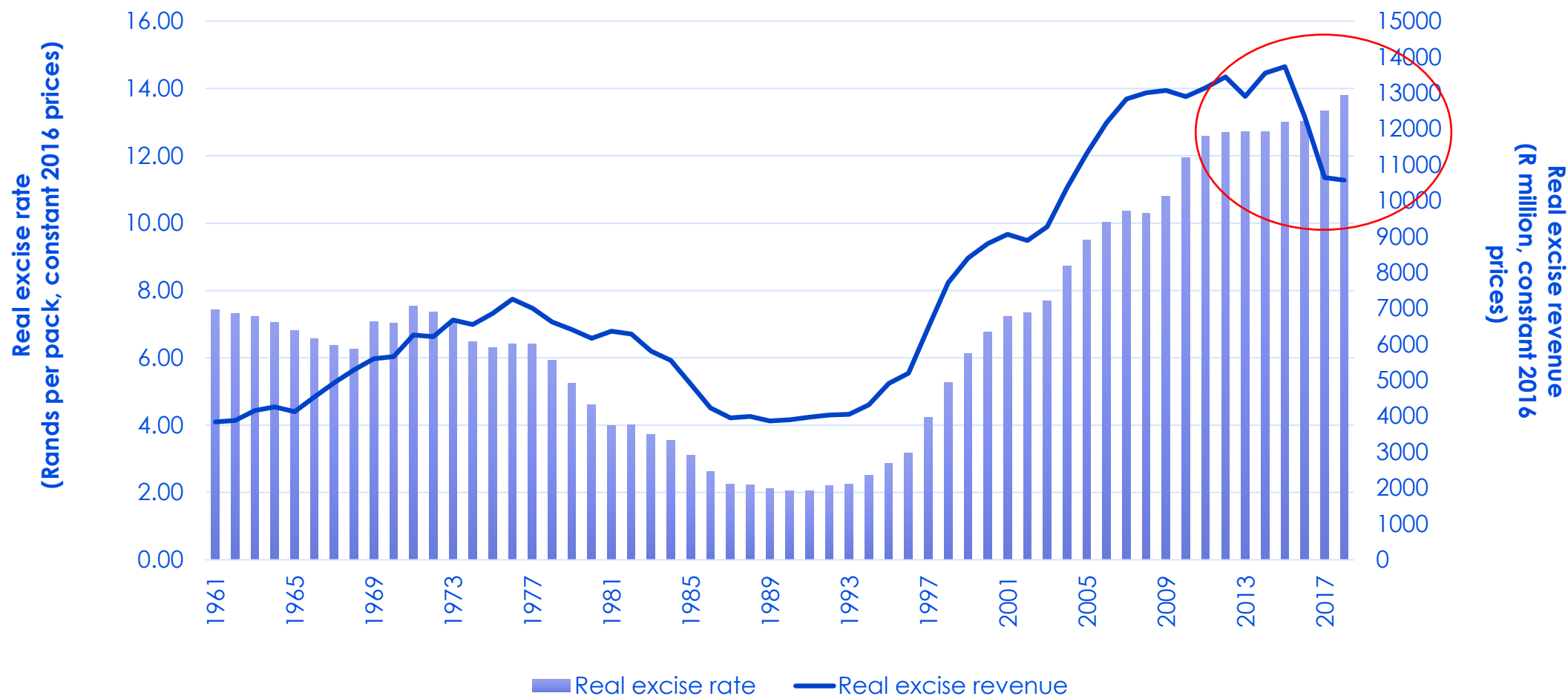
- SA has displayed committed to strong and effective tobacco control policy.
 - Ratified the FCTC.
 - Strong legislation (Tobacco Products Control Act of 1993 and various amendments) and tax policy.
- International acclaim: SA often quoted as a model for other developing countries in tobacco control.
- MOH received Luther Terry Award in 2000 for efforts in tobacco control.



Real Cigarette Price and Consumption, 1960-2018



Real Excise Tax and Excise Revenue, 1960-2018



Reduction in Revenue and Tax-paid Cigarette Sales

- Sharp increases in excise taxes from 1990's resulted large reduction in consumption and increase in government revenue.
- Between 2004 and 2015, tax-paid consumption stabilised, other than a sharp decrease in 2009 and 2010—deep recession and illicit trade spike.
- Turn for the worse: Between 2015 and 2018, volume of tax-paid cigarettes, as recorded by National Treasury, decreased by 23%.
- While the economy was underperforming over this period, this does not explain the decrease in tax-paid cigarette consumption. Prevalence estimates are still approx. 20%.



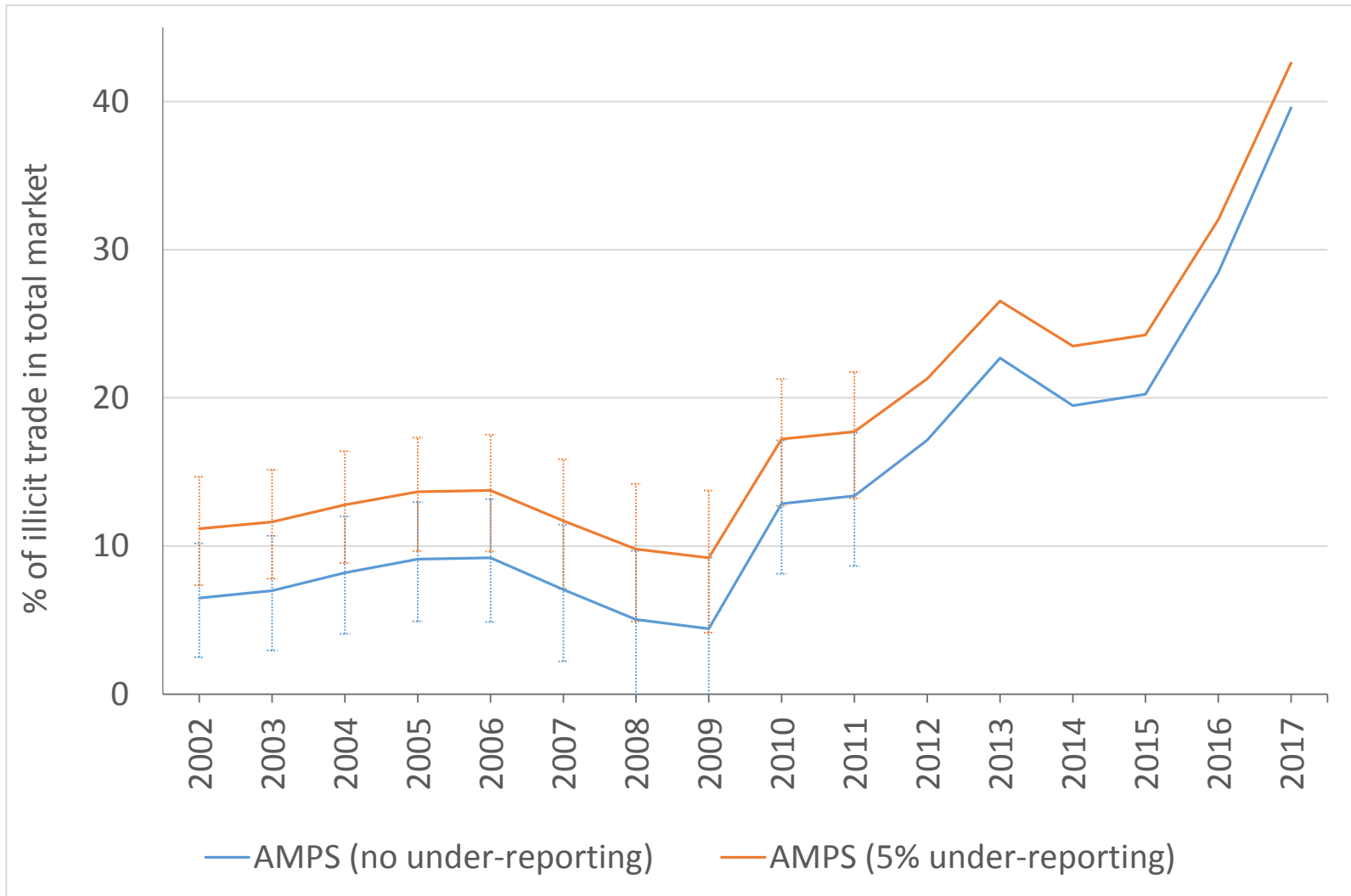
| Illicit Cigarette Trade in | South Africa

The Illicit Trade in South Africa: Gap Analysis

- Recent ETCP study on trends in illicit trade, using gap analysis—under review at *Tobacco Control*.
- Gap analysis: method to measure illicit trade, compares tobacco consumption data, to national revenue data.
- SA national accounts data were compared to two national surveys, the All Media and Products Survey (AMPS) and National Income Dynamics Study (NIDS).
- Finding: illicit trade increased significantly since 2014.



The Illicit Trade in South Africa: Gap Analysis



The Illicit Trade in South Africa: Price Analysis

- Another recent ETCP study used a nationally representative household survey (2017), to investigate the market for cheap cigarettes in SA.
- Data on the price of the most recent cigarette purchase, calculate the proportion of cigarettes sold at very low prices.
- 2017: Total tax (excise + VAT) on a 20-pack was R16.30 (1.22 USD).
- Four definitions of cheap cigarettes: $Price < R16.30$, $Price < R20$, $Price \leq R20$, $Price < R23$ —allows for production costs and profits.

The Illicit Trade in South Africa: Price Analysis

Percentage of Cheap Cigarettes Bought at Various Price Cutoffs, 2017

	<R16.3	<R20	≤R20	<R23	N
Overall	19.6	20.9	30.7	32.8	3507
Pack Type					
Single	11.8	12.1	32.0	32.3	1253
10-Pack	3.4	3.4	13.0	13.4	498
20-Pack	23.0	24.1	31.4	33.9	1541
30-Pack	29.1	32.1	34.1	38.3	78
Carton	42.8	48.7	49.3	55.7	137



The Illicit Trade in South Africa: Price Analysis

Proportion of Smokers buying Cheap Cigarettes at Various Price Cut-offs, 2017

	<16.3	<20	≤20	<23
Race				
African	16.7	17.6	29.4	31.0
Mixed Race	22.8	23.9	34.2	35.5
White	25.5	27.7	32.4	36.8
Education				
Primary School or Less	26.9	28.2	46.1	47.4
Incomplete Secondary School	21.1	22.4	32.6	35.2
Complete Secondary School	13.5	14.3	20.6	22.1
Tertiary Education	14.3	15.7	20.4	22.6
Employment Status				
Employed	17.7	19.3	28.1	30.6
Unemployed	25.0	25.4	35.3	35.9
Province				
Western Cape	19.6	20.0	29.3	30.2
Eastern Cape	19.6	19.8	31.8	34.7
Northern Cape	19.3	21.5	37.3	40.0
Free State	18.7	18.8	26.7	32.1
KwaZulu Natal	12.5	14.0	27.4	29.2
North West Province	24.7	25.7	35.7	46.4
Gauteng	21.2	22.7	31.8	33.1
Mpumalanga	24.5	26.1	31.5	33.3
Limpopo	13.6	16.4	26.7	27.3



Illicit Trade Findings

- Illicit trade has grown significantly in recent years, to between 30% and 40% of the market, compared to approx. 10% ten years ago.
- Ubiquity of low-priced cigarettes:
 - Found across all nine provinces (regions),
 - Lower socio-economic groups (poorer, less education) more likely to buy illegal cigarettes, but they are prevalent amongst all socio-economic groups.





Political Context

History of the South African Revenue Service

- Pre-1994: SARS performed poorly, with a burdensome and bureaucratic tax regime, and a poor public image.
- Post-1994: SARS underwent significant restructuring and streamlining, positioning SARS to reach its objectives to collect all national taxes and control illicit markets.
- Utilized modern technology for tax collection and dedicated units to pursue specialized tax evaders.
- Employee vision, inspired by former Commissioners, that they were working for the 'higher purpose', creating a better South Africa.
- SARS was one of the success stories of post-apartheid SA, and was considered a global benchmark revenue collector.

SARS Specialized Units

- Several specialised and highly-skilled units created to investigate illegal cigarette trade—Project Honey Badger.
- Sought to identify cigarette manufacturers who were not paying excise taxes and VAT on their cigarettes.
- July 2014, SARS spokesperson announced: these investigations resulted in a 25% increase in excise and VAT payments.
- Letters sent to the tobacco industry (multinationals and smaller, local producers) warning that they were being monitored.
- This resulted in massive backlash for SARS.



Breakdown in SARS

- In Sept 2014, then-president Zuma appointed Tom Moyane as SARS Commissioner.
- Many senior executives purged, including personnel working on tax and customs enforcement and investigations with a wealth of experience; replaced by executive with little to no experience in tax collection.
- Mr Moyane ordered the disbandment of the High Risk Investigation Unit; termination of surveillance of those under investigation by the unit (incl. Project Honey Badger). No new capacity created to continue this work.
- The significant increase of the illicit cigarette trade since 2015 coincides with the demise of Project Honey Badger.
- Commission of inquiry into SARS; Mr Moyane suspended as a result of the interim report.
- However, the damage of the last 5 years is significant, and much work is needed to resort SARS to its former glory.

“It can be inferred from analytical evidence we have heard that there is at present a material and ongoing loss of revenue from tobacco related taxes for want of investigation and vastly diminished regulation of the illicit economy.”

– Nugent Commission, Interim Report.








Industry Turmoil

- Tobacco Institute of Southern Africa (TISA) often argues that illicit trade (IT) is growing. Rationale: dissuade increases in excise tax. More recently: accusing competitors of undermining them.
- Using TISA as front group, “Big Tobacco” presents themselves as victims of IT and partners of government to curb it.
- TISA commissioned a survey on IT, finding approx. 30% of cigarettes sold below the min. tax price, and SARS losing R7 billion this year.
- Refusal to publicize methodology and data, preventing review.
- TISA launched #takebackthetax campaign, appealing to government to combat IT.
- TISA accuses various brands, members of FITA (Fair-Trade Independent Tobacco Association), and informal retail outlets of selling illegal cigarettes.
- The battle between FITA and TISA has received much media coverage.

THE IPSOS FINDINGS: KEY TAKEOUTS

75% of illicit is from one manufacturer in a local factory licensed by SARS

	Top Five Illicit Brands	Share of Illicit	Manufacturer
1	RG (second biggest brand in market overall) 	50.5%	GLTC
2	SAVANNAH 	8.9%	GLTC
3	CAESAR 	6.3%	BEST TOBACCO
4	SHARP 	6.3%	GLTC
5	CHICAGO 	5.8%	GLTC

Ipsos: The 2018 National Tobacco Market Study, Media Presentation

“Perhaps TISA and its members must be honest with the public for once, take us into their confidence and release these reports for once and for all. It is one thing to point fingers at commercial competition, waiving findings of a report as supposed proof, whilst simultaneously refusing to provide the underlying documents, and crying foul all the time. It is an entirely different thing, if TISA insisted that its members, such as British American Tobacco, release the findings of reports which relate to allegations implicating them in organised crime.” -FITA Press Release, 18 September 2018

Lessons Learned



Lessons Learned

- SARS was a revered, respected institution, with vast capacity to collect national taxes and counter the illicit trades;
- South Africa was viewed as a “golden child” for tobacco control in LMICs.
- This changed with the breakdown of the institution responsible for collecting taxes and monitoring illicit markets.
- Suspension of the SARS Commissioner and commission of inquiry are the beginning steps to remedy SARS;
- However, more needs to be done: Implementation of track and trace system; ratify the Protocol to Eliminate Illicit Trade in Tobacco Products.
- The presence of IT in SA should not undermine tobacco control, specifically tax increases:
 - The rapid increase in the illicit market occurred while the real excise tax on cigarettes was largely unchanged. In contrast, there is no evidence that the illicit market grew when the excise tax was growing rapidly (1995 – 2009).

Thank You



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