

## Illicit Trade in South Africa: Has it Undermined Tobacco Control?

New research shows the extent of the illicit trade in cigarettes in South Africa. *“A mountain or a molehill: is the illicit trade in cigarettes undermining tobacco control policy in South Africa?”* by South African economist Evan Blecher, now with the American Cancer Society, shows that by 2007, illicit trade accounted for up to seven percent of the total market in South Africa. However, the evidence shows that tobacco control policy was successful and only partially undermined by illicit trade; consumption of tobacco products has continued to decline while tax revenue has risen, thanks to sharply higher excise taxes.

### Smoking Rates

Since the early 1990s, South Africa has introduced significant tobacco control legislation. In 1993, smoking was restricted on public transport, warning labels introduced on packaging and advertising and sales restricted to people over 16 years old. In 1999, smoking was banned in most public places, advertising and sponsorship and the distribution of free product was ended. Since 1991, there have also been significant increases in excise taxes which have led to large increases in the retail price of cigarettes.

The tobacco industry has long argued that high taxes are responsible for the growth in illicitly traded cigarettes, because higher prices encourage cross border smuggling, tax evasion on domestic production and brand piracy. The Tobacco Institute of South Africa, which represents most tobacco growers and cigarette manufacturers, claims the size of the illicit market to be 20 percent of the total market. Yet no research has been published to substantiate these claims.

Evan Blecher estimated the total consumption of cigarettes in the country from national survey data on smoking prevalence and daily cigarette smoking rates. He then adjusted this data for the known ‘legal’ market to estimate the unknown ‘illicit’ market, a methodology similar to that used to measure indirect tax losses in the United Kingdom. His conclusion is that the total size of the illicit market – up to seven percent in 2007 – is much smaller than the tobacco industry has been claiming.

He quotes data showing that legal cigarette consumption declined consistently until the early 2000s, attributed to higher excise taxes on cigarettes, after which consumption stabilised at about 24 billion sticks a year. Smoking prevalence also declined consistently until 2002 after which it stabilised at about 24 percent. The stabilization in prevalence and consumption is attributed to the fact that the tobacco excise taxes did not rise as sharply as in previous years.



**Table 1: Percentage changes in smoking indicators (1993 to 2007)**

Indicator	Change
Real price per pack	148.2%
Aggregate consumption	-31.9%
Per capita consumption	-37.7%
Smoking prevalence	-25.5%
Number of smokers	-2.1%
Average consumption per smoker	-30.4%

Source: Van Walbeek (2005)

**Table 2: Summary of consumption, prevalence and population data**

	Legal consumption Sticks (billions)	Prevalence Percent	Population (millions)	Smokers (thousands)
1993	36.04	32.6	24.83	8.09
1994	35.38	28.8	25.42	7.32
1995	34.16	30.2	26.03	7.86
1996	33.80	30.3	26.66	8.08
1997	31.54	28.4	27.40	7.78
1998	29.90	28.5	28.15	8.02
1999	28.44	27.9	28.93	8.07
2000	26.68	27.1	29.52	8.00
2001	25.52	24.5	30.12	7.38
2002	24.68	24.8	30.56	7.58
2003	24.06	23.8	30.89	7.35
2004	24.04	24.1	31.24	7.53
2005	23.70	23.2	31.69	7.35
2006	24.02	23.3	32.12	7.48
2007	24.56	24.3	32.59	7.92

Source: Van Walbeek (2005), AMPS, StatsSA.

## Extent of Illicit Trade

Blecher concludes that as taxes and prices have risen total consumption has fallen. A small number of consumers have substituted their legal consumption with illicit consumption. But predictions that higher taxes would simply drive the industry underground have not come true. The total market has declined in size by up to 20 percent between 1997 and 2007, in spite of increases in illicit trade.

**Table 3: Euromonitor estimates of illicit market (2002)**

	1997	1998	1999	2000	2001	Average
Legal sales*	32.6	30.4	25.3	25.7	25.7	27.9
Contraband*	4.5	6.2	10.8	10.2	9.6	8.3
Total	37.1	36.6	35.5	35.9	35.3	36.1
Penetration	12.1%	16.9%	29.9%	28.4%	27.1%	22.9%

Notes: \* billions of sticks

**Table 4: Euromonitor estimates of illicit market (2007)**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	Average
Legal sales*	31.54	29.90	26.68	26.68	25.52	24.68	23.51	23.01	22.53	21.90	24.41	25.49
Contraband*	0.25	0.50	0.99	1.43	1.75	2.15	2.40	2.78	3.30	3.47	3.69	2.06
Total	31.79	30.40	27.67	28.11	27.27	26.83	25.91	25.79	25.83	25.38	28.10	27.55
Penetration	0.8%	1.6%	3.6%	5.1%	6.4%	8.0%	9.3%	10.8%	12.8%	13.7%	13.1%	7.7%

Notes: \* billions of sticks

Consumption taxes on cigarettes in South Africa comprise two separate taxes, a specific excise tax levied per packet of cigarettes as well as Value Added Tax (VAT), levied at a flat rate of 14 percent of value added.

Due to the inelastic price nature of cigarettes in South Africa, the increase in the specific excise tax was greater, in percentage terms than the decline in (legal) sales. As a result, even though legal sales were falling excise tax collections rose significantly. Between 1997 and 2007, total excise tax collections rose by over 123 percent in real terms, dwarfing any potential loss through illicit trade.

It is likely that there are other reasons, in addition to higher excise taxes, which have encouraged the growth in illicit trade in South Africa. Illegal traders in South Africa specialise in trade routes rather than commodities and a route can host a wide range of commodities over time, and several commodities at the same time. For instance, routes between South Africa and China include illicit trade in abalone, clothes, electronics, drugs, guns, human beings and diamonds in addition to cigarettes. The illicit trade in a number of commodities has been able to grow in South Africa as a result of large and highly effective organised crime syndicates. This has been compounded by weak border controls and corruption. This conclusion supports the findings of other studies, including a February 2009 report by the influential South African Institute of Strategic Studies, which stated that "cigarette smuggling continues to be a problem in the region. South Africa is a major market, as has been observed by the tobacco industry. Routes lead into the country through Botswana, Namibia and Swaziland. From the various interceptions by customs authorities, the cigarettes appear to originate from China and Zimbabwe. For various reasons, detection of cigarette smuggling tends to be low, and this activity is set to continue in 2009".<sup>1</sup>

<sup>1</sup> [www.iss.co.za/index.php?link\\_id=5&mlink\\_id=7243&link\\_type=12&mlink\\_type=12&tml\\_id=3](http://www.iss.co.za/index.php?link_id=5&mlink_id=7243&link_type=12&mlink_type=12&tml_id=3)

Yet the illicit trade in cigarettes has declined since peaking in at nearly 10 percent of the total market in 2000.

In November 2006, South African Revenue Services (SARS) closed the operations of Mastermind Tobacco Company in a R57 million fraud case. SARS had earlier charged employees and directors of the company with tax evasion and cigarette smuggling. This highlights that the industry are not innocent victims of smugglers but active participants in the illicit trade. Numerous documents available on the Internet also reveal BAT's involvement with smuggling.

## **Conclusions**

It is clear that increased taxes and retail prices have resulted in very large declines in total cigarette consumption in South Africa. The strategy of increasing excise taxes, to reduce cigarette consumption and increase government revenue, has worked with dramatic effect, even in the face of the growth in illicit trade. Even though South Africa has experienced a significant increase in illicit trade it has not undermined tobacco control efforts, since total consumption has fallen and the net impact on tax revenue was positive. The illicit trade in cigarettes must be considered in the broader context of the growth in organised crime and cannot be solely attributed to high excise taxes.

This research supports the strategy of increased cigarette taxation in South Africa. Although it identifies a significant illicit trade problem it also finds that this problem has most likely peaked and is probably in substantial decline. At its current levels illicit trade counts for less than 10 percent of the total market. It is likely that if the government pursues a more aggressive taxation strategy again in the future that total consumption (not only legal consumption) will fall and government revenue will rise even if there is some growth in illicit trade. Action against illicit trade is important, but the existence of the trade is no reason to weaken efforts at tobacco control.

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