

Analysis of KPMG LLP report on use of illicit tobacco in Australia 2013 Full year report

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1. Overview

On 12 April 2014, Australian tobacco companies British American Tobacco Australia, Philip Morris Limited and Imperial Tobacco Australia Limited released a report produced by KPMG LLP Strategy Group, London entitled *Illicit tobacco in Australia: 2013 Full-year report*.^[1] This is an update of the half-year report produced in October 2013^[2] and is the most recent of at least eleven reports on this topic funded by the tobacco industry over the past ten years. Previous reports have been prepared by PricewaterhouseCoopers in 2005,^[3] 2007^[4] and 2010^[5] by Deloitte between 2011 and early 2013^[6-10] and by the International Tax and Investment Center in October 2013.^[11]

The report by KPMG LLP is the most comprehensive of those produced so far and may contain some useful intelligence for revenue authorities. However, the very limited scope of the estimate of legal consumption of foreign packs which is fundamental to the estimate of prevalence of contraband cigarettes is highly problematic. This feature of the half-year report was heavily criticized, and—while some adjustments have been made—the full-year report still fails to account for a great deal of use of foreign tobacco products in Australia that is legal. And fundamental concerns remain about the representativeness of the two surveys which provide the foundation data for the study, namely the 2013 Roy Morgan Internet surveys on which the estimate of the volume of unbranded tobacco is based, and the MS Intelligence Empty Pack Survey which provides an estimate of foreign packs.

Once again it is important to note KPMG LLP's tortuously worded disclaimer.

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Source: KPMG LLP 2013,^[1] p 1

This document briefly describes the major findings of the report, outlines the problems associated with the internet survey and the Empty Pack Study—both of which are highly unlikely to be representative of total consumption of tobacco in Australia—and discusses KPMG LLP's approach to quantifying legal non-domestic consumption. On the basis of these concerns and data and intelligence from other surveys and sources, the Cancer Council Victoria believes that KPMG LLP's estimate of the size of the illicit tobacco market is likely to be substantially higher than is warranted.

2. Terminology

Illicit tobacco can be defined in many different ways. Different schemata (breakdowns of categories) are used by different writers. The varying use and understanding of terminology can lead to a great deal of confusion.

Illicit tobacco in the context of this report is either:

- tobacco purchased in Australia on which neither customs nor excise duty has been paid, or
- tobacco brought into Australia which exceeds personal import allowances.

Since September 2012, travellers to Australia have been allowed to bring in up to 50 cigarettes (down from 250 cigarettes) or the equivalent amount of packaged loose tobacco.[12] These products may be purchased in overseas countries from overseas vendors (with local taxes paid) and brought in to Australia in people's luggage, or they may be purchased *without* duty paid from officially recognised *duty-free* outlets. These products will often bear markings indicating that the products have been produced specifically for the *duty-free* market.

Tobacco products brought in or mailed to Australian residents *within* the allowed amounts have been defined in this report as 'non-domestic legal product'. Products that are brought in with travellers or mailed to Australia *in excess* of these allowed amounts are regarded as one form of contraband tobacco. This ignores the situation of people importing in excess of personal import limits having elected to pay customs duty.

Manufactured products smuggled into the country in shipping containers and distributed to suppliers for retail sale without customs duty having been paid would also be regarded as contraband. Some of the contraband product brought into Australia would be counterfeit, that is, carrying branding without the consent of the trademark owner to imitate popular brands of cigarettes or other tobacco products. Other contraband products are manufactured cigarettes not legally available in any market in the world which appear to be made exclusively for smuggling: these are known as 'illicit whites'.[13] The remaining contraband tobacco products are manufactured by the legitimate trademark owners but may not comply with packaging legislation and have avoided payment of duties inspections in Australia. Counterfeit products are in reality a subset of contraband tobacco.¹ For the purpose of this and similar reports produced in Europe, KPMG LLP has defined contraband as excluding counterfeit products.

Another form of illicit tobacco seen in Australia is unmanufactured or roughly processed tobacco usually sold in unmarked plastic bags. Such tobacco may be sold loose (either alone or with a supply of empty cigarette tubes) or pre-rolled into cigarette tubes. Unbranded tobacco in Australia is generally known as chop-chop. In most surveys (both government and industry funded, including the one relied on in this latest report by KPMG LLP) consumers have been asked about chop-chop as covering unbranded tobacco whether or not it has been pre-rolled into cigarettes.

¹ And some tax-paid products may also be counterfeit.



Figure 1 Chop-chop in a plastic bag together with cartons of cigarette tubes and a device for insertion

3. Approach to quantifying illicit tobacco

KPMG LLP has conceptualised the tobacco market in the following way.

Figure 2.1: Australia tobacco market map

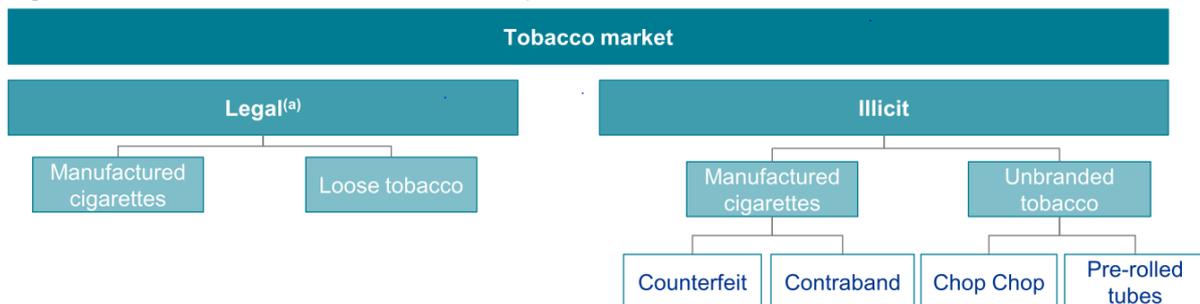


Figure 2 KPMG LLP’s Australia tobacco market map

Source: copied and pasted in from KPMG LLP, *Illicit tobacco in Australia: 2013 Half year report*[2], p9

3.1 Approach to quantifying use of unbranded tobacco

All unbranded ‘chop-chop’ tobacco in Australia is illicit—anyone who grows tobacco must be licensed[14] and, unlike in New Zealand, there is no provision to grow tobacco for personal use—so, to quantify the size of the market for unbranded tobacco in Australia, the approach is to estimate the number of people who are using it, and the average quantities and frequency of purchase. To do this, KPMG LLP, like Deloitte[6-10] and PricewaterhouseCoopers[5] before it, relies on surveys of smokers undertaken by the Roy Morgan Research company. The estimate of the size of the illicit market for unbranded tobacco is therefore only accurate to the extent that this survey is representative of the total market of tobacco users, the quantities used are accurately recorded and the averages correctly calculated. KPMG LLP attempts to corroborate its estimate derived from this

survey by examining legal sales of cigarette rolling papers and cigarette tubes and comparing this to legal sales of smoking tobacco used for roll-your-own cigarettes as well as an estimate of papers and tubes used for cannabis.

3.2 Approach to quantifying use of contraband manufactured cigarettes

To quantify the size of the market for illicit manufactured cigarettes KPMG LLP relies on surveys of discarded cigarette packs collected from litter in a sample of capital cities and major regional centres. Previous estimates of the size of the market for contraband packs in Australia have been derived from telephone surveys of smokers conducted by the Roy Morgan Research company. Using surveys to ask about contraband (including counterfeit) cigarettes is difficult as many people will not know the status of the packs they purchase, may not be prepared to admit to purchase or import of product they know to be contraband, or, on the other hand, may be prepared to believe products are counterfeit with insufficient evidence. Empty Pack Surveys are being funded by tobacco companies in many countries now to assist them with public affairs activities concerning illicit tobacco.[15] As in all these studies currently in place internationally, the collection company used for the Australian survey collects packs from the designated locations and then examines the packs collected and notes any that look ‘foreign’—either illicit white or foreign brands that do not comply with Australian packaging requirements. In collaboration with tobacco companies, the collection company then establishes whether any of the collected packs are counterfeit. In the present study, KPMG LLP then goes on to estimate what component of the foreign packs are likely to have been legitimately purchased (either overseas or from local shops duty-free on entry to Australia). The reliability of this estimate therefore depends crucially on the representativeness of the packs collected in the Empty Pack Survey and the validity of the methods used to calculate legitimate purchase.

4. Fundamental concerns about the representativeness of surveys

The two surveys which form the foundation of the two component estimates of illicit tobacco in the report are highly likely to be unrepresentative.

4.1 Unbranded tobacco

4.1.1 Representativeness of RMR Internet survey

The estimated size of the market for unbranded tobacco is driven largely by the estimated number of people using unbranded tobacco based on the prevalence identified in an internet survey conducted by Roy Morgan Research. The sample size is double the 2010 and 2011 RMR telephone surveys, but it is still likely to be biased towards people more likely to use unbranded tobacco. This is because the sample includes:

- People who are on the Roy Morgan e-mail database, a panel of people who have responded to previous surveys
We cannot rule out that the sample includes a portion of the people who have been interviewed on this topic in previous years.
- Only those people who responded to the invitation to do the survey
People who respond to an invitation and ask to participate in a survey may differ from those who agree if caught by a person on the phone or at the door. The report does not

indicate whether the respondents were paid, but if they were this would introduce a further source of bias in that people who want/need to be paid to do surveys may be more likely to be the kind of people who seek cheap tobacco.

- Only those people who stayed on-line and completed what is likely to have been quite a lengthy survey

Those using illicit products may have better understood the questions and been more engaged with the survey content and less likely to be among the 30% of smoker respondents who opted out part-way through.

The report does not state the basis on which people were screened out based on 'product type' in order to ensure that the sample included only daily smokers. It also did not describe the characteristics of the sample. If the survey over-represented RYO smokers—either dual users or exclusive users of RYO— then it would also have over-represented smokers of unbranded tobacco.

Analysis of unpublished data from the 2007 and 2010 NDSHSs[16, 17] indicates that smokers who smoke any RYO cigarettes are significantly more likely to use unbranded tobacco than those who do not.

4.1.2 Accuracy of estimated quantities used

The KPMG LLP report states on page 9 that unbranded chop-chop tobacco is sold either in one-kilo or half-kilo bags. These response options may have been provided to survey respondents leading to an upward bias in the amounts reported purchased among those not exactly sure of the quantities. Even so, the average volume reported purchased (p 33) was only 0.221, suggesting that many chop-chop users are purchasing much smaller quantities.



Figure 3 Unbranded 'chop-chop' tobacco in a plastic sandwich bag would weigh closer to 100g

Source: image from cover of PricewaterhouseCoopers report 2005[3]

Pre-rolled cigarettes take up a lot more room than loose tobacco, and bags of pre-rolled cigarettes of a size similar to those depicted below would weigh considerably less than half a kilo. If each cigarette weighed less than one gram, including, say, 0.75 grams of tobacco, then the weight of tobacco in 100 cigarettes would be only 75 grams, well under one-sixth the weight of half a kilo of loose tobacco, and less than one-thirteenth the weight of one kilo of loose tobacco.



Figure 4 Image of pre-rolled unbranded cigarettes

The accuracy of the weight of the tobacco purchased is crucial to the calculation of the amount of tobacco used each year.

4.1.3 Correct calculation of averages

The mathematically correct way to calculate the average amount of unbranded tobacco used each year is to estimate the quantity that each (unbranded tobacco) smoker smoked per year (by multiplying their quantity with their frequency of purchase) and to then divide by the number of smokers purchasing unbranded tobacco. The previous Deloitte reports however indicated that the average amount of unbranded tobacco used each year was calculated simply by multiplying the average amount of tobacco purchased across the whole sample with the average number of purchases across the whole sample, and page 47 of this reports indicates that KPMG is using the same method of calculation. This would not matter if the people that purchased smaller amounts purchased more frequently and people that purchased larger amounts purchased less frequently in a roughly linear way, so that the end result was roughly similar. However this method is bound to produce a much higher estimate of total use than the correct method if those smokers of unbranded tobacco who purchase least frequently also tend to be the same people who purchase substantially lower amounts. With bags of unbranded tobacco ranging from 75gms to 1 kilo and occasional use of small amounts a real possibility, the margin for error here is extremely large.

4.2 Manufactured tobacco products

To estimate the prevalence of contraband tobacco, KPMG LLP relies on the results of an Empty Packs Survey conducted by MS Intelligence, a market research company engaged in these sorts of surveys for tobacco companies in many different countries.[15] The company collected 12,000 packs from a selection of cities and towns over Australia. Currently in Australia, smokers consumed in the order of 21 billion cigarettes per year (factory-made and roll-your-own)[18]; that would equate to well over 800 million packs. This means that the survey collected about 0.0015% of all the packs used in Australia—one in every 67,000 packs (approx.) A sample of this size could provide a reliable indication of the level of use of non-domestic packets of cigarettes used in Australia... but only if the packs *collected* are representative of all the packs *used*.

Packs discarded outdoors unlikely to be representative of all packs used in Australia

The Empty Pack Survey collected packs discarded in public places. These would largely comprise packs which are either dropped by smokers or which blow out of rubbish bins. It specifically states (column 2, p34) that it does *not* include packs disposed of in the bins and rubbish receptacles of offices and other workplaces and it does not include domestic rubbish. The survey is therefore not a representative sample of all packs used in Australia and is likely to over-represent packs used by people who work or otherwise spend a lot of time outdoors, and packs used by people who litter. A review conducted by the International Agency for Research on Cancer has suggested that people who use illicit tobacco may also be more inclined to litter.[19] The survey may also be subject to biases resulting from differences in average duration of time that different councils in different areas allow litter to remain on streets.

Packs originating from overseas are likely to be over-represented in the packs discarded

It is highly likely that the Empty Pack Survey over-represents the packs used by tourists and other overseas visitors and students, all of whom are more likely than the average Australian smoker to be eating out and socialising at outdoor venues, and much more likely to be in possession of packs purchased overseas.

Although the KPMG LLP report provides details on the cities and the number of packs collected, it does not provide a description of the neighbourhoods in which packs were collected or indeed whether the same neighbourhoods were sampled in 2013 as in 2012. The report states that MS Intelligence avoided football stadia and the like (p34), however, it does not disclose whether the collection sites included tourist destinations such as Kings Cross and Circular Quay in Sydney or Lygon Street in Melbourne.

Areas frequented by high numbers of overseas students would also be places where there would be a high volume of discarded packs. Many overseas students live close to the institutions in which they study, in budget-style accommodation such as that provided by the [UniLodge](#) chain in several capital cities. Students also tend to eat out a lot in cheap eating places close by, including many serving cuisine from their countries of origin—for instance those in Swanston and Lonsdale Streets in Melbourne. It is interesting that each of the cities surveyed in the report—all of the capital cities plus Geelong, Newcastle, Wollongong, Cairns, Townsville, the Gold Coast, the Sunshine Coast and Toowoomba— is home to at least one university with high numbers of students from overseas. See <https://www.aei.gov.au/research/Research-Snapshots/Documents/International%20students%20in%20Australian%20unis%202010.pdf> Many vocational colleges and English language schools are found in the same cities and towns.



Figure 5 UniLodge accommodation in central Melbourne business district

Propensity to litter

A review of research undertaken by the International Agency for Research on Cancer[19] has raised the possibility that people who use illicit tobacco might be more inclined than those who do not to engage in littering behaviour. The most common people to litter in Australia have been found to be young men,[20] also the highest users of illicit unbranded tobacco.[21] Littering has declined substantially among the resident Australian population over the past ten years, thanks to prominent campaigns such as Clean up Australia, and Keep Australia Beautiful as well as steadily increasing fines in most states and territories[22] If social norms about littering differ in different cultures, and if declines in littering have not been as substantial among populations from other countries, then it is possible that overseas visitors might be more likely to litter than the Australian resident population. It is also likely that overseas visitors would be less aware of fines for littering.

5. Estimation of legal non-domestic consumption

In order to calculate the illicit component of cigarettes brought in from overseas, KPMG LLP must deduct from its estimate of the prevalence of foreign packs, the component of foreign packs that is legitimate—that is, where packs have been purchased in duty-free shops or purchased in overseas countries and brought in legally.

There are at least four types of people who might legally purchase foreign cigarettes in packages that are discarded outdoors in Australia:

- i. Australian residents returning from overseas visits
- ii. Immigrants to Australia
- iii. Overseas visitors on short-term trips to Australia and
- iv. People living in Australia on student visas.

In the first half-year report,[2] KPMG LLP based its estimate only on the first of these, the “Short-term resident departures”. See footnote 3 at the bottom of page 70, referring to Table 7 at <http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3401.0Sep%202013?OpenDocument> . It did not include estimates of packs brought in by “Permanent movement, settlers” or “Visitor arrivals”, Table 12 and Tables 3 to 5 in the same data set. These groups have now been addressed in the full-year report, however there are several reasons why the figures for legally purchased foreign cigarettes are still likely to be underestimates.

5.1 Underestimation of prevalence of purchase of cigarettes among Australian travellers

The calculation for the amount of product brought into Australia by Australian residents returning from short-term visits overseas with duty-free and overseas-purchased packs assumes that smokers are as likely as non-smokers to travel overseas. This is likely to be a false assumption given the breakdown of short-term overseas departures. The ABS report from which the KPMG figures are drawn² indicates that over 80% of these overseas trips are for holidays or for visiting family overseas.

- 5.1.1 A high percentage of overseas trips to Indonesia (Bali), Thailand and Vietnam would have been to the beach resorts most popular with young adults. Young adults have higher smoking rates than teenagers and older people.
- 5.1.2 A high percentage of people making trips home to family would be Australians who have immigrated from China, Vietnam and India who would be more likely than other Australians to be smokers. Smoking rates among Chinese men are among the highest in the world. While smoking rates are low among women from these Asian countries, families returning from overseas would be able to spread packs purchased among smoking and non-smoking family members over 18 years of age so as to remain under the legal limits.
- 5.1.3 People who visit family overseas are likely to purchase cigarettes cheaply overseas and supply them to family living here regardless of their own smoking status.

5.2 Underestimation of cigarette imports by short-term overseas visitors to Australia

The ABS reports that over 575,000 visits to Australia were made in the first six months of 2013 by people from China, Korea, Indonesia and Thailand, the countries from which foreign packs identified in the Empty Pack Survey most frequently came. The Department of Immigration and Border Protections’ Visitor Visa Program granted a total of 951,628 Visa applications for the three-month period to September 2013.[23] These are not small numbers, and they included many people visiting from countries that manufacture the packs detected in the MS Empty Pack Surveys. Given the very high smoking rates among men in these countries,[24] high numbers of visitors would be likely to be smokers who bring in packs for personal use.

² ABS Short-term movement, Resident Departures—Selected Destinations: Trend 2013
<http://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3401.0Sep%202013?OpenDocument>

2.03 Number of Visitor visa applications granted in 2013-14 to 30 September 2013 by citizenship country - comparison with same period in previous year

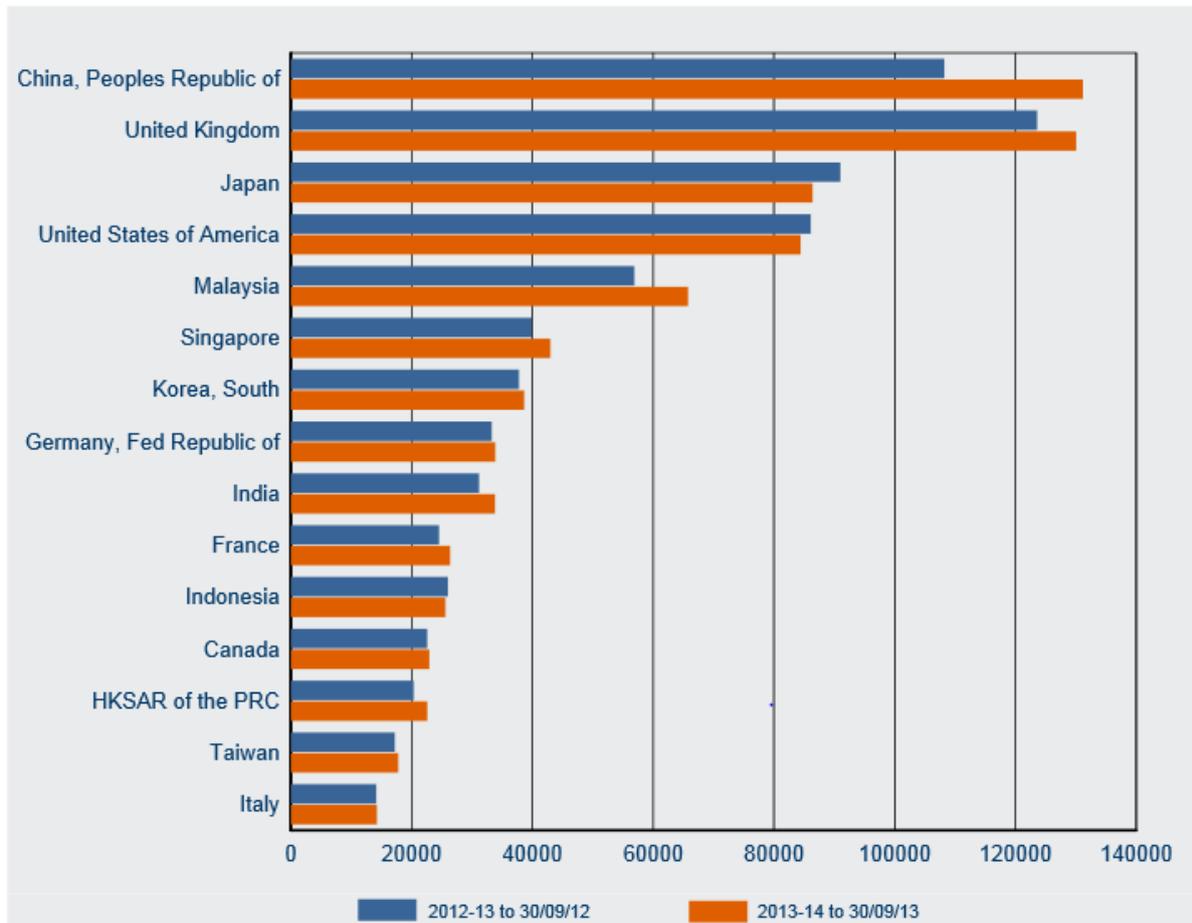


Figure 6 Visitor visa applications, 9 months to September 2013 and compared with previous year

Source: Department of Immigration and Border Protection, Visitor visa programme quarterly report, 30 September, [23]p32

The new KPMG LLP full-year report does now include estimates of packs brought in by visitors from overseas countries, however it only includes estimates for those who come from the top-six countries from which foreign packs were sourced, and it does not account for cigarettes purchased in stop-over countries. Shopping in stop-over countries is an important factor in international travel to and from Australia, where many flights to Asia exceed ten hours.

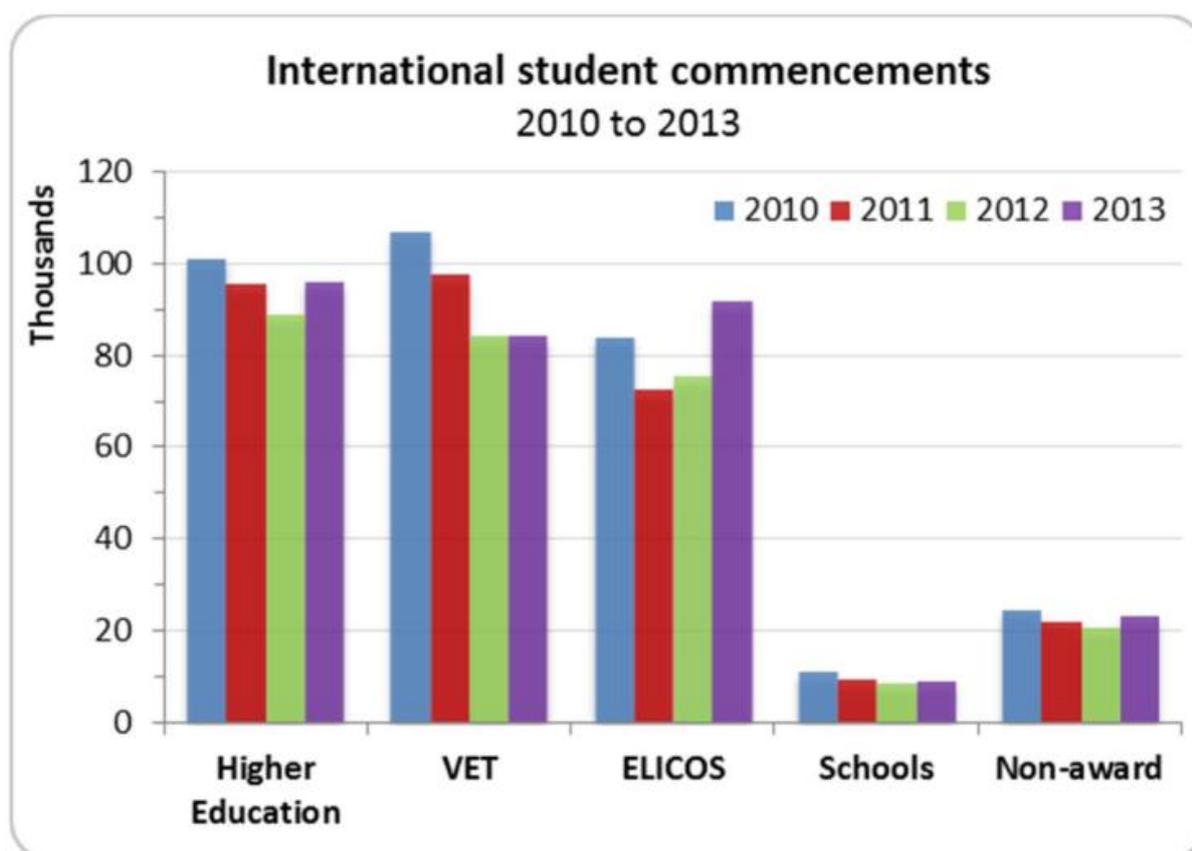
The KPMG figures are also calculated after netting out of the traveller figures those under 18 and those who do not smoke. However, it is likely that children are much less frequent travellers to Australia than adults. Young adults on holiday, working holidays or enrolled in study programs are likely to have higher rates of smoking than the average in their country of origin. Visitors are also likely to bring cigarettes in to Australia even if they do not smoke. A recent study undertaken by the Auckland University of Technology in New Zealand has shown that Pacific Island families visiting relatives living in New Zealand are very likely to arrive with gifts of duty-free cigarettes for their hosts regardless of their own smoking status.[25]

5.3 Use of non-domestic cigarettes by recent immigrants and by visitors staying in Australia for extended periods

The estimates included in the KPMG LLP full year report allow for a small amount of tobacco imported for personal use immediately after arrival. However people who arrive each month in Australia include many people who have immigrated and many who have come for more extended visits. People here for extended times to work or study are likely to continue to seek access to their favourite brands from their own countries, particularly if they can be obtained at a lower cost in those countries – see below for further details.

As of December 2012, 515,853 international students were enrolled in schools, universities, vocational colleges and ELICOS (English language intensive course for overseas students) in Australia—refer https://aei.gov.au/research/International-Student-Data/Documents/INTERNATIONAL%20STUDENT%20DATA/2012/2012Dec_0712.pdf

International education is this country’s biggest non-mining export item, more lucrative for the country than tourism, having grown since 1982 at an average annual rate of 14%. Over 21% of undergraduates in Australian institutions were international students in 2011 compared with the OECD average of 7%.



Australian Education International, End of year summary of International Student Enrolment data, 2013, Australian Government, 2014 <http://www.austrade.gov.au/Education/Student-Data/2013#.UOPsRaJMYcs>

The most common countries from which overseas students come to study in Australia are China, India and South Korea.

“South Korea was Australia’s third-largest source of foreign student enrolments after China and India during the past four years. It was also Australia’s third largest market for goods and services combined in 2011. Australian exports of services to South Korea totalled AUD\$1.7 billion in 2011, mostly recreational and education-related travel.”

Source: Austrade website <http://www.austrade.gov.au/Education/Countries/Republic-of-Korea/Market-profile#.UnjDpFMjYcs>

As well as being a popular tourist destination for Australians (Bali), Indonesia is also a common starting point and destination for education-related travel.

“As of December 2012 there were 17,514 Indonesian students enrolled in Australian educational institutions. Indonesia is currently the fifth most popular destination in Asia for international study experiences by Australian university students.”

Source: DFAT website Indonesia country brief
http://www.dfat.gov.au/geo/indonesia/indonesia_brief.html

In the Empty Pack Survey, the most common countries from which foreign packs originated were **South Korea, China and Indonesia**. **South Korea** was the most frequent country of origin for the cigarettes identified as duty free. South Korea was also the country of origin for almost half the other packs found (the ones that could not be identified as ‘duty free’), that is, the packs that would have been purchased from ordinary shops in South Korea. Packs of cigarettes in Australia cost six times as much as they do in South Korea and China and eleven times as much as they do in Indonesia. People on working holidays and international students are very likely to purchase cigarettes overseas and bring them in to Australia when they arrive either initially or after visits back home. They would be likely to ask visiting relatives to bring such cigarettes with them: this would not be captured in the KPMG LLP estimates where the relatives are themselves non-smokers. Neither does KPMG LLP account for cigarettes legally received in the mail in packages posted in small numbers to students/workers from their home country.

5.4 Tobacco in excess of personal limits on which duty is paid

The report fails to allow at all for the possibility of residents, visitors, immigrants or students opting to pay customs duty on cigarettes brought in for personal use but in excess of personal import limits, a perfectly acceptable and not uncommon occurrence—see <http://customs.gov.au/site/page4352.asp>

The personal limits concerning importation of tobacco products in Australia pertain to the amount that can be brought in free of duty, not the absolute amount that may be imported.[26] It is legal to bring cigarettes into Australia for personal use in excess of the personal limits as long as duty is paid on these products— see <http://customs.gov.au/fag/AlcoholCigTobacco.asp>. As explained in brochures produced by the Customs authority and available in a variety of languages, if someone had a carton of 200 cigarettes with them when travelling, or had one mailed to them in Australia, they would be allowed to bring in or receive that carton provided they paid the amount of duty and tax owing.

A carton of 200 Marlboro cigarettes could easily be purchased for just over AUD\$20 in South Korea or China and well under than amount in Indonesia.[2] Even once duty is paid, this would still be considerably cheaper than the cost of buying the same cigarettes in Australia where retail margins are likely to be higher.

5.5 Non-domestic cigarettes legally purchased could have increased due both to increasing cost in Australia and increasing numbers of overseas visits

The KPMG report calculates that non-domestic legal sales declined in Australia by 10.7% between 2009 and 2013 (Table on page 28).

The number of non-domestic packs legally used could have increased in 2013 despite the reduction in the duty-free allowance for at least two reasons:

- The number of overseas trips by Australian residents to non-domestic source countries (the countries of origin of packs observed in the pack survey) increased slightly between 2012 and 2013 (and almost doubled from 1.22m to 2.37m trips between 2007 and 2013.) The number of visitor arrivals for South Korea, China, Thailand and Indonesia also increased by 11% between 2012 and 2013.
- Because tobacco products are so much more expensive in Australia than they are overseas—particularly so since April 2010—among both overseas visitors to Australia and returning Australian residents, the percentage of smokers buying cigarettes while overseas or duty-free is likely to have increased substantially over time. This would include both cigarettes within the personal import allowance and above it.

6 Corroborating information

The report uses several pieces of corroborating information which it is stated increase confidence about estimates. First it looks at sales of papers for rolling smoking tobacco and estimates the extent to which sales of these may be out-of-kilter with legal sales of smoking tobacco—evidence that the papers or tubes may instead be being used for rolling unbranded loose tobacco. Second it looks at the Roy Morgan Research survey report data on use of contraband tobacco as verification of data from the Empty Pack Survey. Finally it compares reductions in the prevalence of smoking with reductions in legal sales of cigarettes.

6.1 Cigarette rolling paper

KPMG corroborates its estimate of the amount of illicit unbranded tobacco used in Australia by looking at the volume of sales of rolling papers and tubes. It does not disclose the numbers sold due to contractual obligations between Aztec (the data compiler) and the tobacco companies providing Aztec with the data. However, it undertakes its analysis under assumptions that the amount of RYO tobacco used in each cigarette is somewhere between 0.6 and 0.75 grams per cigarette. The estimated volume of unbranded tobacco generated by the rolling paper analysis is highly sensitive to the assumption about amount of tobacco used. At 0.75gms KPMG estimates that 1,315 tonnes of unbranded tobacco is being smoked. At 0.6 grams per cigarette the estimate is only 616 tonnes. If the amount of tobacco used is in actual fact more like the 0.45 grams observed in the Laugesen study in New Zealand in 2009,[27] then presumably the estimated volume would be even smaller

still. The KPMG LLP report states that an adjustment is made for use of rolling papers with cannabis. No details of methodology are provided, however the estimate of the amount of cannabis used in Australia is based on a report from 2007, and the National Drug Strategy Household Survey suggests that the prevalence of use of cannabis increased significantly (by about 10%) between 2007 and 2010 (see AIHW 2011,[28] p 102).

6.2 Survey of smokers—use of contraband tobacco

The Roy Morgan 2013 internet survey of smokers also likely over-estimates the proportion of smokers using contraband manufactured cigarettes for the same reasons as it likely overestimates the percentage using unbranded tobacco products (as in Section 4.1 above). Even so, the estimated amount of contraband/counterfeit cigarettes consumed based on this survey in 2013 is much smaller than the amount generated through the empty pack survey. Moreover, the estimate generated from the consumer survey increased between 2012 and 2013 by a much smaller amount than the increase observed in the empty pack survey (31% compared with 151%). This discrepancy raises more doubt about the validity of the latter estimate and its comparability to the 2012 estimate.

6.3 Gap analysis

The report notes that the decline in the prevalence of smoking is not as great as the decline in legal sales. However consumption could easily fall more steeply than prevalence falls. A steeper decline in legal sales than in prevalence is easily explained by reduced numbers of cigarettes smoked due to higher prices and increasing prevalence of restrictions on where people can (or feel comfortable to) smoke outdoors.

7 Hysterical interpretations

It is likely that there would be some instances of people bringing cigarettes into Australia exceeding personal import levels and failing to pay duty on excess amounts. However, as outlined in Section 5 above, there are many explanations for the presence of foreign packs in litter in Australia. Such packs do not in any way prove the existence of wholesale smuggling from such countries, and most certainly not the involvement of ‘criminal gangs’ as claimed by British American Tobacco Australia.[29]

8 Relationship between study findings and plain packaging

The KPMG LLP study draws no conclusion about the impact of plain packaging on illicit tobacco. Inferences are being drawn by British American Tobacco Australia[29] but these can in no way be supported by anything in the report itself.

Was there really an increase in use in non-domestic packs between 2012 and 2013?

The 2012 and earlier reports were conducted by AC Nielsen, a market research company that works with many different industries. The 2013 empty pack survey was conducted by MS Intelligence, a company established in Geneva Switzerland which specialises in research for the tobacco industry.[15] While the same cities were targeted, insufficient information is provided in the KPMG LLP report to be certain that sampling of packs occurred in exactly the same neighbourhoods in 2013

as in 2012, so it is possible that the observed changes in the prevalence of foreign packs may be a result of changes in sampling. Confidence intervals are not provided and it is likely that many of the changes occurred by chance.

In any case, as indicated in Section 5 above, the prevalence of foreign packs in litter may have increased in Australia due to an increase in travel and overseas visitors resulting in an increase in overseas purchases rather than any increase in illicit purchases. Any reduction in the component of these foreign packs that were acquired legally may be due to a greater incidence of people exceeding personal import limits without payment of duty rather than to an increase in large-scale organised smuggling.

Customs interceptions over the past five years indicate that contraband cigarettes were being smuggled into Australia well before the introduction of plain packaging.[30-34] The overall amount of tobacco intercepted in 2012-13 was not substantially higher than that intercepted in previous earlier years.

Year	No. of detections	Tobacco (tonnes)	Cigarettes (millions of sticks)	Duty evaded (\$ million)	Equivalent tobacco weight (tonnes)
2007-08	58	287	107	114	373
2008-09	33	180	50	70	220
2009-10	42	311	68	120	365
2010-11	55	258	82	135	324
2011-12	45	177	141	125	289
2012-13	76	183	200	151	343

Australian Customs and Border Protection Service, Annual report 2011-12, 2012, Australian Government Canberra. Available from: <http://www.customs.gov.au/site/page4283.asp>

Australian Customs and Border Protection Service, Annual report 2012-13, 2013, Australian Government Canberra. Available from: <http://www.customs.gov.au/site/page4283.asp>

If there was an increase, was it due to plain packaging?

The November/December 2013 survey detected roughly the same number of foreign packs that KPMG deemed to be illicit as were detected in the May/June 2013 survey, a curious result if there really was such a large increase between the November 2012 and the May/June 2013 surveys. Why did the figures not continue to increase? If plain packaging *were* the driving factor, one might have expected more of an increase over the final six months of 2013.

And finally, even if there were an increase in smuggling, this may be attributable to changes in worldwide supply and demand, affected in part by rising prices of tobacco products in Australia relative to the rest of Asia, rather than to any effects to plain packaging. In his recent authoritative report for the UK Government, Sir Cyril Chantler concluded “I have seen no convincing evidence to suggest that standardised packaging would increase the illicit market”[35](5.11) He also noted that “the tobacco industry has a history of attacking new tobacco control measures on the basis that they will boost illicit sales” (Chantler letter to Minister, para 17).

9 Conclusion

Fundamental concerns remain about the representativeness of both the Roy Morgan Research Internet survey and the MS Intelligence Empty Pack Survey.

In addition to the very real possibility of over-sampling of foreign packs, the proportion of foreign packs that are contraband is also likely to be overestimated due to KPMG LLP's substantial underestimation of legal non-domestic consumption. KPMG LLP appears to have underestimated likely amounts brought into Australia both by Australian residents returning from overseas visits and by overseas students and other visitors. And it has neglected to include foreign packs brought in by individual travellers or mailed in excess of personal limits but on which customs duty has been paid.

The total market for illicit tobacco in Australia is likely to be substantially smaller than is suggested in the KPMG LLP report.

Prepared by Quit Victoria, 12 April 2014

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