

Illicit trade of tobacco in Australia:
Report for 2011: a report prepared for
British American Tobacco Australia
Limited, Philip Morris Limited and
Imperial Tobacco Australia Limited,
May 2012

A critique by Quit Victoria, May 2012

Overview

Excise and customs duty on tobacco products increased by 25% in April 2010 resulting in increases of about 20% in the recommended retail price of cigarettes and other tobacco products. The Deloitte report on illicit trade released 3 May 2012 once again beggars belief first because (like the previous years' reports) it features an implausibly large estimate of the size of the illicit market—does anyone seriously believe that one in every eight cigarettes they see people smoking in Australia are fake or come out of plastic bags?—but second and just as importantly, *because it fails to detect any increase in total use of illicit tobacco over the two years to November 2011*. Thus it is of very little practical value to tax authorities in Australia attempting to accurately monitor the extent of use of illicit products and the effectiveness of surveillance and enforcement activities aiming to minimise evasion.

Quit Victoria has analysed previous reports on this topic produced by Deloitte[1] and demonstrated the likely un-representativeness of the survey and the discrepancy between the results of this survey and the results of the Australian Institute of Health and Welfare's National Drug Strategy Household Survey for 2010.[2]

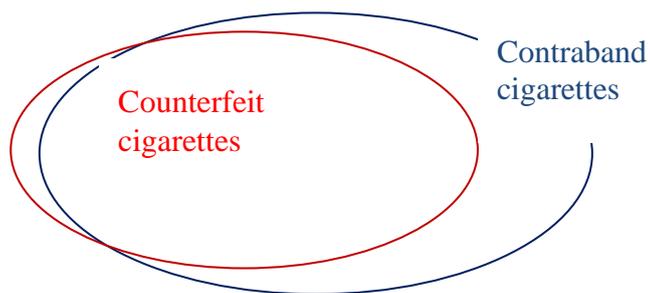
Much the same problems remain in the 2012 report. An extraordinarily high 40% of respondents dropped out of the survey after it commenced meaning that the results reflect the behaviour of a group likely to be skewed towards those interested in the topic of illicit tobacco. The percentage of people believing that they had bought illicit branded cigarettes could well have increased over the past two years due simply to the very high levels of media discussion about cigarette smuggling elicited by the previous Deloitte reports.[3] [4]

While it is clear whether or not you are buying *unbranded tobacco or cigarettes* from a plastic bag, it is exceedingly difficult for consumers to accurately determine whether *branded* cigarettes are counterfeit or contraband or not. People answering questions in the survey may have wrongly assumed any of the following:

- That heavily discounted branded cigarettes are illicit whereas it could just be a case of retailers selling off old or slow-moving stock
- That branded cigarettes that tasted different to usual were counterfeit whereas they may have just been perceived as different because of changes in the manufacturing process (for instance a change to offshore processing, or after the implementation of measures to comply with legislation on reduced ignition propensity)
- That cheap branded cigarettes with Asian names are illicit whereas there are now at least 12 brands which are being imported legally (presumably with duty paid): *Carnival, Esse Blue, and Raison Blue* from Korea; *Dj Mix Special feel* from Hong Kong; *Chunghwa, Double Happiness, Panda, Peony* and *Shuangxi* from China; and also *GD* and *Golden Deer* from the Patron Group and *Yuxi* from ATA International
- That well-known Australian brands with Chinese printing on packaging are illicit whereas some brands are now being produced in Asia. For instance the Australian Retail Tobacconist lists 'Australia/Malaysia/Singapore' as the country of origin for *Dunhill* and Singapore as the country of origin for *Kent*.^[5]

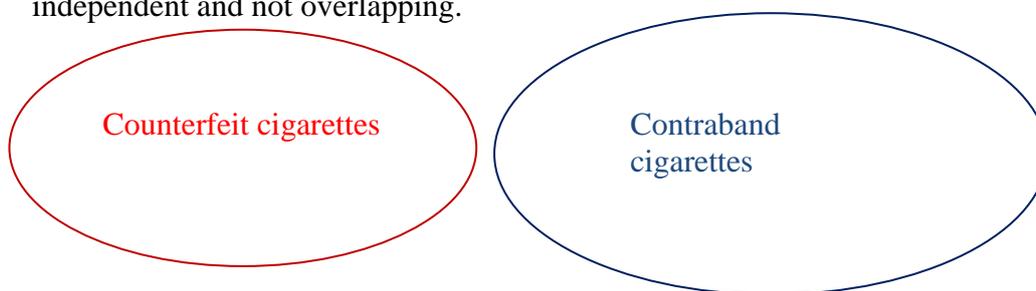
The biggest problem with the 2012 report however lies in the quantifications of use of contraband/counterfeit cigarettes.

According to the definition included in the report on page 2, contraband cigarettes can include counterfeit as well as genuine cigarettes that are imported without payment of taxes.



That is, almost all counterfeit cigarettes are contraband (though there may be a few on which taxes are paid). And the majority but not all contraband cigarettes would be counterfeit.

But the Deloitte consultants have **added** the estimates of use as if they are completely independent and not overlapping.



The entire edifice upon which these implausible estimates rest is a very long and boring survey that the majority of those contacted refused to do/complete. It appears that information on frequency and quantity of tobacco purchased may have been provided by just 150 people ... fewer than 70 people who thought they may have been (but could not have known for sure whether they were) using counterfeit cigarettes. The output of this survey must have consisted of hundreds of tables full of percentages of groups, sub-groups and sub-groups of sub-groups that needed to be added together and analysed to come up with the global estimates of use. And yet the report does not disclose the valid numbers of responses or denominators for the findings for any of the combinations of question. The discrepancies in reported figures (such as the sample size and percentages of people using unbranded tobacco) make it difficult to be confident that the data provided to the consultants has been correctly analysed.

It is pretty much pointless asking consumers questions about illicit branded cigarettes, however the National Drug Strategy Household Survey does provide a reasonable estimate of the usage of unbranded tobacco. And the relative proportions of *branded cigarettes* to *unbranded tobacco products* detected through customs operations could be used to estimate total illicit tobacco in Australia. On this basis, a more realistic quantification of illicit tobacco products used in Australia would be about 350 million cigarettes per year.

In contrast to Deloitte's estimate of 2.3 million kgs of illicit tobacco product and one billion dollars in lost revenue, it is more likely that illicit tobacco in Australia amounts to about a quarter of a million kilos and less than \$165 million in revenue foregone. This pales into insignificance with the additional \$1 billion in total government revenue (excise, customs and GST) that resulted from increasing excise and customs duty on tobacco products in April 2010 despite an estimated 8% decline in tobacco population smoking.

Likely over-representation of illicit tobacco users in the Roy Morgan survey

Like those in previous years, the 2011 Roy Morgan survey is unrepresentative of the current Australian smoking population in several important ways.

- It uses a five-year old data base from which to draw possible respondents and is therefore likely to under-represent new smokers and people who more frequently change address.
- It is based on telephone interviews of people identified in household surveys over the past five years, so may exclude many (mainly younger) people who only use mobile phones and don't have landlines
- It excluded 44% of people who could have been included merely because they lived outside the five major capital cities (why did they need to be excluded?) or did not smoke at least five days a week. And yet analysis of data from the 2010 NDSHS suggests that non-daily users make up an increasing proportion of the total tobacco market, and that use of illicit tobacco is lower outside the large metropolitan centres.
- It is reported that 40% of the respondents dropped out of the survey after it started. Given that the subject of the survey was apparent right at the beginning, it is likely that those who felt that they had something they wanted to say about illicit tobacco were more likely to stay in the survey.

Likely over-estimation of use by users

As well as over-representing users, it is likely that respondents inadvertently over-estimated the extent of their use. Levels of perceived use could be unrealistically high due to people making any of the following erroneous assumptions:

- People may have assumed that heavily discounted cigarettes are illicit whereas it could just be a case of retailers selling off stock that has become old or difficult to move.
- Cigarettes that tasted different to usual may have been assumed to have been counterfeit whereas they may have just been a batch that was slightly different because of small changes in the manufacturing process (for instance a change from local to offshore processing, or after the implementation of measures to comply with legislation on reduced ignition propensity)¹

It should be noted that the Reduced Fire Risk cigarette regulations did come into force in 2010 (over the period of the Roy Morgan surveys),[6] implementation having been brought forward as a result of concerns in the wake of the Black Saturday bushfires.[7]

- Cigarette cartons with Asian print on the packaging may be assumed to have been counterfeit when they were in fact merely manufactured in Asia.

¹ This observation applies equally to the estimates generated in the National Drug Strategy Household Survey.

The Australian Retail Tobacconist for instance lists Malaysia and Singapore as places of manufacture for *Dunhill* cigarettes. Now that tobacco is no longer grown in Australia, companies are increasingly manufacturing overseas.

- People may have assumed that very cheap cigarettes they had tried with Asian-sounding names were counterfeit or contraband when in fact they were just very cheap cigarettes imported from Asia with the duty legitimately paid.

There are now at least 12 brands that are now being legitimately imported from Asia, all substantially cheaper than local much better known brands. The table below lists the recommended retail prices of these brands from the Australian Retail Tobacconist, but it is likely that many are sold in Asian groceries and the like at discounted prices considerably lower than these. For comparison:

Brand	Local manufacturer	Country of origin		RRP May/June 2011
Dunhill	British American Tobacco	Australia (in addition to Malaysia and Singapore)		\$13.90 for 20s, \$17.20 for 25s
Winfield	British American Tobacco	Australia		\$13.45 for 20s, \$16.55 for 25s

But note:

Brand	Local importer	Country of Origin	Overseas manufacturer	RRP as at May/June 2011
Carnival	Pt Korea Pty Ltd	Korea	KT&G South Korea	\$9.90
Chunghwa	Patron Group (Australia) Ltd	China	Shanghai Cigarette Factory	\$11.40
DJ Mix Special Feel	Trojan Trading Company	Hong Kong	Not stated	\$12.64
Double Happiness,	Patron Group (Australia) Ltd	China	Shanghai Cigarette Factory	\$9.15
Esse Blue	Pt Korea Pty Ltd	Korea	Not stated	\$10.70
Golden Deer	Patron Group (Australia) Ltd		Not stated	
Panda	Patron Group (Australia) Ltd	China	Shanghai Cigarette Factory	\$17.00
Peony	Patron Group (Australia) Ltd	China	Shanghai Cigarette Factory	
Raison Blue	Pt Korea Pty Ltd	Korea	KT&G South Korea	\$10.70
Shuangxi	Everbright Int'n Trading Co Pty Ltd	China	China Tobacco Guandong Industry Corp	\$9.60
Yuxi	ATA International Pty Ltd	ATA International	Not stated	\$10.55

Source: The Australian Retail Tobacconist trademarks and prices lists, May–July 2011[5] [8]

Given the difference between the prices of these brands and top selling brands such as Winfield 25s, it would be little wonder if many people thought that Asian brands were contraband.

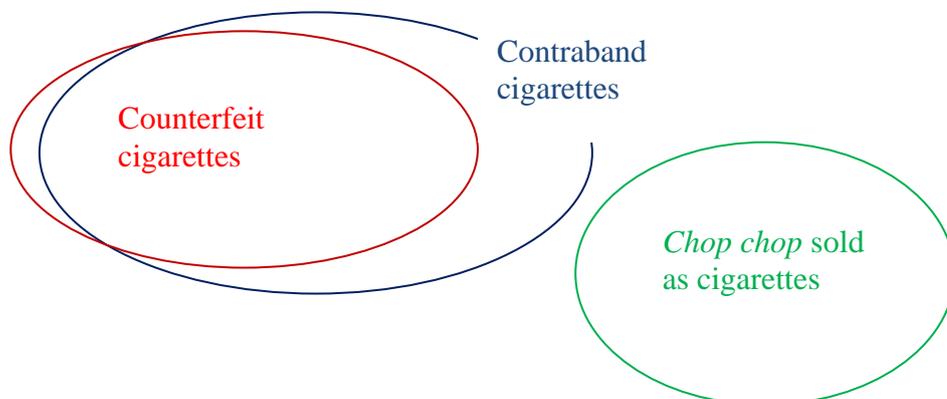
Given the subjective nature of judgements about taste, and the likelihood that consumers who've heard publicity about counterfeiting would be more attentive to brand names and packaging, it is likely that the percentage of people believing that they had bought such cigarettes increased over the past two years due simply to the very high levels of media discussion about cigarette smuggling elicited by the previous Deloitte reports[3] [4] and the extensive media coverage about this topic generated by media releases from BAT and other tobacco companies.

Likely over-reporting by users

In addition to falsely concluding that many of the cigarettes that they purchased were contraband when they were not, it is also likely that respondents over-reported their use by responding positively to the questions for more than one type of illicit tobacco product when in fact they only used one type of product.

The definitions of each of these sorts of products is complex, overlapping and likely to have been confusing to many respondents. People were asked first about their awareness and use of unbranded tobacco, then about contraband cigarettes and then about counterfeit cigarettes. The report fails to report on the percentages of people who used more than one sort of illicit tobacco.

Question 24A covers contraband, so anyone who suspected they had purchased cigarettes on which tax had not been paid (whether counterfeit or genuine) would answer positively to that question. Then Question 24B asks whether they had purchased counterfeit. A person who had purchased what they thought were counterfeit cigarettes would probably have correctly answered 'yes' to the first question about contraband tobacco, figuring that tax was unlikely to have been paid on these counterfeit cigarettes. They would then have responded 'yes' to the question about having smoked counterfeit cigarettes so that they would be counted as responding 'yes' to both questions. This would be the correct way to answer the survey according to Deloitte's own definition of the various types of illicit tobacco.... i.e. that counterfeit are almost always (but not always) contraband and that some but not all contraband cigarettes are counterfeit.



It is also possible that persons who bought unbranded cigarettes in bags, cartons or pack and who were thus counted as ‘unbranded tobacco users’, may also have answered ‘yes’ to the question ‘do you suspect you have ever purchased contraband cigarettes’.

Likely over-counting of responses by Deloitte

In addition to double-counting people’s unintended over-reported estimates of use (such as mistakenly calling chop chop cigarettes ‘contraband’ as described above), it seems that Deloitte further over-counted these estimates by *adding* the figures for counterfeit and contraband together when in fact most people would have been talking about exactly the same product and set of purchases.

The exact sequencing of the questions is not reported in Appendix B, and no denominators are reported anywhere in the report. How many people were aware of unbranded tobacco and what percentage of these used it? The output that would have been generated by this survey would have been very complex and confusing and one cannot rule out the possibility that the percentages reported (for instance 7.6% of the sample reported using contraband tobacco) were not just merely percentages of sub-sample ... for instance, a percentage of the people who were *aware* of the existence of contraband products.

Failure to report on the decline in the total market and the large increase in total revenue to government

As for the 2011 report, Deloitte fails to tabulate its estimates of sales and government revenue lost against the total market and total government revenue. Applying simple mathematics to its own estimates of the quantity of tobacco used and the amount this represents as a percentage of the legitimate market, then total government revenue must have increased substantially between 2010 and 2009 (and again between 2011 and 2010) despite a large decline in the quantity of consumption (illicit and legitimate combined) following the tax increase and despite any increase in revenue forgone due to smuggling.

	2009	2010	2011
1. Deloitte estimates of amounts purchased, '000 kgs	2,348.00	2,680.00	2,264.00
2. Percentages of markets stated in each Deloitte (and PWC) report			
as % of legal market	(must have been 14%)	15.9%	13.40%
as % of total consumption	12.3%		
3. Estimated size of legal market derived from 1 and 2 above, '000 kgs	16,741.43	16,855.35	16,895.52
4. Derived estimate of total market, '000 kgs (1 divided by 2, or 1 plus 3)	19,089.43	19,535.35	19,159.52
6. Derived % illegal of total market (legal plus illegal) (1 divided by 4)	12.3%	13.7%	11.8%
8. Deloitte estimates of excise value of illicit purchased (\$m), Table 8.1 p37	\$624.00	\$1,126.00	\$982.00
10. Assumed rate of excise per kilo (8 divided by 1)**	\$265.76	\$420.15	\$433.75
11. Estimated total revenue collected from legal market, \$m (3 x 10)	\$4,449.17	\$7,081.76	\$7,328.36
12. Est. net additional revenue (revenue paid on remaining legal market) using Deloitte figures		\$2,632.59	\$246.60

The Datamonitor figures in Table 1.1 on page 8 include forecasts for 2010 and 2011 which do not appear to take into account the 20% increase in the price of tobacco products resulting from the April 2012 tax increases. Euromonitor data for the same years shows a very different picture, with a much higher estimate of the total market in 2010 and a much higher estimate for 2011. Actual revenue figures for the financial years 2009 to 2011 suggest a picture much closer to the Euromonitor data, with a large increase in sales (by value) evident in 2010. This accords with the actual revenue collected by the Australian Tax Office on excise receipts combined with data from the ABS on customs revenue for tobacco products over the same periods.

	2006	2007	2008	2009	Projections	
					2010	2011
Estimated sales, Datamonitor (as reported in Deloitte 2012)	9,395.0	9,669.0	9,946.0	10,223.0	10,502.0	10,782.0
Estimate of sales, Euromonitor						
Cigarettes	8083.7	8403.7	8793.8	9001.1	10388.4	10351.1
Cigars	243	239.7	244.5	248.1	254.6	253.7
Smoking tobacco	698.5	736.3	772.7	807.1	877.8	896.8
Smokeless Cigarettes	1.9	1.9	1.9	1.9	1.9	1.9
Including RYO equiv	8,773.1	9,130.8	9,557.2	9,798.8 1	11,206.6	11,222.4
Total tobacco	9,027.1	9,381.6	9,812.9	10,058.2	11,472.7	11,487.4

Source: Euromonitor 2012[13]

Total (all actual) customs and excise revenue on tobacco products, financial years ending June

	2006	2007	2008	2009	2010	2011
	\$5,830.26	\$5,970.43	\$6,263.90	\$6,357.80	\$6,455.06	\$7,513.52

Sources: Australian Taxation Office[14], Australian Bureau of Statistics[15]

The actual quantities of tobacco dutied in 2010–11 are now calculable from ABS data and data published this week by the ATO[16]—see Attachment 1

As can be seen from Attachment 1, the quantity of tobacco dutied in Australia has declined substantially following the increase in excise and customs duty in April 2010. Despite this, revenue has increased by just over \$1b (almost exactly as predicted). And according to Deloitte’s own calculations, the size of the total (legal plus illegal) was 4% lower in 2011 than what it was in 2009. **By these measures, the Government’s tax increase on tobacco was a policy triumph, reducing consumption by about 8% , increasing revenue by 16% (again almost exactly as predicted) with no apparent increase in use of illicit tobacco products.**

What might be a more accurate estimate of extent of use of illicit tobacco in Australia?

As indicated above, asking consumers to report on use of illicit branded cigarettes is fraught with difficulty. However, perhaps the relative amounts of loose unbranded tobacco and illicit

branded cigarettes detected by the Customs and Border Protection Service could provide a guide for estimation. Now that tobacco is no longer grown in Australia and most of the loose tobacco appears to be coming from overseas, perhaps the ratio of tobacco to cigarettes provides a basis on which estimates of population use of unbranded tobacco could be inflated to gain a measure of total use of illicit tobacco products.

	2006-07	2007-08	2008-09	2009-10	2010-11
No. detections loose tobacco			18	28	
Quantity of loose tobacco, '000 kgs					
67		180	287	175.4	310.7
No. of detections cigarettes			15	14	
Quantity of sticks '000 pieces	42000	107000	50176	68728	82000
Total number of seizures	19	58	33	42	55
Ratio of loose tobacco to kgs of sticks (allowing 1 gm per stick)					
x to 1		3.60	3.50	4.52	3.15
Proportion that cigarettes make up of total illegal tobacco products detected					
		28%	29%	22%	32%

Source: Australian Customs and Border Protection annual reports[9-12]

The Quit Victoria analysis of the National Drug Strategy Household Survey data from 2010 calculated that the total market for unbranded tobacco was between 1.6 to 2.6% depending on what assumptions one makes about the amounts of tobacco smoked by users of unbranded tobacco relative to users of other tobacco products.

So, perhaps a more realistic estimate of the total use of illicit tobacco products in Australia (unbranded tobacco and cigarettes as well as branded tobacco products (counterfeit and/or contraband) would be more like 2 to 3% of the total market. This equates to about 350 million cigarettes with revenue forgone of about \$165 million.

Prepared by Quit Victoria, May 2012

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Questions about the survey and its findings

What response options are respondents given to Question 13H

- When you last purchased unbranded tobacco, how many grams of unbranded tobacco did you purchase?
How would people know how many grams were contained in a carton of cigarettes when these are sold by number?

What definitions of 'counterfeit' and 'contraband' cigarettes were provided

- to all the respondents of the survey
- to respondents who asked for clarification?

What percentage of the respondents who reported using contraband cigarettes (i.e. who answered 'yes' to Q 24A) also reported using counterfeit cigarettes (i.e who answered 'yes' to Q 24B)?

What were Questions 24D and 24H... they seem to have been left out of the list on questions on page 39?

The report states on **page 26 that 16%** of survey respondents stated "that they had purchased or were aware of and had purchased illicit tobacco products (in unbranded form)." But **page 33 states that 14% were illicit tobacco users** (line 9 of Consumption model in Table 8.3). Which is correct? Our guess is that 16% relates to users of all any three of the product types (unbranded contraband or counterfeit), and that the difference between the 14% and 16% represents the percentage of people who reported using contraband or counterfeit who did not report using unbranded.)

Page 22 states that the final sample size was **931**, but page 22 states that it was **949** – which is correct?

Questions about the calculations

Unbranded chop chop is sold in either 500gm or 1 kg bags as stated on page 2 of the report. The average figure for loose tobacco has got to be a figure somewhere between 500 to 1000gms depending on the proportions of people who buy half versus 1 kg bags. But the average quantity of unbranded tobacco purchased is reported at 334–8gms,

If this average takes into account the people buying unbranded tobacco in cartons and packs (and presuming the average weight of these must be less), then how could the average amount purchased be *virtually the same* in 2011 compared to 2010 if, as the report suggests on page 27, the percentage on unbranded tobacco users buying in packs has fallen from 50% in 2010 to 20% in 2011?

Exactly what percentages of respondents reported using

- only loose unbranded tobacco
- only unbranded tobacco in packs
- only unbranded tobacco in cartons
- loose unbranded tobacco AND unbranded tobacco in packs
- loose unbranded tobacco AND unbranded tobacco in cartons
- unbranded packs AND cartons but not loose tobacco
- loose tobacco, packs AND cartons

And what was the average reported number of purchases each year for each of these groups? Were the average quantities purchased (during the most recent purchase) constructed separately for each group? (The average for the first group would presumably be much higher than the average for the second).

How do the consultants compute frequency of use of contraband or counterfeit cigarettes when no questions appear to be asked about this (or is that perhaps what Qs 24 D and 24 H cover)?

Questions about the report

Last para above graph on p 16 appears to be scrambled in editing. Is this talking about increases in the alcohol and tobacco group of the CPI rather than the excise? Why is that relevant here?

Page 21 states that the survey included smokers aged 18 years and over but page 22 states that those over 64 years were screened out. Which is correct?

Questions Quit would like an answer to

Page 15. Interested to note that BATA issued proceedings against retailers alleged to have sold Winfield and wondered why were these matters settled out of court. Were the same retailers investigated for possible evasion of customs duty? Were they prosecuted? If so, was this reported in the media? Would there not be deterrence value in media coverage of such proceedings?

What brands do BATA and PMI and Imperial now currently import into Australia (i.e. that are no longer manufactured here in Australia)?

Data from the survey that might be useful to Customs for surveillance activities

What were the responses to Question 13BB about 'where did it come from' – useful to Customs surely?