Summary Brief

Summary Brief Number 22

ICTD

De-linking Tobacco Taxation and Illicit Trade in Africa

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Smoking in Africa: Low but rising quickly

Smoking tobacco has been much less common traditionally in Africa than in Europe or North America. But this is changing. Africa has become a growth market for the tobacco industry, as people in the global North have started to smoke much less. The prevalence of smoking in Europe since the 1990s has dropped by one-third, and even further in the Americas (44%). Over the same period, smoking levels in Africa have increased by over 50% (Reitsma et al. 2017).[1] Africa's youth, in particular, is overrepresented among new smokers (N. Ramanandraibe and A.E. Ouma 2011; Blecher and Ross 2013). This is part of a wider shift in tobacco consumption from richer to poorer countries – it has been projected that 6.8 million of a global total of 8.3 million tobacco-related deaths will occur in low- and middle-income countries by 2030 (Mathers and Loncar 2006). Africa is not only facing rising health care costs connected to tobacco consumption, but also the loss of lives, particularly men, as a consequence of smoking-related diseases.

Tobacco taxes to the rescue?

Smoking rates in Africa are still low, but rising rapidly. This puts African governments in a position to take action now to dramatically improve health in the coming decades (Blecher and Ross 2013; Méndez et al. 2013). Alongside measures such as restrictions on advertising, information campaigns and protecting people from second-hand smoke, tobacco taxation has been highlighted as the single most effective policy tool available to decrease overall smoking. Studies suggest that a 10% increase in the price of tobacco in low- and middle-income countries would be expected

[1] Some exceptions to this will be discussed below.

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to reduce consumption by 5% (National Cancer Institute 2017). Article 6 of the WHO Framework Convention on Tobacco notes that 'price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons', and encourages their adoption. In addition to generating new revenue, tobacco taxes are comparatively cheap to implement, at an estimated cost to low- and middle-income countries of as little as USD0.05 per capita per year (Chisholm et al. 2011). From the different types of taxes levied on tobacco products, studies have shown that specific excise taxes have the most significant effect on raising prices, and hence affecting health impacts (Petit and Nagy 2016).

And yet, despite the effectiveness and comparatively cheap implementation of excise taxes on tobacco products, low- and middle-income countries across the globe have on average maintained much lower levels of tobacco taxation than high-income countries (WHO 2020). Although 44 African countries have signed up to the WHO Framework Convention for Tobacco Control, tobacco taxes on the continent remain remarkably low. Only three countries across the continent (Mauritius, Madagascar and Egypt) met the WHO recommended standard of the total share of taxes making up at least 75% of the retail price in 2019. In fact, cigarettes have actually become cheaper over the past decade in more than a dozen countries across Africa (WHO 2020: 145).[2] Why are African governments not taking the right action?

Tobacco tax and tobacco smuggling: Achilles heel or Trojan horse?

One of the most common arguments against tobacco taxation is the risk that, by increasing the price of cigarettes and in particular contributing to price differences between countries, tobacco taxation could lead to more smuggling of tobacco products. This argument rests largely on the assumption that smuggling is heavily influenced by cross-border price differences, and higher taxation increases its profitability. In addition to undermining or even eliminating the desired revenue effects of tobacco taxes, tobacco smuggling poses a risk to a broad set of health policies. It lowers the retail price of cigarettes, which are frequently distributed through unregulated channels and hence more easily accessible to children and teenagers (Dutta 2019). It also risks financing organised crime groups, with a variety of negative knock-on effects throughout society.

Reports commissioned by the tobacco industry highlight high levels of tobacco smuggling in Africa. Discussions at *The Economist*'s Illicit Trade Summit in Addis Ababa in 2019 indicate that 40% of the tobacco sold in Ethiopia was imported illegally.[3] A study by the Tobacco Institute of Southern Africa estimates that in 2008 smuggled cigarettes made up 20% of the market in South Africa, one of the countries with relatively high levels of specific excise taxes, implying a government revenue loss of USD236 million (van Walbeek and Shai 2015). These claims highlight the potential scope of this argument, but also its main problem – many of these studies come with a significant conflict of

[2] Data here is restricted to WHO data availability.

[3] https://www.capitalethiopia.com/capital/about-40-of-ethiopian-tobacco-market-is-illegal/

interest. *The Economist*'s Illicit Trade Summit in Addis Ababa was co-sponsored by Japan Tobacco International – who had recently become the majority shareholder in Ethiopia's privatised National Tobacco Enterprise.[4] The Tobacco Institute of Southern Africa represented an industry lobbying group, which in a subsequent study corrects its estimate for the same year down to 7.9% (van Walbeek and Shai 2015).

The usefulness of the bogey man of tobacco smuggling for tobacco industry arguments against tobacco taxation has led the industry to fund a deluge of so-called research and analysis. The tobacco industry has a vested interest in overstating both the amount of tobacco smuggling and the extent to which it is caused by taxation – a tendency in industry-funded research that has been systematically highlighted by independent studies (Gallagher et al. 2019; Smith et al. 2013; Chen et al. 2015). 'Through their assiduous efforts over recent years, tobacco companies have effectively hijacked the Illicit Trade Protocol (…)' one of these argues, 'and are actively using the threat of illicit [trade] to counter tobacco control policies by arguing, misleadingly, that tobacco control policies drive increases in illicit [trade]' (Gilmore et al. 2015: 12).

Independent research has been much more doubtful of the link between tobacco taxation and smuggling. A recent global report by the World Bank concludes that 'contrary to tobacco industry arguments, taxes and prices have only a limited impact on the illicit cigarette market share at country level' (Dutta 2019). Africa provides a fitting illustration of this observation at a macro-level, as it has both a low level of tobacco taxation and low tobacco prices compared to

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Europe, and higher levels of tobacco smuggling in some parts of the continent. Consequently, understanding the relationship between tobacco taxation and smuggling in Africa requires a critical reading of available data, and a focus on independent and peer-reviewed research. While there is a scarcity of research on these issues in Africa compared to other regions, the available evidence points to a more complex relationship between taxation and smuggling.

Tobacco taxation and tobacco smuggling in South Africa

A large number of independent studies on tobacco smuggling in the continent focus on South Africa. South Africa started to employ a deliberate tobacco control policy in the 1990s,

[4] https://events.economist.com/events-conferences/emea/global-illicit-trade-summit/ (accessed 26 March 2020).

which included a large increase in excise taxes. As a consequence, cigarette consumption per capita fell by more than 60% by the early 2000s (van Walbeek and Shai 2015). Despite the rapid increase in taxation, the market share of smuggled cigarettes seems to have grown only marginally during this time, with independent studies finding it substantially lower than tobacco industry estimates suggest (Blecher 2010). Crucially, it does not appear to have substantially undermined the desired revenue and health effects of these tax increases. Using a synthetic control method to estimate tobacco consumption trends in South Africa, a 2017 study directly traces the substantial decrease in smoking to tax measures (Chelwa et al. 2017). Even as the relative market share of smuggled cigarettes increased somewhat, actual consumption in both the licit and illicit market decreased. Notably, the tax revenue from higher excise taxes offset the tax losses caused by illicit trade (Blecher 2010).

More recently, however, a set of studies finds that the market share of illicit cigarettes in South Africa spikes substantially post-2010, to approximately one-third of the market (Vellios et al. 2019). However, many of these are not smuggled but produced in-country. While there have been relatively small tax increases during this time compared to the 1990s, and a recent study could find no statistically significant effect of the smaller increases on the market share of smuggled cigarettes, the case of South Africa demonstrates that non-price related factors rather than tax increases are driving smuggling (Vellios et al. 2019).

Tax administration and enforcement

Several recent studies in the tobacco control literature emphasise that the volume of the illicit tobacco trade depends more on tax administration than tax levels, and in particular the effectiveness of enforcement and tracking mechanisms (Joossens and Raw 2003, 2008; Chaloupka et al. 2011). This remains a particular challenge on the African continent. A study of cigarette smuggling in the Southern Africa Customs Union highlights the low capacity and skill of government agencies across the region in combatting the illicit tobacco trade (Eads et al. 2019). This is echoed in a related study on South Africa, which argues that the high spike in tobacco smuggling into South Africa since 2015 correlates with a ‘turbulent time at the South African Revenue Service, when many of the enforcement functions were greatly reduced’ (Vellios et al. 2019: 1). Conversely, a study of cigarette and alcohol prices in the borderlands of Botswana highlights that, despite imposing higher levies on these goods, Botswana managed to limit smuggling through effective

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customs and border control measures (van der Zee and van Walbeek 2019). Similarly, evaluations of the implementation of track-and-trace systems combined with electronic cargo monitoring in Kenya highlight the effect that strengthening enforcement systems can have on limiting smuggling and supporting tax revenue, alongside the importance of implementing consistent and comprehensive measures. 'The government of Kenya, with its system to control the illicit trade in place', the study concludes, 'should not allow the illicit trade to be used as an excuse for not pursuing more vigorous tobacco tax reform' (Ross 2019: 582).

While low enforcement capacity and corruption in key agencies are both causes of smuggling and serious challenges across Africa, they also do not exist in a political or economic vacuum. A recent study of smuggling in North Africa notes that state actors often tolerate smuggling economies, not because they are corrupt, but because they are economically essential for border regions (Gallien 2020; Malik and Gallien 2019). If income from smuggling economies is essential to the livelihood of marginalised borderland populations, stricter enforcement along borders risks local economic collapse or widespread unrest. Here, policies on smuggling need to be combined with broader development interventions in order to be politically and socially acceptable.

Furthermore, economic interests in tobacco smuggling and tax evasion go beyond bootleggers and small-scale smugglers. As a range of recent studies note, large international tobacco companies have also at times relied on illegal trade channels in order to position their products in new markets and evade tax and tariff costs, to subvert packaging and price regulations, or undermine national monopolies (Collin et al. 2004). This further highlights the importance of supply-chain control and industry monitoring in combatting illicit cigarette trade in Africa.

De-linking tobacco taxation and illicit trade in Africa – key policy recommendations

The research summarised here strongly suggests that the existence of an illicit tobacco trade should not discourage policymakers from raising taxes on tobacco products. Taxation has been shown to be the most effective policy tool to limit overall tobacco consumption, and its associated human and healthcare costs, while also raising revenue. Best practice points to the use of specific excise taxes that apply equally across all tobacco products, which are increased regularly to account for inflation and income effects. With very few countries across the continent currently taxing tobacco products at the 75% of retail price suggested by the WHO, there is substantive scope for increased tobacco taxation in Africa. If illicit trade levels rise as a consequence, they will represent a health, revenue and governance threat that policymakers need to address. However, the increase in illicit trade is neither automatic nor inevitable, is unlikely to cancel out either the health or revenue effects of higher tobacco taxation, and can be avoided through a range of other policy tools. A recent report concludes that measures to reduce illicit tobacco trade and tobacco tax reform, including a significant increase in tobacco taxes, should be viewed as complementary, helping countries to reduce preventable morbidity and mortality, and increase public revenue (Dutta 2019). We highlight five further policy recommendations below:

1. Regional cooperation and coordination of tobacco tax and price levels is a powerful option to weaken the link between tobacco tax increases and illicit trade. While price differences are only one of a range of drivers of the illicit tobacco trade, arbitrage opportunities for smugglers at borders can be reduced by limiting tax discrepancies between neighbouring countries. WHO-recommended levels can provide a benchmark for coordination. It is important to intensify implementation efforts for such coordinated measures, for example within ECOWAS, and encourage implementation of the WHO Framework Convention on Tobacco Control (FCTC) and Protocol to Eliminate Illicit Trade in Tobacco Products (ITP).

2. Improving control of the tobacco supply chain across Africa is a central priority in limiting the illicit tobacco trade on the continent. This is not limited to borderlands or border crossings, but extends from production to import and distribution, transit zones and free trade zones. Excise stamps and fiscal stickers can support supply chain control, however best practice calls for more expansive track and trace measures. As larger track and trace systems typically require a substantive infrastructure, a close examination of providers is crucial. As highlighted in the ITP, tobacco industry involvement in the development of this infrastructure should be rejected, and products offered by tobacco industry actors, such as Codentify, should be treated with utmost caution (Ross et al. 2018; Gilmore et al. 2019).

3. Given the still comparatively small but growing tobacco market in many African countries, policies on tobacco taxation and the elimination of the illicit tobacco trade should be closely coordinated with wider policies on smoking prevention and public education.

4. Both policy on reforming tobacco taxation and countering the illicit tobacco trade should be developed with a clear consideration of distribution and equity considerations. Recent research highlights that tobacco taxation should not be considered regressive due to its positive health and behavioural effects on lower-income households (Fuchs Tarlovsky et al. 2019). At the same time, policies to counter illegal trade can have distributional effects, particularly when they interact with marginalised populations in border regions. If necessary, policies should be closely coordinated with wider developmental policies in affected regions.

5. The structures and causes of smuggling are highly context-dependent, and cannot be deduced by solely considering price and tax information. Policy in this field, and particularly in the politically and economically diverse context of the African continent, should be developed with consideration of both the capacity of the tax and enforcement institutions, and the market for both legal and illicit tobacco – particularly the wide set of drivers of illicit trade. The existing evidence base on tobacco smuggling and consumption in Africa needs to be further strengthened to support effective policymaking in this context, with a particular emphasis on research that is financially independent of the tobacco industry.

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Credits

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Thank you to Dr Hana Ross of the Research Unit on the Economics of Excisable Products (REEP) at the University of Cape Town for her comments and guidance. This brief is published in association with the Tobacco Tax Reform in West Africa project, which is part of the Economics of Tobacco Control Research Initiative funded by the International Development Research Centre and Cancer Research UK.

The ICTD is funded with UK aid from the UK Government and by the Bill & Melinda Gates Foundation; however, the views expressed herein do not necessarily reflect the UK Government's official policies, nor those of the Bill & Melinda Gates Foundation.

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First published by the Institute of Development Studies in March 2020

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