



School of Economics

Research Unit on the Economics of Excisable Products
University of Cape Town
Private Bag X3
Rondebosch 7701
SOUTH AFRICA
Telephone: +27 21 650 2723
Fax: +27 21 650 2854

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The Select Committee of Finance
Parliament
Republic of South Africa

Dear Members of the Select Committee

Comments about the Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2020)

Thank you for this opportunity to address the Select Committee on Finance. As an economist with extensive experience on the demand for tobacco and tobacco taxation, I urge the Committee to substantially increase, even double, the excise tax on tobacco products.

I am the Director of the Research Unit on the Economics of Excisable Products (REEP), based at the University of Cape Town. Our website is found at www.reep.uct.ac.za. We are a group of researchers with extensive experience in the economics of tobacco control. Our aim is to promote public health through objective and rigorous research. The unit is independent of the tobacco industry and is funded primarily by international organisations such as the Bill & Melinda Gates Foundation, the International Development Research Centre and Cancer Research UK.

REEP conducted two online surveys of smokers during the tobacco sales ban period (from 27 March to 17 August 2020). Our reports, which are available on the REEP website, received a lot of media attention when they were published. The second and more comprehensive survey, which was conducted between 4 and 19 June 2020, attracted more than 23 000 responses. By that time the average price of cigarettes was R114 per pack of 20 cigarettes – an increase of nearly 250% relative to the pre-lockdown period. More than 50% of the respondents that indicated that they had tried to quit, did so because cigarettes had become too expensive, illustrating the effectiveness of price increases to reduce the demand for these products.

The international literature is very clear. Despite the addictiveness of cigarettes, people will reduce their consumption when faced with higher prices. During the lockdown, the prices spiked as the legal sale of cigarettes was banned, and smokers had to purchase their cigarettes in the informal and illicit market. Because everyone knew that the sales ban was temporary, most smokers did not quit smoking, but decided to “grin and bear it”. Shortly after the sales ban was lifted, British American Tobacco announced that it would increase the retail price of cigarettes (relative to pre-lockdown), to recover some of the losses that they had incurred during the lockdown. It seems that BAT has calculated that, despite the existence of cheap brands and the illicit market, they do better by raising the retail price and extracting a greater per-cigarette profit from its customers. Based on the standard economic principle of the law of demand, the price increase will result in a slight decrease in cigarette consumption, but that the increase in per-cigarette profits will more than make up for that, thus enhancing BAT’s profits.

If the tobacco industry can enhance its profitability by raising the net-of-tax price of cigarettes, the government should raise its total excise tax revenue by raising the excise tax. The sales ban experience has shown that the market can carry a much higher retail price of cigarettes, than the current price of between R30 and R45 per pack for most brands.

Based on previous experience, it seems likely that the tobacco industry will call for a moratorium on the excise tax increases, on the grounds that the illicit market is out of control. They would probably argue that the government should first control the illicit market before it can raise the excise tax. This argument is self-serving. Why would BAT increase the retail price of cigarettes, which would increase the price gap between their product and the cheap (illicit) cigarette, if the threat of the illicit market is so grave? If the illicit market was truly out of control and was undermining their market share, it would not have increased its price in the way that it has.

That does not mean that the threat of illicit cigarettes is not real. Our unit estimated that illicit cigarettes comprised about 30-35% of the market in 2017. The illicit market share dropped substantially (by between 8 and 10 percentage points according to our estimates) in 2019. While the tide was turning, the battles was not yet won.

The sales ban has greatly complicated matters, and it seems likely that the illicit market has become more entrenched. The work of SARS in fighting the scourge has never been more pressing than now. However, as international research has shown, illicit trade has much less to do with high cigarette taxes than with a general sense of lawlessness, the existence of organised crime syndicates, high levels of corruption, and relatively modest penalties when caught trading in illicit cigarettes. Sadly, many of these things characterise South Africa, but with the appropriate resources, these can be addressed. We saw that happening in 2019 after the creating of the Illicit Economy Unit at SARS. The fight against illicit cigarettes is winnable.

We urge the Select Committee to substantially increase the excise tax on tobacco products in the next budget cycle. Lives are at stake. An increase in the excise tax will raise the retail price of cigarettes and will encourage some smokers to quit smoking, but it will also increase government revenue. It is a win-win situation.

Either myself, or my colleague Sam Filby (samanthy.filby@uct.ac.za) would like to make a short presentation to the Committee about our research and to potentially answer questions by the members.

Best regards



Corne van Walbeek
Director: Research Unit on the Economics of Excisable Products (REEP)