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17 September 2023

Dear Members of the Finance Standing Committee,

Re: Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill:

Specifically, Schedule II Part I (Section 7): amendment of part 2A of schedule No.1 to Customs and Excise Act, 1964

Thank you for the opportunity to comment on the 2023 amendments to the excise taxes rates. We are based at the Research Unit on the Economics of Excisable Products (REEP), at the University of Cape Town (www.reep.uct.ac.za). REEP comprises a group of researchers with extensive experience in the economics of tobacco and alcohol control. Our aim is to promote public health by providing independent and rigorous research. The unit is independent of the tobacco and alcohol industries. We are funded by international organisations such as the Bill & Melinda Gates Foundation, Cancer Research UK, and Vital Strategies.

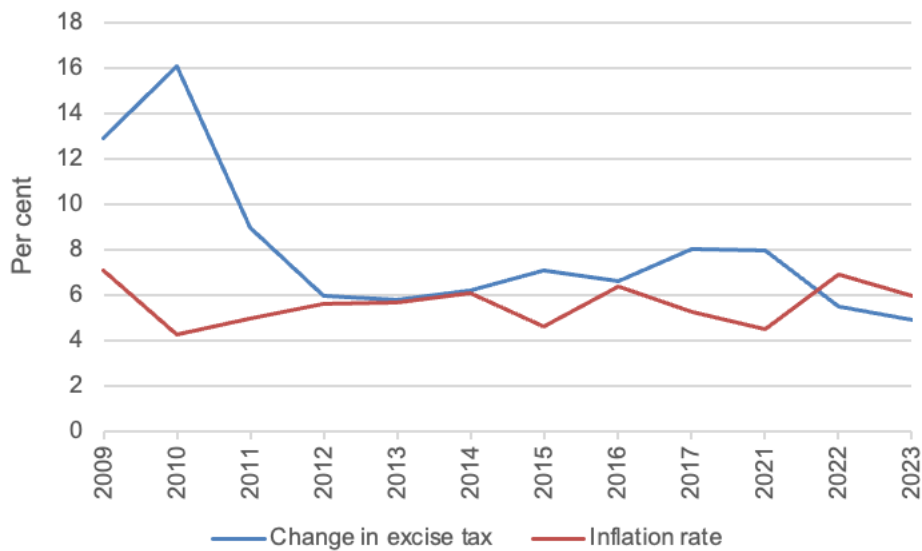
We have structured this letter in three parts: (1) cigarette taxation, (2) e-cigarette taxation, and (3) alcohol taxation. Although e-cigarette taxation is not specifically mentioned in the bill, we include it as the e-cigarette tax was introduced on 1 June 2023.

We would like to make a submission at the public hearings on 19 and 20 September 2023.

1. Cigarette excise taxation

The evidence that increases in the excise tax on tobacco products reduces tobacco use is largely undisputed. Since the early 1990s, the National Treasury has consistently increased the excise tax on tobacco products. Before 2011, excise tax increases were generally substantially higher than the inflation rate, with the result that the real value of the excise tax was increasing. However, after 2011, the excise tax increased by only marginally more than the inflation rate (Figure 1). In 2022 and 2023, the increase in the excise tax was lower than the inflation rate.

Figure 1: Nominal year-on-year increases in the excise tax on cigarettes



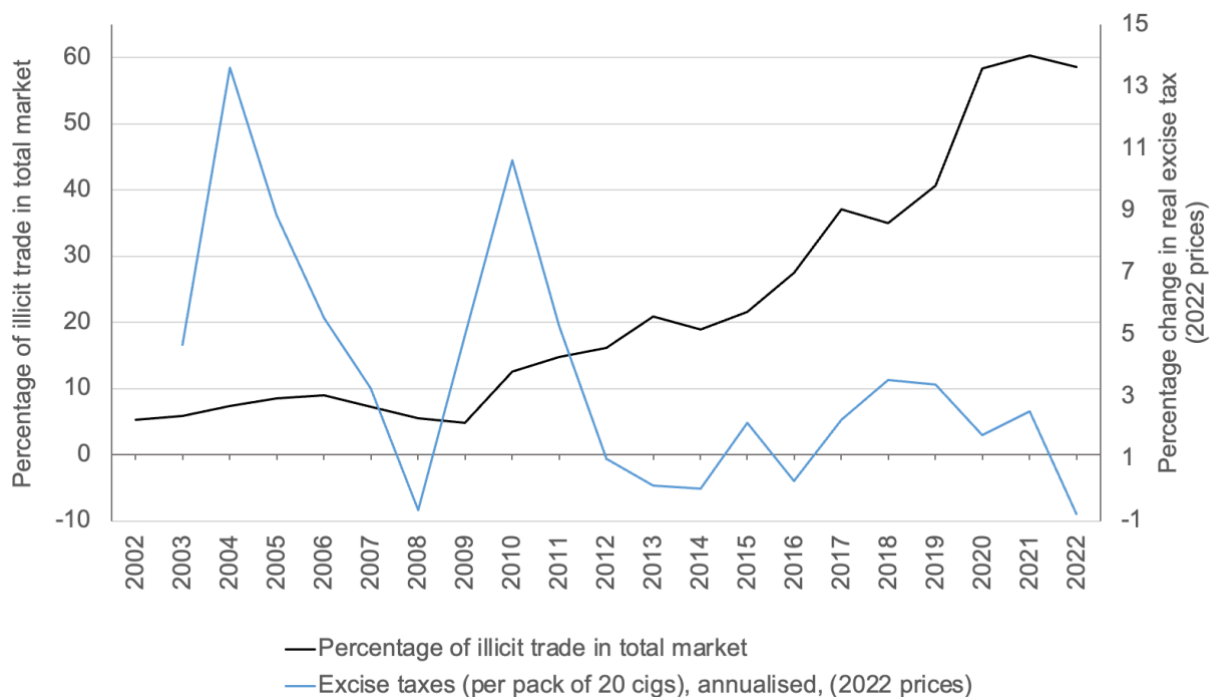
We would like to draw your attention to alarming findings from the most recent Global Adult Tobacco Survey (GATS), which was conducted in South Africa in 2021. GATS is a nationally representative household survey that monitors tobacco use among people aged 15 years and older across countries, using a standardised protocol. According to the results from South Africa’s survey, 24% of the South African population currently smoke cigarettes.¹ This is significantly higher than the 20% estimated in the most recent wave of the National Income Dynamics Study that was conducted in 2017.² It is well-documented that tobacco use imposes a significant health and economic burden on countries, and that consistent, year-on-year increases in tobacco excise taxes reduce tobacco use. The cost of smoking in South Africa amounted to nearly 1% of the South African GDP in 2016.³ These costs are likely to have increased as a result of the observed rise in smoking prevalence over the past five years.

Within this context, **we urge National Treasury to substantially increase the excise tax on tobacco products in the 2024/2025 budget cycle.** We suggest a 10% increase in the excise tax above the inflation rate. **We also recommend that Treasury introduces a multi-year taxation approach** in which, each year, tobacco excise taxes are increased by the inflation rate, plus a pre-announced additional percentage. This will ensure that tobacco products become less affordable over time. It would also align South Africa’s tobacco taxation strategy with the recommendations of the World Health Organization’s Framework Convention on Tobacco Control,⁴ an international treaty that requires ratifying countries to implement policies to reduce the demand and supply of tobacco products. South Africa ratified the treaty in 2005.

For many years, countries like the UK, Australia, and the Philippines have annually increased the excise tax on tobacco products by the sum of the inflation rate and a pre-announced additional percentage. This ensures that cigarettes become less affordable over time. For example, Australia increased the excise tax on cigarettes by 12.5% above the nominal increase in average wages for eight consecutive years from 2013 to 2020.⁵ Through a multi-year approach, tax increases are more predictable.

The tobacco industry has worked tirelessly in South Africa, and across the globe, to convince policymakers that increases in the tobacco taxes cause increases in illicit trade.⁶ This argument is self-serving and has no credible research backing. Peer-reviewed research examining trends in illicit trade in South Africa between 2002 and 2017 finds no evidence that the illicit market grew when cigarette excise taxes were growing rapidly in the 1990s and early 2000s.⁷ Instead, the research shows that the illicit cigarette trade only became a significant problem in South Africa from 2009 onwards. Since 2011 the real (inflation-adjusted) excise tax on cigarettes remained largely unchanged.⁷ This fact dispels the tobacco industry’s arguments about the link between tobacco taxes and illicit trade in South Africa. Figure 2, which updates the 2019 paper,⁷ shows the illicit trade from 2002 to 2022 (black line, primary axis), and excise taxes in 2022 prices (blue line, secondary axis). There is no link between excise taxes and illicit trade.

Figure 2: Percentage of Illicit trade in total market and real excise tax increases, 2002 to 2022



While we do not agree with the tobacco industry that tax increases result in higher illicit trade, we do agree with them that illicit trade is currently out of control. The illicit market accounted for 58% of total cigarette sales in 2022. Illicit trade should be addressed through effective enforcement mechanisms which include, amongst other things, measures to secure the tobacco supply chain, not by lowering the excise tax. **We recommend that South African government should ratify the Protocol to Eliminate Illicit Trade in Tobacco Products and implement its provisions.**⁸ Should South Africa ratify the Protocol, the country will commit itself to implementing measures that have been proven to reduce the illicit trade in cigarettes. Measures include the adoption of track and trace technology (independent of the tobacco industry), and licensing of agents in the tobacco supply chain, amongst other things.

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. Illicit trade has much less to do with 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. Illicit trade should not be addressed by reducing the excise tax.

2. E-cigarettes

As of 1 June 2023, nicotine and nicotine-substitute solutions in vaping products are taxed at a flat excise duty rate of R2.90/ml.⁹ Reducing demand is necessary as there is growing evidence that vaping products are not harmless, and contain hundreds, even thousands, of unknown chemicals.¹⁰ The new vaping tax has enraged vaping lobby groups and vaping manufacturers.^{11 12 13 14} The vaping industry argues that e-cigarettes are less harmful than traditional cigarettes. It also claims that the newly-introduced tax will spawn an illicit industry, that people will go back to smoking traditional cigarettes, and the tax will not dissuade the youth from starting vaping.¹³

Disposable vapes (which are closed systems thrown away once the liquid is finished), have become increasingly popular among the youth. These are not teenagers switching from smoking cigarettes to e-cigarettes, but rather teenagers who are starting a potential lifelong addiction to nicotine through vapes. In 2022, nine schools (both publicly and privately funded) in three South African provinces were surveyed.¹⁵ Among the 5583 learners in grades 8–12 who completed the survey, 15% used vaping devices.¹⁵ The prevalence is higher among grade 11 (17%) and grade 12 learners (27%).

With the exception of 75 ml and 100 ml e-liquid containers, the newly-introduced tax on e-cigarettes yields tax burdens that are consistently below the tax burdens on cigarettes. Currently the excise tax burden on cigarettes is about 45% of the retail price. The excise tax burden on disposable e-cigarettes is very low (Table 1: last column in yellow), ranging from 6% to 14% of the retail price. Specifically, under the current tax of R2.90 per ml, a 6ml AirsPops is subject to an excise tax of R17.40, plus 15% VAT on excise (R2.61), which would increase the price of a unit from R159 to R179.01 (Table 1). The excise tax incidence is only 11%. Similarly, the excise tax incidence of Vuse disposables is only 6% (for the 2ml product).

Table 1: The likely impact of the vaping excise tax on the prices of selected vaping products

	Volume of e-liquid	Retail prices on 12 June 2023* (no excise taxes applied)	Current policy				REEP's proposal			
			Specific excise tax (R2.90/ml) + 15% VAT on excise	Retail price with specific excise and VAT	% change in the retail price	Specific excise tax share of retail price (%)	Specific excise tax (R2.90/1 ml), floor of R50 per unit + 15% VAT on excise	Retail price with specific excise, floor of R50 per unit + 15% VAT	% change in the retail price	Specific excise tax share of retail price (%)
Disposables										
Vuse Go (BAT)	2 ml	R100.00	R6.67	R106.67	7%	6%	R57.50	R157.50	58%	37%
AirsPops One Use (Airscream)	6 ml	R159.00	R20.01	R179.01	13%	11%	R57.50	R216.50	36%	27%
AirsPops One Use (rechargeable) (Airscream)	12 ml	R249.00	R40.02	R289.02	16%	14%	R57.50	R306.50	23%	19%
E-liquid										
Vuse (BAT)	20 ml	R124.95	R66.70	R191.65	53%	35%	R66.70	R191.65	53%	35%
Burtz (sold by Vaperite)	75 ml	R240.00	R250.13	R490.13	104%	51%	R250.13	R490.13	104%	51%
Spook (sold by Vaperite)	100 ml	R280.00	R333.50	R613.50	119%	54%	R333.50	R613.50	119%	54%

*Note: Although the prices are from 12 June 2023 (i.e. after the tax was implemented), it is unlikely that these prices include the excise tax. The price of a 3ml Airspops disposable on 24 August 2022 was R95 (the same price as 12 June 2023), and in a BusinessTech article published on 12 June 2023,¹² Vaperite's managing director said that a 100ml bottle of e-liquid costs R280 (without excise or VAT), which is the price we use in the table.

Per millilitre of e-liquid, the larger containers are relatively cheaper than the smaller containers. Vaperite sells 100 ml of Spook e-liquid for R280 (irrespective of nicotine strength). The new tax on 100ml of Spook e-liquid will be R290, plus VAT on excise ($R290 \times 0.15 = R43.50$), which means that the retail price is expected to increase to R613.50, a more than 119% price increase, and a total tax incidence of 54% (Table 1). While this price increase is substantial, this applies only to the largest containers. From the vaping industry's perspective, this is the worst-case scenario. The impact of the tax on the prices of smaller containers is much less.

Users of 100 ml bottles of e-liquid are likely to be seasoned vapers and are more likely to vape as an alternative to smoking cigarettes. Youths who are experimenting with or starting vaping are not likely to purchase large containers of e-liquid; they would typically start with disposable vapes. Large containers have a much higher tax incidence than disposable vapes. This is a problem, because the excise tax is not well-targeted at reducing the consumption of vaping products among the youth. To address this anomaly, **we recommend that the National Treasury introduces a minimum excise tax amount on e-liquid.** A minimum tax amount of R50 per unit/container would have no additional tax impact for e-liquid containers with more than 17.5 ml, but would have an impact on small-volume containers, especially disposables (See the green columns in Table 1). The tax incidence on a 2ml Vuse disposable would increase from 6% to 37%. The tax incidence of e-liquid sold in units of 20 ml or more, would remain the same.

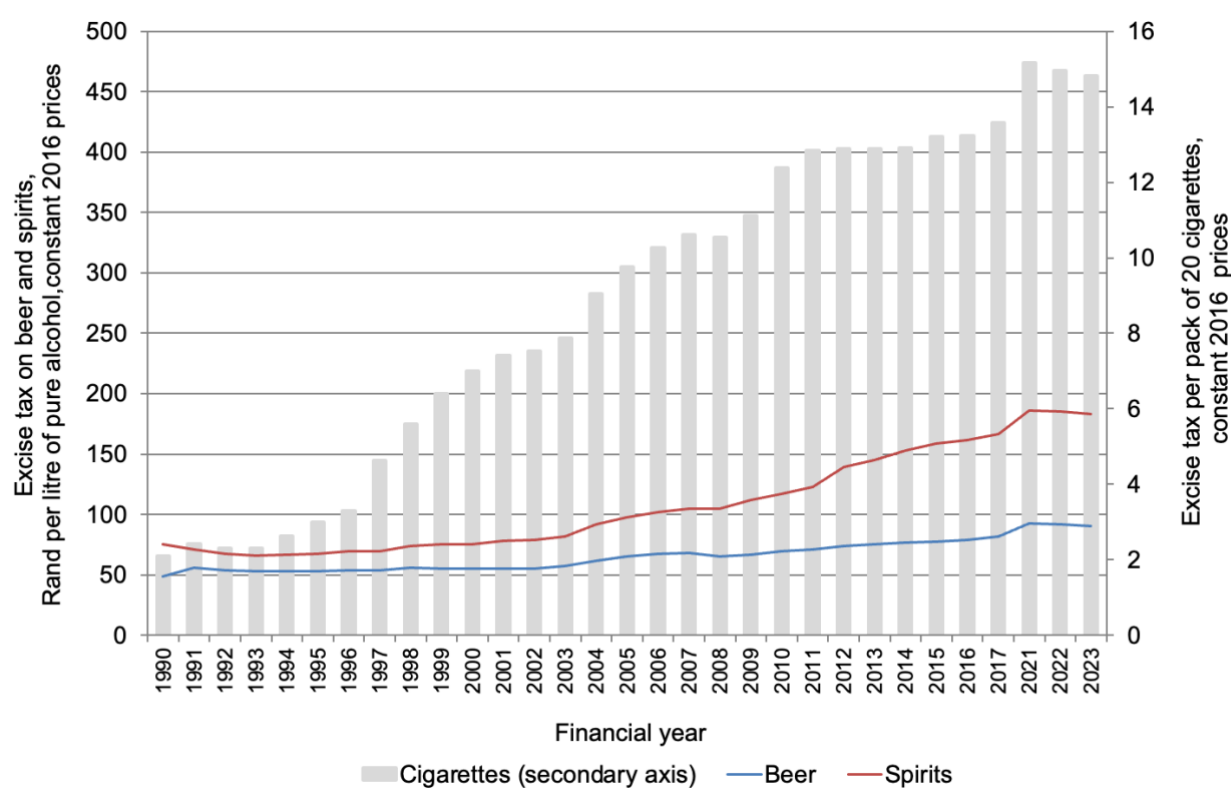
In addition to imposing a minimum excise tax on all vaping products, **we recommend that National Treasury, each year, increases the excise tax on e-cigarettes by the inflation rate, plus a pre-announced additional percentage.** This will ensure that e-cigarettes become less affordable over time.

3. Alcohol

Recently South African Breweries held a media conference where they gave some of their insights and concerns regarding the beer industry in South Africa, including the excise tax regime.¹⁶ In this section we provide some statistics that provide additional and independent context to some of the arguments that have been raised, and that could potentially be raised.

Firstly, compared to cigarettes, alcohol excise taxes have increased by a much lower percentage over a very long period. Between 1990 and 2022, the real (inflation-adjusted) excise tax on cigarettes increased by more than 600%. Over the same period, the real excise tax on spirits increased by about 120% and the real excise tax on beer increased by about 90% (Figure 3). In recent years, the National Treasury has increased the excise tax on alcohol by slightly more than the inflation rate. Such modest increases in the excise tax do very little to reduce alcohol consumption.

Figure 3: Real excise taxes on cigarettes, spirits, and beer



The literature on alcohol price elasticities indicates that heavy drinkers are less responsive to a change in the retail price than moderate drinkers.¹⁷ As such, an increase in the excise tax on alcohol is not a particularly sharp tool in addressing problematic drinking (e.g., binge and regular heavy drinking). However, as a means to raise revenue and to reduce overall drinking, an increase in the excise tax remains an effective tool.

Secondly, we highlight that there are very large differences in the excise tax on different categories of alcohol (Figure 4). Per litre of pure/absolute alcohol, spirits attracts by far the highest excise tax. In fact, the excise tax per litre of alcohol for spirits is double that of malt beer and other fermented beverages.

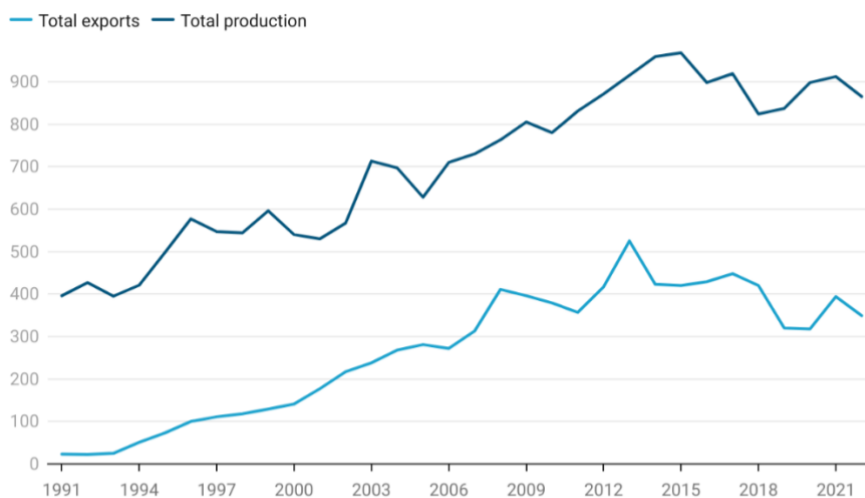
Figure 4: 2023/24 excise rates, based on absolute alcohol content



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The excise tax on the absolute alcohol in wine is about a quarter of the excise tax on beer, and one-eighth of the excise tax on spirits. The favourable treatment of wine may have had a historical precedent, i.e., a desire to grow the industry, domestically, but especially internationally. The international market has grown substantially in the past three decades (Figure 5). Exported wine does not attract excise taxes in South Africa. Wine, like other alcoholic beverages, imposes a very substantial cost on communities when consumed in excess. Why, then, does wine receive preferential treatment?

Figure 5: Total production and exports of wine (million litres)



Source: Data collated from various Excel files from the South African Wine Industry Information and Systems. Data for 2011 to 2022 is available at https://www.sawis.co.za/info/download/Book_2022.1.pdf. • Created with Datawrapper

There is no incentive to producers to reduce the alcoholic content of wine, since the excise tax is levied per litre of beverage. In contrast, beer and spirits are taxed according to the alcoholic content of the beverage. This has created an incentive for producers to produce lower-alcohol beverages¹⁸

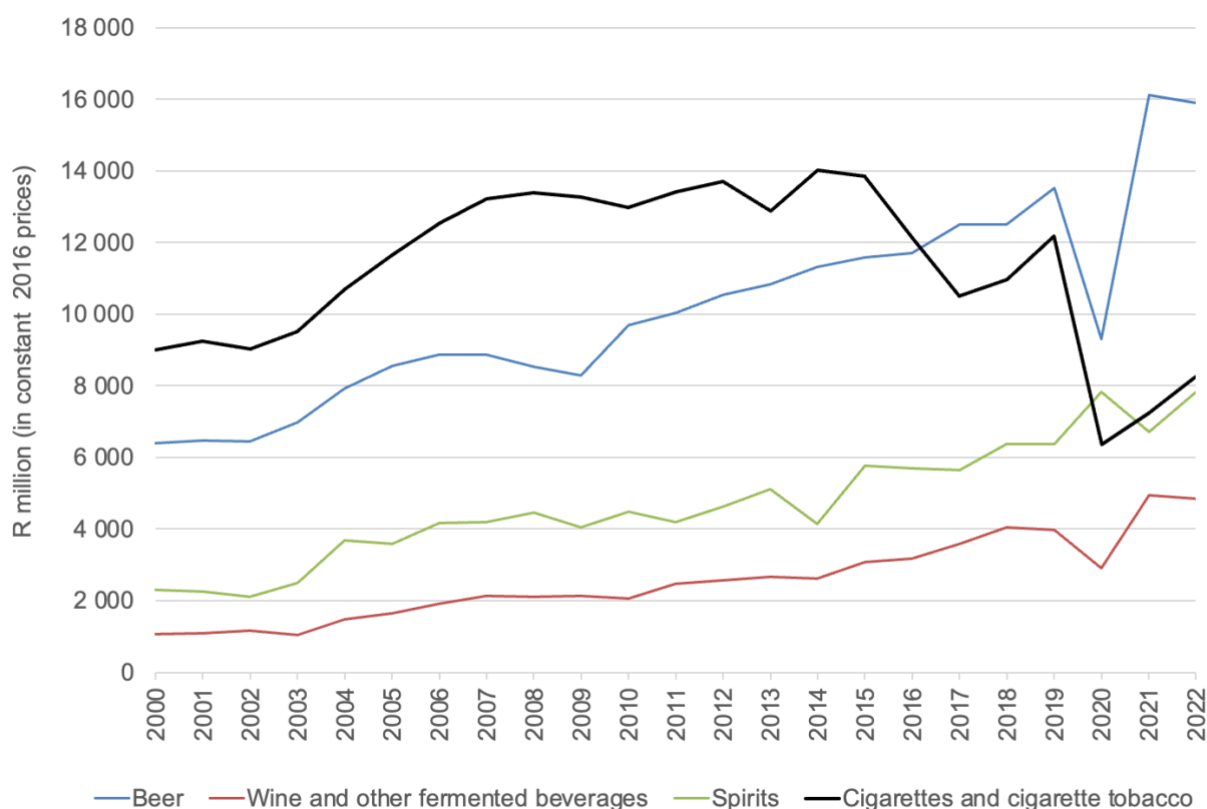
The wine industry has received special dispensation. **We recommend that the taxation on wine be reviewed such that the benchmarks between the three categories (wine, beer, and spirits) is narrowed.** Tourists can generally afford higher prices, and wine exported is not subject to local excise taxes. South Africa has now developed a successful export industry. Also, much alcohol abuse, especially in the Western half of the country, derives from wine consumption.

Thirdly, we want to comment on an issue that is sometimes raised in the media, and that the alcohol industry might raise in these presentations, namely illicit trade in alcohol. It is very easy for the respective industries to make unsubstantiated claims that (1) the illicit market is out of control, and (2) that the increase in illicit trade is attributable to an increase in the excise tax on these products.

Currently the illicit trade in *tobacco products* is out of control, as we have discussed previously. Other than the very negative public health consequences of this (i.e. people being able to buy very cheap cigarettes on the black market), it substantially reduces government revenue. This is very clearly illustrated in Figure 6, where we show the real excise tax revenue from tobacco for the 2000–2022 period. From its peak in 2014, real tobacco tax revenue decreased considerably. It was lowest in 2020, driven by the 20-week sales ban in that year, but has recovered only marginally subsequently.

In contrast, there is no such trend for alcohol excise tax revenue. Other than a substantial dip in 2020 for beer and wine, which can be attributed to the numerous alcohol sales bans in that year, real excise tax revenue from alcohol has been increasing consistently over the past two decades. The increase in alcohol revenue (and therefore sales) is not due to rapid increases in household income because macro-economic performance during this period has been weak. Any arguments about the increase in alcohol illicit trade should be questioned. Whereas the increase in the illicit trade in tobacco products is reflected in the tax revenue numbers, there is nothing in the alcohol revenue numbers to suggest that this is a problem.

Figure 6: Real excise tax revenues from tobacco and alcohol



In conclusion, here are our recommendations:

1. National Treasury should substantially increase the excise tax on tobacco products in the 2024/2025 budget cycle;
2. National Treasury should introduce a multi-year taxation approach, where taxes on tobacco products, e-cigarettes and alcohol increase annually by a pre-announced amount (or percentage) above the inflation rate;
3. The South African government should ratify the Protocol to Eliminate Illicit Trade in Tobacco Products and implement its provisions;
4. National Treasury should introduce a minimum excise tax amount on e-liquid;
5. The taxation on wine should be reviewed, such that the benchmarks between the three categories (wine, beer, and spirits) is narrowed.

We would like to make a short presentation to the Committee about our research and to potentially answer questions by the members.

Best regards,



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