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Smoke signals for reform?

The South African illicit cigarette trade

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South Africa's illicit cigarette trade is not merely large and growing but outperforms the legitimate sale of tobacco products. Extensive criminal networks operate it, it deprives the state of tax revenue, and although the measures are in place to curb the problem, they are proving to be unequal to the task. The inability of South African authorities to effectively regulate this grey market (where the legal and illegal coincide), paired with its outdated approach, is the kindling that feeds this illicit trade's flame. This article describes the current scale and nature of the illicit cigarette trade and evaluates the attempts to combat it in South Africa. We conclude with recommendations on measures the state, commerce and legal authorities could take to confront the problem with a reasonable chance of success.

Introduction

Cigarettes form part of the wider illicit tobacco trade if the distribution, sale or manufacturing thereof is prohibited, alternatively, if the

applicable taxes are not paid.² In South Africa, the illicit cigarette trade, presently estimated to make up more than 30% of the total tobacco market,³ continues to grow and is estimated to

cost the government over ZAR seven billion in lost revenue every year.⁴

The threat posed by the illicit cigarette trade is multi-faceted and cumulative. For example, due to the accessibility of cheap cigarettes, the prevalence of smoking increases, which in turn necessitates higher government spending on healthcare and increases smoking-related premature deaths.⁵ Moreover, the sales of illicit cigarettes can serve as a source of income for criminal syndicates, bolstering their foothold and interests in the South African region.⁶ The impact of the illicit cigarette trade is therefore not limited to the loss of tax revenue – the smoke from the illicit cigarettes permeates South African communities.

The risk associated with illicit cigarette trade-related crimes, as perceived by criminals and opportunists alike, is acceptable when compared to the potential profits.⁷ Citizens see participation in the trade as a tax-saving, money-earning tactic, often with only minor consequences, such as penalties or facing social judgment. The current approach to regulation does little to dissuade such tactics, as illustrated during the COVID-19 pandemic. South Africa temporarily prohibited the sales of legal cigarettes, which led to a massive surge in the illicit cigarette trade, most notably as friends and family stepped in as alternative suppliers.⁸ Opportunistic neighbours and family members, alongside the recently unemployed, readily joined the illicit cigarette trade, with little fear of retribution (especially socially).⁹ What, therefore, needs to be done or changed to combat South Africa's illicit cigarette trade more effectively?

In this article, we describe the current scale and nature of the illicit cigarette trade and evaluate South Africa's attempts at legislation to combat the problem or regulate the associated legal trade. Based on our interdisciplinary evaluation of the illicit cigarette trade, we provide recommendations that consider best practice

measures alongside contributing drivers, such as socio-economic factors. We conclude with recommendations about measures that the state, commerce and legal authorities could take to confront the problem with a reasonable chance of success.

Profile: South African tobacco market

With a population just short of 60 million, South Africa has over seven million smokers, consuming an average of 27 billion cigarettes annually.¹⁰ However, South Africans are not just consumers – commercial tobacco farming takes place on a small scale, with some 620 farms on 4 700 hectares of land. The tobacco industry is credited with employing over 108 000 individuals and contributing on average R40 million per day to the fiscus through tobacco taxes (for the 2019/20 financial year).¹¹

Tobacco products come in two classes: flue-cured tobacco (FCT), mainly exported for use in cigarettes, and air-cured tobacco (ACT), which delivers snuff and pipe tobacco.¹² These products can be either unprocessed or processed. The latter refers to the end of the supply chain where retailers or suppliers (such as *spaza* shops) sell FCT and ACT to their consumers. The unprocessed leaf is sold to farmer co-operatives and tobacco wholesalers. These products are primarily (90%) sold to The South African component of the listed British American Tobacco (BATSA), which employs 2 100 of the 108 000 South Africans who work in the tobacco trade.¹³ BATSA and other multinationals have extensive influence and power in communities.

The South African market shifted in 2010.¹⁴ A spike in local manufacturing saw a steady decline in the market share of multinational companies such as BATSA, the unchallenged price leader). This shift came about because lower-priced brands, including Gold Leaf Tobacco, offered more attractive alternatives to

South Africans.¹⁵ The increased market share changed the competitive environment, allowing small firms to offer substantially cheaper products while reducing multinationals' power to raise retail prices.¹⁶

A fivefold increase in excise taxation, more stringent tobacco control interventions, and steep bi-annual price increases by the multinationals reduced smoking prevalence from a third to a fifth of the adult population between 1994 and 2012.¹⁷ However, the discretionary price increases of multinationals largely halted in the more competitive post-2010 period as multinationals could no longer shift the brunt of an increased tax burden onto the consumer.¹⁸ This change in consumer behaviour also benefited the international tobacco trade.¹⁹

The illicit trade further poses a multi-dimensional threat to South Africans.²⁰ The illicit tobacco trade threatens public health by opening the market up to consumers who were previously deterred by high prices or lack of availability (specific brands or types). The youth and poor are especially susceptible to the lure of the illicit tobacco trade's low prices. The poor are also disproportionately impacted, as their high consumption exacerbates poverty and tobacco-related diseases.

The illicit tobacco trade also negatively impacts public welfare by *inter alia* decreasing tax revenue and subsequent investments in programs such as employment schemes. Consequently, combatting the illicit tobacco trade and related corruption and organised crime groups could improve governance, overall tax administration, compliance and enforcement capabilities. The illicit tobacco trade allows the tobacco industry to spread misinformation, including distorted facts and inflated estimations of the extent of the market. This can be used to sway public opinion and unduly influence public policy, particularly related to health and excise tax initiatives. For

example, BATSA told the media in August 2022²¹ that an Ipsos study showed that 70% of all cigarettes consumed in South Africa are illicit. Subsequent research²² conducted to verify the claim's veracity found that the estimate was not a national average but was based on stores sampled in Gauteng that sold cigarettes below the minimum tax threshold.

The number one seller in South Africa is the Remington Gold brand (manufactured by Gold Leaf Tobacco Corporation), which retails below the tax threshold 89% of the time.²³ Cigarettes sold at a price below the minimum tax threshold, although not illegal due to their low price alone (as no regulation stipulates a minimum price for cigarettes), could form part of the illicit tobacco trade. This is because their low price, which sits below the tax threshold, indicates illegal behaviour (specifically tax evasion) in the manufacturing, distribution and sale of the cigarettes. As a judgment from the Eastern Cape High Court noted, it is 'not realistically possible'²⁴ to sell a pack of cigarettes at a price below the minimum tax threshold because VAT and other basic costs such as transportation still need to be added to the excise tax payable to the fiscus. Consequently, almost 90% of the top-seller's sales could be regarded as illicit based on its below-threshold price.²⁵ Some of these packs are priced for as little as R5.00, with popular loose (single) cigarettes selling at R0.50 each, in a period when excise tax and VAT amounted to R16.30 per pack.²⁶

Other identifiers of illicit cigarettes include a lack of health warnings required on cigarette packaging, the absence of the diamond-shaped excise markings, a 'reduced ignition propensity' marking not appearing on the pack, missing or incorrect help-line numbers, and readings exceeding 12 mg tar or 1.2 mg nicotine.²⁷ All these identifiers, specifically pricing, are an indication that costs were spared at the expense

of best practice requirements and to the detriment of smokers' wellbeing.

Naturally, companies are enticed to explore more profitable avenues, even in South Africa, where production costs can be as low as R2.00 per 20-pack.²⁸ South African companies primarily produce 'genuine' contraband – cigarettes (cheap whites) produced by registered brands, in registered factories – instead of counterfeit goods.²⁹ Their illicit nature comes from the subsequent tax evasion,³⁰ which illustrates how the legal and illegal are intertwined in the illicit cigarette trade.

Drivers for South Africa's illicit cigarette trade

The illicit cigarette trade results from demand (from smokers) and supply (from legal and illegal manufacturers). Smokers are generally attracted to the illicit cigarette trade as it offers cheaper cigarettes or specialist brands or types that are otherwise not available. Likewise, existing suppliers normally enter the illicit cigarette trade to maximise profits and increase their market share.³¹

Individuals may engage in illicit trade when legal markets are blocked and social institutions are weak. Inequality and economic deprivation could, in turn, lead to crime as citizens aim to alleviate poverty. Alternatively, law enforcement's low prioritisation of deterrence efforts may attract illicit opportunists (such as organised crime groups).³²

Enticing opportunities may, therefore, be created for illicit role-players looking to expand.³³ Such catalysts or drivers can be classified as either price or non-price factors. Non-price factors often relate to the context in which the illicit market is operated, the strength of regulatory frameworks, the social acceptability of the illicit practise and the prevalence of the informal distribution channels. Price factors relate to

elements that directly influence the price of the underlying goods.³⁴

Existing literature differs on the identified drivers. Aziani, Calderoni and Dugato highlight the lower affordability of licit products, proximity to cheap cigarette source countries, high income inequality, large population and the prevalence of illicit cigarettes in neighbouring countries.³⁵ The study also noted the importance of non-price factors such as the ease and cost of operating in a country, the probability of being caught, subsequent punishment, levels of corruption, and the sophistication of criminal networks present.³⁶ Almenar, Sánche and Sapena point to the tax burden, enforcement capabilities, labour force traits, regulations, trust in government and morality.³⁷ Other studies focused on inflation, the strength of the licit sector (including the strength of official institutions), the country's Gross Domestic Product (GDP), opportunities for sub-contracting to the illicit market, incentives to seek cheaper alternatives, and the opportunity cost of producing underground.³⁸ The World Bank Group concluded that corruption, ineffective tax administration and weak enforcement and judicial systems are key drivers. They also highlight access to the illicit market (for example, via organised crime groups), the expected benefits offered by the illicit cigarette trade, and the existence of illicit cigarette trade in bordering countries.³⁹

This study will focus on both price and non-price factors, deemed most appropriate in the South African context.

Price factors

Taxation

In South Africa, as of February 2021, R21.40 of tax is levied on a 20-pack of cigarettes. This is the highest tax rate (52%) among the Southern African Customs Union (SACU) member countries. However, South Africa's tax ratios, while close to the world average, are

still far below the recommended best practice of at least 70%.⁴⁰ Consequently, cigarettes in the South African region retail at a low price compared to the international community.⁴¹

The success of a taxation strategy, however, is not necessarily indicated by tax rate levels, but rather by the effectiveness of underlying tobacco control policies. Filby identified barriers that hinder the success of South Africa's tobacco taxation systems. These barriers predominantly relate to a lack of consideration during the establishment or increase of taxation. South Africa's policymakers appear to ignore the price and income elasticity of the demand for tobacco products and fluctuations in household income.⁴²

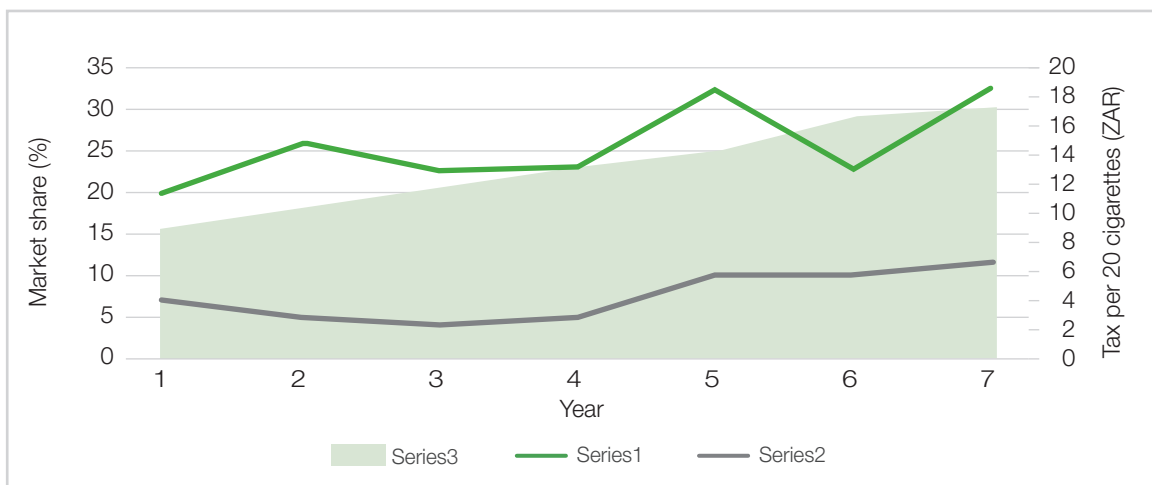
Furthermore, South Africa's taxation policy offers deferred payment of duties, while the other SACU countries require payment at the time of declaration. This creates the opportunity for tax evasion due to over-reliance on tobacco companies for self-declaration and insufficient audit resources to do the necessary follow-up.⁴³ South Africa also provides for a duty-free allowance of 200 cigarettes, 250-gram pipe tobacco and 20 cigars.⁴⁴ These sales can erode the effects of tax and price measures that reduce the demand for tobacco products. It also opens another portal for exploitation,

specifically by foreign diplomats who buy these products only to resell them later.⁴⁵

Policy can, however, also be influenced by external factors, such as powerful multinationals and their political clout. Filby explains that 'the current taxation strategy is based on a formula that gives the tobacco industry significant power in determining the quantum of the excise tax change'.⁴⁶ Tobacco industry interference is, therefore, another facet that warrants attention. The power granted to the multinationals through their influence over the taxation strategy inadvertently impacts related public health strategies aimed at reducing smoking. This represents a conflict of interest.⁴⁷

Another cause of concern is that a price-focused taxation strategy may also have inherent flaws. A positive correlation between higher price (higher taxation) and increased consumption of smuggled cigarettes can be drawn.⁴⁸ Thus, increasing cigarette prices through taxation, which forms the foundation of smoking reduction policies, could potentially stimulate the related illicit market.⁴⁹ Chart 1 below plots the South African illicit tobacco trade against the excise tax on a 20-pack of cigarettes at the specific period. Additionally, the international illicit tobacco trade is indicated to account for the general trajectory of the illicit tobacco trade.

Chart 1: Illicit tobacco trade growth comparison⁵⁰



However, recent literature has indicated that increased taxation does not necessarily result in a higher illicit tobacco trade presence.⁵¹ According to Bui and Nor, ‘numerous studies have also debunked the purported claims made by the tobacco industry about high taxes and prices as the primary determinant of illicit cigarette trade.’⁵² Additionally, the complexity of the drivers behind the illicit cigarette trade would most probably indicate that suggestions of drastic price changes would not result in an equally drastic shift in the illicit cigarette trade. This phenomenon can be illustrated by looking at Pakistan and New Zealand. In Pakistan, in 2018, a 20-pack retailed for around R5.23 (RPK 48.00), yet the illicit share of the cigarette trade was around 35%. New Zealand sold a 20-pack for R218.55⁵³ (NZD 23.90),⁵⁴ and its illicit cigarette trade represented less than 5% of its market, also in 2018.

Consequently, the illicit cigarette trade (and by effect the broader illicit tobacco trade) may not only be a result of market forces; thus, exploring non-price factors, such as the existing legal frameworks and the fear of punishment, could prove valuable.⁵⁵

Non-price factors

Geography and politics

South Africa is the main destination country for illicit cigarettes that are smuggled from source points, such as Zimbabwe.⁵⁶ Neighbouring countries, such as Lesotho, have customs and excise controls that are perceived to be relatively weak. Thus, these countries can be used as destination markets for round-tripping, which involves creating fake exports for products that are kept and sold locally.⁵⁷ For example, cigarettes are exported tax-free from South Africa to Lesotho and then smuggled back into South Africa. Alternatively, cigarettes are declared for export to Lesotho but diverted back to the local South African market before

exiting the country. These illicit cigarettes can subsequently be sold on the local market without paying duties.⁵⁸

The extensive South African border (1840 km in length) poses an enforcement challenge as it is estimated to have around 96 illegal points of entry – of which more than half are on the border with Zimbabwe.⁵⁹ Hence, border provinces or points of entry generally face a higher risk of being used for smuggling operations, whether to facilitate physical transport or be used as a false destination on paperwork. The Beitbridge border, situated between South Africa’s Limpopo River and Zimbabwe, is a significant gateway for tobacco contraband.⁶⁰ South African seizure data indicates that Zimbabwe’s Pacific Cigarette Company, previously known as Savanna Tobacco, produces the contraband.⁶¹ This contraband includes the Gold Leaf brands – the most popular seller in South Africa’s illicit cigarette trade.

The contraband enters South Africa from Zimbabwe through two general types of smuggling operations: small-scale entrepreneurial operations or organised smuggling networks, some of which enjoy political protection. The small-scale operations use informal border-crossing points in the bush – which are abundant at the Limpopo River border. Runners (mostly unemployed men) cross these entry points between midnight and 03h00, using backpacks or plastic bags to transport the contraband. When border patrol officials are encountered, a bribe is often offered to avert any scrutiny. This method of smuggling has become more popular due to the installation of truck scanners, which increased the risks of discovery for *malaityas* (cross-border transporters). However, for some, the risk is outweighed by the potential profit, and some *malaityas* continue to operate using smaller

vehicles, like cars, that are only subjected to sporadic searches.⁶²

Cigarette smugglers use tactics like hiding contraband in secret compartments of their vehicles. For example, truckers defray their costs by smuggling cigarettes instead of completing their trip with an empty container. In addition, organised smuggling networks use corruption and political connections to ensure that illicit consignments reach their destinations, such as *spaza* shops (small general dealers). A cartel operating between Durban and Harare employed political connections to ensure that their contraband trucks were not searched, even when entering through a formal border crossing. This underscores the claims made by some multinational manufacturers like Savanna Tobacco⁶³ and Amalgamated Tobacco⁶⁴ that up to a third of their cigarettes ‘go missing’ somewhere along the supply line.⁶⁵

Like the powerful tobacco manufacturers, the international tobacco trade is said to occupy a prominent place in politics due to the broader market’s great fiscal contributions through paying taxes. These multinational tax contributors are granted a seat at the table, which often coincides with power over policy and enforcement decisions. Therefore, conflict (explicit and covert, violent and non-violent) over who profits most and who controls the international tobacco trade is a main feature of South Africa’s political economy.⁶⁶

South Africa has a history of accommodating these powerful, private multinationals, and of high corruption levels throughout the tobacco control process.⁶⁷ Entrepreneurs may well go underground not necessarily to evade tax, but rather to avoid bureaucracy and corruption.⁶⁸ Profitability also serves as a driving force, especially for local manufacturers.

South Africa is estimated to produce 60% of its illicit cigarettes locally.⁶⁹ The local production makes the cheap cigarettes on

offer even cheaper – and more attractive as a substitute – which may lead to higher profits for the producers.⁷⁰ Mr Yusuf Kajee, the chief executive at Amalgamated Tobacco, argues that the producers’ choice to converge with the illicit is justified as the only way that South Africa can profit. Given the low average selling price of R40.00, only R 3.60 remains after royalty payments and excise tax, after which VAT and production costs must still be paid.⁷¹ However, the *Sunday Times*⁷² revealed that the same tobacco tycoon ‘paid tens of thousands of rands every month for several years’ to ‘facilitate business deals’⁷³ – starkly contrasting his purported image as a struggling business owner.

Socioeconomic context

The average South African smoker faces socioeconomic difficulties and experiences high rates of poverty, social inequality, unemployment, and public service access disparities.⁷⁴ The extent of these problems, which are key drivers of illicit economic activity, is illustrated by the expanded unemployment rate of 42.6% in late 2020.⁷⁵ In certain countries, particularly developing nations such as South Africa, these factors may act as catalysts for crime.⁷⁶ Improvements in household income may significantly reduce smoking, especially among young adults.⁷⁷ However, poor South African consumers may shift their behaviour towards seeking cheaper goods and alternative employment – needs that the illicit market strives to satisfy, especially in a globalised economy.⁷⁸ Either a need for income or a persistent smoking habit lies at the heart of the shift.

Social and cultural norms

Individual characteristics are important in explaining the probability and intensity of smoking habits.⁷⁹ Various studies have researched the general social and cultural

norms applicable to smoking habits. These trends include:

- Drinkers are more likely to smoke than non-drinkers.⁸⁰
- Women are between 14 and 17% less likely to smoke than men.⁸¹
- There is a strong and consistent trend in smoker age, with older smokers more likely to purchase cheap cigarettes.⁸²
- The average price paid by men is often higher – possibly because cultural roles expect men to provide cigarettes to women (similar to the expectation that men should pay for bills).⁸³
- Nonetheless, a larger proportion of South African women buy cheaper cigarettes than men at all price thresholds.⁸⁴
- Sharing cigarettes with peers may increase smoking intensity, as sharing is often done within a specific social context. Smoking becomes a social event, with an expectation that the smoker will join in and be offered a cigarette if they cannot buy it themselves.⁸⁵
- Religious-conscious individuals are less likely to smoke.⁸⁶
- Married smokers are less likely to purchase cheap cigarettes than unwed smokers.⁸⁷
- More educated smokers are less likely to purchase cheap cigarettes and to smoke (even in townships) – possibly because of increased exposure to information on related health hazards.⁸⁸ In fact, generally, individuals with secondary and tertiary education are less likely to participate in smoking than those with no formal education.⁸⁹

Policies aimed at tobacco control do not necessarily result in initiatives to decrease the prevalence of smoking. Nevertheless, the regulatory framework can influence the manner and size of participation in the illicit cigarette

trade, as its weaknesses or shortcomings may create space for the illegal market.

Local regulation

South Africa's main legislation aimed at addressing the illicit tobacco trade is the Tobacco Products Control Act 83 of 1993 (the TPC Act), as amended. The Act dictates, among other things, tobacco advertising, smoking restrictions, packaging and labelling.⁹⁰ Regulations were also issued under the TPC Act regarding signage, which is required to display price and health warnings.⁹¹ This Act was last amended by the Tobacco Products Control Amendment Act 63 of 2008 to align South Africa with the World Health Organisation's tobacco control framework (discussed below).

South Africa's legislative framework was considered one of the most comprehensive when it was initially implemented. However, even with the relatively recent amendments, tobacco control measures fall short compared to other nations,⁹² and fail to combat the illicit tobacco trade because of its reliance on outdated measures such as the archaic diamond excise stamp that has been used since the 1970s.⁹³

Other considerations

South African regulation does not operate within a vacuum. The Southern African region also faces region-specific threats, which hamstring those attempting to implement the admittedly limited controls effectively. These challenges include the sale of single cigarettes (which drastically decreases chances of traceability); an exorbitant manufacturing wastage allowance (from 5 to 20%, while international standard practice allows none); and significant sales in prisons – a destination market that remains unchecked and unmeasured, thus unregulated.⁹⁴

Informed reform

South Africa signed the World Health Organisation’s Framework Convention on Tobacco Control (WHO FCTC) in 2003 and ratified it in April 2005.⁹⁵ This global convention, read along with the Protocol to Eliminate Illicit Trade in Tobacco Products (ITT Protocol), provides several best practice measures. The ITT Protocol, undersigned on 10 January 2013, has yet to be ratified; therefore, South Africa remains non-compliant.⁹⁶ Ratification grants states ‘the necessary time-frame to seek the required approval for the treaty on the domestic

level and to enact the necessary legislation to give domestic effect to that treaty.⁹⁷ A lack of political will to properly legislate and resource efforts to combat the problem lies at the core of many tobacco control issues.

South Africa’s response to the illicit cigarette trade is measured against some of the best practice measures prescribed by the ITT Protocol. Chart 2 evaluates South Africa’s performance in the areas of licensing, due diligence, track-and-trace technology, record-keeping and the destruction of contraband.

Chart 2: Evaluation South Africa’s tobacco control practices

ITT Protocol reference	South Africa’s performance
<p>Article 6: Licensing</p>	<p>Licensing across the supply chain (as recommended) is not required. This only applies to manufacturers and importers.⁹⁸</p> <p>Physical compliance review processes have been unsuccessful, due to the contact between the inspectors and the business owners. Thus, fraud and corruption opportunities arise.⁹⁹</p> <p>A licence to manufacture is awarded after undergoing a vetting process. This process may be susceptible to corruption and can be used for extortion (threats to revoke license or not award it).¹⁰⁰</p>
<p>Article 7: Due diligence</p>	<p>No obligations to conduct know-your-customer checks during license vetting are performed, as proposed. This would include identifying the bank accounts intended for use and performing criminal background checks. Assessment of whether orders correspond with the demand in the intended destination, is also not mandated.¹⁰¹</p>
<p>Article 8: Tracking and tracing</p>	<p>South Africa’s diamond-shaped excise stamp is a simple ink impression placed upon packs (rather than the suggested affixed paper tax stamp or banderol-based stamps). The number of stamps is not kept recorded and the mark itself is easily forged. Additionally, it provides no assurance that the pack is genuine, the applicable tax has been paid, and its origin can seldom be confirmed.¹⁰²</p> <p>Efforts have been made to draft legislation, but no noticeable progress has been made.¹⁰³ Furthermore, about a third of South African smokers buy single cigarettes, which poses another hurdle altogether.¹⁰⁴</p>
<p>Article 9: Record-keeping</p>	<p>Proper record-keeping would require all licensees to provide general information, on request, of market volumes, trends, quantities of tobacco products and manufacturing equipment. Information regarding the movement and inspection of such products is also required.¹⁰⁵ South Africa’s ineffective tracking and tracing system creates opportunities to obfuscate figures, or simply lose track of the tobacco products.</p>

ITT Protocol reference	South Africa's performance
Article 18: Destruction of contraband	<p>In South Africa, a representative body of the tobacco industry is often tasked with the destruction of seized tobacco products. This directly contradicts the WHO FCTC which recommends that an independent regulatory authority, rather than the tobacco industry itself, should be given this task.¹⁰⁶</p> <p>However, the South African Revenue Service (SARS) are also actively shown to be destroying contraband, which could satisfy the recommendation.¹⁰⁷</p>

Limitations

This article has the inherent limitation of being based upon secondary sources. The reliability of findings was verified, where possible, through cross-referencing and verification with other sources from credible sources such as peer-reviewed articles. Verification through interviews was not attempted, due to the covert and criminal nature of the illicit tobacco trade. However, a comprehensive, holistic approach was followed by gathering multidisciplinary sources from various recognised international institutions.

Conclusion and recommendations

Controls may only be deemed effective if they are matched with successful enforcement and the prosecution of offenders.¹⁰⁸ In South Africa, the core of the challenge with illicit cigarette trade lies in the state's inability to effectively regulate this grey industry, where the illegal and legal habitually overlap.¹⁰⁹ We have examined the existing regulatory framework to identify gaps and possible remedies in the form of recommendations. These recommendations consider best practice measures alongside relevant contributing factors, thereby providing a holistic reform proposal with, we believe, a reasonable chance of success.

We explored the underlying drivers of the illicit cigarette trade, including both price and non-price factors. The price factors were distilled into a single consideration, namely

taxation. Taxation on cigarettes is regarded by some as the most effective control policy to limit cigarette consumption, yet many smokers (excluding the poor) do not concern themselves with the amount of tax paid for their habit.¹¹⁰ Additionally, the practice of self-declaration for duty payments and duty-free allowances still leave room for exploitation, as illustrated recently in the media the reported the abuse of these provisions by diplomats.¹¹¹

Non-price factors – geopolitics, socioeconomics, social and cultural norms and local regulation – are considered in some studies as being more relevant than price.¹¹² As an illustration, South African geopolitics indicate a precarious relationship between Zimbabwean producers and South African consumers. The Beitbridge border crossing's reputation of being a contraband gateway is reaffirmed by investigating reports of smuggling operations (of OCGs and on a smaller scale).¹¹³ However, the literature is clear that 60% of South Africa's illicit cigarettes are produced domestically.¹¹⁴ Improvement of supply management, especially through more effective regulation of the producers, should therefore be a priority. It could place pressure on the artery that supplies illicit cigarettes, thereby also cutting off blood to the hand that serves illicit customers.

South Africa faces multiple socio-economic difficulties, such as high rates of poverty and unemployment. These circumstances drive poor South Africans towards seeking

cheaper goods and alternative employment, both of which the illicit market can satisfy.¹¹⁵ Furthermore, a lack of education of consumers compounds the attractiveness of smoking, which in turn drives the illicit cigarette trade.¹¹⁶ Health initiatives aimed at reducing smoking prevalence through emphasising the health hazards of the habit may therefore have potential.

The existing South African legislative framework, primarily the TPC Act (last amended in 2008), is not keeping up with the ever-changing illicit tobacco trade. Its various stipulations are outdated and therefore have a limited effect. For example, the identification of points of origin or destinations of illegal goods may not be effective. Reform is consequently urgently necessary if South Africa is to regulate the tobacco trade.

Participants in the illicit cigarette trade are not afraid of the potential consequences of their participation in the business, such as penalties or social retribution. A lack of fear due to the perception of this illicit market further entices those looking to generate low-risk profits, which includes organised crime groups.¹¹⁷ Efforts to increase the perceived risk associated with participation in the illicit tobacco trade may thus also prove effective.

Consequently, we propose refashioning the illicit cigarette trade's image to better align public perception of the trade with its definite criminal nature. Success in the tobacco trade can encourage the commissioning of crimes or the formation of alliances with illicit market participants.¹¹⁸ Crimes such as corruption, money laundering, racketeering and fraud are often the results of efforts by enterprises (including the multinational tobacco producers) to increase profits.¹¹⁹ A conviction for tax evasion should, therefore, not be the main penalty associated with the illicit cigarette trade. This would serve two purposes:

- The perceived risk of participating in the trade would increase if participants were seen to be more severely punished. Conviction of tax evasion results in a fine or a maximum of five years imprisonment. Instead, alternative charges, including racketeering and money laundering (30 years imprisonment or a fine of R100 million fine), should be imposed. The illicit tobacco trade would become less attractive with higher penalties and stricter legislation, as demonstrated by Italy and Spain.¹²⁰
- The prevailing public consensus is that the biggest problem caused by the illicit cigarette trade is the loss of tax income.¹²¹ If the illicit cigarette trade's image can more closely identified as the face of organised crime, the public's perception could also shift. The public may perceive financial crime (tax evasion in this case) as victimless, whereas organised crime inherently conjures up cinematic images of dangerous mafias.

However, reform efforts should not only focus on consumers but also attempt to address those factors that enable or strengthen the tainted manufacturer's positions in the tobacco trade. Efforts should be made to address worrisome political connections between tobacco role-players and those tasks with regulation.

We recommend scrutinising the tobacco industry to identify high-risk enterprises, participants and their relationships. For example, a red flag should be raised if politically exposed persons are involved with the management of the enterprise. The anti-money laundering field and related institutions, such as the Financial Intelligence Centre, can provide valuable guidance here.¹²²

Similarly, in line with the geopolitics in South Africa, the risks due to the country's geological position warrant attention. Special attention should be given to the Zimbabwean border.

One option is to impose mandatory rotations of border officials to manage the risk of having a co-conspirator in the role of a gatekeeper. The example of Kenya can also be followed by deploying additional scanners that enhance cargo's non-intrusive inspection at borders).

The World Bank Group also advises segregation of duties: 'The personnel managing the scanning function are not involved in the analysis and interpretation of the scanner images, to eliminate a motivation for undue influence.'¹²³ Ideally, both the scanning and interpretation functions would be automated, thereby removing the human element and its possible undue influence.

Additionally, the following actions are proposed to address the inadequacies of specific South African initiatives (including those discussed in Chart 2). These actions are informed by international best practices as prescribed in the ITT Protocol –

- License requirement: Licensing across the entire supply chain should be pursued; the Canadian province of Quebec's comprehensive approach can be referenced.¹²⁴ Adequate non-compliance penalties should be imposed on vendors and manufacturers. Additionally, the licensing process should be secured and include due diligence to limit the risk of undue human interference (for example, granting a license due to bribery).
- Due diligence: Suppliers and manufacturers must be required to perform at least basic know-your-customer (KYC) checks. Financial institutions are required by law to conduct KYC checks; such principles, tailored as required, should also be followed.¹²⁵
- Track and trace technology: The tender process¹²⁶ to procure much-needed track-and-trace technology must be reinvigorated. The ability to accurately

determine destinations and points-of-origin is necessary when uncovering smuggling networks or identifying perpetrators. This process can also be pursued as part of a broader, excisable goods management system (EGMS) for tobacco and alcohol. Kenya's EGMS¹²⁷ can serve as an example; it provides for 'production counting, tracking and tracing products, stock control, tax revenue forecasting, tax stamp forecasting and processing, accounts management, and the collection of other business intelligence'.

- Duty payments: The practice of allowing deferred duty payments should be reviewed to prevent suppliers from relying on self-declaration.
- Excise stamp: The archaic diamond tax stamp needs to be replaced with high-security markings, thereby improving resistance to attempts at forgery. Banknote features like covert markings should inspire the new stamp features. Alternatively, automated monitoring systems¹²⁸ (digital stamps automatically placed by special manufacturing equipment) can be used. An automated system enhances production recordkeeping, as each stamp that identifies each pack of cigarettes is recorded in a database, reducing tax evasion. This model is in place in Brazil.¹²⁹

Following these recommendations, regulatory initiatives should emphasise supply-chain management, while educational initiatives should focus on eliciting public support and redressing the illicit cigarette trade in the eyes of South Africans. Relying too heavily on taxation-based policies to regulate the tobacco industry is short-sighted as it does not acknowledge the grey nature of the tobacco trade and, as recent history shows, ultimately fails to prevent the illicit cigarette trade from expanding.



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