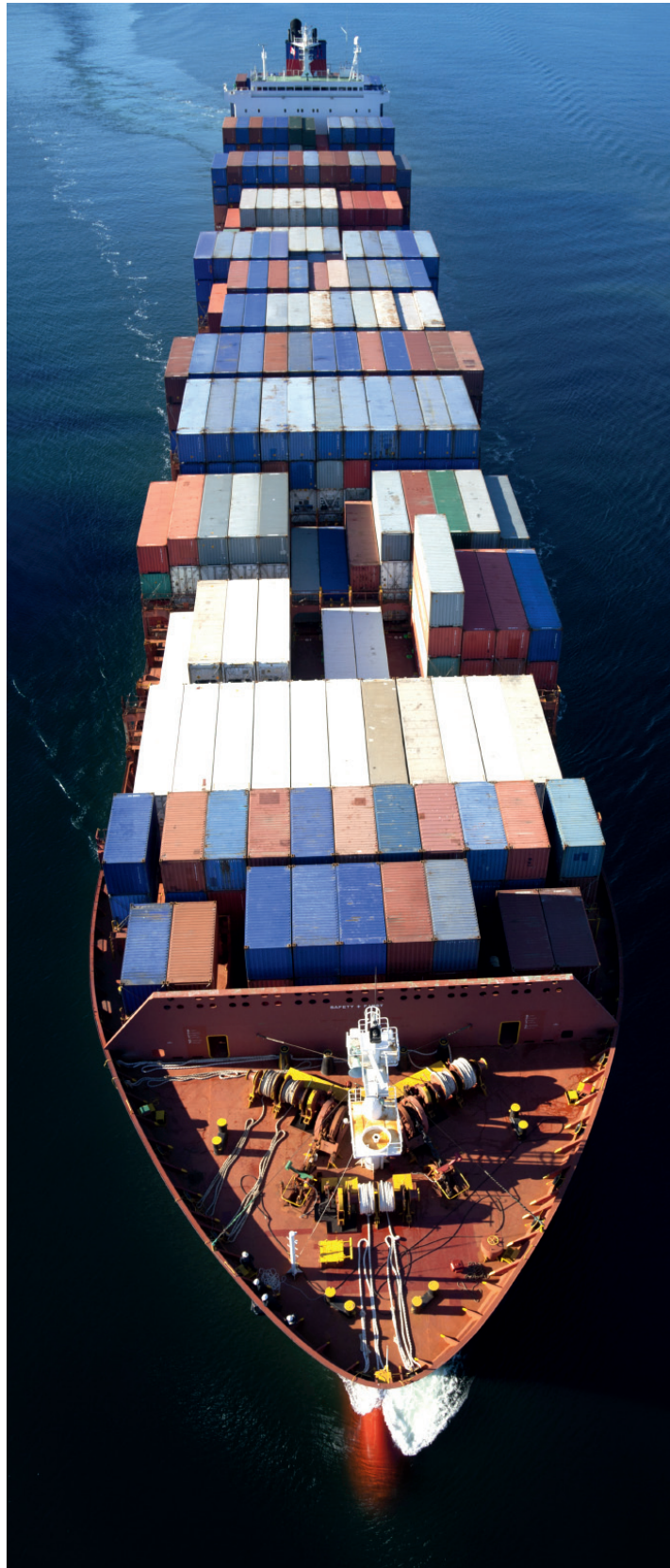


Illicit trade of tobacco in Australia

*A report prepared for British American
Tobacco Australia Limited, Philip Morris
Limited and Imperial Tobacco
Australia Limited*



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Executive summary

This study

This report has been commissioned by British American Tobacco Australia Limited (BATA), Philip Morris Limited (PML) and Imperial Tobacco Australia Limited (ITA). The purpose of this report is to:

- Provide an overview of the nature and dynamics of the illicit tobacco market in Australia
- Provide an update to the estimated size of the illicit tobacco market in Australia (as a proportion of the licit tobacco market) as published in PricewaterhouseCoopers's (PwC) report *Illegal tobacco: counting the cost of Australia's black market* based on 2009 survey data (the 2009 Report)¹.

To estimate the size of the illicit tobacco market in Australia, a consumption model approach has been adopted. The consumption model estimates the size of the illicit market based on surveyed consumers' behaviour on unbranded, counterfeit and contraband tobacco products. Key variables that input into the consumption model are:

- Frequency of purchase: how regularly survey respondents purchased illicit tobacco products
- Quantity of purchase: the amount of illicit tobacco purchased by survey respondents.

In October 2010, Roy Morgan Research Limited (RMR) conducted a survey of adult tobacco users in Australia (2010 RMR Tobacco Usage Study). As for the survey conducted by RMR for the 2009 Report, questions focused on respondents' awareness of the illicit tobacco market, in addition to the frequency and quantity of illicit tobacco purchased.

Anecdotal evidence provided by retailers combined with recent research conducted by Deloitte into tobacco product retailing informed our understanding of the nature of the illicit tobacco market in Australia.

Key findings

Increase in the level of illicit tobacco trade compared to previous studies

As detailed in Table E-1 below, Deloitte estimates the amount of illicit tobacco purchased in Australia in 2010 to be approximately 2.7 million kilograms. The size of the illicit tobacco market, represented as a proportion of the licit tobacco market, in Australia for 2010 is estimated to be equivalent to 15.9 per cent of the licit tobacco market. The estimated 2.7 million kilograms of illicit tobacco consumed represents foregone tobacco excise revenue of approximately \$1.1 billion.²

Table E-1: Headline results

Market indicator	2007 estimate ³	2009 estimate ⁴	2010 estimate
Amount of illicit tobacco purchased ('000 kg)	1,827	2,348	2,680
Size of the illicit tobacco market represented as a proportion of the legal tobacco market	6.4%	12.3%	15.9%
Equivalent excise value (\$m)	\$450	\$624	\$1,126

¹ PricewaterhouseCoopers 2010

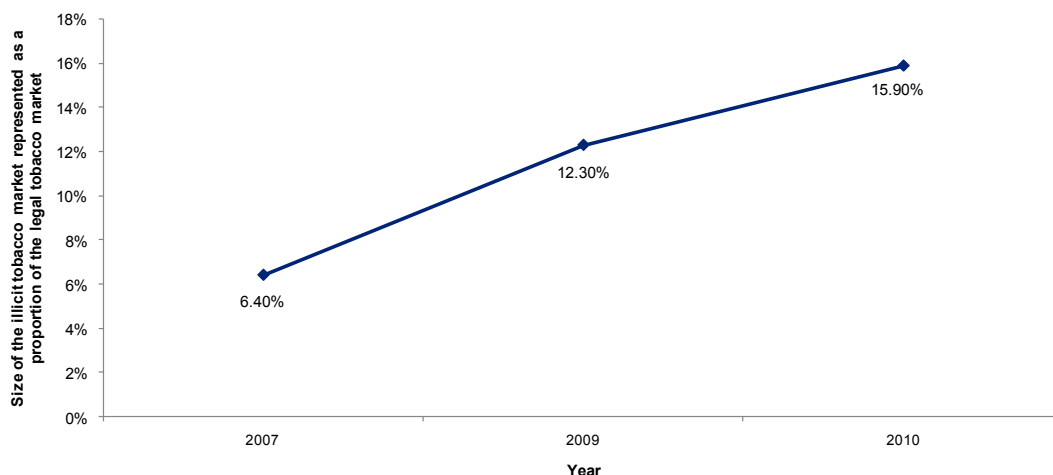
² Based on current excise rates as at February 2011.

³ PricewaterhouseCoopers 2007; Note: this estimate of the 2007 illicit tobacco market size does not include counterfeit or contraband tobacco products.

⁴ PricewaterhouseCoopers 2010

Figure 1 below highlights the increase in the illicit tobacco market size since 2007. As noted in Chapter 7: Australian border seizures, this increase in the illicit tobacco market size is aligned with an increase in detections of smuggled tobacco by the Australian Customs and Border Protection Service.

Figure 1: Size of the illicit tobacco market

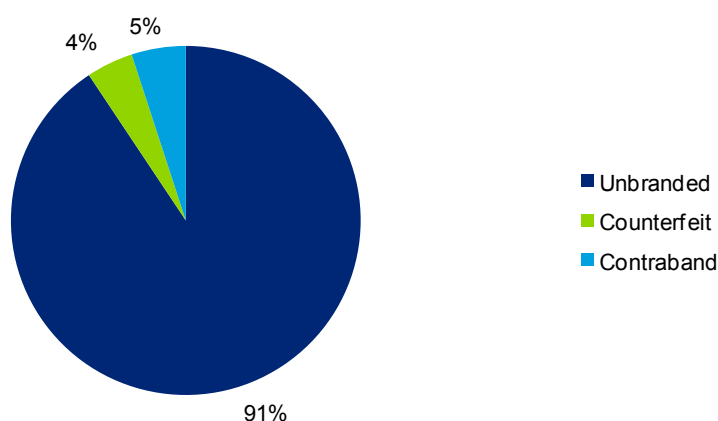


Source: PricewaterhouseCoopers 2007; PricewaterhouseCoopers 2010; Deloitte analysis 2011

Changes in surveyed consumer behaviour compared to previous studies

Unbranded tobacco was found to be the most consumed illicit tobacco product in Australia, constituting 91 per cent of the illicit tobacco market. Figure 2 below illustrates the estimated breakdown of the illicit tobacco market in Australia.

Figure 2: Illicit tobacco market breakdown, 2010



The 2010 RMR Tobacco Usage Study identified key reasons explaining the purchasing decisions of unbranded tobacco consumers.⁵ These include:

- Awareness: Consumers surveyed were aware of and wanted to try unbranded tobacco
- Price: Unbranded tobacco is typically cheaper than legal tobacco products
- Ease of purchase: It is not difficult to obtain unbranded tobacco.

⁵ Unbranded tobacco consumers constitute 91 per cent of the illicit tobacco market

With respect to price, the 2010 RMR Tobacco Usage Study noted that more than 60 per cent of adult unbranded tobacco consumers surveyed identified that the lower price was their reason for purchasing unbranded tobacco.

As outlined in Chapter 6, the 2010 RMR Tobacco Usage Study noted key observable changes in consumer behaviour including:

- Increase in participation: 15.4 per cent of survey respondents acknowledged purchasing unbranded illicit tobacco in 2010, up by 2.4 per cent from 2009 results.⁶
- Increase in frequency of purchase: unbranded tobacco was found to be purchased more frequently (on average, 15 times per annum) in 2010 compared to 2009 (on average, 11 times per annum).⁷
- Increase in the supply of illicit tobacco products at convenience stores and independent supermarkets compared with a decline from local markets, particularly in Melbourne.

Changes to the regulatory and taxation regime

There have been a number of newly implemented and proposed changes to the regulatory and taxation regime for tobacco products. The estimated increase in illicit trade has occurred concurrently with some material changes in the regulatory and taxation regime, primarily:

- Excise rate: a 25 per cent increase effective 30 April 2010. This was the first increase in excise above CPI indexation in more than ten years. The CPI indexation is a twice yearly increase in the excise applied to tobacco
- Retail display ban (RDB): prohibiting the display of tobacco products at retail outlets. The RDB will be fully implemented in all states by 2012.

In addition the Federal government also intends to legislate for the introduction of plain packaging of all tobacco products during the course of 2011.

⁶ Roy Morgan Research 2009, Roy Morgan Research 2010a

⁷ Roy Morgan Research 2009, Roy Morgan Research 2010a

1 Introduction

1.1 Purpose of this study

This report was commissioned by British American Tobacco Australia Limited (BATA), Philip Morris Limited (PML) and Imperial Tobacco Australia Limited (ITA).

The purpose of this report is to:

- Provide an overview of the nature and dynamics of the illicit tobacco market in Australia
- Provide an update to the estimated size of the illicit tobacco market in Australia (as a proportion of the legal tobacco market) as published in PricewaterhouseCoopers's 2009 Report.

Previous studies into illicit trade, including the 2009 Report, were commissioned solely by BATA. The 2010 report has been jointly commissioned by BATA, PML and ITA with Deloitte jointly selected and commissioned to undertake this analysis.

The following sections provide an overview of the legal and illicit tobacco markets as context for estimating the size of the illicit market.

1.2 Report structure

This report covers the key characteristics of the illicit tobacco market and provides an indicative estimate of its size in Australia. The report's structure is outlined below:

- Chapter 1 provides an introduction to the study and the nature of the legal tobacco market
- Chapter 2 provides background context to the illicit tobacco market including regulation, taxation and enforcement
- Chapter 3 outlines the methodology underlying the RMR Tobacco Usage Study
- Chapter 4 details information on the supply of illicit tobacco
- Chapter 5 provides a profile of illicit tobacco users
- Chapter 6 estimates the size of the illicit tobacco market represented as an equivalent proportion of the legal tobacco market in Australia
- Chapter 7 provides an overview of Australian border seizures
- Chapter 8 summarises the overall conclusion of this report.

1.3 Legal tobacco market overview

The tobacco market consists of cigarettes, cigars and cigarillos, roll-your-own (RYO) and pipe tobacco. In 2009, the estimated value of the global tobacco market was US\$429.3 billion.⁸ The Australian tobacco market value was estimated at US\$7.9 billion for the same year (see Table 1-1).⁹

⁸ Datamonitor 2010a, p. 2
⁹ Datamonitor 2010b, p. 10

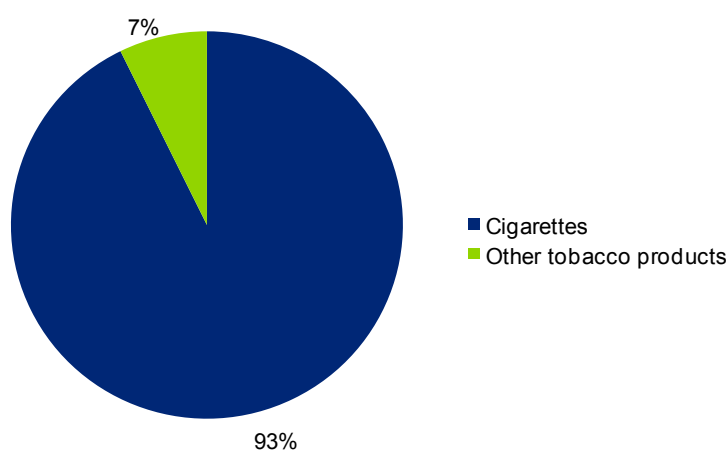
Table 1-1: Tobacco market value

Year	Global market value	Australian market value
	US\$ billion	US\$ billion
2005	\$379.3	\$7.1
2006	\$389.3	\$7.3
2007	\$402.0	\$7.6
2008	\$415.5	\$7.8
2009	\$429.3	\$7.9

Note: Based on retail sales of cigarettes, cigars and cigarillos, loose tobacco and chewing tobacco.

Source: Datamonitor 2010a p.10; Datamonitor 2010b p.10

In Australia, it is estimated that approximately 18 per cent of adults smoke legal tobacco products on a daily basis.¹⁰ Cigarettes currently account for approximately 93 per cent of legal tobacco products sold in Australia with cigars, cigarillos, RYO and pipe tobacco comprising the remainder of the market (see Figure 3).

Figure 3: Legal tobacco market segmentation, by value, 2009

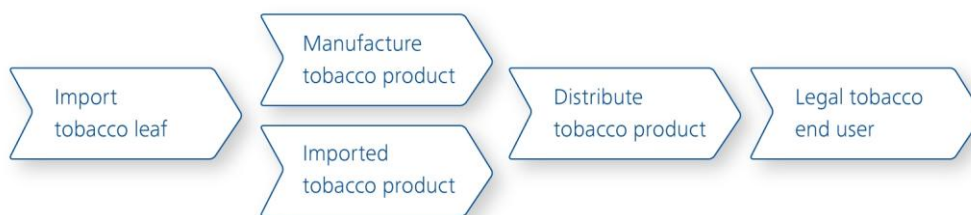
Source: Datamonitor 2010b, p.11

1.3.1 Tobacco cultivation and manufacturing

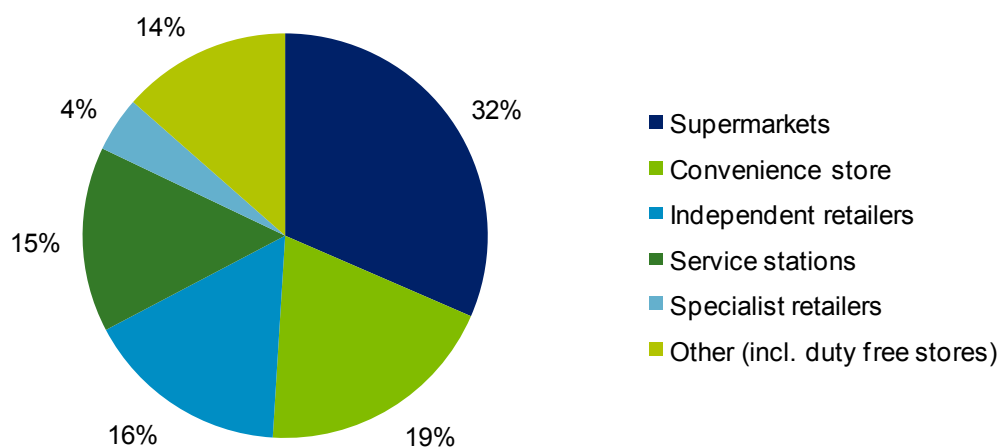
Commercial tobacco is no longer grown in Australia. BATA and PML manufacture Australian-made cigarettes using imported tobacco leaves. Although ITA is a major company in the Australian tobacco industry, it does not have local manufacturing operations and instead sub-contracts production to BATA alongside manufacturing in New Zealand and Europe.

Figure 4 illustrates the supply-chain for legal tobacco products in Australia.

¹⁰ Australian Bureau of Statistics 2009

Figure 4: Supply chain for legal tobacco products in Australia

Tobacco products are distributed throughout Australia to an estimated 35,000 retail businesses.¹¹ The majority of tobacco products are sold at supermarkets and grocery stores.¹² The remainder of sales are made primarily at convenience stores, independent retailers and service stations (see Figure 5).

Figure 5: Supply of legal tobacco products, by value, 2008

Source: Datamonitor 2009, p.31

¹¹ Scollo & Winstanley 2008

¹² Datamonitor 2009, p. 31

1.3.2 Tobacco duties in Australia

Duty-paid clearances of Australian-made and imported tobacco products destined for sale in Australia are levied by the Australian government. There are two forms of such duties:

- Excise duty: levied on tobacco products that are produced or manufactured in Australia but which are not destined for export
- Customs duty: levied on tobacco products imported for sale in Australia which are comparable to those subject to excise.

Imported tobacco products attract customs duty levied at the same rate as the excise rate to ensure that imported and locally-produced tobacco products are taxed in an equivalent manner.¹³

As of February 2011, the Australian government currently levies the following duty rates:

- \$0.33633 per stick (stick form not exceeding in weight 0.8 grams per stick of actual tobacco content)
- \$420.43 per kilogram of tobacco content (for those tobacco products in loose form or those in stick forms which weigh more than 0.8 grams).¹⁴

These taxation rates are indexed twice a year in line with movements in the consumer price index.

In 2009/10, an estimate of \$5.92 billion of tobacco excise revenue was collected, which accounts for approximately 2.2 per cent of Australia's taxation revenue.¹⁵

1.4 Illicit tobacco market overview

The illicit tobacco market represents an important issue for government and the tobacco industry as it results in lost government taxation revenue, undermines public health initiatives to curb tobacco consumption and can harm the interests of legitimate businesses throughout the supply chain.¹⁶

1.4.1 Key characteristics

There are three types of illicit tobacco products available within Australia:

- Unbranded tobacco
- Counterfeit cigarettes
- Contraband cigarettes.

¹³ Commonwealth of Australia 2010a

¹⁴ Australian Taxation Office 2011

¹⁵ Commonwealth of Australia 2010b

¹⁶ Joosens, Merriman, Ross & Raw 2009, p. 1

The Tobacco Industry Forum (TIF)¹⁷ defines the different types of illicit tobacco below in Table 1-2.

Table 1-2: Illicit tobacco products in Australia

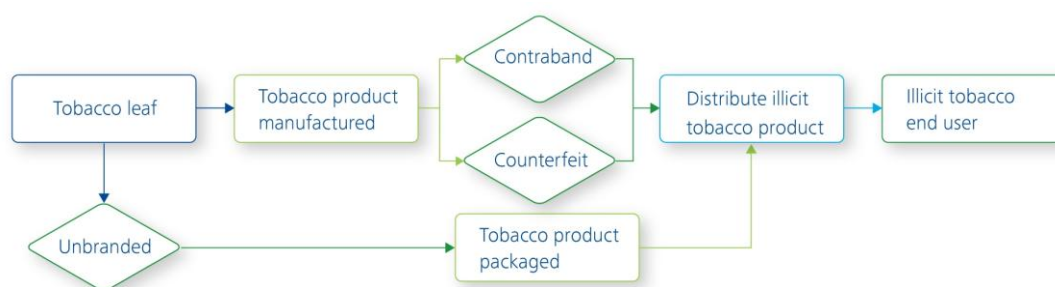
Illicit tobacco	Definition
Unbranded tobacco	<ul style="list-style-type: none"> Sold as finely cut loose leaf tobacco in half kilogram or one kilogram amounts May be grown illicitly without a licence in Australia but is most commonly imported Carries no labelling or health warnings Consumed in RYO form or inserted into empty cigarette tubes and sold in boxes which are available from tobacco retailers Commonly known as 'chop chop'.
Counterfeit cigarettes	<ul style="list-style-type: none"> Made from tobacco leaf. Specifically manufactured overseas in countries with large scale tobacco production and sophisticated tobacco manufacturing machinery Illicitly smuggled into Australia most commonly via ports on large container freight and other channels including airmail and online purchases Carry trademark or branding without the consent of the trademark owner to imitate popular legitimate tobacco product brands Do not adhere to industry production standards Pose additional serious health risks Also known as fake cigarettes.
Contraband cigarettes	<ul style="list-style-type: none"> Any cigarettes, counterfeit or genuine, that are sold without the payment of applicable excise taxes Manufactured legally outside of Australia adhering to local regulations and smuggled into the Australian market Carry legitimate branding and trademarks Avoid government regulations, quarantine inspections and ingredient controls.

Source: Tobacco Industry Forum

¹⁷ Convened by the Australian Tax Office, the Tobacco Industry Forum comprises of other Australian government departments and corporate representatives with interests in the tobacco industry

Illicit tobacco products can be available for purchase from both legitimate tobacco retailers and black market suppliers. Figure 6 illustrates the supply chain for illicit tobacco products.

Figure 6: Supply of illicit tobacco products in Australia



1.4.2 Recent illicit market highlights

The illicit trade of tobacco products is a significant global issue. The World Health Organisation (WHO) considers cigarettes to be the world's most widely smuggled legal consumer product.¹⁸ According to the WHO, sales of smuggled cigarettes will overtake legal tobacco sales by 2020.¹⁹

A recent study published by the International Union against Tuberculosis and Lung Disease estimated that 11.6 per cent of the global cigarette market was illicit, resulting in losses to government revenues of US\$40.5 billion globally. According to Joossens et al. (2009) whilst the size of the illicit tobacco market varies across geographies, it tends to be higher in lower income countries than in higher income countries.²⁰

The TIF estimates that approximately 40 per cent of illicit cigarette imports into Australia during the 12 months to February 2010 were counterfeits of major known brands.²¹ The remaining 60 per cent of illicit cigarette imports represent "exotic" brands which predominantly originate from China.²²

In addition, recent seizures by the Australian Customs and Border Protection Service indicate that there appear to be increasing attempts to import unbranded tobacco ahead of counterfeit and contraband tobacco products.²³

1.4.3 Tobacco industry initiated monitoring and enforcement

Tobacco industry operators are actively involved in monitoring the availability of illicit tobacco and engaging with federal government agencies on the management issues associated with illicit trade. For example, a private investigation firm has been contracted by one leading industry player to undertake covert purchases of illicit tobacco products across major cities in Australia. This information is shared with the Australian Taxation Office and the Australian Customs and Border Protection Service. Consultations with an illicit tobacco market investigator utilised by the tobacco industry have helped to inform the analysis contained in this report.

¹⁸ World Health Organisation 2009a p. 55

¹⁹ World Health Organisation 2009b, p.90

²⁰ Joossens, Merriman, Ross & Raw 2009, p.2

²¹ Australian Taxation Office 2010b

²² Australian Taxation Office 2010b

²³ Australian Taxation Office 2010b

2 Regulation, taxation and enforcement

This section provides an overview of the regulation, taxation and enforcement environments, including key recent and/or proposed changes.

2.1 Regulation

In recent years, there has been a move, at both state and local council levels, to introduce various regulations on smoking (see Table 2-1).

Table 2-1: Recent anti-smoking regulation

Jurisdiction	Legislation title (if appropriate)	Regulation type	Enactment date	Brief description
Australia	<i>Tobacco Advertising Prohibition Amendment Bill 2010</i>	Additional restrictions to tobacco advertising	Introduced into the Commonwealth Parliament on 17 Nov 2010	<p>Purpose is to bring restrictions on tobacco advertising on the internet or in electronic media into line with restrictions in other media and at physical points of sale.</p> <p>The main offence provision includes subsection 15A(1) which makes it an offence for a person to publish electronically in Australia anything that meets the definition of a tobacco advertisement. A person also commits an offence if they cause or authorise such a publication.</p>
New South Wales	<i>Public Health (Tobacco) Act 2008</i>	A notification and negative licensing scheme	1 Jul 2009	A negative licensing scheme introduced for tobacco retailers – tobacco retailers must not engage in tobacco retailing unless they have notified the Director-General of the NSW Department of Health.
		Single point of sale	1 Jul 2009	Tobacco retailers are restricted to selling tobacco and smoking products from a single point of sale.
		Protecting children	1 Jul 2009	Smoking in cars when a child under the age of 16 years is a passenger will be an offence and attract a \$250 on-the-spot
		Shopper-loyalty programs	1 Jul 2009	Removal of tobacco products from all shopper-loyalty programs

		Increased penalties	1 Jul 2009	An increase by up to ten-fold of the penalties applying for tobacco-related offences
		Vending machine restrictions	1 Jul 2009	Cigarette vending machines only allowed in licensed venues restricted to over 18s must be activated by a staff member or by a token which is only available from a staff member.
		Retail Display Ban (RDB)	1 Jan 2010	All tobacco products must be stored out of sight for retailers that employ more than 50 people as at 25 Sept 2008 and tobacco vending machines (including the limitation of one per venue).
			1 Jul 2010	All tobacco products must be stored out of sight for retailers that employ less than 50 people
			1 Jul 2010	Approved specialist tobacconists may only display tobacco products & non-tobacco smoking products in the following circumstances: <ul style="list-style-type: none"> – Not more than one package facing for each product line is displayed – No cartons are displayed – The entire display is restricted to a maximum size of three square metres – The display is at least two metres from any public-facing opening.
			1 July 2013	Approved specialist tobacconists will be subject to the total display ban meaning that all tobacco and non-tobacco smoking products and accessories cannot be seen by the public from inside or outside the premises.
Victoria	<i>Tobacco Act 1987</i>	Protecting children	1 Jan 2010	Smoking bans in a motor vehicle if a person under the age of 18 years is present.
		Temporary outlets ban	1 Jan 2010	Ban on the sale of tobacco products from temporary outlets.
		Ban on sale of		A power for the Minister of Health to

		appealing products to young people	Jan 2010	ban the sale of certain tobacco products & packaging that appeal to young people
		Penalties & enforcement provisions	1 Jan 2010	Amendments to certain penalties and enforcement provisions
		RDB	1 Jan 2011	A ban on the display of tobacco products at point-of-sale with an exemption for certified 'specialist tobacconists' and duty free retailers.
Queensland	<i>Tobacco and Other Smoking Products Act 1998</i>	Smoke-free cars with kids	1 Jan 2010	Smoking in cars carrying children under the age of 16 years in Queensland banned.
		Smoking in public places	1 Jan 2010	Queensland's local governments can choose to regulate smoking in pedestrian malls and at public transport waiting points such as bus stops.
	<i>Tobacco and Other Smoking Products Regulation 2010</i>		27 Aug 2010	<p>Items that are primarily used in the consumption of a tobacco product, herbal cigarette or loose smoking blend - such as cigarette papers, tubes, filters and rolling machines - captured as 'smoking related products' under Queensland's tobacco laws.</p> <ul style="list-style-type: none"> - The display of these items at retail outlets is restricted in the same way as all other tobacco products. - Prescribed restrictions on price tickets for these items & tobacco product vending machine.
Western Australia	<i>Tobacco Products Control Amendment Act 2009</i>	Tighter restrictions on tobacco use	22 Sep 2010	<p>Ban on smoking in some 'outdoor areas' including:</p> <ul style="list-style-type: none"> - Eating areas e.g. cafes - 10 metres of a children's playground equipment - Between the flags of patrolled beaches. <p>Ban on smoking in or on cars with children under 17 years present.</p> <p>RDB – Ban on display of tobacco products & smoking implements in retail premises excluding 'specialist retailers'.</p>

Tasmania	<i>Public Health Act 1987</i>	RDB	2 Feb 2011	Retail premises from which tobacco or tobacco products are sold must not be displayed other than in plain sales units or a concealed storage facility with the exception of 'specialist tobacconists'.
Northern Territory	<i>Tobacco Control Act</i>	RDB	2 Jan 2011	Tobacco products must not be displayed and kept out of sight, from both the inside and outside of the premises.
Australian Capital Territory	<i>Tobacco Act 1927</i>	RDB	1 Jan 2010	Smoking products must be kept out of view of customers in retail and wholesale outlets.
			1 Jan 2011	Smoking products cannot be displayed at specialist tobacconists whose main business is the sale of these products.
	<i>Smoke-Free Public Places Act 2003</i>	Ban on smoking in some 'outdoor' areas	9 Dec 2010	Smoking is not permitted in enclosed public places, outdoor eating and drinking places and at underage functions.

The impacts of these regulatory changes on smoking rates are yet to be fully realised. The regulatory changes have prompted media and community attention, particularly with respect to the RDB. Australian retailers who sell legal tobacco products have suggested that the RDB could have significant operational impacts. In previous studies undertaken by Deloitte, retailers have estimated one-off and recurring costs between the range of \$9,530 and \$21,560 as a result of outfit, increased transaction and restocking times in order to comply with the RDB.²⁴

2.1.1 Proposed regulatory changes

In addition to existing anti-smoking regulation, community groups and the National Preventative Health Taskforce continue to call for further legislative changes, including:

- Increasing the average price of a packet of 30 cigarettes to at least \$20 (in \$2008 terms) with equivalent increases in the price of RYO and other tobacco products
- A ban on all forms of advertising and promotion of tobacco products. A key focus of this ban would be the introduction of legislation to restrict Australian internet advertising of tobacco products
- The introduction of plain packaging. In April 2010, the Federal government announced that it would be developing legislation to introduce mandatory plain packaging of tobacco products
- Prohibiting smoking in any public place. Public places of key interest include outdoor seating areas, CBD precincts e.g. outdoor shopping malls, sporting venues and universities
- An abolishment of duty-free tobacco sales.

2.2 Tobacco excise and customs duties

Duty-paid clearances of Australian-made and imported tobacco products destined for sale in Australia are levied by the Australian government. There are two forms of such duties:

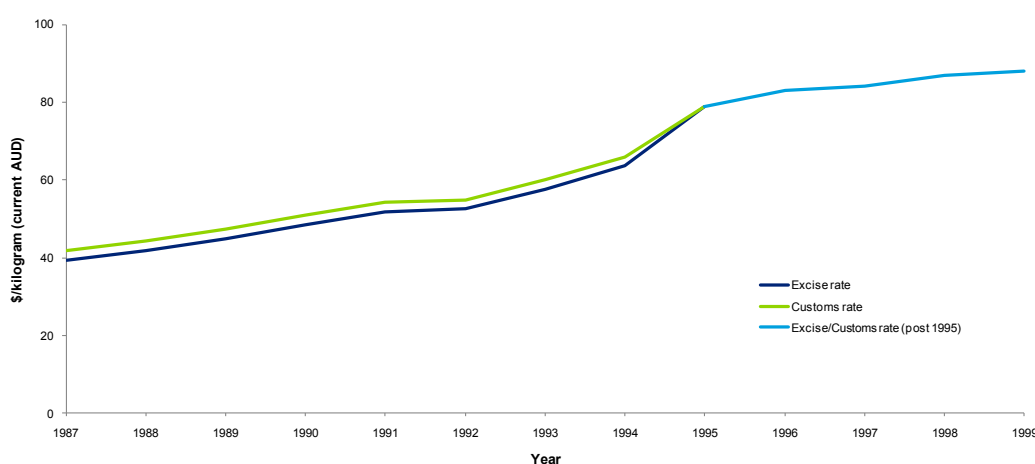
²⁴ Deloitte 2009

- Excise duty: levied on tobacco products that are produced or manufactured in Australia but which are not destined for export
- Customs duty: levied on tobacco products imported for sale in Australia which are comparable to those products subject to excise.

Imported tobacco products attract customs duty that includes a component at the same rate as the excise rate to ensure that imported and locally-produced tobacco products are taxed in an equivalent manner.²⁵

Until 1999, the federal excise and customs duties were calculated on the basis of the weight of tobacco products. Figure 7 below shows the changes in excise and customs duty rates up until 1999. As can be seen, the customs duty became equal to the excise duty in 1995.

Figure 7: Rate of federal tobacco duty per kilogram, all tobacco products (1987-1999)



Source: Scollo & Winstanley 2008

Since 1999, the federal government has followed a system that calculates duty rates based on the number of cigarettes (sticks) at 0.8 grams of tobacco weight. These taxation rates are then indexed twice a year in line with the consumer price index.

On 29 April 2010, the federal government announced an increase to the excise and customs duties on tobacco products of 25 per cent, immediately effective on 30 April 2010 (see Table 2-2 below). This was the first increase in excise above CPI indexation in more than ten years.

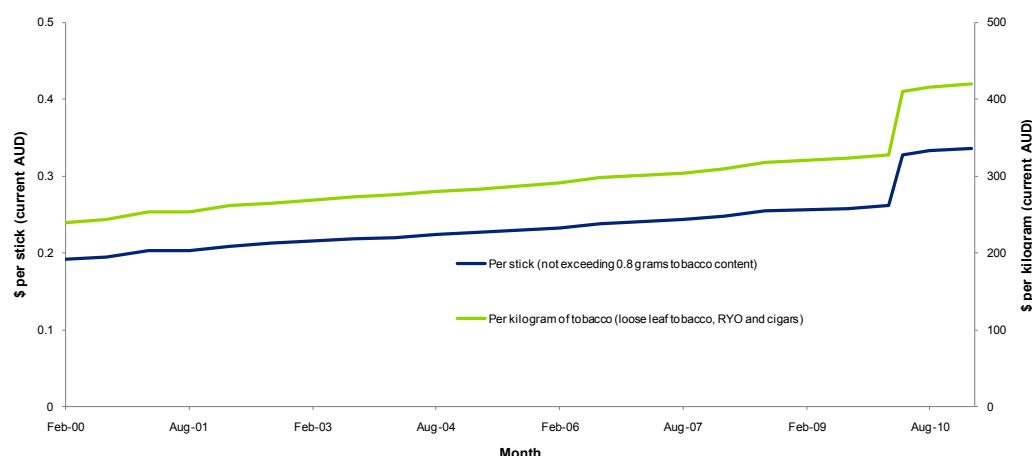
Table 2-2: Increase in tobacco excise

Tobacco product	Previous tobacco excise (pre 30 April 2010)	Post tobacco excise (as at 30 April 2010)
Per stick (not exceeding 0.8 grams tobacco content)	\$0.26220	\$0.32775
Per kilogram of tobacco (loose leaf tobacco, RYO and cigars)	\$327.77	\$409.71

Source: *Excise Tariff Act 1921* (cTh)

Figure 8 illustrates the timeline of applicable excise and customs duty rates on tobacco products in Australia. As can be seen, the 25 per cent increase applied on 30 April 2010 had a considerable impact.

²⁵ Commonwealth of Australia 2010

Figure 8: Rates of federal tobacco excise and customs duties (1999-2011)

Source: Scollo & Winstanley 2008; Australia Taxation Office 2010a; Australia Taxation Office 2011

The increase in the federal excise and duty was aimed at reducing smoking rates in Australia, especially amongst young tobacco users who are believed to be more sensitive to price.²⁶ The federal government estimated that the excise increase would lead to 87,000 Australians ceasing to smoke almost immediately.²⁷ By 2020, the federal government estimates that if health preventative measures (which include the 30 April 2010 rise in the tobacco excise and customs duties) are adopted there may be one million fewer tobacco users.²⁸

2.3 Monitoring and seizures

The Australian Customs and Border Protection Service emphasises the importance of monitoring the illicit tobacco market. A combination of solid intelligence focused targeting, advanced X-ray technology and skilled staff is maintained at „fontline’ programs to prevent and control the access to illicit tobacco products.²⁹

Looking ahead, the Australian Customs and Border Protection Service reported that it will seek to combat the illicit trade in tobacco products through approaches that include:

- A review of the current penalty regime
- The implementation of changes that improve the Service’s deterrence measures.³⁰

2.4 Penalties

There are a range of penalties in Australia associated with illicit tobacco production and sales. Penalties range from fines to imprisonment and can be imposed at a distribution, point of sale or end-user level.

2.4.1 Australian Customs and Border Protection Service

In 2009/10, the Australian Customs and Border Protection Service served 60 convictions with respect to illicit tobacco trade resulting in \$513,616 awarded in fines and penalties.³¹ Prosecutions resulted in nine custodial sentences ranging from one year to ten years.³²

²⁶ Prime Minister Commonwealth Parliamentary Offices, 2010

²⁷ N. Roxon 2010

²⁸ Australian Government National Preventative Health Taskforce 2009

²⁹ Australian Customs and Border Protection Service 2009

³⁰ Australian Customs and Border Protection Service 2010

³¹ Australian Customs and Border Protection Service 2010

³² Australian Customs and Border Protection Service 2010

The maximum penalty for tobacco smuggling is ten years. Suggestions have been made to increase this penalty to bring the maximum term in line with other illicit drug behaviour.³³ For example, the maximum penalty for smuggling illicit drugs is 25 years.

In a recent case, a woman was sentenced to three years in jail after the Australian Customs and Border Protection Service intercepted two shipping containers in Sydney, which were found to contain over 18,000 kilograms of undeclared molasses tobacco.³⁴

2.4.2 Australian Tax Office

The Australian Tax Office (ATO) has the ability to impose fines and commence prosecution on persons that possess tobacco products that evade taxation. Such tobacco products may be smuggled or illicitly produced tobacco products that are sold in Australia. This extends once the tobacco product has moved past the Border and is no longer enforceable by the Australian Customs and Border Protection Service.

The *Excise Tariff Act 1921* imposes controls in three main areas:

- Growing, dealing in and moving of tobacco seed, plant and leaf
- Manufacturing, storing and moving of excisable tobacco products
- Payment of duty for excisable tobacco products.

Licenses to manufacture, store and move excisable tobacco products are granted under the *Excise Tariff Act 1921*. The *Excise Tariff Act 1921* requires that tobacco not be manufactured outside the control of the ATO to ensure that the correct amount of duty is ultimately paid or the tobacco is otherwise appropriately dealt with. A conviction for an offence against the *Excise Tariff Act 1921* may lead to a penalty in the form of penalty units, a term of imprisonment or an appropriate monetary fine.

2.4.3 Intellectual property infringements

Counterfeiting tobacco products infringes on the World Trade Organisation (WTO) Agreement on Trade-Related Aspects of Intellectual Property (the TRIPS Agreement). Under this agreement, minimum levels of protection are established whereby governments must adhere to the intellectual property of other WTO member nations. This is particularly important for the registration of trademarks. If an infringement against the intellectual property within a member state occurs, governments are obliged to take enforcing steps against the infringement of these standards.³⁵

Producing counterfeit tobacco infringes upon the WTO's TRIPS Agreement. In addition to government action, tobacco companies can pursue convictions in a civil manner in response to infringements of their intellectual property.

Tobacco companies have been active in pursuing action over infringements in an attempt to defend their brands and intellectual property. Since October 2008, 18 per cent of tobacco purchases made by illicit tobacco market investigators at retail outlets have resulted in purchases of illicit tobacco.³⁶ There have also been 144 cease and desist letters sent to infringers and 19 incidences where damages have been paid.³⁷

³³ L. Murdoch & G. Strong 2010

³⁴ Australian Customs and Border Protection Service 2010b

³⁵ World Trade Organisation 2010

³⁶ Illicit tobacco market investigator, pers. comm., 14 December 2010

³⁷ Illicit tobacco market investigator, pers. comm., 14 December 2010

3 Roy Morgan Research Tobacco Usage Study

Roy Morgan Research was commissioned by BATA to conduct a survey of adult tobacco users across Australia. Respondents were also asked about their consumption of illicit tobacco products. The survey responses were provided to Deloitte for the purposes of this report.

Roy Morgan Research Limited (RMR) is an established market research company in Australia. In 2010, RMR was commissioned by BATA to conduct a survey of adult tobacco users in Australia (referred to as a Tobacco Usage Study).

As for the question design and survey approach previously followed by RMR for the 2009 Report, questions in the 2010 Tobacco Usage Study focused on respondents' awareness of the illicit tobacco market and their level of participation (if any). The 2010 RMR Tobacco Usage Study was conducted in October 2010 with the collected data provided by RMR to Deloitte for the purposes of this report.

3.1 Tobacco Usage Study methodology

The 2010 Tobacco Usage Study involved a Computer-Assisted Telephone Interviewing (CATI) survey of adult tobacco users across Australia. Before commencing the 2010 Tobacco Usage Study, RMR drew a sample of tobacco users from its Establishment Survey.

3.1.1 RMR Establishment Survey

The Establishment Survey is a comprehensive household survey conducted across Australia. Random clustered sampling is utilised to select households across metropolitan and regional areas throughout Australia. Door-to-door interviewing is then conducted each weekend, with one person (aged 14 years or older) per household being interviewed on a variety of topics, including whether they consume tobacco.³⁸ In total, a sample size of 50,000 is collected over the course of 12 months.

3.1.2 Tobacco Usage Study sample selection

The 2010 Tobacco Usage Study drew a sample of tobacco users from the past 48 months worth of data from RMR's Establishment Survey. This initial sample comprised of 9,206 identified people. However after allowing for natural sample attrition, 949 respondents completed the survey, none of whom participated in the survey previously used in the 2009 Report.³⁹

3.1.2.1 Key requirements of sample

Adult participants who qualified for the survey satisfied the following criteria:

- Aged between 18-64 years
- Resided in Sydney, Melbourne, Brisbane, Perth or Adelaide
- Smoked manufactured cigarettes or RYO at least five days a week (on average).

Table 3-1 illustrates the distribution of the sample across capital cities.

³⁸ Roy Morgan Research 2010b

³⁹ Further details on the attrition of the sample can be found in Appendix #1

Table 3-1: Sample distribution across capital cities

City	Percentage of total sample
Sydney	33%
Melbourne	27%
Brisbane	18%
Perth	13%
Adelaide	9%

Source: Roy Morgan Research 2010a

3.1.2.2 Margin of error

Typically in statistical research, a census of the entire population is impractical. As a result, a random population sample is drawn from the total population which is underlined by an assumption that the sample's statistics reflect those of the total population.

To quantify the degree to which the sample reflects the true population values, the sample's margin of error can be assessed by estimating a confidence interval. Analyses based on sample sub-groups have reduced reliability however data from sub-samples of 100 or more are commonly reported. The confidence interval for data derived from a sample of 100 is \pm ten per cent at the 95 per cent confidence level.

For this report the standard 95 per cent confidence level was used. As a result, the total sample of 949 smokers is expected to be accurate to within \pm 3.2 per cent of the population figures at the 95 per cent confidence level. Essentially, this margin of error infers that there is only a five per cent chance that the population value is more than 3.2 per cent away from the values observed with the sample of 949 smokers.

4 Supply of illicit tobacco

Illicit tobacco is available for purchase by consumers from a variety of suppliers including convenience stores, specialist tobacconists and local markets.

4.1 Characteristics

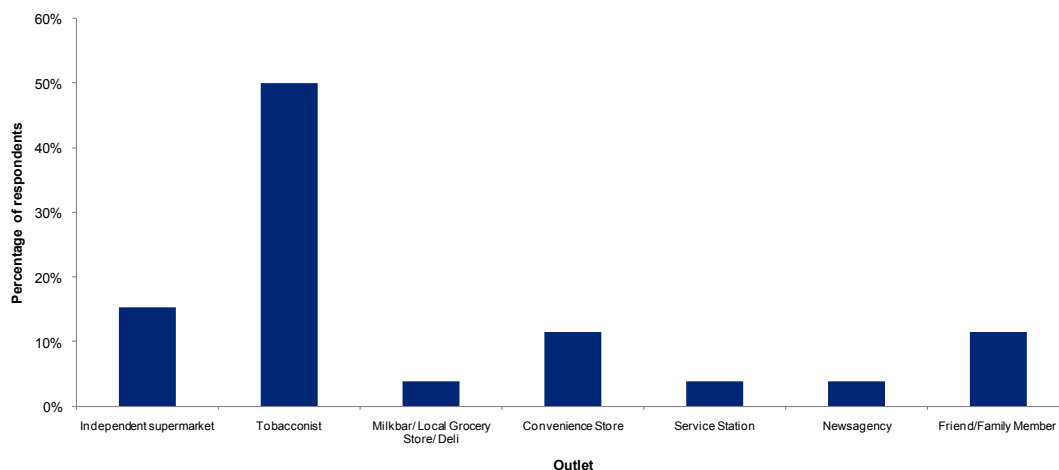
4.1.1 Key suppliers

Respondents advised they purchase illicit tobacco from a variety of points of sale including:

- Convenience stores
- Family and friends
- Independent supermarkets
- Service stations
- Tobacconists.

Figure 9 illustrates the major points of sale for unbranded tobacco products. In recent years, the most identified point of sale for unbranded tobacco by respondents has been at specialist tobacconists (approximately 50 per cent of those that identified their supply outlet).⁴⁰

Figure 9: Identified major supply outlets for unbranded tobacco products (2009-2010)



Source: Roy Morgan Research 2009; Roy Morgan Research 2010a

In addition, approximately 30 per cent of identified unbranded tobacco consumers chose not to identify where they purchased their unbranded tobacco. This may include purchases made at local markets (see Box 4-1).

⁴⁰ Roy Morgan Research 2010a

Box 4-1: Supply of illicit tobacco at local markets

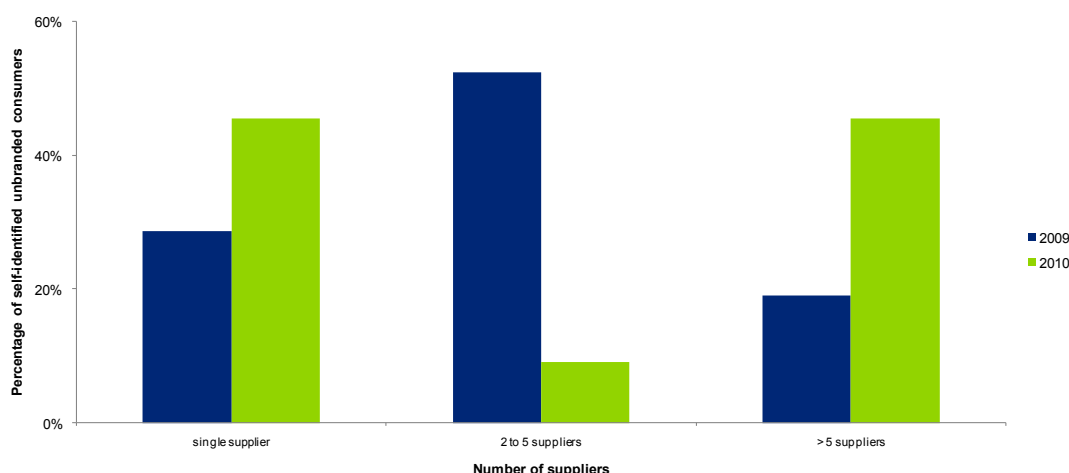
Illicit tobacco market investigators have indicated that there has been a decline in purchases of illicit tobacco at local markets. This could be due to the recent phenomenon of local markets redeveloping to reflect a 'farmers' market' style rather than the traditional 'flea market' concept. In addition, management at local markets are beginning to enforce stricter conditions that include prohibiting stall holders from selling products that violate intellectual property laws.

Source: Consultation with illicit tobacco market investigator, 03/11/2010

4.1.2 Number of suppliers

Illicit tobacco consumers are able to source illicit tobacco products from multiple suppliers. Since 2009, there appears to have been a decrease in consumers sourcing unbranded tobacco from between two-five suppliers. In 2010, the majority of adult unbranded tobacco users surveyed were largely split between obtaining unbranded tobacco from a single supplier and opting to source it from a variety (see Figure 10).

Figure 10: Number of suppliers for unbranded tobacco consumers



Note: The data does not specify the frequency of purchase from a particular supplier

Source: Roy Morgan Research 2010a

4.1.3 Origin

The survey indicates that half of all adult unbranded tobacco consumers surveyed are unaware of the origin of the illicit tobacco product purchased. Of the consumers who stated that they were aware of the country of origin, approximately 50 per cent believed the illicit tobacco product came from Australia. Other international sources for illicit tobacco identified by adult survey respondents included China, India and Germany.

The Australian Customs and Border Protection Service have also identified Indonesia as a potential source of illicit tobacco arriving into Australia. During 2009-10, the Australian Customs and Border Protection Service engaged with the Indonesian Directorate General of Customs and Excise to discuss an information-sharing relationship in response to illicit tobacco trade between the two nations.⁴¹

⁴¹ Australian Customs and Border Protection 2010

5 Profile of illicit tobacco users

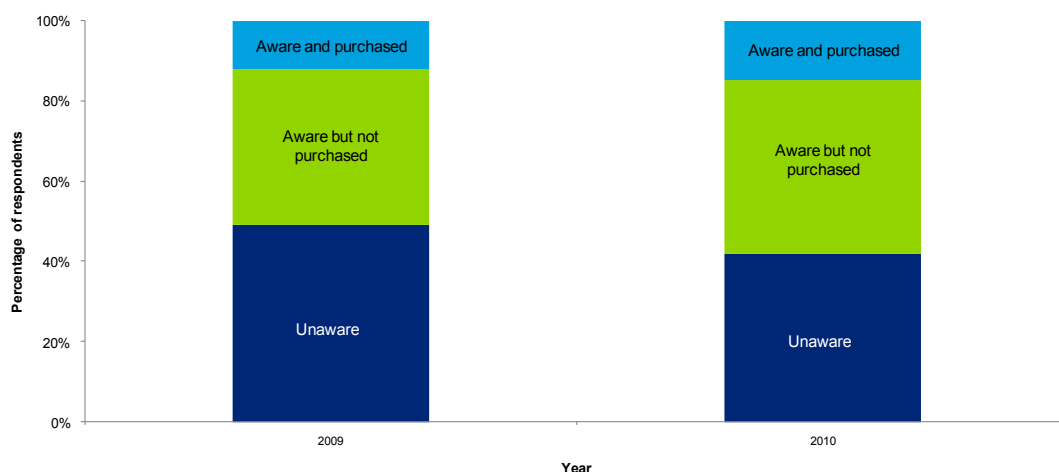
A large proportion of adult tobacco consumers surveyed are aware of unbranded tobacco. Those that have consumed it acknowledge their main reasons for purchase being price and availability. While also citing price as being a primary reason for consumption, some consumers of counterfeit and contraband tobacco claimed their purchase was made unknowingly.

5.1 Awareness of illicit tobacco

In 2010, more than half of adult tobacco consumers surveyed indicated that they are aware of illicit tobacco products. Regardless of whether or not illicit tobacco was actually purchased, as can be seen below in Figure 11, this translates into an increase of approximately seven per cent from the level of awareness identified in 2009.

In 2010, approximately 45 per cent of adult survey respondents stated that they were aware but had not purchased illicit tobacco products. An additional three per cent of adult survey respondents, compared to 2009, acknowledged that they were aware and had purchased illicit tobacco products (in unbranded tobacco form). Figure 11 illustrates the awareness of illicit tobacco products.

Figure 11: Awareness of illicit tobacco products



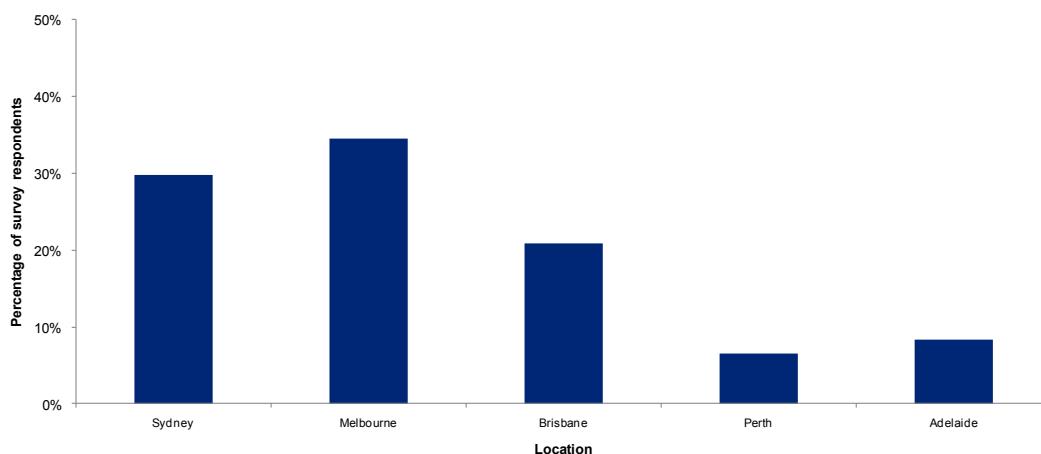
Source: Roy Morgan Research 2009; Roy Morgan Research 2010a

5.2 Unbranded tobacco consumers

Unbranded tobacco consumers include those survey respondents aged 18 years and over who have purchased unbranded tobacco at least once within the last 12 months. Of all adult unbranded tobacco consumers surveyed, 75 per cent were male compared to the near even gender split for legal tobacco users. In 2010, 42 per cent of adult unbranded tobacco consumers surveyed were older than 45 years of age. One-quarter of adult unbranded tobacco consumers surveyed were employed on a full-time basis and consumers were widely distributed across low and high income brackets.

The majority of adult unbranded tobacco consumers surveyed were located in Melbourne and Sydney. Figure 12 provides an indicative geographical spread of unbranded tobacco consumers.

Figure 12: Geographical spread of unbranded tobacco consumers, 2010

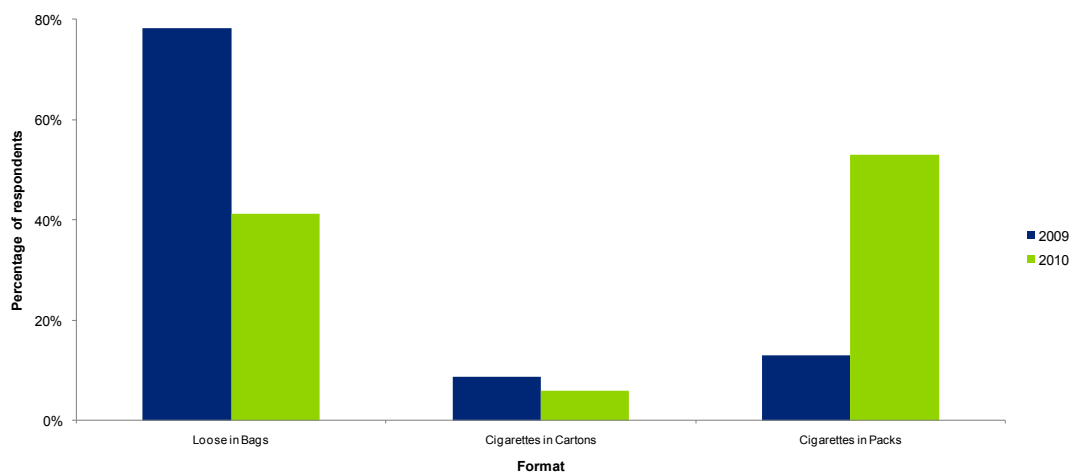


Source: Roy Morgan Research 2010a

5.2.1 Size and cost of purchase of unbranded tobacco

Unbranded tobacco can be purchased loose in bags, as cigarette sticks in cartons or as cigarette sticks in packs. Results from the 2010 RMR Tobacco Usage Study indicated that approximately 50 per cent of unbranded tobacco consumers purchased cigarettes in packs. This represents a significant change from 2009 whereby 81 per cent of unbranded tobacco consumers purchased unbranded tobacco loose in bags. Figure 13 illustrates the format of purchase for unbranded tobacco.

Figure 13: Format of purchase for unbranded tobacco



Source: Roy Morgan Research 2010a

Consultations with an illicit tobacco market investigator confirmed the shift from unbranded tobacco loose in bags to unbranded tobacco purchased as cigarettes in packs (see Box 5-1).⁴²

⁴² Consultation with illicit tobacco market investigator, 03/11/2010

Box 5-1: Purchasing format of unbranded tobacco

A large proportion of unbranded tobacco consumers smoke roll your own (RYO) cigarettes. Tobacco can either be rolled by hand or by using a cigarette rolling machine. Cigarette rolling machines fill loose leaf tobacco into rolling paper or empty cigarette tubes. In this way, unbranded tobacco can be sold pre-rolled to consumers in cartons and packs.

Source: Consultation with illicit tobacco market investigator, 03/11/2010

The total cost of unbranded tobacco that a respondent paid for their most recent purchase varied depending on the format of purchase. Consultations with an illicit tobacco market investigator have confirmed the cost of unbranded tobacco products (see Box 5-2).

Box 5-2: Cost of unbranded tobacco

Since 2009, new retail outlets and suppliers appear to have increased their sale prices of unbranded tobacco. As a result, this has caused the average price of unbranded tobacco to currently be between \$40 and \$50 for 250 grams of loose tobacco. In contrast, the average price for 250 grams of legal tobacco is approximately \$165.

Source: Consultation with illicit tobacco market investigator, 03/11/2010

5.2.2 Reasons for purchase of unbranded tobacco

The 2010 RM Tobacco Usage Study identified the key reasons for the purchasing decisions of unbranded tobacco consumers. These include:

- Awareness: Consumers were aware of and wanted to try unbranded tobacco
- Price: Unbranded tobacco is typically cheaper than legal tobacco products
- Ease of purchase: It is not difficult to obtain unbranded tobacco.

More than 60 per cent of adult unbranded tobacco consumers surveyed identified that the lower price was the reason for purchasing unbranded tobacco. Box 5-3 illustrates anecdotal evidence provided by surveyed unbranded tobacco consumers.

Box 5-3: Reasons for purchasing unbranded tobacco

"It was so much cheaper and easily obtained" – Female, 45–49 years old

"I was in the area where it was sold and I was trying to save money" – Female, 55–59 years old

"I heard lots about it...I thought I would give it a try and see what it was like" – Male, 50 – 54 years old

"It is a healthier option" – Male, 21–24 years old

Source: Roy Morgan Research 2010a

5.2.2.1 Perception that unbranded tobacco is healthier

A study by Bittoun (2004) prepared for the Commonwealth Government Department of Health and Ageing, *'The Medical Consequences of Smoking 'Chop-Chop Tobacco,'*⁴³ discusses the potential health effects of consuming unbranded tobacco products. The study suggests that smoking unbranded tobacco has the potential to induce illnesses such as allergic reactions, chronic bronchitis, aspergillosis, alveolitis, pneumonitis, lung cancer and Legionnaire's disease.⁴⁴ Such illnesses are suggested to be caused by a number of contaminants, such as twigs, raw cotton and grass clippings, often used to bulk up the weight for sales of unbranded tobacco products.⁴⁵ Bittoun states that "it is likely that smokers have had severe medical repercussions from using this [unbranded] type of tobacco but are not aware of the implications nor make the link with the type of tobacco smoked".⁴⁶

⁴³ Bittoun 2004

⁴⁴ Bittoun 2004, p.13

⁴⁵ Bittoun 2004, p.6

⁴⁶ Bittoun 2004, p.18

These findings by Bittoun are important in the context of the responses by some adult survey respondents who indicates that they purchased unbranded tobacco products because they believed it to be a healthier option. Given the medical inferences made by Bittoun, the perception that unbranded tobacco is relatively healthier than legal tobacco would appear to be a misconception held by consumers.

5.3 Counterfeit and contraband tobacco consumers

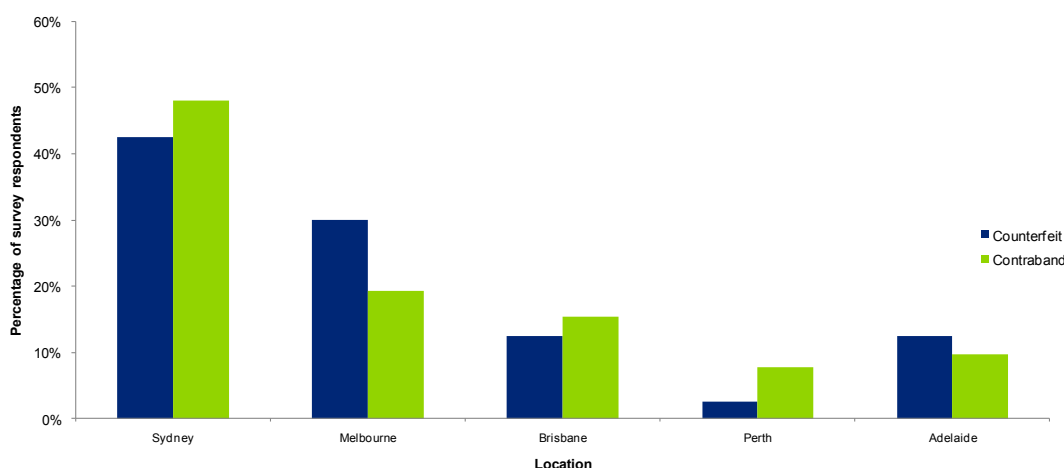
5.3.1 Demographic breakdown

Counterfeit and contraband tobacco consumers are those survey respondents aged 18 years and over that have purchased either counterfeit or contraband tobacco at least once within the last 12 months.

From the 2010 RMR Tobacco Usage Study, the majority of identified consumers were male, older than 45 years of age and in full-time employment.

The majority of respondents identified as counterfeit or contraband tobacco consumers were located in Melbourne and Sydney. Figure 14 indicates their geographical spread.

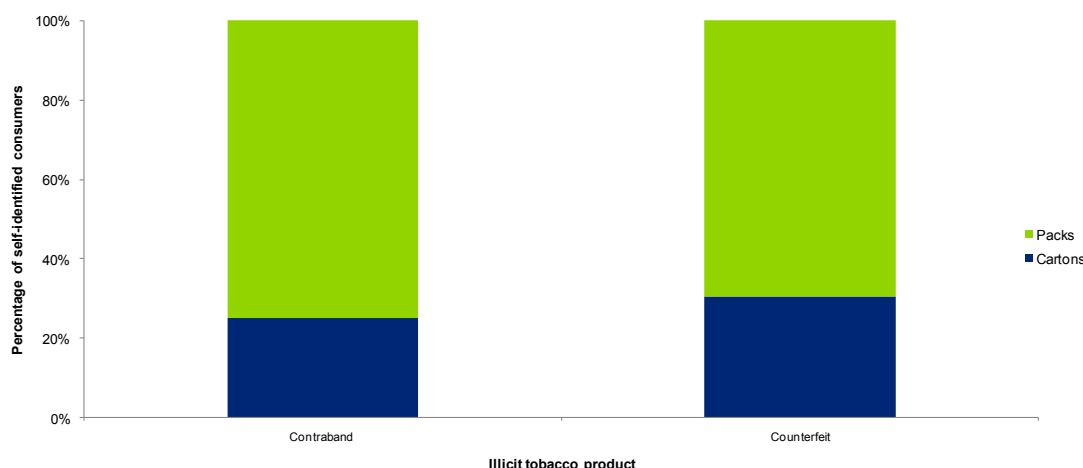
Figure 14: Geographical spread of counterfeit tobacco consumers, 2010



Source: Roy Morgan Research 2010a

5.3.2 Purchase format

Counterfeit and contraband tobacco products can be purchased as cigarettes in cartons or in packs. Results from the 2010 RMR Tobacco Usage Study indicated that approximately 70 per cent and 75 per cent of counterfeit tobacco consumers and contraband tobacco consumers respectively made purchases in pack formats. Figure 15 illustrates the format of purchase for counterfeit and contraband tobacco.

Figure 15: Format of purchase for counterfeit and contraband tobacco products, 2010

Source: Roy Morgan Research 2010a

5.3.3 Reasons for purchase

Survey results highlighted two key reasons as to why respondents identified as counterfeit or contraband tobacco consumers made such purchases:

- Price: Counterfeit and contraband tobacco products were thought to be less costly than legal tobacco products
- Lack of awareness: Consumers did not realise they had purchased counterfeit or contraband tobacco until afterwards. It was not until they had commenced smoking the product and/or recognised differences in the packaging did they realise it was counterfeit or contraband⁴⁷

Box 5-4 illustrates anecdotal evidence provided by counterfeit tobacco consumers.

Box 5-4: Reasons for purchasing counterfeit tobacco

"When I purchased counterfeit cigarettes the price was very cheap, about 25-30% less" – Male, 40–54 years old, counterfeit consumer

"Couldn't afford to buy the proper ones at the time" – Male, 50-54 years old, contraband consumer

"It's just something I noticed after I bought it. There were no health warnings on the packaging." – Female, 45–49 years old, counterfeit consumer

"I did not realise at the time but noticed later on that the taste was completely different" – Male, 50–54 years old, contraband consumer

Source: Roy Morgan Research 2010a

Consultations with an illicit tobacco market investigator further revealed that tobacco consumers are often unaware of purchasing counterfeit tobacco products.⁴⁸ Counterfeit cigarettes are not a common purchase request by tobacco consumers. Incidents of purchases have increased where counterfeit cigarettes are sold to consumers who request the least expensive tobacco product available or where counterfeit cigarettes are sold instead of the legal tobacco product (see Box 5-5).

⁴⁷ Counterfeit and contraband cigarettes present anomalies in their packaging such as the absence of Australian health warnings

⁴⁸ Consultation with illicit tobacco market investigator, 03/11/2010

Box 5-5: Uninformed purchase of counterfeit tobacco

Tobacco consumers who purchase counterfeit cigarettes are largely unaware that they have purchased an illicit product. While some incidents involve tobacco consumers specifically requesting counterfeit tobacco in an 'under-the-counter' type of transaction, other consumers are sold counterfeit cigarettes in place of the legal tobacco product. For example, a consumer may request a carton of cigarettes from a tobacco retailer but may receive seven packs of the legal product and three packs of counterfeit product. Counterfeit tobacco is usually recognised by taste or differences in packaging.

Source: Consultation with illicit tobacco market investigator, 03/11/2010

6 Size of the illicit tobacco market

Using a consumption based model approach, an indicative estimate of the size of the illicit tobacco market in Australia can be formed based on the 2010 RMR Tobacco Usage Study.

Estimating the size of the illicit tobacco market is not a straightforward task due to a lack of available information and data. The Australian Customs and Border Protection Service collects and records information on seizures at Australian ports of smuggled tobacco however this typically underestimates the illicit market size because of:

- A failure to capture unbranded tobacco grown in Australia
- The Australian Customs and Border Protection Service only searching (and subsequently seizing) a proportion of containers that arrive in Australia.

Since it is subsequently difficult to obtain a picture of the illicit tobacco market from a supply-side point of view, Deloitte adopted a consumption model approach based on the purchasing patterns of illicit tobacco consumers. This approach captures the purchases and use of all types of illegal tobacco, irrespective of its form, type or country of origin. The data inputted into the consumption model was drawn from the 2010 RMR Tobacco Usage Study which provides the most statistically robust and current measure of the purchasing behaviour of illicit tobacco consumers.

6.1 Consumption model methodology

The consumption model approach that Deloitte adopted to estimate the size of the illicit tobacco market is consistent with that adopted for the previous estimate of the market in the 2009 Report.

The consumption model estimates the size of the illicit market based on consumer purchasing decisions on unbranded, counterfeit and contraband tobacco products. The model is informed by the 2010 RMR Tobacco Usage Study combined with publicly available information on the legal tobacco market and smoking population.

Since limited data exists on the overall supply of illicit tobacco, a survey of adult tobacco consumers in which respondents acknowledge purchasing illicit tobacco products is an alternative data collection approach. As a result, purchases and the consumption of all types of illicit tobacco, irrespective of its form, type or country of origin, can subsequently be captured.

On the following page, Table 6-1 outlines the consumption model, including underlying formulae. Key variables in the consumption model are:

- Frequency of purchase
- Quantity of purchase.

The quantity of illicit tobacco consumed in Australia can then be estimated by applying the consumption model. This approach captures purchases and use of all types of illicit tobacco, irrespective of its form, type, or country of origin.

Table 6-1: Consumption model

Consumption model inputs (for each illicit tobacco product)	
Quantity of illicit tobacco purchased per occasion (g) [1]	[1] taken from Roy Morgan Research 2010, <i>Tobacco Usage Study 2010</i>
Frequency of illicit tobacco purchase per annum [2]	[2] taken from Roy Morgan Research 2010, <i>Tobacco Usage Study 2010</i>
Quantity of illicit tobacco purchased per annum (g) [3]	[3] = [1] x [2]
Number of illicit tobacco users, Australia ('000) [4]	[4] = [5] x [7]
Illicit tobacco users as % of Australian tobacco users [5]	[5] taken from Roy Morgan Research 2010, <i>Tobacco Usage Study 2010</i>
Quantity of illicit tobacco purchased in Australia ('000 kg) [6]	[6] = [3] x [4]
Total adult smoking population ('000) [7]	[7] taken from Australian Bureau of Statistics 2009, <i>National Health Survey: Summary of Results 2007-2008 (Reissue)</i>

The estimated total quantity of illicit tobacco used in Australia (item [8] in Table 6-2) is a sum of:

- Quantity of unbranded tobacco purchased
- Quantity of counterfeit tobacco purchased
- Quantity of contraband tobacco purchased.

As detailed in Table 6-2, represented as a proportion of the total quantity of legal tobacco used in Australia (item [9]), an indication of the size of the illicit tobacco market is then estimated (item [10]).

Table 6-2: Size of the illicit tobacco market as a proportion of legal tobacco market

Inputs	
Total quantity of illicit tobacco used in Australia ('000 kg) [8]	[8] = [6] _{unbranded} + [6] _{counterfeit} + [6] _{contraband}
Total quantity of legal tobacco used in Australia ('000 kg) [9]	[9] taken from Datamonitor 2009, <i>Tobacco in Australia to 2013</i> , (adjusted for quantity of tobacco per cigarette stick)
Size of the illicit tobacco market (as an equivalent proportion of the legal tobacco market) [10]	[10] = [8] / [9] x 100%

6.2 Consumption model

Following the methodology outlined in Section 6.1, the following outlines the results from the application of a consumption model approach to estimate the illicit tobacco market size.

Box 6-1 outlines the key assumptions that fed into the consumption model.

Box 6-1: Key assumptions in the consumption model

Deloitte adopted the following key assumptions in the consumption model:

- **Amount of tobacco per legal cigarette stick** – The assumption regarding the amount of tobacco per legal cigarette stick is based on an average of weights provided on a confidential basis to Deloitte by BATA, PML and ITA
- **Amount of tobacco per illicit cigarette stick** – Given the illicit nature of the market, there is no independently available information on the average weight of an illicit stick. The amount of tobacco per illicit cigarette stick has been revised to 1.0 gram from the 1.25 grams adopted for the 2009 Report. This revision reflects the observed increase in the consumption of unbranded tobacco in stick form and other qualitative market information provided during the preparation of this report
- **Total adult smoking population** – We assumed that the total adult smoking population in Australia is three million persons, based on the most recent publicly available information⁴⁹
- **Quantity of legal tobacco used in Australia** – We assumed the Australian legal tobacco market in quantity terms totalled 18,142 million kilograms. This is based on the most recent publicly available information⁵⁰ and our assumption on the number of tobacco grams per legal cigarette stick (taken to be an average of weights provided to Deloitte by BATA, PML and ITA) to convert total sticks consumed into a quantity amount in kilograms.

On the following page, Table 6-3 illustrates the results of the consumption model based on the 2010 RMR Tobacco Usage Study.

⁴⁹ Australian Bureau of Statistics 2009

⁵⁰ Datamonitor 2009, p. 2

Table 6-3: Consumption model

	Unbranded	Counterfeit	Contraband
Quantity of illicit tobacco purchased per occasion (g) [1]	344	258	224
Frequency of illicit tobacco purchase per annum [2]	15	3	4
Quantity of illicit tobacco purchased per annum (g) [3] = [1]x[2]	5,160	774	896
Number of illicit tobacco users in Australia ('000) [4] = [5]x[7]	471	150	150
Illicit tobacco users represented as % of Australian tobacco users [5]	15.7%	5.0%	5.0%
Quantity of illicit tobacco used in Australia ('000 kg) [6] = [3]x[4]	2,430	116	134
Total adult smoking population ('000) [7]	3,000	3,000	3,000

Based on the consumption model approach, the total quantity of illicit tobacco consumed in Australia is estimated to be nearly 2.7 million kilograms. Using this estimate, the size of the illicit tobacco market is estimated to 15.9 per cent measured as a proportion of the total quantity of legal tobacco consumed in Australia (as shown below in Table 6-4).

Table 6-4: Estimated size of the illicit tobacco market as a proportion of the legal tobacco market

	Estimates
Total quantity of illicit tobacco used in Australia ('000 kg) [8]	2,680
Total quantity of legal tobacco used in Australia ('000 kg) [9]	16,853
Indicative size of the illicit tobacco market (represented as an equivalent proportion of the legal tobacco market) [10]	15.9%

Compared to the results from the 2009 Report, the indicative increase in the size of the illicit tobacco market is due to an overall increase in the quantity and frequency of illicit tobacco purchases in Australia. The results in the consumption model and the increase in quantity purchased since 2009 appear to have been driven by two factors:

- Increase in participation: the 2010 RMR Tobacco Usage Study showed that 15.4 per cent acknowledged purchasing unbranded illicit tobacco in 2010, up by 2.4 per cent from 2009 results⁵¹
- Increase in frequency of purchase: unbranded tobacco was found to be purchased more frequently (on average, 15 times per annum) in 2010 compared to 2009 (on average, 11 times per annum).⁵² In addition, a greater proportion of respondents identified having purchased unbranded tobacco once a week

Table 6-5 summarises the indicative estimates of the illicit tobacco market size based on results from the consumption model approach and its comparable excise value.

Table 6-5: Estimated size of the illicit tobacco market

Approach	Quantity of illicit tobacco ('000 kg)	Illicit tobacco users (as % of Australian tobacco users)	Equivalent excise value (\$m)
Consumption model	2,680	15.9%	\$1,126

Note: Comparable excise value is calculated as quantity of illicit tobacco in kilograms multiplied by current excise charge as at February 2011 of \$420.43 per kilogram of tobacco.

⁵¹ Roy Morgan Research 2009, Roy Morgan Research 2010

⁵² Roy Morgan Research 2009, Roy Morgan Research 2010

7 Australian border seizures

Another useful indicator of the incidence of illicit tobacco is the monitoring and seizure activities of the Australian Customs and Border Protection Service.

As previously mentioned in Chapter 6, the Australian Customs and Border Protection Service collects and records information on seizures of illicit tobacco at Australian ports. Such information, however, typically underestimates the illicit market size because of:

- A failure to capture unbranded tobacco grown in Australia
- The Australian Customs and Border Protection Service only searching (and subsequently seizing) a proportion of containers that arrive in Australia.

Nevertheless, information on seizures can provide a useful insight into attempts to smuggle illicit tobacco into Australia.

Table 7-1 highlights the recent seizure activities and the associated foregone excise revenue.

Table 7-1: Australian border seizures

Approach	Quantity of illicit tobacco (‘000 kg)	Quantity of sticks (‘000 pieces)	Excise revenue foregone (\$m)
Seizures	310.7	68,728.0	\$153.7

Note: Comparable excise value is calculated as quantity of illicit tobacco in kilograms multiplied by current excise charge as at February 2011 of \$420.43 per kilogram of tobacco and \$0.33633 per stick of tobacco (not exceeding in weight 0.8 grams per stick actual tobacco content)

Source: Australian Customs and Border Protection Service 2010

In terms of actual smuggled tobacco seizures, in 2009-10 the Australian Customs and Border Protection Service detected more sticks of cigarettes than in the previous year. In turn, there was a resulting increase in the quantity of smuggled tobacco seized. In 2009-10, there were 27 detections of smuggled tobacco, a 50 per cent increase in detections compared to 2008-09 (see Table 7-2 below).

Table 7-2: Australian border detections and seizures of smuggled tobacco

Approach	2008-09	2009-10	% Change
Number of detections (loose tobacco)	18	27	+50%
Quantity of loose tobacco seized (‘000 kg)	175.4	310.7	+77%
Number of detections (cigarettes)	15	14	-7%
Quantity of cigarettes seized (‘000 sticks)	50,177.6	68,728.0	+37%

Source: Australian Customs and Border Protection Service 2010

An assessment of the amount of smuggled tobacco seized between 2008-09 and 2009-10 indicates that there has been an apparent increase in the quantity per detection of illicit tobacco attempted to have been smuggled. This increase in quantity is for both loose tobacco and cigarettes seized despite there being a fall in detections of cigarettes in 2009-10.

As outlined earlier, this approach of assessing detections and seizures by the Australian Customs and Border Protection Service tends to underestimate the quantity of illicit tobacco in Australia. However, the results from this approach do align with the results from the consumption model that the illicit tobacco market has increased in size since 2009.

8 Conclusion

8.1 Increase in the level of illicit tobacco trade compared to previous studies

As outlined in Table 8-1, the key finding of this report is that the consumption of illicit tobacco products in Australia has increased. The estimated size of the illicit tobacco market (represented as a proportion of the legal tobacco market) has increased from 12.3 per cent in 2009 to 15.9 per cent in 2010. The estimated 2.7 million kilograms of illicit tobacco is equivalent to foregone tobacco excise revenue of approximately \$1.1 billion.⁵³

Table 8-1: Headline results

Market indicator	2007 estimate ⁵⁴	2009 estimate ⁵⁵	2010 estimate
Amount of illicit tobacco purchased ('000 kg)	1,827	2,348	2,680
Size of the illicit tobacco market represented as a proportion of the legal tobacco market	6.4%	12.3%	15.9%
Equivalent excise value (\$m)	\$450	\$624	\$1,126

8.2 Changes in surveyed consumer behaviour compared to previous studies

The 2010 RMR Tobacco Usage Study identified key reasons explaining the purchasing decisions of unbranded tobacco consumers.⁵⁶ These include:

- Awareness: Consumers were aware of and wanted to try unbranded tobacco
- Price: Unbranded tobacco is typically cheaper than legal tobacco products
- Ease of purchase: It is not difficult to obtain unbranded tobacco.

With respect to price, the 2010 RMR Tobacco Usage Study noted that more than 60 per cent of respondents self-identified as adult unbranded tobacco consumers acknowledged that the lower price was the reason for purchasing unbranded tobacco.

As outline in Chapter 6, the 2010 RMR Tobacco Usage Study noted key observable changes in consumer behaviour included:

- Increase in participation: 15.4 per cent of survey respondents acknowledged purchasing unbranded illicit tobacco in 2010, up by 2.4 per cent from 2009 results⁵⁷
- Increase in frequency of purchase: unbranded tobacco was found to be purchased more frequently (on average, 15 times per annum) in 2010 compared to 2009 (on average, 11 times per annum)
- Increase in the supply of illicit tobacco products at convenience stores and independent supermarkets compared with a decline from local markets, particularly in Melbourne.⁵⁸

⁵³ Based on current excise rates at February 2011

⁵⁴ PricewaterhouseCoopers 2007; Note: this estimate of the 2007 illicit tobacco market size does not include counterfeit or contraband tobacco products.

⁵⁵ PricewaterhouseCoopers 2010

⁵⁶ Unbranded tobacco consumers constitute 91 per cent of the illicit tobacco market (Source: Roy Morgan Research 2010a)

⁵⁷ Roy Morgan Research 2009, Roy Morgan Research 2010a

These observed increases in the quantity and frequency of purchase of illicit tobacco products have been a key factor in the estimated increase in the overall illicit trade.

8.3 Changes to the regulatory and taxation regime

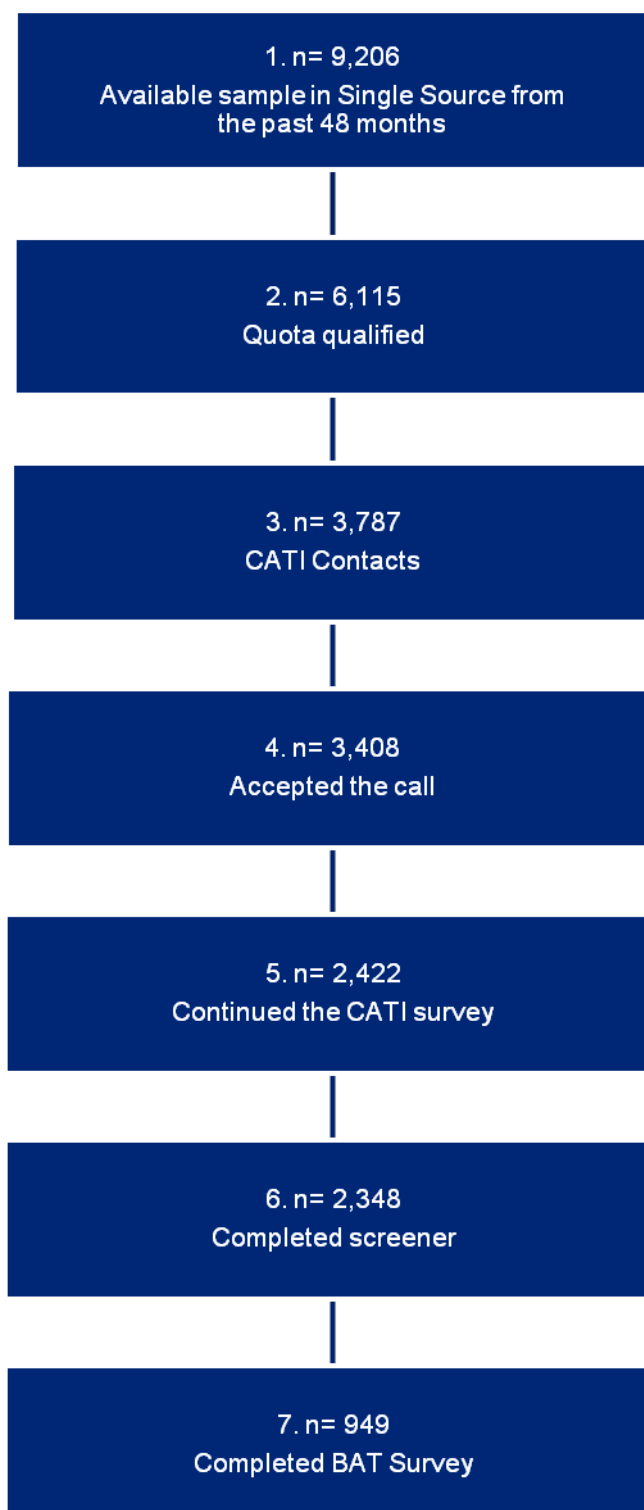
As noted in Chapter 2, there have been a number of newly implemented and proposed changes to the regulatory and taxation regime for tobacco products. The increase in the trade of illicit tobacco has occurred concurrently with some material changes to the regulatory and taxation regime including:

- Excise rate: a 25 per cent increase effective 30 April 2010. This was the first increase in excise above CPI indexation in more than ten years
- Retail display ban (RDB): prohibiting the display of tobacco products at retail outlets in New South Wales.

As outlined in Chapter 2, the RDB will also be fully implemented in all states by 2012. In addition the federal government also intends to legislate for the introduction of plain packaging of all tobacco products during the course of 2011.

Appendix 1

2010 RMR Tobacco Usage Study - sample attrition flowchart



Notes:

1. From the Research Establishment Survey, start with all the people who said they have smoked factory-made or RYO cigarettes.

2. From the sample, 33 per cent did not need to be contacted because quota was full (i.e. there were enough smokers from a particular age group x gender x capital city).

3. Out of the quota qualified sample, 38 per cent did not answer the phone, the phone was engaged, the call went to the participant's answering/fax machine or the call did not go through to the number provided.

4. 10 per cent of participants refused to do the survey after being asked whether they would like to participate in a survey conducted by RMR on behalf of a major consumer products company to learn about product consumption patterns.

5. 28 per cent of participants terminated during the survey because they were busy and could not complete the survey or they dropped out/hung up.

6. 3 per cent of participants made an appointment with CATI to call back at another or specific time/day.

7. 59% of respondents screened out because they are not 18-64 years of age living in Sydney, Melbourne, Brisbane, Perth or Adelaide who smoke manufactured or RYO cigarettes at least 5 days a week on average.

Appendix 2

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Statement of responsibility

This report was prepared for British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited solely for the purpose of estimating the size of the illicit tobacco market, as set out in our agreement with British American Tobacco Australia Limited and Philip Morris Limited dated 23 August 2010 and our agreement with Imperial Tobacco Australia Limited dated 26 November 2010.

In preparing this report we have relied on the accuracy and completeness of the information provided to us by British American Tobacco Australia Limited, Philip Morris Limited and Imperial Tobacco Australia Limited, information collected through market research by Roy Morgan Research Proprietary Limited, and from publicly available sources. We have not audited or otherwise verified the accuracy or completeness of the information and, to that extent, the information contained in this report may not be accurate or reliable. This is normal practice when carrying out an engagement such as this, but contrasts with an audit.

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