Asia-11 Illicit Tobacco Indicator 2012

Prepared by International Tax and Investment Center and Oxford Economics
September 2013

More Myth Than Fact

A Critique by SEATCA

Southeast Asia Tobacco Control Alliance
June 2014
ITIC’s Asia-11 Illicit Tobacco Indicator 2012: 
*More Myth than Fact*

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**EXECUTIVE SUMMARY**

The Asia-11 Illicit Tobacco Indicator 2012, a report on illicit tobacco trade by the International Tax and Investment Center (ITIC) and Oxford Economics (OE) was released in September 2013. This report, while claiming to be done by independent researchers, was actually funded by Philip Morris International and prepared according to agreed terms of reference provided by Philip Morris Asia Ltd. The ITIC itself, despite its declaration of independence, is funded by the major transnational tobacco companies.

The main conclusions of the report echo the assertions of tobacco companies:

- Nine percent (9%) (66.5 billion cigarettes) of cigarettes consumed in the countries surveyed are illicit, either illegally imported (5.6%) or illegally locally manufactured (3.4%);
- Some Asian countries, namely Brunei, Hong Kong, Malaysia and Singapore, that have high taxes on tobacco also had the highest volumes of illicit cigarettes, over 25% in 2012;
- Governments are losing billions of dollars in tax revenue due to illicit trade, particularly related to tobacco tax increases and high prices.

Authors of the report have done road shows to release the report in individual countries, provide greater publicity to the findings, and reach policy makers.

This critique provides an expert review of the methodology of the Asia-11 report (which relies on litter surveys), questioning its reliability and accuracy of the estimates of illicit consumption, which are highly debatable as there is no detailed discussion on research method, sampling design, and data sources in order to allow for validation by independent researchers.

The critique exposes the gaps, selective use of data, inconsistencies, and overestimation found in the report on Australia, Brunei Darussalam, Indonesia, Hong Kong, Malaysia, Philippines, Thailand and Vietnam. For example Brunei, which has stringent tobacco control legislation, has come under vicious criticism in this report indicating it has the highest tobacco smuggling among all the countries surveyed. However a closer scrutiny of the methodology reveals an overestimation of total consumption and further assumptions that result in gross overestimations of the number of...
illicit cigarettes. Furthermore, assuming smokers in Brunei consume an average of 9.2 cigarettes per day, as in Malaysia, the total number of illicit cigarettes would then fall by over 43%, from ITIC/OE’s estimate of 315.2 million down to 179.4 million.

The Protocol to Eliminate Illicit Trade in Tobacco Products (more commonly referred to as the Illicit Trade Protocol or ITP) is the first Protocol to the WHO FCTC and was adopted on 12 November 2012 at the fifth session of the Conference of the Parties in Seoul, Republic of Korea. It is currently open for ratification, acceptance, approval or accession by the Parties to the WHO FCTC.

It must be realized that substantial improvement in arresting illicit trade of tobacco can be achieved as a consequence of operative actions by the authorities, such as contained in the ITP, and not by keeping tobacco excise taxes low as recommended by the tobacco industry. Governments should continuously implement effective and novel strategies to combat illicit tobacco trade by stepping up enforcement measures. As Governments had actively participated in the drafting of the ITP, they should ratify this new legal tool as soon as possible. Relevant laws and regulations should be enacted consistent with the articles and guidelines in this Protocol.

RECOMMENDATIONS

- Reject the ITIC/OE Asia-11 report as it is not an independent study, uses flawed methodology, and results in skewed findings supportive of the tobacco industry’s positions on taxation;
- Implement FCTC Article 5.3 Guidelines and reject any partnership with the tobacco industry and its representatives in tackling the illicit tobacco trade problem;
- Step up enforcement to reduce illicit tobacco trade;
- Ratify the Protocol on Illicit Trade of Tobacco Products.

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Background:

Tobacco taxation is one of most effective tools to curb tobacco use, while also increasing government revenues. It is recognized in Article 6 of the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC), which recommends that countries (Parties) adopt or maintain tax and price measures to achieve their tobacco control objectives. To effectively reduce consumption, tax and price increases need to be substantial, with periodic adjustments for inflation, to reduce affordability. The tobacco industry therefore challenges regular and/or large tax increases and has repeatedly claimed that such tax increases will lead to increased illicit tobacco trade and other negative economic impacts to national economies.

On 26 September 2013, the International Tax and Investment Center (ITIC), headquartered in Washington DC, launched a 132-page report titled Asia-11 Illicit Tobacco Indicator 2012 (hereafter "Asia-11 Report") at a meeting in Singapore attended by senior government customs and finance officials from Asian countries. This report claims to provide an overview of the nature of the illicit trade of cigarettes in Australia and 10 Asian countries (Brunei, Hong Kong, Indonesia, Malaysia, Pakistan, Philippines, Singapore, Taiwan, Thailand, and Vietnam), providing allegedly credible estimates of consumption of illicit cigarettes in these countries and the supposed impact this would have on tobacco tax revenue.

The report’s main conclusions:

- Nine percent (9%) (66.5 billion cigarettes) of cigarettes consumed in the countries surveyed are illicit, either illegally imported (5.6%) or illegally locally manufactured (3.4%);
- Some Asian countries, namely Brunei, Hong Kong, Malaysia and Singapore, that have high taxes on tobacco also had the highest volumes of illicit cigarettes, over 25% in 2012; and
- Governments are losing billions of dollars in tax revenue due to illicit trade, particularly related to tobacco tax increases and high prices.

These main conclusions echo the assertions of tobacco companies that the black market for tobacco products in the region is significant, causing large tax revenue losses, and driven by supposedly excessive tax increases among other factors such as weak enforcement and the involvement of criminal networks.

The Asia-11 Report was produced by ITIC, which describes itself as "an independent non-profit research and education foundation that serves as a clearinghouse for information on best practices in taxation and investment policy", and UK-based Oxford Economics (OE), which describes itself as "a key adviser to corporate, financial and government decision-makers and thought leaders". Despite its declarations of independence, ITIC sponsors include the major transnational tobacco companies, Philip Morris International (PMI), British American Tobacco (BAT), and JT International (JTI), which calls into question ITIC’s independence to undertake this study. In addition, while being presented as an independent study, this report was funded by PMI, prepared by ITIC and OE according to agreed terms of reference provided by Philip Morris Asia Ltd., and relied on inputs and data provided by the tobacco industry, which cannot be considered as a neutral stakeholder on this issue.

This Asia-11 Report is therefore another attempt of the tobacco industry to protect its profits and to counter the public health benefits of tobacco taxation by persuading governments that tax increases will result in increased illicit trade and subsequent revenue losses. The report even faults governments for raising taxes and implementing other effective (labelled by the industry as “excessive”) tobacco control measures to protect public health in compliance with the FCTC’s objectives.

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3International Tax and Investment Centre, http://www.iticnet.org/
In its report launch press release, Daniel Witt, President of ITIC concludes that the Asia-11 Report “means governments and the legal tobacco sector must step up their efforts to tackle the causes of the illicit tobacco trade and its economic and social consequences,” implying incorrectly that the tobacco industry is a stakeholder, despite its being complicit in illicit trade\(^5\), and that cooperation between governments and the tobacco industry is necessary to address illicit trade.

The FCTC does recognize the crucial role of civil society in tobacco control and FCTC implementation, and in fact, public health authorities and regional organisations (e.g. WHO and the Southeast Asia Tobacco Control Alliance (SEATCA)) have published best practice recommendations and regional reports on tobacco taxation\(^6,7,9\) and have held related workshops and meetings with government officials. Consultations and partnerships with the tobacco industry, however, violate FCTC Article 5.3, which requires Parties to protect public health policies from the commercial and other vested interests of the tobacco industry.

This critique of the Asia-11 Report examines the report’s methodology and country findings compared with alternate data, comments from in-country researchers/advocates, regional action on this report, and the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP). It also traces how the report has been used by the industry in countries. Country-specific comments in this critique are limited to Australia, Brunei, Hong Kong, Indonesia, Malaysia, Philippines, Thailand, and Vietnam (excludes Pakistan, Singapore, and Taiwan).

II. Problematic Methodology

The value of any research hinges on the design of its methodology, which must be scientifically sound and rigorous. Otherwise the whole exercise would be futile and without value. The reliability and accuracy of the Asia-11 Report’s estimates of illicit consumption are highly questionable as there is no detailed discussion on research method, sampling design, and data sources, in order to allow for validation by independent researchers. Multiple data sources (empty pack survey, surveys in destination markets, expert opinions, consumer surveys, retail audits, etc.) are cited, but ITIC/OE fail to provide a detailed description of each data source, the limitations of data derived from each source, and how such would affect the accuracy of the estimates in the report.

Dr. Frank Chaloupka, Distinguished Professor of Economics at the University of Illinois at Chicago\(^9\), who is an expert in the economic analysis of substance use and abuse, and on the effect of prices and substance control policies in affecting the demands for tobacco, alcohol, and illicit drugs and who has authored hundreds of publications on these topics, has raised several concerns\(^11\) when reviewing the Asia-11 Report and its conclusions, from various aspects of the methodology to the inconsistency of the resulting estimates for specific countries compared with estimates for these countries produced in academic studies or by other organizations. We have incorporated his concerns here.

1. Choice of countries

The authors did not provide a clear rationale for selecting and including countries in the Asia-11 Report. Countries included were a mixture of high, middle and low-income countries, ranging in size from very small (e.g. Brunei and Singapore) to relatively large (e.g. Indonesia and the Philippines), and excluding many of the region’s largest cigarette consuming countries, such as China, Japan and South Korea, the

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\(^6\) IARC Handbooks of Cancer Prevention, Tobacco Control, Vol. 14: Effectiveness of Tax and Price Policies for Tobacco Control (2011: Lyon, France)


\(^8\) WHO Pacific taxation project. http://www.wpro.who.int/tobacco/pacific/tobacco_taxationproject/en/

\(^9\) Affordability of Cigarettes and the Impact of Raising Tobacco Excise Taxes in Southeast Asia. www.seatca.org


world’s first, fifth and eleventh largest cigarette consuming countries, respectively, where the market share of illicit cigarettes is estimated by Euromonitor to be relatively low: 6.9% in China, 0.0% in Japan, and 0.4% in South Korea.\textsuperscript{12} By excluding large countries with high cigarette consumption where the illicit cigarette consumption is relatively low, the report overestimates the extent of illicit trade in the region.

2. Industry role
   The tobacco industry provided key data inputs to the report such as sales data, prevalence, and/or other inputs, including specifically the empty pack surveys that were "conducted by PMI or jointly by several tobacco manufacturers"\textsuperscript{13}. Several studies already show that such industry surveys typically overestimate the extent of illicit cigarette consumption, often double the estimates produced by independent academic researchers. Recognizing the tobacco industry’s opposition to significant tobacco tax increases that can reduce consumption and its history of exaggerating the extent of illicit cigarette trade, ITIC/OE’s use of industry-provided data raises questions about the reliability and accuracy of their reported estimates.

3. Empty pack survey (EPS) / litter survey
   Empty pack surveys (collections of littered cigarette packs) commonly conducted by tobacco companies provide key inputs for estimating illicit cigarette trade in the Asia-11 report; however, there is little information provided on the research protocol and sampling methodology for such surveys, which have the potential to overstate the extent of illicit cigarette trade\textsuperscript{14}. When conducted in popular public places in urban areas and/or during peak tourist times, or when conducted in a non-randomized unscientific manner (e.g. selecting known hotspots for illicit consumption), such surveys will overestimate the extent of illicit cigarette trade, given that they will over-represent packs discarded by tourists, foreign students and workers, and other visitors. The Asia-11 Report notes that rural areas are not covered in empty pack surveys in at least some countries and provides no information on the timing and specific geographic areas of the surveys. There is also no description of the method used to identify and distinguish between legal and illicit empty packs. The representativeness and data analysis from such surveys are therefore problematic and dubious.

   It is also worth noting that estimates of outflows of domestic duty-paid cigarettes are based on empty pack surveys in other Asia-11 countries. Since it is possible for duty-paid cigarettes in one country to be smuggled into another country as well as brought in legally, such estimates are also inherently defective.

4. Smoker survey
   Surveys of smokers (either passers-by or through telephone) are another data source to estimate the extent of illicit cigarette trade in some countries. Again, very little information is provided on these surveys, making it difficult to assess the extent to which these surveys provide representative, meaningful data. Passer-by surveys are problematic given that they are often conducted in areas with heavy foot traffic and produce an unrepresentative sample of respondents; telephone interviews can be problematic in lower income countries where some households may not have telephones. In addition to the sampling issues, data quality depends on the questions asked in the survey. Again, little to no information is provided on the questions used in the various surveys. Poorly worded survey questions that do not clearly distinguish among various types of illicit trade can lead to double or triple counting of some illicit cigarettes, upwardly biasing estimates of the size of the illicit market (e.g. asking separately about counterfeit cigarettes and contraband cigarettes but not clearly distinguishing between them could lead to the same illicit product being reported twice).

5. Modeling
   The overview of the model applied in the study suggests a comprehensive approach to assessing the extent of illicit trade by analyzing licit and illicit domestic production and inflows/outflows of licit and illicit cigarettes, and adjusting for smoking prevalence and consumption among smokers, tourist flows,

\textsuperscript{13}Asia-11 Report, page 11
and duty-free shopping. Nonetheless, there is limited information to explain how the model captures the various factors that influence consumption and insufficient information to independently replicate the report’s estimates. In addition, the model is applied inconsistently in each country, as shown in the sections below, and there is no accounting for non-duty-paid cigarettes marked for export flowing out of the legal supply chain and into the illicit market.

6. “Bottom up” estimation
When convenient, the authors use a "bottom up" estimate (using data on smoking prevalence and average daily consumption of cigarettes, plus UN population data) to compare with legal sales and corroborate the estimates from their IT Flows model and/or empty pack surveys, such as for Brunei, Malaysia, and Singapore. For Vietnam, however, the "bottom up" approach estimated that consumption was less than legal sales, implying no evidence of substantial illicit share, thus again calling into question the robustness of the Asia-11 Report’s methodology.

Given the non-transparent methods and potentially biased data used by the authors, their estimates of the extent of illicit cigarette trade are likely also similarly biased and highly suspect. The Asia-11 Report cannot be relied on as a source of data on illicit trade until there is significant transparency over the underlying methodology and data inputs and the contractual arrangements under which it was produced. The authors themselves seem to acknowledge this by stating clearly in their disclaimer, "The purpose of the report is to serve as a public policy resource pursuant to ITIC’s mission. Nevertheless, should any party choose to rely on the report, they do so at their own risk. ITIC and OE will not accept any responsibility or liability in respect of the report.”

III. Regional Overview raises questions

In addition to the problematic methodology used by its authors, the Asia-11 Report contains unexplained gaps and inconsistencies and shows selective use of the information presented.

For example, the Asia-11 Report identifies Brunei, Hong Kong, Malaysia, and Singapore as having had the highest volumes of illicit cigarettes (over 25% of total consumption) in 2012, yet on the same page of the report, it also shows Brunei, Hong Kong, and Singapore having significantly smaller numbers of illicit cigarettes consumed. In addition, when estimating the tobacco tax revenue losses due to illicit trade, the report identifies the largest losses in absolute terms being in Australia, Malaysia, Hong Kong, and Vietnam, conveniently not mentioning Brunei (which they claimed to have close to 90% illicit share) and the Philippines (which they claimed had over 6 billion illicit cigarettes), both countries having low tax revenue losses despite the high illicit consumption claimed.

Portrayal of Pakistan and Vietnam as being the largest consumers of illicit cigarettes is also misleading in that the shares of illicit in these countries are estimated by the authors to be smaller than Brunei, Hong Kong, Malaysia, and Singapore, which have much smaller populations.

ITIC/OE define illicit consumption as consisting of consumption of both non-domestic and domestic illicit cigarettes. They also categorize non-domestic illicit products into counterfeit, contraband and illicit whites, including unspecified variant cigarettes, and further define contraband as being of two types: bootlegging and wholesale smuggling through organised crime. However, the authors do not appear to recognize the possibility of contraband facilitated by manufacturers, either illegally exporting their products to other countries or exporting and illegally re-importing their products into the country of manufacture. In other words, the onus of illicit trade is placed on the consumer rather than the manufacturer despite the clear evidence and global recognition of control of the supply chain as a key component of the Protocol to Eliminate Illicit Trade in Tobacco Products.

Furthermore, “unspecified market variants” comprise the largest share (52.3% or 34.8 billion out of 66.5 billion) of the ITIC/OE estimate of illicit consumption, the term “unspecified” referring to cigarette packs that do not bear specific market labelling or duty-free labelling. Since these are differentiated from counterfeit products, it appears that the report again ignores the tobacco industry as a possible source of illicit products and the probability that the legal supply chain is not secure. Similarly, the Asia-11 Report estimates that domestic illicit comprises 95% of illicit consumption in the Philippines. Given
that, in 2012, Philip Morris Fortune Tobacco Corporation Philippines (PMFTC) controlled over 90% of the market and that the most popular brands consumed are PMFTC brands, why does the report not raise the possibility that the source of the domestic illicit cigarettes could be PMFTC?

III. Country-specific estimates

a. Australia

*Asia-11 Report findings*

The Asia-11 Report claims that out of Australia’s total (legal and illicit) consumption of cigarettes and loose tobacco (23.7 billion cigarettes in 2012), 11.3% or 2.7 billion cigarettes is illicit. Of this illicit volume, using the empty pack survey method, the report identified 71% or 1.93 billion cigarette equivalents as unbranded loose tobacco (chop chop), as well as much smaller minorities of non-domestic cigarettes from Korea, China and other countries. Counterfeit cigarettes were estimated at 80 million sticks.

*Exposing the myths*

The main source of the Asia-11 Report estimate is a 2012 report by Deloitte commissioned by British American Tobacco Australia (BATA) Limited, Philip Morris Limited, and Imperial Tobacco Australia Limited, which is an update to a 2011 report published in May 2012 using the same methodology. Chaloupka points out “the Deloitte estimate suffers from several methodological flaws, from the unrepresentativeness of the sample population where key data is obtained to potential double-counting of different types of illicit tobacco.”

Similarly, Quit Victoria in its critique of the May 2012 Deloitte report, says that apart from substantially overestimating the number of smokers using unbranded loose (chop chop) tobacco, the BATA-sponsored report on illicit tobacco also overestimates the amount that such smokers may have purchased. “In contrast to Deloitte’s estimate of 2.3 million kgs of illicit tobacco product and one billion dollars in lost revenue, it is more likely that illicit tobacco in Australia amounts to about a quarter of a million kilos and less than $165 million in revenue foregone. This pales into insignificance with the additional $1 billion in total government revenue (excise, customs and GST) that resulted from increasing excise and customs duty on tobacco products in April 2010 despite an estimated 8% decline in tobacco population smoking.” Based on findings from the National Drug Strategy Household Survey (NDSHS), which had over 26,000 respondents, Quit Victoria estimated that the illicit market in Australia must have been only about 2–3% of the total tobacco market, a much smaller figure than the 13.9% estimate reported in the 2011 Deloitte report or the 10.5% reported in the 2012 Deloitte update, both widely touted by the tobacco industry and used as the basis for the Asia-11 Report.

With respect to ‘chop-chop’ specifically, the Deloitte report assumed that roll-your-own cigarettes made from ‘chop chop’ contain 1.0 gram of tobacco, well above the estimates from academic studies and the equivalence factor used by some governments (e.g. New Zealand) when setting tax rates so as to equalize the tax on roll-your-own cigarettes and manufactured cigarettes.

\[\text{Source:} \text{Deloitte (2020)}\]


\[\text{Rosenberry ZR, Strasser AA, Canlas LL, Potts JL, Pickworth WB (2013). Make your own cigarettes: characteristics of the product and the consumer.} \text{Nicotine & Tobacco Research} \text{15(8):1453-1457.}\]

\[\text{Connolly GN, Alpert HR. Trends in the use of cigarettes and other tobacco products.} \text{Journal of the American Medical Association} \text{299(22):2629-2630.}\]
although based on the Deloitte report, used a conversion rate of 0.8 gram of loose tobacco per cigarette. Chaloupka estimates that using a more reasonable assumption of 0.7 grams of tobacco per roll-your-own cigarette made from 'chop chop' would reduce the Asia-11 Report estimate of the number of 'chop chop' cigarettes from 1.9 billion to 1.3 billion, and reduce the total estimate for illicit cigarettes by over 22%, from 2.7 billion to 2.1 billion.

Taken at face value, both the Deloitte and Asia-11 reports also show that illicit trade has decreased despite Australia’s bi-annual, inflation-adjusted excise tax increases, contradicting the industry’s arguments about higher taxes and prices as drivers of illicit trade.

On 1 August 2013, the Australian government announced a 12.5% increase to the excise rate on tobacco each year over the next four years\(^\text{19}\), a testament to how little importance it gives to the industry-funded reports of Deloitte and ITIC.

b. Brunei Darussalam

Asia-11 Report findings

ITIC/OE estimated the total (legal and illicit) consumption in Brunei at 351.2 million cigarettes in 2012, of which 89.8% or 315.2 million cigarettes was deemed illicit based on the IT Flows Model employed, making Brunei the economy with the highest incidence of illicit cigarette consumption among the 11 markets covered in the report. Allegedly, this large illicit volume grew as a result of Brunei’s significant 2010 excise tax increase. Furthermore, the report also indicated that the collapse of the legal market after the exit of international tobacco manufacturers left the Brunei market served largely by illicit imports with brands Era, Extreme, and Harvy topping the list.

Exposing the myths

Dr. Chaloupka points out that the total cigarette consumption estimated by ITIC/OE was based on the assumption that a typical smoker in Brunei consumes 15 cigarettes per day, which is described as 'similar to neighbouring countries'; however, the estimated average daily consumption per smoker in Malaysia, as reported in Euromonitor, is just over 9 cigarettes. Thus, by overestimating the total consumption and assuming that the difference between total consumption and legal sales consists of illicit cigarettes, the Asia-11 Report grossly overestimated the number of illicit cigarettes. Furthermore, assuming smokers in Brunei consume an average of 9.2 cigarettes per day, as in Malaysia, the total number of illicit cigarettes would then fall by over 43%, from ITIC/OE’s estimate of 315.2 million down to 179.4 million.

The Royal Customs and Excise Department also totally disagrees with the Asia-11 Report, stating that it is based only on assumptions without official data from relevant agencies in Brunei and that “there is no evidence that all the cigarettes consumed in Brunei are most likely smuggled from our neighbouring countries”\(^\text{20}\).

Another flaw pointed out by Brunei’s Ministry of Health\(^\text{21}\) is ITIC/OE’s erroneous assumption that all non-domestic cigarettes are illicit. While Brunei imposes a zero-allowance of duty-free personal imports as stated in the amended Excise Order (2010), the MOH explained that in practice, the provision is currently only implemented for travellers coming through the international airport. The zero-allowance is yet to be implemented for travellers coming via numerous land control posts. As such, a large proportion of non-domestic cigarettes assumed to be illicit have in fact been brought in legally. Thus, the figure quoted for Brunei in the Asia-11 Report is grossly over-estimated.

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\(^{20}\)Private communication from Ms. Bunga Galawing, Superintendent of Customs, Brunei Darussalam, 21 June 2014.

\(^{21}\)Private communication from Dr. Anie H. Abdul-Rahman, Ministry of Health, Brunei Darussalam, 9 December 2013.
Another obvious scenario that the Asia-11 Report ignores is one where consumption may actually have decreased as a result of the government’s successful regulations in addition to the 2010 tax hike, i.e. stricter enforcement of the ban on smoking in public places in 2010 and its expansion to more public areas in 2012, stricter retail licensing regulations (higher license fees and limits on where tobacco can be sold) since 2010, and very large (75%) pictorial health warnings since 2012. Thus the decision of importers to discontinue doing business in Brunei is likely a result of their unwillingness to comply with the stricter regulations, as well as a shrinking demand and much smaller retail network (from 487 retailers in 2010 to 70 in 2012)\(^2\), and not because of increased competition from illicit traders.

c. Hong Kong

\textit{Asia-11 Report findings}

According to the Asia-11 Report, Hong Kong’s total tobacco consumption was estimated at 5.1 billion cigarettes in 2012. Of this, 1.8 billion cigarettes were deemed illicitly traded, as derived from their IT Flows Model, making 1 in every 3 cigarettes smoked in Hong Kong illegal. The report notes that seizures of illicit cigarettes by Hong Kong Customs averaged 86 million cigarettes per year between 2010 and 2012. The volume of illicit cigarettes is blamed on steep tobacco tax increases introduced in 2009 and 2011, claiming that these further widened price differences with neighboring countries.

\textit{Exposing the myths}

Chaloupka notes that when a process similar to that used by ITIC/OE in Brunei is applied to Hong Kong (using prevalence, population, and average consumption data to derive an estimate of total consumption), the estimated total consumption is only 4.1 billion cigarettes. However, in contrast to their approach for Brunei, ITIC/OE decided to rely on their IT Flows Model, which resulted in an estimated total consumption of 5.1 billion cigarettes and 1.8 billion illicit cigarettes for Hong Kong. If they had used the 4.1 billion estimate derived from prevalence, population and average consumption data, the estimated volume of illicit cigarette consumption in Hong Kong would only have been 0.8 billion cigarettes, more than 55% lower than the 1.8 billion cited in the Asia-11 Report.

In a news report\(^3\), the HK Customs and Excise Department disputed the Asia-11 Report saying measures combating illegal cigarettes at the source were improving. From January to August 2013, 59.5 million illegal cigarettes were seized by customs operations, a 38% year-on-year increase, while during the same period, revenue from tobacco excise rose to HKD 3.48 billion from HKD 3.2 billion brought in over the same period in 2012. According to Customs and Excise Department data\(^4\), after the 50% increase in excise (from HKD 0.8 to HKD 1.2 per stick) in 2009, the number of seizures in 2010 actually decreased by 25% compared to 2009, while the number of seized cigarettes for the local market decreased by 19% (from 58 million sticks to 47 million sticks). In contrast, in 2011 (after no tax increase in 2010), the number of seizures increased by 44%, and the number of seized cigarettes for the local market increased by 51%. Such data clearly disproves the Asia-11 Report and recurring tobacco industry claims about tax increases as drivers of illicit trade.

Customs and Excise also point out that tobacco excise revenues contribute only 2-3% of Hong Kong’s entire tax revenue collections and that the reason for the large tobacco tax increases is to improve public health, not revenue generation.

It is also worth noting that while there is a reduced duty-free allowance of 19 sticks (one open pack), travelers are still able to bring in a larger volume after paying the corresponding duties.

\(^2\) Data from Brunei Ministry of Health as State Licensing Authority

\(^3\) Chan S. 1 in 3 cigarettes smoked in Hong Kong are illegal, controversial study finds. South China Morning Post 3 October 2013. Available at http://www.scmp.com/news/hong-kong/article/1323028/1-3-cigarettes-smoked-hong-kong-are-illegal-controversial-study-finds

\(^4\) Customs and Excise Department Powerpoint presentation, 12 October 2012.
d. Indonesia

*Asia-11 Report findings*

The Asia-11 Report estimated that only 0.1% (300 million cigarettes) out of Indonesia’s total consumption of 302.7 billion cigarettes for 2012 was illicit. ITIC/OE attributed this to the fact that cigarette prices in Indonesia are generally low, which provides little incentive to smuggle illicit products, and presumed that most non-domestic cigarette packs found in their empty pack survey were likely to be legal personal imports.

*Exposing the myths*

While the Asia-11 Report states that this very low estimation may be understating the actual incidence of illicit consumption, referring to local press reports citing seized illicit cigarettes include locally-produced cigarettes that partially evade taxes (e.g. tax stamps from a lower tax category are placed on products that should be taxed in a higher tax category) and counterfeit products from small manufacturers, it ignores the obvious fact that (low prices notwithstanding) the large majority of Indonesian smokers consume clove cigarettes (*kreteks*), which are produced only in Indonesia, and thus there is no incentive for any non-*kretek* cigarettes to be smuggled into Indonesia.

Noting how the domestic illicit production was assumed by ITIC/OE to be zero and that cigarette litter surveys are unheard of in their country, researchers from the University of Indonesia’s Demographic Institute (DI) have also questioned the representativeness of the areas covered in the Asia-11 Report’s Empty Pack Survey and the validity of the IT Flows Model to estimate illicit consumption. In comparison, Satriawan et al. surveyed points of sale in 16 out of 33 provinces in Indonesia and purchased a total of 20,000 packs in selected villages to identify whether cigarette packs were illicit or not and estimated illicit cigarette consumption to be about 6%. In a different 2010 study by the DI, wherein 2,000 respondents were interviewed in East and Central Java provinces, the illicit cigarette consumption was estimated at 4.58%.

e. Malaysia

*Asia-11 Report findings*

ITIC/OE estimated that illicit cigarette incidence in Malaysia was 34.5% (7.9 billion cigarettes) of the total (legal and illicit) 23.0 billion cigarettes consumed in 2012, the estimated non-domestic share being based on Empty Pack Surveys.

*Exposing the myths*

The Asia-11 Report estimate is exactly the same as that of the Confederation of Malaysian Tobacco Manufacturers (CMTM)’s illicit cigarette survey in 2012, which is also an empty pack survey and most likely the source of data for the Asia-11 Report. This figure is expectedly consistent with results of previous litter surveys by CMTM, which is composed of BAT Malaysia Bhd, JTI Bhd, and Philip Morris (Malaysia) Sdn Bhd, all of whose parent companies provide funding to ITIC.

Since 2003, CMTM estimates for the prevalence of illicit cigarettes have consistently been on the upward trend, except for 2004. Compared with 20% in 2003, the 2004 figure was 14.4%, and this reduction, which was attributed to the introduction of security features (security ink and banderole) on cigarette packs as mandated by the Government, was despite a 55% tax increase compared to the previous year.

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25Personal communication. NurHadiWiyono. Demographic Institute, Faculty of Economics, University of Indonesia. (2014)

In 2009 and 2010, CMTM claimed illicit consumption was 37.5% and 36.3%, respectively. These estimates are significantly higher than Malaysian government estimates, which are also based on CMTM data. Government estimates are corroborated by illicit cigarette research conducted in 2009 by the International Tobacco Control (ITC) Policy Evaluation Project, which produced an estimate of 19.2%. The ITC Project used cross-sectional survey data from participants, who were selected by multistage stratified cluster sampling and who shared their used cigarette packs during a standardized interview.

In contrast, CMTM's litter surveys over the past decade in Malaysia sample only litterbins from selected hotspots where crowds congregate (e.g. stadiums and markets) and rural spots where consumption of illicit cigarettes is known to be high, such as palm oil estates where poor folk and immigrants (mostly Indonesian migrants) reside. Selection of only these specific areas would certainly yield biased data and subsequently inaccurate overestimates of illicit consumption. Surveys of Malaysian smokers show that the top three illicit brands mentioned in the Asia-11 Report (Gudang Garam, John, and Canyon) are not commonly smoked by the locals. Obviously the incidence of illicit cigarettes, particularly the Indonesian brand Gudang Garam, would be high all the time in such litter surveys, given that kreteks are popular among Indonesian smokers, who are a major part of the migrant population. The tobacco industry in Malaysia consistently uses results derived from this non-representative sample to extrapolate and make deductions about the national situation.

f. Philippines

Asia-11 Report findings

As per the Asia-11 Report, total consumption (legal and illicit) for the Philippines in 2012 was estimated at 108.7 billion cigarettes. Of this, 5.9%, or 6.4 billion cigarettes, was deemed to be illicit, majority (6.1 billion sticks) of which was domestic illicit, while counterfeit inflows believed to originate mostly from China (220 million) and non-domestic illicit inflows (90 million), were a minority.

Exposing the myths

It is not so surprising that ITIC/OE does not comment on its estimate of domestic illicit, which it says accounts for 95% of total illicit consumption. Given that the most popular brands consumed in the Philippines belong to Philip Morris Fortune Tobacco Corp., it is highly possible that these also comprise the majority of domestic illicit, an embarrassing potential conclusion for the Asia-11 Report's funders.

As with other countries, the estimated non-domestic share was based on a Q4 2011 Empty Pack Survey. Identification of illicit packs by this process is highly disputable, because of the ambiguous and non-transparent methodology employed. In addition, only cigarette packs imported into the Philippines are currently required to affix tax stamps, which have no holographic security elements or other high-tech security features, and these are easily replicated by normal reprographics methods. This makes it particularly difficult for a litter survey to determine with accuracy whether a pack is licit or illicit. Conversely, it is prone to either overestimation or underestimation, leading one to conclude that the estimate of illicit cigarette consumption in the Philippines is inaccurate and unreliable.

g. Thailand

Asia-11 Report findings

The Asia-11 Report's estimate of total consumption (legal and illicit) for Thailand in 2012 was 40.5 billion cigarettes (excluding roll-your-own tobacco). Of this, only 2.9% (1.2 billion cigarettes) was deemed illicit consumption, all from non-domestic sources (domestic illicit was zero).

Exposing the myths

Again, ITIC/OE's primary data source is an Empty Pack Survey carried out by the tobacco industry within Thailand and, for outflows of domestic duty-paid cigarettes, in other Asia-11 markets. Given the limitations of the empty pack survey method the estimate is unlikely to be reliable and valid. It even
labels 650 million cigarettes or over half of non-domestic illicit inflows as “unspecified”, even while being able to categorize illicit cigarettes from China and Cambodia and stating that “counterfeit products make up a significant (20%) of total illicit inflows” without any explanation for how these were identified as counterfeit.

Similarly, the method used to calculate total non-domestic inflows using passenger data, smoking rates and personal allowance is not clearly spelled out and thus unreliable and invalid. Many other measures are also based on OE estimates, but how these estimates were derived is unspecified; thus it is very difficult to evaluate the accuracy and reliability of all these measures in the IT Flows Model and thus the final estimate of illicit cigarette consumption.

The Asia-11 Report also stated that non-domestic legal inflows are relatively high due to tourist inflows (pp 80) but does not show how this conclusion was arrived at and provides no evidence to support this conclusion.

Lastly, while ITIC/OE estimated the tax loss associated with the illicit consumption of cigarettes amounted to Baht 2.4 billion (USD 76 million) in fiscal year 2011/12 or Baht 2.5 billion (USD 80 million) for the calendar year 2012, it failed to mention that the tobacco excise revenues collected in 2012 amounted to USD 1.997 billion, dwarfing the claimed illicit trade tax losses.

h. Vietnam

Asia-11 Report findings

ITIC/OE estimated the total consumption (legal and illicit) for Vietnam in 2012 at 103.3 billion cigarettes. Of this, an estimated 19.4% (20.1 billion cigarettes) was deemed illicit consumption based on estimates by the Vietnam Tobacco Association (VTA), while a 2011 Empty Pack Survey conducted in urban areas only (15 cities) suggested a non-domestic share over 30%.

Exposing the myths

Similar to other countries, the major criticism of the Asia-11 Report estimate for Vietnam is the non-transparent methodology employed. While ITIC/OE base their estimates on those of VTA, there is no description or appraisal of the VTA survey methodology, which supposedly is different from the 2011 empty pack survey, whose estimates are also mentioned as being much higher.

The Asia-11 Report notes the empty pack survey limitation of being conducted only in (15 cities) urban areas but fails to point out that 68.3% or 60.6 million Vietnamese live in rural areas, such that sampled areas are unrepresentative of the general population. Furthermore, as with other similar surveys by the tobacco industry, it is likely that these selected urban areas are known hotspots for illicit consumption, thus creating highly biased data and results. Findings from a cross-sectional study\textsuperscript{27} of smokers recruited from Vietnamese households to determine the magnitude of illicit cigarette consumption showed that illicit consumption was markedly higher in urban areas (28.9%) than in rural areas (16.1%). A majority (42.0%) of illicit consumption was in Vietnam’s southern region, while the northern and central regions accounted for only 4.9% and 7.0%, respectively, with some provinces having zero percent illicit consumption. Most of the illicit-cigarette smokers were concentrated in the bigger cities in the southern part of the country: Dong Thap (45.5%), Long An (44.1%), Ho Chi Minh City (41.7%) and Binh Phuoc (26.3%), while the percentage of smokers who smoke illicit-cigarette is low in the central and northern regions: Da Nang (12.9%) and Dak Lak (10.6%), and Hanoi (7.0%), respectively.

The Asia-11 Report also distorts information on excise duties applied to cigarettes (p. 85 bar chart). There has been no change in the ad valorem tobacco excise rate in Vietnam since 2008; however, the bar

chart indicates a 149% excise increase in 2010 and a 26% increase in 2012, both of which are due to higher prices determined by the industry rather than an increase in the government’s tax rate.

IV. Regional Dissemination and Response

While the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP) is now open for ratification and accession, the recommendations from the Asia-11 Report seem to undermine the ITP in that they promote alternate solutions, including building on existing memoranda of understanding and forming public-private partnerships with the industry, both of which have been proven to be ineffective in tackling illicit trade and which violate FCTC Article 5.3:

“Though it cannot form the complete solution to the problem, the Protocol does merit detailed analysis to understand the options, implications and costs before countries embark on implementation. Whilst this process gets underway, countries with similar concerns and commitment to tackling this illicit trade may wish to proactively establish regional partnerships to develop a consistent and thus more effective approach to implementation building on existing memoranda of understanding, public-private partnerships and multilateral agreements.”

Among recommendations from the Singapore meeting was a call for stronger international cooperation between national governments, industry, and internationally recognized & specialized agencies such as the World Customs Organization and Interpol.

The Asia-11 Report was disseminated to all the related government ministries and agencies and its tobacco industry allies in all the 11 Asian countries after the regional launch in Singapore on 26 September 2013. ITIC and OE have been actively publicizing it at national level and meeting with high-ranking government officials at various venues. For example:

- Launch of Asia-11 Report in Kuala Lumpur on 30 September 2013 with the former Customs Director General endorsing the report;
- ITIC media briefing held in Bangkok in October 2013;
- ITIC’s Myanmar Natural Resources Taxation Working Group meeting held in Nay Pyi Taw, Myanmar on 10-11 February 2014, where government participants requested an immediate follow-up meeting as soon as possible.
- ITIC President met with Vietnamese Minister of Finance in Washington, DC on 11 March 2014.
- ITIC’s third annual Diplomatic Dialogue for High Commissioners and Ambassadors from Asia held in London on 6 March 2014

This systematic promotion of the industry-friendly report and its pro-industry position serves to counter other evidence-based information and initiatives on tobacco taxation available to governments. It also undermines initiatives such as the Southeast Asia Initiative on Tobacco Tax (SITT) and the WHO Pacific Tobacco Taxation Project.

Soon after the regional launch in Singapore, this report was again launched through a press conference in Malaysia by the former Director General of the Royal Malaysian Customs, Datuk Seri Mohamed Khalid Yusuf. The Malaysian launch coincided with the Government’s announcement of a 14% tobacco tax increase, giving the industry opportunity to utilize the ITIC/OE information to their advantage. The President of ITIC, Daniel Witt, was positioned as a tax expert and made a direct comment on Malaysia’s 14% tobacco tax increase, telling the media, “an increase that was too high, implemented over too short a term, could shock the market and create a demand for black market goods. …Increasing excise tax should be done in a predictable way to stabilize the legal market, meaning those who can be taxed.” The event received extensive media coverage appearing in many major newspapers in September and October 2013. The issue was kept alive in January 2014 when CMTM again made references to this

29International Tax and Investment Center Facebook page https://www.facebook.com/pages/International-Tax-Investment-Center-ITIC/411136648933607
report in news articles. Prior to this, BAT issued a statement on how this increase in duty was “shocking and could lead to an increase in illegal cigarette trade.”

It is unsurprising that the Vietnam Tobacco Association (VTA) has been using the Asia-11 Report’s findings to oppose an effective (pro-health) increase of tobacco excise tax in the ongoing process of revision of Vietnam’s excise tax law. VTA has been emphasizing the Asia-11 Report estimate that Vietnam is the 2nd largest market of illicit cigarettes among the 11 Asian countries and that any large tax increase will lead to increased smuggling, which will lead to decreased excise revenues.

The ITIC President had also introduced the ‘ASEAN Excise Tax Study Group’ “stressing the need for balanced tax policies on excisable goods to avoid market distortions and ensure stable and predictable government tax revenues,” and concluded that the next step is the development of a “resource to assist policy makers in reforming excise taxes.” This means ITIC has set itself up as the main ‘resource’ to provide technical assistance to the ASEAN governments, although it has disqualified itself since its sponsors include the major transnational tobacco companies.

This stresses the need for official inter-governmental bodies such as the Conference of the Parties (COP) to the WHO FCTC and the ASEAN to actively take charge of discussions and meetings rather than allow the process to be hijacked by a tobacco industry-funded initiative. This also stresses the need to take a whole-of-government approach to implementing the FCTC and the ITP.

The government of Brunei Darussalam received the Asia-11 Report from its authors and wrote to the WHO Western Pacific Regional Office alerting WHO staff about it and informing them that the report’s methodology applied for Brunei was flawed. Alerting the WHO and civil society is important as both institutions monitor the tobacco industry’s interference in policy development as outlined in the FCTC Article 5.3 Guidelines.

SEATCA wrote to the FCTC Convention Secretariat alerting them to this report and raising issues it presents, highlighting how Parties to the FCTC were being contacted directly by ITIC, despite the fact that ITIC, though claiming to be an independent organisation, was actually funded by major transnational tobacco companies and that the study was funded by PMI. SEATCA also wrote to several governments advising caution to this report.

When the Asia-11 Report was launched in Singapore, an international news agency contacted SEATCA. SEATCA provided a statement whose main point was: “The public needs to know that ITIC, despite claiming to be an independent organisation, is funded by major transnational tobacco companies. The fact that Philip Morris had also funded this research, as well as the KPMG Star study in Europe, also calls into question the credibility of this report.” The news agency decided not to run the story on the ITIC report.

V. Use of Interpol’s name

In June 2012, Philip Morris International announced it was donating 15 million Euros to INTERPOL to combat illicit trade, including of tobacco products. Artyom Chernis, PMI Vice President for Illicit Trade Strategies and Prevention, said, “The eradication of illicit cigarettes and the criminality associated with it requires a concerted and coordinated cross-border effort which INTERPOL is ideally placed to lead. We look forward to our cooperation and the positive results we are confident it will yield.” According to PMI, its contribution to INTERPOL’s Fund for A Safer World will be used for coordination of information gathering, training programs for law enforcement officials, development of product authentication standards and the execution of public information campaigns.30

Governments and tobacco companies have different objectives in combating illicit trade in tobacco products. For governments, eliminating illicit trade will result in increased revenues and greater

protection of health by preventing access to cheap illegal tobacco products. For tobacco companies, their aim is to regain market share for their legal products, which in themselves are harmful to health.

By co-opting INTERPOL and customs and other relevant government agencies, the tobacco industry, despite its inherently harmful nature, is able to improve its public image as a responsible industry and influence the development and implementation of policies to regulate the industry and its products.

Specific to INTERPOL, shortly after accepting PMI’s donation, in July 2012, INTERPOL announced the creation of the INTERPOL Global Register (IGR), which it said would make accessible the industry’s supply authentication system, Codentify31, which the industry deceptively promotes to governments as a tracking and tracing system for controlling illicit trade.

In November 2012, at its Fifth Session, the COP decided “to defer consideration of the application for observer status submitted by the International Criminal Police Organization (INTERPOL); and to mandate the Bureau of the COP to liaise with INTERPOL to seek clarification on considerations relating to its application for observer status, taking account Rule 30 of the Rules of Procedure of the COP, in particular in relation to Article 5.3 of the WHO FCTC”.

VI. The WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products

The Protocol to Eliminate Illicit Trade in Tobacco Products is the first Protocol to the WHO FCTC and was adopted on 12 November 2012 at the fifth session of the Conference of the Parties in Seoul, Republic of Korea. It is currently open for ratification, acceptance, approval or accession by the Parties to the WHO FCTC.

As a treaty attached to a Framework Convention, the Protocol was open for signature by all Parties to the WHO FCTC from 10 January 2013 until 9 January 2014. When it was closed for signature, the Protocol had been signed by 53 States and the European Union (out of 178 eligible Parties), five of which belong to the Asia Pacific region: China, Fiji, Mongolia, Myanmar, and Republic of Korea. Nicaragua is the only country to have ratified the Protocol. The Protocol will enter into force on the 90th day following the date of deposit of the 40th instrument of ratification, acceptance, approval, formal confirmation or accession with the UN Depositary.

The Protocol aims to eliminate all forms of illicit trade in tobacco products and provides tools for preventing and counteracting illicit trade through an array of national measures and international cooperation.

Key measures pertain to controlling and securing the supply chain of tobacco products, such as licensing for the manufacture, import, and export of tobacco products and manufacturing equipment; establishing a national or regional tracking and tracing system for all tobacco products (which will be part of a global tracking and tracing regime that includes a “global information-sharing focal point” located at the FCTC Secretariat); due diligence requirements; subjecting the and international transit.

Law enforcement measures such as establishing a number of conducts as unlawful and subjecting them to effective and dissuasive sanctions are another major area of the Protocol, as is broad international cooperation in the investigation of illicit trade, including by affording mutual legal assistance and extradition and through information sharing, technical assistance and cooperation.

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31Joossens L, Gilmore AB. The transnational tobacco companies’ strategy to promote Codentify, their inadequate tracking and tracing standard. Tob Control 2013 April 27. Epub ahead of print. http://tobaccocontrol.bmj.com/content/early/2013/03/11/tobaccocontrol-2012-050796.full.pdf
VII. Conclusion and Recommendations

The proposal to implement gradual tobacco tax increase (instead of huge hikes) made by the Asia-11 Report is exactly the same as the decades-old annual calls made by the tobacco industry in every country. There is absolutely nothing new that can be drawn from the study, and governments should continue to raise tobacco taxes in order to reach their public health and fiscal objectives.

It must be realized that substantial improvement can be achieved as a consequence of operative actions by the authorities. Governments should continuously implement effective novel strategies to combat illicit tobacco trade by stepping up enforcement measures. As governments had actively participated in the drafting of the WHO FCTC – Illicit Trade Protocol, they should ratify this new legal tool as soon as possible. Relevant laws and regulations should be enacted consistent with the articles and guidelines in this Protocol.

Recommendations

• Reject the ITIC/OE Asia-11 report as it is not an independent report, uses flawed methodology, and results in skewed finding supportive of the tobacco industry’s position
• Implement FCTC Article 5.3 Guidelines and reject any partnership with the tobacco industry and its representatives in tackling smuggling problem
• Step up enforcement to reduce tobacco smuggling
• Ratify the Protocol to Eliminate Illicit Trade in Tobacco Products