BIS OXFORD ECONOMICS

ECONOMIC IMPACT OF ILLICIT TOBACCO IN AUSTRALIA

NOVEMBER 2021

ABOUT BIS OXFORD ECONOMICS

Oxford Economics was founded in 1981 as a commercial venture with Oxford University's business college to provide economic forecasting and modelling to UK companies and financial institutions expanding abroad. Since then, we have become one of the world's foremost independent global advisory firms, providing reports, forecasts, and analytical tools on 200 countries, 100 industrial sectors and over 3,000 cities. Our best-of-class global economic and industry models and analytical tools give us an unparalleled ability to forecast external market trends and assess their economic, social, and business impact.

Headquartered in Oxford, England, with regional centres in London, New York, and Singapore, Oxford Economics has offices across the globe in Belfast, Chicago, Dubai, Miami, Milan, Paris, Philadelphia, San Francisco, and Washington DC. We employ over 300 full-time people, including more than 200 professional economists, industry experts and business editors—one of the largest teams of macroeconomists and thought leadership specialists. Our global team is highly skilled in a full range of research techniques and thought leadership capabilities, from econometric modelling, scenario framing, and economic contribution analysis to market surveys, case studies, expert panels, and web analytics. Underpinning our in-house expertise is a contributor network of over 500 economists, analysts, and journalists around the world.

Oxford Economics is a key adviser to corporate, financial and government decision-makers and thought leaders. Our worldwide client base now comprises over 1500 international organisations, including leading multinational companies and financial institutions; key government bodies and trade associations; and top universities, consultancies, and think tanks.

In March 2017 Oxford Economics purchased the respected Australian forecasting and consultancy company, BIS Shrapnel to become BIS Oxford Economics. BIS Oxford Economics has an Australian staff of over 50. It combines deep knowledge of the Australian economic environment with access to Oxford Economics' global capabilities to provide powerful insights to clients.

November 2021

All data shown in tables and charts are BIS Oxford Economics' own data, except where otherwise stated and cited in footnotes, and are copyright © BIS Oxford Economics Pty Ltd. This report is confidential to British American Tobacco Australia and may not be published or distributed without their prior written permission.

The modelling and results presented here are based on information provided by third parties, upon which BIS Oxford Economics has relied in producing its report and forecasts in good faith. Any subsequent revision or update of those data will affect the assessments and projections shown.

BIS Oxford Economics,

Level 6, 7 Macquarie Place, Sydney, 2000

Tel: +61 2 8458 4200

TABLE OF CONTENTS

Executive summary 3
Overview 3
Australia's legal tobacco trade 3
The illict tobacco problem 3
The economic consequences of Illicit tobacco 4
Other negative impacts of illicit tobacco on society 4
1. Introduction 5
1.1 Background 5
1.2 Structure of this report 6
2. Australia's tobacco trade 7
2.1 Trends in consumption 7
2.2 Taxation of tobacco products 8
2.3 Australia's tobacco industry 10
2.4 Modelling the Australian tobacco industry 11
2.5 Economic impact of the legal market 12
3. The illicit tobacco market 17
3.1 Background to the illict market 17
3.2 Prices, risks and returns 18
3.3 Importation, domestic production and enforcement 21
3.4 Quantifying the illicit market 24
4. IllicIt market impacts 28
4.1 The socio-economic impacts of illicit tobacco trade 28
4.2 International evidence on illicit activity 30
4.3 Illicit impacts on Australia 31
Appendix 1 – Estimating legal and illict market size 35
Appendix 2 - Illustrative estimate of potential laundering revenues 40

EXECUTIVE SUMMARY

20.4%

Estimated proportion of Australia's tobacco consumption comprised of illicit products in 2019.

This level of illicit market penetration in that year appears higher than in previous years.

OVERVIEW

The consumption of Illicit tobacco has become a substantial problem for Australia in recent years.

With illicit tobacco offering higher profit margins than illegal drugs such as cocaine, it presents several significant problems for government and society, including:

- depriving the government of tax revenues, reducing its ability to deliver basic services and valuable social programmes;
- displacing legal activity within the retail, wholesale and logistics industries; and
- corrupting institutions, enabling money laundering, and providing revenues for organised crime, including potentially financing terrorist activities.

This study by BIS Oxford Economics, commissioned by British American Tobacco Australia (BATA), provides information on several key issues, namely:

- assessment of the value of the legal supply chain;
- estimation of the tax and industry;
- legal economy losses to illicit operators; and
- examination of the harms caused by illicit tobacco trade

AUSTRALIA'S LEGAL TOBACCO TRADE

The legal tobacco industry supported an estimated 20,000 jobs and $2.3 billion in Gross Value Added (GVA) across the retail, wholesale and transport and logistics industries in calendar year 2019. Gross revenues totalled some $20.2 billion in 2019 with an estimated $16.0 billion in tax and $4.2 billion accruing to industry itself. Spending on the industry also creates ripple (or multiplier) effects across the economy with each dollar directly spent on the industry generating $2.4 to $2.6 dollars across the Australian economy as a whole (depending on the sector).

$3.8 billion tax lost

Total amount of tax evaded by the illicit trade in tobacco in 2019.

We estimate total revenue losses to industry and government at $4.9 billion

THE ILLICT TOBACCO PROBLEM

Based on data reported by KPMG, illicit consumption accounted for 20.4% of Australia's tobacco consumption in calendar year 2019, equating to just over 3.0 million kg (or 3,000 tonnes) though data for 2020 indicate that this had fallen back to 16.9% of the total market and 2.2 million kg (or 2,200 tonnes) in 2020.

Illicit tobacco includes factory made cigarettes manufactured outside Australia as well as loose tobacco imports (often known as Chop Chop).

Most of the illicit tobacco consumed in Australia (about 80% based on ATO data) is thought to be imported. A smaller quantity is illegally grown within Australia (there is no legal domestic manufacturing within Australia) and sold as loose tobacco.

THE ECONOMIC CONSEQUENCES OF ILLICIT TOBACCO

In total, we estimate around $4.9 billion in revenue was lost by the legal economy to the illicit economy by the illicit tobacco trade in 2019.

Of this, some $3.8 billion of taxes were notionally evaded by the illicit trade in tobacco (the "tax gap") in calendar 2019.

$2.1 billion

in estimated revenues accrued to illicit operators in 2019.

Roughly 80% of illicit revenues are estimated to flow to organised crime rings.

Illicit tobacco avoids both excise duty and GST on final retail prices and, in so doing, deprives the government of substantial revenues. Lost excise duty on tobacco is estimated as some $3.3 billion in 2019, with a further $0.5 billion in lost GST revenues. If it were not captured by the illicit trade, at least some of this money could be used to fund essential community services.

In addition to lost tax revenues, we estimate an additional **$1.1 billion in revenues** was lost to legal industries due to the operations of the illicit trade. These industries include wholesalers, retailers and those involved in the logistics chain.

The industry loss is equivalent to approximately $615 million in Gross Value Added (GVA) and 5,800 jobs from the legal economy

Of the $4.9 billion lost to the legal economy in 2019, we estimate some $2.1 billion flowed to illicit operators. The remainder ($2.8 billion) was captured by consumers of illicit products who evaded taxes by paying lower tobacco prices than in the legal market.

OTHER NEGATIVE IMPACTS OF ILLICIT TOBACCO ON SOCIETY

The illicit trade in tobacco has several other negative consequences on Australia's society.

Illicit tobacco supports the finances of organised crime rings (who account for an estimated 80% of illicit tobacco activity).

The trade also corrupts institutions (including those in the logistics chain), contributes to money laundering and has been linked to terrorist financing.

And, to the extent that the production of illicit tobacco has a local component, it also diverts farmland away from other productive uses and can result in the misuse of such land (and the labour on it).

1. INTRODUCTION

1.1 BACKGROUND

Australia faces a significant challenge in tackling the illicit trade in tobacco. Attractive profit margins for illicit traders, capitalising on the rising price of legal tobacco and the availability of cheap illegal cigarettes, have created substantial enforcement, economic and social problems.

The illicit tobacco trade deprives government of much-needed tax revenues. Moreover, it displaces activity from retailers, wholesalers, and the logistics chain in the legal market, contributes to the distorted use of economic resources and provides opportunities for negative follow-on impacts such as corruption, money laundering and terrorist financing.

This report highlights the economic consequences of the illicit trade on the Australian economy. The analysis is focused on the last full pre-pandemic calendar year (2019) to ensure data consistency, although more recent data and observations are also discussed.[1]

As well as quantifying the size of the legal and illicit tobacco markets and measuring lost taxation revenues, we measure the gain to illicit operators and highlight the issues flowing from the illicit trade. These include displacement of the legal industry and the potential for corruption, money laundering and the misuse of economic resources.

[1] Key data sources include Euromonitor International (2021) *Tobacco in Australia* and KPMG (2020) *Illicit Tobacco in Australia 2019 Full Year Report.* The focus on 2019 also provides a "base year" free of the considerable volatility associated with the COVID-19 pandemic which affected economic and social statistics across Australia and the world. That said, we do also note some more recent trends in illicit tobacco production and consumption in the course of this report. In addition KPMG (2021) *Illicit tobacco in Australia 2020: Full Year Report* was released in the course of the writing of this report and we have taken some of its updates for 2019 into account. KPMG'(2021) indicated substantial declines in the consumption of both legal and illicit tobacco, with the latter falling to an estimated 16.9% of total consumption and overall tobacco consumption decreasing by 11.4%. Legal tobacco consumption declined by 7.4% and illicit tobacco consumption by 26.6%. KPMG (2021) suggested that the decline in total consumption may have been driven by the COVID-19 pandemic, noting particular declines in manufactured cigarettes during the first lockdown period in 2020 (roughly March -June).

While noting (and indeed because of) this volatility in 2020 we have retained 2019 as the base year as stated above and based our analysis on the KPMG's 2020 report for that year unless otherwise indicated. One minor change is that KPMG (2020) indicated illicit tobacco consumption accounted for 20.7% of total tobacco consumption in 2019 whereas KPMG (2021) indicated the proportion was 20.4% based on updated Australian Institute of Health and Welfare (AIHW) data. We have incorporated this change into this report. This has only a minor effect on illicit volume estimates for 2019 (a reduction of illicit tobacco volumes of some 51,000 kg out of an estimated market of some 3 million kg) which we have also incorporated into our calculations.

In addition, we focus only on cigarettes and loose tobacco, excluding other tobacco products (such as cigars) which account for only a minor part of the market.

1.2 STRUCTURE OF THIS REPORT

This report is divided into a number of sections:

- Chapter 2 describes Australia's legal tobacco supply chain.
- Chapter 3 describes the illicit tobacco trade in Australia, its impacts on government finances, disruption to legal industry the revenues flowing to illegal operators.
- Chapter 4 explores the broader impacts of the illicit trade including issues such as involvement of organised crime rings, money laundering, potential for terrorist financing and misuse of agricultural land.

2. AUSTRALIA'S TOBACCO TRADE

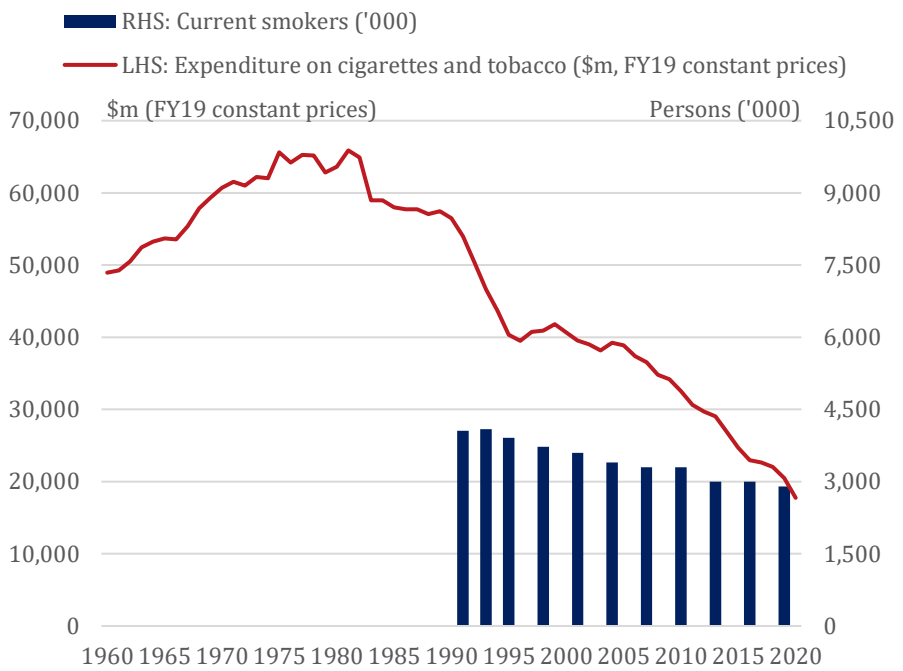
2.1 TRENDS IN CONSUMPTION

According to the Australian Institute of Health and Welfare (AIHW), there were an estimated 2.9 million current smokers in Australia in 2019 (down from around 4 million in 1991).[2]

Legal domestic sales of cigarettes and loose tobacco were estimated as equivalent to 11.8 million kg in that year (including over 11.9 million cigarette sticks with the remainder as loose tobacco) down from 17.6 million kg in 2009 (a fall of 33%)[3], with $20.4 billion spent on cigarettes and tobacco products.[4]

Based on constant (2019) values, consumer expenditure on cigarettes and tobacco products fell by 23% between the 2016 and 2020 financial years alone.[5]

Fig. 1. Expenditure on cigarettes and tobacco products



Source: ABS, AIHW, Oxford Economics

[2] AIHW (2020) *National Drug Strategy Household Survey, 2019*

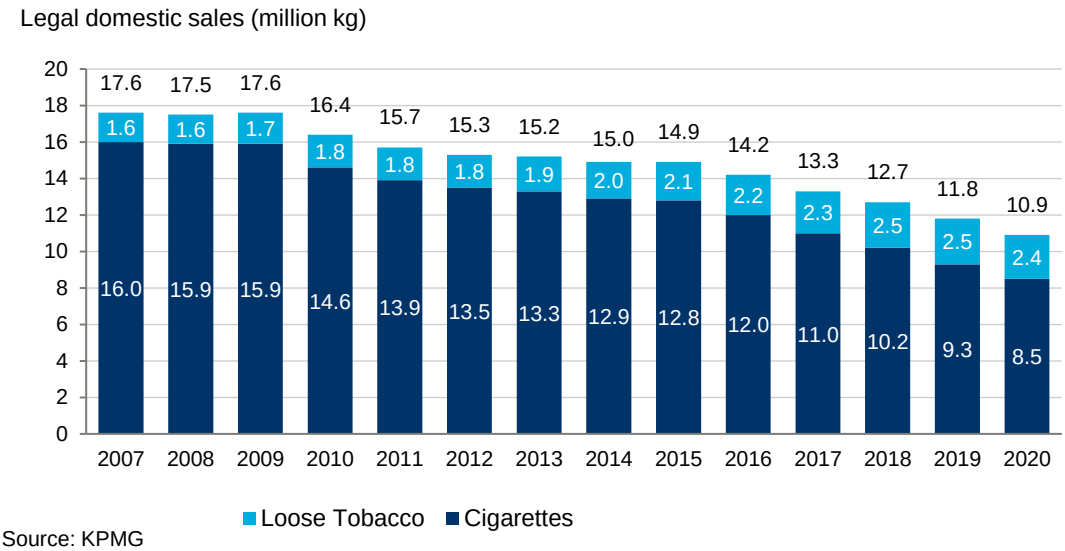
[3] Euromonitor International (2021) *op. cit.*; KPMG (2020) *op. cit*.

[4] Based on Australian Bureau of Statistics (ABS) household expenditure data. We use ABS data for the purposes of expenditure comparisons over time. Unless otherwise indicated, Euromonitor data are used for revenue estimates in this report – Euromonitor estimates $20.2 billion of expenditure on cigarettes and tobacco products in 2019, similar to the ABS estimate.

[5] ABS (2021), *Australian National Accounts, National Income Expenditure and Product; Household Final Consumption Expenditure Cat No. 5206.0*

Examining long term trends in the sale of legal tobacco based on data from KPMG (2021) indicates that between 2007 and 2020 legal tobacco domestic tobacco sales in Australia fell from 17.6 million kg to 10.9 million kg – equivalent to a compound annual growth rate of -3.9% (i.e. an average annualised *decline* in tobacco consumption of 3.9% per year)[6].

Fig. 2. Legal domestic tobacco sales in Australia – 2007 to 2020



Source: KPMG

2.2 TAXATION OF TOBACCO PRODUCTS

Taxation accounts for 79 cents in every dollar of the retail price of Australian tobacco.

There are two main forms of taxation on Australian tobacco products, both of which are levied by the Federal government:

- *Excise duty (also known as customs duty)* - Taxation on tobacco products into Australia is often referred to as an excise duty. In reality (as excise is defined as applying to domestic products and no domestic tobacco is manufactured in Australia), tobacco is treated as an "excise equivalent good" (EEG). So, instead of paying excise duty on tobacco, a customs duty, equivalent to the excise amount, is payable upon entry into Australia.

- *Goods and Services tax (GST)* – GST is also applicable to tobacco products. As is the case with all Federal GST revenues, the resulting GST is then distributed to the States.

[6] KPMG (2021) *op. cit.*

Excise (customs) duty

As a result of legislative changes implemented on 1 July 2019, tobacco importers are now required to pay excise duty upon the point of entry at the Australian border.

After payment of the duty, tobacco products are held at customs depots prior to unpacking and transport.

This change was one of the measures taken to curtail illicit tobacco trade in Australia as recommended by the Black Economy Taskforce.[7]

It replaced a prior system of licenced warehouses (also sometimes referred to as bonded warehouses) under which excise duty was payable when the product left the warehouse for distribution. This created a risk as criminals sought to obtain untaxed tobacco, through infiltrating bonded warehouses. Charging tobacco excise upon entry to an Australian port is aimed at curtailing this weakness in the supply chain.

Starting in 2013, a series of Federal governments committed to raising the excise duty rate on tobacco by 12.5% per year for the years leading up to 2020. These increases were in addition to twice-yearly indexation of excise on tobacco products based on average weekly ordinary time earnings.[8] This led to a set of substantial price rises up to 2020.

We estimate that, over calendar 2019, the excise duty rate averaged out at $0.839 (i.e., 84 cents) per cigarette stick weighing less than 0.8g (i.e., a typical cigarette stick) and $1,127.82 per kg for tobacco products weighing more or loose tobacco.[9] By the end of 2019, excise duty rates stood at 94 cents per cigarette and $1,291.77 per kg for tobacco products weighing more or loose tobacco.[10]

Since then, excise duty rates have since risen considerably. As at March 2021, the excise duty rate applied to cigarettes in Australia had risen to $1.10 per cigarette and $1,576 per kg for loose tobacco. By September 2021, the rates had risen further to $1.12 per cigarette and $1,598.64 per kg for loose tobacco.[11]

[7] Commonwealth of Australia (2017), *Black Economy Taskforce: Final Report*

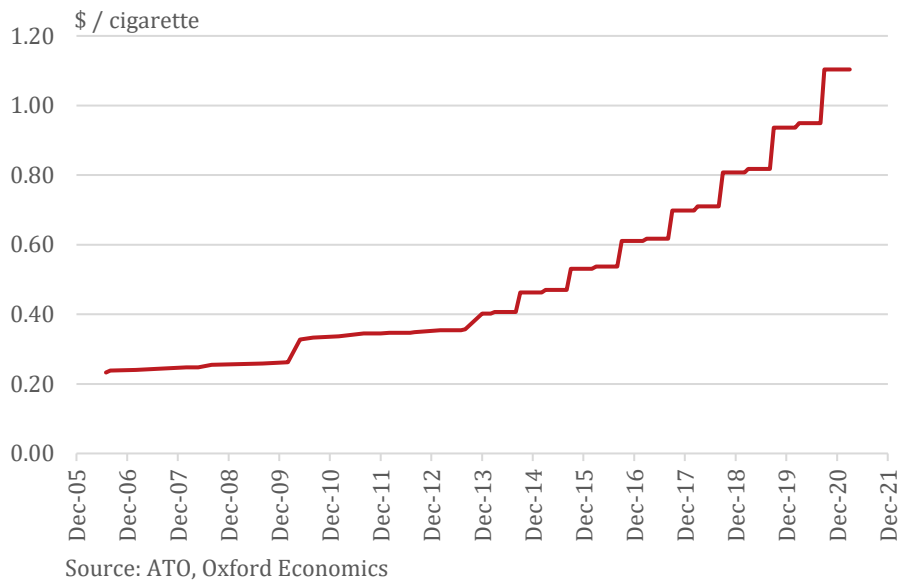
[8] Parliament of Australia "Tobacco excise increase" https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/BudgetReview201617/Tobacco

[9] Ibid

[10] Australian Taxation Office (ATO) "Excise duty rates for tobacco" https://www.ato.gov.au/Business/Excise-on-tobacco/Excise-obligations-for-tobacco/Excise-duty-rates-for-tobacco/ and "Historical Excise Duty Rates" https://data.gov.au/data/dataset/excise-data/resource/b9227cdf-4c04-492d-bd84-65031adc408e?inner_span=True

[11] See https://www.ato.gov.au/Business/Excise-on-tobacco/Excise-obligations-for-tobacco/Excise-duty-rates-for-tobacco/

Fig. 3. Excise duty applied to cigarettes in Australia



Goods and Services Tax

A 10% Goods and Services Tax (GST) also applies to all tobacco products in addition to excise duty.

As with all other taxable products and services in Australia, the GST is calculated by adding 10% to the pre-GST sales price.

Accordingly, GST makes up one-eleventh or 9.1% of the final price of each packet of cigarettes or loose tobacco.

2.3 AUSTRALIA'S TOBACCO INDUSTRY

The Australian tobacco industry is highly regulated, with restrictions on both the production and importation of tobacco products.

It is illegal to grow tobacco in Australia without an appropriate excise licence. There have been no such domestic licenses issued since 2006 and domestic manufacturing operations across the country ceased by 2015.[12] Tobacco in Australia is now a wholly imported product.

The vast majority of tobacco products sold in Australia are comprised of :

- *Manufactured cigarettes* – sold in packets and accounting for some 83% of the market by value.
- *Loose leaf tobacco* – sold in pouches and used in Roll Your Own (RYO) cigarettes (accounting for 17% of the market by value).[13]

[12] See https://www.ato.gov.au/general/the-fight-against-tax-crime/our-focus/illicit-tobacco/ and https://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-3-the-manufacturing-and-wholesaling-industry-in-australia

[13] Euromonitor *op. cit.*

While there is no domestic manufacturing of tobacco, several forms of economic activity are involved in the supply and distribution of tobacco products from "port to shop".

Most tobacco products (including cigarettes, molasses tobacco, heat-not-burn products, and loose-leaf tobacco) have been classified as prohibited imports under Australian law. Accordingly, companies and individuals must apply for import permits from the Australian Border Force (ABF) in advance.[14] Once authorized and imported, tobacco products are offloaded in containers off-ship and through docks into Australian customs depots, as indicated above.

While data identifying every port of entry are difficult to establish with precision, analysis by BIS Oxford Economics indicates that the majority of tobacco products are imported through Sydney and Melbourne. The dominance of these ports in the importation supply chain may be due to their size and the nature of shipping calls to Australia (with international lines often limiting their calls to major centres).

From the customs depots, wholesalers and retailers are responsible for distributing the tobacco products to the point of sale. The wholesale market in Australia is dominated by three companies: British American Tobacco Australia (BATA), Philip Morris International Australia (PMA) and Imperial Tobacco Australia (ITA). These three companies are wholly owned subsidiaries of their overseas parent counterparts and hold a combined wholesale market share of roughly 83%.[15]

After transportation from wholesalers, tobacco retailers form the last component of the "port to shop" supply chain.

Based on 2017 data, supermarkets are estimated to make up some 55% of gross retail sales of cigarettes alone (i.e., excluding other tobacco) with tobacconists close to 20% and convenience stores roughly 10%. Petrol stations and grocers make up 6% each. Other channels include internet sales and hotels/restaurants/bars, but these account for minor proportions of overall cigarette sales.[16]

Comparing these figures to ABS data, cigarette sales alone made up some 8.1% of total supermarket and grocery gross retail sales in 2017.[17]

2.4 MODELLING THE AUSTRALIAN TOBACCO INDUSTRY

BIS Oxford Economics has modelled the economic footprint of Australia's tobacco industry. The model outlines the economic value created across multiple stages of importing tobacco products, for the wider Australian economy.

---

[14] It is worth noting that this classification does not apply to cigars and small quantities of tobacco brought in by tourists.

[15] https://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-3-the-manufacturing-and-wholesaling-industry-in-australia

[16] https://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-6-retail-value-and-volume-of-the-australian-tobacco-market

[17] *Ibid* and ABS (2021) *Retail Trade Australia,* Cat No. 8501.0

After importation, offloading and excise payment, the bulk of the tobacco industry's economic footprint is generated between the wholesale and retail stages of the domestic supply chain. To capture this footprint, our model addresses four stages of the supply chain:

1. Wholesale-related transport and storage activities
2. Wholesaling activities
3. Retail-related transport and storage activities
4. Retail activities

The revenues generated from these stages of the supply chain are termed as the **"economic impact"**, illustrated in a stylised manner in the figure below.

Fig. 4. Direct Economic Impact: Stages of the Tobacco Supply Chain

The wholesale stage includes the economic contributions of wholesalers like BATA, PMA and ITA; while retail includes contributions from supermarkets, tobacconists, convenience stores and other channels. Wholesale and retail-linked transport and storage account for any business generated by companies which help move and store tobacco between supply chain stages (e.g., from the customs depot to a wholesaler, or from a wholesaler to a supermarket) or on behalf of wholesalers and retailers within these stages (e.g., transporting goods between the different facilities of one wholesaler).

The economic impact accounts for the Gross Value Added (GVA) and employment generated by these stages for the Australian economy. However, it also accounts for the income contributed by the two major types of taxes on tobacco products.

2.5 ECONOMIC IMPACT OF THE LEGAL MARKET

Gross revenues of the legal tobacco market

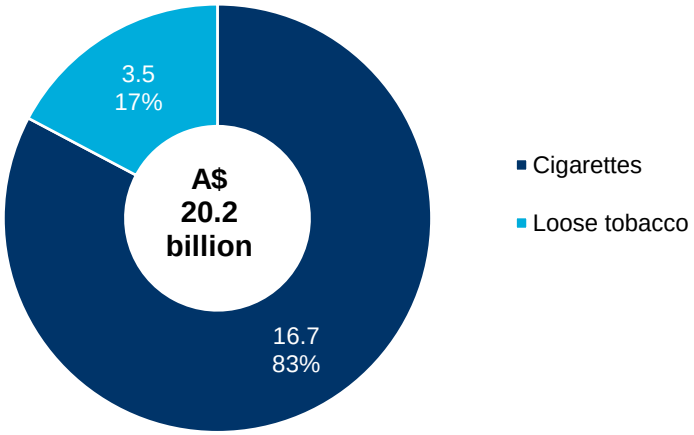
Legal tobacco sales in Australia accounted for A$20.2 billion in gross revenue in 2019 according to data from Euromonitor.[18] This figure included

[18] Euromonitor *op. cit*. Our definition of the tobacco industry in this report includes cigarettes and loose tobacco. We have excluded cigars, cigarillos, and e-vapour products, from these figures and this report, however these make up only a minor part of the total market. 2019 was the last year before the COVID-19 pandemic for which comprehensive data was available

A$16.7 billion worth of revenue earned from cigarette sales, and approximately A$3.5 billion from loose-leaf tobacco sales.

Fig. 5. Total Revenues from the Legal Tobacco Market, 2019

A$, billions



Source: Euromonitor

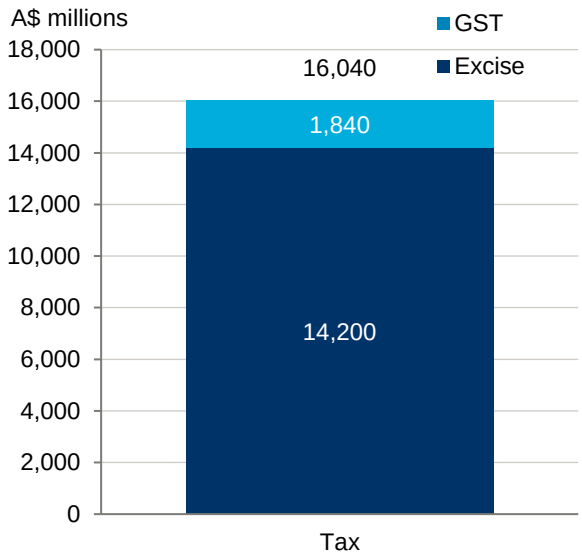
The economic footprint from these gross revenue figures can be segregated into GVA within the Australian economy accruing to retailers, wholesalers, transport, and storage, as well as tobacco tax contributions.[19]

Tax and industry gross sales split

While a portion of the gross sales revenue above can be attributed to the domestic tobacco supply chain, the great majority of this revenue is attributed to tobacco taxes. **We estimate that of the A$20.2 billion in gross sales revenue in 2019, approximately A$16.0 billion (or 79%) comprised of taxes.** This includes A$14.2 billion from excise duty and A$1.8 billion from GST.

[19] On an economy wide basis, GVA is similar to the more familiar Gross Domestic Product (GDP). The difference is that GVA excludes taxes on products such as GST and excises/customs duties.

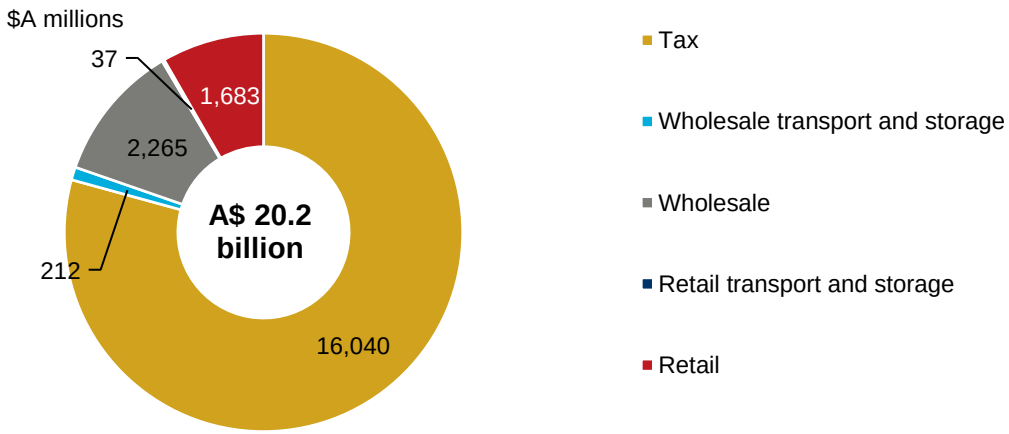
Fig. 6. Legal Market Tax Revenues, 2019



Source: Australian Government, BIS Oxford Economics

In other words, tax makes up the great majority of the retail price of cigarettes and other tobacco products. Out of every $1 spent on tobacco by Australian consumers at the "shop front," in 2019, approximately 79 cents flowed to the Federal government through various forms of taxation, a little over 11 cents to wholesalers, 8 cents to retailers and 1 cent to transport and storage providers.[20]

Fig. 7. Gross tobacco sales: tax and industry split



Source: Euromonitor, BIS Oxford Economics

[20] Based on the split of tax, wholesale and retail margins as reported in Euromonitor *op. cit*. and ABS (2021), *Australian National Accounts, Input-Output Tables 2018-19*. See Appendix 1 for further details. Note these figures are approximate – the apparent sum to 99 cents is due to rounding.

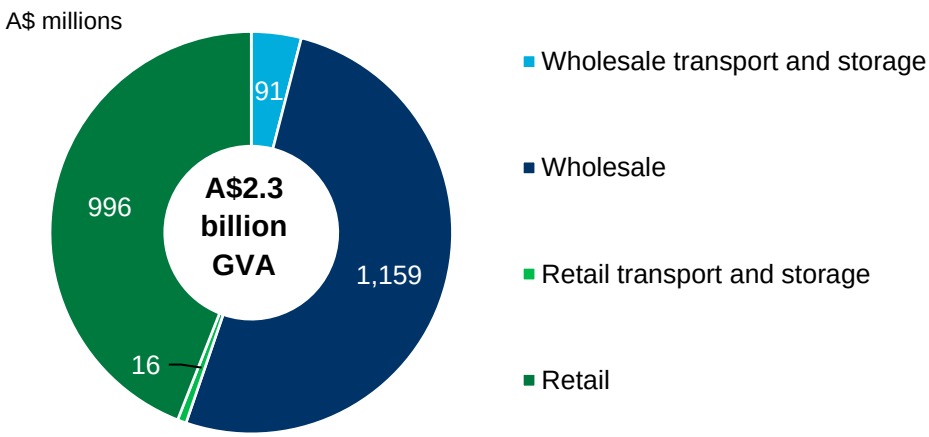
Industry gross value added (GVA) and employment

After accounting for tax revenues to the Federal government of some $16.0 billion, the Australian tobacco industry itself accounts for $4.2 billion in gross revenue.

The economic contributions of the industry (as measured by GVA and employment) can also be assessed based on this gross revenue estimate.[21]

The legal tobacco industry contributed A$2.3 billion in GVA to the Australian economy in 2019. The bulk of this was made up of $1.2 billion in GVA attributable to retailers and about $1 billion to wholesalers. Smaller portions were attributable to transport and storage, with A$16 million from retail transport and storage and A$91 million from wholesale transport and storage.

Fig. 8. Legal Market Direct Economic Footprint, 2019: GVA

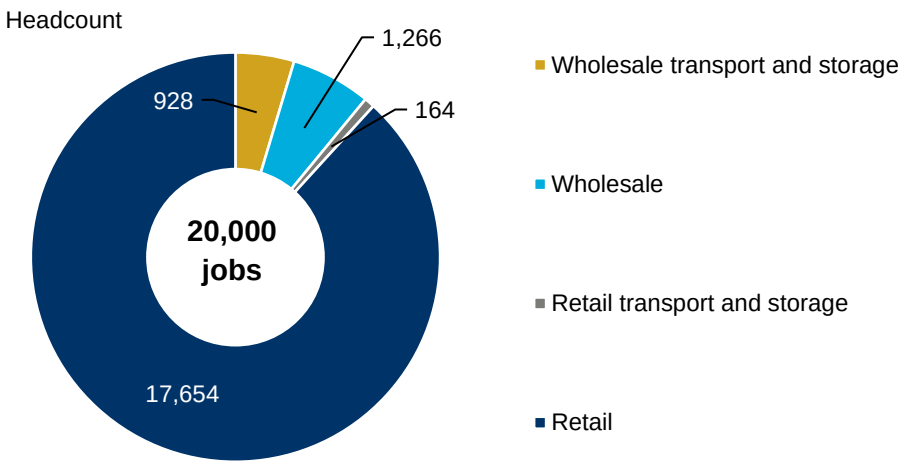


Source: BIS Oxford Economics

The industry also supported 20,000 jobs across different stages of the supply chain in 2019. 88% of these jobs (or some 17,650 employees) were employed in the retail sector. 6% of the jobs attributable to the wholesale sector, while an additional 6% were estimated to be employed in the transportation and storage sector.

[21] As indicated, GVA is distinct from revenue. It equates to the more familiar Gross Domestic Product (or GDP), excluding taxes on products such as GST and excise duties. GVA and employment estimates can be derived from gross revenue estimates using data sourced from ABS' *Australian National Accounts Input Output Tables 2018-19*. See Appendix 1 for further details.

Fig. 9. Legal Market Direct Economic Footprint, 2019: Employment



Source:BIS Oxford Economics

Indirect and induced impacts (multiplier effects)

The above comprises the direct economic contributions of the tobacco industry to Australian GVA. Additional economic impacts are also created via the indirect impact of the tobacco supply chain, and the induced impact from wage expenditure of employees.

These additional impacts can be broadly estimated using multipliers based on direct economic impacts. Gross output multipliers in the wholesale and retail sector are typically in the order of 2.6 (i.e., every $1 spent in direct gross output (sales) generates a total of $2.6 total gross output) while those in transport and storage range from 2.4 to 2.6.[22]

[22] Estimation of these multipliers was based on BIS Oxford Economic analysis of ABS (2021), *Australian National Accounts, Input-Output Tables 2018-19.* See Appendix 1 for further details.

3. THE ILLICIT TOBACCO MARKET

3.1 BACKGROUND TO THE ILLICT MARKET

Since no tobacco products are legally manufactured in Australia, the illicit market in finished manufactured cigarettes is comprised wholly of imported products smuggled into the country, while illicit loose tobacco is comprised of both imported and domestically grown product.

There have also, more recently, been signs of growing illicit domestic production.

Illicit tobacco imports into Australia and illicit domestic tobacco may be categorised into a variety of types:[23]

- *Contraband* – These are cigarettes legally manufactured outside of Australia however are smuggled into Australia to avoid Australian regulations (including tax) quarantine and product controls. This may include cigarettes which have been purchased legally outside Australia but exceed personal duty-free allowances or have no duty paid.

  Illicit whites are also sometimes classified under contraband. These are cigarettes manufactured outside Australia (often intended for other markets but diverted), smuggled across one or more borders *en route* to Australia and sold without the payment of tax. Illicit whites can be further subdivided into Domestic Illicit Plains (with packaging designed for Australia) and illicit Whites (non-domestic) which do not have plain packaging designed for Australia.

  Key source markets for contraband cigarettes include China, South Korea, and Indonesia.[24]

- *Counterfeit* – These are cigarettes illegally manufactured and sold by parties other than trademark owners They are made offshore and are typically smuggled into Australia through shipping containers or airmail. They are also commonly referred to as “fake cigarettes” and may pose additional health risks due to their unregulated production. However their contribution to the Australian market is thought to be relatively minor.

- *Unbranded tobacco* – This is effectively loose tobacco sold in packs of varying sizes from 30 grams to half a kilogram. The product is typically sold in Roll Your Own (RYO) form. Bags of loose tobacco are typically known as ‘Chop Chop’. Alternatively, Chop Chop can also be inserted into empty cigarette tubes, typically sold in boxes of 100 for more convenient consumption.

[23] KPMG (2020) *op. cit.*
[24] KPMG (2020) *op. cit.*

Unlike contraband and counterfeit tobacco, unbranded tobacco may derive from either imported or domestic Australian sources. It is believed by authorities such as the Australian Criminal Intelligence Commission (ACIC) that most unbranded tobacco is imported though there has been an overall trend of increasing domestic seizures in recent years.[25]

All forms of the above tobacco products may be sold in a variety of ways. These include:

- tobacconists, grocery, and convenience stores who also sell illicit products under the counter;
- independent tobacco, gift and accessories stores which can be vertically integrated with the illicit tobacco supply chain which are owned by criminal organisations and serve as their "shop front";
- peer to peer; and
- websites and social media (traffic to these appears to be growing).

Some retail outlets may be controlled by Outlaw Motorcycle Gangs (OMCGs). There is also evidence of a growing domestic market with some growers selling direct to the public.[26]

3.2 PRICES, RISKS AND RETURNS

Prices

Australia has experienced significant increases in excise duties on tobacco products in recent years.

In 2019, excise duty alone accounted for 70% of the typical retail price of an average tobacco product (cigarettes and loose tobacco combined) while GST accounts for an additional 9%. Recent increases in tobacco excise duty since 2019 have taken these proportions higher.[27]

The rising price of tobacco may have been one factor in reducing public consumption. As indicated above, tobacco consumption in Australia has fallen over time.

Recent tax increases are in accordance with the World Health Organisation (WHO) Framework Convention on Tobacco Control (FCTC) which recommends a minimum 75% tax share of the retail price of tobacco.[28] As indicated above, by our estimates by 2019 Australia has now exceeded this

[25] Ibid

[26] Black Economy Taskforce , *op. cit.*

[27] WHO data from 2018 indicate that based on the most sold pack of cigarettes globally (as opposed to all tobacco products) Australia's total tax incidence had reached 77.5% by that year. See https://www.who.int/tobacco/global_report/Table-9.1-Taxes-and-retail-price-for-a-pack-of-20-cigarette-most-sold-brand.xls Data separately estimated by British American Tobacco indicate that tobacco taxation equated to 81% of the gross retail price in 2020.

[28] See https://www.euro.who.int/en/health-topics/disease-prevention/tobacco/publications/key-policy-documents/who-framework-convention-on-tobacco-control-who-fctc/key-areas-of-tobacco-control-policy/taxation

level with approximately 79% of the retail price of tobacco being comprised of taxes in 2019, noting that tobacco excise has increased since that time.

However, price increases are not without their problems. In particular, they create the opportunity for a black market to emerge and the opportunity for criminals to provide tax free cigarettes to consumers while enjoying a high profit enterprise. This is especially so if countries surrounding highly taxed markets offer cheaper tobacco prices. The price gap issue has also been acknowledged by the WHO.[29]

At the same time the market share of illicit tobacco in Australia has risen in recent years.

Although the tax driven increase in the price of legal tobacco has reduced overall consumption levels, it has also increased the incentive for illicit market operators, since it creates an obvious avenue for arbitrage by such operators with a growing gap between overseas product prices and increasing expensive legal Australian products.

The ACIC's *2020-21 Annual Report* noted that profitability has increased alongside excise and duty rate increases. High profitability makes disruption of the market difficult – for example organised crime groups could recover their costs even were they to lose 30 shipping containers holding illicit tobacco to law enforcement. [30]

Risks and returns

Work by KPMG indicates that while a packet of 20 Marlboro cigarettes had a retail price of $33.16 in Australia in 2019. That market price was on average 121% higher than surrounding markets in South East Asia. Comparable brands for example cost $4.95 in China, $5.51 in South Korea and $2.84 in Indonesia in that year. By 2020 the price differential had risen to 159%.[31]

KPMG also provides estimates of prices for illicit products equivalent in weight to a major legal cigarette brand (Winfield 25s). These range from 20%-26% of the equivalent legal price for a packet of Winfield 25s (in the case of unbranded tobacco) to 50% (in the case of contraband cigarettes).[32]

One estimate suggests that a 40ft shipping container could accommodate up to 400,000 packets of cigarettes for an initial purchase price of as little as $200,000. Given an average price of $17.00 for a packet of illicit cigarettes in Australia, this implies $6.8 million in revenue for a single container (and at least

[29] Ibid

[30] ACIC (2021) *2020-21 Annual Report.* For more on the debates surrounding the impact of price increases in turning local consumers to the illicit market see the Commonwealth of Australia (2020), *Parliamentary Joint Committee on law Enforcement: Illicit Tobacco* ("the Parliamentary Joint Committee"). However regardless of the domestic legal/illicit market split and the motivations behind local consumer behaviors, key law enforcement agencies agree that the risk/reward calculation for illicit operators is very attractive (see below). Price differentials between Australian and foreign tobacco products are obviously one factor in driving this.

[31] KPMG (2020); KPMG (2021) *op. cit.*

[32] KPMG (2020) *op. cit.*

$6.6 million gross profit before allowing for the "cut" to intermediaries and/or other costs).[33]

Other estimates by the Black Economy Taskforce noted that cigarettes with a street price of $3 in China and South Korea had a retail price $23 in Australia (in 2017) and a profit of $3-4 million per shipping container.[34] They suggest even higher gross profit margins with a purchase of $150,000 worth of smuggled tobacco selling for $10 million in Australia (i.e. 98.5% gross margin). By comparison purchasing $150,000 of cocaine (wholly imported into Australia) will yield a street price of $2.3 million in Australia – a gross margin of "only" 93.5% and a far lower market price.[35]

In other words, the profits on the importation of illicit tobacco into Australia can exceed those for other commonly recognised illegal drugs, providing an obvious incentive for criminals to target illicit tobacco. This is especially so given the behavioural economics of crime – i.e., if one is going to engage in illicit activity and take the associated risk, the more profit the better.[36] This would be true even for the same level of risk. However, submissions by multiple parties (ABF, AFP, ACIC) to the *Parliamentary Joint Committee on law Enforcement: Illicit Tobacco* ("the Parliamentary Joint Committee") indicated that the risk for illicit tobacco smuggling is in fact lower than that for other illicit items such as firearms and illegal drugs.[37]

The ability to obtain packaged and unpackaged tobacco relatively easily in overseas markets, combined with the absence of official domestic production means that importation makes up the majority of Australia's illicit tobacco. Nonetheless, a smaller domestically sourced market also exists, as discussed below.

Analysis by KPMG suggests that the illicit market hovered around the 14-15% mark of total tobacco consumption in Australia in 2014-2018 before spiking to 20.4% in 2019 and falling back to 16.9% in 2020. This data suggests a rise in illicit tobacco volumes from 2.1 million kg in 2018 to 3.0.million kg (or 3,000 tonnes) in 2019 – an increase of approximately 43% before falling back to 2.2 million kg (or 2,200 tonnes) in 2020.[38]

---

[33] British American Tobacco Australia Limited (2019) *Submission to the Parliamentary Joint Committee on Law Enforcement Inquiry into illicit tobacco*

[34] Black Economy Taskforce *op. cit.* .Note that excise price increases have raised the price of legal cigarettes in Australia substantially since that time. KPMG (2020) op. *cit*. p. 32 refers to an Australia-China price differential of $28.21 for a packet of 20 Marlboro cigarettes in 2019.There have also been additional increases in Australian excise duty post-2019. The difference in profits per shipping container is likely explicable that the use of the more standard 20ft shipping container (or Twenty-foot Equivalent Unit TEU) as opposed to the 40ft container measure noted above. Once this is allowed for the profitability per container measures are roughly comparable.

[35] Black Economy Taskforce *op. cit*. As discussed below, however illicit operators may face other costs and not all revenues are likely to remain onshore.

[36] At the time the taskforce also noted that penalties for illicit tobacco importation were considerably lighter than for illegal drugs although new legislation has sought to address this – see below. Similar risk/return considerations provided the foundation for Gary Becker's economic model of crime .

[37] *Parliamentary Joint Committee on Law Enforcement: Illicit Tobacco* (2019) pp 29-31

[38] KPMG (2020) *op. cit* ; KPMG (2021) *op. cit*

We note that the Australian Taxation Office (ATO) produces different estimates of the illicit tobacco market and the resulting tobacco "tax gap" and there have been debates about the size of the illicit market. A discussion of this issue is provided in Appendix 1.

Regardless of these debates however, ATO data can also help to give insights into various aspects of the illicit market. These include the ATO's own estimates of changes in imported domestic and total illicit tobacco volumes, seizure data and patterns and the relative split between domestic and imported tobacco.[39]

More details on recent seizure data are provided below.

3.3 IMPORTATION, DOMESTIC PRODUCTION AND ENFORCEMENT

Enforcement

Concerns about the attractiveness of illicit tobacco importation and sales, relatively light sentencing, and gaps in the enforcement regime (such as sales from licensed warehouses) highlighted by the Black Economy Taskforce and others, have led to legislative tightening of Australia's illicit tobacco enforcement regime. These measures include:[40]

- Enactment of the *Treasury Laws Amendment (Illicit Tobacco Offences) Act 2018 (Cth)* and the *Customs Amendment (Illicit Tobacco Offences) Act 2018 (Cth).* The *Treasury Laws Amendment (Illicit Tobacco Offences) Act 2018 commenced on 28 August 2018* and had the effect of providing for tiered prison terms and penalties depending on the amount of tobacco involved. A change in the standards of evidence required made it easier to prosecute illicit operators. The legislation also created new offenses for the manufacture of tobacco in Australia. The *Customs Amendment (Illicit Tobacco Offences) Act 2018 (Cth* commenced on 1 September 2018 and introduced new offenses for the importation and transport of illicit tobacco.

- Enactment of the *Treasury Laws Amendment (Black Economy Taskforce Measures No. 2) Act 2018* (Cth) and the *Excise Tariff Amendment (Collecting Tobacco Duties at Manufacture) Act 2018 (Cth).* As, indicated, from the 1 July 2019, this abolished the old, licenced warehouse system (which could be subject to criminal infiltration) and moved the collection of excise duty to the point of entry into Australia.

- Creation of the Illicit Tobacco Task Force (ITTF) from 1 July 2018 to create a more effective and coordinated response to tackling illicit importation. This body is comprised of the ATO, Australian Border Force (ABF), Department of Home Affairs, Australian Criminal Intelligence Commission (ACIS), Australian Transaction Reports and

[39] See ATO's detailed analysis at https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/tobacco-tax-gap/?anchor=Methodology#Methodology
[40] A more detailed description of these measures is provided in KPMG (2020) *op. cit.*

Analysis Centre (AUSTRAC) and the Commonwealth Department of Public Prosecutions. In particular the ATO was given responsibility for (and additional resources to undertake) the detection and destruction of domestic tobacco production with the ABF focussed on importation.

Recent seizure data by the ABF and ATO is also of interest considering these changes.

While calendar year data are not available, when compared to the previous financial year seizures of importations by the ABF rose 44% in 2018-19, fell back by 23% in 2019-20 before rising by 158% in 2020-21.[41] ATO seizure data for domestic production show considerable volatility – a 58% decline in 2018-19 on the previous year followed by a 220% increase in 2019-20 and finally a 17% decline in 2020-21. The overall trend however appears to be upwards.[42]

This is also true for combined domestic and international seizures which are dominated by importation. These show a 25% rise in 2018-19, an 8% decline in 2019-20 and a 120% rise in 2020-21.[43]

Accordingly, a combined (imported and domestic) total of 1,357 tonnes of illicit tobacco was seized in 2020-21 compared to 537 tonnes in 2017-18. While there is considerable volatility in seizures, the overall trend appears to be upward.

The figure below summarises seizures in recent years.

Seizures themselves of course may be a function of various factors (including resourcing). The creation of the ITTF on 1 July 2018 and legislative changes introduced ion 1 July 2019 may also have contributed to increased seizure efficiency (as was its intent). The COVID-19 pandemic may also have influenced both the imported (and domestic) illicit tobacco markets with supply chain disruptions affecting all imports (legal and illicit).

The disruptions to both cargo and international mail arriving in Australia were also noted in the recent Department of Home Affairs *Annual Reports*.

The Department of Home Affairs *Annual Report 2019-20* indicated that COVID-related supply disruptions to travel and trade resulted in a decrease in overall illicit tobacco detections in 2019-20. However, detections of tobacco in *international mail* increased substantially, with the ABF indicating this was due to legislative and enforcement changes as from 1 July 2019 which prohibit the importation of tobacco through international mail.[44]

---

[41] Department of Home Affairs (2021) *Annual Report 2020-21*

[42] See https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illicit-Tobacco/

[43] *Ibid* ; Department of Home Affairs (2021), *op. cit.* These differ slightly from the combined imported and domestic seizure volumes reported by ATO – at https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/?anchor=Methodology#Methodology This may be due to the use of slightly different reporting dates and sources by ATO and the ABF. Accordingly, ATO figures reported at this website likewise show similar trends with total (domestic and imported) seizures rising by 27% in 2018-19 over the previous year before falling by 5% in 2019-20 (combined ATO figures for 2020-21 were not available).

[44] Department of Home Affairs (2020), *Annual Report 2019-20*

The Department of Home Affairs *Annual Report 2020-21* states that the redeployment of ABF staff from international traveller streams to cargo and mail streams had significant effects on the detection of illicit tobacco. The report notes that the majority of illicit tobacco detections were in fact through international mail with Sydney being the largest port of entry followed by Melbourne and Brisbane.

In referring to the major overall increase in seized tonnage of illicit tobacco in 2020-21 (an increase of 158%), the Department of Home *Affairs Annual Report 2020-21* states that:

> *The number and weight of tobacco detections have increased compared to 2019–20, despite lower air and sea passenger movements following COVID-19 border measures. This growth is attributed to increased efforts on targeting and intervention in the cargo and mail streams.*[45]

Considering these results, the general upward trend in seizures, despite the pandemic, might provide one indicator of the size and growth of the illicit market. At first sight, it raises the question of whether the illicit market is growing and/or whether the market is larger than estimated.[46] However, as indicated, this is complicated by the fact that the seizure regime may have become more efficient and because seizures themselves are subject to considerable volatility. This issue is discussed in more detail in Appendix 1.

Fig. 10. Recent illicit tobacco seizures in Australia (tonnes)[47]

Year	Imported (ABF)	Domestic (ATO)	Total
2017-18	439	98	537
2018-19	631	41	672
2019-20	484	131	616
2020-21	1,248	109	1,357

Source: ATO, Department of Home Affairs

International sourcing

As indicated, the differential between Australian and regional tobacco prices opens up a clear incentive to smuggle tobacco into Australia. Accordingly, it is thought that the majority of Australian illicit tobacco is international in origin. Analysis of data supplied by the ATO suggests that some 80% of illicit tobacco (by weight) was thought to be imported in 2019-20 (compared to 83% in the preceding financial year and 78% in 2017-18).[48]

[45] Department of Home Affairs (2021) *op. cit.*

[46] ATO estimates of the total (pre seizure) illicit market for example were 1,002 tonnes in 2015-16 rising to 1,408 tonnes in 2019-20.

[47] Department of Home Affairs (2021), *op. cit.,* ATO https://www.ato.gov.au/General/The-fight-against-tax-crime/Our-focus/Illicit-Tobacco/

[48] https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/?anchor=Methodology#Methodology These reflect ATO estimates of total market size which as indicted are smaller than those used in this report. Nonetheless the estimate of relative proportions is of interest in this context regardless of total market size.

The ACIC has commented that the most imported tobacco originates from Asia and the Middle East, with key source countries including China, Indonesia, the UAE, Malaysia, Singapore, and the Philippines.[49] KPMG (2020) has suggested that China, South Korea, and Indonesia are key source countries for contraband cigarettes in particular.[50]

Criminal organisations are thought to use customs brokers and freight forwarders to help facilitate some illicit shipments with most illicit tobacco entering the country through sea cargo. Nonetheless, air cargo has also been used and a growing trend has been the use of small consignments sent through international mail. Changes in legislation banning the shipment of tobacco by mail as from 1 July 2019 and improvements in detection may contributed to a rise in such detections. As indicated, the ABF reported a 125% increase in international mail detections in 2019-20 compared to the previous year and have noted that the majority of illicit tobacco detections are through international mail.[51]

Domestic sourcing

It is illegal to grow tobacco in Australia without a specific excise licence. Since there are no current licence holders, any current cultivation is by definition illegal. Although the vast majority of Australian illicit tobacco appears to be imported as indicated, perhaps 20% of illicit product appears to be locally cultivated. Local cultivation generally takes place on illegal farms but also through home grown and boutique greenhouses.

Although domestic seizure volumes are subject to some volatility recent comments by the ABF indicate that illicit tobacco farming activity may be increasing due to international supply chain disruptions associated with COVID-19.[52]

3.4 QUANTIFYING THE ILLICIT MARKET

Size of the illicit market

While Australia's legal tobacco market is well documented, it does not paint a complete picture of the country's tobacco industry. Sales of illicit tobacco represent a substantial portion of (and problems within) Australia's market.

In the Australian context, illicit tobacco constitutes any tobacco products which are grown or manufactured in Australia without the required excise licencing, or products which are imported without the necessary excise payment. In practice, the great majority of illicit tobacco is imported, though illegal tobacco farms also constitute a substantial problem. Regardless of source, illicit tobacco creates a significant problem for the regulated legal market, as

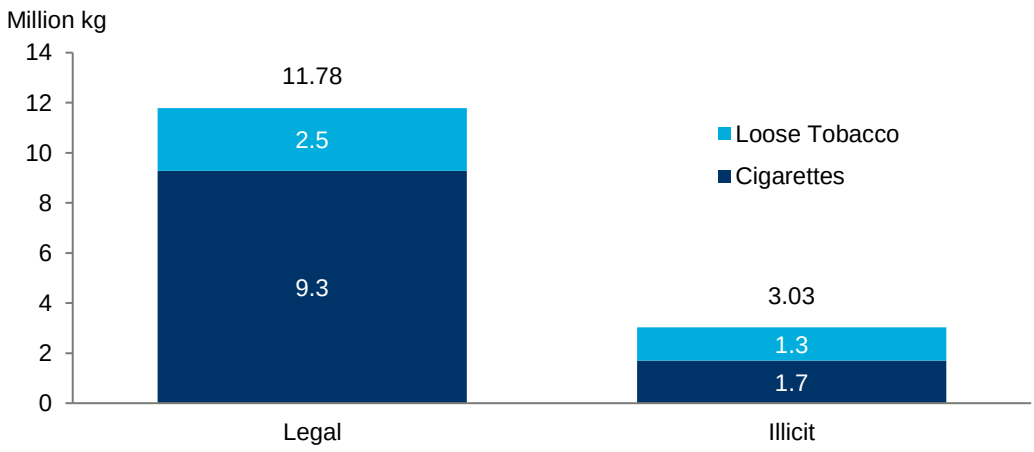
[49] Parliamentary Joint Committee *op. cit.*
[50] KPMG (2020) *op. cit.*
[51] Department of Home Affairs (2020, 2021) *op. cit.*
[52] See https://www.smh.com.au/national/nsw/criminal-groups-farm-illicit-tobacco-as-authorities-confiscate-imports-20210719-p58avl.html

revenue is lost to legal markets and gained by illicit traders including organised crime rings.

In quantity terms, based on illicit sales figures estimated by KPMG, it is estimated that in 2019, illicit sales accounted for just over 3.0 million kg (or 3,000 tonnes), compared to legal market sales of 11.8 million kg (implying a total Australian tobacco market of 14.8 million kg).[53] **In other words illicit sales accounted for about 20.4% of Australian tobacco sales by quantity in 2019.**

The illicit tobacco market is distributed between cigarettes and loose-leaf tobacco, with 1.7 million kg and 1.3 million kg respectively estimated to be sold through the illicit market in 2019.[54]

Fig. 11. Size of the legal and illicit markets, 2019



Source: KPMG

In dollar value terms **illicit sales were estimated to account for $4.9 billion in lost gross revenues** (i.e. money lost to the legal market) of which $3.8 billion was lost taxation revenue and the remaining $1.1 billion lost industry revenue.[55]

On the other side of the ledger we estimate that **illicit sales generated some $2.1 billion in revenue for illegal sellers** (including organised crime operations) in 2019.[56] The implications of such money flowing into the hands of illegal actors is examined in other sections of this report.

[53] KPMG(2021) *op. cit.*

[54] Ibid

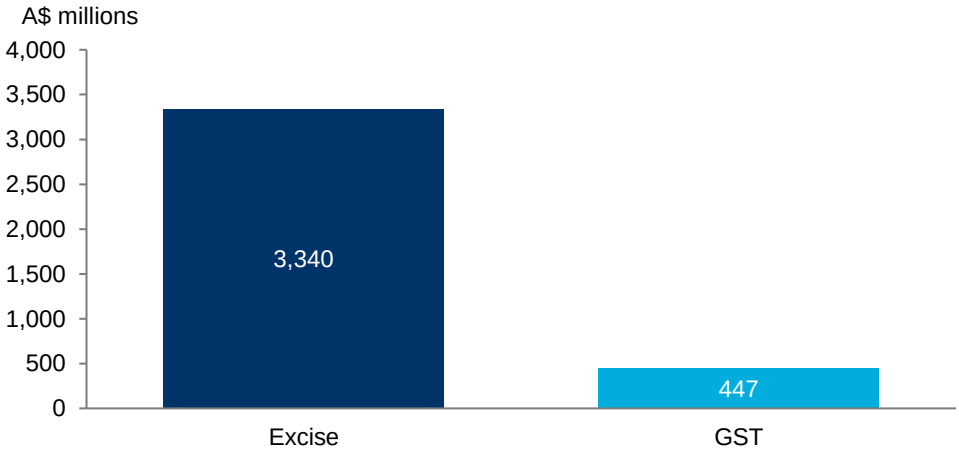
[55] These tax gap figures exclude allowance for price elasticities.

[56] Note this implies that $2.8 billion in savings accrued to consumers (before allowing for price elasticity effects) due to their ability to obtain tobacco at a lower price. Technically, this can be thought of as a notional gain in what economists call "consumer surplus" (i.e., the benefit to consumers from having a lower priced good). However, a convention in most studies is to exclude benefits to participants (buyers and sellers) in illegal transactions as a positive gain to society.

Tax losses (tax gap)

From the taxation perspective, the $3.8 billion worth of lost tax revenues (or "tax gap") can be further broken down into excise and GST losses. Roughly $3.3 billion of this total sum represents lost excise duties, while the remaining $447 million represents lost GST.

Fig. 12. Illegal Market Lost Tax Revenues, 2019



Note: This data does not account for price elasticities.
Source: KPMG; BIS Oxford Economics

Lost industry value added and employment

Based on the estimate that illegal tobacco sales resulted in the loss of $1.1 billion in revenue (or gross output) from Australia's legal tobacco supply chain in 2019, the economic footprint of the equivalent legal activity (now lost to the illicit tobacco market) in terms of GVA, employment and taxes can also be estimated.

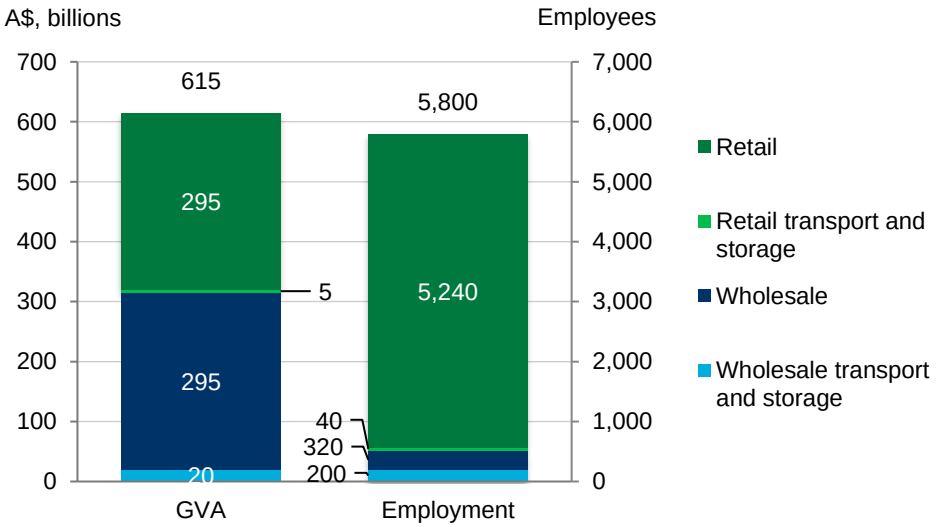
This serves to indicate the potential economic value and employees lost by legal activities within the Australian economy. To the extent that the illicit market grows, it also means that more legal market resources are lost to it.[57]

Assuming all cigarettes sold illicitly market would otherwise be legally sold, **we estimate that A$615 million in GVA was lost to legal markets due to the presence of illicit tobacco trade in 2019.**

[57] We note that not all of this revenue may be recoverable in the event that the illegal market was to be eliminated. This is due to price elasticity (responsiveness) effects which mean that since prices are higher in legal markets, some demand is likely to drop off if legal products were to be the only ones available. However, there is considerable debate over the price elasticity of demand for tobacco. Rather than attempting to resolve this debate (and in the interests of simplicity) we present the impact of jobs and GVA lost to the legal economy. This is an illustration of the practical impacts of the loss of revenues from the legal economy. The ATO likewise notes that a limitation of their calculation of the tobacco tax gap is that smokers may reduce their smoking rates if excise duty was actually applied to illicit tobacco. This would impact on the amount of duty realistically recoverable if the illicit market was actually eliminated. See https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/?anchor=Methodology#Methodology

Reflecting the pattern of legal market proceeds, most of the losses are experienced by the wholesale and retail segments. The wholesale sector experienced a A$297 million loss attributable to illicit sales in 2019, while retail accounted for A$295 million. Transportation and storage losses sum to $22 million.

Fig. 13. Lost legal economic activity due to illicit market, 2019



Source: BIS Oxford Economics, figures have been rounded

In terms of lost employment opportunities, the illicit tobacco marked displaced some 5,800 jobs from legal industries. This includes some 5,200 jobs in the retail sector selling tobacco products to consumers, roughly 300 jobs in the wholesale sector and roughly 200 jobs in the transport sectors.

4. ILLICIT MARKET IMPACTS

4.1 THE SOCIO-ECONOMIC IMPACTS OF ILLICIT TOBACCO TRADE

Some of the costs of the illicit tobacco trade have been referred to above. However, there are additional costs to the Australian economy and society. above and beyond these. A comprehensive list of costs would include the following:

1. *Distortions to taxation* – Much of the direct loss is made up of taxes, which would otherwise be redistributed to provide government services (e.g., schools, hospitals, roads).

2. *Distortions to legal industry* – The forced transfer of resources away from legitimate industry is, like lost taxation a cost imposed on society.

3. *Misallocation and misuse of productive resources* – Apart from the issues discussed above, domestic cultivation of tobacco in has its own implied costs. This is because the process of cultivating illicit tobacco pulls resources (land, labour and capital) away from other productive uses within the economy.[58]

4. *Laundering/other macroeconomic distortions* (externality) – To the extent that funds derived from the sale of illicit tobacco are subsequently laundered either within Australia or offshore this can induce further rounds of economic distortions including.[59]

    - Inflation
    - Impacts on economic growth
    - Infection of legitimate business
    - Corruption and bribery
    - Political destabilisation

    Work by Stamp and Walker indicates that some 80% of illicit drug proceeds are laundered.[60] It might be assumed the figure is similar for illicit tobacco.

    The effects of money laundering can be seen as an externality (third party cost) in that while it does not directly relate to the market exchange between illicit tobacco sellers and buyers it is nonetheless a distortion of resources within legal markets.

[58] Note that the cost of this would be effectively subsumed within the revenue to the illicit market. As indicated below we broadly estimate revenues of $400 million to domestic Australian producers.
[59] Gjoni et. Al (2015) *Money Laundering Effects*, International Conference on Management, Business and Economics, Nov 2015
[60] Stamp J and Walker J, (2007) "Money laundering in and through Australia", Australian Institute of Criminology *Trends, and Issues No. 342*

5. *Distortions to investment patterns (externality)* –Criminals may spend and/or invest money (laundered or otherwise) in patterns that are different to the average or optimal investor. This can lead to distortions, particularly when money is explicitly laundered. Studies in Australia and the Netherlands have both identified real estate in particular as a common target for launderers. Real estate is a "sterile investment" in terms of the broader economy as a whole, generating less output and jobs than other potential investments.[61]

6. *Organised crime and terrorism (externality)* – Links between illicit tobacco trafficking and organised crime are well established both within Australia and internationally. International evidence also suggests links to terrorism and some evidence has also emerged in the case of Australia .

7. *Additional spending on law enforcement (externality)* – The illicit trade obviously requires extra resources to be dedicated to policing and enforcement.

Accordingly, there is a good argument for considering the $4.9 billion in lost revenues, cited above, as a cost of crime based on points 1-3 above. Points 3-6 could also be considered as externalities – i.e., third party costs addition to direct costs.

Fig. 14. Potential impacts of illicit tobacco market and money laundering

[61] Ibid ; Kruisbergen *et al*. (2014) "Profitability, Power or Proximity", *European Journal of Criminal Policy Research* Evidence from Canada also suggests that money laundering may have pushed up real estate prices by some 5% in the province of British Colombia. See Expert Panel on Money Laundering in BC Real Estate (2019) *Combatting Money Laundering in BC Real Estate* . Money laundering connected with the illicit tobacco trade may also act to further increase the already high real estate prices faced by Australian home purchasers

4.2 INTERNATIONAL EVIDENCE ON ILLICIT ACTIVITY

From an international perspective harms from the illicit tobacco trade include the following:

- *Organised crime* – Most of the illicit trade of tobacco requires involvement from organised crime groups which could then use the funds for other crimes.[62] Transnational organised crime was estimated in 2009 to have turnover profits of US$870 billion, amounting to 1.5% of global GDP.[63] This total excludes organised crime restricted to national borders.

- *Terrorism* – Illicit trade in tobacco may be funding terrorism. In the US, cigarette smuggling is a major source of revenue for terrorist groups and organised crime.[64] For example, a Hezbollah cell in the USA was caught for trafficking cigarettes from North Carolina to Michigan in the late 1990s, profiting from differences in tax structures between the states. The leaders of the cell were convicted for providing material support to Hezbollah (a designated terrorist organisation), cigarette smuggling, money laundering, conspiracy, racketeering and immigration fraud.[65] Cigarette smuggling schemes that have been known to finance terrorists have been identified across a range of countries and regions, including the USA, Europe, Turkey, the Middle East, and North Africa.[66]

- *Money laundering* – As indicated, laundered money is hidden to protect proceeds and may be directed towards low quality investments offshore.

- *Financial markets disruption* – Likewise international money laundering can undermine the integrity of financial markets with large sums of money arriving at international financial institutions and be moved out without notice.

- *Economic disruption* – Loss of control of economic policy in developing countries where money laundering is so large that it can affect currencies and interest rates.

---

[62] United States Department of Homeland Security (2015), *Global Illicit Trade in Tobacco: A Threat to National Security: Inquiry into Illicit Tobacco Submission* (December 2015)
[63] United Nations Office on Drugs and Crime (2011) *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crimes: Research Report*
[64] Shelley, Louise I., and Sharon A. Melzer. "The nexus of organized crime and terrorism: Two case studies in cigarette smuggling." *International Journal of Comparative and Applied Criminal Justice* 32.1 (2008): 43-63.
[65] U.S. Immigration and Customs Enforcement. (27 January 2011). "Mohamad Youssef Hammoud sentenced to 30 years in terrorism financing case" https://www.ice.gov/news/releases/mohamad-youssef-hammoud-sentenced-30-years-terrorism-financing-case
[66] Rollins, John, and Liana Sun Wyler (2013) *Terrorism and transnational crime: Foreign policy issues for Congress*. Vol. 1. Washington, DC: Congressional Research Service

- *Unregulated products* – Illicit tobacco products expose consumers to unregulated products that may be manufactured in unsanitary conditions Once again this problem can affect poorer countries disproportionately. [67]

4.3 ILLICIT IMPACTS ON AUSTRALIA

Evidence presented to Australia's Parliamentary Joint Committee and past reporting by the Australian Institute of Criminology ("ACIC") both found that organised crime is heavily involved in the illicit tobacco trade. Such evidence also provides support for some of the harms identified above.

The attractive risk/return calculus relative to other illegal drugs and high profit margins have served to attract organised crime. Organised crime is involved in every stage of the illicit tobacco supply chain. This includes the sourcing, packaging and distribution of illicit products as well as hiring of intermediaries and liaison with other criminal groups to ensure the successful delivery of product.[68]

The similarities between illicit tobacco smugglers and those involved in the narcotics trade have been noted by the Parliamentary Joint Committee. This is hardly surprising. Evidence to the Committee suggested that offenders could be categorised as:

- organised crime rings engaging in tobacco smuggling as a part of many other illicit activities
- enterprises that specialised in the illicit trade
- individuals who simply undertook smuggling for personal use.[69]

Work by the Australian Institute of Criminology (based on earlier studies by the ACIC) suggests a mid-range estimate that some 78% of illicit tobacco activity is undertaken by serious and organised crime.[70] The Parliamentary Joint Committee also heard evidence of corruption, with people and entities engaged in the legitimate tobacco supply chain who may also engaged in the illicit trade. This includes freight forwarders and customs brokers. It is thought that organised criminal groups with links to Asia and the Middle East are the main bodies responsible for illicit importations into Australia. Outlaw Motorcycle Gangs (OMCGs) have also been cited as being involved in the trade.[71]

The involvement of organised crime in particular holds the potential to facilitate corruption and undermine institutional integrity. Recent examples of the extent of organised criminal behaviour include Operation Ironside a three-year

[67] US Government Publishing Office (2017) *A Hazy Crisis: Illicit Cigarette Smuggling in the OSCE Region : Hearing before the Commission on Security and Cooperation in Europe, One Hundred Fifteenth Congress, First Session*, July 19, 2017. Washington.
[68] Black Economy Taskforce *op. cit.* pp.27-31
[69] Parliamentary Joint Committee, *op. cit.*
[70] Smith, R, (2019) *Estimating the costs of serious and organized crime in Australia* 2016-17, Australian institute of Criminology
[71] Parliamentary Joint Committee*, op. cit.*

corporative operation between the AFP and FBI which disrupted the operation of an organised crime ring focussed on the importation of illicit tobacco and narcotics. Raids under this operation in July 2021 led to the arrest of 271 people in Australia, including 20 "trusted insiders" with secure access to Australian sea and airports. [72] In August 2021 a Sydney man with links to OMCGs was apprehended and charged with the illegal import of nearly eight million cigarette sticks. [73]

Links to terrorist organisations have been noted above and there is some evidence that these have also been active in Australia. The head of the ABF has noted links to groups in the Middle East including Hezbollah and the potential for proceeds of illicit tobacco trade to flow back to such groups [74] Another notable example is a police investigation of terrorist funding links which led to the seizure of seven tonnes of illicit tobacco worth $9 million in illicit tobacco in Sydney in 2019.[75]

Other cited harms include the lack of public safety safeguards in some illicit cigarettes themselves with seized counterfeit cigarettes showing high levels of cadmium, tar, and lead.[76]

As indicated, we have calculated gross revenues of the illicit tobacco trade as $2.1 billion. It is also possible to go beyond this to try to determine the split of these revenues in various ways. It should be noted however that the estimates below are necessarily speculative given the considerable uncertainties about the nature of illicit markets.

With this caveat in mind, the ATO data discussed above referring to estimates of importation vs domestic production of illicit tobacco between 2017-18 and 2019-20) implies that roughly 80% of illicit tobacco in Australia is imported. Applying this estimate to the estimated $2.1 billion in gross revenues accruing to the illicit market suggests that $1.7 million in revenues relates to imported product and some $400 million in gross revenues accrues to domestic producers.

The gross retail revenues can also be disaggregated to determine profits (proceeds of crime). While no good estimates of the split of revenues exists for illicit tobacco, past work for imported illicit drugs such as MDMA/ecstasy in Australia imply retail margins of some 61%.[77] This implies that net retail profits for illicit tobacco might be in the order of $1.3 billion (though given the

[72] https://www.abc.net.au/news/2021-07-28/crime-gangs-adapting-operation-ironside-insiders/100331240
[73] https://www.afp.gov.au/news-media/media-releases/sydney-man-linked-plot-import-8-million-worth-illicit-cigarettes
[74] https://www.abc.net.au/news/2016-12-05/illegal-tobacco-trade-fuelling-drug-trafficking-and-terrorism/8075174
[75] https://www.smh.com.au/national/nsw/terror-funding-investigation-uncovers-syndicate-that-imported-9m-worth-of-illegal-tobacco-20190521-p51pp0.html
[76] https://www.spectator.com.au/2021/07/illegal-tobacco-syndicates-are-a-problem-australia-and-asia-doesnt-need/
[77] Based on work cited in McFadden et al. (2014) *Targeting the Profits of Illicit Drug Trafficking through Proceeds of Crime Action*, University of Queensland

exceptionally high margins for illicit tobacco this may be a conservative estimate).

Much of this may ultimately be laundered. As indicated, estimates above suggest that 80% of drug proceeds (i.e., profits) are laundered and one might expect a similar situation for illicit tobacco.

We provide some indicative estimates of laundering in Appendix 2. While speculative (and confined to the retail level) based on the above, these suggest that some $1 billion (out of $2.1 billion in total gross illicit tobacco revenues) may ultimately be laundered (after allowing for retailer costs and the fact that not all funds will be laundered). Based on past analysis for the uses of laundered funds in general, over $200 million in laundered funds could find their way into real estate markets and an additional $200 million to finance other forms of organised crime. However, some of this would also likely flow offshore.

Domestic farm production for the supply of local Chop Chop constitutes another area of growing concern. As indicated above, it would appear that domestic production may be increasing, perhaps fuelled by supply disruptions connected with COVID-19 pandemic.[78] As is common with illicit products, the production of illicit tobacco often involves flouting existing health and safety procedures.

These include:

- misuse of agricultural assets and water diversion, with a typical acre of tobacco crop estimated to require 2 million litres of water and 163 person hours to fully mature;[79]
- exploitation of both legal and illegal migrants with reports of indentured workers getting paid in cash and working under duress; and
- a lack of sustainable farming practices resulting in soil degradation and reduces the capacity for yield on surrounding farmland for legitimate farmers.

Recent media reports also refer to indications of soil damage and the exploitation of foreign labourers.[80] There have also been indications of organised criminal involvement in local tobacco farming either directly or through coaxing local farmers to grow illicit tobacco.[81]

[78] https://www.smh.com.au/national/nsw/criminal-groups-farm-illicit-tobacco-as-authorities-confiscate-imports-20210719-p58avl.html

[79] Information supplied by BATA. See also https://www.industry.nsw.gov.au/media/releases/2021-media-releases/nrar-works-with-illicit-tobacco-taskforce-on-latest-prosecution?utm_source=miragenews&utm_medium=miragenews&utm_campaign=news

[80] Ibid

[81] https://www.theland.com.au/story/4621413/illegal-tobacco-scourge/

In 2019-20 131 tonnes of illicit tobacco was seized grown across an area of 184 acres, valued at $171 million in excise duty revenue.[82]

As indicated, the diversion of resources to illicit tobacco farming is a subset of the costs of illicit tobacco in general. We estimate the sales value of illicit domestic production as $400 million. The costs of diverting land labour and capital away from the legitimate economy would be incorporated into this estimate. However, as indicated, there may be additional costs on top of this due to the poor treatment of labourers, poor treatment of soil and/or the use of fraud and deception in production. Apparent financial returns to illicit operators may be illusory in an economic sense as they do not include these third party costs (i.e., externalities).

Regardless of the balance between costs, profit and revenue, the point above remains: the whole of the $400 million constitutes a cost to the economy as it involves not only the diversion of productive resources away from other uses but the diversion of funds away from taxation and legitimate industry.

[82] https://www.ato.gov.au/Media-centre/Media-releases/ATO-destroys-$171-million-of-illicit-tobacco/ These figures declined slightly in 2020-21 with 109 tonnes of illicit product being seized see https://www.ato.gov.au/general/the-fight-against-tax-crime/our-focus/illicit-tobacco/

APPENDIX 1 – ESTIMATING LEGAL AND ILLICT MARKET SIZE

SIZING TOTAL CONSUMPTION

KPMG's (2020) *Illicit Tobacco in Australia :2019 Full Year Report* along with Euromonitor *(2021) Tobacco in Australia* (2021) were used as key reference sources for estimating:

- The size of the legal market in terms of the weight of manufactured cigarettes and loose tobacco (KPMG, Euromonitor)
- Market revenues for cigarettes and loose tobacco (Euromonitor) [83]

These sources closely corresponded with each other, along for an estimation of gross revenue for both cigarettes and loose tobacco.

Note that the analysis was confined to domestic sales of cigarettes and loose tobacco only. Cigars and other tobacco products were excluded from the analysis as was tobacco brought into the country by travellers. (These constituted relatively minor amounts.)

These estimates indicated approximately:

- $20.2 billion gross retail revenue generated by domestic sales in Australian cigarettes and loose tobacco in 2019.
- Legal domestic sales of approximately 11.9 million cigarette sticks weighing 9.3 million kg along with 2.5 million kg in loose tobacco for a total of 11.8 million kg of legal tobacco sold.

ESTIMATING THE SPLIT OF GROSS REVENUES INTO TAX AND INDUSTRY ACTIVITY

Excise duty revenues were then estimated using Final Budget Outcome data from the Australian Government. Although calendar year data were not available, the average of Final Budget Outcome revenue data (on a cash basis) for 2018-19 and 2019-20 was used to determine the approximate excise take in calendar 2019.[84] This yielded an estimate of $14.2 billion in combined cigarette and loose tobacco excise revenues in calendar 2019. GST of 10% of the final sale price also applies to tobacco products in Australia. Accordingly, GST revenues were estimated by dividing the final sales revenue of $20.2 billion by 11. This produced an estimate of at $1.8 billion in calendar 2019. Total excise and GST revenues were estimated as $16.0 billion or 79% of gross sales revenues.

The residual $4.2 billion in revenues was then allocated to the tobacco supply chain (retailers, wholesalers and the transport and storage (i.e. logistics) network). Retail margins were derived from gross margin data for cigarettes reported in Euromonitor. Gross wholesale margins were also derived from this source. It was assumed that margins for loose tobacco were similar to those for cigarettes.

---

[83] KPMG (2020), Euromonitor, *op. cit.*

[84] See Australian Government, *Final Budget Outcome 2018-19* https://archive.budget.gov.au/2018-19/fbo/FBO_2018-19_web.pdf and *Final Budget Outcome 2019-20* https://archive.budget.gov.au/2019-20/fbo/download/FBO-2019-20.pdf Note that this may have included some duty for cigars and other small items. It was not possible to separate these out but these occupy only a very minor share of the total market.

An allowance was then made for transport and storage (i.e. logistics) costs based on the bought in costs for the retail and wholesale industries as reported in ABS *Input-Output Tables 2018-19*.[85] These provided gross output measures for these three stages of the domestic tobacco supply chain.

The ABS Input-Output tables were used to derive the GVA per unit of gross output.

Data on the number of employees in the tobacco wholesaling industry was based on numbers reported on the websites of BATA and Phillip Morris International while those for Imperial Tobacco were based on independent website reporting.[86] An allowance was also made for independent wholesalers, market share based on independent website reporting.[87] ABS' *Australian Industry 2019-20* was used to derive employment per dollar GVA for the other supply chain industries.[88]

The figure below indicates the derivation of the GVA and employment estimates using the sources referred to above

Fig. 15. Derivation of GVA and employment estimates

Tobacco industry sector	Gross revenue estimate ($m)	$ GVA per $ gross revenue (gross output)[89]	GVA ($m)	Employees per $ million GVA[90]*	Employees*
Retail	1,683	0.59	996	17.7	17,654
Wholesale	2,265	0.51	1,159	-	1,266
Wholesale and retail transport and storage	249	0.43	107	10.2	1,092
Total	**4,197**		**2,262**		**20,011**

Source: ABS, BIS Oxford Economics analysis
All figures subject to rounding
*Tobacco wholesale employees estimated from independent website sources as noted above

This process allowed for the estimation of gross output, GVA and employment figures across the tobacco supply chain.

The ABS Input-Output tables also allowed for the derivation of (Type II) multipliers for gross output (i.e. revenue) in the retail and wholesale and transport and storage industries (i.e. the industries relevant to the retailing, wholesaling, transportation, and storage of tobacco products). Type II multipliers indicate the impacts on the broader economy from the expenditure within a given industry. These arise because when a dollar is spent on, say, the wholesaling of tobacco, wholesalers must in turn spend money on their suppliers who spend on their suppliers and so on. In addition to these effects, workers at both the wholesaler and supply chain industries also spend their wages on goods and services creating another chain of economic effects. The combination of these effects creates Type II gross output multipliers, taking into account both wholesaler and retailer effects.

[85] ABS (2021), *Australian National Accounts, Input-Output Tables 2018-19*

[86] See, https://www.bata.com.au/group/sites/BAT_9RNFLH.nsf/vwPagesWebLive/DO9RNGBC ; https://www.pmi.com/markets/australia/en and "Tobacco in Australia" https://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-3-the-manufacturing-and-wholesaling-industry-in-australia

[87] See "Tobacco in Australia" https://www.tobaccoinaustralia.org.au/chapter-10-tobacco-industry/10-3-the-manufacturing-and-wholesaling-industry-in-australia

[88] ABS (2021), Australian Industry 2019-20

[89] Based on ABS (2021), *Australian National Accounts, Input-Output Tables 2018-19*

[90] Based on ABS (2021), *Australian Industry 2019-20* with the exception of tobacco wholesale employees.

We estimate that gross output multipliers in the wholesale and retail sector are typically in the order of 2.6 (i.e., every $1 spent in direct gross output (sales) generates a total of $2.6 total gross output) while those in transport and storage range from 2.4 to 2.6.[91]

ILLICT MARKET ESTIMATES

Illicit market size estimates were based on KMPG's reporting as noted above. This reporting in turn was based on Empty Packet Survey (EPS) data.

KPMG estimated approximately 3.0 million kg (or 3,000 tonnes) of illicit tobacco sales in 2019: 1.7 million kg of illicit tobacco sales in manufactured stick form and 1.3 million kg in loose tobacco. (See the note below for differing estimates of the size of the illicit market).[92]

Excise duty loses were estimated by KPMG at approximately $3.35 billion based on rates prevailing at the time.[93]

We use the KPMG and Euromonitor data on legal sales noted above to estimate gross sales revenue per kg of tobacco in 2019. This equated to $1,804 per kg for cigarettes and $1,397 per kg for loose tobacco. Given the relative splits of the cigarette and loose tobacco markets in the illicit trade this produces a gross sales revenue loss of $4.921 billion (i.e., approximately $4.9 billion) in 2019.

Our estimates of lost sales excise revenue based on average rates prevailing in 2019 are likewise $3.35 billion, consistent with KPMG's estimates,[94] while GST losses were $0.45 billion based on the method applied to the legal market above, making total tax losses $3.79 billion (after rounding).

The remainder ($1.1 billion) was then allocated as gross losses to industry. These were allocated into GVA and employment components for the respective parts of the tobacco supply chain using the methodology for the legal market indicated above.

Revenues to illicit operators were estimated based on data provided by KPMG (2020). This indicated the prices of illicit tobacco cigarette sticks and loose tobacco relative to the price of an equivalent amount of tobacco of a well-known legal brand (Winfield 25s).[95] This, in turn, allowed for an estimation of the amount of revenue illicit operators would actually obtain from selling these two forms of tobacco relative to the revenues that would be generated in the legal market. In the case of cigarette sticks this was estimated as 50% of the prevailing gross sales revenue of manufactured cigarette sticks ($1,804/kg) in 2019 while in the case of loose tobacco it was estimated as 23% of this price.

Applying these ratios and prices to the quantity of cigarette sticks and lose tobacco indicated above produced an estimate of some $2.1 billion in illicit revenues in 2019.

As noted in the main text, not all of the $4.9 billion diverted to the illicit market would be recoverable if indeed the illicit market were eliminated.

---

[91] Estimation of these multipliers was based on BIS Oxford Economic analysis of ABS (2021), *Australian National Accounts, Input-Output Tables 2018-19.* See Appendix 1 for further details.

[92] KPMG (2021*) op. cit.*

[93] Originally estimated as $3.41 billion in KPMG (2020), *op. cit.* and re-estimated as $3.35 billion in KPMG (2021*) op. cit.*

[94] As reported at https://data.gov.au/data/dataset/excise-data

[95] KPMG (2020) *op. cit.*

A NOTE ON ILLICT MARKET SIZING

We note that there has been an ongoing debate on the sizing of the illicit market. Some of this was discussed in the recent Parliamentary Joint Committee.[96] In particular, the ATO produces separate figures on the size of Australia's illicit tobacco market in order to estimate the tax gap. These suggest much smaller illicit market tonnages and a smaller tax gap (taking into account lost excise duty only at prevailing rates) than suggested by KPMG's reporting.

For example, in 2029-20 ATO estimates indicate a tax gap of $909 million (net of seizures and compliance) in contrast to KPMG's estimate of $3,354 million in calendar 2019.[97] This is based on total illicit tobacco supply of 1,408 tonnes (of which 1,124 tonnes is imported and 284 domestically produced). Accounting for seizures of 639 tonnes this leaves a residual (unseized tonnage) of 770 tonnes, this suggests roughly 45% of illicit product was seized in that year.[98]

An extract of recent ATO market sizing and tax gap estimates and estimated seizure percentages is provided in the figure below.

Fig. 16. ATO market sizing and tax gap estimates[99]

	2015-16	2016-17	2017-18	2018-19	2019-20
Estimate of illicit tobacco importations (tonnes)	642	878	978	1,233	1,124
Estimate of illicit domestic Chop Chop cultivation (tonnes)	110	192	274	256	284
Estimated warehouse leakages (tonnes)	250	233	222	0	0
Total gross tax gap (tonnes)	1,002	1,302	1,474	1,490	1,408
Seizures and compliance outcomes (tonnes)	206	475	531	674	639
Net tax gap (Gross gap less seizures and compliance outcomes) (tonnes)	796	827	943	816	770
Net tax gap (Gross gap less seizures and compliance outcomes) (tonnes) ($m)	520	621	834	860	909
Implied percentage of total illicit market seized	*21%*	*36%*	*36%*	*45%*	*45%*

Source: ATO, BIS Oxford Economics analysis

Apart from KPMG ,other analysts also suggest that the illicit market is larger than ATO estimates:

- Euromonitor indicates that illicit cigarette stick consumption alone in 2019 as 1,621.7 million. Converting this at a rate of 0.775g/stick suggests illicit usage of 1,257 tonnes in manufactured cigarette sticks alone.[100] While noting the slight difference in reporting periods, this is well above ATO estimates for all unseized tobacco products in 2018-19 or 2020-21.

---

[96] Parliamentary Joint Committee *op. cit.*

[97] KPMG (2021) *op. cit.*

[98] See https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/tobacco-tax-gap/?anchor=Methodology#Methodology

[99] ATO https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/tobacco-tax-gap/?anchor=Methodology#Methodology

[100] This estimation is based on the weight per factory cigarette used by the ATO in 2017. We note that estimated weights of tobacco per RYO cigarette have decreased since that time to 0.7g/RYO cigarette. This was done with the aim of aligning the loose tobacco excise with the excise applicable to manufactured cigarettes and to prevent

- Pike's submission to the Joint Parliamentary Committee suggests an illicit tobacco market of 2.5 billion cigarette sticks and 3,000 tonnes of other illicit tobacco products (including 1,00 tonnes of molasses tobacco) in 2016. This is considerably larger than KPMG and Euromonitor, 2019 estimates.[101]

As indicated combined imported and domestic seizure volumes for 2020-21 by the ABF and ATO amount to 1,357 tonnes.

While noting the differences in reporting period (2020-21 results vs. 2019-20 ATO total illicit market estimates) the 2020-21 seizure result equates to 94% of the ATO's estimated total (i.e. imported and domestic) illicit tobacco supply in 2019-20 of 1,408 tonnes.

There may be a number of reasons for this result:

- Legislative changes and in particular the formation of the ITTF have allowed for a far more effective enforcement regime (as suggested in the Home Affairs Annual Reports cited above)
- The amount of illicit tobacco supply has increased since 2019 (despite the international supply disruptions imposed by the COVID-19 pandemic) perhaps through making increased use of international mail as suggested by Home Affairs
- The illicit market is larger than the ATO estimates
- A combination of all of the above.

A definitive answer to this question is beyond the scope of this report. Its results have been presented based on the KPMG and Euromonitor reports above, while noting the inevitable caveats which come with estimation of the size of any illicit market. Regardless of different views on the exact size of the market, we believe that this exercise is of value in itself. The issues highlighted in the main report (laundering, corruption, diversion of monies away from social uses, lack of licencing harmonisation) are serious ones. All stakeholders have an interest in addressing these regardless of the differing estimates on the precise size of the illicit market.

consumers from switching to cheaper RYO cigarettes. See https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1718a/18bd007 However, our estimates suggest the older (2017) rate provides a more comparable basis for estimating the weight of factory manufactured cigarettes based on loose tobacco weights.

[101] Rohan Pike Consulting, *Submission to the Parliament Committee on Law Enforcement: Illicit Tobacco*

APPENDIX 2 - ILLUSTRATIVE ESTIMATE OF POTENTIAL LAUNDERING REVENUES

MONEY LAUNDERING ESTIMATION

As indicated in the main text, we estimate that some $2.1 billion in gross revenues to illicit tobacco operators. Based on this, it is also possible to derive some illustrative estimates of potential money laundering using these revenues. We note that these estimates are by necessity subject to considerable uncertainty that surrounds all illicit markets. They should be taken as illustrative rather than as definitive. Nonetheless, given ongoing concerns about the impacts of laundering it is worth attempting to model this issue.

We have estimated the amount of laundered revenue as follows:

- Although there is no explicit parallel to the illicit tobacco market, perhaps the closest is the MDMA/ecstasy market, which also relies on an imported product, although, as indicated, margins are likely to be higher for illicit tobacco.
- We confine our estimates to the Australian illicit tobacco retail market (although some of the proceeds of the wholesale market would likewise be laundered at other stages such as the wholesale stage and of course other funds would be laundered internationally).
- Based on the work of Atkins cited by McFadden *et. al.*, ecstasy retail level profits (i.e. proceeds) are approximately 61% of gross revenues.[102] This is slightly higher than Walker *et al*.'s estimate of 52% for the ecstasy market but the McFadden estimates should probably be preferred given the margins for illicit tobacco are likely to be higher than either estimate.[103]
- Some revenue is likely to flow to foreigners and some to Australians. We estimate that the international market accounts for some 80% of gross sales revenues and that approximately 20% of gross international retail sales value flows to foreign suppliers. The former estimate derives from ATO estimates of the imported/domestic market split as noted above while the latter derives from the work cited by McFadden *et al.* on Australian ecstasy market.[104] This suggests some $0.3 billion flows offshore to foreigners
- Applying the margin of 61% to gross retail sales of $2.1 billion suggests profits of roughly $1.3 billion at the retail level. Note the costs of $0.8 billion would effectively incorporate the $0.3 billion to offshore organisations.

[102] McFadden et al. (2014) T*argeting the Profits of Illicit Drug Trafficking through Proceeds of Crime Action*, University of Queensland

[103] Walker J., Austrac, RMIT (2007) *The Extent of Money Laundering in and through Australia in 2004*

[104] See the discussion in the main body and in Appendix 1. More precisely, based on ATO data discussed in Appendix 1, the estimated proportion of domestic cultivation accounted for some 19% of the total illicit market between 2015-16 to 2019-20. See also https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/tobacco-tax-gap/?anchor=Methodology#Methodology

- Stamp and Walker suggest 80% of illicit drug proceeds (i.e. profits) are laundered. Applying the same ratio to illicit tobacco proceeds of $1.3 billion suggests just over $1 billion in laundered funds in 2019.
- Stamp and Walker provide information on the uses of laundered funds. These include 23% laundered through real estate and 21% used to finance other criminal activities. If applied to the estimates above, this implies $234 million laundered through real estate and $214 million on other criminal activities

While not all of these funds may be laundered in Australia, we note that laundering monies through real-estate market has the potential to artificially push up prices. Moreover, “other criminal activities” could include a range of activities including support for international organised crime rings and/or terrorist financing.

BIS OXFORD ECONOMICS

Sydney
Level 6, 7 Macquarie Place
Sydney NSW 2000
Tel: +61 2 8458 4200

Global headquarters
Oxford Economics Ltd
Abbey House, 121 St Aldates
Oxford OX1 1HB, UK
Tel: +44 (0) 1865 268 900

London
4 Millbank, Westminster
London SW1P 3JA, UK
Tel: +44 (0)20 3910 8000

New York
5 Hanover Square (8th floor)
New York NY 10004, USA
Tel: +1 646 503 3050

Singapore:
6 Battery Road
38-05, Singapore 049909
Tel: +65 6850 0110

Europe, Middle East and Africa

Oxford
London
Belfast
Frankfurt
Paris
Milan
Stockholm
Cape Town
Dubai

Americas
New York
Philadelphia
Boston
Chicago
Los Angeles
Toronto
Mexico City

Asia Pacific
Singapore
Sydney
Melbourne
Hong Kong
Tokyo

Email:
mailbox@oxfordeconomics.com

Website:
www.oxfordeconomics.com

Further contact details:
www.oxfordeconomics.com/about-us/worldwide-offices