

With reference to the article titled, “Opinion: Cigarette smuggling in Sri Lanka, Hype vs. Reality” written by LBO, published on October 17 2019 and on the issue of cigarette smuggling.

Addressing illicit markets – why it’s a priority

THE RESEARCH INTELLIGENCE UNIT (RIU), United Kingdom

Recent media publications on the above topic has raised concerns among our research team since these articles appear to contradict the findings of our most recent primary research into this area. Our research into this issue in Sri Lanka is ongoing and prioritised. We believe that failing to tackle the growth of illicit markets has grave consequences of a country’s fiscal targets as well as the consequent implications on health, which can be fatal, especially in the case of illicit alcohol markets. Moreover, leaving the growth of illicit market operators unaddressed also leads to very dangerous social implications and the growth of criminality in society.

Policy making

Policy making is not always a black and white process. It involves making trade-offs. In such circumstances, policy makers are forced to face the harsh realities that may arise from the social and economic impact of their decisions. It is therefore important for them to strive to maintain pragmatism. Tobacco taxation is a case in point where the politicisation of the issues has resulted in a sub-optimal achievement of both the health and fiscal targets in the past.

With reference to recent articles published in the media, we at the RIU were alarmed to read arguments that seem to belittle the presence and growth of a very profitable illicit tobacco market in Sri Lanka. Perhaps we can start to address this issue with a quick background as to how we got here.

The RIU has always been an organisation that has addressed issues of national interest and has been advocating pursuance of prudent policies. As a forward-thinking organisation, we have addressed issues such as asbestos, challenges of meeting an aging population and the impact of imposing VAT on apartments.

Most recently, at the RIU Sri Lanka Economic Forum, we pointed out the need to have a coherent and sustainable excise tax policy on tobacco to meet the government’s health objectives, while maximising government revenue. In the same Forum, the RIU also showed that, based on purchasing parity, Sri Lanka is the most expensive country in the world to purchase cigarettes and thus has become a hotspot for smuggling. This report is an extension to the RIU’s previous report “Towards a Sustainable Policy Framework for the Tobacco Industry in Sri Lanka” where our research focused on estimating the size of the market and understanding the key driving factors of illicit tobacco trade. Using the findings, the RIU attempts to recommend a list of policy prescriptions to curb the growth of illicit trade.

LOST TAXES IN 2019



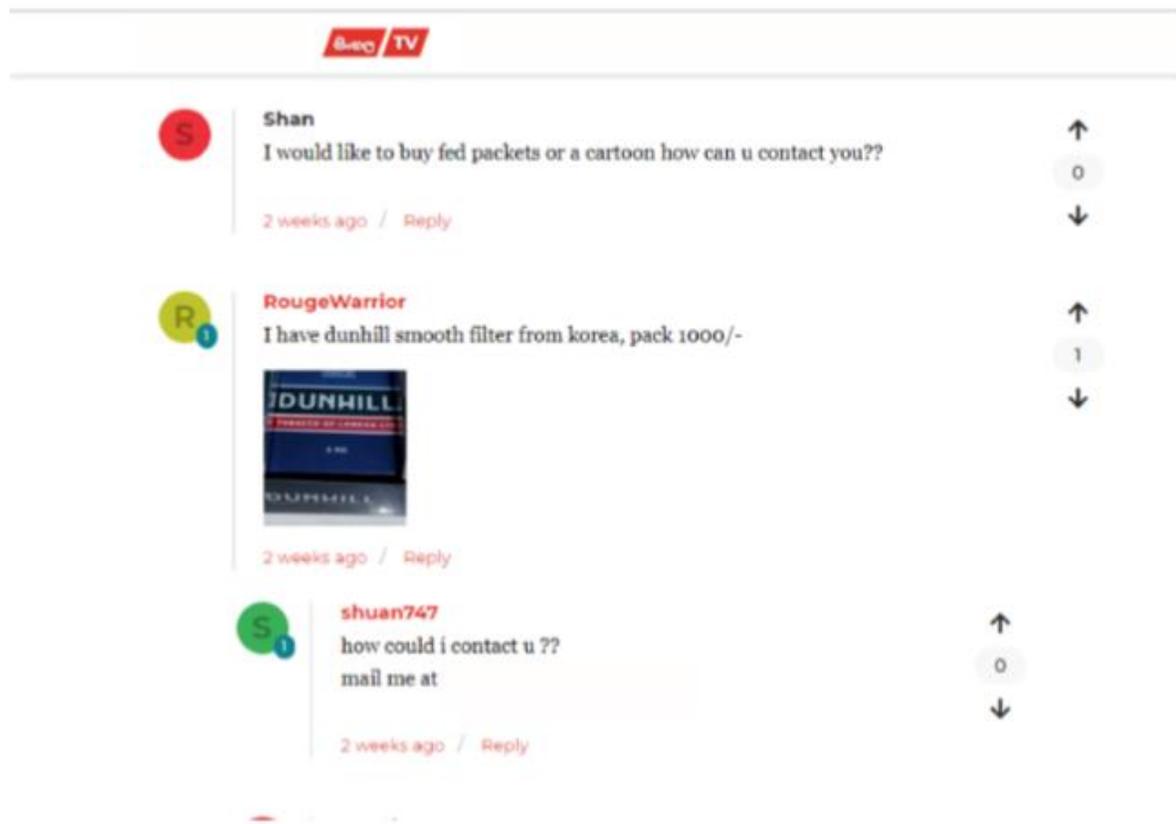
Confusing the debate

One of the claims made in a recent article by a researcher representing a reputed institute, is that the estimates revealed that 'other' reports are not robust and reliable, despite the fact that the RIU research is one of the only primary studies that have been conducted into looking at the growth of the illicit tobacco market in Sri Lanka. Instead of addressing the data presented in a constructive manner, this researcher presented data from Bristol (UK), California and other corners of the world where the macro conditions have absolutely no relevance to the currently evolving situation in Sri Lanka. Taking anecdotal and random snippets from different parts of the globe does not serve the purpose of understanding and analysing the ongoing situation in the domestic market.

It is also claimed that the presence of tourism in the country has skewed the past studies done on the basis of collecting cigarette butts and empty packets on the streets. At any given time, the number of tourists in Sri Lanka is 0.33% of the total population, with some variation according to seasonality. It is somewhat mind boggling to think that such a small percentage of the population can have any significant impact on the cigarette butt and empty packet survey results.

Also, to claim, as they do in this article, that only the surveys based on the number of retailers selling illicit products are relevant. Also shows a shocking and fundamental lack of understanding and insights on the nature of the illicit market operators. The RIU research has actually deciphered new platforms that are used by those operating in the illicit market such as the internet, where sellers connect with buyers online.

In the current environment, multiple platforms from the internet to small retailers, to beach parties and to the school playgrounds, are used for connecting the buyers with the sellers of illicit cigarettes.



Source: RIU, 2019

Income inelasticity

The research conducted by the RIU this year takes the few past studies that have been completed in this area in Sri Lanka and remodels it based on the most recent economic indicators, including GDP per capita, cigarette and beedi consumption data and the growth of tourism. Our results provide a range which we believe is a realistic estimate of the actual percentage of illicit cigarettes that currently account for up to 21% of the total market. These estimates sit well with all the reputed stakeholders in the industry who the research team have met with, including the Customs and the Police.

Another ludicrous claim made in some of the recent articles published in the media, states that cigarette consumption is inelastic and consumers do not switch to smoking beedi as a cheap substitute. This claim once again is far-fetched to say the least and goes against all the data and information that the RIU research report presents. Fundamentally, South Asia is a region where lower income groups smoke the

very much cheaper and often locally manufactured beedi, which is considered to be of a lower standard and more dangerous to health. It is widely accepted that cigarettes have a low-income elasticity and in poor countries, consumers switch to beedi. In the developed world, consumers switch to smuggled cigarettes as an alternative.

Germany is a case in point where ad-hoc increases during the past led to a massive upward incline in smuggling from across the Eastern European border. Consequently, the German Government failed to achieve both its fiscal and health objectives and had to engineer a different approach that is based on economic data. The current system makes annual reviews on taxation rates for tobacco sensible, predictable, based on actual economic data and in line with the health objectives and provide desired fiscal outcomes.

Why do we urgently need to address the growth in illicit markets?

In 2012, the illicit share in Sri Lanka was under 10% of the total market. A 52% increase in the price of cigarettes in October 2016 and the several increases that followed, has made Sri Lankan cigarettes the most expensive, in absolute terms, on the purchasing power parity (PPP) basis globally, by 2018. The base case estimate indicates the illicit share was around 14% in 2018 and with the 2019 July excise revision, it is about to increase to 21%. The value of the illicit cigarette market will reach 24bn in 2019 - up from 15bn in 2017, at the expense of the legitimate industry.

This massive size of the illicit market means a loss of revenue for the Government, to the industry and for those whose livelihoods are connected with the tobacco industry - such as tobacco farmers and beedi rollers. In 2019, the Government stands to lose over Rs.14.5bn due to illicit cigarettes. This is equivalent to around 36% of the annual Samurdhi spending.

Furthermore, the illicit tobacco network is also a threat to national law and order as well as security. Many countries have identified the illicit tobacco trade as one of the modus operandi for terrorist financing for high profile terrorist groups such as Al-Qaida. This is mainly because the illicit tobacco trade is a high profit low risk operation, that fuels the overall spread of criminality in society.

Our ongoing research into the growth of illicit markets also looks at alcohol. According to the WHO, 40% of the alcohol consumed in Sri Lanka is illegal and only 60% is contributed towards government tax revenue and is estimated at around LKR 120bn. Therefore, the loss in taxation is colossal. However, the human cost is far worse. Dozens of people have lost their lives at recent well publicised events where they have consumed illicit liquor.

As with tobacco, Policy makers have to get it right in terms of taxation in order to reduce the economic loss to the country as well as the human harm the illicit market is causing. Our ongoing research into this area will hopefully shed more light in this regard.

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