



Australian Government

Department of Health

**Australian Government
Department of Health**

Submission

to the

**Australian Competition and Consumer Commission
Interested Party Consultation**

on the

**British American Tobacco Australia Limited & Ors
Application for Authorisation
A91550**

November 2016

Thank you for your invitation to make a submission as part of the public consultation process regarding the application for authorisation (the Application) lodged by British American Tobacco Australia Limited, Imperial Tobacco Australia Limited, and Philip Morris Limited (together, the Applicants).

The Department of Health (the department) welcomes the opportunity to comment on the Application, which the department has considered in detail, and in consultation with other stakeholder agencies.

The goal of the department (and of the Australian Government more broadly) in respect of tobacco control is to *'improve the health of all Australians by reducing the prevalence of smoking and its associated health, social and economic costs, and the inequalities it causes'*.¹ The department is concerned about illicit trade in tobacco products because it impacts directly on the effectiveness of price-based public health policies aimed at decreasing smoking rates, and because smokers accessing illicit products may not benefit from other public health measures including tobacco plain packaging and graphic health warnings.

Accordingly, the department is supportive of efforts to tackle illicit trade in tobacco products which are appropriate and adapted to their intended purpose, are consistent with Australia's international obligations, and do not compromise Australia's broader tobacco control strategies (discussed further below).

As we understand it, in considering whether to authorise the arrangement sought by the Applicants, the ACCC is required to identify, analyse and weigh up the public benefits and detriments associated with the Application.

The department takes no formal position as to the Application itself. Rather, in this submission the department seeks to clarify certain matters put forward by the Applicants, and raise other issues for consideration by the ACCC which may assist in reaching its determination on the Application.

1. Role of the Department, and Whole of Government Approach to Illicit Tobacco

The department has primary responsibility for developing the Australian Government's public health policies, and is the focal point for tobacco control in Australia (in accordance with the World Health Organization (WHO) Framework Convention on Tobacco Control (FCTC)).²

Consistent with obligations under the WHO FCTC, Australia is implementing a comprehensive tobacco control framework which addresses both supply of and demand for tobacco products, including with regard to illicit tobacco. Enforcement and compliance is a critical pillar of that framework, as it ensures the effectiveness of tobacco control measures.

In order to ensure that the tobacco control framework is as robust as possible, Australia has taken a whole of Government approach to the development and implementation of tobacco control policies. This is underpinned by a strong collaborative process of cooperative engagement with numerous Commonwealth, state and territory stakeholder agencies, and the tobacco industry (where this is appropriate, and only to the extent necessary as required under Article 5.3 of the WHO FCTC).

This whole of government approach provides (among other benefits) the most effective means of addressing issues relating to illicit tobacco, particularly through the involvement of law enforcement agencies including the Department of Immigration and Border Protection (DIBP), the Australian Tax Office (ATO), the Australian Federal Police (AFP) the Australian

¹ National Tobacco Strategy 2012-2018 (page iii).

² *World Health Organization Framework Convention on Tobacco Control*, opened for signature on 16 June 2003, 2302 UNTS 166 (entered into force 27 February 2005) - see Article 5.2 (a)

Crime Commission (ACC), the Australian Consumer and Competition Commission (ACCC), and state and territory police.

Illicit tobacco is a high priority for the Australian Government, with the creation of the DIBP Tobacco Strike Team, and further funding of \$7.7m allocated over the next two years to strengthen efforts to combat the illicit trade in tobacco. The ATO and DIBP's Tobacco Strike Team have had some considerable success over the last couple of years in tackling illicit tobacco as outlined in the Applicant's supporting submission. In addition to the apprehensions detailed in the Application, the department notes that as recently as this month, 750kg of illegally imported tobacco was detected, leading to identification of a further 1,850kg of illicit molasses tobacco³; and in August 2016, a man in South Australia was sentenced to 4 years imprisonment for the importation of almost 700,000 cigarettes and 50kg of loose tobacco⁴.

The department also notes that work continues at a whole of government level – through various fora including the Tobacco Control Inter-Departmental Committee – on a legislative reform program aimed at strengthening the ability of Commonwealth, state, and territory law enforcement agencies to tackle illicit tobacco at all levels of the supply chain. Further detail regarding the illicit tobacco legislative reform agenda can be found in DIBP's submission to this public consultation.⁵

2. Clarification of Certain Issues in the Application

As outlined above, the department takes no formal position as to whether or not the Application should be approved by the ACCC. However, in considering the Application, the department has formed the view that in weighing up the public benefits and detriments associated with the Application and assessing the Applicants' 'Counterfactual', ACCC may be assisted by some additional information and/or clarification regarding a number of matters raised by the Applicants.

Size of the Illicit Tobacco Market in Australia

The true size of the illicit tobacco market in Australia is unknown, as due to the nature of tax avoidance and evasion, developing accurate methods of estimation is highly challenging.⁶ As such there is currently no official or reliable estimate of the size of Australia's illicit tobacco market, and those estimates that have been produced vary considerably in both market size and means of measurement.⁷

In support of their Application, the Applicants rely on the KPMG report '*Illicit Tobacco in Australia*' 2015 Full Year Report published in April 2016 (the KPMG Report), which is commissioned by the Applicants, and which estimated that illicit tobacco accounted for 14.3% (rounded down in the Application to 14%) of overall tobacco consumption in the 12 months to the end of June 2015 - down 0.2% from 14.5% in the 12 months to the end of December 2014.

The department does not consider the tobacco industry's KPMG Report to provide a reliable estimate of the illicit tobacco market in Australia, including for the reasons adequately addressed in other submissions to this public consultation, most notably from Cancer Council Victoria (CCV), and Cancer Council Western Australia (CCWA). There is also research to suggest a global trend of tobacco industry estimates of illicit tobacco markets being

³ DIBP newsroom - <http://newsroom.border.gov.au/releases/abf-seizes-over-750-kilograms-of-tobacco>

⁴ DIBP newsroom - <http://newsroom.border.gov.au/releases/man-sentenced-to-four-years-in-prison-for-illegally-importing-tobacco>

⁵ <http://registers.accc.gov.au/content/index.phtml/itemId/1198125/fromItemId/278039/display/submission>

⁶ IARC (2011) *IARC Handbooks of cancer prevention: Tobacco Control* (Vol14) – Effectiveness of tax and price policies for tobacco control. Lyon France, IARC, WHO, p. 299

⁷ AIHW *National Drug Strategy Household Survey* (available at <http://www.aihw.gov.au/alcohol-and-other-drugs/ndshs-2013/>)

significantly higher than estimates produced by other authorities.⁸ For instance, Gilmore and colleagues (2013) conducted a comparison of Philip Morris International's 'Project Star' estimates, and estimates published by the NGO commissioned Pricing Policies and Control of Tobacco in Europe (PPACTE) in Europe.⁹

Country	PMI (Project Star)	PPACTE
<i>France</i>	13.7	2.4
<i>Finland</i>	15.9	3.5
<i>Ireland</i>	19.3	4.6
<i>UK</i>	10.5	3.4

In contrast to the results of the KPMG Report, the Australian Institute of Health and Welfare's (AIHW) 2013 National Drug Strategy Household Survey Report found that the proportion of smokers who reported using 'unbranded' tobacco was 3.6%, down from the 4.9% reported in 2010. The department notes that this is not the same measure as the KPMG report (the AIHW report measures the prevalence of unbranded tobacco smoking among smokers, whereas the KPMG report measures the *market share* of illicit tobacco), however the department is of the view that the AIHW Report provides a useful indicator of illicit tobacco use in the Australian community, against which the KPMG Report may be compared.

The department remains of the view that in order to effectively combat illicit trade in tobacco products, it is essential to have a robust estimate of the size of the market in Australia. As such, the department supports the work of DIBP and the ATO in developing more accurate models to estimate the size of the illicit tobacco market.

Reduction in the Loss of Excise Equivalent Customs Duty

In their supporting submission, the Applicants claim that the cost of illicit tobacco to the Australian Government in lost revenue in 2015 was in the order of \$1.49 billion, and that the arrangement for which they seek authorisation, if successful, will benefit the public by reducing the amount of lost excise equivalent customs duty.

Whilst the Applicants are circumspect regarding the precise benefit of their arrangement in dollar terms to the Australian public, the department notes that the Applicants' claim is closely linked to the KPMG estimate of the *size* of the illicit tobacco market in Australia. The department also notes that even in the event that Applicants were successful in curbing the illicit tobacco market in Australia, it is not necessarily the case that any reduction in illicit tobacco would translate to an equivalent increase in licit tobacco use and government revenue. This is also addressed in DIBP's submission to this public consultation.

Impact of Excise Increases on Illicit Tobacco

In the supporting submission to their Application, the Applicants state that in their opinion there is '*clear, strong and building support for the view that the combination of plain packaging laws and the continuing rounds of excise increases on legal tobacco products is fuelling an increase in the importation, availability, supply of, and demand for, illicit tobacco products in Australia*'.

The department accepts that it is recognised that in some circumstances, increasing excise (leading to increases in price) may influence both the demand for cheaper tobacco and the

⁸ Peter Reuter and Malay Majmundar (eds), *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences* (2015) National Research Council and Institute of Medicine of the National Academics, National Academic press, Washington DC

⁹ Ibid citing Gilmore et al 2013

profitability of illicit tobacco imports. There is however no reliable evidence that increases in excise on tobacco products have influenced the illicit tobacco market in Australia.

In so far as the price of tobacco products drives, or is an indicator of the size of the trade in illicit tobacco products, studies have observed that countries with lower tobacco product prices tend to have larger illicit tobacco markets (see Table 1 below, which illustrates the relationship between cigarette price and the illicit cigarette market across the low, middle and high World Bank Income Groups in 2007).

Table 1: Relationship between legal price of cigarettes and illicit trade in 2007¹⁰

World Bank Income Group	Average legal price of a pack of cigarettes in US \$	Average percentage of illicit cigarette market
Low-income	1.13	16.8
Middle-income	1.89	11.8
High-income	4.89	9.8

Consistent with the relationship between World Bank Income Group and illicit trade demonstrated in Table 1 (above), there is international evidence to suggest that illicit tobacco market size tends to be driven more by supply factors. These include the cost of supply of illicit product to the market (which is high in Australia due to geographical factors), the level of tobacco industry participation in the illicit market (which the department takes the view is more relevant in overseas jurisdictions), the presence of informal distribution networks and organized crime, the scale of corruption, the level of law enforcement activity, likelihood of detection and the scale of penalties.^{11,12}

The department also notes that the Applicants claim that the illicit tobacco market is growing and *will continue to grow* as excise levels increase is inconsistent with the results of the tobacco industry's most recent KMPG Report, which estimated that as a proportion of overall tobacco consumption, illicit tobacco accounted for 0.2% less in the 12 months to the end of June 2015 than in the 12 months to the end of December 2014 – despite sustained excise increases.

Impact of Tobacco Plain Packaging on Illicit Tobacco

As outlined above, the Applicants also attribute claimed current and future 'increases' in the illicit tobacco market to the introduction of tobacco plain packaging. This is not a new claim, as outlined in the submissions lodged by CCV and CCWA to this public consultation.

There is no reliable evidence that plain packaging has had any effect on the illicit tobacco market. On the contrary, there is credible and reliable evidence that tobacco plain packaging has had no effect on illicit trade.

Peer reviewed studies aimed specifically at detecting and measuring changes in the illicit tobacco market over the time of the introduction of plain packaging found that there was no change in smokers' reported use of unbranded illicit tobacco, no evidence of increases in use of contraband cigarettes, low levels of use of cigarettes likely to be contraband, and no increase in purchases of tobacco from informal sellers.¹³

¹⁰ World Health Organization, *Illegal trade of Tobacco Products: What you should know to stop it* (2015) (page 7), available at http://apps.who.int/iris/bitstream/10665/170994/1/WHO_NMH_PND_15.3_eng.pdf?ua=1&ua=1

¹¹ International Agency for Research on Cancer (2011). *IARC Handbooks of Cancer Prevention, Tobacco Control, Volume 14: Effectiveness of Tax and Price Policies for Tobacco Control*. Lyon, France: International Agency for Research on Cancer, World Health Organization. All Party Parliamentary Group, *APPG Inquiry into the illicit trade in tobacco products*, UK, 2013.

¹² Joossens L, Merriman D, Ross H, Raw M. How eliminating the global illicit cigarette trade would increase tax revenue and save lives. Paris: International Union Against Tuberculosis and Lung Disease; 2009.

¹³ The peer-reviewed studies are also consistent with the Australian Institute Health and Welfare (AIHW) National Drug Strategy Household Survey (NDSHS) data that indicates that the reported use of illicit tobacco in Australia declined from 6.1% in 2007 to 3.6% in 2013. M. Scollo, M. Zacher, K. Coomber and M. Wakefield, 'Use of Illicit Tobacco Following Introduction of Standardised

Furthermore, on 15 October 2015 the Australian Border Force's Assistant Commissioner Murray supported this position in an interview with the ABC,¹⁴ stating that DIBP had not detected any discernible impact on the illicit tobacco trade as a result of the introduction of plain packaging.

3. Other Issues

As foreshadowed above, in addition to clarifying certain matters raised by the Applicants in their application, the department wishes to address a number of other issues which may assist the ACCC in reaching its determination on the Application.

Article 5.3 of the WHO, Framework Convention on Tobacco Control

Effective tobacco control is, by its nature, antithetical to the economic interests of the tobacco industry. Whilst governments around the world seek to reduce tobacco use in their populations, the aim of the tobacco industry is to increase the amount of tobacco that people use, by dissuading cessation by existing smokers and encouraging new smokers (including young people).

Accordingly, it is unsurprising that to achieve this goal, the tobacco industry has a long, proven history of trying to delay, dilute and defeat the WHO's and governments' attempts to reduce tobacco use.¹⁵ The tobacco industry also tends to be well-funded and well-organised in this regard, with significant lobbying power and influence.

The department also notes, in this regard, that tobacco companies overseas have played a role in illicit trade. One such example is from Canada, where in July 2008¹⁶ and April 2010 five tobacco companies pleaded guilty and admitted 'aiding persons to sell or be in possession of tobacco products manufactured in Canada that were not packaged and were not stamped in conformity with the Excise Act'.¹⁷

With this in mind, and recognising that there is a fundamental and irreconcilable conflict between the tobacco industry's interests and public health policy interests, Article 5.3 of the WHO FCTC, to which Australia is a Party, provides that:

'In setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law'.

The Australian Government has declared its interpretation of the obligations of the Parties to the WHO FCTC pursuant to Article 5.3 by way of Declaration communicated to the United Nations Secretary-General, that parties to the FCTC 'should interact with the tobacco industry only when and to the extent strictly necessary to enable them to effectively regulate the tobacco industry and tobacco products, and should ensure that any such interactions are conducted transparently'.¹⁸

Packaging of Tobacco Products in Australia: Results from a National Cross-sectional Survey' (2015) 24 *Tobacco Control* pp. ii76-ii81; M. Scollo, M. Zacher, S. Durkin and M. Wakefield, 'Early Evidence about the Predicted Unintended Consequences of Standardised Packaging of Tobacco Products in Australia: A Cross-sectional Study of the Place of Purchase, Regular Brands and Use of Illicit Tobacco' (2014) 4(8) *BMJ Open* <http://bmjopen.bmj.com/content/4/8/e005873.full> (accessed 25 May 2015), page 3.

¹⁴ ABC news online, *Millions of cigarettes smuggled into Melbourne seized in raids*; 15 October 2015. Available at <http://www.abc.net.au/news/2015-10-15/millions-of-cigarettes-smuggled-into-melbourne-seized-in-raids/6856290> (accessed on 5 April 2016)

¹⁵ For instance: *Extramural and Defensive Activities: Objectives and Strategies* Philip Morris Europe, 1983.

¹⁶ Canada Revenue Agency, Federal and provincial governments reach landmark settlement with tobacco companies, accessed 16 April 2013 from <http://www.cra-arc.gc.ca/nwsrm/rllss/2008/m07/nr080731-eng.html>.

¹⁷ Canada Revenue Agency, Federal, provincial, and territorial governments conclude landmark settlements with tobacco companies accessed 16 April 2013 from <http://www.cra-arc.gc.ca/nwsrm/rllss/2010/m04/nr100413-eng.html>.

¹⁸ Clarified by the Australian Minister for Foreign Affairs on 5 January 2015. See https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4&chapter=9&clang=en.

The department is of the view that Government measures to address illicit trade in tobacco products fall within the definition of public health policies with respect to tobacco control.¹⁹ Article 5.3 obliges States Parties to 'act to protect these policies from commercial and other vested interests of the tobacco industry'.

Further Considerations

In considering the Application, the department has also identified a number of other issues which the ACCC may wish to take into account in making its determination. The department raises these in brief as whilst they may be relevant to the ACCC's consideration of the Application, they do not fall within the policy remit of the department.

1. The quasi law-enforcement activities that the Applicants wish to undertake may interfere with investigations being conducted by law enforcement (particularly if there is the perception that the Applicants are working with the Government). This may undermine the ability of law enforcement agencies to apprehend criminals, and disrupt the supply chain of illicit tobacco in a more significant way than can be achieved by the Applicants at the retail level.
2. There is a clear conflict of interest regarding the business interests of the Applicants and other minor tobacco brands which may form part of the licit market.
3. Non-compliance with tobacco plain packaging does not necessarily mean that a product is illicit. Particularly with smaller brands that are not within the product portfolio of the Applicants, without access to customs records, how will the Applicants determine if a product is illicit?
4. There may be issues with consistency, transparency and accountability:
 - a. How will the applicants identify the seriousness of each breach?
 - b. There is no formal recourse for a trader to seek review of a decision.
 - c. Who makes a final determination that a product is illicit?

The department trusts that this information will assist the ACCC in its consideration of the Application. In the event that you require any further information or clarification of any of the issues raised above please contact the Tobacco Control Branch of the department at your convenience.

¹⁹ A view also supported by Article 15 of the WHO FCTC – 'Illicit trade in tobacco products', within Part 4 of the Convention on 'Measures Relating to the Reduction of the Supply of Tobacco'