



The Recent Spike in Illicit Tobacco Trade in South Africa

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Abstract

Since 2015, the South African National Treasury has experienced declines in tax-paid cigarette revenues. The declines have been attributed to upward spikes in the illicit tobacco trade. This dissertation explores the upward spike in the illicit tobacco trade, in order to assess whether or not a relationship exists between tobacco companies' actions and the spike in illicit activity. The study analyses information gathered from semi-structured key informant interviews in order to derive expert insights into the spike. The results indicate that the tobacco industry as a whole is using a variety of tactics to protect their interests. This thesis suggests that the recent increase in the illicit tobacco trade is the result of an increase in under-declared cigarette production by the tobacco industry, which exploits a weak enforcement of anti-tobacco laws.

1 Introduction

A rising illicit tobacco trade undermines tobacco control policies, resulting in significant negative consequences for public health and tax revenue (World Health Organization, 2013). The World Health Organisation's (WHO) concerns about these negative consequences led to the expansion of Article 15 of the WHO's Framework Convention on Tobacco Control (FCTC), which focuses on combating illicit tobacco products. According to WHO FCTC, *'The term illicit tobacco trade is defined as a practice or a conduct prohibited by law which relates to production, shipment, receipt, possession, distribution, sale or purchase of tobacco products, including any practice or conduct intended to facilitate such activity.'* Article 15 gave rise to the WHO FCTC's first Protocol, the Protocol to Eliminate Illicit Trade in Tobacco Products (World Health Organization, 2013).

Amongst other factors, the Protocol is aware of the need to control the tobacco supply chain, owing to the global tobacco industry's historical involvement in the illicit tobacco trade to maximise profits (U.S. National Cancer Institute & World Health Organization, 2016, World Health Organization, 2013). The global tobacco industry has also heavily opposed any threats to their vested interests by lobbying the government against both tax-based and non-tax tobacco control measures (Ross, 2015, Ross *et al.*, 2016b, van Walbeek & Shai, 2015).

Since the early 1990s, the tobacco industry has opposed the South African government's attempts to use tobacco tax to strengthen tobacco control (van Walbeek, 2005). According to the tobacco industry, the prime cause of the illicit tobacco trade is the high taxation of tobacco products, which ultimately impedes the generation of tax revenue (Joossens & Raw, 2012, Kelton & Givel, 2008, van Walbeek & Shai, 2015). van Walbeek & Shai (2015) discuss the South African tobacco industry's opposition to rising tobacco taxes and the tactics they have used to combat tobacco control measures. The South African tobacco industry and private market research companies have, in the past, published inconsistent and sometimes exaggerated size and growth estimations, raising questions as to the reliability, credibility, and motives behind these estimations (Blecher, 2010, Blecher *et al.*, 2015, IARC, 2011, van Walbeek & Shai, 2015).

Despite the tobacco control measures in place in South Africa, from 2015/16 to 2017/18, the National Treasury began to see a sharp decline in tax-paid cigarette consumption (ETCP, 2018). From 2016, the 20% decline in tax-paid cigarette consumption coincided with increases in the illicit tobacco trade (Liedeman & Mackay, 2015, van der Zee, van Walbeek & Magadla, forthcoming 2019).

The downward trend in tax-paid cigarette consumption and associated upward spikes in the illicit tobacco trade since 2015 have raised questions about the tobacco industry's possible role in illicit tobacco activity. Historical evidence of exploitative illicit tobacco practices by the tobacco industry makes it imperative that more research be conducted in order to understand the extent and magnitude of the illicit tobacco trade in low-and middle-income countries, including South Africa (World Health Organization, 2013).

This thesis explores the recent upward spike in the illicit tobacco trade in South Africa, in order to assess whether or not a relationship exists between tobacco companies and the spike in illicit activity. The study analyses information obtained from semi-structured key informant interviews, which were used to derive expert insights regarding the motives behind the spike in illicit tobacco trade. This study considers the context of the political economy of tobacco trade, while remaining grounded in economic theory. The results could potentially contribute to government decision-making on tobacco control policies, tax revenue, and law enforcement.

This paper is structured as follows: *Section Two* discusses existing literature on industry complicity in the supply of illicit tobacco at a global and domestic level. *Section Three* describes the research design of the study, why it was chosen, and how it was applied. The section also explains how the data was handled and analysed and the associated limitations. *Section Four* discusses how the market entry of competitors, and the strengthening of government legislation, threatened the interests of the established tobacco industry, and how they responded. *Section Five* provides a discussion of the study's findings followed by a brief conclusion in *Section Six*.

2 Literature Review

Since the 1990s the South African government has been committed to reducing tobacco consumption (van Walbeek, 2005). This was first done by using excise taxes¹ as a tool to raise the price of cigarettes (Chaloupka, Straif & Leon, 2011). Successful implementation of effective tobacco control measures resulted in the country being regarded as a global leader in tobacco control (Chelwa, van Walbeek & Blecher, 2016). The country's commitment was reaffirmed in 2005 when it signed the WHO FCTC (Roemer, Taylor & Lariviere, 2005). According to the World Health Organization (2003), *'The WHO FCTC is an evidence-based treaty that reaffirms the right of all people to the highest standard of health. The WHO FCTC represents a paradigm shift in developing a regulatory strategy to address addictive substances; in contrast to previous drug control treaties, the WHO FCTC asserts the importance of demand reduction strategies as well as supply issues.'* Supply issues were divided into the licit and illicit supply of tobacco products.

The WHO FCTC recognises the important negative consequences of illicit tobacco supply on public health and tobacco control measures and has therefore developed the *Protocol to Eliminate Illicit Trade in Tobacco Products* (van Walbeek *et al.*, 2013). The Protocol provides a toolkit for controlling illicit trade, which includes the use of globally integrated monitoring systems, measures to enhance international cooperation and collaboration, and law enforcement (World Health Organization, 2013). However, despite the country's previous commitment to tobacco control, South Africa has yet to ratify the Protocol. The failure to ratify sends signals to illicit tobacco suppliers that the government is less committed to the fight against the illicit tobacco trade.

Since the increase in domestic tobacco companies in South Africa in 2009/10, tobacco industry participants have accused each other of complicity in supplying illicit tobacco. Ironically, all of the industry participants have been under suspicion and in some cases found

¹ According to the U.S. National Cancer Institute & World Health Organization (2016), *excise tax* is defined as *'a tax or duty imposed on the sale or production of selected products, such as tobacco products.'*

guilty, of improper business conduct (Pauw, 2017, van Loggerenberg, 2014, van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016). This chapter discusses previous instances of industry complicity in illicit tobacco trade, providing a brief overview of the general motives behind illicit tobacco supply, followed by global and domestic instances in which the tobacco industry was found to be complicit in the supply of illicit tobacco.

2.1 General motives behind the illicit supply of tobacco

The illicit tobacco trade is essentially the failure to pay government-imposed tobacco taxes. The IARC (2011), Ross (2015), U.S. National Cancer Institute & World Health Organization (2016) describe how the circumvention of taxes can take the form of tax avoidance, which is legal, and tax evasion, which is illegal. According to Ross (2015), *'Tax Avoidance includes legal activities and purchases in accordance with customs and tax regulations, most of which include the payment of some tobacco taxes and are done mostly by individual tobacco users (e.g., cross-border shopping, duty-free shopping, Internet and mail/phone purchases), but tobacco companies also engage in it (e.g. changing some product features or its production process in order to reduce tax liability).'* On the other hand, tax evasion, according Ross (2015), is defined as *'illegal activities intended to avoid paying some or all taxes. It includes smuggling cigarettes across borders, selling genuine cigarettes that were manufactured illegally, selling counterfeit or illicit white cigarettes, or selling or buying cigarettes via Internet, phone or mail without paying the appropriate taxes.'*

To date, the majority of scholarly research on the illicit tobacco trade, across several disciplines, has focused on scope measurements of tax avoidance/evasion, which indirectly serve as indicators for the measurement of the illicit tobacco trade. Various theoretical models have been developed to measure the scope of such trade (IARC, 2011, Ross, 2015, U.S. National Cancer Institute & World Health Organization, 2016). No matter which scope measurement instruments is used, however, the primary motive for engaging in the illicit tobacco trade is profit maximisation.

To maximise their profits, illicit tobacco traders often seek out and exploit weaknesses or vulnerabilities in countries' economic and political systems. Certain systems can provide the conditions that make tax circumvention practices easier and thus create the economic

incentives for illicit tobacco activity. IARC (2011), Legresley *et al.* (2008), Nakkash & Lee (2008), Ross (2015) and U.S. National Cancer Institute & World Health Organization (2016) identify some of these conditions: tax/price differences and magnitudes, weak tax and customs administration and control, weak governance, corruption, duty-free shops and trade free zones, illicit trade routes, informal distribution networks, affordability of tobacco products, political instability and tobacco industry involvement.

As demonstrated by Ross *et al.* (2016a), the tobacco industry has engaged in elaborate tax avoidance strategies in order to circumvent tobacco control mechanisms, particularly high tobacco taxes. Some of these strategies include:

- Flooding the market with a product before a new tax is imposed, thus encouraging stockpiling. The difference in tax levels provides a profit opportunity for the manufacturer or importer.
- Exploitation of complex non-uniform tax structures. This can lead to the tobacco industry manipulating tax systems and circumventing the prescribed taxes by adjusting products or production processes so that products can be re-classified to a lower tax category. Non-uniform tax structures for products may prompt tobacco manufacturers to adjust their pricing models, lowering prices on products aimed at price-sensitive consumers while increasing prices on products aimed at less price-sensitive consumers.
- Lowering cigarette prices, which tends to drive tobacco volume sales, increasing tobacco consumption as cigarettes become more affordable to a wider market.
- Optimising on profits by raising the net-of-tax price on products in line with, or in excess of, the increase in tax rate, and thereafter lobbying against further government increases in taxes. By contrast, tobacco manufacturers may also reduce their profit margins relative to the tax rate in order to increase sales volumes so as to preserve their original profit margins; this is more likely to affect economy than premium brands.
- Reducing the quantity of product per pack, so as to maintain the price per pack, thus preserving the perceived affordability of the pack.

- Reducing tax liability and profit margins by lowering products' prices so as to influence *ad valorem* excise taxes, since excise taxes are calculated as a function of the retail price.

South Africa provides a clear example of the tobacco industry's influence on excise rates as a result of multinational tobacco companies (MTCs) controlling retail prices. Van Walbeek (2010) indicated how, historically, the South African government had been successful in reducing cigarette consumption and raising tax revenues through the imposition of excise taxes. In response to the rise in excise taxes, however, the tobacco industry, mainly through its representative body, the Tobacco Institute of Southern Africa (TISA)², heavily lobbied against increases in the excise tax. They believe that a strong positive relationship existed between excise taxes and the illicit tobacco trade (Rowell, Evans-Reeves & Gilmore, 2014, van Walbeek & Shai, 2015).

² According to their website, *'The Tobacco Institute of Southern African (TISA) was established in 1991 and is a non-profit organisation representing the major tobacco manufacturers and tobacco farmers in South Africa. Main business: Representative of the non-commercial, common interest of manufacturers and marketers of tobacco products as well as the tobacco growers in South Africa.'* At the time of writing the members of TISA included British American Tobacco South Africa, Philip Morris South Africa, JT International South Africa, Clippa Sales, OTP Distributors, Imperial Tobacco Southern Africa, Universal Leaf South Africa, Dimon South Africa, Tobacco Traders and LTP Tobacco.

2.2 Industry complicity in illicit tobacco supply

Historical MTC complicity in the illicit tobacco trade has been found in Africa, the Middle East, Europe, Asia, and the Americas (Joossens & Raw, 2008, Joossens & Raw, 2012, Joossens *et al.*, 2016, Kelton & Givel, 2008, Lee & Collin, 2006, Legresley *et al.*, 2008, Nakkash & Lee, 2008). Kelton & Givel (2008) discuss how the '1998 legal settlement in the case of *State of Minnesota, et al., v. Philip Morris, Inc., et al.* and the subsequent *1998 Master Settlement Agreement*', resulted in the release of previously undisclosed tobacco-industry documents. These documents exposed the intricate tax evasion practices of MTCs and the role of smuggling. The nature of smuggling has changed over time, from large to small batches of illicit tobacco moving across borders. What has remained consistent during this time, however, is MTCs complicity in either supplying illicit tobacco or the failing to control their supply chains, despite knowing that their products were destined for illicit markets (Joossens *et al.*, 2016).

Large-scale smuggling by MTCs has, in some instances, led to MTCs' own admission of complicity (Joossens & Raw, 2008, Kelton & Givel, 2008). A letter sent by president and CEO of Imperial Tobacco Ltd, Don Brown, to a senior executive of Imperial Tobacco Ltd in 1993 (as cited by Kelton & Givel, 2008) states that: *"As you are aware, smuggling cigarettes (due to exorbitant tax levels) represents nearly 30% of total sales in Canada, and the level is growing. Although we agreed to support the Federal government's effort to reduce smuggling by limiting our exports to the U.S.A., our competitors did not. Subsequently, we have decided to remove the limits on our exports to regain our share of Canadian smokers. To do otherwise would place the long-term welfare of our trademarks in the home market at great risk. Until the smuggling issue is resolved, an increasing volume of our domestic sales in Canada will be exported, then smuggled back here for sale."* According to the chairman of BAT in 2000 (as cited by Joossens & Raw, 2008), *"Where any government is unwilling to act or their efforts are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market."*

In many instances MTCs have not been held accountable or been sufficiently penalized for questionable behaviour (Joossens & Raw, 2008, Joossens *et al.*, 2016, Kelton & Givel, 2008).

In fact, Philip Morris International (PMI), Japan Tobacco International (JTI), British American Tobacco (BAT), and Imperial Tobacco Limited (ITL), in an attempt to avoid litigation, signed various agreements with the European Union (EU) to fight collaboratively against the illicit tobacco trade. The agreements themselves contained loopholes, which protected MTCs from the consequences of complicity in supplying illicit tobacco (Joossens *et al.*, 2016).

Industry complicity in Canada remains one of the most notorious instances of tobacco smuggling. Beginning in the 1980s, Canadian tobacco manufacturers exported tobacco products to the United States (US) and thereafter illegally reimported the products via Native American reservations and Canadian First Nation reserves. This was done in order to take advantage of tax/price differentials between the two countries (Kelton & Givel, 2008). In the 1990s, local tobacco manufacturers in Canada actively participated in smuggling, exporting cigarettes to the US and smuggling the cigarettes back into Canada without any leakage into the US domestic market (Joossens & Raw, 2008, Joossens & Raw, 2012). According to Joossens & Raw (2008) and the U.S. National Cancer Institute & World Health Organization (2016), in 2008, Canadian tobacco manufacturers, ITL, and Rothmans Benson and Hedges pleaded guilty to illicit tobacco trading between 1989 and 1994. The companies were fined CA\$1.5 billion for illicit tobacco activity. In a similar case, according to Joossens & Raw (2008), significant quantities of two ITL brands, Regal and Superkings, were exported from the UK to Latvia, Kalingrad, Afghanistan, Moldova and Andorra, and a large proportion of the exports were illegally smuggled back into the UK.

In the late 1990s and early 2000s, the European governments and European Community suspected that American tobacco companies, specifically PMI and RJ Reynolds, were taking advantage of tax/price differentials between countries by exporting American cigarette brands to countries with lower tobacco taxes, and then illegally smuggling products back into the US (Joossens & Raw, 2008, Joossens *et al.*, 2016). According to Joossens *et al.* (2016), the EU alleged in 2002 that RJ Reynolds were engaging '*in organised crime, money laundering and narcotics trafficking and in transactions that financed both the Iraqi regime under Saddam Hussein and terrorist groups*'. There have also been numerous instances of cigarettes which have been produced in one country and consumed in another country, without the necessary

taxes been paid, such as illicit whites.³ According to Joossens & Raw (2012), illicit whites dominated cigarette consumption in Libya and were produced in Luxembourg and Bulgaria. Another example is the Jin Ling brand which was produced in Russia and consumed within the EU (Joossens & Raw, 2012). In 2014, BAT was fined £650 000 by UK tax authorities for over-supplying their brands to the Belgian market (Joossens *et al.*, 2016).

Since the 1980s, the global tobacco giant, BAT, has engaged on numerous occasions in various forms of illicit tobacco trade in pursuit of their strategic corporate objectives (Gilmore, AB & McKee, M, 2004, Gilmore, AB. & McKee, M., 2004, Lee & Collin, 2006, Legresley *et al.*, 2008). Smuggling has been used as a strategy to gain entry into otherwise restricted markets and to compete for market share. Such practices have been observed in Asia, the former Soviet Union, the Middle East, and Africa, among others (Gilmore, AB & McKee, M, 2004, Gilmore, AB. & McKee, M., 2004, Lee & Collin, 2006, Legresley *et al.*, 2008). A number of studies (Joossens *et al.* (2016), Kelton & Givel (2008), Legresley *et al.* (2008), Nakkash & Lee (2008), Rowell, Evans-Reeves & Gilmore (2014) that have analysed newspaper articles, company document depositories, tobacco company press releases, court judgements, and litigation show how MTCs have either been complicit in the illicit tobacco trade or have used media platforms to influence stakeholders' understanding of the nature and magnitude of the illicit tobacco trade.

Collin *et al.* (2004), whose study included the analysis of confidential documents from BAT's Guildford depository,⁴ argued that the evidence indicated that, in order to gain access to restricted markets, BAT smuggled tobacco products into Burma, Vietnam, Thailand, and Bangladesh. Nakkash & Lee (2008) show how BAT and PMI, in an attempt to gain access to - and expand - market share, took advantage of weak governance and political unrest during the Lebanese civil war. The war resulted in the eradication of local cigarette production and led to the influx of contraband to the Lebanese market. Even after the civil war ended in the

³ Ross *et al.*, (2016) define *illicit/cheap whites* as, '*cigarettes manufactured by legitimate business enterprises, but a large share of the production is sold illegally outside the jurisdiction where they are produced.*'

⁴ The Guildford depository is a collection of documents which contain detailed activities of the tobacco industry; it is located in the United Kingdom and is run by BAT.

1990s, BAT continued to supply the Lebanese tobacco market with licit and illicit cigarettes. BAT also exploited transition economies, such as the former Soviet Union (FSU), which it used to gain entry into the Chinese market (Gilmore, AB. & McKee, M., 2004). In line with their corporate objectives and in an attempt to penetrate the lucrative Chinese market, BAT used a variety strategies to overcome barriers to entry, including restructuring their Asian business divisions, so as to supply private traders and to control prices (Lee & Collin, 2006).

The African continent has not been free from illicit tobacco activities. Legresley *et al.* (2008), in an analysis of BAT documents from the Guildford depository and the BAT Document Archive, indicated that at least 40 of 54 African countries were exposed to smuggling and that smuggling formed a key part of the company's corporate strategy. They also show that BAT took advantage of the opportunities available for illicit activity in Zaire (DRC), Togo, Ghana, and Angola. A study of BAT's Guildford depository, conducted by Wen *et al.* (2006) and Collin *et al.* (2004), indicated that other leading global tobacco companies were also complicit in illicit tobacco activity. BAT documents also revealed PMI's proposed plans to engage in illicit activity in Nigeria to support their arguments against government increases in taxes (Legresley *et al.*, 2008).

MTCs have, over decades, been complicit in the illicit tobacco trade despite collaborating with governments and various agencies in the fight against it. These practices have cast doubt on the credibility of their role in the fight against the illicit tobacco trade. Many scholars have appealed to the WHO FCTC and governments to reject industry interference as part of their commitment to eliminate the illicit tobacco trade (Legresley *et al.*, 2008, Nakkash & Lee, 2008, Rowell, Evans-Reeves & Gilmore, 2014). It is also stressed in Article 5.3 of the FCTC which requires "*Parties to protect their tobacco control and public health policies from commercial and other vested interests of the tobacco industry*" (van Walbeek & Filby, 2018).

2.3 Industry complicity: The South African context

According to van Loggerenberg (2018) and van Loggerenberg & Lackay (2016), tobacco smuggling has been a lucrative business in South Africa since 1994, and by 2013 '*had reached epidemic proportions*'. Van Loggerenberg & Lackay (2016) indicated that, in 2008, South African Revenue Services (SARS) confiscated 45 million illicit cigarettes from Masters International Tobacco Manufacturing. The controversial owner of the business was linked to the South African Arms deal (van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016). According to Corruption Watch (2018), '*The Arms deal was not a single event, but rather a series of corruption scandals and cover-ups*'.

Escalating illicit activity within the country prompted a SARS investigative unit to probe into the *modus operandi* of the illicit tobacco value chain (Project Honey Badger). Their findings indicated the possibility of unlawful business practices by fifteen tobacco companies (Pauw, 2017, van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016). Investigations also exposed a complex and intricate network of money, which was sourced from smuggling activities, and which was used to pay "*influential businessmen, gangsters and politically connected individuals*" (Pauw, 2017). A domestic tobacco company, Carnilinx, was found guilty of unpaid taxes. SARS seized '*over R200 million worth of illicit tobacco*' and an affidavit by Carnilinx indicated that '*the company unlawfully and wrongfully smuggled two tonnes of tobacco every week for 40 weeks to avoid paying excise duty*' (Pauw, 2017:193). They were not the only participants in the underground illicit tobacco world: British American Tobacco South Africa (BATSA) was exposed in the media for using spies to infiltrate government agencies and report on their competitors' businesses (Walter, 2015).

From 2015, South Africa's tobacco economy was revealed to be multi-layered, in that it involved corruption, tobacco industry state infiltration, and industry espionage. These had significant negative consequences for the country both economically and politically. The National Treasury's Budget Review reveals that, since 2015, the country witnessed a sudden decline in tax-paid cigarettes which could not be attributed to economic factors entirely and indicated an increase in the trading of illicit tobacco (van Walbeek, 2014). Studies by van der Zee, van Walbeek & Magadla (forthcoming 2019) show how the proliferation of low-

priced/illicit cigarettes penetrated all racial and socio-economic groups in South Africa. Case studies by Liedeman & Mackay (2015) indicate the increased availability of illicit cigarettes in Delft, Cape Town, between 2010/11 and 2015.

The change in conditions that allowed illicit tobacco to flourish from 2015 was linked to the appointment of the new SARS commissioner, Tom Moyane, in 2014. Moyane's leadership decisions severely weakened SARS law enforcement capacity, resulting in conditions that allowed undeclared cigarette production to thrive (Pauw, 2017). During his time as SARS commissioner, the tax authority witnessed leadership purges and multiple state commissions of inquiry into SARS, including SARS tax administration and governance.

The "*epidemic proportions*" of the illicit tobacco trade mentioned by van Loggerenberg & Lackay (2016) in 2013 was dwarfed by subsequent developments. A 2018 Ipsos study, commissioned by the Tobacco Institute of Southern Africa (TISA), showed that undeclared cigarette production was spiralling out of control, with three out of four non-organised shops⁵ selling cigarettes below the amount of the combined excise tax and VAT (TISA, 2018b). The cigarettes were deemed to be illicit, as the full tax could not have been paid on them. The study also identified a domestic tobacco manufacturer, Gold Leaf Tobacco Company, as the main perpetrator, claiming that they accounted for 75.1% of sales at a price below the cost of the taxes. A follow up study conducted by Ipsos in the latter part of 2018 indicated that, within three months, illicit trade in the informal market increased from 33% to 42% (TISA, 2018a).

Given the tobacco industry's history of avoiding, and at times evading, the tobacco tax, this thesis looks at the factors behind the recent upward spike in the illicit tobacco trade in South Africa. The section that follows will specify the qualitative methods used.

⁵ According to the Ipsos study, non-organised shops included '*independent small and medium businesses, including spazas, general dealers, corner cafes and hawkers*', excluding '*mobile hawkers, taverns and shebeens*'.

3 Research Methods

The aim of this study is to explore the recent upward spike in the illicit tobacco trade in South Africa. A qualitative method, using data collection and analysis was deemed most appropriate for this study. This took the form of semi-structured key informant interviews. This section details the method used and is structured as follows: first a brief overview of the chosen research design will be given, followed by a detailed description of the application of the research design. The section will close with a discussion of ethical considerations.

3.1 Research design

One research design was applied to this study.

3.1.1 Methodology: Semi-structured key informant interviews

To explore and better understand the underlying motives behind the recent upward spike in the illicit tobacco trade, semi-structured interviews with key informants⁶ were conducted so as to gain insights into the local context of the illicit tobacco market. Given the highly complex and sensitive nature of the illicit tobacco market, a flexible research instrument was considered necessary to collect the primary data.

According to Ross (2015), U.S. National Cancer Institute & World Health Organization (2016) and IARC (2011), interviewing key informants who have expert knowledge related to the nuances of licit and illicit tobacco activity is a widely-used and recommended approach to measure the scope of the illicit tobacco trade. This approach, however, has been less used in the South African context, particularly because of the sensitive nature of the subject matter. There are currently no South African academic studies that have used this approach (Ross, 2015). There are, however, private market research companies who have adopted this approach to inform their assumptions and estimations regarding the market sizes and shares of various industries. This information is thereafter sold for market research purposes.

⁶ The words *key informant* and *research subjects* will be used interchangeably throughout this paper.

Key informant interviews in this study are not used to determine which interviewee narratives are correct, but merely to understand the socio-economic context that allows the illicit tobacco trade to flourish in South Africa. The purpose is to delve into the social construction of the illicit tobacco market in order to gain a deeper understanding of stakeholder engagement in such activities, from a supply perspective. This information is expected to build on the local knowledge base of the economics of tobacco control, so that a greater pool of information is available for economic decision-making purposes.

Key informants, who work within - or who have expert knowledge of - the tobacco industry, were interviewed in order to obtain primary data and gain expert insights into the tobacco industry. Since these interviews were conducted on human subjects, ethics clearance was required and obtained (see Appendix C).

The research design used in this study has been previously applied locally and internationally in the field of tobacco control and public health. Tam & van Walbeek (2014) used semi-structured interviews in a Namibian case study, *'to illustrate challenges faced by low-income countries working to forward tobacco control legislation'*. Skafida *et al.* (2014) also applied key informant interviews *'to determine how transnational tobacco companies tried to penetrate the Bulgarian cigarette market and influence tobacco excise tax policy after the fall of communism and during Bulgaria's accession to the European Union'*. The next section will explain in detail the application of the research design.

Research Instrument: Semi-structured key informant interviews - Primary data

Semi-structured interviews were selected as the appropriate research instrument for this study since these allow for more digression than structured interviews. The fixed format of structured interviews is restrictive as it does not allow for sufficient follow-up and probing of interviewee responses. Probing for further clarification was imperative in this study because it allowed the researcher to establish the interviewee's comprehension of the question, and how it was being interpreted in the answers, to direct questioning to what was said, to get clarification of the decision/estimation process, and to extract complete narratives in the responses (Qu & Dumay, 2011). Probing forms an essential part of investigating markets where deep questioning is essential in order to arrive at reliable conclusions about specific

subjects. The aim of the semi-structured interviews of key informants who have expert knowledge was to assess whether or not a relationship exists between tobacco companies' actions and the recent upward spike in the illicit tobacco trade.

The research process involved the following steps:

1. Development of semi-structured interview questions (see Appendix A: Sample Interview Guide).
2. Development of interviewing follow-ups and probes.
3. Development of a key informant sample list.
4. Contacting and securing interviews at a specific date and time.
5. Conducting semi-structured interviews.
6. Collating data.
7. Analysis of results.

As suggested by IARC (2011), Ross (2015) and U.S. National Cancer Institute & World Health Organization (2016), research subjects were selected from role players across the tobacco value chain, tobacco industry representatives, tobacco control and public health advocates, appropriate government ministries, law enforcement agencies, private researchers, independent consultants, customs and excise specialists, and officials within the government and private sector. Further suggestions of individuals to contact were also obtained from interviewees during the interview process. These were used to extend the key informant sample list. The research subjects excluded any vulnerable groups and focused entirely on experienced adults who have expert knowledge on the licit and illicit tobacco markets.

In order to protect the privacy of the research subjects, personal identifiers were removed to ensure anonymity. Privacy was further maintained through pseudonymisation which ensured that identifying fields were substituted with artificial identifiers.

Process of setting up interviews

After the key informant sample list had been developed, research subjects were contacted, the researcher introduced herself and the study, and voluntary participation was specified (see Appendix B: Information Sheet and Consent Form). Initial contact occurred by either

phone or email. Contact that occurred via phone was followed up by an email that re-introduced the study to the research subject. The email included the *Information Sheet and Consent Form* (see Appendix B). All further communication setting a date and time for interviews was done via phone or email, whichever was preferred by the subject. The interviews were conducted at the convenience of, and at a location specified by, the interviewees, such as company premises or a public venue. The signed *Information Sheet and Consent Form* was either emailed to the researcher or manually handed over to the researcher before the interview.

In cases where the interview was conducted by phone, the researcher re-introduced the study and read out the *Information Sheet and Consent Form* (see Appendix B). The *Form* specified that interviewees who agreed to be interviewed by phone or Skype automatically provided consent. In instances where the researcher had both a contact number and an email address for the prospective interviewee but was unable to reach the individual by phone, she sent an e-mail introducing herself and the study. Details regarding voluntary participation, confidentiality, and the *Information Sheet and Consent Form* (see Appendix B) were also provided. With the verbal consent of the subject, more than one interview may have occurred in some instances. This allowed for follow-up questions based on first-round interviews.

Data

Key informant interviews are relatively simple to conduct (Ross, 2015). Information can be obtained relatively quickly and can provide valuable background and corroborating information on a specific subject. Despite the wide range of information gathered, the researcher was aware that the selected technique also tends to be associated with subjectivity and related bias, which are often shaped by individual experiences (Ross, 2015, U.S. National Cancer Institute & World Health Organization, 2016). The information gathered tended to be very broad in nature and not limited to discussions merely about the size of the illicit tobacco market. Some of the issues discussed included legislation, the efficiency of government agencies, industry interference in state and tobacco industry functioning, moral viewpoints, and business strategies.

Given the sensitivity of the gathered information, it was necessary to protect interviewees from any risks that might arise if their participation became known. For this reason, research data obtained from key informant interviews was tape recorded and thereafter transcribed onto a password-protected Microsoft Word document. The names of research subjects were anonymized and pseudonymised during transcription. The tape-recorded research data was deleted once transcribed. The Word document was stored on Google Document using Google Document encryption to protect the data from third parties. Only the researcher has access to the passwords. The research data was stored to support any queries that may arise from potential thesis publication.

Because of work that the Economics of Tobacco Control Project (ETCP) does, the researcher and supervisor are aware that the tobacco industry takes a special interest in the ETCP. They therefore had to conduct the research with extraordinary care and ensure that the work was done both ethically and thoroughly.

Analysis

Semi-structured key informant interviews included both face-to-face and phone interviews, which took place from August to December 2018. Twenty individuals were interviewed, including representatives of: domestic tobacco companies (6), multinational tobacco companies (1), National Treasury (2), law enforcement agencies (2), the informal sector (1), financial intelligence (1), tobacco control/public health advocates (3), independent consultants (3), as well as one journalist. Research subjects were identified based on their roles working within - or in relation to - the tobacco market and had specialist knowledge regarding the nuances of the tobacco trade, including the illicit part of it. The list of interviewees was compiled from names of individuals found on tobacco-related media articles, books on the subject matter, referrals within the Economics of Tobacco Control Project, referrals obtained during the interview process, and direct enquiry. Ex-employees of tobacco companies, who had more than ten-years of experience within the tobacco industry, were also included.

The term '*domestic and multinational tobacco companies*' includes each group's industry representative bodies. Multiple members of one of the industry representative bodies agreed

to participate in the study, but all industry members of the other industry representative body refused to participate individually. They directed the researcher to contact their industry representative body about study participation. Two of the 20 interviewees refused to be recorded. They happened to form part of the same cohort, written notes were taken during the interview process and more detailed notes were made immediately after the interview, so as to reduce the likelihood of recall error.

Owing to the sensitive nature of the study's subject matter, certain subjects who were contacted refused to participate in the study. They believed that participation could compromise national investigative efforts and their job security. Those who did agree to participate did so in their professional capacities, and one interviewee gave permission for the individual's name to be disclosed even though this was not sought. One interviewee requested that the tape-recording be paused on multiple occasions during the interview, so as to disclose information *off the record*.

Questions for each interviewee were adapted as appropriate, and the following themes were probed: 1) the reasons behind the recent upward spike in illicit tobacco trade, 2) the *modus operandi* of illicit tobacco trade, 3) industry complicity in the illicit tobacco trade, 4) the role of law enforcement with respect to the illicit tobacco trade, 5) opinions regarding reliable sources of illicit tobacco market estimates. Interview data, which took the form of entangled stories, was used to identify narratives which would aid the understanding of the social construction of the South African illicit tobacco market. Key narratives were identified as those most frequently mentioned or discussed in the greatest detail, or one that was mentioned uniquely.

Limitations

The limitations of applying such a method and speaking to, in certain interviews, nervous or uncertain interviewees meant that often the interviews included large amounts of irrelevant material. Interviewees may have presented distorted responses which could be associated with an attempt to promote a certain narrative, trying to compensate for being uncertain about a specific question/topic, bias in recalling events and experiences, cautious limiting of

their responses in order not to be identified, or being influenced by emotional states, for example, stress or fear of reprisal.

Because of the sensitive nature of the subject matter, it was very difficult to find interviewees from government agencies who were willing to speak, even with all the safeguards and precautions in place to preserve anonymity. This was anticipated by the researcher and was a challenge. The researcher was also fully aware that certain cohorts, particularly members of specific industry representative bodies, were pushing certain narratives. In such cases, the responses of individuals or a group of individuals affiliated to a representative body were designed to invoke a specific narrative and in certain instances the researcher asked the question '*why have you agreed to speak with me? What is the narrative that you are wanting to convey?*'. Some respondents had well-rehearsed answers, and this was evident throughout the interview.

The researcher was aware that what was communicated by the interviewees during the interview process might contain inaccuracies and have been driven by strategic commercial objectives unique to each interviewee or group of interviewees. For this reason, great care was taken to ensure that responses were not accepted uncritically but rather approached with some skepticism. Given the nature of the research and complexity of the market, gaining an understanding of the various narratives was the best that the researcher could do.

3.2 Ethical considerations

Since the collection of primary data for this study involved interviews with human subjects, ethics clearance was required and granted (see Appendix C) by the University of Cape Town (UCT) Commerce Faculty Ethics in Research Committee. Primary data collection only commenced once ethics approval was granted by the Committee.

4 Results

Since the 1990s, the South African tobacco industry has been characterised by the presence of only three MTCs, with British American Tobacco South Africa (BATSA) holding a near-monopoly market position (van Walbeek, 2005). The two other tobacco companies included Philip Morris South Africa (PMI) and Japan Tobacco International South Africa (JTI). The near-monopoly market position of BATSA resulted in strong barriers to market entry, limiting competition within the sector and securing the positions of the MTCs for decades. However, gradual changes in government-imposed tax and non-tax tobacco-control measures, starting with the Tobacco Products Control Act, 1993, impeded MTCs' further exploitation of the tobacco market. The Tobacco Products Control Act of 1993 was amended in 1999, 2007, and 2008. Some of the main provisions of the Act included: a complete ban on tobacco advertising and sponsorship, smoke-free public areas and workplaces, restrictions on cigarettes sales to minors, restrictions on smoking in cars where minors are present, and maximum-level restrictions on tar and nicotine content.

In response to the tobacco control measures, MTCs persistently lobbied the government against the tightening of tobacco legislation, increases in the excise tax, and the entry of new competitors, all of which posed a threat to the interests of the established tobacco industry. Rising competition (actual and potential) within the sector and government legislation conflicted with MTCs' interest in maintaining the status quo of the tobacco industry. MTCs soon realised that they could not sustain the traditional power dynamics of the tobacco market. As a result, they used a range of tactics to protect their interests. This section explores the tactics adopted by MTCs to protect themselves from the rising threat of competition and government legislation in the South African tobacco market.

The results presented below take the form of a narrative of the chronological development of the tobacco trade since 1990, with a specific focus on the illicit trade narrative since 2009. The story is framed around *how the vested interest of an established industry came into conflict with potential and actual competitors, and with the government*. The narrative is primarily shaped by information obtained from tobacco industry stakeholders during the study's interview process and from published literature.

The narrative will first provide an overview of the South African tobacco industry (1990 to 2009/10), which was followed by the disruption of the traditional tobacco market status quo (from 2009/10). Thereafter the study explores suspicions of industry complicity in illicit tobacco trade (from 2012 to 2014) and the unravelling of the multi-layered tobacco industry (from 2014). This will be followed by an overview of under-declared production and its impact on excise revenue (from 2015). Finally, the study explores multinational tobacco companies' recent tactics to protect their interests.

4.1 Overview of the South African tobacco industry (1990 to 2009/10)

In 1999, British American Tobacco South Africa (BATSA) dominated the South African tobacco industry, accounting for more than 90% of tobacco market share (van Walbeek, 2005). Their position in the market was entrenched by BATSA's advantage as first-mover into the country and the merging of British American Tobacco plc (BAT) and Rothmans International, to form BATSA in 1999 (van Walbeek, 2005). The strength of their market share allowed them to establish strong and unrivalled pricing power within the sector. BATSA's extensive cigarette brand portfolios - including Peter Stuyvesant and Rothmans - retained their dedicated followers in South Africa for decades.

Until 2010, BATSA had only two significant competitors, both of which were familiar rivals to BAT at a global level: PMI and JTI (Gordon & Hedley, 2011). Market share rankings of the three MTCs, led and dominated by BATSA, and followed by PMI and JTI in that order, allowed BATSA to control the South African tobacco market. Although Philip Morris International historically tended to be the dominant MTC in global market share rankings, in South Africa, they played second fiddle to BATSA. According to an ex- PMI employee, PMI's exit from - and re-entry to - the South African tobacco market during periods of political instability did not aid their competitive position and they persistently ranked second in terms of market share. PMI's *Marlboro* brand, however, helped to secure their market share. That, and their small brand portfolio, relative to BATSA, played a significant role in sustaining their second-place market share ranking.

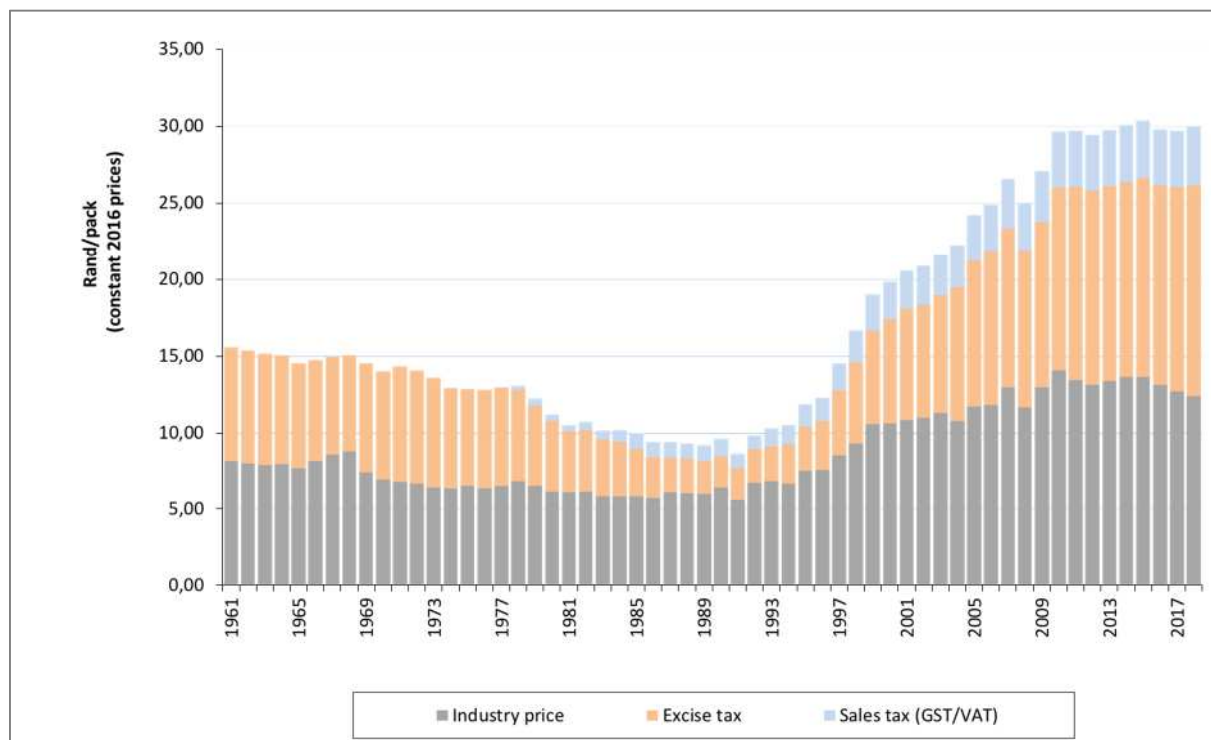
Interviewees indicated that BATSA was, and still is, the only MTC in the South African tobacco market that manufactures cigarettes locally, while both PMI and JTI import all their cigarettes. Investment in local manufacturing and market share dominance resulted in BATSA, rather than PMI and JTI, having a greater stake in the economic and political developments affecting the South African tobacco industry. However, irrespective of whether cigarettes are manufactured locally or imported, all three MTCs are represented by the same tobacco industry representative body, the Tobacco Institute of Southern Africa (TISA). According to TISA, they represent *"major tobacco manufacturers and tobacco farmers in South Africa. Their main business includes the representation of the non-commercial, common interest of*

manufacturers and marketers of tobacco products as well as the tobacco growers in South Africa.”

From its inception to the present, TISA’s chairperson, Francois van der Merwe, has been a tobacco grower. For domestic cigarette manufacturing, TISA member tobacco growers have supplied, and continue to supply, tobacco leaf predominantly to one cigarette manufacturer, namely BATSA. Thus BATSA, given their market share dominance and strong tobacco leaf purchasing power, is likely to have the greatest influence on TISA’s agenda. In fact, during the interview process multiple stakeholders used the words *TISA* and *BATSA* interchangeably, and two interviewees specifically mentioned that TISA and BATSA are synonymous: “*TISA is basically run by BATSA and Francois van der Merwe is in BATSA’s pocket*”. Owing to the blurred lines that separate TISA and BATSA, multiple interviewees indicated scepticism and caution regarding the narratives presented by TISA to tobacco industry stakeholders and the public, via the media.

By decomposing the real retail price of cigarettes into tax and non-tax components (Figure 1) we are able to assess how BATSA, between 1994 to 2010, leveraged their market power and took advantage of margin opportunities (Linegar & Van Walbeek, 2018). The grey bars in Figure 1 represent the industry price or the net-of tax-price while the orange bars represent the excise tax and the blue bars represent sales tax (GST/VAT). With the release of Nelson Mandela from prison and the abolition of apartheid in the early 1990s, the tobacco industry became aware that significant political changes were approaching. From 1994, the Department of Health publicly announced their commitment to protect public health. In 1994 the Minister of Finance announced that they would target a total tax burden of 50% of the retail price of the most popular cigarette price category (Minister of Finance, 1999, Minister of Finance, 2000). This was achieved in 1997. In 2004, the Treasury raised the tobacco tax (excise tax plus VAT) benchmark to 52% of the recommended retail selling price of the most popular brand of cigarettes (Minister of Finance, 2004). The most popular brand of cigarettes was owned by BATSA.

Figure 1: Decomposing the Real Retail Price of Cigarettes into Tax and Non-Tax Components



Source: The Economics of Tobacco Control Project (ETCP) calculations, derived from various issues of the National Treasury Budget Review (1980-2018). Real excise revenue is displayed in millions of Rands, with 2016 as the base year.

The tobacco industry responded by making use of their strong market position and dramatically raised the net-of-tax price (grey bars) of cigarettes over a short period of time, massively increasing their revenue. As a result, the net-of-tax price of cigarettes almost doubled. Since the excise tax is a function of the recommended retail price of the leading cigarette brand, the doubling of the net-of-tax price of cigarettes significantly raised excise taxes (Linegar & Van Walbeek, 2018). This means that if the grey bars (net-of-tax price) are increasing, then the orange bars (excise tax) have to increase to keep up with the rule that the government has set; that is, the excise tax is at 52% of recommended retail price. This occurred despite cigarette consumption declining over the same period. Thus, BATSA's pricing strategies allowed them to increase profits and enjoy a self-constructed *golden age* of tobacco market share dominance. BATSA's large profits however also played a significant role in attracting new market entrants to the tobacco industry (Linegar & Van Walbeek, 2018).

Until 2010, despite government-imposed tax and non-tax tobacco-control measures, market conditions enabled BATSA to earn impressive profits. Neither competition nor government legislation at the time were in conflict with BATSA's growth strategy, which centered heavily on increasing the overall profitability of the company by increasing the profit per cigarette in a decreasing market. BATSA's objective was to maintain its stronghold on the tobacco market and, as far as possible, limit competition and oppose the strengthening of tobacco legislation. Up to 2009/10, the threat of competition from actual and potential competitors, and from tobacco legislation, was more of a minor inconvenience than a major threat.

In 2009/10, however, changes the form of rising competition in the tobacco market started to threaten BATSA's market position. The change was driven mainly by the entry of domestic tobacco companies (DTCs) and, to a lesser extent, changes in tobacco-control legislation. In response to the threat, BATSA/TISA employed an assortment of tactics to protect their interests and maintain BATSA's dominance in the sector.

4.2 The disruption of the traditional tobacco market status quo (from 2009/10)

In the period leading up to 2009/10, non-MTC tobacco companies and prospective new market entrants became increasingly aware of the margin opportunities that BATSA had enjoyed for decades and they wanted a share of the lucrative tobacco market. In 2009/10, DTCs began penetrating the tobacco market with relatively affordable cigarette brands, increasing competition and thus threatening the market shares of more expensive and well-established BATSA-owned cigarette brands. As a result, since 2010, the net-of-tax price of cigarettes (Figure 1) began to decrease, reducing BATSA's profit margins. The entry of DTCs in 2010 also coincided with the upward spike in the illicit tobacco trade (van Walbeek, 2015).

The spike in the illicit tobacco trade implied either under- or non-payment of the relevant tobacco taxes (van Loggerenberg & Lackay, 2016). Under- or non-payment of taxes meant that illicit cigarette brands could be sold at much lower price points than BATSA-owned cigarette brands. Cheaper licit cigarette brands could also be sold at lower price points than BATSA-owned cigarette brands. Thus, cheaper illicit and licit cigarette brands were more affordable options for price-sensitive smokers (Mukong & Tingum, 2018). Smokers responded by shifting away from higher-priced to lower-priced cigarette brands. Consequently, the shift towards cheaper cigarette brands negatively affected the profit margins of BATSA-owned cigarette brands. BATSA's profit margins, which had been increasing for almost two decades, reached a tipping point.

Cigarette price volatility as a result of an upswing in the illicit tobacco trade and an increase in DTCs since 2010 led to a decrease in the real net-of-tax price of cigarettes of MTC-owned brands (Figure 1). This disrupted the traditional tobacco industry status quo and threatened the established MTC power dynamics. As of 2009/10, BATSA could no longer sustain their market dominance. The entry of new competitors was major threat to their market share and profit margins.

Consistent with tactics previously adopted by MTCs globally in response to threats to their interests, TISA, on behalf of BATSA, embarked on a number of national advertising campaigns (van Walbeek & Shai, 2015). The campaign included billboards (as cited by van Walbeek & Shai, 2015) with "an angry young man, peering through the sights of a gun, with the caption:

Warning: The money you spend on illegal cigarettes, he uses to buy guns". The campaigns promoted the narrative that the illicit tobacco trade, in 2010, was spiralling out of control and leading to a proliferation of organised crime (van Walbeek & Shai, 2015). The aim of the campaign presumably, was to dissuade the National Treasury from raising the excise tax on cigarettes and to lobby the government to take action against organised crime. The claims, however, were disputed by members of the public through the Advertising Standards Authority (ASA); upon the ASA's instruction, BATSA withdrew their campaign (van Walbeek & Shai, 2015). This was not the first time, however, that TISA had used the media to promote a similar narrative.

In 2006, despite the lack of evidence of an illicit tobacco trade, TISA, via the media, began to present the same argument (Blecher, 2010, van Walbeek, 2014, van Walbeek & Shai, 2015). TISA-driven illicit tobacco trade narratives, in 2010, thus represented a recycling of previously-used media narratives, the difference being that in 2010 there was an actual increase in illicit trade. This upward spike in illicit trade was subsequently confirmed by independent, academic tobacco-control experts, from the University of Cape Town (van Walbeek & Shai, 2015).

It is likely that the threat of the entry of DTCs into the market in 2010, coupled with their cheaper cigarette brands, severely threatened BATSA's market share and the security of their near monopoly status. In order to protect their market share, BATSA used the media to promote the narrative that the illicit tobacco trade was associated with organised crime, which threatened the safety of the country's citizens. This scaremongering was used by TISA/BATSA to lobby the government to take decisive steps against organized crime, but, more importantly, to curb competition within the industry. van Walbeek & Shai (2015) illustrate how between 2006 and 2011, TISA misrepresented the size of the illicit tobacco market by adjusting previous estimates downwards in order to create the impression that illicit trade was spiralling out of control. This was all done on public platforms, including in the media, which has thus become an important tool for the tobacco industry's self-serving promotion of their interests.

A former MTC employee indicated that BATSA had the economic resources to eradicate the illicit tobacco trade had they wanted to, but that retaining barriers to market entry was more important to their interests. Historically, BATSA made a strategic choice to condone moderate levels of illicit tobacco trading as moderate levels helped BATSA to deter the entry of new competitors. BATSA believed that prospective competitors were likely to sell their cigarette brands at prices lower than BATSA-owned cigarette brands in order to gain traction in the industry. New entrants would therefore have to compete against DTC-owned cheap cigarette brands. However, within the cheap cigarette market, there was a large proportion of illicit cigarette which were being sold far below the amount of the combined excise tax and VAT and were therefore more affordable. Illicit cigarettes made it very difficult for licit cheap cigarettes brands owned by new market entrants to compete. New market entrants would not be able to compete effectively against cheap *illicit* cigarette brands and would therefore be automatically kept out of the market. Thus, moderate levels of illicit tobacco trade aided BATSA in deterring the entry of new competitors.

In 2009/10, however, the rise in illicit cigarettes exceeded the *tolerated levels* that BATSA had previously condoned. Companies trading in illicit tobacco, which BATSA openly accused in the media as being synonymous with DTCs, posed a severe threat to BATSA's market share. The illicit tobacco trade shifted from being regarded as a minor inconvenience, that indirectly supported BATSA's interests, to being a major threat, in direct conflict with BATSA's interests.

4.2.1 Industry transformation and the role of informal markets

Interviews with DTCs offered an alternative perspective regarding the entry of new participants to the South African tobacco market. All six DTC interviewees shared a narrative that advocated the *transformation* of the South African tobacco industry to *level the playing field* for market participants. *Levelling the playing field* alluded to equal opportunities being granted to all market participants, by the abolition of the anticompetitive business practices that had been imposed by BATSA. Anticompetitive business practices included deliberate efforts at imposing and maintaining barriers to market entry and restricting DTCs' entry to formal retail channels.

The narrative revolved around the history of the tobacco industry, which interviewees claimed is deeply embedded in apartheid-era ideals and which is dominated by white monopoly capital. White monopoly capitalists, and BATSA in particular, are believed to have imposed barriers to market entry in order to maintain exclusivity and impede the entry of previously disadvantaged non-white market participants. They believe that white-owned capitalist multinationals continue to control lucrative sectors of the economy, while forcing DTCs to operate on the margins of tobacco trade.

Believing these things, DTCs use the theme of *transformation* as a slogan to justify forcefully growing their positions- and demarginalizing themselves within the tobacco market. The word *transformation* was often used as the politically correct term to express the sentiment that *'we will take control, with or without consent'*. The term is thus used as a form of rebellion against the traditional South African tobacco industry status quo and the established power dynamic. Further justification was found in the perception that pre- and post-apartheid governments have consistently favoured MTCs for various reasons, despite incidences of competitor spying and "state capture", turning a blind eye to any doubtful business practices (Pauw, 2017, van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016).

All six interviewees indicated very little confidence in the ability of the government to support DTCs in gaining a foothold in the tobacco market. This was captured in one of the comments made by a DTC interviewee: *"The tobacco industry, when it comes to multinationals, get full support from the government, SARS (South African Revenue Services) and the police. This is because they are all on the multinational's payroll. The smaller players and FITA (Fair-Trade Independent Association) on the other hand, get harassed by the police."* FITA is the industry representative body for domestic tobacco companies. According to Fair-Trade Independent Tobacco Association (2019), at the time of writing, their members included Afroberg Tobacco Manufacturing, Amalgamated Tobacco Manufacturing, Carnilinx, Folha Manufacturers, Gold Leaf Tobacco Corporation, Home of Cut Rag and Protobac. FITA's website reflects their views regarding the lack of government support for domestic tobacco companies: *"FITA was established in 2012 with a spirit to encourage smaller manufacturers in the tobacco industry in Southern Africa to collaborate in respect of industry, regulatory and legislative matters which are common to all and which, individually, there is little hope of making any significant*

difference. Small manufacturers in Southern Africa are not afforded the same opportunities, rights of appearance and opportunities to make industry representations as large industry players” (Fair-Trade Independent Tobacco Association, 2019).

For these reasons, in their attempt to penetrate the tobacco market, and in the face of a perceived lack of government support, DTCs embarked on a radical socio-economic transformation of the tobacco industry. The transformation was governed by their own set of rules, which permitted an ideological tax revolt leading to tobacco tax evasion and the sale of illicit cigarettes (van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016). Tobacco tax evasion enabled DTCs to sell illicit cigarettes at relatively cheap price points, making cigarettes more affordable to smokers and enabling their market share to grow (van der Zee, van Walbeek & Magadla, forthcoming 2019). All of this was justified under the slogan of *transformation*. According to one DTC interviewee: *“The illicit tobacco market was a way for new entrants to introduce their brands. A lot of the players were engaging in illicit trade. Some are not as active now and some of them were previous employees of multinational companies, engaging in rogue and lawful operations simultaneously.”*

According to all six DTC interviewees, BATSA continues to capitalise on their history in the South African tobacco market, which has allowed them to form, over decades, strong relationships with formal retailers. Established relationships with retailers, coupled with their strong portfolio of heritage cigarette brands, gave them a competitive advantage in the market. They abused this advantage by persistently dictating retail shelf management practices to formal retailers; that is, they dictated where their own brands and competitor brands should be positioned on retail shelves.

DTCs argue that their brands, if allowed to be sold in formal retail channels at all, are often placed under the shelf and out of the consumer’s line of sight, whereas BATSA brands are placed on optimal shelf spaces, giving their brands an unfair competitive advantage. The movement of DTC brands to below countertops significantly reduces the sales of such brands, and therefore DTC brands could not compete effectively in formal retail channels. Since trade in formal retail channels was not feasible, the only option was to trade through informal markets.

Three of the DTC interviewees indicated that BATSA solidifies their shelf positions by providing an assortment of incentives to retailers, particularly financial incentives with which DTCs cannot compete. DTCs were not the only tobacco industry participants who criticised BATSA's anticompetitive business practices. According to the Competition Tribunal (2009), in 2009, the multinational tobacco company, JTI and the South African Competition Commission complained to the Competition Tribunal alleging BATSA's abuse of dominance and anticompetitive business practices in formal retail stores. The case was, however, dismissed by the Tribunal.

According to all six DTC interviewees, anticompetitive market entry practices, imposed by BATSA, forced new entrants to penetrate the tobacco market through more novel channels, such as South Africa's abundant informal markets. The unregulated nature of the informal markets created the conditions for illicit product sales to flourish. Weak law enforcement capacities and resources in informal markets led to informal markets becoming places where the illicit tobacco trade could thrive.

Two DTC interviewees indicated that prior to becoming cigarette manufacturers, they had been traders of an assortment of other goods in the informal market; clothing was mentioned specifically. Thus, over the years, they developed extensive business expertise trading within the informal market. It was during this time that they became aware of the attractive margin opportunities available in trading in illicit cigarettes. They therefore, amongst other things, began selling smuggled cigarettes.

Their business prowess gave them a deep understanding of the functioning of informal markets and how to exploit opportunities within the market, initially as traders and later as manufacturers of cigarettes, in the latter case supplying both licit and illicit cigarettes to the informal market. A deep knowledge of informal markets, rebellion against anticompetitive business practices, weak law enforcement capacity in the informal markets, a tax revolt in the name of transformation, and the desire to maximise profits in the shortest possible time, all played a significant role in driving DTCs' engagement in the illicit tobacco trade.

One DTC interviewee, while agreeing with the theme of transformation, also provided a moral justification for engagement in the illicit tobacco trade. This revolved around the

interpretation of religious law in relation to “fairness” in terms of his obligation to pay excise duties. According to the interviewee’s interpretation, religious law supersedes secular law and in instances where a secular law is deemed unjust or unfair, it does not have to be followed. He believed that tobacco excise taxes in South Africa were too high and unfairly imposed on DTCs. Despite indicating that the excise tax was too high, the interviewee could not specify what excise rate would be considered fair. His interpretation of religious law and his perception of the excise tax as unfair led him to conclude that he is therefore under no obligation to pay the excise tax. He believes that he is morally justified in evading tobacco tax. This interviewee, however, made a clear distinction between excise duty and VAT, the latter of which he perceived as fair. Since the rate of VAT is deemed to fair, he therefore has religious obligation to obey the secular law and pay VAT to the relevant tax authorities.

4.2.2 Methods to transform the tobacco industry: DTCs’ perspective

DTCs’ emphasis on the need for the transformation of the tobacco industry was also coupled with suggestions on how government could show their commitment to the inclusion of DTCs. All of the suggested methods involved the dilution of BATSA’s market share. None of the DTCs mentioned PMI or JTI. The methods specified by two of the DTCs included implementing a quota system, the nationalisation of the tobacco industry, and a rebate system. The justification for the implementation of a quota system was that it would ensure that the total tobacco market share would be split evenly amongst the tobacco companies, thus transforming the traditional tobacco market which is still biased towards BATSA. The South African fishing industry was cited as an example of the efficient use of a quota system, but this was not elaborated on.

Both interviewees referred to Egypt as an example of why nationalisation of the tobacco industry is an appropriate method for transformation. They claimed that nationalisation of the tobacco industry would require industry participants to tender for the supply of tobacco, at a specific price per case, decided upon by the government. One of the two DTC interviewees specified that only DTCs should be included in the tendering process and acknowledged that MTCs were unlikely to be receptive to this method, as they have the most to lose and because transformation of the market is in conflict with their vested interests.

The rebate system was the preferred method by most of the interviewees, who argued that the government should provide a rebate to DTCs, allowing these players to pay reduced excise taxes. The perceived rationale behind the system is that lower excise taxes will allow DTC-owned cigarette brands to be priced lower than MTC-owned cigarette brands. The lower duty would enable DTCs to increase their tobacco market share by selling legal cigarettes at a cheaper price, while moderating BATSA's market share. Interviewees were of the opinion that this method would transform the existing tobacco market structure.

They also believed that the implementation of a rebate system creates an incentive for DTCs to declare cigarette production levels more accurately. DTC interviewees claimed that the rebate system automatically forces non-compliant DTCs to become compliant, ridding the tobacco industry of illicit tobacco since the rebate system would result in a multi-tiered tobacco tax structure where DTCs pay lower excise taxes than MTCs. DTCs can therefore legally sell their cigarette brands at lower prices and automatically minimise their supply of illicit cigarettes. The justification for the implementation of the rebate system was summed up by one DTC interviewee, who said: *"we believe that a rebate system should be implemented to allow the local manufacturers to pay a smaller duty on the products so as to gain market share and then the local manufacturers can legitimately sell their products cheaper and gain market share."*

DTCs preference for the rebate system is consistent with the self-serving nature of the tobacco industry and their attempts to influence government decision-making on tobacco-control measures. DTC interests, in this instance are concerned with ensuring that DTCs maximise their revenues by paying the lowest possible amount of excise tax with no restrictions on production levels. Their perception of a rebate system includes higher excise taxes being paid by MTCs. The rebate system, which in essence is a reduction in excise taxes for DTCs, would logically result in cigarettes being sold at lower price points, making them affordable to a wider market. Since consumer demand for cigarettes responds to changes in prices, when cigarettes become more expensive, consumers tend to respond by downtrading to cheaper alternatives (Mukong & Tingum, 2018). Lower excise taxes on cigarettes positively impact cigarette consumption, undermine tobacco-control measures and negatively impact

public health (van Walbeek, 2010). The design of a country's tobacco tax structure, therefore, is particularly important for effective tobacco control and public health outcomes.

The design of Indonesia's tobacco tax structure shows the negative consequences of implementing ineffective excise tax systems and their associated impact on tobacco-control measures. Indonesia adopted a multi-tiered tobacco tax structure, based on production scales, where cigarette manufacturers who produced lower volumes of cigarettes paid lower excise taxes (Barber & Ahsan, 2009). The multi-tiered tobacco tax structure was intended to protect small-scale producers (Rong *et al.*, 2018). What resulted was that cigarettes were sold at a wide range of price points, giving consumers a range of prices to choose from. Accordingly, consumers responded by downtrading to cheaper cigarettes, and thus cigarettes became more affordable (Rong *et al.*, 2018). The structure also resulted in the legitimisation of tax evasion on the highest excise tax brackets, since manufacturers responded by adjusting their production levels downwards in order to take advantage of the lower excise rates; consequently, cigarette prices decreased and profit margins increased (Barber & Ahsan, 2009).

The methods suggested by DTC interviewees reveal the tobacco industry's attempts to influence state decision-making on tobacco tax structures, for their own self-preservation, while discounting public health consequences. One of the two DTC interviewees, who suggested the above-mentioned methods, indicated that transformation was necessary to shift market dominance away from BATSA to a specific DTC. The suggested methods must therefore be viewed with caution in that it is not transformation for the upliftment of *all* previously disadvantaged group-owned companies who were previously denied market entry that is sought, but rather a shifting of power dynamics. The aim is to establish a new kingpin within the South African tobacco industry.

Despite DTCs' arguments regarding the lack of government effort on transformation, all DTCs indicated support for the Draft Control of Tobacco Products and Electronic Delivery Systems Bill, 2018, which was opened for public comment on 9 May 2018. The key areas of the Bill that won the favour of DTCs were related to "*standardisation of packaging.*" DTCs were in favour of plain packaging and the removal of branding and logos since it ensures uniformity

of all brands. The unanimous agreement amongst DTCs is that, for the first time, there will be fair competition on retail shelves, thus *levelling the playing field* in terms of brand competition. They believe that, if plain/standardised packaging is introduced, BATSA will no longer be able to use anticompetitive business practices in the form of retail shelf management control. Standardisation is therefore perceived by DTCs as evidence of government's commitment to transform the tobacco market.

4.3 Suspicions of industry complicity in illicit tobacco trade (from 2012 to 2014)

The entry of DTCs to the market, followed by the rise in the illicit tobacco trade in 2010, raised suspicions at South African Revenue Services (SARS) regarding tobacco industry business practices (van Loggerenberg & Lackay, 2016). Further probing into the matter resulted in a letter being sent to tobacco industry representative bodies (TISA and FITA) in 2012, regarding SARS' suspicions of tax and customs non-compliance activities by fifteen domestic and multinational tobacco companies (van Loggerenberg & Lackay, 2016). The letter, which was sent by the Group Executive of Projects, Evidence, Management and Technical Support of SARS at the time, Johann van Loggerenberg, warned of tobacco industry participation in tax evasion, smuggling, concealed international transactions, uncompetitive business practises, exploitation of law enforcement agencies, spying, information peddling, and undue access to and influence over state institutions (van Loggerenberg, 2014, van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016).

Around 2013, while SARS was investigating the tobacco industry, the MTCs, and BAT plc (British American Tobacco's London-based headquarters) in particular, sought insider information of the business activities of DTCs. Much of their need for such information was based on BATSA's suspicion of DTCs' complicity in the illicit tobacco trade and the associated negative impact on their market share. In order to attain such information, they infiltrated state agencies, via the National Intelligence Authority (later renamed State Security Agency), which established the Fair-Trade Independent Tobacco Association (FITA) around June 2012 (Walter, 2015). At the time, FITA was established under the guise of being the industry representative body for DTCs. The shroud of secrecy regarding FITA's establishment was subsequently exposed in the media, that is, that it was created in order to *spy* on DTCs (Pauw, 2017, van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016, Walter, 2015).

FITA was set up by Attorney Belinda Walters, under instructions from the State Security Agency (SSA), with the objective of spying on DTCs (Walter, 2015). In her affidavit, she stated that she was tasked with spying on DTCs and shared the information with the Anti-Illicit Tobacco Task Team, which was composed of the National Prosecuting Authority (NPA), SSA, the Directorate for Priority Crime Investigation (Hawks), and Police Crime Intelligence; the

Team excluded SARS (Walter, 2015). The Anti-Illicit Tobacco Task Team had close ties with Forensic Security Services (FSS), which was funded by TISA/BATSA.

According to Walter (2015), *“FSS is renowned in the tobacco industry as the security arm or contractors acting under instruction and mandate of TISA and/or its members, particularly British American Tobacco (BATSA). It is unknown whether FSS is a registered security service provider or what the exact contractual arrangements between FSS and TISA are. It is, however, known that the business’ operations are very lucrative and tens of millions of Rands are paid to the business each year for its services in the tobacco industry.”* TISA/BATSA were thus paying FSS for private investigative purposes, which included infiltrating state investigations in order to gain insider information on DTCs.

Media exposés of BAT’s participation in *“industry espionage”* increased rapidly (Pauw, 2017, van Loggerenberg & Lackay, 2016). What surfaced was a network of agents whom BAT paid through obscure payment systems using Travelex cards; they declared payment transactions incorrectly so as to mask their spying activities (Pauw, 2017, van Loggerenberg, 2014, van Loggerenberg & Lackay, 2016). This was confirmed in an affidavit by Walters, who was a recipient of such payments. Walters was paid to spy on DTCs and acted as a conduit for BATSA state infiltration (Walter, 2015). Walters’ affidavit also included statements regarding her triple role as informant for the SSA and BAT plc and the attorney for the DTC, Carnilinx. She said that she was introduced to BAT plc through the SSA (Walter, 2015). Aside from holding multiple positions, she also infiltrated SARS by embarking on an intimate relationship with Johann van Loggerenberg. During their relationship, she also confessed to van Loggerenberg that she was an informant for BAT plc, SSA, and the Tobacco Task Team (Pauw, 2017, van Loggerenberg, 2014, van Loggerenberg & Lackay, 2016). By the end of 2013, Walters stepped down from her position as chairperson of FITA.

BAT’s payments in the form of international Travelex cards eventually raised suspicions at SARS. SARS also became increasingly suspicious of TISA/BATSA state and industry interference and their abuse of the Anti- Illicit Tobacco Task Team which was aiding anticompetitive business practices by disclosing competitor business practices to BATSA. In 2014, SARS raised their growing concerns and suspicions with the NPA and specifically mentioned tobacco

industry interference by BAT, TISA, and the FSS (van Loggerenberg & Lackay, 2016). Despite evidence of industrial espionage, including 12 000 online documents available via Twitter regarding unlawful conduct by BATSA, both TISA and BATSA denied any association with spying and the use of fraudulent payment systems.

The findings of law enforcement agencies' investigations into the business activities of both DTCs and MTCs, coupled with the allegations of industrial espionage by TISA/BATSA, highlight two important points:

- the tobacco industry as a whole was complicit in some form of tobacco tax avoidance, and in some cases tax evasion;
- new competitors were posing a severe threat to BATSA's interests.

The infiltration of state institutions by BATSA/TISA indicates the extent to which BATSA would go to maintain the traditional tobacco industry power dynamics and protect their interests.

4.4 The unravelling of the multi-layered tobacco industry (from 2014)

In early 2014, Walters disclosed to FITA member, Carnilinx, and SARS that she was juggling multiple conflicting roles simultaneously (Walter, 2015). In the same year Walters and van Loggerenberg's romantic relationship ended. This led to the unravelling of the multi-layered tobacco industry, disrupting the stability of SARS and exposing state capture by the industry. The unravelling was set off when Walters made allegations against van Loggerenberg of impropriety at SARS, including, amongst other things, the illegal monitoring and interception of political figures in the country (Pauw, 2017, van Loggerenberg, 2014, van Loggerenberg & Lackay, 2016). She accused van Loggerenberg of leading a rogue unit within SARS who were spying on politicians and disclosing taxpayer information, thus breaching taxpayer confidentiality (van Loggerenberg, 2014, van Loggerenberg, 2018). What followed was a heavily-publicised 'SARS rogue unit' campaign. Walters' accusations regarding the rogue unit were refuted and dismissed in the state commission of inquiry into SARS, however the accusations reshaped important state institutions in the country (van Loggerenberg, 2018).

Walters' accusations prompted the Acting Commissioner of SARS at the time, Ivan Pillay, to establish an external panel, referred to as the Kanyane Panel, to examine the accusations. Despite the Kanyane Panel finding that no breach of law had occurred, a second panel, the Sikhakhane Panel, was initiated to investigate the matter further. One of the report's findings stated: *"While SARS remains an efficient and effective organisation, the unlawful establishment of a unit operated ostensibly in a covert manner, has created a climate of intrigue, fear and subterfuge within the organisation"* (Sikhakhane, 2014). Against this backdrop, President Jacob Zuma appointed Tom Moyane as the new SARS commissioner in 2014. Moyane, upon receiving the Sikhakhane reports findings, suspended Ivan Pillay.

This was followed by the disbanding of the SARS executive committee and special investigative units (project Honey Badger), leading to an exodus of senior managers, the very people who built the once world-class and globally respected tax administration and collection agency (van Loggerenberg & Lackay, 2016). In the 2018 Nugent Commission of Inquiry into Tax Administration and Governance at SARS, Judge Frank Kroon: *"reported to the Minister, and issued a media statement, saying the unit was unlawful, but in evidence he told*

the Commission that was not a conclusion reached independently by the Board, but had been adopted from the Sikhakhane panel, and he had come to realise it was wrong. Indeed, he supported the re-establishment of capacity to investigate the illicit trades, which we recommend” (Nugent, 2018). Ultimately however, Moyane’s decisions resulted in the crippling of the agency by severely weakening the ability of SARS to act as tax administrators, as law enforcers in terms of tax collection, and as investigators of complex tax crimes, thus leaving the country vulnerable to exploitation (van Loggerenberg & Lackay, 2016).

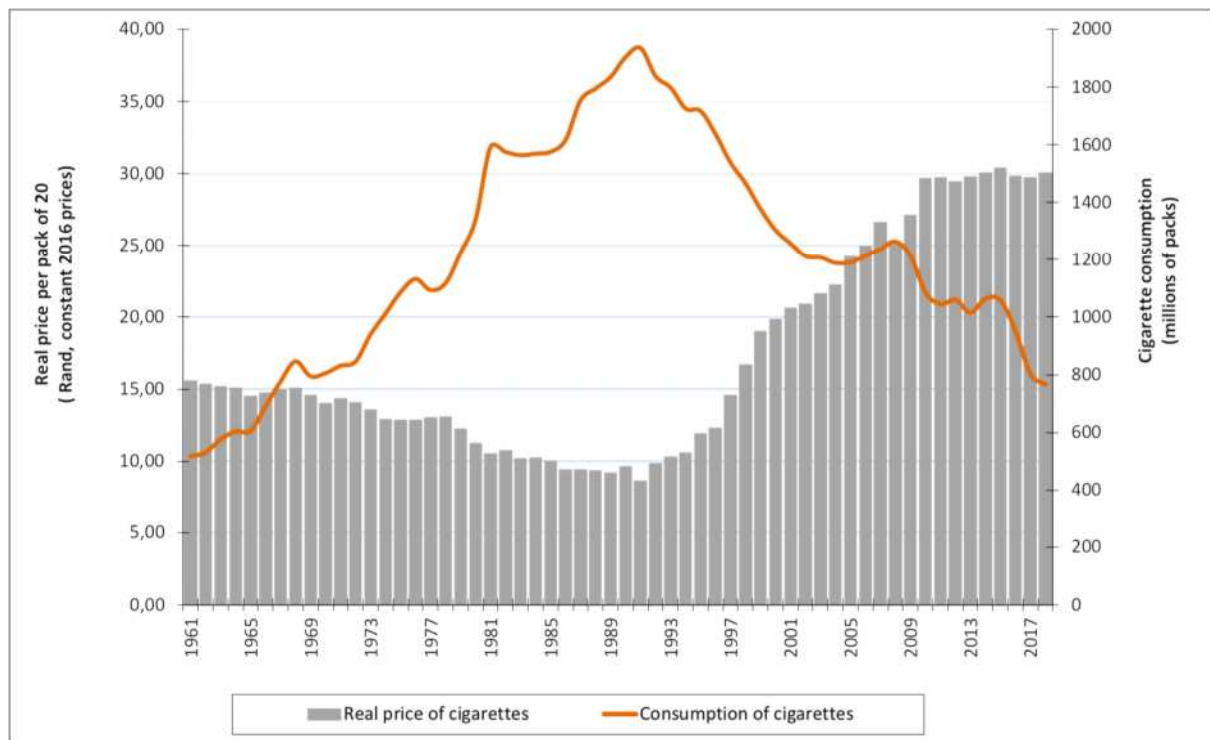
Previous SARS investigations of tobacco-industry related tax evasion, during Project Honey Badger, had exposed the tobacco industry’s evasive tax practices and the multi-layered tobacco industry which was engaging in parallel licit and illicit tobacco trade. One of the findings of Project Honey Badger was under-declared production by tobacco manufacturers, prompting SARS to raid the manufacturing premises of suspected perpetrators. Amalgamated Tobacco Manufacturing (ATM) was one of the offenders.

Until 2011, Edward Zuma, the son of the then-President of South Africa, was one of ATM’s directors. This prompted further questions in the media regarding tobacco industry complicity in the illicit tobacco trade and the participation of influential political affiliates and “state capture” in relation to the illicit tobacco economy (Pauw, 2017). Because of the raids, illicit tobacco traders became concerned about SARS’s commitment to tackling illicit tobacco trade. This prompted some of the tax-evading DTCs to disclose their tax-evasive practices to SARS. Domestic tobacco companies, Carnilinx and ATM were among the offenders that “came clean” with SARS.

4.5 Under-declared production and its impact on excise revenue (from 2015)

By 2015 the negative consequences of illicit tobacco activity began to be evident in the South African economy. From that year, the National Treasury began witnessing declines in tobacco-related excise revenue. According to the *Budget Review*, between 2016 and 2018 the number of tax-declared cigarettes decreased by approximately 20%. According to interviews with tobacco-control experts, the decrease in cigarette consumption within the country could not be explained by dramatic decreases in smoking patterns (Figure 2).

Figure 2: Cigarette real prices and official consumption



Source: The Economics of Tobacco Control Project (ETCP) calculations, derived from various issues of the National Treasury Budget Review (1980-2018). Real excise revenue is displayed in millions of Rands, with 2016 as the base year. Consumption is in millions of 20-packs.

Figure 2 is a historical representation of how South Africa applied excise taxes as a means of reducing cigarette consumption. Official cigarette consumption (tax-paid consumption) is represented on the secondary Y-axis (orange line) while the primary Y-axis represents the price of cigarettes in real terms. Over a period of about three decades, starting from the 1960s, the price of cigarettes declined in real terms as the price of cigarettes increased by less

than the inflation rate. Cigarettes became more affordable, which coincided with a very strong increase in cigarette consumption. By the mid-1990s, cigarette prices started increasing very sharply and from about 2010, they have remained relatively constant. Until 2000, excise taxes had a positive impact on reducing cigarette consumption; consumption was going down and real cigarette prices were increasing. From 2005, consumption patterns began to change, despite the price of cigarettes staying relatively constant, consumption began declining. The illicit tobacco trade was not a major concern in South Africa until 2009/10.

Since 2009/10, there has been a substantial decrease in the consumption of tax-paid cigarettes, with SARS collecting less money in cigarette taxes. Sharp declines in 2009/10 occurred in conjunction with a global recession and upswings in the illicit tobacco trade (van Walbeek & Shai, 2015). The even more drastic decline in tax-paid consumption since 2015 suggested another upswing in illicit tobacco trade. This discovery began to raise serious questions regarding the state of the illicit tobacco trade in South Africa.

Non-DTC interviewees generally agreed that the sudden downward move in tax-declared cigarette consumption was the result of an upward spike in the illicit tobacco trade. DTC interviewees, however, offered alternate explanations for the sudden decline in tax-declared cigarettes, including the growth in popularity of electronic delivery systems and a decrease in smoking prevalence because of the country's shift towards healthier lifestyles. One DTC interviewee was of the opinion that both licit and illicit cigarette consumption was increasing in recent years, with smokers shifting to more affordable cigarette brands. When questioned further, none of the interviewees could support these arguments by any evidence.

From 2015, there was a distinct shift in the tobacco-trading environment, in that the *modus operandi* of the illicit tobacco trade shifted from smuggling to under-declaring cigarette production. According to the former Chief Director in the Economic and Tax Analysis Unit at National Treasury, upward spikes in the illicit tobacco trade were the result of problems with SARS' ability to enforce the law. He indicated that the substantial slowdown in tobacco-related excise revenue between 2014 and 2016, and the sharp decline in revenue from 2016

to 2018, was attributable to smuggling and the rise of under-declared production (van Wyk, 2019).

The vast majority of non-DTC interviewees were of the opinion that the appointment of Tom Moyane as SARS commissioner in 2014, followed by his instruction to put an end to the SARS investigative units, allowed the illicit trade to flourish. They believe that inadequate levels of experienced personnel at SARS and the overall weakening of SARS' law enforcement capacity resulted in a *free for all* attitude in which illicit tobacco traders could thrive.

The destabilisation of SARS' law enforcement role was exacerbated in 2015 by the dismantling, on instructions from Moyane, of important institutions, including the Large Business Centre (Joffe, 2018). The Large Business Centre was a specialised unit responsible for, amongst other things, the investigation of tax evasion and illicit cash flows, as well as the analysis of the complex financial structures of large corporations (Joffe, 2018, SARS, 2018). DTC interviewees did not agree with the opinion that Moyane played a role in creating the conditions which allowed the *modus operandi* of the illicit tobacco trade to shift.

4.5.1 DTCs: internal shifts in power dynamics

One respondent from a DTC acknowledged that there had been a change from smuggling, which was dominant prior to 2014, to under-declared cigarette production, which was dominant from 2014 onward. The interviewee indicated that all DTCs were under-declaring production from 2015. He confirmed his company's involvement in both smuggling and under-declared production during the periods in which each was more prevalent. The interviewee did not comment on why the shift occurred and did not believe that the change in leadership at SARS played a role.

Interviewee justification for the shift in *modus operandi* revolved around a disruption of the agreed-upon power dynamics amongst DTCs. It alluded to a breach of agreement between DTCs, which involved maintaining a form of quota system whereby each DTC would supply a specific quantity of illicit cigarettes to the market. Abiding by the agreement ensured that all DTCs were profiting from the lucrative gains associated with the illicit tobacco trade while maintaining a certain power balance amongst DTCs.

The DTC interviewee explained that, as of 2014, the disparities in price amongst cheap cigarette brands was widening as a result of certain DTCs reducing the price of their cigarette brands in an effort to attain the highest profits in the shortest time. This resulted in the market share amongst DTCs shifting towards lower-priced cigarette brands, and thus other DTC brands at higher price points were losing market share to the lower-priced brands. The impromptu change in pricing by some DTCs breached the agreement that existed between DTCs, by which each DTC agreed to maintain certain price points. This disrupted the power dynamics of the DTCs, leading to a price war between DTCs and the flooding of the market with illicit cigarettes.

In response to the breach of agreement, one DTC interviewee adjusted his business strategy so as to recoup his company's market share through sales in both the formal and informal market. The strategy included the launching of a new cigarette brand in 2015, the purpose of which was to flood the informal market with large volumes of undeclared cigarettes, via informal retailers. The brand was positioned at a price point that was lower than all other cheap cigarette brands. The DTC took advantage of their well-established distribution networks in the informal market to ensure that the under-declared cigarette brand deeply penetrated the market. Declared production of the brand was distributed to formal retailers, where it was priced at a price point higher than other cheap cigarette brands but substantially lower than international cigarette brands.

By penetrating the formal market with the new brand, the DTC began to gain market share from international cigarette brands. The DTC was selling declared and undeclared cigarettes to formal and informal markets, respectively, and thus gaining share from both markets. The interviewee claimed that this was the primary reason for the upward spike observed in the illicit tobacco trade since 2015. What the above explanation indicates is the extent to which DTCs will go to protect their stakes and to maintain a predetermined power dynamic amongst themselves. Despite the DTCs' narrative of transformation as a means of shifting the power dynamic away from the traditionally established multinational tobacco players, a parallel power structure also exists amongst DTCs.

In an attempt to establish a stronghold within the South African tobacco market, DTCs, like BATSA before them, began to infiltrate state institutions, mainly through funding controversial South African political figures. Carnilinx is one of the domestic players that has been revealed to have funded political figures. The co-director of Carnilinx, Karl Phillips, gave Julius Malema R1 million to settle his outstanding tax bill with SARS. In 2014, the alleged criminal and tobacco-tax evader, and also a co-director of Carnilinx, Adriano Mazzoti, paid R200 000 for the registration of Julius Malema's political party, the Economic Freedom Fighters (Pauw, 2018). Julius Malema at the time was trying to establish a political party to contest the 2014 presidential elections. Mazzoti enabled him to realise his ambition. Mazzoti, however, seems to have no political party affiliation per se and would appear to mix with influential political figures in the hope of influencing state decision-making to favour his business. In 2017, photographs appeared in the media of Mazzoti, his business partner, Mohammadh Sayed, and a leading political party presidential candidate, Nkosazana Dlamini-Zuma. Mazzoti is believed to be one of the funders of Dlamini-Zuma's 2017 presidential campaign.

Another DTC, and an alleged tobacco-tax evader, who also infiltrated state institutions in the interests of his business, is Yusuf Kajee, owner of Amalgamated Tobacco Manufacturing (ATM). According to van Loggerenberg & Lackay (2016), Kajee influenced state decision-making through his business partner and the ex-president's son, Edward Zuma, who facilitated the securing of Kajee's cigarette production license. According to Pauw (2017), Kajee also made indirect payments to fund the upgrade of ex-president Jacob Zuma's controversial Nkandla homestead.

4.6 MTCs recent tactics

Since 2015, undeclared cigarette production by DTCs was seriously affecting BATSA's market share and profit margins, and BATSA was struggling to maintain control of the South African tobacco market. By 2018, BATSA's interests were severely threatened by proposed legislative changes and the loss of market share to rising competition. In response to these threats, BATSA/TISA sharpened their defence tactics.

4.6.1 Threats posed by government

With the aim of changing the Tobacco Control Products Act of 1993, the Department of Health published the Draft Control of Tobacco Products and Electronic Delivery Systems Bill, 2018, for public comment. The Bill included, amongst other things, the standardisation of packaging. In response, TISA publicly opposed the Bill, indicating that the government should reassess their priorities by addressing the illicit tobacco trade rather than imposing stricter tobacco control measures. In line with globally-observed MTC tactics, TISA persistently argued that stricter tobacco control measures would only further stimulate the illicit tobacco trade (Rowell, Evans-Reeves & Gilmore, 2014). The chairman of TISA, Francois van der Merwe, stated that *"we predict strong opposition from small business to the bill's restrictions on point-of-sale advertising"* (Kahn, 2018b).

What followed in the media was a public denouncement by trade unions and representative bodies of the new Bill, some of whom embarked on protest action in opposition to the Bill (Mahlokwane, 2018). The Food and Allied Workers Union (FAWU) whose *"aim is to organise all workers in the food industry (including the primary and secondary agricultural sectors) in South Africa into one union"*, and whose members include BATSA, responded negatively to the Bill. Their strong opposition to the Bill included arguments related to the perceived negative consequences of the Bill on microbusinesses whose livelihood they claim, is reliant on cigarettes sales. They also stated that the Bill will further stimulate the illicit tobacco trade, which would threaten the job security of the most vulnerable socio-economic groups. These groups rely heavily on the *legal* tobacco industry for employment.

Their narratives coincided with narratives promulgated by TISA/BATSA, that is, narratives related to *stimulation of the illicit tobacco trade and job loss*. Another opponent of the Bill was the South African Informal Traders Alliance (SAITA), who represent informal traders, street vendors, and microbusinesses. Their rejection of the Bill mimicked those of FAWU and TISA/BATSA. BATSA, amongst others, has made financial contributions to their Alliance. Other groups who also denounced the Bill included AgriSA, SA Spaza and Tuckshop Association (SASTA), and eKasi Entrepreneurship Movement (Kahn, 2018a).

The opposition to the Draft Bill is by no means the first time that MTCs have lobbied the government against the strengthening of tax- and non-tax related tobacco-control measures (Smith, Savell & Gilmore, 2013). Historically, BAT has argued that increases in excise taxes lead to increases in the illicit tobacco trade when in fact the illicit trade is directly linked to inflated retail prices, which, in South Africa, are set by BATSA (Ross & Vellios, 2015, Ross *et al.*, 2016a, Ross *et al.*, 2016b, The World Bank, 1999, van Walbeek & Shai, 2015). BATSA's opposition to increases in the excise tax is predominantly based on the argument that a rise in excise taxes increases the incentive to engage in the illicit tobacco trade and thus excise taxes fuel illicit trade.

In response to such claims, a representative of the National Treasury stated, *"I've got very little sympathy for that view, actually no sympathy for that view, to be honest."* What BATSA persistently fail to mention in their campaigns is that rising excise duties negatively impact cigarette profit margins and this is the primary reason why BATSA is opposed to increases in excise taxes. As indicated by one DTC interviewee, *"BATSA generate reports regarding illicit tobacco trade and one of the solutions that they advocate is always the reduction of or keeping the excise rate at a constant. This is only to serve their agenda of protecting their profit margins."*

BATSA have used the findings from privately commissioned research studies to oppose increases in excise taxes. According to research commissioned by BATSA, and conducted by economic consulting company, Econometrix: *"considering the high price elasticity for tobacco products, holding excise at current levels is the only way to prevent further erosion of the tax base, while enforcement measures are implemented to curb the illicit tobacco trade"* (Niselow,

2019). Econometrix also *“recommends a price freeze be implemented until the capacity of the South African Revenue Service is improved and law enforcement authorities clamp down on illicit cigarettes”* (Niselow, 2019).

4.6.2 Threats posed by competitors

By 2018, the shifting power dynamics within the tobacco industry prompted TISA/BATSA to embark on deliberate media campaigns to fight the competitors that most threatened their interests. TISA/BATSA were of the opinion that law enforcement authorities were simply not doing their job and they wanted to compel the government to act. One month after the Draft Control of Tobacco Products and Electronic Delivery Systems Bill was opened for public comment, TISA embarked on a national media campaign. The campaign was built on the findings of a TISA/BATSA funded study which measured the illicit tobacco trade in South Africa. TISA commissioned a private market research company, Ipsos, to conduct a study on the South African tobacco market. Wave 1 of the study occurred in June 2018, and wave 2 occurred in September 2018. The study’s findings centered around DTCs’ complicity in the supply of under-declared cigarettes and the associated loss to the fiscus.

The methodology included retail audits, in which data was collected from store-based records which were shared by store owners or employees (TISA, 2018b). In order to estimate the size of the retail universe, a retail census was first conducted, and a representative sample was selected and used for retail audit purposes. The audit occurred in non-organised shops, which the study defined as, *‘independent small and medium businesses, including spazas, general dealers, corner cafes and hawkers’*, excluding *“mobile hawkers, taverns and shebeens”*. Audits were conducted in 2058 outlets, at the middle and the end of the month. The information gathered included cigarette purchases by outlet, cigarette selling prices, cigarette manufacturers, cigarette brands, and sales format.

The report included a disclaimer that: *‘Figures and statistics referred to represent an industry view based on external research and publicly available market information. The definition of ‘illicit trade’ for purposes of this document includes any product sold to consumers below R17,85, and/or being non-compliant to the Tobacco Products Control Act, No 83 of 1993 (as amended). The various brands referred to herein are assumed to be manufactured and/or*

distributed by the corporate entities who publicly claim to do so. TISA accepts no responsibility or liability whatsoever with regard to the information or statistics quoted incorrectly or out of context from this presentation by any person.'

Wave 1 of the study's findings indicated that 33.4% of cigarettes sold in non-organised shops sold for less than the minimum tax owed (R17.85), that is, the combined amount of the excise tax and VAT. The report specified the names of DTCs and the cigarette brands (Chicago, RG, Savannah, Pacific, Caesar, Sharp, Carvela) which they claimed were selling for below the minimum tax owed and were thus indicative of illicit cigarettes (TISA, 2018b). Gold Leaf Tobacco Company was named as accounting for 75.1% of sales below the minimum tax owed.

The Ipsos report raised questions, principally because of its failure to disclose publicly the methodology. Ipsos responded that the proprietary nature of their information prevented them from sharing further information on public domains. Selective public disclosure of report findings and non-disclosure of the study's methodology and raw data made it impossible to evaluate and interrogate the study rigorously and raised questions regarding the study's intent and TISA/BATSA's commercial agenda (Gonzalez, Malan & van Dyk, 2018, Rowell, Evans-Reeves & Gilmore, 2014).

Various non-tobacco value-chain stakeholders, such as tobacco control/public health advocates and journalists, have raised questions in the media and in interviews regarding the secrecy surrounding the study's methodology and the overall credibility of the report (Gonzalez, Malan & van Dyk, 2018). One tobacco control/public health advocate stated that: *"Industry-funded research is a conflict of interest and the research cannot be credible. If a study's preliminary finding is not palatable to the client, then the client cuts out or manipulates the study's findings. Often information that reaches the public is used as a tool to restrict tobacco control measures and excise tax increases. Anyone who is conducting industry-funded research is compromised in their ability to conduct unbiased research. You cannot take money from the industry and give them results that they will not be happy with."*

The report excluded any mention of MTCs in relation to the illicit tobacco trade; it did however specify the contribution of MTCs to the South African economy in terms of government tax revenue, job creation, and exports. This is an important distinction that the

report used to separate TISA members from DTCs (FITA and non-FITA members). TISA/BATSA had previously reiterated this narrative on numerous occasions in the media, emphasising that they represent the *legal* tobacco industry and by default, all DTCs are part of the illicit tobacco industry. In taking this position, they absolve themselves of any industry complicity in the illicit tobacco trade and persistently portray themselves as the industry's *good guys*.

Taking the position of industry *good guys* is highly contentious. TISA/BATSA continue to deny their engagement in unlawful business practices while persistently arguing that DTCs need to be held accountable and that SARS is failing at doing its job in terms of eliminating the illicit tobacco trade. According to BAT plc's 2017 Annual Report, BATSA has a contingent liability of R2.01 billion, covering both tax and interest, if they are found guilty by SARS of manipulating their debt financing from 2006 to 2010.

Most non-MTC interviewees were of the opinion that BATSA, given their global history of avoiding and on occasion evading tobacco taxes (Collin *et al.*, 2004, Legresley *et al.*, 2008, Nakkash & Lee, 2008), is also engaging in the illicit tobacco trade, albeit at much more sophisticated levels. Despite SARS investigations that pointed to BATSA's participation in tax avoidance strategies such as transfer pricing⁷ and tax-base erosion, TISA/BATSA have avoided discussing the findings (van Loggerenberg, 2018, van Loggerenberg & Lackay, 2016).

The weakening of SARS' investigative functions since 2014, the demise of the Large Business Centre in 2015, and the failure of the criminal justice system to investigate SARS's findings further, resulted in a halt to investigation of MTCs' tax avoidance for possible tax evasion (Joffe, 2018). At present, and as indicated by one of the MTC interviewees, SARS is investigating BATSA's financial inconsistencies. According to a law enforcement interviewee, *"the South African tobacco industry has always played games regarding tax evasion/avoidance, the multinational tobacco manufacturers have played more sophisticated*

⁷ According to van Loggerenberg (2018), *"transfer pricing refers to rules and methods for pricing transactions within and between enterprises under common ownership. Because of the potential for cross-border transactions to distort taxable income, SARS can adjust intragroup transfer prices that differ from what would have been charged by unrelated enterprises dealing at arm's length."*

games.” According to one public health advocate interviewee: “We know that the multinational tobacco companies have been involved in tobacco tax evasion across the continent. There is no reason for us to believe that they are currently not involved in illicit tobacco trade. This is a competition between tobacco companies and they are trying to pin the blame on somebody else. They are basically trying to cut the competition.”

Despite the concerns raised about the Ipsos study, TISA used the study’s findings and embarked on a comprehensive public advertising campaign. The campaigns were used to trigger citizen lobbyist action against the illicit tobacco trade by citing the value of tax lost to the fiscus and the threat to the job security of employees in the *legal* tobacco industry. Citizens were provoked to lobby against tobacco-related government policies. TISA’s campaigns used slogans such as #TakeBackTheTax, which were displayed on below- and above-the-line advertising platforms. The #TakeBackTheTax campaign also included the paying of social media influencers to promote the campaign’s narrative, making it accessible to a wider audience (Gonzalez, Malan & van Dyk, 2018). The campaign also encouraged South African citizens to sign an online petition “imploing” SARS and Parliament to take “urgent” and “decisive” steps to combat the illicit tobacco trade.

The extensive use of media campaigns to reach wide audiences raises the question of whether or not TISA/BATSA are using less-traditional forms of advertising and marketing to circumvent the restrictions that were imposed on tobacco advertising in South Africa. Gilmore, AB & McKee, M (2004) show how, in order to circumvent tobacco advertising restrictions in the Soviet Union, BAT changed their marketing and advertising strategy and resorted to heavily promoting their corporate image through sponsorships, donations and emergency relief funds. This was done in order to portray a positive corporate image which was ultimately used to market their cigarette brands. Ever since restrictions on advertising were first imposed by the Tobacco Products Control Amendment Act, 1999, BATSA has embarked on a more targeted approach to advertising. It has also invested heavily in research in order to optimise their communication with the public (Sunday Times, 2010). This raises questions as to whether industry-commissioned research is a new way for BATSA to overcome advertising restrictions.

In response to the *minimum tax owed* being used as an indicator of an illicit tobacco product, two DTC interviewees indicated that a cigarette price set below the rate of the duty does not imply non-payment of the duty, neither does a cigarette price above the duty imply payment of the duty. Three DTC interviewees cited the loss-leader argument to explain why their cigarette brands were being sold below the minimum tax owed. From a marketing perspective, the loss-leader argument revolves around selling a product below the wholesale price in order to entice customers into a store, where it is expected that the customer will buy other, higher-priced goods. One DTC interviewee indicated that discounting cigarettes to below the minimum tax owed was a form of marketing, since tobacco legislation limited traditional forms of advertising. The vast majority of interviewees agreed with the argument that cigarettes that are priced above the minimum tax owed do not necessarily pay duty. One public health advocate indicated that TISA/BATSA's persistent suggestion of using minimum tax/price as an indicator of illicit tobacco products, is merely an example of the MTC's efforts to restrict excise tax increases.

Despite all the scepticism surrounding the credibility of the Ipsos report, one DTC interviewee agreed with the study's findings on under-declared production. The interviewee believed that BATSA was struggling to win back lost market share on their Peter Stuyvesant brand and therefore commissioned a study to discredit the DTCs that posed the biggest threat to the Peter Stuyvesant brand. The interviewee also related how he himself began engaging in under-declared cigarette production and how his brand played a role in taking market share from Peter Stuyvesant.

After being raided by SARS in early 2000, the interviewee reconsidered the way in which his business was distributing illicit cigarettes. He was prompted to clean up his financial records, so as to appear to be more tax-compliant. He revised his distribution system to include parallel distribution networks, one which distributes legal cigarettes through a team of sales representatives to formal markets, and the other which distributes under-declared illicit cigarettes to informal markets via third-party agents. Immigrants participating in informal markets were cited as key participants in terms of illicit cigarettes reaching the end consumer. Before the commencement of any given tax year, the manufacturer decides what amount of tax he would like to pay to SARS. He thereafter uses that amount as a benchmark to guide his

business operations and ensures that all of his business's legal financial transactions tally up to that predetermined tax amount. This allows him to appease SARS auditors.

The interviewee emphasized that the very nature of the illicit tobacco trade involves the manipulation of the cash side of one's business and that all tobacco companies were engaging in the illicit tobacco trade, albeit to varying degrees. He was, however, the only DTC interviewee to make such a statement. He claimed that all DTCs were manipulating the cash side of their businesses and adjusting their total sales relative to total production ratios. A law enforcement interviewee agreed with this viewpoint. He emphasised that MTCs, and BATSA in particular, cannot use this approach owing to the complexity of their financial systems and were thus using more sophisticated methods to avoid or evade taxes.

5 Discussion

The narrative of the development of the South African tobacco market reveals tobacco industry complicity as a factor in relation to the upward spikes in the illicit tobacco trade that have been observed since 2015. The study reflects the shifting power dynamics within the industry and the tactics used by both MTCs and DTCs in response to rising threats to their interests. The results of the study indicate widespread avoidance of taxes by the industry, with some participants being more brazen in their tactics than others. Historically, the MTCs had the advantage of near-monopoly power but the entry of DTCs to the market diluted this advantage.

In an effort to protect their interests, MTCs and DTCs put forth two uncorrelated narratives which shared no common ground. DTC and FITA narratives have strong racial overtones, focusing on white monopoly capital and transformation. DTCs strategically present their business practices as part of the struggle towards the transformation of the sector. By using the term *transformation*, they are claiming the moral high ground and portraying themselves as rebels against white monopoly capital and who, altruistically, are leading the struggle for economic balance and participation for *all* within the tobacco industry. However, this is simply a facade to cover self-seeking and at times unscrupulous acts. Their pursuit of transformation has very little to do with genuine economic development and benefitting *all* previously disadvantaged groups, and instead is focused on shifting tobacco industry dominance away from MTCs to specific DTCs.

DTCs are no longer the underdogs on the margins of tobacco trade; they do not fear the power of the established tobacco industry and are taking on the MTCs using whatever means they deem most expedient. The DTCs are carving their own place within the tobacco industry, both legally and illegally. Legally they are improving on their business practices by increasing production efficiency, establishing relationships with retailers, diversifying their portfolios and expanding their networks into African markets. Illegally and unethically, they are also allegedly engaging in cabal practices and bribing of government officials. The culmination of these activities has been that power has shifted within the tobacco industry and, in response, the MTCs have retaliated.

The strategic narratives of the MTCs are focused on condemning the criminal behaviour of the DTCs. In order to protect their interests, MTCs are using industry-funded research and media coverage to drive their narratives. They do this by intensifying public and government attention away from their possibly unlawful business practices towards the alleged unlawful business practices of DTCs. Like DTCs, MTCs are claiming the moral high ground by presenting themselves as altruistic, the protectors of the working class, whose job security and welfare, they claim, is threatened by DTC criminality. By doing so, they distract attention from their own business practices.

MTCs are using self-funded research results to provoke citizen lobbyist action in an attempt to influence tobacco-related government priorities and policies. TISA/BATSA's most recent #TakeBackTheTax campaign exploits structural and socio-economic constraints that South Africa has struggled with for decades. TISA/BATSA are deliberately engaging in fear-mongering by linking the study's findings to negative consequences for job security and the livelihoods of the working class. In a country where jobs are scarce and unemployment rates are unacceptably high, TISA/BATSA are playing on citizens' deepest vulnerabilities.

To protect their own interests, they are using the most vulnerable of society as pawns in their fight against the strengthening of tobacco control measures. Nurturing civil protest has important systemic consequences for the society at large and the fragile political economy. BATSA is apparently not concerned with these potential ramifications. The tobacco industry of South Africa provides a kaleidoscope of exploitation of the poor, self-preservation, greed, market share wars, disinformation and propaganda campaigns, state infiltration, and research aimed at protecting vested interests and driving strategic narratives.

In instances where studies are industry-funded, it should be required that the research methodologies be made public and open to scrutiny, particularly by non-industry-funded peer reviewers; peer reviewers should also be named. Cohorts of journalists have taken a stand against industry-funded research, but the media as a whole must act responsibly when publicising industry-funded research findings (Gonzalez, Malan & van Dyk, 2018). It is imperative that the government remain both sceptical and cautious regarding information

provided by the industry. Research on the illicit tobacco trade needs to be conducted, without industry interference and the findings need to be made more accessible to wider audiences.

It cannot be denied that the illicit tobacco trade poses a major impediment to the objectives of tobacco-control and public health policies and places an increasing burden on the fiscus. The South African government needs to expedite the tackling of the illicit tobacco trade and at the same time strengthen tobacco-control legislation. They should first demonstrate their commitment to tobacco control by ratifying the WHO FCTC's Protocol to Eliminate Illicit Trade in Tobacco Products, as the Protocol provides a template for how to tackle the illicit tobacco trade.

Ratification of the Protocol, together with additional policies that attempt to curb industry interference may reduce tobacco industry infiltration and influence on government decision-making on tobacco control priorities and policies (Craig *et al.*, 2019). Skafida *et al.* (2014) showed how the tobacco industry has historically interacted with '*government officials and politicians*' to influence tax policy and protect their interests. It is therefore important that the government adhere to Article 5.3 of the WHO FCTC in order to ensure the minimisation of industry interference on tobacco-control policies and legislation. Clear signals need to be given to all tobacco stakeholders that an industry that is part of a problem, cannot be part of its solution when that solution runs counter to their interests. Should it be necessary to engage with the tobacco industry, however, all engagement must be made transparent and public. Close monitoring of the tobacco value-chain is crucial. The implementation of a track-and-trace-system and the use of secure supply-chain technologies such as hyper-ledger block chains are important for tracking and tracing goods throughout the tobacco value-chain. Again, removing human interference in this process should be mandatory.

Behind the multi-layered tobacco industry there is the further problem of an inefficient government whose members often prioritise their own interests over the government's stated goals of socio-economic reform. For this reason, state institutions have become vulnerable to industry interference. Government reform is also an important part of addressing the illicit tobacco trade. State institutions need to rebuild capacity, which should

include multi-disciplinary teams committed to serving the country's needs, accountability, and freedom from further industry interference.

South Africa's criminal justice system should adopt a zero-tolerance policy towards tobacco-tax evasion in order to send a clear message to the industry. South Africa needs to take more decisive steps to tackle illicit trade and strengthen tobacco legislation, to avoid undoing years of tobacco-control measures that once made its tobacco-control policies globally respected. To do this, the government needs to recognise the tobacco industry's attempts to influence government decisions in their favour.

6 Conclusion

Recent upward spikes in the illicit tobacco trade in South Africa are undermining tobacco-control measures and have serious negative consequences for public health outcomes. Government inefficiency and a susceptibility to corruption have left the country vulnerable to tobacco-industry infiltration. As a result, since 2015, declines in tax-paid cigarettes are the result of upswings in illicit tobacco trade and the fiscus is being increasingly burdened. The increase in under-declared cigarette production since 2015 reveals the tobacco industry's exploitation of weakened enforcement of the laws.

The study's findings indicate that a positive relationship exists between the tobacco industry's actions and the upward spike in the illicit tobacco trade in South Africa from 2015. The study also suggests that the South African tobacco industry is complicit in a range of exploitative tactics aimed at circumventing tobacco-control policies. In an attempt to protect themselves from competition and from government legislation, MTCs (TISA) and DTCs (FITA) use opposing narratives to influence public opinion and government decision-making. Each group presents itself as altruistic and disassociates itself from complicity in industry malpractice. Their motives need to be made public to protect both citizens and government from manipulation.

State institutions must, therefore, be reconstituted to tackle the illicit tobacco trade adequately, and the criminal justice system must hold offenders accountable for their actions. The tobacco industry should not be participating in government decision-making on tobacco-control measures. The scale of illicit tobacco activity in South Africa reinforces the need for the country to adhere to the WHO FCTC and ratify the Protocol to Eliminate Illicit Trade in Tobacco Products (World Health Organization, 2013).

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8 Appendices

Appendix A: Sample Interview Guide



1. What is your current job description? How long have you held this position? What are some of your main responsibilities in this position?
2. How many years of experience do you have working within- or in relation to- the tobacco industry? In what position/s? What did your responsibilities include?
3. Talk a little about your industry
4. Do you specialise in low, medium or high-priced cigarettes? Have you always specialised in the categories?
5. What are some of the current trends facing the South African licit/illicit tobacco industry? What factors are driving such trends?
6. What has been the impact of the entry of new competitors on the South African tobacco market?
7. How has recent changes in legislation affected/ or likely to affect the licit/ illicit tobacco market?
8. Since 2014, do you think that illicit tobacco trade in South Africa has increased, decreased or remained stable? Why? What is your source for this information? What are the main contributing factors?
9. What are the conditions within the country that allow for illicit tobacco trade to occur?

10. What are the motivations for why people consume illicit tobacco? Have the motivations changed in the last 5 years (2013-2017) relative to the previous 5 years (2008-2012)? Why? What are the main contributing factors?
11. In your opinion, do you think the motivations for why people consume illicit tobacco products, likely to change over the next 3 years (2019-2021)?
12. In your opinion, which part of the tobacco value chain is the start of illicit tobacco activity? Why?
13. Are there certain parts of the country that are more prone to the production, sale and consumption of illicit tobacco? Why?
14. Has the illicit tobacco market changed in the last 5 years (2013-2017) relative to the previous 5 years (2008-2012)? Why? What are the main contributing factors?
15. What was the size of the illicit tobacco market end 2014/15/16/17? Are you confident about this estimate? What is your source for this estimate? Do you know how this estimate was derived? If yes, can you explain the derivation?
16. What are the common types of illicit/illegal tobacco activity that you are seeing in the market? Example, smuggling, contraband, counterfeit. Why do you believe this type of activity is popular relative to other types of illicit tobacco activity?
17. Has the type of illicit tobacco activity changed in the last 5 years (2013-2017) relative to the previous 5 years (2008-2012)? Why? What are the main contributing factors?
18. Describe the type of illicit tobacco products that are most popular within the country?
19. Has the type of illicit tobacco products that are being consumed changed in the last 5 years (2013-2017) relative to the previous 5 years (2008-2012)? Why? What are the main contributing factors?
20. Since 2015, there has been a sharp spike in illicit tobacco trade. What are the factors driving this recent trend? Who do you think is responsible for this trend? Why? Do you have any evidence to support this view?
21. What are the motives behind the recent spike in illicit tobacco trade? Why? What are the main contributing factors?
22. Have the motives to engage in illicit tobacco trade changed in the last 5 years (2013-2017) relative to the previous 5 years (2008-2012)? Why? What are the main contributing factors?

23. Have you come ever across any incidents were tobacco companies were found guilty of engaging in illicit tobacco trade? What is your source for this information? Please describe in detail.
24. In your opinion, what percentage of local tobacco production is undisclosed to SARS?
25. What do you think is the role of SARS in terms of illicit tobacco trade? Do they perform regular audits at your company? Why/why not?
26. What mechanism does SARS have to ensure that the number of cigarettes declared is equal to the true number produced? Does SARS have a person on site?
27. In your opinion, who do you think is the most reliable source of information when it comes to measuring the size and growth of the South African illicit tobacco market? Why?
28. In your opinion, who do you think is the least reliable source when it comes to measuring the size and growth of the South African illicit tobacco market? Why?
29. In your opinion, who do you think are the main offenders when it comes to illicit tobacco trade in South Africa? Why?
30. In your opinion, is the government doing enough to control illicit tobacco trade? Why?
31. How do you expect the illicit tobacco market to perform over the next 3 years (2019-2021)? Why?
32. Do you have any documents related to illicit tobacco that you believe will be useful to my research and are willing to share?
33. Do you have any suggestions on who else I should be speaking with regarding my research? Are you willing to share the contact/s details or put me in touch with the company and/or individual/s?
34. Why have you chosen to speak with me? What narratives do you want to convey?



INFORMATION SHEET

Exploration of the recent spike in illicit tobacco trade in South Africa

My name is Zeenat Ebrahim, I am a Masters in Economic Development candidate at the University of Cape Town. I am conducting research regarding the recent spike in illicit tobacco trade in South Africa. I would like to invite you to participate in this study.

Project Overview

Since 2015, there has been a significant spike in illicit tobacco trade in South Africa. Numerous studies have indicated that rising illicit tobacco trade is a serious problem for the country, and it has important negative consequences on public health and tax revenue. In order to better understand the nature of this trend, this study seeks to explore the motives behind the recent spike in illicit tobacco trade. As such, I would like to interview people who are involved in or engage with, the South African tobacco industry.

Voluntary Participation

Should you wish to participate in this study, the interview will last no longer than one hour. I will interview you either telephonically or at a venue of your choice; you are not expected to incur any travel costs. During the interview process, should you wish to not answer any of the questions, you may say so and I will move on to the next question. Participation in the interview will be of no direct benefit to you however, your participation is likely to improve the knowledge that is available for the country to tackle illicit tobacco trade. You are invited to participate in this research because we feel that your experience and expertise can

contribute to our understanding of the economics of tobacco control challenges in South Africa.

Confidentiality

With your permission, the interview data will be transcribed and analysed for research purposes. The entire interview will be tape-recorded; however, no person will be identified by name on the tape. The recorded information is confidential, only myself and my supervisor will have access to the information documented during your interview. I will give you feedback in the form of a final graded thesis, should you wish to receive it. There are no known risks to your association with this study. The researchers will not attempt to identify you with the responses to the questions, or name you as a participant in the study, nor will they facilitate anyone else's doing so.

CONSENT FORM

Should you wish to participate in this study, please complete the section below:

I consent voluntarily to be a participant in this study. I understand that I may refuse to participate or stop participating at any time without penalty. If I wish, I will be given a copy of this consent form.

Signature of participant

Date

Name of participant.....

CONTACT

Should you have any questions, you can ask them now or later. If you wish to ask questions later, you may contact:

Name: Professor Corné van Walbeek, Department of Economics, University of Cape Town

Email: cornelis.vanwalbeek@uct.ac.za or cwalbeek@gmail.com

Telephone Number: +27(0)21 650 4689



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UCT Commerce Faculty Office

29/08/2018

Ms Zeenat Ebrahim
School of Economics
University of Cape Town

REF: REC 2018/008/084

Dear Zeenat Ebrahim,

Investigation into the recent spike in illicit tobacco trade in South Africa.

We are pleased to inform you that your ethics application amendment from the 27 August 2018 has been approved. We are pleased to inform you that your ethics application has been approved. Unless otherwise specified this ethical clearance is valid for 1 year and may be renewed upon application.

Please be aware that you need to notify the Ethics Committee immediately should any aspect of your study regarding the engagement with participants as approved in this application, change. This may include aspects such as changes to the research design, questionnaires or choice of participants.

The ongoing ethical conduct throughout the duration of the study remains the responsibility of the principal investigator.

We wish you well for your research.

Modie Sempu
Administrative Assistant
University of Cape Town
Commerce Faculty Office
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