

Tobacco Excise Taxation in South Africa

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Introduction

The past ten years have witnessed a major turnabout in government policy on tobacco control in South Africa. Within a relatively short time, government policy has changed from complete apathy to one where the tobacco control measures are regarded as some of the most progressive in the world.

South Africa's tobacco control policy rests on two important pillars: legislation and excise tax increases. In 1999 the government passed legislation that banned tobacco advertising and sponsorship, prohibited smoking in all public places (including workplaces), and banned the sale of tobacco to minors. This legislation was an amendment to an act passed in 1993 that prohibited smoking on public transport and introduced health warnings for the first time.

As well as increasing the implicit costs of smoking, the legislation prohibiting smoking in public and work places represents a clear transfer of property rights from smokers to non-smokers. Whereas previously smokers enjoyed the right to pollute the air, the legislation unambiguously assigns non-smokers the right to unpolluted air. Although the direct impact of the legislation on tobacco consumption is still unclear, the legislation has continued the trend of deglamorising smoking in South Africa. As a result, smoking is no longer regarded as socially acceptable by large sections of the population.

In the past decade the government has substantially increased the excise tax on tobacco products for health reasons. Since 1994 the nominal tax on cigarettes has increased by nearly 25 per cent each year. Econometric evidence indicates that the resulting price increases have had a significant impact on cigarette consumption. The aim of this paper is to investigate tax increases in some detail.

Description of the Intervention

During the 1970s and 1980s tobacco control was not on the public agenda. The tobacco industry used its cordial relations with the government to prevent any measures that would harm the industry. On tobacco issues, the government regularly consulted the industry. For example, before the budget was presented to Parliament the tobacco industry was consulted about possible tax increases. Not surprisingly, the tax increases were generally very modest. In fact, between 1970 and the early 1990s the real (i.e. inflation adjusted) excise tax on cigarettes

decreased by 70 per cent. This rapid decrease occurred despite calls by the medical community and the Ministry of Health to increase the excise tax.

In 1994 the African National Congress became the dominant party in the Government of National Unity after the first democratic elections. In the early 1990s the outgoing government had started introducing some tobacco control measures, in the form of legislation mandating health warnings, and increases in the excise tax. In 1993 the ANC announced that it would accelerate the tobacco control measures if it came to power.

The new government made its intentions clear at the reading of the Budget in June 1994, when the Minister of Finance announced that the government would increase the tax on tobacco products to 50 per cent of the retail price.¹ At that point, excise taxes amounted to 21 per cent of the retail price and the total tax burden (i.e. including sales tax) was 32 per cent of the retail price. However, after being pressurised by the industry, the government opted for a slower phasing in of the adjustment. While the phasing in approach was a temporary setback for the tobacco control lobby, the government kept to its promise, increasing the excise tax by substantially more than the inflation rate at subsequent readings of the Budget. In 1997 the Minister of Finance announced that the 50 per cent target had been achieved. Subsequent tax increases were aimed at keeping the tax percentage at that level.

Some trends regarding tobacco taxation in South Africa are shown in Table 1. Column (f) illustrates the rapid decrease in real excise tax between 1970 and the early 1990s, followed by a sharp increase subsequently. A recent study has shown that, in the past decade, South Africa has had the third highest percentage change in tobacco taxes (after Korea and France) amongst 90 countries. It is interesting that, despite the industry's protes-

¹ In South Africa, as in many countries, the excise tax is levied as a specific tax, i.e. a certain amount per pack of cigarettes. Unless the tax is adjusted regularly, inflation will erode the tax. This is exactly what happened in South Africa during the 1970s and 1980s.

However, even though the excise tax is technically a specific tax, the government's policy of setting the tax at 50 per cent of the retail price has turned it into a *de facto ad valorem* tax.



Table 1

Trends in cigarette prices, taxes and consumption^a

Year	Cons, millions of packs	Price, Nominal, Cents per pack	Price, Real, 1995 base, Cents per pack	Excise tax, Nominal, Cents per pack	Excise tax, Real, 1995 base, Cents per pack	Excise tax as % of price	Total tax as % of price	Industry price, Real, 1995 base, Cents per pack	Excise revenue, Real, 1995 base, R millions
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)
1961	517	19.1	449	9.1	214	47.6%	47.6%	235	1106
1965	608	19.4	417	9.1	196	46.9%	46.9%	222	1189
1970	783	22.1	405	11.1	203	50.2%	50.2%	202	1593
1975	1048	31.8	373	14.6	171	45.9%	45.9%	202	1795
1980	1283	49	328	20.1	134	41.0%	44.9%	181	1725
1981	1443	53	308	20.1	117	37.9%	41.8%	179	1684
1982	1632	62	314	21.1	107	34.0%	39.1%	191	1745
1983	1551	66	298	24.1	109	36.5%	42.2%	172	1686
1984	1570	74	299	24.6	99	33.2%	41.0%	176	1560
1985	1571	84	292	26.1	91	31.1%	41.4%	171	1425
1986	1591	94	276	26.1	77	27.8%	38.5%	170	1217
1987	1671	109	275	26.1	66	23.9%	34.7%	180	1101
1988	1795	122	273	27.1	61	22.2%	32.9%	183	1089
1989	1809	138	269	30.6	60	22.2%	33.5%	179	1079
1990	1868	165	281	33.1	56	20.1%	31.6%	193	1055
1991	1927	171	253	37.6	56	22.0%	32.9%	170	1072
1992	1900	222	288	44.6	58	20.1%	29.2%	204	1100
1993	1802	255	302	53.2	63	20.9%	31.3%	204	1135
1994	1769	284	309	60.5	66	21.3%	33.6%	205	1162
1995	1708	348	348	75.3	75	21.6%	33.9%	230	1287
1996	1690	387	360	92.0	86	23.8%	36.1%	230	1447
1997	1577	497	426	117.5	101	23.6%	35.9%	273	1588
1998	1495	608	487	169.5	136	27.9%	40.2%	292	2032
1999	1422	730	558	214.3	164	29.3%	41.6%	325	2332
2000	1333	803	582	254.5	184	31.7%	44.0%	326	2453
2001 ^b	1272	889	608	291.5	199	32.8%	45.1%	334	2540

^a Sources: Auditor-General, Statistics South Africa (previously Central Statistical Services and Department of Statistics), Budget Review, Tobacco Board.

^b Preliminary figures.

Table 2

Nominal percentage changes in the excise tax on various tobacco products^a

Financial year	Cigarettes	Cigarette tobacco	Pipe tobacco	Cigars	Inflation rate
1990/1	11	11	10	13	12.0
1991/2	14	14	11	14	11.4
1992/3	8	8	4	5	8.3
1993/4	9	19	2	2	9.7
1994/5	25	29	25	30	9.0
1995/6	24	27	25	28	8.7
1996/7	18	20	18	19	7.4
1997/8	52	56	52	53	8.6
1998/9	29	31	29	29	6.9
1999/00	20	85	166	3669	5.2
2000/1	16	40	56	74	5.4
2001/2	12	12	20	17	5.7
Average 1990/1 – 1993/4	11	13	7	9	10.4
Average 1994/5 – 2001/2	25	38	49	490	7.1
Average 1990/1 – 2001/2	20	29	35	330	8.2

^a Source: Budget Review

² However, during the 1960s cigarettes, like all goods, were not subject to sales tax. The imposition of sales tax, since the late 1970s has increased the effective tax burden above the level of the 1960s.

³ Since 1997 the Ministry of Finance has claimed that it has achieved the 50 per cent tax target. This is more illusory than real. When the Ministry calculates the tax incidence percentage, the denominator they use is the retail price before the tax increase. This is unrealistic. The tax increase causes the retail price to increase, with the result that the denominator increases. So, ex post, the total tax percentage is much lower than the claimed 50 per cent, as is illustrated by column (h) of Table 1.

tations about the “unreasonableness” of the excise tax increases, the real excise tax in 2001 is no higher than the level of the 1960s.² Total tax as a percentage of the retail price follows a similar trend, as indicated in column (h). The tax proportion decreased from 50 per cent in 1970 to 30 per cent in 1992, after which it rose to 45 per cent in 2001.³ Despite the excise tax increases, the tax proportion of South African cigarettes, compared to many Western countries, is still low.

The real retail price of cigarettes has more than doubled over the past decade, as is shown in column (d). This means that cigarettes, in comparison to a basket of other goods and services, have become very expensive. In fact, of all commodities surveyed by the South African statistical



authorities, cigarettes have been subject to the largest price increases over this period. This was a dramatic reversal of the previous 20 years' trend, since between 1970 and the early 1990s the real price of cigarettes had fallen by a third. At purchasing power parity, the price of South African cigarettes is currently comparable to those of many European countries and Japan.

In South Africa cigarettes represent more than 90 per cent of tobacco sales. Some of the poorer sections of society buy pipe and cigarette tobacco and roll their own cigarettes. However, despite the large increases in the real price of cigarettes, the non-cigarette tobacco segment has remained small.

In order to be effective, tobacco excise tax increases should not create incentives for people to shift their tobacco consumption from one form to another. The tax increases should thus be similar for the various tobacco products. In Table 2 the percentage changes in the excise tax for the four excisable tobacco products are shown. In most years the tax increases on potential substitutes to cigarettes (i.e. pipe and cigarette tobacco) have been similar to that of cigarettes, but in some years, notably 1999 and 2000, the tax increases have been substantially greater. This suggests that the government was aware of the possible substitutability of tobacco products, and did not want to create an incentive for consumers to switch to substitutes.

An important omission is snuff, which is not taxed at all. According to the National Council Against Smoking, in South Africa, almost as many women use snuff as smoke cigarettes. Despite tobacco control groups lobbying for a tax on snuff, no tax has been imposed to date.

In South Africa the excise tax on cigars has traditionally been very low. However, this changed dramatically in 1999 when the excise tax was increased nearly forty-fold. This was followed by another 74 per cent increase in the excise tax in 2000. The Minister of Finance claims that the large increases in the tax on cigars were necessary to bring them into line with the tax on cigarettes. However, the fact that few people in South Africa smoke cigars on a regular basis, and that they are regarded as luxury and "special events" items, suggests that the primary aim of increasing the tax on cigars was to increase government revenue.

Implementation

In contrast to tobacco control legislation, which has to go through a lengthy parliamentary process, it is very easy to increase the excise tax on tobacco products. Even before 1994, the Minister of Finance announced increases in the tobacco excise tax at the annual reading of the Budget. However, as pointed out, the increases were small and usually less than the inflation rate.

In South Africa a vocal tobacco control lobby, led by the Medical Research Council (MRC) and the National Council Against Smoking (NCAS), had been arguing for significant tax increases since the 1970s. They appealed for a comprehensive tobacco control strategy resting on three basic pillars: (1) an advertising ban, (2) restrictions on smoking in public places, and (3) rapidly increasing tobacco taxes. They pointed out that international evidence had shown that increasing the excise tax on tobacco is the most effective tobacco control measure. Despite the fact that tobacco is addictive, numerous studies, performed in a variety of countries, have shown that excise-induced increases in tobacco prices causes tobacco consumption to decrease. They also pointed out that international experience had clearly shown that increasing tobacco excise taxes also increases government revenue.

The tobacco control lobby wanted the government to earmark a proportion of the tobacco excise taxes for general health promotion strategies. However, the lobby groups were unsuccessful with these requests, even after the changes of the 1990s were implemented. As a rule, the South African government does not earmark revenues.⁴ It is argued that earmarking distorts the prioritization of government policies, and could lead to economic inefficiency in the spending of these funds.

The MRC and NCAS regularly pointed out that the real excise tax rate had been decreasing during the 1970s and, even faster, during the 1980s. Even though this point was well taken in the Department of Health, the Ministry of Finance did not increase the tax. The government explained its inaction as follows: (1) increasing the tax would stimulate smuggling, and (2) an increase in the tax might, in fact, decrease government revenue, because the

⁴ Exceptions to the rule are the Unemployment Insurance Fund, the Skills Levy, and levies to fund regulatory bodies of specific industries

tax-induced price increase would cause a sharp reduction in demand. In providing these explanations, the Ministry of Finance apparently did not question their empirical foundations; they were generally taken as an article of faith from the tobacco industry.

In the early 1990s, after the ban on the ANC had been rescinded,⁵ and negotiations for a democratic transition were taking place, the tobacco control groups started lobbying the ANC for stricter tobacco control measures, including rapid tax increases.⁶ The tobacco control lobbyists found an ally in Dr Nkozasana Zuma, the later Minister of Health. She was passionately against smoking and, in this regard, had the full support of the president-to-be, Nelson Mandela.

In June 1994, less than two months after the democratic transition, the Minister of Finance announced that the government would increase the tax on tobacco products to 50 per cent of the retail price. The Ministry of Health and tobacco control lobby groups had been lobbying the Ministry of Finance for a doubling of the excise tax that year. Because of pressure exerted by the tobacco industry,

the Minister of Finance increased the tax by only 25 per cent in 1994. Although this was a temporary setback for the health community, the tax was increased by substantially greater percentages in subsequent years. The guiding principle for each of the subsequent tax increases was the “50 per cent goal” announced in 1994.

The industry was naturally furious about the excise tax increases. The Tobacco Institute of South Africa was particularly vocal about the “discriminatory” tax increases. They argued that tobacco was already the most highly taxed consumer product, and that such large tax increases would encourage smuggling. Furthermore, they argued that the tax would decrease tobacco consumption, which would cause large numbers of workers to be retrenched. The chairman of the Rembrandt Group, the country’s largest cigarette manufacturer, wrote an open letter to the Minister of Health in 1996 in which he argued that smuggling was out of control, and that the government was losing revenue as a result. He quoted the example of Canada where smuggling had reached epidemic proportions, which was reduced significantly after the taxes were reduced.⁷

⁵ The African National Congress is a political party which was founded in 1912. It was banned for 30 years under the apartheid regime, from 1960 to 1990.

⁶ It must be noted that the National Party government passed the country’s first tobacco control legislation in 1993. This was the result of persistent lobbying with the then Minister of Health. The legislation was mild, even by 1993 standards, but it nevertheless represented a schism between the NP government and the tobacco industry. This legislation did not make any provisions for tax increases. However, the more comprehensive legislation of 1999 did not include such provisions either.

⁷ However, subsequently it was found that the tobacco industry was involved in the smuggling network. Litigation is currently being brought against Brown & Williamson regarding their role in the smuggling.

⁸ The ETC Project was not the first to investigate the economic impact of smoking, but it was the most comprehensive. So, for example, a cost benefit analysis performed by the University of Cape Town’s Health Economics Unit in 1988 indicated that, for every R1 received in tobacco taxes, the economy incurred medical costs and lost productivity of R4.

In 1996 the tobacco control lobby was strengthened when the Economics of Tobacco Control (ETC) Project was established at the University of Cape Town. Among other things, the Project quantified how much revenue the government had lost during the 1970s and 1980s by allowing the real excise tax to fall so sharply. This effectively destroyed the industry’s argument that the government might lose revenue by increasing the tax, because of the reduction in consumption that it would cause. The tobacco control lobby used these and other research results of the ETC Project to counter the industry’s claims that tobacco benefits the economy as a whole.⁸

The tobacco control lobby was heavily dependent on information and news in order to retain the attention of the public and the policymakers. Research results and tobacco related news from developed countries certainly maintained public awareness, but locally produced research results generally received more media attention. The tobacco control lobby in South Africa used locally generated research outputs to influence policymakers. This is important because policymakers want to know what the impact of certain interventions is likely to be on the South African situation. They are generally not very interested in, or persuaded by, research that has been performed in a different country, possibly under very different circumstances.



The public's reaction to the tax increases has been mixed. In the "letters" section of newspapers people have expressed both support for and disappointment in the tax increases. Surveys indicate that most people, mainly non-smokers, but also a sizeable proportion of smokers, generally support strategies aimed at reducing smoking.

Success of the Intervention

Internationally, tobacco control advocates generally propose a comprehensive strategy in the fight against tobacco. Such a strategy would typically consist of an advertising ban, clean indoor air policies, restrictions on sales to minors, an effective education programme, and tax increases. The international literature indicates that, of all these interventions, increases in tobacco taxes are the most effective in reducing tobacco use.

The South African experience confirms these findings. Econometric studies have shown that the average price elasticity of cigarettes in South Africa is between 0.5 and 0.7. This means that, all other factors (e.g. income) remaining constant, the consumption of cigarettes decreases by between 5 and 7 per cent for every 10 per cent increase in the real price of cigarettes.

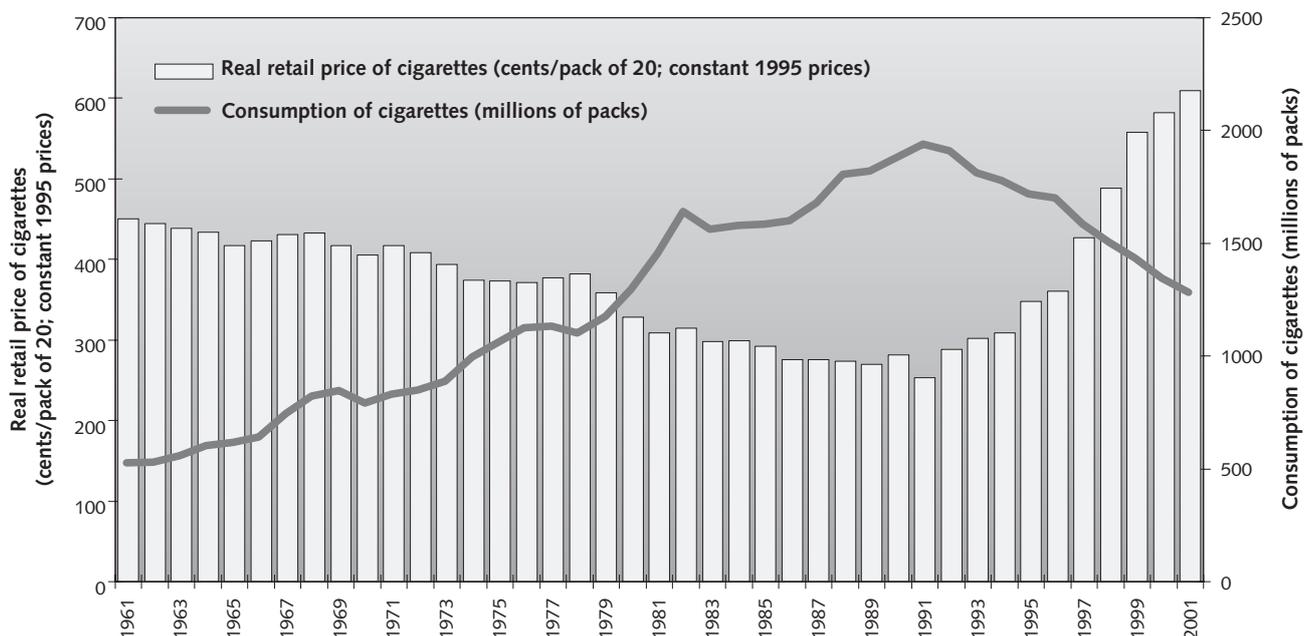
In Figure 1 the relationship between cigarette consumption and the real price of cigarettes is shown for the past four decades. The figure clearly illustrates the inverse relation-

ship between these two variables. The increase in excise taxes explains about half of the real price increase since 1991; the other half is attributed to the industry's pricing strategy (discussed in section 5). Since 1991 total cigarette consumption has decreased by a third; in per capita terms it has decreased by more than 40 per cent.

It was found that approximately 40 per cent of the decrease in cigarette consumption was to be ascribed to people giving up smoking. This is reflected in the fact that the smoking prevalence percentage among adults decreased from 33 per cent in the early 1990s to 27 per cent in 2001. The other 60 per cent of the decrease in cigarette consumption is explained by the fact that smokers are smoking less. In fact, average cigarette consumption per smoker has decreased by approximately 20 per cent in the past decade.

An analysis of smoking prevalence in South Africa reveals that young people, low-income earners, black South Africans and males have experienced the largest reductions in cigarette smoking. Smoking prevalence among young people decreased from 23 per cent in 1993 to 19 per cent in 2000; among low-income earners from 31 per cent to 25 per cent; among black South Africans from 28 per cent to 23 per cent, and among males from 51 per cent to 44 per cent. Surprisingly, smoking prevalence among black South Africans has decreased despite a heavy tobacco advertising campaign, specifically focused on emerging

Figure 1
Cigarette consumption and real prices of cigarettes in South Africa, 1961 to 2001





middle-class black South Africans in the second half of the 1990s. The demographic groups that have not experienced significant decreases in smoking prevalence include females (although, admittedly, their smoking prevalence level, at 13 per cent, is relatively low), high-income earners (32 per cent), and white South Africans (36 per cent).

Studies performed in other countries indicate that young people and the poor are more responsive to cigarette price changes than older and more affluent people. The reason is straightforward: an increase in the price of cigarettes makes the product too expensive to those groups, with the result that they either reduce their consumption or quit altogether. The evidence from South Africa supports the hypothesis that young people and the poor tend to reduce their cigarette consumption by a greater percentage than other groups in reaction to a price increase.

A related issue concerns the regressivity of an excise tax on cigarettes. Some people are against using excise tax increases as a tobacco control tool because it could have a detrimental impact on the poor. Since the poor, vis-à-vis the rich, generally spend a larger portion of their income on tobacco products, they pay proportionally more tax. This implies that the tax is regressive, which is regarded as socially inequitable.

However, it has been shown that, in South Africa, an increase in the tax on cigarettes causes a larger reduction in cigarette consumption among the poor than among the

⁹ The Department of Customs and Excise has recently commissioned a study aimed at quantifying the number of smuggled cigarettes. However, to the author's knowledge, the results of this research are not yet known. An analysis by the Economics of Tobacco Control Project, based on rather cursory data, suggests that between 5 and 7 per cent of cigarettes consumed in South Africa are not taxed by the authorities. This percentage compares well with most European countries.

¹⁰ In a recent newspaper article, BAT claims that 148 million cigarettes were confiscated by the Department of Customs and Excise in 2001. This is about 0.6 per cent of total cigarette consumption in South Africa. However, the proportion of smuggled cigarettes impounded by the authorities is unknown. On the other hand, the smuggling and trade in hard drugs (especially heroin and cocaine) is a serious problem in South Africa, and attracts much media attention.

rich. This means that, while the absolute burden of the tax is likely to increase for all income groups, the burden on the poor, relative to that of the rich, is reduced. Thus, even though excise taxes are regressive, increases in excise tax reduce the regressivity of excise tax.

Other Effects of the Intervention

While the primary aim of a tobacco control strategy is to reduce tobacco consumption, an agreeable by-product of increasing the excise tax on tobacco is that it increases government revenue. Column (j) of Table 1 shows that, despite a 33 per cent reduction in tobacco consumption over the past decade, real government revenue has more than doubled. Since 1994, for every 10 per cent increase in real excise tax, real excise revenues have increased by approximately 6 per cent.

The tobacco industry has been ferocious in its opposition to any tobacco control measures, including excise tax increases. Under the present government, the policy on tobacco and tobacco control is unlikely to change. The industry has had to drastically change its marketing strategy under these difficult external conditions.

Whereas the pricing strategy of the cigarette manufacturing industry before the 1990s was focused primarily on the growth in cigarette quantities, there is currently a much stronger focus on the growth in price. Column (i) in Table 1 shows that the real industry price (i.e. the retail price less all taxes) did not change much between the 1960s and the early 1990s. If anything, the real industry price decreased over this period. However, there has been a very rapid increase in the real industry price since 1991 and especially since 1996. In 2001 the real industry price of cigarettes had increased by more than 60 per cent compared to the early 1990s. An analysis of the industry's major cost factors indicates that this increase is not the result of an increase in the real costs of producing cigarettes.

There is only one explanation: the industry is maintaining its overall profitability by increasing the profit per cigarette, despite the fact that quantities are falling. The external environment has turned against the industry to the extent that future growth in cigarette quantities seems unlikely. Since the merger between Rothmans (of the Rembrandt Group) and British American Tobacco (BAT) in 1999, one company has controlled 95 per cent of the South African cigarette market. This gives the newly created BAT the necessary monopoly power to raise cigarette



prices above competitive levels. The industry can disguise the retail price increases behind the well-publicised tax increases.

A simulation analysis has indicated that this strategy has been very beneficial to the cigarette manufacturing industry. The strategy has increased total sales revenue for the industry, with the result that the profitability of the industry has been enhanced. Also, the strategy has reduced the government's ability to increase its excise tax revenue. By increasing the real industry price the industry siphoned off the extra revenue to itself, at the expense of the government. The downside, from the industry's perspective, is that its pricing strategy has further reduced cigarette consumption. The actions of the industry suggest that they are in an end-game scenario, looking to milk the cow for all it is worth before it finally dies.

From a tobacco control perspective the industry's pricing strategy has been beneficial, because it has reduced cigarette consumption by a much greater percentage than what the excise increases would have achieved in isolation. It is ironic that the industry itself, in its attempt to further its own short-term interests, followed a strategy that benefited both the industry and the tobacco control lobby.

An issue of considerable importance in many countries is that of cigarette smuggling. In South Africa, whenever the excise tax on tobacco products is increased, the industry claims that this will increase smuggling activities. Unfortunately, given the dishonest character of cigarette smuggling, accurate data do not exist.⁹ Over the past decade there have been very few reports of smuggled or counterfeit cigarettes being impounded by the South African police or customs authorities.¹⁰ While this is not meant to imply that cigarette smuggling is not a problem, it can be said with confidence that South Africa does not experience the cigarette smuggling problems currently experienced by the UK and, in previous years, by Canada. Also, considering the official consumption statistics (as shown in column (b) of Table 1), the decrease in cigarette consumption in the past decade seems reasonable in view of the very sharp increase in the real price of cigarettes.

An interesting characteristic of the South African cigarette market is the absence of the Marlboro brand. In fact, Philip Morris has no presence in South Africa. In a court case in 1998 Rembrandt accused Philip Morris of smuggling cigarettes into South Africa via neighbouring countries. Tobacco industry documents clearly reveal that cigarette smuggling is used to gain market entry and/or share

and to undermine tax policies. If smuggling, especially of Marlboro, into South Africa becomes uncontrolled, this could enable Philip Morris to formally enter the market. For this reason it is in the interest of the dominant incumbent (first Rembrandt, and now BAT) to contain smuggling.

Apart from keeping Philip Morris out, the industry has obvious motives for emphasizing the smuggling problem in South Africa. If cigarettes were smuggled on a large scale, the logical step, according to the industry, would be to reduce the tax on cigarettes. This is exactly what happened in Canada in the early 1990s.¹¹ While some informal bootlegging and some more organized smuggling definitely occur, cigarette smuggling is not a serious threat to the government's excise tax policy.

Conclusion

South Africa has been able to significantly reduce its tobacco consumption in a decade. While strong tobacco control legislation and changing social norms have created an environment where smoking is increasingly regarded as socially unacceptable, the instrument with the biggest impact has been excise taxation.

In South Africa, as in most countries, it is administratively easy to change the excise tax on tobacco. What is required is the political will to challenge the vested interests of the tobacco industry. In South Africa the Minister of Health and nongovernmental organizations played a pivotal role in implementing a comprehensive tobacco control strategy, of which large increases in the excise tax are a key part.

The effects of an increase in the excise tax on cigarettes are soon felt: cigarette consumption decreases and government revenue increases. In South Africa the impact of the excise tax increases was enhanced by the industry when it increased the real retail price by more than the increase in the real excise tax.

An important proviso concerns cigarette smuggling. While South Africa's experience can, in principle, be easily duplicated in other countries, the success of such a strategy will depend crucially on whether the country can contain

¹¹ However, the logic is flawed. Evidence from several countries shows that tax reductions do not, in themselves, reduce smuggling.

cigarette smuggling within reasonable limits. In South Africa cigarette smuggling certainly did not undermine the strategy, despite the industry's claims to the contrary. Although individual countries may differ, international experience shows that, despite smuggling, higher tobacco tax decreases tobacco consumption and increases government revenue. Smuggling erodes but does not completely destroy the benefits of higher taxes.

Regarding cigarette smuggling, the industry has its own reasons for exaggerating the threat. In countries where smuggling could be a problem, the authorities should impose strong control mechanisms, including stiff penalties, cooperative efforts with customs and law enforcement officials in other countries, and laws to make exporters responsible for their exports all the way to a final legal and taxed destination, thus discouraging potential smugglers.

