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Illicit tobacco and vaping:

Economic and socio-economic costs that warrant being considered in the review of Australia's Tobacco Control Laws



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What's new in this report

This report was commissioned by British American Tobacco to highlight the full spectrum of impacts and costs associated with the illicit tobacco and vaping market, for consideration as part of Australia's consultation on the draft legislation of the announced tobacco reforms.

It builds on the two previous reports, which analyse the markets for tobacco and vaping in Australia, written by Llewellyn Consulting and Independent Economics.

The first, published October 2022 and titled '*Tobacco and vaping products in Australia - an economic assessment*' examined, in the context of Australia's economy at large, the plateauing of tobacco tax revenue, the growing illicit tobacco issue, and the growth of illegal vaping. ([Link](#))

A follow-up, in March 2023, '*Tobacco and vaping products in Australia - an updated economic assessment*', included new data, information derived from a Roy Morgan consumer survey commissioned by Independent Economics, and an analysis of broader economic impacts of illicit tobacco and vaping. ([Link](#))

Summary and recommendations

1. The Australian Government has "... announced tobacco reforms [the aim of which is to] bring together current legislation and introduce new measures to reduce tobacco prevalence. [They are] now consulting on the exposure draft legislation for these reforms."
2. It is important, in our judgement, that this consideration of whether to amend existing regulations and / or introduce new ones should extend to taking into account the effects on both illicit tobacco use and the already widespread and growing practice of vaping.
3. Moreover, as part of this overall process, it would, in our judgment be good practice to conduct an impact assessment, in line with The *Australian Government Guide to Policy Impact Analysis*. The OECD too offers a suite of policy guides.
4. It would be appropriate for an impact assessment to consider the full spectrum of costs and benefits regarding the effects of the Tobacco Control Laws (TCLs) on:
 - Illicit trade in tobacco on the economy and society; and similarly on
 - Vaping – again, both economic and socio-economic costs.
5. Under Australia's existing regulatory system, consumption of illicit tobacco has expanded rapidly, and has reached a scale that is already problematic in a number of respects. Particularly importantly it is undermining public health objectives.
6. Since the last major revision of TCLs in 2011, tobacco excise has increased by close to 250%, illicit tobacco has doubled, now accounting for some 25% of the overall tobacco market, and notwithstanding mounting expenditure on enforcement, including on the Illicit Tobacco Taskforce in 2018, a large vaping market has developed. It is estimated that 1.3 million Australians now consume vaping products.
7. These illicit markets are costly to the Australian economy. They result in foregone tax revenues that undermine achievement of the Treasury's policy objectives; have numerous other harmful economic impacts; and cause significant socio-economic damage.
8. It is hard to see how any of the proposed changes to the TCLs are going to help. Placing legislative focus on legal tobacco consumption would indeed make it harder to consume duty-paid legal tobacco; and this would reduce, somewhat, its consumption. But – and this is a big 'but' – it would also incentivise smokers to move even further into the illicit, unregulated, tobacco and vaping markets, which the proposed legislation does not seek to address.

9. As a contribution to this consultation process, and in the spirit of assessing and quantifying impacts, this paper is put forward to provide a concise, broad, overview of some of the economic costs – direct, indirect, and induced – as well as some of the socio-economic impacts associated with Australia’s growing trade in illicit tobacco and vaping. That said, this paper does not purport to represent anything like a full impact assessment. That should be undertaken by Government as part of assessing which TCLs to adopt and which to amend.
10. Already the direct costs to Australia in the form of foregone revenue are substantial:
 - An estimated AUD 1.9 bn to AUD 4.2 bn per year in tax receipts is currently being ‘lost’ due to illicit tobacco; and
 - A further forgone AUD 415 m-odd could be gained were vaping to be regulated for adult retail sale.
 - Some AUD 395 m of gross value added (GVA) is being foregone; and
 - A further AUD 489 m of GVA could be gained by regulating vaping for adult retail sale.
11. These foregone tax revenues reduce the Government’s ability to deliver basic services and social programmes.
12. The illicit market also results in lost (legal) employment opportunities: estimates suggest that illicit tobacco alone displaced around 5,800 jobs in 2019 within the retail, wholesale, and transport sectors.
13. However, the full impacts and thereby economic costs extend beyond the retail, wholesale, and transport sectors: additional, ‘indirect’, impacts are experienced in the extended tobacco supply chain, by activities that supply these sectors.
14. Moreover, there are also ‘induced’ impacts, which come from the expenditure multiplier effect as employees spend their wages in the wider economy.
15. Oxford Economics Australia estimate, based on Australian Government input-output tables, that for every AUD 1 of gross output in legal wholesale, retail, and transport sectors, AUD 2.6 of total output is generated in the economy.
16. These various direct, indirect, and induced impacts, and thereby their economic costs, of the illicit tobacco trade are thus substantial. But, in addition, there are socio-economic impacts and costs. These too are clearly already considerable.
17. Profits from the illicit trade in tobacco and vaping are being used by organised criminal groups (OCGs) to underpin and fuel various other illicit activities.
18. Here, evidence from abroad serves as a portent. Worldwide, illegal tobacco contributes importantly to financing narcotics, arms dealing, people smuggling, people trafficking, and terrorism. It leads to exploitation of legal and illegal migrants, misuse of agricultural assets and water diversion. And most of these activities damage health.
19. It might be thought that, while such activities are rife abroad, they scarcely apply to Australia. But in Australia the incentives for criminals to supply more illicit tobacco and become progressively more organised are already powerful – the illicit tobacco market offers an attractive risk/return calculus: margins are higher than for illegal drugs such as cocaine.
20. Hence, while the wider socio-economic consequences have, so far, gone only a limited distance in Australia, self-reinforcing synergies and organised crime are pervasive and diversifying. And they have the potential to grow considerably further.
21. Just how far such developments go in Australia will depend in important part on how serious these potential costs are recognised as being, and the steps taken to reduce the

incentives that lead to them. In countries where the nettle has not been grasped adequately, or soon enough, the problems have progressively become extremely serious.

22. Reducing illicit trade in tobacco products is thus vital from the perspective of public health, public finance, governance, and equity – as highlighted by the World Bank.
23. Tackling illicit tobacco and vaping markets effectively requires full understanding of the causes, drivers, and types of illicit trade in tobacco products and joined up, whole-of-Government policy that works across sectoral silos to reduce financial incentives, and is carefully balanced. Any policy, or group of policies, that does not materially reduce financial incentives to criminal activity will simply fail.
24. For all these reasons, we judge it important that an impact risk assessment be conducted that considers all potential economic and socio-economic impacts, and hence costs, in order properly to appraise whether proposed legislation, while narrowing the legal market, risks allowing the illicit market to flourish.

1. The scale of illicit tobacco and vaping

The growing trade in illicit tobacco

1. Australia's approach to taxing and regulating tobacco products over the past decade or so, and its enforcement efforts, have not prevented rapid growth in the consumption of illicit tobacco products. (See figure 1).
2. In 2022, illicit tobacco accounted for 23.5% of Australia's tobacco consumption.¹ Such a scale is problematic in a number of respects, including in terms of meeting public health objectives.² And there is a risk that any further tax increases and/or regulatory tightening would increase the scale of the problem worse. This has been highlighted by, *inter alia*, the Australian Parliament:³

“Higher excise and excise-equivalent customs duty rates for tobacco improve the health of Australians by discouraging tobacco consumption and reducing their exposure to tobacco products. However, they significantly increase the risk of illicit tobacco being produced or manufactured domestically, or imported into Australia. This is particularly the case given the increase in tobacco excise and excise-equivalent customs duty rates following the 2016-17 and 2017-18 Budget measures.”

And also by PwC:⁴

“Higher prices for duty-paid cigarettes, driven predominantly by increases in taxes, lead to higher potential profits for the suppliers of illicit cigarettes, and larger potential savings for the consumer, therefore generating higher levels of illicit market activity.”

“Other country-specific factors, particularly geography, income levels and societal norms, also affect the overall size of the illicit market.”

“Addressing the size of the illicit market is critical in order to achieve governments' public health and revenue raising objectives.”

3. Before the COVID pandemic, typically, around half (just under 46% in 2020) of illicit tobacco was contraband – i.e. legally manufactured, but smuggled, cigarettes. The other half was unbranded tobacco ('chop chop').
 - 3.1. These products do not comply with Australian regulations. Unbranded tobacco carries no labelling or health warnings. There is also evidence that chop-chop tobacco is more harmful than its legal counterparts.⁵
4. In 2021, however, during the COVID pandemic, the contraband share fell considerably, to 29%: and this was counterbalanced by an increase in unbranded tobacco produced domestically, the share of which rose to an estimated 69%.
 - 4.1. In October 2022, The Australian Tax Office (ATO) estimated that in 2021 attempts were made to bring a total of 2,599 tonnes of illicit tobacco to the Australian market. An estimated 1,365 tonnes were seized, so an estimated $(2,599 - 1,365) = 1,234$ tonnes of illicit tobacco made it to market, amounting to over 10% of all tobacco consumed in Australia.⁶
5. FTI Consulting estimates that 2,608 tonnes of illicit tobacco were consumed in Australia in 2022, accounting for 23.5% of the overall tobacco market, and compared with an estimated 12.2% a decade or so ago.⁷

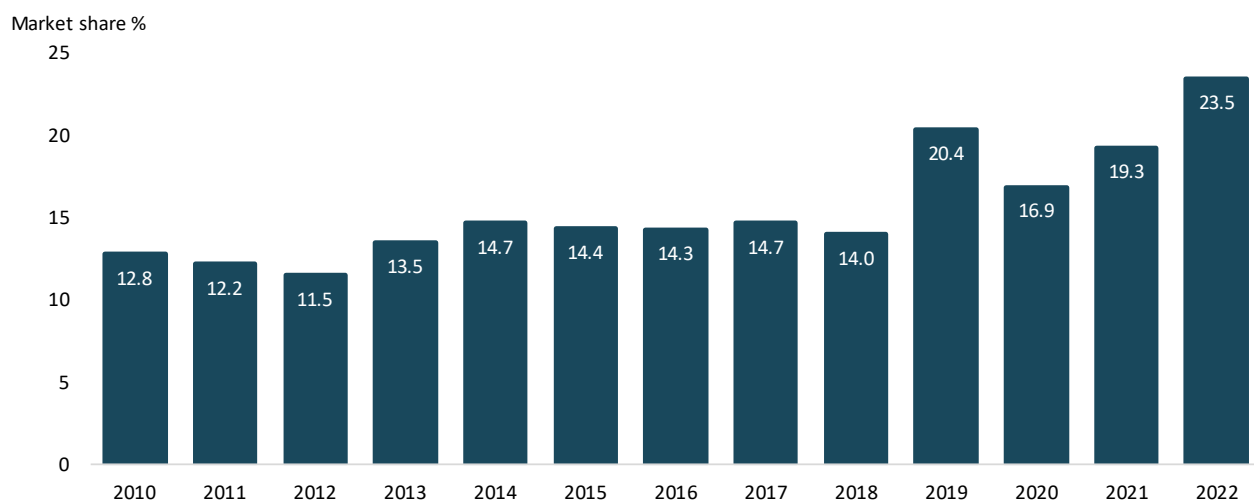
6. In 2022, the contraband share has recovered to 36.0% while unbranded tobacco became 61.3% of illicit consumption.⁸

The explosion of illicit vaping

7. The sale and consumption of illicit vaping products in Australia has also grown rapidly. This growth similarly risks being accelerated by any further increases in tobacco taxes and further regulatory tightening of duty-paid legal tobacco and / or vaping products.
8. Roy Morgan survey data indicate that there are currently around 1.3 m adult vapers in Australia. This represents a more than three-fold increase over the past five years.
9. Australia's adult vaping incidence rate of 6.5% is higher than in other countries that permit the adult retail sale of nicotine vaping products.
10. There are substantial differences in vaping product consumption across Australian States and Territories.
- 10.1. In New South Wales, an estimated 7.4% of adults consume vaping products.
- 10.2. In Tasmania, an estimated 3.5% of adults consume vaping products.⁹
- This suggests that, to the extent that other States and Territories catch up with the rate in New South Wales, there remains significant scope for consumption of vaping products to grow further in Australia as a whole.
11. This is despite Australia having one of the world's most restrictive laws on nicotine vaping.

(For further detail see '*Tobacco and vaping products in Australia - an updated economic assessment*', March 2023, Independent Economics. [\(Link.\)](#))

Figure 1: Market share of illicit tobacco in Australia



Source: FTI Consulting

2. Australia's Tobacco Control Laws

The consultation

12. The Australian Government has “... *announced tobacco reforms [which] bring together current legislation and introduce new measures to reduce tobacco prevalence. [They are] now consulting on the exposure draft legislation for these reforms.*¹⁰

13. **The Tobacco Control Laws (TCLs) as set out aim to:**

1. Improve public health by discouraging smoking and the use of regulated tobacco items.
2. Give effect to certain obligations that Australia has as a party to the World Health Organization (WHO) and Framework Convention on Tobacco Control (FCTC).
3. Address the health risks posed by vaping and the use of e-cigarette products.

14. **These objectives are to be achieved by the following broad range of means:**

- a. Limiting the exposure of the public to communications, recommendations or actions that may persuade people to: start smoking or continue smoking; start vaping or continue vaping.
- b. Reducing the appeal of regulated tobacco items and e-cigarette products to consumers.
- c. Preventing the retail packaging of tobacco products from misleading or deceiving consumers about the harmful effects of smoking or using tobacco products.
- d. Increasing consumer knowledge of health effects relating to the use of tobacco products.
- e. Increasing the effectiveness of health warnings, and health promotion messages, on and in the retail packaging of tobacco products.
- f. Discouraging people who have given up smoking or vaping from relapsing.
- g. Preventing and reducing nicotine addiction.
- h. Reducing people's exposure to smoke from tobacco products.
- i. Reducing the environmental risks of tobacco products.
- j. Limiting novel developments and emerging innovation in tobacco products.
- k. Limiting the risk of e-cigarette products becoming a gateway into smoking and the use of regulated tobacco items.
- l. Increasing public knowledge about tobacco products and the tobacco industry.

15. **The new measures being proposed include:**

1. A comprehensive ban on all advertising of tobacco products and e-cigarettes (even if they do not contain tobacco).
2. Full standardised pack size, cigarette dimensions, and pouch weight for Roll Your Own tobacco (RYO).
3. Banning of flavour accessories (e.g. 'crush balls').
4. Banning of several terms used on packaging as well as limiting the length of brand names.
5. Inclusion of health promotion inserts in packaging.

6. Banning of certain flavours and additives.
7. Updated images for plain packaging.
8. Banning of chewing tobacco and snuffs.
9. Reporting of sales data by tobacco companies.

Effects of the proposed TCL legislation

16. It is important, in our judgement, that this consideration of whether to amend existing regulations and / or introduce new ones should extend to assessing the likely effects on both illicit tobacco use and the already widespread and growing practice of vaping.
17. Since the last major revision of TCLs in 2011, tobacco excise has increased by close to 250%,¹¹ illicit tobacco has doubled, now accounting for around 25% of the overall tobacco market, and notwithstanding mounting expenditure on enforcement,¹² including on the Illicit Tobacco Taskforce in 2018,¹³ a large vaping market has developed. It is estimated that 1.3 million Australians now consume vaping products.¹⁴
18. There is a risk – significant in our judgement – that any further narrowing of the legal market would cause the illicit market to flourish further:
 - 18.1. While placing legislative focus on making it harder to consume duty-paid legal tobacco would further reduce consumption of legal tobacco, it would also drive additional consumption towards the illicit unregulated tobacco and vaping markets, as smokers looked for alternatives to legal tobacco, as highlighted by the Australian parliament¹⁵ and PwC.¹⁶ Any reduction in legal tobacco consumption might well be offset by a similar increase in consumption in the illicit markets.
 - 18.2. Moreover, and importantly, the proposed legislation does nothing to address the growing illicit market.
19. Accordingly it would, in our judgment, be wise, as well as good practice, to conduct an impact assessment as part of the overall consultation process.
 - 19.1. Australia has, in *The Australian Government Guide to Policy Impact Analysis*,¹⁷ good guidelines for how impact assessments should best be conducted. And the OECD too offers a suite of policy guides.¹⁸
20. Such an impact assessment would need to consider the full spectrum of costs and benefits – both economic and socio-economic – regarding the effects of the Tobacco Control Laws (TCLs) on:
 - Illicit trade in tobacco on the economy and society; and similarly on
 - Vaping – again, both economic and socio-economic costs.
21. As a contribution to this consultation process, and in the spirit of assessing and quantifying impacts, this paper is put forward to provide a concise, broad, overview of some of the economic costs – direct, indirect, and induced – as well as some of the socio-economic impacts associated with Australia’s growing trade in illicit tobacco and vaping. That said, this paper does not purport to represent anything like a full impact assessment. That should be undertaken by Government as part of assessing which TCLs to adopt and which to amend.

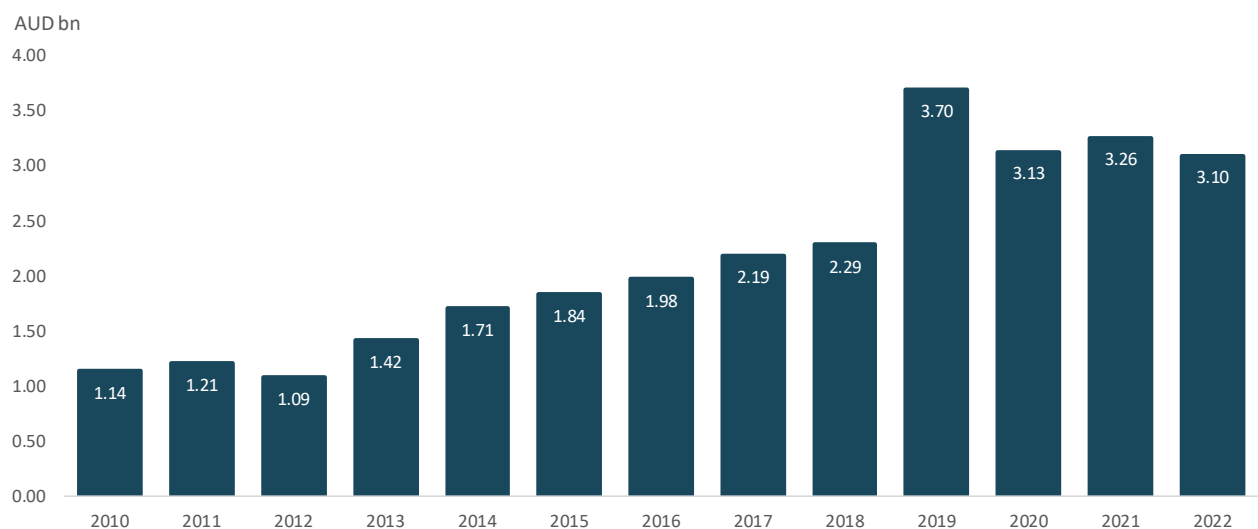
3. Economic and social impacts of illicit tobacco and vaping

Direct, indirect, and induced effects

Tobacco

22. The most obvious and **direct impact** from the consumption of illicit tobacco is the (considerable) tax revenue foregone.
23. The ATO puts this '**tax gap**' in 2020-21 (the difference between theoretical tax according to the law, and actual tax paid voluntarily or collected as a result of compliance activities),¹⁹ at AUD 1.89 bn. This is made up of AUD 1.6 bn evaded through illicit imports, and AUD 0.29 bn evaded through illicit production.²⁰
- 23.1. The figure has grown rapidly, being an estimated 42% higher than that for the previous year – some AUD 1.3 bn.
24. Other estimates are somewhat higher: KPMG has put the net excise duty gap (both smuggled and domestic production) in 2021 at AUD 3.4 bn.²¹ (See figure 2).
25. However, the impacts of consumption of illicit tobacco extend considerably beyond foregone revenue. In addition to potential excise revenue not captured by the Government, **legal industries** – including wholesalers, retailers, and those involved in the logistics chain – also miss out on potential revenue.
26. Taking FTI's estimate of 2,608 tonnes of illicit tobacco consumed in Australia in 2022, we estimate that of the order of AUD 395 million (m) of **gross value added (GVA)** was forgone due to illicit tobacco. (GVA is a measure of an entity's contribution within an economy: i.e. the value of its gross output minus its purchased inputs).²² An approximate apportionment:
- 26.1. AUD 320 m of GVA from the retail sector; and
- 26.2. AUD 75 m of GVA from the wholesale sector.
27. Our estimates also suggest that AUD 537 m was forgone in **GST and company taxes**. (See figure 3).

Figure 2: The illicit tobacco 'tax gap'



Source: FTI Consulting, KPMG, ATO, BAT Market Survey

28. Altogether, the estimated cost to the economy as a whole is currently over AUD 5 bn per year.

Figure 3: Foregone annual tobacco market tax receipts

Tax	Value (AUD m)
GST	520
Company Tax (Retail)	13
Company Tax (Wholesale)	4
Total Tax Receipts	537

29. The illicit tobacco market also results in lost (legal) employment opportunities: Oxford Economics Australia estimated that illicit tobacco alone displaced around 5,800 legal jobs in 2019 within the retail, wholesale, and transport sectors.²³
30. However, the full impacts, and thereby costs, extend beyond the retail, wholesale, and transport sectors: additional, **'indirect'**, **impacts** are experienced along the extended tobacco supply chain, by activities that supply these sectors.
31. Moreover, there are also **'induced'** **impacts**, which come from the expenditure multiplier effect as employees spend their wages in the wider economy.
32. Oxford Economics Australia estimate, based on Australian Government input-output tables, that for every AUD 1 of gross output in legal wholesale, retail, and transport sectors, AUD 2.6 of total output is generated in the economy.²⁴
33. These various direct, indirect, and induced impacts, and thereby their economic costs, are thus substantial.
34. The Oxford Economics Australia report, although recent, warrants being updated in order to consider:
- How costs have grown as the illicit tobacco problem has continued to accelerate;
 - Any further impacts insofar as the Tobacco Control Laws potentially exacerbate the scale of both illicit tobacco and vaping; and
 - The additional economic costs of the illicit vaping market, to which we now turn.

Vaping

35. In addition to lost economic activity, jobs and tax receipts from tobacco products, there are also considerable foregone potential revenues due to illicit vaping. The corollary is that legalising the market would generate significant new revenues.
36. Taking Roy Morgan's estimate of 1.3 m vapers in Australia in Q4 2022, we estimate that of the order of AUD 489 m of **gross value added (GVA)** could be gained from legalising vaping.²⁵ The broad composition could be as follows:

- 36.1. AUD 381 m of GVA in the retail sector.
- 36.2. AUD 108 m of GVA in the wholesale sector.
37. In turn, we estimate that of the order of AUD 415 m annually of **GST, company taxes (retail and wholesale), and import tariffs** at a rate of 5%, could be gained if vaping were legalised. (See figure 4).
38. This would amount to AUD 1.7 bn over the four-year forward estimates budget cycle for the Government.²⁶
39. The estimated potential gain to the economy as a whole from legalisation is thereby estimated at AUD 904 m per year, being the sum of GVA (AUD 489 m) and tax receipts (AUD 415 m).

Figure 4: Potential annual additional tax revenues from legalising vaping products

Tax	Value (AUD m)
GST	\$254
Company Tax (Retail)	\$46
Company Tax (Wholesale)	\$13
Import Tariffs	\$103
Total Tax Receipts	\$415

Note: Totals may not add up precisely because of rounding.

40. As for tobacco products, lost economic activity, employment and tax receipts from vaping extend beyond the direct impacts. In addition to the direct, indirect, and induced impacts and costs, there are also socio-economic impacts and costs. These are the subject of the next section, which looks further at known socio-economic impacts of illicit tobacco, and summarises some of the main findings from the literature.

(For further detail see *'Tobacco and vaping products in Australia - an updated economic assessment'*, March 2023, Independent Economics. [\(Link\).](#))

Wider known socio-economic impacts

41. The impacts of the illicit tobacco and vaping markets do not stop at foregone tax revenues, which reduce the Government's ability to deliver basic services and social programmes; displaced employment; indirect impacts to extended supply chains; and induced multiplier effect. The illicit trade in tobacco has known socio-economic impacts and costs.
42. This section provides a brief overview of the key conclusions from relevant literature and evidence from around the world, including from Oxford Economics Australia and PwC,²⁷ on known socio-economic impacts of Illicit tobacco. The analysis follows a 'cycle-of-crime' framework to convey the linkages and self-reinforcing negative synergies involved. (See figure 5).

Figure 5: the self-perpetuating cycle of crime



Step 1: More illicit tobacco

43. Illicit markets for tobacco, including in Australia, offer criminals an attractive risk/return calculus. In the EU, for example, profit margins are higher than for illegal drugs such as cocaine, making tobacco an attractive market in which to operate and grow.²⁸
44. Not having to adhere to restrictive regulations governing production standards, consumer protection regulations, and other regulations results not only in products that are thereby more dangerous than they would be were they regulated,²⁹ but also in reduced supply costs.³⁰ Evidence from a study on illicit tobacco in the EU finds that:³¹
- 44.1. Low production and transportation costs, combined with high sales value and demand, create large margins in illicit tobacco, reportedly of up to 900%.
 - 44.2. Yet illicit tobacco is often treated by law enforcement as less important than illicit drugs.
45. The incentive for criminals to supply more illicit tobacco, and become more organised, is thereby powerful.

- 45.1. In Australia, where duty paid cigarettes are amongst the most expensive in the world, illicit cigarettes are some 2.2 times cheaper,³² and vape sales are restricted, trade in illicit tobacco products has been rising progressively. This year, based on the data so far, illicit tobacco stands to account for 25%-odd of Australia's total tobacco market, more than double the global average World Bank estimated illicit market share of 10%.³³
- 45.2. Estimates suggest that a 10-percentage point increase in illicit cigarette consumption in Australia would result in an additional AUD 1 bn profits for organised criminal groups (OCGs).³⁴

Step 2. Illicit tobacco profits are used to fund organised crime groups

46. Profits from illicit tobacco are typically 'reinvested', not only into the illegal tobacco market, but also into other synergistic activities, including illicit alcohol and pharmaceuticals, that are similarly low-risk/high-value, as well as higher-risk activities including illegal drugs, human trafficking, arms dealing, and even terrorism.³⁵
47. Europol reports that OCGs today are "*well-structured*" and getting more so, with illicit tobacco "*produced on an industrial scale*", underpinned by "*sophisticated logistics and distribution channels*". And tobacco is a large part of global organised criminal activity.³⁶
- 47.1. Well-structured international OCGs, which are able to source containers of cigarettes from abroad, are already operating in Australia: illicit tobacco is sourced from international 'illicit whites brands' from countries that include South Korea, the UAE, and China, alongside locally grown 'chop chop' which may also be imported from Indonesia. The proliferation of illegal vape sales also demonstrates how other products have been able to make it into the country.
- 47.2. Organised crime is involved in every stage of the illicit tobacco supply chain, including sourcing, packaging, and distribution of illicit products, as well as hiring of intermediaries and liaison with other criminal groups to ensure product delivery.
48. As the sophistication of the illicit tobacco operation increases, so too does the quality and reliability of illicit supply chains. This makes it possible to spend and reinvest more, including on the shipping of tobacco products, thereby increasing the difficulty and cost of law enforcement. In the EU for example:
- "... illicit tobacco products are increasingly produced ... in modern and more professional production facilities, established closer to destination markets."*³⁷
49. By international standards, Australia has a comparatively low criminality score, and a high resilience score. Nevertheless, organised crime in Australia is already pervasive and is diversifying: an estimated AUD 2.1 bn flowed to illicit operators from selling tobacco products in 2019 alone, supporting OCGs which today account for some 80% of illicit tobacco activity.³⁸
50. Indeed, the Organised Crime Index report for Australia confirms the presence of organised crime in the country:
- "... the criminal group often referred to as the Australian 'Ndrangheta' is a prominent feature in the organized-crime landscape in the country."*

Although the group has clear foreign origins, a considerable proportion of its members are naturalized Australian citizens.”

“Evidence suggests that such criminal networks have diversified their activities, engaging in the illicit trade of various commodities across regions and shifting business alliances, as needed.”

Organised Crime Index report for Australia (2021).³⁹

51. Links in other countries between profits from illicit tobacco and ‘amalgamated supply chains’ – i.e. the use of tobacco supply chains to further other illegal activities – are well documented. Illicit tobacco dealers in Czechia, for example, were found to have started selling crystal meth using their existing tobacco-based network.⁴⁰
52. This, in turn, can lead to growing money laundering problems, and, in addition, insofar as the supply of narcotics and weapons increases, can create further socio-economic problems with increased addiction, gun crime, and lawlessness.
53. Higher illicit tobacco activity also corrupts institutions, including notably those in the logistics supply chains such as freight forwarders and customs brokers, and is generally correlated with a worse corruption-index score.
54. When illegal tobacco production has a local component it also frequently leads to land misuse and water diversion. Each acre of tobacco crop typically requires an estimated 2 million litres of water and 163 person hours to mature fully. And unsustainable farming practices result in soil degradation and reduced capacity for yield on surrounding farmland for legitimate farmers.⁴¹
55. Illegal tobacco also often leads to the exploitation of both legal and illegal migrants, with workers reportedly being paid in cash and working under duress.

(For a thorough investigation into how criminal tobacco funds criminal organisations and its socio-economic effects, see:

- *The Global Illicit Trade In Tobacco: A Threat to National Security*, a US-based report about illicit tobacco in the US by the US Gov (2017),⁴² and
- *The Organised Crime in Australia* Government report (2017),⁴³ which provides the most comprehensive unclassified profile of organised crime in Australia, including the characteristics of those involved, what drives them, activities they are involved in, and the extent and impact of organised crime.)

Step 3: Facilitating more severe criminal activities

56. The Terrorism, Transnational Crime and Corruption Center (TraCCC) points repeatedly to the ‘crime convergence’ associated with illicit trade – i.e. the use of illicit trade to finance other activities. Numerous law enforcement prosecutions around the world have highlighted multiple illicit trades, such as tobacco, drugs, firearms, and people smuggling connected to the same group.
 - 56.1. While not as profitable, people smuggling for example is often an important element in furthering OCG operations, by enabling the placement of people under their control into locations where they undertake the illicit activities.
57. TraCCC also finds that OCGs are increasingly using their internationally-connected hubs of illicit trade around the world for various different products. The authorities in Poland recently detained an OCG that was transporting drugs from Spain through Poland to Ukraine, and then smuggling illicit cigarettes in the opposite direction.⁴⁴

58. There are various examples of OCGs using cigarettes to help drive other activities. Cartels in Mexico have now started to control the illicit cigarette market to help fund their other activities.⁴⁵ And there is evidence that the proceeds of illicit cigarettes in Iran have funded drugs and the terrorist operations of Hezbollah.⁴⁶
59. Criminal networks often share routes with terrorist organisations and armed groups. In West Africa, criminal organisations and members of Islamic State of Iraq and the Levant (ISIL) and Al-Qaida have been documented as sharing the same smuggling routes for cigarette, drug, and arms trafficking.⁴⁷

Step 4: More socio-economic costs

60. As organised crime and illicit markets grow, so do the negative socio-economic consequences; and typically these have a disproportionate effect on the most vulnerable in society. Mechanisms and feedback loops are many and varied, but include:
- 60.1. Growth in illicit drugs or pharmaceuticals exacerbating public health problems and making the ‘war’ on illegal drugs harder.
 - 60.2. The takeover of illicit supply chains by OCGs, resulting in greater oppression and poverty.
 - 60.3. Illicit trade becoming harder to tackle as a result of fewer prosecutions, as large parts of the population become increasingly ‘ruled’ by illicit trade.
61. Impacts can become so serious that they hinder a country’s economic development.

“In Honduras, an association of private business owners stated contraband was getting so bad it was hindering the country’s economic development.”⁴⁸

(For more on how OCGs exploit the most vulnerable, see the Report by TRACC, and specifically the section on how OGCs exploit the most vulnerable in society.⁴⁹ And for various case studies on the fuelling of poverty by organised crime, see West Africa and Sahel⁵⁰ and Latin America.)⁵¹

Step 5: More money laundering, internationalisation, consolidation, etc.

62. The greater the proceeds, the more are third parties willing to help with money laundering. Key cash-driven businesses, including casinos, bars, and fixed-odds betting terminals (FOBTs) – ‘pokies’ in Australia – are routinely used to ‘clean’ billions of AUD from illicit trade.⁵²
63. Money laundering around the world is rife, and international, with banks often complicit.⁵³
64. Money laundering is already a big problem in Australia,⁵⁴ where some 80% of drug proceeds are estimated to be laundered, with illicit tobacco likely not dissimilar.⁵⁵ Interpol reports that:

“There is a clear link between illicit trade and other types of crime, such as human trafficking, drug trafficking, corruption, bribery and money laundering. Illicit trade damages the global economy and harms public health worldwide. All regions of the world and all industry sectors are affected.”⁵⁶

(For more on the links between crime and money laundering, see Interpol article about links between crime and money laundering,⁵⁷ and for more case studies see: Rampant money laundering in Saudi Arabia;⁵⁸ and CRIMJUST workshop calls out money laundering as key facilitator of drug trafficking (Panama)⁵⁹

Step 1: More illicit tobacco, again

65. Just how far such developments will go in Australia will depend in important part on how serious these potential costs are recognised as being, and the steps adopted to reduce the incentives that lead to them. In countries where the nettle has not been grasped adequately or soon enough, the problems have become extremely serious.
66. Reducing illicit trade in tobacco products is thus vital from the perspective of public health, public finance, governance, and equity – as highlighted by the World Bank.⁶⁰
67. It is for all these reasons that we judge it important that an impact risk assessment be conducted, and that it should consider all potential economic and socio-economic impacts and hence costs in order properly to appraise whether proposed legislation, while narrowing the legal market, risks allowing the illicit market to flourish.
68. Tackling illicit tobacco and vaping markets effectively requires full understanding of the causes, drivers, and types of illicit trade in tobacco products and joined up, whole-of-Government policy that works across sectoral silos to reduce financial incentives.⁶¹

Annex

¹ FTI Consulting. *Illicit Tobacco in Australia*. May 2023.

² As set out in the *National Tobacco Strategy*.

<https://www.health.gov.au/resources/publications/national-tobacco-strategy-2023-2030>

³ The Parliament of the Commonwealth of Australia. *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018. Exploratory Memorandum*. 2018.

https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6049_ems_7d941399-f916-400d-b044-97f2830340f8/upload_pdf/663268.pdf;fileType=application%2Fpdf#search=%22legislation/ems/r6049_ems_7d941399-f916-400d-b044-97f2830340f8%22

⁴ PwC. *An economic assessment of the drivers of the illicit trade in cigarettes*. June 2022.

⁵ <https://www.tobaccoinaustralia.org.au/chapter-3-health-effects/3-27-health-effects-of-smoking-tobacco-in-other-fo>

⁶ <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/>

⁷ FTI Consulting. *Illicit Tobacco in Australia*. May 2023.

⁸ FTI Consulting. *Illicit Tobacco in Australia*. May 2023.

⁹ Roy Morgan surveys.

¹⁰ <https://consultations.health.gov.au/phd-tobacco/public-consultation-for-tobacco-review/>

¹¹ <https://www.ato.gov.au/Business/Tobacco-and-excise/Excise-duty-rates-for-tobacco/>

¹² <https://www.afr.com/policy/foreign-affairs/our-borders-are-being-infiltrated-border-force-seeks-more-powers-20221114-p5by7b>

<https://www.smh.com.au/politics/federal/home-affairs-underfunded-overstretched-and-set-up-to-fail-says-leaked-report-20230330-p5cwl.html>

¹³ <https://www.abf.gov.au/about-us/taskforces/illicit-tobacco-taskforce>

¹⁴ Roy Morgan surveys.

¹⁵ The Parliament of the Commonwealth of Australia. *Treasury Laws Amendment (Illicit Tobacco Offences) Bill 2018. Exploratory Memorandum*. 2018.

https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6049_ems_7d941399-f916-400d-b044-97f2830340f8/upload_pdf/663268.pdf;fileType=application%2Fpdf#search=%22legislation/ems/r6049_ems_7d941399-f916-400d-b044-97f2830340f8%22

¹⁶ PwC. *An economic assessment of the drivers of the illicit trade in cigarettes*. June 2022.

¹⁷ <https://oia.pmc.gov.au/sites/default/files/2023-02/oia-impact-analysis-guide-nov-22.pdf>

¹⁸ <https://www.oecd.org/gov/pcsd/guidanceandtoolsforpolicymakers.htm>

¹⁹ The 'tax gap' is defined by the Australian Taxation Office as the difference between theoretical tax according to the law, and actual tax paid voluntarily or collected as a result of compliance activities. See:

<https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Principles-and-approaches-to-measuring-gaps/?page=7#Glossary>

²⁰ <https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Tax-gap/Tobacco-tax-gap/>

²¹ Calculated by KPMG by taking their estimates of illicit volumes and multiplying them by actual tax rates.

²² Note that the results are highly sensitive to changes in assumptions of gross margins and pre-tax margins. The assumptions made are as follows:

a. The gross margins for tobacco in the retail and wholesale sector are assumed to be 30% and 10% respectively.

- b. The pre-tax margins for tobacco are assumed to be 4% in retail and 2% in wholesale.
- c. A conversion factor of 0.7g of loose tobacco per stick.
- d. Elasticity of demand for tobacco is unchanged.
- e. Given that there is no legal domestic production of tobacco products in Australia, the supply chain consists only of wholesale and retail sectors.

Gross value added (GVA) and tax receipts are calculated based on the above assumptions, together with current tax rates, data about the supply chain of the legal tobacco industry, all then applied to illicit tobacco quantities to 'scale down' the legal market. (More details available on request).

²³ BIS Oxford Economics, *Economic Impact of illicit tobacco in Australia*, November 2021.

Note that BIS Oxford Economics are now known as 'Oxford Economics Australia' which is the organisation to which we refer in the main body of this report.

<https://www.oxfordeconomics.com/resource/economic-impact-of-illicit-tobacco-in-australia/>

²⁴ BIS Oxford Economics, *Economic impact of illicit tobacco in Australia*, November 2021.

<https://www.oxfordeconomics.com/resource/economic-impact-of-illicit-tobacco-in-australia/>

²⁵ Note that the results are highly sensitive to changes in assumptions regarding gross margins and pre-tax margins. The assumptions made are as follows:

- a. Gross margins of the retail and wholesale sector are 15% and 5% respectively.
- b. The pre-tax margins are 6% in retail and 2% in wholesale.
- c. As with tobacco, no legal domestic production of vaping products in Australia: the supply chain consists only of wholesale and retail sectors.
- d. A (standard) import tariff of 5%.

Gross value added (GVA) and tax receipts are calculated on the basis of the above assumptions, estimates of the size of the Australian vaping market, and prevailing tax rates. (More details are available on request).

²⁶ This figure assumes that tax receipts remain unchanged over the Australian Treasury's four-year forecast period.

²⁷ PwC. An economic assessment of the drivers of the illicit trade in cigarettes. June 2022.

²⁸ Arndt Sinn. The Link Between Illicit Tobacco Trade and Organised Crime.

https://www.eesc.europa.eu/sites/default/files/files/mr_arndt_sinn_speech.pdf

²⁹ Not unlike in other industries including the spare-parts industry for aircraft.

<https://www.theguardian.com/business/2002/jan/29/theairlineindustry.internationalnews>

³⁰ <https://www.rusi.org/explore-our-research/projects/tap-uk-organised-crime-and-illicit-trade-tobacco-alcohol-and-pharmaceuticals>

³¹ Arndt Sinn. The Link Between Illicit Tobacco Trade and Organised Crime.

https://www.eesc.europa.eu/sites/default/files/files/mr_arndt_sinn_speech.pdf

³² PwC. An economic assessment of the drivers of the illicit trade in cigarettes. June 2022. In particular section 3, case studies on countries with an illicit cigarette problem.

³³ World Bank, *Confronting Illicit Tobacco Trade, A Global Review of Country Experiences*, January 2019

<https://documents1.worldbank.org/curated/en/677451548260528135/pdf/133959-REPL-PUBLIC-6-2-2019-19-59-24-WBGTobaccoIllicitTradeFINALvweb.pdf>

³⁴ Based on estimates for the total number of cigarettes consumed in Australia (15 billion), 1.5 billion cigarettes would move into the illicit market with a 10% increase. These cigarettes, sold at AUD 0.83 per stick, with 80% of the profits made going to OCGs, would result in AUD 1 billion dollars into the hands of criminal organisations.

- ³⁵ Arndt Sinn. The Link Between Illicit Tobacco Trade and Organised Crime.
https://www.eesc.europa.eu/sites/default/files/files/mr_arndt_sinn_speech.pdf
- ³⁶ <https://www.europol.europa.eu/publication-events/main-reports/european-union-serious-and-organised-crime-threat-assessment-socta-2021>
- ³⁷ <https://www.europol.europa.eu/publication-events/main-reports/european-union-serious-and-organised-crime-threat-assessment-socta-2021>
- ³⁸ BIS Oxford Economics, *Economic impact of illicit tobacco in Australia*, November 2021.
<https://www.oxfordeconomics.com/resource/economic-impact-of-illicit-tobacco-in-australia/>
- ³⁹ <https://ocindex.net/country/australia>
- ⁴⁰ <https://www.europol.europa.eu/publication-events/main-reports/european-union-serious-and-organised-crime-threat-assessment-socta-2021>
- ⁴¹ BIS Oxford Economics, *Economic impact of illicit tobacco in Australia*, November 2021.
<https://www.oxfordeconomics.com/resource/economic-impact-of-illicit-tobacco-in-australia/>
- ⁴² <https://2009-2017.state.gov/documents/organization/250513.pdf>
- ⁴³ <https://www.acic.gov.au/publications/unclassified-intelligence-reports/organised-crime-australia-2017>
- ⁴⁴ <https://traccs.schar.gmu.edu/wp-content/uploads/2020/09/Research-Findings-Illicit-Hubs-Tobacco-Trade-and-Convergence-with-Illicit-Commodities.pdf>
- ⁴⁵ <https://insightcrime.org/news/jalisco-cartel-cashing-in-on-mexicos-illegal-cigarette-market/>
- ⁴⁶ <https://iranwire.com/en/features/70072/>
- ⁴⁷ https://www.unodc.org/unodc/en/data-and-analysis/Tocta_Sahel.html
- ⁴⁸ <https://insightcrime.org/news/analysis/gamechanger-black-markets-new-normal/>
- ⁴⁹ <https://traccs.gmu.edu/wp-content/uploads/2023/05/Hubs-of-Illicit-Trade-White-Paper-Final-19052023.pdf>
- ⁵⁰ <https://press.un.org/en/2022/sc14761.doc.htm>
- ⁵¹ <https://insightcrime.org/news/analysis/gamechanger-black-markets-new-normal/>
- ⁵² <https://www.mondaq.com/australia/crime/1248278/poker-machine-money-laundering-in-new-south-wales#:~:text=%22The%20NSW%20club%20industry%20has,completely%20baseless%2C%22%20ClubsNSW%20said.>
<https://www.bangkokpost.com/world/2423003/slot-machines-are-laundering-billions-in-drug-money-in-australia>
- ⁵³ <https://www.ultimahora.com/caso-forex-fiscalia-acusa-directivos-bancos-lavado-dinero-n1002435>
- ⁵⁴ <https://www.theguardian.com/australia-news/2023/feb/13/no-questions-asked-money-laundering-thrives-in-australia-because-of-professionals-willing-to-facilitate-it>
 Government of Australia. Modernising Australia's anti-money laundering and counter-terrorism financing regime
<https://consultations.ag.gov.au/crime/aml-ctf/>
- ⁵⁵ BIS Oxford Economics, *Economic impact of illicit tobacco in Australia*, November 2021.
<https://www.oxfordeconomics.com/resource/economic-impact-of-illicit-tobacco-in-australia/>
- ⁵⁶ <https://www.interpol.int/en/Crimes/Illicit-goods/Illicit-goods-the-issues>
- ⁵⁷ <https://www.interpol.int/en/Crimes/Illicit-goods/Illicit-goods-the-issues>
- ⁵⁸ <https://www.transparency.org/en/news/the-united-arab-emirates-a-key-piece-in-the-global-money-laundering-puzzle>

⁵⁹ <https://www.unodc.org/unodc/en/drug-trafficking/crimjust/news/crimjust-workshop-calls-out-money-laundering-as-key-facilitator-of-drug-trafficking-panama.html>

⁶⁰ <https://blogs.worldbank.org/health/confronting-tobacco-illicit-trade-global-review-country-experiences>

⁶¹ For an assessment of the effectiveness of the implementation on the government's Black Economy Taskforce's whole-of-government strategy and policy agenda to address the shadow economy, see the 2023 report: <https://www.anao.gov.au/work/performance-audit/implementation-the-government-response-to-the-black-economy-taskforce-report>

Important notice

This Report has been prepared by Independent Economics LLP for British American Tobacco ('Australia BAT'). It builds on the two previous reports, which analyse the markets for tobacco and vaping in Australia, written by Llewellyn Consulting and Independent Economics.

The first, published October 2022 and titled '*Tobacco and vaping products in Australia - an economic assessment*' examined, in the context of Australia's economy at large, the plateauing of tobacco tax revenue, the growing illicit tobacco issue, and the growth of illegal vaping. ([Link](#))

A follow-up, in March 2023, '*Tobacco and vaping products in Australia - an updated economic assessment*', included new data, information derived from a Roy Morgan consumer survey commissioned by Independent Economics, and an analysis of broader economic impacts of illicit tobacco and vaping. ([Link](#))

Independent Economics recognises the wider public policy context within which governments decide regulatory and fiscal changes for the tobacco industry, and that the analysis in this Report considers only the economic and socio-economic aspects.

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14 July 2023.