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RE: SUPPLEMENTARY 2020-21 PRE-BUDGET SUBMISSION

INTRODUCTION

Imperial Brands Australasia (Imperial) welcomes the opportunity to participate in the Australian Government's 2020-21 Pre-Budget Submission process and submits this paper as a supplementary inclusion to our original submission dated December 19, 2019 under the trading name 'Imperial Tobacco Australia Limited'. The change to the business name was made in late 2019 to better reflect a change in focus from a traditional tobacco business to a more diverse brands business which includes the developing Next Generation Product (NGP) sector.

Imperial participates in a range of government consultations that are relevant to our business. We do this on the basis that our views will be considered in an objective manner and that the evidence and views we provide will be properly evaluated, with due regard given to relevant legal and legislative requirements and the principles of best practice regulation. We are a legal industry, we sell a legal product, and comply with high standards of regulation.

Since Imperial last engaged with The Treasury, Australia, and indeed the whole world, has seen significant and unprecedented disruptions to everyday life.

Australia experienced the worst fire season and a record-breaking heat wave between the end of 2019 and the beginning of 2020. The unprecedented bushfires hit the Australian economy, devastating tourism areas and causing damage to the retail, construction and finance sectors. In March 2020, COVID-19 pushed Australia deeper into uncharted territory with wide scale lockdowns and major disruptions impacting all facets of life. The challenges to global economic and social stability are widely considered the greatest since World War 2.

The implications on Australian public finances and tax revenues are significant. After 29 years of steady, unimpeded growth, the Australian economy now finds itself in a truly critical stage. With record Government expenditure, climbing debt levels, rising unemployment and shrinking revenue, careful consideration of the practical outcomes from economic reform is required.

The growing calls for tax reform are underscored by the need to increase tax revenue, boost demand and increase consumption at a time of rising unemployment and diminished economic activity. Australia's tax system will be integral to economic recovery necessitating a model conducive to economic growth with a foundation of efficient, fair and sustainable taxes.

Low income smokers disproportionately bear the negative outcomes of excessive tobacco taxes with affordability pressures born from years of successive excise increases also contributing to the establishment and growth of the illicit tobacco market in Australia. Recent Laffer curve modelling brings attention to the decreasing tax receipts that are expected should tax rates continue to increase, making tobacco excise increasingly ineffective at achieving public health and state revenue objectives.

PRACTICAL OUTCOMES OF TOBACCO TAXATION IN AUSTRALIA

Australia is a high tax environment for tobacco products with prices today among the most, if not the most expensive in the world¹, the cumulative effect of successive annual 12.5% excise increases running from 2013-2020 and initiated by a one off 25% excise increase in 2010. It has historically been proposed that increasing tobacco taxes and cigarette prices is one of the most effective and efficient means of reducing tobacco consumption and raising state revenue. Today, raising tobacco excise is looking increasingly ineffectual at achieving either of these objectives.

The Laffer curve model theorises that there is an optimal tax rate at which tax revenue is maximised and that subsequent increases in tax rates beyond this point will result in declining tax receipts for Government. Economic modelling recently undertaken by Imperial Brands highlights Australia's position nearing the crest or tipping point along the Laffer curve. The modelling indicates that continued tax increases will push tax revenue into the prohibitive range in the short term and result in declining tax revenue for Government.

There are nearly 3 million adult smokers in Australia, many of whom are from disadvantaged and lower socioeconomic segments of society. The excessive tax levied on tobacco products has created financial hardship and budget pressure on those Australians most in need of relief. The growth in the price of cigarettes has far outpaced the prices of other consumer goods². The regressive nature of tobacco taxes means lower income smokers face a disproportionately larger

¹ Katherina, Buchholz, Statista August 16 2019; The Price of a Pack of Cigarettes Around the World

² Ting I, Tobacco Tax Rise Comes After Cigarette Prices Soar 343% in 20 Years, Sydney Morning Herald 2016

burden and are left with less money to spend on general basic needs, or alternatively forced to participate in the illicit market.

The high tobacco tax environment places severe additional financial pressure on low income adult smokers at a time when COVID-19 has already exposed the massive challenges disadvantaged households face. Imposing further hardship on those unable to quit smoking creates a myriad of associated negative economic and social costs. It is an unfortunate actuality that despite the stated public health intentions of tobacco excise, many adult smokers will divert significant portions of their weekly budget away from essential goods such as housing and food and spend more on tobacco consumption. The economic knock-on effect from low income households spending less on essential goods necessitates further consideration of what constitutes a fair and efficient tax structure.

Affordability pressures born from years of successive excise increases have also contributed to the establishment and growth of the illicit tobacco market in Australia. Excise increases are resulting in exorbitantly high prices, ultimately encouraging the movement of consumers out of the legal market and into the illicit market.

EXCISE AND THE ILLICIT TRADE

The KPMG Illicit Tobacco in Australia 2019 Full year Report confirms that the black market for illicit tobacco has continued to entrench itself as a significant segment of the tobacco market in Australia. At 20.7% of consumption, the illicit market represents one in every five cigarettes and \$3.41 billion dollars in lost revenue to the Government. This is a marked increase from the previous year's figure of 14.1%.

As intimated in Imperial's previous submission to the Treasury, It is necessary to highlight that the illicit tobacco trade is intimately linked to excise. Australia is a high tax environment for tobacco products and this essentially drives both the demand, and supply side of the equation. Excise increases result in higher prices, driving down trading and, ultimately, movement of consumers to the illicit market. These large excise increases also fuel the black market by making it even more lucrative for organised criminals to smuggle illegal tobacco into Australia. For example, a pack of 20 cigarettes is up to 15 times more expensive in Australia than Indonesia³. These high profit margins undoubtedly provide an attractive and valuable source of income for organised crime syndicates who are increasingly involved in the illegal trade.

The illicit behaviour is being compounded by the entrenchment of 'social norms', or the complicit nature of illicit tobacco, with participants on the demand side of the equation seeing the activity as commonplace and justified based on high pricing of the legal market caused by excessive excise.

³ KPMG Illicit Tobacco in Australia, 2019 Full year Report, 05 May 2020



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Legitimate Australian retailers are anecdotally reporting a growing number of customers seeking out cheaper illicit tobacco products. Businesses choosing to do the right thing have expressed their concern at the loss of regular customers and the corresponding decline in their sales as a result. In order to stay competitive and maintain the profitability of their stores, unfortunately, some retailers within the legal supply chain have felt compelled to participate in the illegal supply of tobacco.

PUBLIC HEALTH OUTCOMES

Australia has some of the most stringent plain packaging laws, display bans, POS restrictions and the highest cigarette prices in the world; the combined effect of which permits Australia to boast, what are widely considered to be the strictest tobacco controls in place globally. Nonetheless, the latest figures show that Australia is falling behind the rest of the world when it comes to reducing smoking incidence.

From 2013 to 2016 Australia experienced a statistically insignificant decline in smoking incidence of 0.6%⁴. This is particularly arresting when viewed against the accelerated declines in many contemporary countries in Europe, the UK and the US where smoking rates have declined between 3%-12%⁵. There is growing consensus that the successful experiences of these countries can be attributed to their harm reduction approach to tobacco control (in contrast to that taken in Australia). For example, the smoking rate in Norway fell by half from 22% to 11% between 2007-2017, supported by the widespread uptake of Swedish Snus, a low risk, moist oral tobacco product, which is banned in Australia⁶.

Cigarettes are a known cause of serious disease in smokers and many countries have stated aims for future generations to be smoke-free. Yet over a billion adults around the world still choose to smoke and will continue to do so well into the future. Next Generation Products (NGP) – particularly vapour products, which do not contain tobacco; are seen as representing a less harmful alternative to cigarettes, thereby creating a huge global public health opportunity.

Australia is one of only 2 OECD nations, the other being Turkey, which has prevented adult smokers from accessing less harmful NGP. Imperial was discouraged with recent efforts to further impede access to liquid nicotine and is hopeful that the postponement of the import ban will provide time for governments, regulators and public health bodies to play a positive role, which includes a legislative framework that allows this category to develop and gives consumers the confidence to trial, and ultimately switch, to these less harmful products.

⁴ The Department of Health, National Drug Strategy Household Survey 2016 Key Findings

⁵ SOURCE: ATHRA, <http://au.news.yahoo.com/australia-highest-priced-cigarettes-world-arent-peoplequitting-012023457.html>

⁶ <https://www.reuters.com/article/us-norway-smoking/snus-tobacco-on-the-rise-as-norway-smoking-halved-in-a-decade-iduskbn1f7ori>

Despite nicotine containing liquids remaining de facto illegal, *Use of e-cigarettes is increasing—between 2016 and 2019, lifetime use and current e-cigarette use increased for smokers*⁷. Consumers are already making the choice and by doing so, are essentially engaging in an illegal activity. Many consumers purchase liquid nicotine online from overseas retailers with unknown product quality and control measures while local businesses have been effectively sidelined from the market.

This demand is better met by tax paying, responsible manufacturers. The legalisation and regulation of e-cigarettes will quickly lead to the establishment of an industry in Australia at a time when there is a critical need for increased economic activity while also providing a much needed boost for Australia's struggling small business retail sector.

In light of the growing consensus among public health specialists that e-cigarettes can contribute greatly to tobacco harm reduction and therefore offer significant potential public health benefits, the sale and supply of nicotine e-cigarettes and liquids containing nicotine should be permitted.

CONCLUSION

As we continue to navigate through this unprecedented health crisis, much of the discussion has turned to the economic recovery and the post-COVID19 Australia. Excessive tobacco excise increases have had a number of negative economic and socio-economic consequences. The high tax environment has exasperated affordability pressures and places a huge financial burden on some of the most disadvantaged segments of society. The regressive nature of tobacco taxes means that lower income adult smokers shoulder a disproportionately larger burden and are often forced to forego basic goods to maintain consumption patterns. These affordability pressures exemplify how tobacco excise strengthens the demand for illicit products while simultaneously creating the incentive for criminal supply.

Excise is a key driver of the illicit tobacco trade. As excise increases continue to drive the price of legitimate tobacco products up, the demand for illicit tobacco will similarly see a continued increase as consumers seek more affordable alternatives. Those criminals involved in the illicit tobacco market do not pay taxes, and therefore illicit tobacco will always be quite significantly cheaper.

Excessive excise increases are the stimulus to encourage both the supply and demand side of this problem. Stabilisation of the excise environment, and return to AWOTE only excise increases, should be considered.

Assertions that excise increases are an effective means for raising state revenue and reducing smoking incidence are challenged by the practical outcomes of Australia's experience. Australia

⁷ Australian Institute of Health and Welfare, Tobacco Smoking, National Drug Household Survey 2019



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has a strong track record of tobacco control but has in recent times fallen behind. England, Canada and a number of European countries, all of which provide adult consumers with access to e-cigarettes, have experienced significant declines in smoking rates in recent years, while Australia has seen the decline plateau over the same period.

Electronic Vapour Products represent a huge public health opportunity. There is a growing international consensus that e-cigarettes are significantly less harmful than conventional cigarettes⁸ and lead to an accelerated decline in both youth and adult smoking rates in markets where sold⁹. The legalisation and regulation of Electronic Vapour Products will support struggling Australian retailers who have been sidelined from this global industry while creating onshore manufacturing jobs at a time when investment in Australia is vital for economic recovery.

Imperial Brands Australasia would be pleased to discuss any aspect of this submission in more detail.

⁸ See for example; <https://www.gov.uk/government/news/phe-publishes-independent-expert-e-cigarette-evidence-review>, or; <https://www.rcplondon.ac.uk/projects/outputs/nicotine-without-smoke-tobacco-harmreduction>

⁹ Australian Tobacco harm reduction association