
POST-IMPLEMENTATION REVIEW:
25 PER CENT TOBACCO EXCISE INCREASE

THE TREASURY

February 2013

© Commonwealth of Australia 2013

ISBN 978-0-642-74882-9

This publication is available for your use under a Creative Commons BY Attribution 3.0 Australia licence, with the exception of the Commonwealth Coat of Arms, the Treasury logo, photographs, images, signatures, all material from the Medical Journal of Australia and where otherwise stated. The full licence terms are available from <http://creativecommons.org/licenses/by/3.0/au/legalcode>.



Use of Treasury material under a Creative Commons BY Attribution 3.0 Australia licence requires you to attribute the work (but not in any way that suggests that the Treasury endorses you or your use of the work).

Treasury material used 'as supplied'.

Provided you have not modified or transformed Treasury material in any way including, for example, by changing the Treasury text; calculating percentage changes; graphing or charting data; or deriving new statistics from published Treasury statistics — then Treasury prefers the following attribution:

Source: The Australian Government the Treasury.

Derivative material

If you have modified or transformed Treasury material, or derived new material from those of the Treasury in any way, then Treasury prefers the following attribution:

Based on The Australian Government the Treasury data.

Use of the Coat of Arms

The terms under which the Coat of Arms can be used are set out on the It's an Honour website (see www.itsanhonour.gov.au).

Other Uses

Inquiries regarding this licence and any other use of this document are welcome at:

Manager
Communications
The Treasury
Langton Crescent Parkes ACT 2600
Email: medialiaison@treasury.gov.au

Contents

Post-Implementation Review: 25 per cent Tobacco Excise Increase	1
Introduction.....	1
Background	1
Problem	9
The case for intervention	12
Objectives of Government Action	13
Impact analysis.....	13
Consultation	24
Conclusion	28
Attachment A.....	31
Anti-smoking action.....	31
Excise increase.....	32
Cracking down on cigarette advertising	32
Anti-smoking advertising.....	33
Attachment B	35
Attachment C.....	37
Data on pharmaceutical benefit scheme medicines used to help quit smoking	37

Post-Implementation Review: 25 per cent Tobacco Excise Increase

INTRODUCTION

1. On 29 April 2010, the Government increased the excise and excise-equivalent customs duty applying to tobacco products by 25 per cent.

Background

2. Excise is a tax on certain goods produced in Australia including alcohol (other than wine), tobacco and fuel. Imported goods comparable to those subject to excise, known as 'excise-equivalent goods', attract customs duty imposed at the same rate as the excise rate so that imports and locally-produced goods are taxed in an equivalent fashion. This component is commonly referred to as 'excise-equivalent customs duty'.¹
3. Compared to other taxes which are designed to raise revenue, excise can also be applied selectively to pursue non-revenue objectives by taxing products such as tobacco. In the case of tobacco this intervention is justified by the strongly addictive qualities of tobacco, its serious health impacts, its uptake by minors and the costs that smoking imposes on non-smokers.

Changes to tobacco excise

4. In 1999 the tobacco excise was changed from the complex weighted and *ad valorem* surcharge to per cigarette stick taxation. This resulted in a higher price for some consumers.
5. The per stick excise applies to all cigarettes with a tobacco content not exceeding 0.8 grams per cigarette. All other tobacco products (including cigarettes containing more than 0.8 grams of tobacco, loose tobacco and cigars) are taxed per kilogram of tobacco at a rate equivalent to the per stick rate effectively imposed on the tobacco content of cigarettes.
6. Prior to the increases in April 2010, the last (non-CPI) general increase in the excise rate for tobacco occurred in the 1995-96 May Budget which increased the excise rate by 10 percentage points.

¹ Since 2006 tobacco has not been grown commercially in Australia.

7. With the introduction of the goods and services tax (GST) on 1 July 2000, tobacco products became subject to the GST imposed at a rate of 10 per cent in addition to excise.

8. The tobacco excise and customs rates are subject to an increase in line with the CPI, occurring in February and August each year.

International tobacco taxation

9. Studies have demonstrated that an excise that represents at least 70 per cent of the retail price will make a difference with respect to the lives saved.² The World Health Organisation has recommended since 2010³ as best practice that countries adopt excise levels that account for 70 per cent of the retail price for tobacco products.

10. The Minister for Health and Ageing, the Hon Nicola Roxon, launched the National Preventative Health Strategy on 1 September 2009. The report of the National Preventative Health Taskforce⁴ recommended increasing the rate of tobacco taxation to meet international best practice standards.

April 2010 rate increase

11. On 29 April 2010, the Prime Minister, the Treasurer and the Minister for Health and Ageing issued a joint media release, *Anti-smoking Action* (Attachment A). This media release announced a range of anti-smoking measures applying to tobacco products including:

- a 25 per cent increase in excise;
- the introduction of plain packaging;
- extending existing restrictions on advertising to Australian internet advertising of products; and
- spending an additional \$27.8 million on anti-smoking campaigns.

12. The Government's decision to increase excise applying to tobacco by 25 per cent is consistent with the goals of the National

² Ross HZ, Shariff S and Gilmore A (2009). *Economics of tobacco taxation in Ukraine*. Paris: International Union Against Tuberculosis and Lung Disease. Ross HZ, Shariff S and Gilmore A (2008). *Economics of tobacco taxation in Russia*. Paris: International Union Against Tuberculosis and Lung Disease.

³ World Health Organisation Technical Manual on Tobacco Tax Administration 2010 Reprinted 2011, available from: http://whqlibdoc.who.int/publications/2010/9789241563994_eng.pdf, p 104.

⁴ Australia: the healthiest country by 2020 Technical Report 2 *Tobacco control in Australia: making smoking history* including addendum for October 2008 to June 2009 Commonwealth of Australia 2009, available from: <http://www.preventativehealth.org.au/internet/preventativehealth/publishing.nsf/Content/national-preventative-health-strategy-1lp>, page 15.

Tobacco Strategy (NTS) 2004-2009. This strategy states the NTS is a statement:

*‘of our resolve as federal, state and territory governments to work together and in collaboration with non-government agencies on a long term, comprehensive, evidence based and coordinated national plan to reduce the often hidden but very real misery and wasted human potential caused by tobacco smoking in Australia’.*⁵

13. The objectives of the NTS are:

- to prevent the uptake of smoking;
- to encourage and assist as many smokers to quit as soon as possible;
- to eliminate harmful exposure of tobacco smoke among non-smokers; and
- where feasible to reduce harm associated with the continuing use of, and dependence on, tobacco and nicotine.

14. The NTS recognised that taxes on tobacco products increase prices which helps to discourage consumption and that the policy intention is to make tobacco products less affordable.⁶

15. All four of the measures outlined in paragraph 11 also responded to the major recommendations of the National Preventative Health Taskforce.

16. The National Preventative Health Taskforce was established in 2008 to develop the National Preventative Health Strategy focussing initially on obesity, tobacco and alcohol. In its report⁷, released in September 2009, the Taskforce recommended an increase in tobacco excise on public health grounds. It identified reducing the affordability of tobacco products as a key action area to reduce tobacco consumption and prevalence. It recognised that taxes on cigarettes in Australia when compared to other OECD countries are very low as a proportion of total price.

17. The Taskforce recommended an increase in tobacco excise, above normal indexation, of 7.5 cents per stick (29 per cent) in the first year followed by increases in successive years which would result in a

⁵ National Tobacco Strategy, 2004-2009: Ministerial Council on Drug Strategy November 2004 Commonwealth of Australia. iii.

⁶ Ibid p 21.

⁷ Australia: the healthiest country by 2020 Technical Report 2 *Tobacco control in Australia: making smoking history* including addendum for October 2008 to June 2009 Commonwealth of Australia 2009 Available from: <http://www.preventativehealth.org.au/internet/preventativehealth/publishing.nsf/Content/national-preventative-health-strategy-1lp>.

68 per cent overall increase in the excise rate (and excise equivalent customs duty rate).⁸ The recommendation had the aim of making the price of a packet of cigarettes reach \$20 within three years.

18. As outlined in the Government response to the recommendations of the National Preventative Health Task Force, it did not adopt the recommendation of a staged increase in tobacco excise which would result in a 68 per cent overall increase in the excise rate at that time because of the financial stress on people who continue smoking.⁹ The Government recognised that the proportion of cigarette prices represented by taxes are lower than in many comparable countries and that an increase in excise would bring Australia's taxes on tobacco into line with other OECD countries and, in combination with other measures including the Government's world first plain packaging initiative, bring Australia back to the forefront of international tobacco control efforts.

19. The 25 per cent tobacco excise increase is also consistent with the commitments made by Commonwealth and state and territory governments in 2008 to reduce the adult daily smoking rate to 10 per cent of the population, and halving the rate of smoking among Aboriginal and Torres Strait Island people by 2018.¹⁰

20. The Australia's Future Tax System (AFTS) review recommended that 'the existing regime for tobacco taxation in Australia should be retained, with the rates of tax substantially increased, depending on further evidence on the costs of harm from tobacco smoking' (Recommendation 73).¹¹

21. The AFTS review noted the following about tobacco taxation:

'While consumer sovereignty is an important principle in tax policy design, government intervention in the tobacco market is justified by the strongly addictive qualities of tobacco, its serious health impacts, its uptake by minors and the costs that smoking imposes on non-smokers'.

'Tobacco taxes raise prices and reduce both smoking rates and smoking intensity. Australian retail prices for cigarettes are moderate by international standards and taxes constitute a relatively small share of the retail price'.

'As Australia's tobacco taxes are low by international standards, it is feasible to increase them substantially'.

⁸ Ibid page 19.

⁹ Taking Preventative Action A response to Australia: the healthiest country by 2020 Commonwealth of Australia 2010 Available at: <http://www.preventativehealth.org.au/internet/preventativehealth/publishing.nsf>.

¹⁰ COAG Reform Council National HealthCare Agreement 2011, Sydney.

¹¹ *The final report of the Australia's Future Tax System Review (AFTS)*, 2011 Commonwealth of Australia 2011. Available from <http://taxreview.treasury.gov.au/content/Content.aspx?doc+html/home.htm>.

22. In 2003, Australia became a signatory to the World Health Organisation (WHO) Framework Convention on Tobacco Control which supports the use of price and tax measures to discourage tobacco consumption. An increase in tobacco excise is consistent with Australia's obligations under this Convention, and represents a move towards international best practice in the pricing of tobacco products.

- Article 4(4) of Framework Convention on Tobacco Control states that comprehensive multi-sectoral measures and responses to reduce consumption of all tobacco products are essential.
- Article 6 of the Framework Convention on Tobacco Control describes price and tax measures as 'an effective and important means' to reduce tobacco consumption and Article 7 recognises that non-price measures are also an effective and important means to reduce tobacco consumption.

23. The Government's decision to increase the excise applying to tobacco is consistent with national strategies, goals and international obligations.

Impact of 25 per cent increase

24. The 25 per cent excise increase from 30 April 2010 increased the rate from \$0.2622 to \$0.32775 per stick (not exceeding 0.8 grams in weight) and from \$327.77 to \$409.71 per kilogram of tobacco content for other tobacco.

25. The 25 per cent increase in excise was estimated to result in a price increase of \$1.80 per pack of 25 cigarettes, and an increase of \$2.16 per pack of 30 cigarettes, an increase of around 15 per cent.

26. As at February 2013, excise and duty rates are \$0.35447 per stick (not exceeding 0.8 grams in weight) and \$443.11 per kilogram of tobacco content for other tobacco which includes CPI increases since 30 April 2010.

Case for higher taxation

27. It is well publicised that anti-smoking measures should include high taxation. Higher taxes on tobacco products lead to higher prices, which reduce tobacco use, which in turn, reduce the health and social costs associated with tobacco use.¹²

28. Jonathan Gruber in Smoking's 'Internalities' states:

¹² WHO Framework Convention on Tobacco Control Price and tax policies (in relation to Article 6 of the Convention) (Technical Report by WHO's Tobacco Free Initiative, 2010 FCTC/COP/4/11 15 August 2010, paragraphs 4–6.

‘Individuals have self-control problems when it comes to smoking and need commitment devices to overcome the problems ... There is no way to truly commit oneself to not smoke or to not buy cigarettes through the private market. But government or the courts can provide an excellent commitment device: cigarette taxation ... higher taxes remain a much better commitment device than anything available in the private market’.¹³

29. The WHO and the World Bank recognise that price and tax measures are one of the most effective instruments to reduce tobacco consumption, especially among young people and poor people.¹⁴

30. WHO studies, based on the concept of price elasticity,¹⁵ have shown that a tax increase that increases tobacco prices by 10 per cent can lead to a decrease in tobacco consumption by about 4 per cent in high-income countries and by up to 8 per cent in low and middle income countries.¹⁶

31. In 1999, a World Bank review *Curbing the Epidemic* also concluded that, all else being equal, price rises of about 10 per cent would on average reduce tobacco consumption by about 4 per cent in developed countries. Further, the review stated that there is thought to be a strong correlation between sharp price increases and sharper declines in tobacco consumption, although there may be a time lag.¹⁷

32. The World Bank review findings are supported by a more recent review by the WHO¹⁸ which states that a large and growing body of empirical literature, dominated by studies from the USA and to a less extent the UK has found that tobacco consumption decreases when the price of tobacco increases. It states that since the World Bank’s publication *Curbing the Epidemic* the evidence suggests that, at least based on aggregate demand studies, the consensus price elasticity of around -0.4 is still valid for high income countries, although the price elasticity estimates for high-income countries other than the USA and the United Kingdom are somewhat more dispersed.

¹³ Gruber, J *Smoking’s Internalities* Regulation Winter 2002-2003.

¹⁴ WHO report on the global tobacco epidemic, 2009: implementing smoke-free environments. Geneva, World Health Organisation, 2009.

¹⁵ The concept of price elasticity is the proportionate reduction in consumption resulting from a 1 per cent increase in price. For example, a price elasticity of cigarette demand of -0.5 indicates that a 10 per cent increase in cigarette prices reduces overall cigarette consumption by 5 per cent.

¹⁶ Technical Report by WHO’s *Tobacco Free Initiative*, 2010 paragraphs 4-6.

¹⁷ Prabhat Jha, Chaloupka, Frank J The World Bank *Curbing the Epidemic Governments and the Economics of Tobacco Control* 1999 Washington DC, page 6.

¹⁸ International Agency for Research on Cancer WHO IARC Handbooks of Cancer Prevention Tobacco Control Volume 14 Effectiveness of Tax and Price Policies for Tobacco Control 2011.

33. Additionally, there will be a difference in elasticities over the short term as compared to the longer term. That is, a reduction in smoking prevalence due to current smokers quitting will have an immediate impact on smoking rates whereas a reduction in prevalence due to a lower take-up of smoking will have an impact over the longer term as it affects potential future smokers. Studies that measured responses to price changes in the short term tended to report lower elasticity than studies that reported long-run estimates (-0.40 compared with -0.44).¹⁹

34. The latest US National Bureau of Economic Research study on tobacco taxes²⁰ has questioned the effectiveness of taxes in reducing cigarette consumption. The study claims that increases in cigarette taxes are associated with insignificant decreases in adults' consumption, and estimates that it will take a 100 per cent tax increase to decrease adult smoking by as much as 5 per cent. However, it is important to note that this study looks at the effect on adult smokers, who are likely to have smoked for years and are addicted to tobacco, and hence, are highly price inelastic. It has not taken into account the effectiveness of tobacco excise increases in deterring up-take from non-smokers, or in reducing consumption among young people.

Responsiveness of young people to price change

35. Studies have found that teenagers and young adults are significantly more responsive to price increases. The economic literature on price elasticity of demand for smoking offers estimates that a 10 per cent increase in cigarette prices reduces consumption by approximately 5 to 12 per cent for teenage smokers compared to around 1 per cent for smokers in their late 20s.²¹

36. A recent study undertaken in the US,²² has confirmed the different elasticities between underage and mature age smokers. The study found that there is lower elasticity for adult smokers who are most likely to have smoked for many years. Furthermore, cigarette taxes are likely to represent a relatively small portion of the adult smokers' wealth.

37. The recent WHO review referred to in paragraph 32 also noted that many econometric studies from countries at all income levels find that smoking prevalence and intensity among young people decreases as

¹⁹ Gallet C and List J. Cigarette demand: a meta-analysis of elasticities. *Health Econ* 2003; 12:821–35.

²⁰ Callison, K and Kaestner, R (2012), Do higher tobacco taxes reduce adult smoking? New evidence of the effect of recent cigarette tax increases on adult smoking, National Bureau of Economic Research.

²¹ For example, Harris, J.E. and Chan, S.W. (1999), The continuum-of-addiction: cigarette smoking in relation to price among Americans aged 15-29, *Health Economics*, pages 81-86.

²² Serginio Sylvain The Effects of Excise Tax on Cigarette Consumption: A Divergence in the Behaviour of Youth and Adults University of Michigan Journal of Business April 2008 Vol 1 Issue 2.

cigarette price increases. The estimated overall price elasticity of demand for young people in most high-income country studies ranges between -0.05 and -1.2.

Responsiveness of lower socio-economic groups

38. The WHO review mentioned at paragraph 32 also found that the price responsiveness of tobacco demand is generally higher among the poor than the rich in high-income countries, based largely on evidence from the USA and United Kingdom.

Impact on lower socio-economic groups

39. An issue is whether tobacco excises are regressive. That is, whether they impact disproportionately on people from lower socio-economic groups who are more likely to be smokers, and less able to afford the increased purchase price of tobacco. This may mean these smokers cutting back on essential expenditure rather than quitting.

40. The National Preventative Health Taskforce stated:

‘there is little direct evidence of food insecurity attributable to tobacco use in Australia, although it is likely that some heavy smokers already spend less than is optimal on food, clothing and other goods and services’.

41. The NTS recognises that tax increases will cause financial stress for people on low incomes unable to quit; price increases would not be acceptable in the absence of greatly improved quality of, access to and affordability of treatment services and therapies.²³

42. According to Australian tobacco researcher, Michelle Scollo:²⁴

‘the key issue in determining whether tobacco taxes are regressive is the extent to which people in various socio-economic groups actually do reduce tobacco consumption in response to price increases’.

43. Scollo’s rationale is that if tobacco excise increases deter people from lower socio-economic groups from taking up smoking, or influence them to quit, then they may be viewed as progressive. This is because it is these people who stand to gain the most financially and in health terms from excise increases that provide an incentive for them to quit or reduce their consumption.

44. Because of this, together with the 25 per cent excise tax increase, the Government also implemented a range of initiatives to help tobacco users quit. As announced in the Joint Media Release Anti – smoking Action of 29 April 2010 (see Attachment A) these include an

²³ National Tobacco Strategy, 2004-2009: Ministerial Council on Drug Strategy November 2004 Commonwealth of Australia. p 21.

²⁴ M Scollo, ‘A regressive tax?’ in M Scollo and M Winstanley (eds.), *Tobacco in Australia: facts and issues*.

extra \$27.8 million on hard hitting advertising campaigns over four years, bringing the total investment to more than \$85 million in the next four years, to encourage Australians to quit smoking. This additional investment will be used for campaigns targeting people in high-need and highly disadvantaged groups such as low socio-economic communities and pregnant women and their partners. As noted in paragraph 112 record investments have been made to support Indigenous communities.

Problem

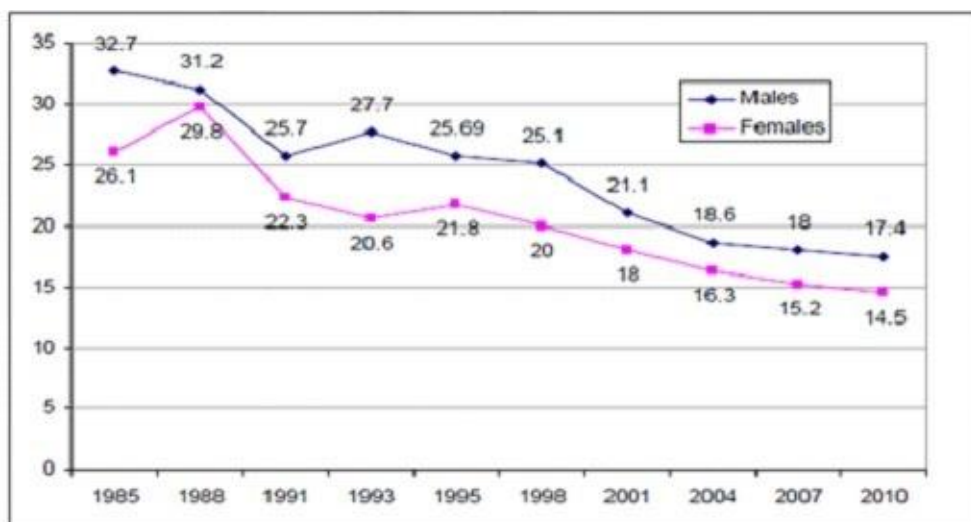
45. The problems associated with tobacco consumption can be identified as:

- the rate of smoking;
- health impacts; and
- social and economic costs of smoking.

Rates of smoking in Australia

46. Diagram 1 shows the steady decline over time in the daily smoking rate for males and females aged 18 and over between 1985 and 2010.

Diagram 1: Prevalence of current daily smokers in Australia aged 18+



Sources: National Campaign Against Drug Abuse Social Issues Survey 1985, 1998; National Campaign Against Drug Abuse Household Survey 1991, 1993; National Drug Strategy Household Survey 1995, 1998, 2001, 2004, 2007, 2010

N.B. Caution should be used in interpreting the decline as a range of data sources has been used and data within series may not be strictly comparable between years.

47. Other studies or surveys show that:

- in 2008, 47 per cent of Aboriginal and Torres Strait Island people aged 15 years and over were smokers;²⁵
- in 2003, over 40 per cent of pregnant teenagers were smokers;²⁶
- in 2004, 32 per cent of people with mental illness were smokers;²⁷ and
- in 2010, 27.6 per cent of unemployed people were smokers.²⁸

48. Smoking rates among the most disadvantaged groups are extremely high.²⁹ In 2007, children living in households in the most disadvantaged areas in Australia were more than three times more likely to be exposed to tobacco smoke in the home compared to those living in the more advantaged areas.³⁰

Health impacts of smoking

49. Tobacco smoking continues to be the largest cause of preventable death and disease in Australia.³¹ In 2003 it was responsible for 7.8 per cent of the total burden of disease and injury in Australia, with lung cancer, chronic obstructive pulmonary disease (COPD) and ischaemic heart disease accounting for more than three-quarters of this burden.

50. The current state of scientific knowledge, summarised in *The Health Consequences of Smoking: A Report of the Surgeon General* (United States Department of Health and Human Services, 2004),³² is that smoking harms nearly every organ of the body, causing many diseases and reducing the health of smokers in general.

51. The Surgeon-General's report highlights the authoritative and generally accepted scientific opinion that smoking is a cause of many forms of cancer (lung, larynx, lip, tongue, mouth, pharynx, oesophagus, pancreas, bladder, kidney, cervix, stomach and also acute myeloid

²⁵ 2008 National Aboriginal and Torres Strait Islander Social Survey Cat. no. 4714.0 Australian Bureau of Statistics 2009.

²⁶ Sullivan EA Laws P & Grayson N 2006 Smoking and pregnancy. Cat. no. PER 33. Canberra: AIHW.

²⁷ National Health Survey 2004-05, Summary of Results Cat no. 4364.0 Australian Bureau of Statistics.

²⁸ AIHW 2011 2010 National Drug Strategy Household Survey report 2011. Drug statistics series no 25. Cat no. PHE 145. Canberra AIHW.

²⁹ AIHW 2011 2010 National Drug Strategy Household Survey report 2011. Drug statistics series no. 25. Cat. No. PHE 145. Canberra: AIHW.

³⁰ AIHW 2009 A picture of Australia's children 2009, Canberra.

³¹ Begg S, Vos T, Barker B, Stevenson C, Stanley L & Lopez A 2007. *The burden of disease and injury in Australia* 2003. Cat. No. PHE 82. Canberra: AIHW p 5.

³² The report is available at: http://www.cdc.gov/tobacco/data_statistics/sgr/index.htm.

leukaemia), several serious cardiovascular diseases, many kinds of respiratory diseases and impairments and some other diseases, and that smoking by women also reduces their fertility and has adverse consequences for expectant mothers, their unborn children — including adverse consequences for the course of a pregnancy itself — and their young infants, including sudden infant death syndrome. Further, the report states that the risk of such diseases reduces in groups of people who quit smoking, and the reduction of risk increases from quitting earlier.

52. Compared with non-smokers (never smoked or ex-smokers), smokers are more likely to rate their health as being fair to poor, more likely to have asthma and more likely to suffer psychological distress. In Australia, tobacco smoking is a major risk factor for coronary heart disease, stroke, peripheral vascular disease, cancer and various other diseases and conditions.³³ Tobacco has been responsible for the greatest disease burden in Australia.³⁴

53. Smoking remains a significant cause of poor health among newborn babies, and that smoking is a major contributor to the poorer health outcomes for Indigenous babies.³⁵

Social costs of smoking

54. Smoking kills over 15,000 Australians each year.³⁶ The social costs of tobacco use have been estimated to amount to \$31.5 billion per year, including \$5.7 billion per annum attributed to absenteeism and a reduction in the workforce.³⁷ The table below sets out the key components of the social costs of smoking.

Table 1: Key components of the economic costs of smoking

<i>Component</i>	<i>\$m</i>
Net healthcare costs	318.4
Total net labour costs(including lost production in the workplace and in the household)	8009.1
Resources used in tobacco consumption	3635.6
Value of loss of life from tobacco consumption	19459.7

³³ AIHW 2011 2010 National Drug Strategy Household Survey report 2011. Drug statistics series no. 25. Cat. No. PHE 145. Canberra: AIHW: pages xii page 1.

³⁴ Begg S, Vos T, Barker B, Stevenson C, Stanley L & Lopez A *The burden of disease and injury in Australia* 2003. PHE 82. Canberra: AIHW 2007.

³⁵ Wills R and Coory M. Effect of smoking among Indigenous and non-Indigenous mothers on preterm birth and full-term low birth weight. *Medical Journal of Australia*. 2008;189(9): pages 490-494.

³⁶ Begg S, Vos T, Barker B, Stevenson C, Stanley L & Lopez A 2007. *The burden of disease and injury in Australia* 2003. Cat. No. PHE 82. Canberra: AIHW p 5.

³⁷ Collins and Lapsley, *The cost of tobacco, alcohol and illicit drug abuse to Australian society in 2004/05*, Commonwealth of Australia 2008.

55. In 2009 it was projected that based on patterns of uptake and quitting, prevalence of daily smoking would still be over 14 per cent in 2020 and that smoking cessation rates would need to double for Australian smoking prevalence to reach a policy target of 10 per cent by 2020.³⁸

- This suggested that the commitment made by Australian Governments in 2008 to reduce the adult daily smoking rate to 10 per cent, and halve the rate of smoking among Aboriginal and Torres Strait Island people by 2018 would not be met unless tough action was taken.

56. Given the health, community and economic costs associated with tobacco consumption, any action that can be taken to reduce the consumption and prevalence of tobacco in Australia, including actions of Government, is essential.

The case for intervention

57. In terms of economic theory, market failure is a justification for government intervention. In the case of tobacco consumption, three market failures justify government intervention in tobacco control. These market failures include:

- information failure about the health risks of smoking;
- information failure about the addictiveness of smoking; and
- the external costs of smoking, that is, all costs imposed by smoking on people other than smokers themselves, as well as those costs borne by smokers and their families that result from addictive rather than voluntary consumption.³⁹

58. The literature identifies the need for the approach to tobacco control to be comprehensive to discourage smoking, and most importantly, to prevent new people from taking up the habit.⁴⁰ Article 5(1) of the WHO Framework Convention on Tobacco Control requires Parties to adopt comprehensive tobacco control strategies and plans.

³⁸ Gartner CE, Barendregt J and Hall W. Predicting the future prevalence of cigarette smoking in Australia: how low can we go and by when? *Tobacco Control* 2009; 18: 183-189.

³⁹ Anita Lal and Michelle Scollo *Tobacco in Australia – Facts and Issues* Vic Health Centre for Tobacco control 2008.

⁴⁰ 1999 World Bank Report *Curbing the Epidemic Governments and the Economics of Tobacco Control* page 10.

Objectives of Government Action

59. The Joint Media Release of 29 April 2010 indicated that a 25 per cent increase in the tobacco excise, and corresponding excise-equivalent customs duty had the policy objectives of:

- cutting tobacco consumption — estimated to be around 6 per cent;
- cutting the number (prevalence) of smokers — estimated to be in the order of 2 to 3 per cent, or around 87,000 Australians;
- providing additional funding to be directly invested in better health and hospitals through the National Health and Hospitals Network Fund — estimated at \$5 billion over four years; and;
- bringing Australia's tax treatment of tobacco closer to comparable countries noting that the taxes on tobacco in Australia as a percentage of the retail price of tobacco were only 62 per cent in comparison to 80 per cent in France and 77.5 per cent in the United Kingdom.

Impact analysis

60. This section assesses the impact of the 25 per cent increase in tobacco excise in relation to objectives outlined above. It also provides an overview of the tobacco industry in Australia and considers any likely impacts.

61. It is important to note that the 25 per cent increase coincided with other initiatives such as those outlined in the Joint Media Release of 29 April 2010 on Anti-smoking action.

- As such, there will be limitations in directly attributing outcomes specifically to this measure, as the outcomes will most likely have been influenced by the other initiatives such as advertising restrictions and anti-smoking campaigns.
- However, one of the initiatives, — the plain packaging of tobacco products — did not commence until 1 October 2012 (and be fully implemented by 1 December 2012), and the extension of existing restrictions on tobacco advertising to the internet did not commence until 6 September 2012.

62. It should be noted that an increase in tobacco excise will reduce tobacco consumption through the following effects:

- some smokers will smoke less;

- others will stop smoking altogether;
- ex-smokers will be prevented/discouraged from relapsing; and
- smoking uptake-up may also decline, increasing the number of non-smokers.

Data limitations

63. A limitation is the lack of data that directly examines smoking cessation before and after the increase in tobacco excise. That is, smoking cessation data of a smoking population would need to be undertaken immediately before the price increase and then in the months subsequent to the price increase.

- There is only one known study of this nature. This is a survey undertaken by the University of Sydney⁴¹ but this study is limited to NSW and focusses only on smoking prevalence.
- It was possible for this study to be undertaken because of a Tobacco Tracking Survey of the Cancer Institute NSW. Data collected in 2009 allowed a comparison of quitting patterns in the two consecutive years but as recognised in the survey report the findings are subject to certain limitations.

Cutting tobacco consumption

64. As stated in the Joint Media Release of 29 April 2010 a policy objective of the 25 per cent increase in tobacco excise was to cut tobacco consumption by around 6 per cent. Treasury estimated that a 25 per cent increase in the tobacco excise, and corresponding excise-equivalent customs duty would reduce tobacco consumption by 6 per cent on the following basis:

a 25 per cent increase in excise leads to a 15 per cent price increase (assuming approximately 60 per cent of a packet of cigarettes is excise). A 15 per cent increase in price leads to an approximate 6 per cent decline in consumption (assuming an elasticity of -0.042).

65. Data on tobacco clearances is collected by the Australian Taxation Office (ATO) and the Australian Customs and Border Protection Service (Customs and Border Protection Service). Tobacco is no longer grown in Australia. Tobacco manufacturing in Australia uses imported loose tobacco and the excise on this tobacco is collected by the ATO after manufacture. Customs and Border Protection collects duty on imported,

⁴¹ SM Dunlop, TF Cotter, DA Perez, Impact of the 2010 tobacco tax increase in Australia on short-term smoking cessation: a continuous tracking survey *Med J Aust* 2011; 195(8): 469-472. © Copyright 2011.

ready-to-sell tobacco. The term ‘clearance’ refers to the product being entered into home consumption and broadly covers all tobacco sold legally in Australia.

66. Clearances of tobacco through the ATO and Customs and Border Protection cannot be presented in detail due to taxpayer confidentiality. However, an indicative measure of the decline in tobacco clearances of 11 per cent is observed when comparing clearances in the three months before the policy change with clearances for the same period, 24 months later.

67. This decline in tobacco is calculated using clearances per adult population for the months February, March and April and has been de-trended to account for the observed decline in tobacco clearances before the excise increase.

68. On 4 August 2011, at a public hearing held by the House of Representatives Standing Committee on Health and Ageing as part of its inquiry into plain packing legislation, British American Tobacco’s Chief Executive Officer, David Crow, stated that:

We understand that the price going up when the excise goes up reduces consumption. We saw that last year very effectively with the increase in excise. There was a 25 per cent increase in the excise and we saw the volumes go down by about 10.2 per cent; there was about a 10.2 per cent reduction in the industry last year in Australia.⁴²

Cutting smoking prevalence

69. As stated in the Joint Media Release of 29 April 2010 a policy objective of the 25 per cent increase in tobacco excise was to reduce the number of smokers by 2 to 3 per cent. Treasury estimated that a 25 per cent increase in the tobacco excise, and corresponding excise-equivalent customs duty would reduce the number of smokers by 2 to 3 per cent (around 87,000 Australians) on the following basis:

- Given an adult (18 and over) population of approximately 17 million, and a smoking rate of approximately 17 per cent this results in approximately 2.9 million smokers. Three per cent of these quitting would be 87,000.

⁴² Official Committee Hansard, Standing Committee on Health and Ageing Tobacco Plain Packaging Bill 2011, Trade Marks Amendment (Tobacco Plain Packaging) Bill 2011 Thursday, 4 August 2011.

70. The University of Sydney undertook a survey using population-level data to monitor the impact on smoking cessation activity as a result of the 25 per cent increase in tobacco excise.⁴³

71. The size of the samples were:

- for February to September 2009, 67,573 telephone numbers were randomly selected then reduced for eligibility⁴⁴ with the final sample size being 1604; and
- for January to September 2010, 47,243 telephone numbers were randomly selected then reduced for eligibility with the final sample size being 1699.

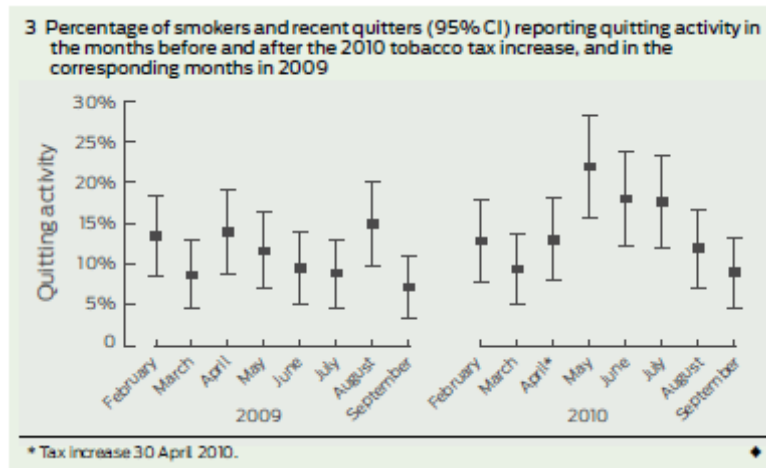
72. The main findings of the report were:

- 22 per cent of the sample reported that they had quit smoking or attempted to quit smoking in May 2010 compared with 13 per cent in April 2010 and 12 per cent in May 2009; and
- respondents interviewed in the three months after the tax increase (May-July) were significantly more likely to report quitting activity than those interviewed in the three months before the tax increase. This quitting activity was not sustained in the subsequent months.

⁴³ SM Dunlop, TF Cotter, DA Perez, Impact of the 2010 tobacco tax increase in Australia on short-term smoking cessation: a continuous tracking survey *Med J Aust* 2011; 195(8): 469-472. © Copyright 2011. The Medical Journal of Australia – reproduced with permission. Excluded from Creative Commons licence.

⁴⁴ The analysis was limited to smokers and recent quitters as defined for the purposes of the survey.

Diagram 2



*SM Dunlop, TF Cotter, DA Perez, Impact of the 2010 tobacco tax increase in Australia on short-term smoking cessation: a continuous tracking survey Medical Journey Australia 2011 October 17: 195(8): page 471.

73. The survey states that if the data were extrapolated, if 22 per cent of the NSW smoking population quit or attempted to quit in the month of May, this would be more than 200,000 smokers, almost double the number who had stopped smoking or tried to quit in April before the tax increase.

74. The report concluded that the tobacco tax increase was associated with a short term increase in the rate of smoking cessation among NSW adult smokers and recent quitters, suggesting that regular increases in tobacco tax may further encourage quitting activity.

75. The report acknowledges that it could not investigate whether reductions in smoking prevalence are sustained after a tax increase and it did not examine the effect of the tax increase on rates of smoking uptake. That is, the data is based on retrospective reports of quitting as opposed to a longitudinal follow-up of individuals who quit. Furthermore, the report notes that the low response rate of the survey may have led to some bias in the sample composition.

Other data

76. A table showing the number of calls made to Quitline is included at Attachment B. This data shows a material increase in calls in May 2010, just after the tobacco excise increase occurred. The number of calls then fell in June 2010, and by July 2010 appears to be back to the long-term trend. This data appears to support the findings of the University of Sydney survey that the excise increase resulted in a short-term increase in the number of quit attempts.

77. PBS data for medicines used in the treatment of nicotine dependence — Bupropion Hydrochloride and Varenicline — for January 2010 through to May 2012 are included at Attachment C.

78. Medicines used in the treatment of nicotine dependence are prescribed under complex authority requirements that make it difficult to determine patterns in treatment uptake. Despite this, there appears to be a clear rise in prescription volumes for Bupropion and Varenicline following the April 2010 excise increase, although these volumes appear to fall to long-term trends within a few months. Again, this pattern seems to be broadly consistent with the University of Sydney survey.

79. PBS data on nicotine patches conceivably may also be relevant. However, the PBS listing for nicotine patches was only extended to include all eligible individuals (general and concessional patients) from 1 February 2011. Prior to February 2011, PBS-subsidised nicotine patch volumes were negligible, rendering this data of little assistance in determining the impact of the 25 per cent excise increase.

80. The available data on the impact of the excise increase on smoking prevalence suggests that it may have prompted an increase in quit attempts in the following two to three months, after which it appears quit attempts returned to their long-term trend. Furthermore, the available data does not indicate how many smokers actually quit (permanently or temporarily).

81. The 2010 *National Drug Strategy Household Survey* conducted between late April and early-September 2010 states the number of people smoking daily in 2010 decreased by approximately 100,000 people (2.9 million in 2007 down to 2.8 million in 2010).⁴⁵

More funding for better health and hospitals

82. As part of the 2010-11 Budget, the Government announced additional funding would be provided to be directly invested in better health and hospitals for all Australians through the National Health and Hospitals Network Fund. The 25 per cent increase in tobacco excise estimated to raise an additional \$5 billion over four years (including 2009-10), would be directly invested in better health and better hospitals for all Australians along with existing excise revenues from tobacco.

83. Since the 2010 announcement, the Government has made the following commitments investments in health and hospitals.

National Health Reform Agreement 2011

84. The National Health Reform Agreement (NHRA) was signed in August 2011. It aims to improve the public hospital system through

⁴⁵ AIHW 2011 2010 National Drug Strategy Household Survey report 2011. Drug statistics series no. 25. Cat. No. PHE 145. Canberra: AIHW.

improving efficiency, transparency, accountability and sustainability. Under the NHRA, states will receive at least \$16.4 billion in additional funding for public hospital services from 2014-15 to 2019-20. From 2014-15 the Commonwealth will fund 45 per cent of efficient growth in public hospital services. This will increase to 50 per cent in 2017-18.

National Partnership Agreement on Improving Public Hospital Services

85. All states and territories have signed a revised National Partnership Agreement on Improving Public Hospital Services (NPA-IPHS), under which the Commonwealth will provide them up to \$3.4 billion by 2017-18. The NPA-IPHS will improve access to emergency departments, increase elective surgery and provide new sub-acute beds.

Mental health

86. In May 2011, the Australian Government announced a \$2.2 billion mental health package to fund National Mental Health Reform. The funding will deliver genuine, practical and sustainable mental health reform to ensure that Australians living with mental illness get the care they need, when they need it. When combined with the 2010 Budget and election commitments, the Government will be providing \$2.2 billion over five years for mental health services.

Revenue raised

87. There are no figures to ascertain whether the \$5 billion of additional revenue estimated to be raised by the 25 per cent increase in tobacco excise was achieved. Revenue forecast methodology uses historical collections, forecast growth, market intelligence and costings of new policy. Discrepancies between forecasts and outcomes can be due to any of these factors. Given these considerations, it is not possible to readily assess the revenue under the counterfactual of no policy change. Further, the Government has not published in the Budget papers total collections of tobacco excise through the ATO and Customs and Border Protection.

Bringing Australia closer to comparable countries

88. The Joint Media release of 29 April 2010 stated that taxes on tobacco constituted 62 per cent of the retail price of tobacco, compared to 80 per cent in France and 77.5 per cent in the United Kingdom.

89. The 62 per cent figure was taken from the World Health Organization (WHO) Country Profile for Australia for 2008, and was calculated by taking tobacco excise and Goods and Services Tax as a percentage of the price of the most popular brand of cigarettes.

90. In July 2010, the WHO estimated that the ratio of tobacco taxes to price in Australia was 64 per cent (based on the price of most sold brand, pack of 20 cigarettes). However, by late-2012, it appears that

tobacco taxes in Australia only constitute around 59 per cent of the price of tobacco — see Table 4.

Table 4— Tax/price ratio for tobacco products, December 2012

Average online supermarket price of a pack of 20 popular brand cigarettes (at 11 December 2012): \$14.10	
Excise:	34.889 cents per stick
GST:	10 per cent
Total tax:	\$8.26
Tax/price ratio:	59 per cent

91. While the ratio of tobacco taxes to price is often used to compare how different countries tax tobacco products, the use of this ratio is problematic. Tobacco product prices, rather than underlying tax rates, influence tobacco consumption and the *WHO Report on Global Tobacco Epidemic 2011* found that prices in Australia were the third highest in the world.

92. The tax-price ratio can also fall even if tax rates do not change, if prices increase because of rising production and distribution cost or profit margins. This appears to have happened in Australia since mid-2010, as the tax-price ratio has fallen while taxes have remained unchanged in real terms.

Impact on industry

93. There are only three major tobacco companies in Australia, British American Tobacco (Australasia Holdings) Pty Ltd, Philip Morris (Australia) Limited and Imperial Tobacco Australia Limited. Philip Morris and British American Tobacco have manufacturing operations in Australia while Imperial Tobacco subcontracts production to British American Tobacco and imports some products.⁴⁶ In 2010, British American Tobacco's revenue was \$1,798.4 million, Philip Morris's \$817 million and Imperial Tobacco's sales in 2010-11 were \$476.5 million.⁴⁷

94. The 25 per cent discretionary increase was not anticipated to create any significant distortion in business decision-making of tobacco manufacturers, producers or importers. Further, tobacco companies are accustomed to excise rate changes in general, as the excise rates (and excise-equivalent customs duty rates) increase biannually in line with indexation. However, the immediacy of the policy change meant that additional costs were incurred by the three companies. One of the companies estimated the additional administrative costs associated with

⁴⁶ As noted in Budget Paper No. 1, Budget Strategy and Outlook 2012-13 there is a scheduled relocation overseas of a large tobacco producer.

⁴⁷ Annual Report and IBIS World Industry Report C2190 p 24-27.

change to be in the order of \$400,000. The extent of the additional costs to other firms has not been reported.

95. Given the higher price level of tobacco some consumers shifted to cheaper brands and Roll Your Own (RYO). This is likely to impact on the structure of the tobacco industry with potential increases in market share, either temporarily or permanently, to cheaper brands or RYO.

Illicit Tobacco

96. The availability of illicit tobacco products (products on which taxes have been avoided) undermines the effectiveness of taxation in many countries in reducing affordability to prevent uptake and promote quitting, particularly among low-income groups.⁴⁸

97. An increase in excise has the potential to increase the illicit trade in tobacco given the significant profit potential for those engaged in this illicit activity. While detection figures over the past three financial years do indicate a gradual increase in detections of cigarettes and a corresponding decrease in detections of loose tobacco, detections of illicit tobacco at the border continue to be unpredictable and do not appear to have changed in response to the 25 per cent excise increase in 2010.

98. The overall impact on total tobacco consumption will be influenced by the extent of illicit tobacco consumption. Illicit tobacco consumption may have increased because of the increased incentives (from an increase in the price differential) to supply and consume illicit tobacco. The extent to which this has occurred would lead to an overstatement of the reduction of tobacco consumption. The increase in incentive to import illicit tobacco may be partially or fully offset by the announced increases in penalties for this activity (refer below).

99. The Government is conscious of the potential for an increase in excise to lead to an increase in the illicit trade in tobacco products. In its Joint Media Release of 29 April 2010 the Government stated that the Government would continue its successful strong enforcement against the production and importation of illicit tobacco through the ATO and Customs and Border Protection.

100. In a media release of 31 May 2012, the Government announced tougher penalties for tobacco smugglers which includes adding a maximum penalty of ten years imprisonment to the existing financial penalties.

⁴⁸ Australia: the healthiest country by 2020 Technical Report 2 *Tobacco control in Australia: making smoking history* including addendum for October 2008 to June 2009 Commonwealth of Australia 2009, available from: <http://www.preventativehealth.org.au/internet/preventativehealth/publishing.nsf/Content/national-preventative-health-strategy-1lp>, page 16.

101. The report of the Australian Institute of Health and Welfare (AIHW) *2010 National Drug Strategy Household Survey* indicates that the use of illicit tobacco has declined between 2007 and 2010.

Table 5 — Unbranded loose tobacco, awareness and use, recent^(a) smokers aged 14 years or older, by sex, 2010 (per cent)

Behaviour	Males		Females		Persons	
	2007 ^(b)	2010	2007 ^(b)	2010	2007 ^(b)	2010
Aware of unbranded loose tobacco	52.6	51.6	42.7	40.0	48.0	46.3
Ever smoked unbranded loose tobacco						
As proportion of those aware	61.0	55.8 ↓	49.5	45.5	56.3	51.7 ↓
As proportion of smokers	32.1	28.8	21.1	18.2 ↓	27.0	24.0 ↓
Currently smoke this type of tobacco						
Currently smoke it ^(c) (proportion of ever used)	24.4	22.1	19.6	17.5	22.6	20.5
No longer use it (proportion of ever used)	75.6	77.9	80.4	82.5	77.4	79.5
Currently smoke it ^(c) (proportion of smokers)	7.8	6.3	4.1	3.2	6.1	4.9 ↓
No longer use it (proportion of smokers)	24.2	22.3	17.0	15.0	20.8	19.0
Smoke unbranded loose tobacco half the time or more						
As proportion of those who currently smoke it	15.8	30.5 ↑	28.3	32.0	19.6	31.0 ↑
As proportion of smokers	1.2	1.9	1.1	1.0	1.1	1.5

(a) Used in the previous 12 months.

(b) The 2007 question asked about unbranded loose tobacco and unbranded cigarettes; the 2010 question asked about unbranded loose tobacco only.

(c) Smoke unbranded loose tobacco either occasionally, some days or every day.

Note:

1. Base is those who reported smoking in the previous 12 months.

102. In March 2011, a report by Deloitte was released on the illicit trade of tobacco in Australia. This report was commissioned by the tobacco industry.

103. The Deloitte report indicated that:

- the size of the illicit market, represented as a proportion of the legal tobacco market, is 15.9 per cent. These figures, based on the industry's previous reports, equates to a 150 per cent increase from the 2007 estimates of 6.4 per cent;
- the amount of illicit tobacco purchased has grown from 1,827 tonnes in 2007 to 2,680 tonnes in 2010. This equates to a growth in foregone revenue of \$450 million in 2007 to \$1.1 billion in 2010; and
- this increase in the illicit market has occurred concurrently with the increase in the excise rate of 25 per cent in April 2010 and the Retail Display Ban prohibiting the display of tobacco products at retail outlets in NSW.

104. The Deloitte reports notes, estimating the size of the illicit tobacco market is not a straight forward task. Deloitte findings are

inconsistent with the AIHW 2010 report referred to above. The findings of the AIHW report are potentially more reliable given the sample size used in the AIHW survey is more than 26,000 (compared to 949 in the Deloitte report).

105. In May 2012, Deloitte released another report which lowered its estimates on illicit tobacco use in Australia to 2,264 tonnes, some 13.4 per cent of the legal tobacco market. That is, Deloitte in its later report has lowered its estimates on illicit tobacco use in Australia and the amount of revenue foregone.

106. The Minister for Health, the Hon Tanya Plibersek MP has described this report as 'very questionable' and said that it 'vastly overstated the use of illegal tobacco products in Australia'.⁴⁹

107. Neither the ATO or Customs and Border Protection are able to provide an estimate of the size of the amount of excise forgone through the sale of illicit tobacco consumed in Australia. They have instead focused on a risk based intelligence lead approach to focus on high risk areas of non-compliance.

108. Customs and Border Protection is actively engaged in the deterrence and disruption of illicit trade in tobacco through whole of agency activity in collaboration with government, industry and international partners.

- During calendar year 2010, Customs and Border Protection made 47 seizures of smuggled tobacco products in sea cargo, consisting of 279 tonnes of tobacco and 65.56 million cigarettes.
- During 2010, Customs and Border Protection successfully prosecuted 10 cases of tobacco smuggling, resulting in eight custodial sentences and 35 convictions, fines, penalties and costs of nearly \$411,000.

109. Table 6 shows the amount of tobacco detections and amount of duty evaded from 2006-07 to 2011-12.

Table 6 — Tobacco detections and amount of duty evaded

<i>Year</i>	<i>No. of Detections</i>	<i>Tobacco (tonne)</i>	<i>Cigarettes (millions of sticks)</i>	<i>Duty Evaded (\$ million)</i>
2006–07	19	67	42	30
2007–08	58	287	107	114

⁴⁹ Transcript of Joint Press Conference by the Hon Tanya Plibersek MP and the Hon Nicola Roxon MP on 15 August 2012 regarding the High Court decision on plain packaging.

<i>Year</i>	<i>No. of Detections</i>	<i>Tobacco (tonne)</i>	<i>Cigarettes (millions of sticks)</i>	<i>Duty Evaded (\$ million)</i>
2008–09	33	180	50	70
2009–10	42	311	68	120
2010–11	55	258	82	135
2011–12	46	175	122	128

110. In addition to continuing enforcement efforts by the ATO and Customs and Border Protection, the Australian Government participated in international negotiations to conclude a Protocol on Illicit Trade in Tobacco Products under the WHO Framework Convention on Tobacco Control which was adopted by the parties on 12 November 2012.

Consultation

Department of Health and Ageing

111. The Department of Health and Ageing provides policy leadership in the area of tobacco control and coordinates a range of national initiatives designed to discourage people from taking up smoking and to encourage those people who already smoke to stop and to prevent the relapse of tobacco use. These measures include plain packaging of tobacco products, labelling tobacco products with graphic health warnings, national education and media campaigns, and administering comprehensive restrictions on tobacco advertising.

112. The Department of Health and Ageing supported the 25 per cent increase in tobacco excise because increasing the price of tobacco products via the imposition of excise is a highly effective way of reducing tobacco consumption. Tobacco excise is a key element of Australia's comprehensive suite of tobacco control measures which also include:

- minimum age restrictions on purchase of tobacco products;
- extensive and continuing public education campaigns on the dangers of smoking;
- comprehensive advertising restrictions under the *Tobacco Advertising Prohibition Act 1992*, and legislation to extend these restrictions to online tobacco advertising;
- legislation to mandate the plain packaging of tobacco products;

- regulations to update and expand the graphic health warnings appearing on tobacco products, in line with plain packaging requirements;
- retail display bans;
- bans on smoking in offices, bars, restaurants and other indoor public spaces, and increasingly outdoor places where children may be exposed to environmental tobacco smoke;
- the extended listing of nicotine replacement therapies and other smoking cessation supports on the Pharmaceutical Benefit Scheme;
- Quitlines and other smoking cessation support services in each State and Territory to help people quit;
- stronger penalties for people convicted of tobacco smuggling offences; and
- record investments (about AUD\$100 million since 2008) in support for indigenous communities.

Tobacco Companies

113. Tobacco companies, opposed the 25 per cent excise increase and advised of the negative impacts of the 25 per cent increase as described below:

Immediacy of the increase

114. According to tobacco companies, negative impacts of the 25 per cent excise increase resulted largely from the short notice given and the flow-on impact to customers. Tobacco companies reported that there was insufficient time to adjust prices, which normally takes two to three days. They also reported that the excise increase occurred out of cycle and with minimal warning making it very difficult to turn around new price lists before implementation and that this imposed stress on staff and the honouring of orders at the old price and resulted in an additional cost to business. One company submitted that the additional cost to their business as a result of quotas being exceeded was \$401,994.23. In normal circumstances the price would have been loaded the day before and this problem would not have arisen.

115. The tobacco companies also reported that the timing of the increase also caused difficulties in terms of excise payments. For example, orders that had left the bonded warehouse before the announcement but did not arrive until after the announcement required a change of price list during transportation.

A shift in consumption to lower priced cigarette brands

116. Tobacco companies submitted that the 25 per cent increase encouraged adult smokers to move from their current product to cheaper brands and RYO. One tobacco company cited that the market share of low cost brands had increased from 24.9 per cent in 2010, to 31.0 per cent in 2012. Another company submitted the total retail sales of cheap cigarettes had increased from virtually nothing in 2007 to comprise around 9 per cent of the total market for cigarettes in 2011.

117. One tobacco company advised that the price gap between the recommended retail price of a well-known premium price band and the equivalent price band in a leading low-cost brand is 18.8 per cent. Price differentials for the same sized pack range from \$2.90 to \$6.05.

118. One of the companies submitted that the increase in quantity of cheap cigarettes consumed was an unintended effect of the 25 per cent tobacco increase. That is, increases in tobacco excise or excise equivalent duties had unintentionally encouraged smokers to 'down trade' to smoking cheap cigarettes, rather than reducing the total number of cigarettes they consume.

119. The same tobacco company submitted the excise increase had had the effect of unintentionally altering the relative competitive positions of cigarette suppliers in the markets for not only their products, but also in the markets for their inputs of raw materials and factors of production (that is land, labour and capital) and argued that this, in turn, reduced the effectiveness of excise and excise equivalent duties as a means of reducing cigarette consumption.

120. The tobacco companies reported that the 25 per cent increase had also driven a consumer shift from cigarettes to RYO tobacco. In 2010, one tobacco company saw a 3.2 per cent increase in the RYO segment over the course of the year. The upward trend was more evident in the second half of 2010, where the average increase between July and December was 4.2 per cent. Although the trend did not continue in 2011, the volume gained in 2010 was retained within RYO and the segment was flat compared with 2010.

121. Tobacco companies submitted that there was no public health benefit in a policy which encourages adult smokers to move from their current product to a cheaper and/or illicit or unregulated product.

A shift to illicit and unregulated products

122. Tobacco companies submitted that the excise increase in 2010 also contributed to an increase in the illicit tobacco trade. This is discussed at paragraphs 96-110 above.

123. One company noted that after the 25 per cent tobacco excise increase in 2010, Australia is now ranked the second most expensive

country in terms of tobacco affordability among selected OECD countries. The company submitted that this relative position will further exacerbate illegal trade flows into Australia.

Contribution to inflationary pressures

124. One tobacco company expressed concern about the impact of the 25 per cent increase in excise on inflation stating that ‘previous CPI-linked tobacco excise tax increases had neutralised the inflationary pressure but increases above inflation, naturally increase the national inflation rate’.

125. However, tobacco companies recognised that while the 25 per cent increase was a key contributor to inflationary pressures in 2010, it was also recognised that these pressures abated alongside the Government’s return to the practice of twice-yearly, CPI-linked tobacco excise tax increases in 2011.

Customs and Border Protection

126. Customs and Border Protection is responsible for collecting customs duty and plays a key role in detecting smuggled tobacco products and for administering penalties. Smuggling involves the illegal importation of cigarettes and other tobacco products to avoid all duties and taxes. Customs and Border Protection does not differentiate between contraband tobacco products and imported illegal tobacco as both types of imports have evaded payment of customs duty.

Australian Taxation Office

127. The ATO is responsible, under delegation, for administering warehouse licences for storage of imported tobacco.

128. The ATO is responsible for the collection and administration of tobacco excise duties. The ATO is also responsible for administering and monitoring licenses necessary to:

- manufacture tobacco;
- deal in tobacco; or
- store and freight tobacco with permission to sell duty-free.

129. The implementation of the 25 per cent increase in tobacco excise has not had any noticeable effect on the licencing of tobacco related clients.

Conclusion

130. The 25 per cent increase in tobacco excise introduced on 30 April 2010 was part of an anti-smoking action package announced on 29 April 2010.

131. The one-off increase in tobacco excise and excise equivalent customs duty progressed recommendations of the National Preventative Health Strategy Report and the Australia's Future Tax System Review in reducing affordability of tobacco products and in implementing a substantial one-off increase in tobacco excise.

132. The 25 per cent increase in tobacco excise occurred at the same time as the announcement of a range of other anti-smoking measures designed to reduce smoking rates in Australia. As such, it is difficult to attribute the decreases in tobacco consumption solely to this measure, as other measures such as anti-smoking advertising campaigns and tobacco advertising restrictions, or even general consumer caution may also have contributed. In addition, the smoking rate in Australia has been gradually decreasing over time.

Cutting Tobacco Consumption

133. Data on tobacco clearances indicates the objective of reducing tobacco consumption estimated to be around 6 per cent has been met with data indicating a decline in tobacco clearances (which broadly covers legal sale of tobacco) of 11 per cent when comparing clearances in the three months before the policy change with clearances for the same period, 24 months later.

134. Changes to the incentives (because of the increase in excise) and the increases in penalties relating to illicit tobacco may influence the overall decrease in consumption. However, given the large decrease in legal sales and no specific evidence pointing to large increase in illegal sales, it can be concluded that this objective has broadly been met by the package of measures.

Cutting the number (prevalence) of tobacco smokers

135. There is a lack of data specifically examining smoking prevalence before and after the increase in tobacco excise so there is insufficient data to determine whether the measure resulted in the estimated number of smokers being reduced by 2 to 3 per cent. However, a study by the University of Sydney and other data on calls to Quitline and PBS data for medicines used in the treatment of nicotine dependence indicates that the increase in tobacco excise (and thus retail price) increased quitting attempts subsequent to the implementation of the rate increase — however, there was a return to long term trends a few months after the change. Further examination of this issue will be able to be completed following the completion of the next National Drug Strategy

Household Survey undertaken by the Australian Institute of Health and Welfare.⁵⁰

Providing additional funding for related health care

136. The measure was anticipated to raise an extra \$5 billion over five years which would be invested in better health and hospitals. An ex-post analysis of extent of the additional tax revenue received is not available. However, since 2010 the Government has made a number of commitments to provide more funding for better health and hospitals. As part of the 2010-11 Budget, the Government announced additional funding to be invested in better health and hospitals through the National Health and Hospitals Network Fund with revenue raised from the 25 per cent increase in tobacco excise directed to this purpose; under the NHRA signed in August 2011, states and territories will receive at least \$16.4 billion in additional funding for public hospital services from 2014-15 to 2019-20; under the NPA-IPHS the Commonwealth will provide the states and territories with up to \$3.4 billion by 2017-18; and in May 2011, the Government announced a \$2.2 billion mental health package to fund National Mental Health Reform.

Bringing Australia's tax treatment of tobacco closer to comparable countries

137. The measure has not met the objective of bringing Australia closer to comparable countries in terms of the ratio of taxes to the retail price of tobacco. While there was a short-term increase in the excise as a percentage of the retail price, the ratio was lower in 2012 than at the time of the announcement in 2010. However, it should be noted that the ratio of tobacco taxes to price is problematic as it is influenced by tobacco prices. In Australia, the tax-price ratio has fallen due to non-tax related price increases of tobacco.

138. In conclusion, the measure appears to have positively supported other policy, price and taxation measures aimed at reducing the negative effects that tobacco consumption and prevalence have on health, community and economic wellbeing in Australia.

⁵⁰ The data from this survey is unlikely to be available until 2014.

ATTACHMENT A

Anti-smoking action

News Release from Kevin Rudd, posted Thursday, 29 April 2010

The Rudd Government today announced a comprehensive package targeting smoking and its harmful effects, including an increase in the tobacco excise of 25 per cent.

This increase in tobacco excise will provide an extra \$5 billion over four years, which along with existing revenues from tobacco; will be directly invested in better health and hospitals through the National Health and Hospitals Network Fund.

The Government's anti-smoking action includes:

- The first increase in tobacco excise (above inflation) in more than a decade, an increase of 25 per cent.
- Cracking down on one of the last frontiers for tobacco advertising — in a world first, cigarettes will have to be sold in plain packaging.
- Restricting Australian internet advertising of tobacco products.
- Injecting an extra \$27.8 million into hard-hitting anti-smoking campaigns.

All four measures deliver on major recommendations of the National Preventative Health Taskforce.

- Cutting smoking will save lives, take pressure off our hospitals, and deliver significant economic benefits.
- It is one of the best investments in prevention, and keeping people healthy and out of hospital, that we can make.

Smoking kills over 15,000 Australians every year, and is the largest preventable cause of disease and premature death in Australia. The social costs of smoking (including health costs) are estimated at \$31.5 billion each year. Annually, over 750,000 hospital bed days are attributable to tobacco related diseases.

Through tough action over the past two decades, including tax increases and bans on advertising, the number of daily smokers in Australia has been reduced from 30.5 per cent of the population aged 14 and over in 1988 to 16.6 per cent in 2007.

This is important progress, but we can and must do better.

Excise increase

The Government will increase the excise and excise-equivalent customs duty rate applying to tobacco products by 25 per cent from midnight tonight. The excise on cigarettes will increase from \$0.2622 to \$0.32775 per stick and loose leaf tobacco from \$327.77 to \$409.71 per kilogram of tobacco.

This will increase the price of a pack of 30 cigarettes by around \$2.16.

This measure alone is expected to cut total tobacco consumption by around 6 per cent and the number of smokers by 2 to 3 per cent — around 87,000 Australians.

This measure will provide an extra \$5 billion over four years that, together with existing revenues collected from tobacco, will be directly invested in better health and hospitals through the National Health and Hospitals Network Fund.

In this way, all customs and excise duty on tobacco will fund a reformed Australian health and hospital system into the future.

Cigarette price increases have been shown to be effective in cutting smoking, especially among young people, who are particularly sensitive to price.

Taxes on tobacco as a percentage of the retail price of tobacco are currently just 62 per cent in Australia, compared to 80 per cent in France and 77.5 per cent in the United Kingdom.

Today's increase will bring Australia's tax treatment of tobacco closer to comparable countries.

Cracking down on cigarette advertising

In a world first, all cigarettes will be sold in plain packaging by 1 July 2012.

This will remove one of the last remaining frontiers for cigarette advertising, and was a key recommendation of the National Preventative Health Taskforce.

The legislation will restrict or prohibit:

- tobacco industry logos;
- brand imagery;
- colours; and
- promotional text other than brand and product names in a standard colour, position, font style and size.

The Government will develop and test package design that will make cigarettes less appealing, particularly to young people.

Graphic health warnings will be updated and expanded. Research shows that industry branding and packaging design reduce the effectiveness of graphic health warnings on tobacco products.

The National Preventative Health Taskforce concluded that ‘there can be no justification for allowing any form of promotion for this uniquely dangerous and addictive product which it is illegal to sell to children’, including packaging.

The Government will also legislate to restrict Australian internet advertising of tobacco products, bringing the internet into line with restrictions already in place in other media.

Anti-smoking advertising

At the same time, the Government will boost investments in hard hitting advertising campaigns by \$27.8 million over four years, to a total of more than \$85 million in the next four years, to encourage even more Australians to quit smoking.

This additional investment will be used for campaigns targeting people in high-need and highly disadvantaged groups such as low socio-economic communities and pregnant women and their partners.

This will extend and broaden the focus of the previous National Youth Tobacco Campaign.

The first elements of the new campaigns will be rolled out by the end of this year.

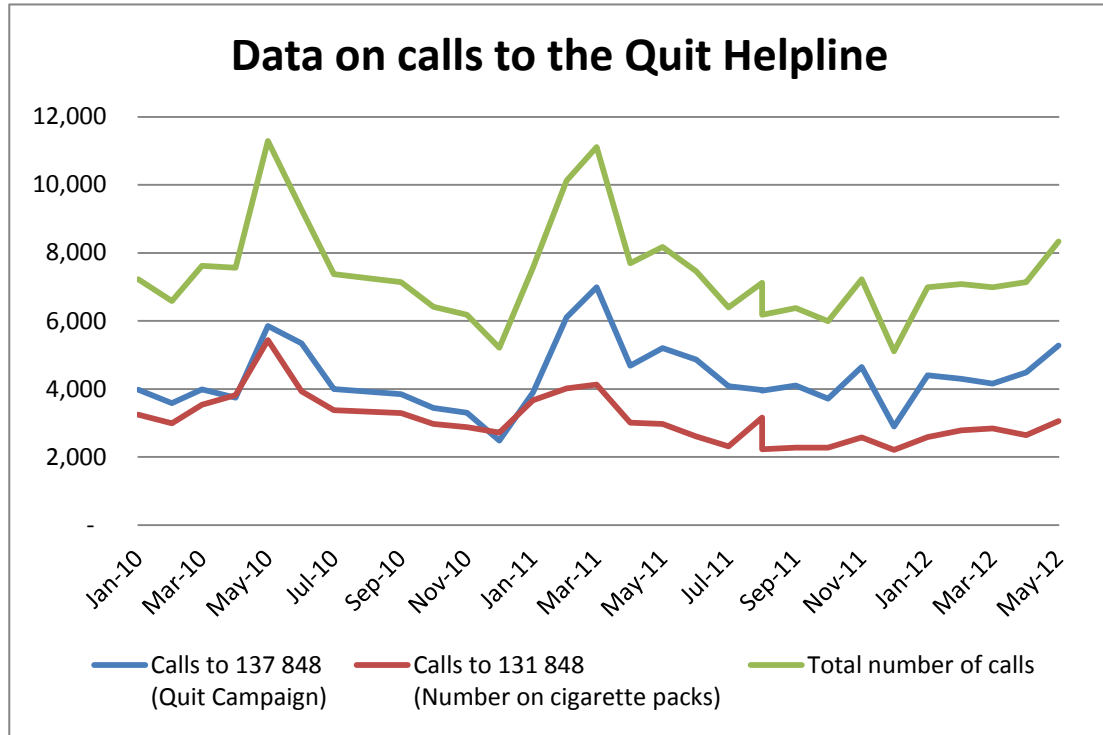
Through the Australian Taxation Office and Customs and Border Security the Government will continue its successful strong enforcement against the production and importation of illicit tobacco.

This comprehensive anti-smoking package follows this week’s landmark COAG agreement delivering fundamental reform to Australia’s health and hospital system, and builds upon other actions the Government has taken to improve preventative health;

- a record \$872 million investment in preventative health including programs in schools, workplaces and community settings; and
- \$103.5 million under the National Binge Drinking Strategy.

The decision to establish the Australian National Preventative Health Agency which is currently being blocked by the Opposition in the Senate.

Attachment B



Attachment C

Data on pharmaceutical benefit scheme medicines used to help quit smoking

