

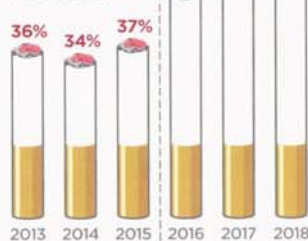
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RED FLAG RAISED OVER MALAYSIA'S TOBACCO INDUSTRY

MALAYSIA'S ILLICIT TOBACCO TRADE

ILLICIT SECTOR MARKET SHARE

Excise hike of almost 40% introduced



Since the excise hike...

5% increase in overall cigarette consumption
32% decrease in legal cigarette sales

AVERAGE PACK PRICE*



PERCENTAGE ILLICIT INCIDENCE (TOP FIVE COUNTRIES, 2018)



LOST TAXES IN 2018

RM331 million of unpaid sales taxes

+ RM4.8 billion of unpaid excise duty
2018 excise duty collected: RM3.0 billion (estimated)

= RM5.1 billion of taxes evaded in total



Pete Collings

tial revenues. Last year, the total excise duty evaded by the illicit activity was estimated to reach almost RM4.8 billion far in excess of the RM3 billion Oxford Economics forecast that the government was supposed to collect that year.

"We estimated that cigarette sales in the illicit sector also avoided RM331 million in sales taxes.

"This means the total amount of tax evaded by the illicit trade in cigarettes in 2018 was over

RM5.1 billion, which equates to over 2.9% of Malaysia's total tax receipts that year," it notes.

The report also points out that the RM5.1 billion in taxes lost is equivalent to three-quarters of the RM6.8 billion owed by borrowers to the National Higher Education Fund. "Alternatively, we estimate excise lost since the 2015 duty increase has reached RM13.5 billion (in constant prices) equivalent to more than the amount that the US Department of Justice cites as having been lost in the Malaysia Development Bhd scandal."

Collings says the damage caused by the illicit tobacco trade goes far beyond unpaid excise duties and sales taxes.

"The illegal trade, and the syndicates that prosper from it, spreads further illegal activity within Malaysia, encouraging corruption and discouraging legitimate business practices throughout the economy," he adds.

'SELLING CONTRABAND CIGARETTES COULD LEAD TO MORE SERIOUS CRIMINAL ACTIVITIES'

Datuk Seri Akhbar Sattar, a criminologist and former president of Transparency International Malaysia, blames weakness in enforcement, lack of integrity and poor customs and border protection facilities for the high illicit tobacco incidence in the country.

"According to a Special Branch report, more than 80% of enforcement officers at Malaysian borders are corrupt. This is a serious issue and it has to be tackled," Akhbar said during a roundtable on "The Economics of the Illicit Tobacco Trade in Malaysia" on June 20.

He was referring to a report by a local daily in 2015, that had quoted findings by the Special Branch which provides intelligence to enforcement agencies based on 10 years of undercover surveillance and intelligence gathering at border checkpoints, as well as enforcement agencies across Malaysia.

Transparency International Malaysia estimates that 4% of the country's GDP has been lost annually to corruption since 2013.

Akhbar also noted that the government doesn't seem to show a commitment to help build and improve the capability of customs and other law enforcement officials, nor to invest in upgrading security equipment such as scanners used for border protection which are mostly outdated.

He urged the government to set up a task force comprising all key stakeholders, such as the big three tobacco companies, the security service, police and customs. He cited the tobacco coalition between BAT Malaysia, JTI Malaysia, Philip Morris (Malaysia) Sdn Bhd and law enforcement agencies that was formed to combat illicit tobacco back in 1983, which he said was an effective one.

Also present at the roundtable was Malaysian Industrial Development Finance Bhd group managing director Datuk Charon Wardini Mokhzani, who said the bigger issue should not be focused on the loss in excise duty revenue from cigarettes, but on how to combat organised crime.

He noted that the increase in excise duty from cigarettes is indirectly promoting illegal activities.

David Lum, the Criminal Investigations Attaché of the US Internal Revenue Service (IRS) based at the US Consulate General Hong Kong, said that while selling contraband cigarettes may be considered a "petty crime", it could lead to more serious criminal activities.

"While people see this as a petty crime, the money generated from the selling of these contraband cigarettes goes into financial institutions and they are laundering money. Even if the selling of contraband cigarettes is a slap on the wrist, money laundering is a serious crime and it threatens that integrity of financial institutions when the proceeds from these illegal activities go into the financial system," he added.

Malaysia has emerged as the country with the highest level of illicit tobacco incidence in the world, where six out of every 10 cigarettes sold in the country last year were illegal, according to a recent report published by Oxford Economics.

This is followed by Brazil where illicit cigarettes accounted for half of the overall tobacco industry in 2018, Ecuador (41%), Panama (34%) and the United Arab Emirates (33%).

But it's a record Malaysia would rather not be associated with.

The warning bells have been ringing, with the three largest tobacco companies in Malaysia, who together control 95% of the legal industry's market share, talking to government officials over the years about how detrimental the illicit tobacco trade has been and will be to their business.

However, this seemed to fall on deaf ears looking at the growth of Malaysia's illicit trade.

An Oxford Economics study commissioned by British American Tobacco last month shows that illicit cigarette consumption levels were hovering between 36% and 37% from 2013 to 2015, but breached the 50% level for the first time in 2016 when it hit 52%.

Since then, illicit tobacco consumption has accounted for more than half of the entire tobacco industry for the last three years, rising further from 56% in 2017 to 59% last year. This equals around 598 million 20-stick packs.

Pete Collings, director of economic impact consulting for Europe and the Middle East at Oxford Economics and the author of the "The economics of the illicit tobacco trade in Malaysia" report, blames the "shock" increase in excise duty in November 2015 for the spike in Malaysia's illicit tobacco trade as many smokers turn to the illegal market.

"In 2015, the excise duty levied on 1,000 cigarettes rose from RM280 to RM400. At the same time, an ad valorem duty of 20% on the factory price was dropped," he tells *The Edge* in an interview.

There are two factors driving the sales of illegal cigarettes, says Collings.

"The easy availability of illegal tobacco from neighbouring countries is one. Nearly three-quarters of all illegal cigarettes found in Malaysia come from Vietnam, Indonesia and the Philippines," he explains.

Another driver, he says, is the affordability level of legal cigarettes relative to illegal alternatives. One simple measure of affordability is the proportion of daily household income required to purchase a pack of cigarettes.



Erik Stoen

Oxford Economics estimates that one pack of cigarettes purchased at the weighted average price of RM16.18 in 2016, accounted for over 17% of the daily income for households in the bottom 40% that year. In contrast, purchasing an illegal pack at the average illicit price would have accounted for only 4.8% of daily income.

Collings points out that the rise in illegal tobacco consumption has also undermined the government's health agenda, as data has shown that instead of curbing smoking, total cigarette consumption (both legal and illicit) has increased by 7%, yet sales of legitimate cigarettes have dropped by nearly a third since 2015.

British American Tobacco (Malaysia) Bhd managing director Erik Stoen says the decline in sales volume had also led to the company and JTI International Bhd shutting down their Malaysian manufacturing base in 2017, resulting in some 600 jobs lost.

The factories made a combined contribution to the economy of RM831 million that year, and generated tax revenues of RM161 million all of which has been lost with their closure.

Both companies had cited that it would be more economical to import cigarettes into the country than operate factories that had previously produced cigarettes for both export and domestic consumption.

Collings concurs, noting that the illicit tobacco trade diminishes the country's attractiveness to international investment and discourages legitimate business operations.

He also points out that today, illicit tobacco trade has become an endemic problem in Malaysia.

"Nielsen data indicates that smuggled contraband or illicit whites cigarettes produced legally abroad for the purpose of selling in the illicit Malaysian market accounted for nearly three-quarters of the illicit market in 2018. The rest are kreteks (tobacco and clove cigarettes) and legal cigarettes carrying fake tax stamps," he says.

ILLICIT TRADE COSTING THE COUNTRY BILLIONS

The Oxford Economics study reveals that the rising illegal cigarettes trade has also deprived the government of substan-