

WORKING PAPER

The Illicit Tobacco Trade in Zimbabwe and South Africa: Impacts and Solutions

MARCH 2019

SIMONE HAYSON

INTRODUCTION

This study was conducted to explore how the illicit trade in licit goods supports organized crime, corruption, and erodes state structures. The illicit tobacco trade in southern Africa occupies a prominent place in southern African politics, due to its prominent role in the ‘state capture’ scandals that characterized politics in South Africa between 2013 and 2018. Indeed, the illicit tobacco trade occupies a prominent place in public debate in South Africa, both about crimes that may have been committed in the last five years, and about how the current administration responds to the illicit economy right now. Conflict—overt and covert, violent and non-violent—over who makes the most money from illicit tobacco, who controls it, and how the state responds to it, is a major feature of South Africa’s, and to a lesser extent Zimbabwe’s, political economy. This conflict now takes places in the midst of huge political transitions within the ruling parties of both countries.

Simone Hayson is a Senior Analyst at the Global Initiative against Transnational Crime, an expert network that provides analysis, convening, and programmatic activities with the objective of achieving a coherent and effective international policy response to transnational organised crime

This case study maps the key dimensions of the illicit cigarette trade in Zimbabwe and South Africa, including the key actors, the pathways of trade and the accompanying ‘modalities’ of criminality, as well as other important dimensions of the illicit cigarette market in southern Africa. It then identifies ‘good-faith actors,’ primarily in South Africa, whose positions could be strengthened by policy and technical interventions, explores opportunities for such intervention, and assesses the practical solutions that can be applied to combat illicit trade and tax evasion in the tobacco industry. The paper contributes to expanding awareness among policymakers and the public of the nexus between the illicit trade in licit goods, corruption, and organized criminal networks.

Method

To gather evidence for this report, the author and researchers conducted semi-structured interviews in April and May 2018.¹ They conducted eighteen interviews in Beitbridge and Harare in Zimbabwe, plus another sixteen in South Africa in Johannesburg, Cape Town, and, via phone, Port Elizabeth. They spoke to people who work in or close to the tobacco industry, including those who have been accused of smuggling, as well people who have studied, reported, or investigated the tobacco industry. Interview questions varied depending on the position of the respondent, but always included their views on the impact of illicit trade and potential solutions, including regulation and technology.

Interviewees included current and former smugglers, staff of tobacco companies, lawyers, active and former law enforcement with a range of mandates, industry representatives, academics, journalists, and other people involved in the regulation of the tobacco industry and processing of tobacco products. Researchers conducted a literature review of academic papers, media and industry reports, and court case proceedings related to the illicit trade.

Regional context

The illicit tobacco market in southern Africa is distinguished by two key facts: first, South Africa provides the largest, most profitable, and therefore most important consumer market and cigarette production hub; second, Zimbabwe is the biggest tobacco producer in the region and indeed the continent.² The trade is regionalized: besides Zimbabwe and South Africa, illicit cigarettes are also sold in and trafficked through neighbouring countries Botswana, Namibia, and Mozambique. Smuggling routes can shift through different countries, depending on the enforcement regime, a feature that complicates policy and enforcement respons-

es. However, because Zimbabwe, Namibia, Botswana, and Mozambique have small populations and lower rates of disposable income, the South African market will remain the focus of cigarette smugglers interested in large profits.

Presently the illicit cigarette market is dominated by ‘genuine’ contraband (as opposed to counterfeit products, which were predominant in the 2000s). Genuine contraband cigarettes are produced in legally registered factories under registered brands, with the profits coming from tax evasion. The specific taxes evaded are either value added taxes (VAT) or excise tax. However, the nature of ‘illicit’ practices in the tobacco industry must be understood more broadly than as just the sale of untaxed products. A comprehensive understanding of the nature and impact of illicit practices must also take into consideration the avoidance or evasion of corporate income tax, anti-competitive practices, and the contribution of illicit trade to facilitating corruption and accelerating the erosion of state institutions. All of these are marked features of the illicit tobacco trade in southern Africa.

British American Tobacco (BAT) is the largest multinational tobacco company present in both South Africa and Zimbabwe. Precise figures are contested, but the most recent Euromonitor report to which we have access (2016) records that BAT held 74 percent share of the licit market, followed by Japan Tobacco International (JTI, 9 percent) and Philip Morris International (PMI, 8 percent) in South Africa.³ The estimate of BAT market share in Zimbabwe—around 80 percent—comes from industry insiders. This dominance of the tobacco market, combined with the high excise tax on cigarettes, makes BAT one of the largest contributors to the fiscus of any company operating in those territories.⁴ In South Africa, this has given BAT ‘a seat at the table’—and we suggest, arguably more—in deter-

1 Two researchers conducted interviews in Zimbabwe, around half of them in conjunction with the author. Research assistance also was provided by Mafaro Kasipo and Micheal McLaggan at the University of Cape Town.

2 Figures on Zimbabwe and other Southern African Development Community (SADC) countries’ tobacco production figures are available from the Tobacco Industry and Marketing Board of Zimbabwe. Other important production hubs in Africa are all much farther north: Algeria, Egypt, Morocco, and Nigeria. See Nicole Vellios, Hana Ross, and Anne-Marie Perucic, “Trends in cigarette demand and supply in Africa,” *PLOS ONE* 13, 8 (2018), <https://doi.org/10.1371/journal.pone.0202467>.

3 “Cigarettes in South Africa,” Euromonitor International (July 2017), as cited and summarized in the South Africa profile at tobaccotactics.org, an academic resource site run by the University of Bath that explores how the tobacco industry influences policy and public health in the United Kingdom, European Union, and internationally. See http://tobaccotactics.org/index.php?title=South_Africa_Country_Profile#cite_ref-em_6-2.

4 Officials who have worked on tobacco industry matters for the South African government suggest this is the case. From interviews conducted in May 2018.

mining the enforcement response. BAT lobbies hard against the illicit cigarette trade to protect its market share and engages its own surveillance and enforcement actions. At the same time, the owners of smaller companies producing illicit cigarettes have, in almost all cases, widely known high-level political connections in either Zimbabwe or South Africa, or both. As a result, illicit tobacco (and we argue, licit tobacco too) has become a major feature of the political economy of corruption in the region.

The final feature of the local context, when considering the climate for curbing illicit trade, is that both Zimbabwe and South Africa have recently undergone political transitions, whereby ruling parties remained in control, but different factions took over from long-standing presidents. Both the new presidents, Cyril Ramaphosa of the African National Congress (ANC) in South Africa and Emmerson Mnangagwa of the Zimbabwe African National Union-Patriotic Front (ZANU-PF) in Zimbabwe, have declared that they are backing strong anti-corruption drives.

1: POLITICAL ECONOMY OF THE ILLICIT CIGARETTE TRADE

ZIMBABWE

Context

In Zimbabwe, between 19 and 35 percent of the population of sixteen million smoke.⁵ BAT has a factory producing cigarettes for the Zimbabwean market and neighbouring countries. Other than BAT, there are two main tobacco-product manufacturing companies operating in Zimbabwe, Savanna Tobacco and Gold Leaf. Both of these companies have their main market in South Africa. Recently, a few more tobacco companies have been set up in Zimbabwe, but their ownership and the nature of their products is unclear.

The prices of tax-paid cigarettes within Zimbabwe differ according to the brand; the range is between \$1.20 and \$1.60 per pack.⁶ The cost of a loose cigarette sold at a retail outlet is about \$0.06 to \$0.10.⁷ The price of a pack of cigarettes on the black market is a third of the price of a pack for which full taxes have been paid.⁸ There is, therefore, a domestic illicit market in Zimbabwe, but in the words of one informant in South Africa: “[In the past] independent factories in Zim existed [only] in order to smuggle to SA.”⁹

Zimbabwe-produced cigarettes are smuggled into all its neighbouring countries, with the clear majority being smuggled into South Africa. The exact scale and number of cigarettes smuggled is unknown. Nonetheless, interviewees were unanimous in the belief that large amounts of cigarettes are smuggled into South Africa daily.¹⁰ The majority of seizures of illicit cigarettes

in South Africa have been of Pacific and Gold Leaf, both brands made by the Savanna Tobacco company.

Fuel tankers and trucks were once used to smuggle cigarettes across the Beitbridge border, making use of the balance of trade discrepancy between the two countries.¹¹ (Beitbridge sits along the Zimbabwe-South Africa border, with the Limpopo River running between the two countries.) This scam made use of the fact that tankers could plausibly claim to be leaving Zimbabwe ‘empty’ after dropping off loads of fuel. (Research conducted by the Global Initiative against Transnational Organized Crime, a non-profit, on other smuggling economies in southern Africa has shown that many trucking companies also actively seek to defray their costs by filling otherwise empty vehicles with illicit loads.)¹² In fact, according to sources, during the heyday of cross-border cigarette smuggling in the late 1990s and early 2000s, some enterprising individuals even set up routes that brought licit goods to Mozambique where ‘empty’ trucks would be filled with second-hand clothes, which were then smuggled into Zimbabwe and replaced with cigarettes that in turn were smuggled into South Africa.¹³

However, since Zimbabwean authorities introduced vehicle scanners, and barcode scanners were introduced on the South African side at some border crossing points (notably the Beitbridge border crossing), all high-loaded trucks are now scanned. Consequently, the use of fuel tankers for smuggling is mostly non-existent now. All large vehicles are scanned and if scanning

5 UNICEF Zimbabwe, Report on the results of the Global Youth Tobacco Survey in Zimbabwe (GYTS ZIMBABWE) (Harare & Manicaland: UNICEF Zimbabwe, 1999–2000). People employed in the tobacco industry proposed figures of 20 to 30 percent. Interview with tobacco company employees 1 and 2, Harare, April 2018.

6 Interview with tobacco company employee 2, Harare, April 2018.

7 Interview with tobacco company employee 1, Harare, April 2018

8 Interview with tobacco company employees 1 and 2, Harare, April 2018; interview with Tobacco Industry and Marketing Board employee, Harare, April 2018.

9 Interview with independent cigarette manufacturer B, Johannesburg, 24 April 2018

10 Interview with Zimbabwean former smuggler, Beitbridge, May 2018; interview with partner of former smugglers, Beitbridge, April 2018; interview with resident of Beitbridge, Beitbridge, April 2018.

11 Interview with Zimra officials, Harare, May 2018; interview with tobacco company employee 2, Harare, April 2018; interview with Tobacco Industry and Marketing Board employee, Harare, April 2018.

12 Jenni Irish, unpublished report prepared in September 2017 for the Global Initiative against Transnational Organized Crime and based on interviews conducted with people in the transport industry in South Africa.

13 Zimbabwe outlaws the import of second-hand clothing in order to protect its domestic textile industry.



Map No. 4210 Rev. 2 UNITED NATIONS
December 2017

Department of Field Support
Geospatial Information Section (formerly Cartographic Section)

images are suspicious the trucks are examined, which entails having their goods physically off-loaded and examined individually.¹⁴ Through the introduction of these measures at the border—notably the use of scanners on trucks—smuggling cigarettes has become high risk for small-scale businessmen who lack political protection.¹⁵

Actors and modalities

The actors involved in the smuggling of cigarettes from Zimbabwe to South Africa can be divided into two groups: organized low-level smuggling operations run

by individual entrepreneurs or groups of entrepreneurs, and organised smuggling cartels with political protection who smuggle the largest loads of illicit cigarettes into South Africa.

1: Small-scale smugglers

Several informants described the practices of small entrepreneurs who are in the cigarette smuggling business. These smugglers send men across the Limpopo River at informal border-crossing points in the bush.¹⁶ Small trucks and minibuses are hired for this purpose

¹⁴ Interview with Zimbabwean former smuggler, Beitbridge, May 2018; interview with South African soldier, May 2018, by phone; interview with clearing agent at Beitbridge Border Post, Beitbridge, April 2018.

¹⁵ Interview with clearing agent at Beitbridge Border Post, Beitbridge, April 2018; interview with Zimbabwean former smuggler, Beitbridge, May 2018; interview with Zimra anti-smuggling unit, Beitbridge, April 2018.

¹⁶ Interview with partner of former smugglers, Beitbridge, April 2018; interview with resident of Beitbridge, Beitbridge, April 2018; interview with clearing agent at Beitbridge Border Post, Beitbridge, April 2018; interview with soldier, May 2018, by phone.

from Harare. Some of these vehicles have their seats taken out and their windows tinted to prevent people from seeing inside.

The process of offloading the cigarettes takes very little time. The cigarettes are brought to the various crossing points to get moved across the river by ‘runners.’ The runners are mostly unemployed young men below the age of forty. This is done at night, between midnight and 3:00 a.m., when most people are asleep. The ‘runners’ physically carry the cigarettes in ‘shangani’ (plastic bags) on their backs and cross the Limpopo River to South Africa. The soldiers who guard these crossing points on both sides of the border are bribed to turn the other way. Informants report that it is easy to bribe the soldiers on both sides of the border.¹⁷

The buyers at the South African side are businessmen who will be waiting to fetch the cigarettes from the runners.¹⁸ To get to their destinations, their trucks use small and private roads to avoid tollgates, roadblocks, and ad-hoc searches by law enforcement on main roads.¹⁹

‘Malaityas’ (people in the cross-border transportation business) argued that the scanners and other measures at the Beitbridge border crossing have made it risky for truck drivers to be involved in cigarette smuggling.²⁰ Over time this has led to greater use of the informal border crossing by small-scale smugglers.

For those who continue to use the official border crossing at Beitbridge, buses with hidden compartments are used to smuggle cigarettes, as they are not scanned but only subject to sporadic road checks.²¹ Small cars are also not scanned, but former smugglers say that as they can only carry small volumes, the risks outweigh

the potential gain, which means this is not a popular method of smuggling.²²

Drivers pay heavy fines to the South African authorities if caught smuggling and, in most cases, people end up losing their vehicles and hence their livelihoods.²³ However, drivers are sometimes able to bribe their way out of trouble—and they allege that some police officers actively seek out illicit goods in order to extract a bribe.

While smugglers and transporters accused both South African and Zimbabwean police and army officials of soliciting bribes, the Zimbabwean side of the border is seen as being more permeable and affected by corruption. According to one malaitya interviewed for this study:

“It’s easier to bribe officials on the Zimbabwe side because they speak the same language, it’s home; everybody understands that life is difficult in Zimbabwe. We all know how everyone is trying to survive. It’s a different story on the South African side. You can even get arrested for trying to bribe an officer.”²⁴

South African police were considered to be periodically effective and harsh. If a smuggler is actually arrested, it is almost always on the South African side of the border, and they are taken to South African courts.²⁵

2: The ‘untouchables’

There are also actors involved in organized cigarette smuggling syndicates who are described by law enforcement as ‘big people’ who are ‘untouchable.’²⁶ A former smuggler claims that one of these cigarette-smuggling cartels involves politicians in the highest levels of

17 Interview with partner of former smugglers, Beitbridge, April 2018; interview with resident of Beitbridge, Beitbridge, April 2018.

18 Interview with soldier, May 2018, by phone; interview with malaitya, Beitbridge, May 2018; interview with Zimbabwean former smuggler, Beitbridge, May 2018.

19 Interview with clearing agent at Beitbridge Border Post, Beitbridge, April 2018; interview with Zimbabwean former smuggler, Beitbridge, May 2018.

20 Interview with malaitya, Beitbridge, May 2018.

21 Interview with Zimbabwean former smuggler, Beitbridge, May 2018.

22 Interview with Zimbabwean former smuggler, Beitbridge, May 2018.

23 Interview with clearing agent at Beitbridge Border Post, Beitbridge, April 2018; interview with Zimbabwean former smuggler, Beitbridge, May 2018; interview with malaitya, Beitbridge, May 2018.

24 Interview with malaitya, Beitbridge, May 2018.

25 Interview with Zimra anti-smuggling unit, Beitbridge, April 2018; interview with legal figure, Beitbridge, April 2018.

26 Interview with Zimra officials, Harare, May 2018; interview with Zimbabwean former smuggler, Beitbridge, May 2018.

government from both Zimbabwe and South Africa, but would not divulge names. This cartel is said to operate a smuggling scheme that runs from Harare to Durban. Huge trucks are used to smuggle the cigarettes from their loading points in Harare through formal border crossing points and onwards to their destination. These trucks are not stopped or searched on the Zimbabwean side of the border.

The cigarette brands that are most frequently smuggled are Remington Gold and Pacific Blue, both owned by Savanna Tobacco.²⁷ Beitbridge border post is a major point of entry.²⁸ Seizures at this border post accounted for 82 percent of seizures of illicit cigarettes made in South Africa in 2016.²⁹ However, in recent years there have been seizures of Zimbabwean cigarettes, mostly Savanna's Pacific brand, on the South Africa-Botswana and South Africa-Mozambique borders.

Savanna Tobacco is owned by Adam Molai, who is married to the niece of former Zimbabwean President Robert Mugabe and appears to have had political protection during Mugabe's regime.³⁰ His company has previously been implicated in tobacco-smuggling allegations. Cigarettes manufactured by Savanna have been intercepted being smuggled across the border hidden in an array of different vehicles, including oil tankers and mobile horse stables, in which the product was hidden in secret compartments, false floors, and/or stashed amongst other stock.³¹

Since the political transition, Molai's position may have changed. Interviews with law enforcement in Zimbabwe confirmed that Savanna Tobacco has recently been ordered to pay tax it has failed to pay the state over the years.³² According to a former smuggler in South Africa, "Adam [Molai] has lost political protection, and is also under financial pressure."³³ For his part, Molai denies all the allegations against him and has shown that he is prepared to sue for libel to protect his reputation.

Another significant figure is Simon Rudland, the owner of Gold Leaf Tobacco Corporation (GLTC), who has cigarette factories in South Africa and a tobacco-processing factory in Zimbabwe. Rudland owns a suite of companies, including farms, mines in Zimbabwe and the Democratic Republic of Congo, a logistics company, and a bus company.³⁴ Rudland has residences in Zimbabwe, South Africa, and the United Kingdom. Our informants claim that he attends Zanu-PF (Zimbabwe's ruling party) rallies and makes large contributions towards Zanu-PF congresses.³⁵ His South African business partner, Ebrahim Adamjee, also owns around fifty petrol stations across the country and a large amount of property in Linbro Park, Johannesburg.³⁶ As far back as 2006, Rudland and Adamjee were both arrested—but not convicted—for respective charges related to money laundering and cigarette smuggling from Zimbabwe to South Africa.³⁷ Rudland has denied any wrongdoing.

27 Interview with Zimbabwean former smuggler, Beitbridge, May 2018.

28 SAPA, "Cigarettes seized at Beitbridge," Independent Online, October 11, 2012, <https://www.iol.co.za/news/cigarettes-seized-at-beitbridge-1401296>; Obey Manayiti, "Face to face with Beitbridge's daring smuggling syndicates," The Standard, December 4, 2016, <https://www.thestandard.co.zw/2016/12/04/face-face-beitbridges-daring-smuggling-syndicates/>; Jonckie, "Hawks probe cigarette smuggling at Beitbridge," Insurance Chat, February 7, 2014, <http://www.insurancechat.co.za/tag/hawks-probe-cigarette-smuggling-at-beit-bridge/>.

29 Court affidavit deposed by Johannes Cornelius Vermaak, Oudtshoorn Magistrate's court, 2016, 201, para 78.

30 Malcolm Rees, "Mugabe link to illegal cigarette trade," Sunday Times, December 29, 2013, <https://www.timeslive.co.za/sunday-times/lifestyle/2013-12-29-mugabe-link-to-illegal-cigarette-trade/>.

31 Herald Reporter, "Horse trailer jam-packed with illegal cigarettes seized at SA-Zim border post," Herald Live, September 30, 2015, <http://www.heraldlive.co.za/news/2015/09/30/horse-trailer-jam-packed-illegal-cigarettes-seized-sa-zim-border/>.

32 Interview with Zimra officials, Harare, May 2018.

33 Interview with former cigarette smuggler B, Johannesburg, 4 May 2018.

34 Interview with independent cigarette manufacturer A, Johannesburg, April 25, 2018; interview with former cigarette smuggler B, Johannesburg, 4 May 2018.

35 Interview with Tobacco company employee 1, Harare, April 2018.

36 Interview with former cigarette smuggler A, Johannesburg, April 23, 2018.

37 Sam Sole, "Smokes, sex and the arms deal," The Mail and Guardian, October 28, 2008, <https://mg.co.za/article/2008-10-28-smokes-sex-and-thee>.

Law enforcement response

Police and military informants described how cooperation between their agencies, the customs agency, and central intelligence authorities had been successful in the past in cracking down on smugglers by conducting regular raids at known smuggling points and tracking cigarette smuggling vehicles from their loading points in Harare to the border.³⁸ But aside from resource constraints and a reliance on ad-hoc ‘tip offs,’ their activities were largely scuppered by constant interference and stonewalling of investigations by superiors if their investigations touched on politically connected people. Junior officers would also be sanctioned for refusing bribes that were intended to filter upwards to their superiors.³⁹

Interviews suggested that officials within enforcement agencies know which individuals run the major cigarette smuggling cartels but cannot act against them because of their political protection.⁴⁰ Even drivers who had been apprehended at the border would sometimes be released if they were able to communicate with people within these cartels.

While it is evident that current Zimbabwean President Emmerson Mnangagwa wants to secure greater legitimacy at home and abroad by being seen to be hard-line on corruption, it seems unlikely that he will tackle major sources of party finance.⁴¹ This would appear to be particularly likely where the profits from these illicit trades accrue to networks within the Zimbabwean military, given the key role the military played in Mnangagwa’s rise to the presidency. (We could not verify a link between the military and cigarette smuggling, though

the military’s involvement in smuggling Marange diamonds and rhino horn is well documented.)⁴² It is most likely that his anti-corruption drive will target the allies of his predecessor, and other political rivals, as already seems to be the case.⁴³

The current crackdown on Molai suggests something of the political economy of enforcement in Zimbabwe. Molai, who was connected to Mugabe and is alleged to have channelled rents toward him, is now subject to an investigation related to an irregularly appointed government tender.⁴⁴ If this takes the same form as other bad-faith, illicit-economy corruption crackdowns in the region, it will either aim to put Molai out of business, in order to allow for new entrants in the illicit market or the expansion of existing interests, or it will lever his patronage towards the new regime.⁴⁵ As stated, Molai denies all the allegations against him.

SOUTH AFRICA

Context

Prior to 1993, a single company, the Rembrandt Group, held the majority of the legitimate tobacco market in South Africa. Rembrandt was an Afrikaner-owned company and received strong support from the apartheid government, and taxes on tobacco and cigarettes were virtually non-existent.⁴⁶ As the apartheid regime ended and the transition to democracy began, the threat of smoking to public health became a priority. The Tobacco and Related Products Control Act was promulgated in 1993. Since then, stringent controls on smoking in

38 Interview with soldier, May 2018, by phone; interview with military officer, Harare, May 2018; interview with police officer 1, Harare April 2018; interview with police officer 2, Harare, May 2018.

39 Interview with soldier, May 2018, by phone; interview with military officer, Harare, May 2018; Interview with police officer 1, Harare, April 2018; interview with police officer 2, Harare, May 2018.

40 Interview with police officer 1, Harare, April 2018.

41 Tendai Kamhungira & Blessings Mashaya, “ED ups ante on corruption,” Daily News, December 21, 2017, <https://www.dailynews.co.zw/articles/2017/12/21/ed-ups-ante-on-corruption>; N. Turak, “Zimbabwe is ‘open for business,’ new president Emmerson Mnangagwa tells Davos,” CNBC, January 24, 2018, <https://www.cnbc.com/2018/01/24/zimbabwe-is-open-for-business-new-president-emmerson-mnangagwa-tells-davos.html>.

42 Global Witness, *An Inside Job: Zimbabwe: The state, the security forces, and a decade of disappearing diamonds* (London: Global Witness, September 2017).

43 Tendai Kamhungira, “Zacc selectively arresting politicians,” Daily News, February 4, 2018, <https://www.dailynews.co.zw/articles/2018/02/04/zacc-selectively-arresting-politicians>.

44 Freeman Razemba, “Zacc probes NSSA over 78m corruption cases,” Chronicle, May 5, 2018, <http://www.chronicle.co.zw/zacc-probes-nssa-over-78m-corruption-cases/>.

45 See this discussion regarding crackdowns on the illicit economy in Tanzania by President John Magufuli in Simone Hayson, Peter Gastrow, and Mark Shaw, *Heroin Coast: A political economy along the eastern African seaboard* (Pretoria and Lyon: ENACT, June 2018).

46 Mia Malan and Rosemary Leaver, “Political Change in South Africa: New Tobacco Control and Public Health Policies” in *Tobacco Control Policy: Strategies, Successes, and Setbacks*, ed. Joy de Beyer and Linda Waverley Brigden (World Bank: Washington, 2011), 121.

SOUTH AFRICA



Map No. 3768 Rev. 6 UNITED NATIONS
February 2007

Department of Peacekeeping Operations
Cartographic Section

public places have been implemented, as well as higher taxes on cigarettes. The end of apartheid also saw the opening of South Africa's markets and borders to the rest of the world, ending a lengthy period of isolation. Following the transition, Rembrandt ceded its market share to BAT, handing over what was a near-monopoly share of approximately 93 percent.⁴⁷

Since the passing of the Tobacco and Related Products Control Act, there has been a recorded reduction in the share of smokers and cigarettes smoked in South Afri-

ca. This has been credited to increasing taxes on cigarettes and a determined public health policy aimed at curbing smoking in public places and raising awareness of the health hazards posed by smoking.⁴⁸ The share of smokers in the population has been declining slowly in recent years to around 20 percent of the total population in 2017.⁴⁹ Companies now compete for a much more limited pool of consumers in South Africa.⁵⁰

The South African Revenue Service (SARS) should collect R17.85/\$1.50 tax (R15.52 in excise duties and R2.33

⁴⁷ Corné van Walbeek, The Economics of Tobacco Control in South Africa, Thesis presented in the Department of Economics, University of Cape Town, October 2005.

⁴⁸ Corné van Walbeek and Lerato Shai, "Are the tobacco industry's claims about the illicit trade credible? The case of South Africa," *Tobacco Control* 24, 2 (2015), 142, <https://tobaccocontrol.bmjjournals.org/content/24/e2/e142>.

⁴⁹ Data from Southern Africa Labour and Development Research Unit, National Income Dynamics Study 2017, Wave 5 (2017), <https://www.datafirst.uct.ac.za/dataportal/index.php/catalog/712>.

⁵⁰ Interview with tobacco industry representative, Johannesburg, 24 April 2018.

in VAT) per pack of cigarettes for the 2018/2019 year, based on the national budget. Any pack of cigarettes selling for less than this amount is assumed to be illicit. Illicit cigarettes are cheap, selling for as little as R5 or R10 (\$0.40 or \$0.85) per pack. These cigarettes can readily be found at street vendors and the average corner store all over the country.⁵¹ The low price and ready availability means that illicit cigarettes are highly accessible and popular with low-income consumers.

Estimates from 2002, when the illicit cigarette trade was picking up pace, indicate that BAT's market share stood at between 86 percent and 95 percent;⁵² more recent estimates put its market share at around 74 percent (see above), though large multinationals claim to have lost 10 percent of their market to illicit cigarettes in the last year alone.⁵³ Other 'independent' tobacco companies make up most of the rest of the market that is not controlled by BAT. Several of these companies have been publicly alleged to have links to the illicit cigarette trade.⁵⁴

Academic and civil society observers of the tobacco market claim that for several years since 2006 the large multinationals deliberately exaggerated the size of the illicit market as a way to lobby against rises in excise duty, which the South African government was pursuing to bring its policy into line with international recommendations and to curb rates of smoking.⁵⁵ An industry group called the Tobacco Institute of Southern Africa (TISA) blamed the purported high and increasing level of illicit trade on the excise tax, which they claimed increased the incentive for criminal actors to enter into the tobacco trade and harmed the market position of multinationals. These claims are not born out by research (see Box: *Do 'sin taxes' encourage smuggling?*)

and, in fact, these claims follow a global pattern which has seen multinational tobacco companies use the issue of illicit tobacco to lobby government to lower taxes.⁵⁶

However, the same observers are in agreement that the scale of illicit activity in the cigarette market has escalated substantially over the past three years, believed to be the result of diminished state capacity from corruption, as explained below. Between 2014 and the 2017 tax year, excise revenue from tobacco products fell by 16 percent.⁵⁷ The number of cigarette packs on which tax was paid fell by 27 percent, while the rate of consumption fell only slightly.

The quantity of taxed cigarettes legally sold and consumed has decreased significantly in the past two years. In the 2017-2018 financial year, the number of taxed cigarette packs amounted to about 763 million. After a relatively stable market size during 2010-2015, there was a steep drop in the legal quantities of cigarettes of 26 percent in the last two years. This steep decrease cannot be explained by standard factors such as the evolution of cigarette price, disposable income, population dynamics, and tobacco control legislation. A possible explanation could be a significant increase in illicit cigarette trade. At the same time, reports by SARS of seizures of illicit cigarettes do not point to an increase in seizures. As SARS has not released consistent figures⁵⁸ on its illicit cigarette seizures over the years, its Annual Report suggests that the tax year 2014-2015 seems to have been the highwater mark for seizures, with 204 million individual cigarette sticks seized and almost 1500 interventions against illicit trade by the revenue service. The rate of seizure almost halved in 2015-2016 to 133 million sticks, and in the years between 2016-2017 and 2017-2018 they were 17.5 million and 61.4 mil-

51 Interviews with shopkeepers in Cape Town, South Africa, March 2018.

52 Lisa Steyn, "The tobacco industry by the numbers," Mail and Guardian, May 18, 2012, <https://mg.co.za/article/2012-05-18-the-tobacco-industry-by-the-numbers>. Phillip Morris International, trading in well-known brands such as Marlboro and Chesterfield, and Japan Tobacco International, best known for the Camel brand, are the other big-name players present in the country, although they do not remotely enjoy the amount of the market that BAT does.

53 Interview with tobacco industry representative, Johannesburg, 24 April 2018.

54 Jacques Pauw, *The President's Keepers* (Cape Town: Tafelberg, 2017).

55 Interview with Corné van Walbeek, Economics of Tobacco Control Project, Cape Town, August 2017; interview with Salvera Kalideen, National Council against Smoking, August 2017.

56 Luk Joossens and Martin Raw, "Cigarette smuggling in Europe: who really benefits?," *Tobacco Control* 1998, 7, pp. 66-71.

57 Tamar Kahn, "Tobacco excise revenue plunge shows SARS collection up in smoke," *Business Day*, May 29, 2018, <https://www.businesslive.co.za/bd/national/2018-05-29-tobacco-excise-revenue-plunge-shows-sars-collection-up-in-smoke/>.

58 The total number of sticks seized is not always declared, and it is not clear how SARS calculates the value of seizures. Indicators of SARS actions are also inconsistently recorded – sometimes the total number of audits is listed, sometimes only warehouse audits are listed, and it is not always clear what actions have been declared as 'interventions'.

lion sticks seized, respectively.⁵⁹ As stated above and in the rest of this paper, this correlates with a serious diminishment of the state's capacity to investigate the illicit economy in general.

A recent study released by IPSOS, and funded by TISA, concluded South Africa loses R7 billion (\$590 million) per annum to the illicit cigarette trade and that of the total cigarette market around 20 percent of trade was illicit.⁶⁰ However, the figure does not count losses to transfer pricing and tax-base erosion or take into consideration that rates of smoking would fall were there to be fewer low-cost products on the market. The calculation of the size of the illicit market is also complicated by the fact that most measures will only count a pack selling below the tax threshold as being illicit – but, where brands are not competing for the bottom of the market, there is nothing to stop ‘untaxed’ cigarettes being sold for prices above the tax threshold.

Actors, routes and modalities

The public debate, state response and industry dynamics of the cigarette trade are highly bifurcated by a line that divides the largest multinationals, including BAT, Philip Morris International and Japan Tobacco International, from around five of the so-called ‘independent’ producers, who have locally or regionally registered brands and are alleged to play the largest role in producing illicit cigarettes.

The multinational tobacco companies are represented by TISA, an organization that the independent producers deride as BAT’s ‘mouthpiece’ and claim exists only to give more credibility to, and suggest a broader range of beneficiaries for, BAT’s lobbying.⁶¹ A separate

industry platform, the Fair Trade Independent Tobacco Association (FITA), was created in 2012 to protect the interests of small tobacco companies in a region dominated by big multinationals, though it is likewise considered to be a propaganda and lobbying tool for members that are allegedly under-declaring. Several of FITA’s members have been accused of smuggling (often in the form of under-declaring). Both TISA and FITA deny that their members are involved in illegal activity and have pledged to take action against any of their members found to be contravening the tax, customs, and excise laws of the country.

Several of the owners of FITA’s ‘independent’ companies are Zimbabwean citizens (including: Hardy Cronje, owner of Home of Cut Rag; David Prioleau, owner of Protobac; and Simon Rudland, co-owner of Gold Leaf Tobacco Corporation, or GLTC). Many of them use distributors who come from Indian, Pakistani, and Bangladeshi networks, with a strong presence in the retail sector catering to low-income markets, particularly supermarkets and bulk wholesalers (such a market is typically referred to as a “cash and carry”).⁶²

BAT has a large factory in Heidelberg that supplies South Africa and the broader southern African region (and is BAT’s eighth biggest factory globally). It produces cigarettes branded by its global trademarks. A mid-range brand such as rival PMI’s Marlboro sells for around R40 (\$3.40) in 2018. BAT distributes across the entire country.

FITA’s members have more localized distribution networks and markets. Most FITA members have their factories in Gauteng, typically in Johannesburg CBD or industrial areas such as Kempton or Linbro Park. Amalgamated Tobacco Manufacturers’ (ATM) factory is in

⁵⁹ Bizarrely, in a presentation to a parliamentary working group in May 2018, SARS gives a figure for its seizures between 2014-2015 and the 2017-2018 tax years which contradicts the Annual Reports by a wide mark – 270 million sticks (instead of over 400 as in the Annual Report). See SARS Presentation to Illicit Tobacco Trade Parliamentary Monitoring Group, Standing Committee on Finance, May 2, 2018.

⁶⁰ Summary findings can be found in 2018 National Tobacco Market Study, Ipsos Mori, May 2018, made available to the author by TISA. For the R7 billion figure see Kahn, “Tobacco excise revenue plunge shows SARS collection up in smoke.”

⁶¹ Interview with former cigarette smuggler B, Johannesburg, May 4, 2018.

⁶² Interview with former cigarette smuggler A, Johannesburg, April 23, 2018.

Pietermaritzburg in Kwa-Zulu Natal, and Home of Cut Rag is located near Port Elizabeth in the Eastern Cape. In terms of market control, there is territorial division. ATM is said to control KZN, Carnilinx controls Gauteng, and Gold Leaf distributes in Gauteng and the Eastern Cape.⁶³ No company has dominance or control over the Western Cape market, which is considered to be the most lucrative.

Illicit cigarettes are typically found for sale in small, owner-staffed general dealers called ‘spaza shops,’ found in townships, or set up as street stalls. According to the BAT-funded IPSOS study, out of the top ten brands found being sold below the tax threshold, six of them are produced by GLTC, owned by Simon Rudland.⁶⁴ GLTC cigarettes are estimated to account for between 70 percent and 80 percent of the illicit cigarette trade.⁶⁵ GLTC has denied claims that it is engaged in illegal activities.

Modalities

Our typology of the smuggling of cigarettes in South Africa distinguishes between what we term ‘internal smuggling,’ which involves various methods for evading paying tax on the sale of goods, and cross-border smuggling, both the conventional variety involving material goods and more intangible financial crimes.

Internal smuggling

The most prominent illicit modality in South Africa is the simple yet effective practice of **under-declaring** production to the revenue service. The undeclared surplus is then sold, tax-free, typically on the black market. This technique has been utilized by tobacco manufacturers globally for years. Factories in South Africa operate double shifts, running their machines at night, and/or they hide the true scale of their production by paying off customs officials and using fraudulent paper-

work. They make use of all the available gaps in SARS’s monitoring of their ‘bond’ warehouses, for example re-using invoices for one hundred cases of cigarettes for multiple deliveries of one hundred cases each time.⁶⁶ Or they obscure the quantity of their production and avoid paying excise through **round-tripping** and **ghost exports**—claiming that stock has been exported, when in fact it has been sold in the domestic market.⁶⁷

Many of the companies that are undeclaring and using round-tripping have a business model that blends licit and illicit—often they have entire brands that are produced and accounted for entirely legally, though these account for a minority of their business.⁶⁸ Academic research has found this combination of licit and illicit production and/or sale to be a feature of illicit cigarette markets in jurisdictions across the world.⁶⁹

Counterfeiting

When cigarettes are counterfeited they are packaged in identical or near-identical branding to popular cigarette brands (typically the premium brands made by multinationals). In addition to this fraud, tax is not paid on these products. Counterfeiting was prevalent in the 1990s, but its incidence was eclipsed, though not entirely eliminated, by under-declaration in the 2000s. Counterfeit cigarettes also can be smuggled across borders.

Cross border modalities

Cross-border smuggling

As described above, a large proportion of illicit cigarette seizures are of Zimbabwe-manufactured cigarettes that have been smuggled over the border. Cigarettes have also been smuggled across the Namibian, Botswanan, and Mozambican borders (though they were not necessarily produced in these adjacent countries). The police’s Directorate for Priority Crime Investigation (also

⁶³ Interview with former law enforcement official, Johannesburg, April 25, 2018; interview with former cigarette smuggler A, Johannesburg, April 23, 2018.

⁶⁴ Interview with tobacco industry representative, Johannesburg, April 24, 2018.

⁶⁵ Interview with tobacco industry representative, Johannesburg, April 24, 2018; interview with independent cigarette manufacturer, Johannesburg, April 25, 2018; interview with security provider for tobacco industry, Johannesburg, April 25, 2018.

⁶⁶ Interview with tobacco industry representative, Johannesburg, April 24, 2018.

⁶⁷ Interview with former cigarette smuggler B, Johannesburg, May 4, 2018.

⁶⁸ Interview with tobacco industry representative, Johannesburg, April 24, 2018; interview with independent cigarette manufacturer A, Johannesburg, April 25, 2018; interview with former law enforcement official, Johannesburg, April 25, 2018.

⁶⁹ Hana Ross et al., “A closer look at ‘Cheap White’ cigarettes,” *Tobacco Control* 2016, 25, pp. 527-531.

known as the Hawks) list cigarettes manufactured in Botswana (Sasha and Caspian brands, produced by Benson Craig) and Mozambique (Pall Mall and Safari brands, produced by BAT) as “commonly smuggled.”⁷⁰ Smuggled cigarettes also have been seized at sea ports, though these all represent a minority of both recorded seizures and alleged illegal activity.

‘Losing’ stock in transit

Surplus stock destined for a cross-border market is sometimes ‘lost’ while in transit, though in fact it has been smuggled into the market where it disappeared or into an adjacent market (as such, it can be internal or cross-border). For a cross-border example, this method was alleged to be have been used in a recent case before the Namibian Supreme Court involving Benson Craig.⁷¹ Namibian authorities impounded a shipment of cigarettes, apparently bound for Namibia. Benson Craig claimed that the shipment had ‘mistakenly’ been marked as bound for Namibia but instead was in transit to another destination, and therefore not subject to tax and had been unlawfully impounded. Benson Craig’s arguments were upheld; the company won the case. Nevertheless, although Benson Craig was vindicated, the alleged methodology has been deployed by others in the past, so that cigarettes could be smuggled into either the Namibian or South African market and sold cheaply on the black market.

Grey Areas

Cross-border financial methods

BAT also has been accused of tax avoidance around its profits in the South African tobacco industry. The boundary between tax avoidance and evasion is not always clear, but the revenue service may lack the expertise to pursue these cases and states also tend to be cautious about litigating on these issues as they run the risk—if they lose the case—of creating entirely legal routes to evade tax.

BAT has been accused of both **profit shifting** and **transfer pricing**.⁷² **Profit shifting** is a tax planning strategy used by multinational corporations to shift profits from higher-tax locations to lower-tax locations. The result is two-fold. First, the corporation makes a larger profit due to lower tax rates, and second, higher-tax locations see a decrease in tax revenue. **Transfer pricing** involves setting a price for goods and services sold between related legal entities within an enterprise, typically between a parent and subsidiary company. This relates to tax-base erosion in that goods and services could be traded between parent and subsidiary companies that exist in different tax locations across borders. By their nature, profit shifting and transfer pricing are modalities that can only be exploited by multinational corporations.

Law enforcement

The fate of law-enforcement efforts against the illicit tobacco trade show that tobacco companies’ political connections have been influential in allowing illicit trade to flourish. Despite being declared a national priority several years ago, the industry has grown with relative impunity since. While the state does make seizures of illicit cigarettes, these are mostly of the Pacific brand, which is produced by Zimbabwean company Savanna and may not fall under South African political protection.

While the state response stretches back to the early 2000s, the past four years are most illustrative of the power that actors in the tobacco industry have amassed, and of the consequent erosion of state capacity.

In 2014, the illicit cigarette trade was made a priority and an interagency task team—the Illicit Tobacco Task Team (ITTT)—was established to investigate and prosecute individuals associated with the industry. This involved a number of enforcement agencies, including the National Prosecuting Authority (NPA), the Hawks and its Crime Intelligence division, as well as the State Security Agency (SSA).

⁷⁰ The “commonly smuggled” brands are all manufactured within Zimbabwe or South Africa. See Department of Priority Crimes Investigation, “Illicit Cigarettes in South Africa”, presentation to Illicit Tobacco Trade Parliamentary Monitoring Group, Standing Committee on Finance, May 2, 2018.

⁷¹ Minister of Finance and another v Benson Craig (Pty) Ltd (SA10/2016) (2017) NASC 29 (26 July 2017).

⁷² Interview with former law enforcement official, Johannesburg, April 25, 2018. Also see Rob Rose, “BAT spies under SARS’s spotlight,” Business Day, June 1, 2014, <https://www.businesslive.co.za/bd/companies/2014-06-01-bat-spies-under-sars-spottight/>.

However, the ITTT effort did not include SARS. At the same time, SARS was running its own investigation, named Project Honey Badger. This investigation was conducted, in part, by the High-Risk Investigations Unit (HRIU) at SARS, an elite investigative unit dedicated to cases involving the illicit economy. There was little collaboration between the two state investigations, as SARS officials considered the ITTT to be compromised and instructed staff not to share information with it. The HRIU was later disbanded under a cloud of scandal. Many believe it was disbanded because it targeted people in the illicit cigarette industry (and other illicit trades) who were important to the president's patronage network.⁷³

Yusuf Kajee of ATM and Adriano Mazzotti of Carnilinx have been most prominently associated with the illicit trade and were under investigation as part of Project Honey Badger. Both have denied that they have engaged in illicit trade and are not tax compliant. ATM has been linked to the Zuma family. Edward Zuma, son of the former South African president, was once director of the company and later became a 'silent partner.'⁷⁴ Carnilinx owner, Adriano Mazzotti, has admitted to smuggling and other illegal activity relating to his business though he has subsequently retracted these statements. Mazzotti donated R200,000 to the opposition political party Economic Freedom Fighters (EFF) in 2013, and Mazzotti's partner at Carnilinx, Kyle Phillips, provided R1 million to the EFF's firebrand opposition-party leader Julius Malema to settle debts that would have prevented Malema from becoming a member of parliament. Journalists claim they have proof that Mazzotti also provided funding for the ANC presidential campaign of Nkosazana Dlamini-Zuma in 2017. In addition to covering part of the costs of Dlamini-Zuma's campaign, he also used his clothing company to produce T-shirts and caps for her campaign.⁷⁵ Mazzotti and Dlamini-Zuma have both denied the claims or that they have any relationship, despite photographic evidence of them together meeting on more than one occasion. In late 2018 it was also revealed that Malema

TOBACCO SMUGGLING BY THE STATE

State bodies have allegedly engaged in smuggling themselves, such as the State Security Agency's 'Project Robin.' This was supposedly an exercise in combating tobacco smuggling—by smuggling tobacco. The true objective of this badly executed plan was most likely not to 'sting' the illicit trade, but for the state employees involved to derive personal benefit from it.¹ This story is indicative of how ineffective and corroded state security institutions became during the Zuma presidency, but also the degree to which weak accountability turned illicit tobacco into an attractive avenue for making quick profits.

¹ Sam Sole and Sally Evans, "The smuggler, the spook and the grabber," amaBhungane, August 27, 2016, <https://amabhungane.org/stories/the-smuggler-the-spoof-and-the-grabber/>.

was living in a house in an upmarket suburb of Johannesburg that is owned by Mazzotti. Mazzotti and Malema claim this is a straightforward rental agreement and is not untoward.

BAT may have been complicit in illegal practices. British American Tobacco has also allegedly sought to maintain its near monopoly share of the market for tobacco in South Africa through anti-competitive practices and corrupt relationships with the state. BAT funded Forensic Security Services (FSS) in a corporate espionage campaign against independent manufacturers and has been accused of bribery.⁷⁶ These claims have been detailed in a signed affidavit by Francois van der Westhuizen, who had worked for FSS, which alleged BAT had bribed police and tax officials to turn a blind eye to "BAT's tax evasion and money laundering." BAT instituted an inquiry led by law firm Norton Rose Fullbright to investigate these claims, but has not yet released the

⁷³ Johann van Loggerenberg with Adrian Lackay, *Rogue: The Inside Story of SARS's Elite Crime-Busting Unit* (Johannesburg and Cape Town: Jonathan Ball, 2016).

⁷⁴ Pauw, *The President's Keepers*, 2017.

⁷⁵ Pauw, *The President's Keepers*, 2017.

⁷⁶ Pieter-Louis Myburgh and Angelique Serrao, "British American Tobacco 'bribed' police - affidavit," News 24, August 16, 2016, <https://www.news24.com/SouthAfrica/News/british-american-tobacco-bribed-police-affidavit-20160816>.

findings, even though media reports the inquiry is complete.⁷⁷ Another key strategy has been to acquire influence in state agencies and promote action against independent manufacturers that threaten BAT's majority. BAT's status as one of the largest single contributors to the national fiscus gives it leverage to gain proximity to state structures and allows it to frame the debate about loss of revenue in a narrow way that hones in on excises loss, rather than tax along the full value chain, which would bring Base Erosion and Profit Shifting (BEPS) losses into view.

The Illicit Tobacco Task Team provides a good example of this: it was not investigating the tobacco industry at large, rather it allowed TISA to be a member of the team. Media sources in South Africa have suggested that being part of the ITTT and having influence in the State Security Agency may have allowed TISA's members a say in who was investigated, while also deflecting scrutiny from their own actions. In 2016, when a whistle blower at FSS released confidential documents, it emerged that, in addition to paying people employed by their competitors to spy for them, BAT also had police officers and advocate Belinda Walters, who was FITA's chairperson, on their payroll.⁷⁸

The Walters case is perhaps the most notorious example of the tobacco industry's overreach into state institutions.⁷⁹ According to leaked documents and media reports, Walters was a triple agent who spied for BAT while also in the employ of the State Security Agency, before turning on BAT to spy on behalf of Carnilinx (the company she was hired to spy on). BAT paid Walter £30,500 to spy for them, disbursed from their London office through Travelex cards, which may have broken anti-money laundering laws.⁸⁰ It was Walter who set in motion the series of events that gave

Tom Moyane the pretext to fire the HRIU's lead investigator and later disband the unit. While BAT ordered an independent inquiry into its involvement in corporate espionage and bribery, it has never released the findings of this inquiry.

Shortly before the SARS High-Risk Investigations Unit was shut down, SARS had launched a case against BAT for a huge shortfall in tax payments, and it is believed to relate to profit-shifting and transfer-pricing practices. According to financial journalist Rob Rose,

"BAT's recent annual report lists a 'contingent liability' for a dispute it has with SARS dating back to 2011, when the tax authority challenged the 'debt financing' of BAT SA between 2006 and 2010. Essentially, this implies that SARS must have believed BAT put in place artificial structures designed to shift profits offshore and reduce the tax it pays. The upshot: SARS hit BAT with a tax bill for R2.01 billion for 'tax and interest' it should have paid."⁸¹

This debt is the single biggest dispute between the Revenue Service and any single taxpayer. BAT has subsequently downplayed the significance of this debt, saying that it covers a twelve-year period in which the company paid over R100 billion in taxes, and R14 billion in 2017 alone. However, the investigation into BAT's tax affairs appears to have halted at the beginning of the inquiry and sources with knowledge of complex disputes with high-value tax payers say that initial calculations of BEPS (Base Erosion and Profit Shifting) disputes are usually the "tip of the iceberg." BAT subsidiaries have been fined or investigated for tax evasion or fraud charges in Australia, Korea, Vietnam, Bangladesh, and Russia.

⁷⁷ Rob Rose, "BATs cocktail of misconduct," Financial Mail, May 10, 2018, <https://www.businesslive.co.za/fm/opinion/editors-note/2018-05-10-rob-rose-bats-cocktail-of-misconduct/>. When contacted for details of the expected release date for this paper, BAT did not respond.

⁷⁸ The original documents are still available through links to cloud sharing services on @espionageafrica and this matter has been widely reported in the press. Most recently, see Tim Cohen, "Illicit Cigarettes: the evil burning down SA's economy," Financial Mail, November 22, 2018, <https://www.businesslive.co.za/fm/features/cover-story/2018-11-22-illicit-cigarettes-the-evil-burning-down-sas-economy/>. These were ostensibly one of the matters to be investigated in BAT's internal inquiry, which has not been publicly released.

⁷⁹ If the web of double loyalties was not complex enough, Walters was also the first chair of the Fair-trade Independent Tobacco Association and was integral in its formation.

⁸⁰ These allegations are contained in affidavit ostensibly written by Walters in April 2015 (which is not signed), made public through leaked documents published by espionageSA. In a subsequent complaint to the Press Ombudsman around the affidavit, Walter denied the veracity of the leaked document. These claims were also reproduced in an internal SARS inquiry labelled 'The Kanyane Report' that was leaked to the media. Walters' complaint to the Press Ombudsman about a journalist's reliance on the report to substantiate these claims was dismissed by the Ombudsman.

⁸¹ Rob Rose, "BATs cocktail of misconduct," Financial Mail, May 10 2018, <https://www.businesslive.co.za/fm/opinion/editors-note/2018-05-10-rob-rose-bats-cocktail-of-misconduct/>.

After the appointment of Tom Moyane, an ally of then-President Zuma, as head of SARS, many of the staff involved in investigations against illicit trade ground to a halt. The events surrounding the decimation of SARS' investigative capacity were highly controversial at the time and have continued to generate embarrassment for the ruling party. Early in 2018, President Ramaphosa ordered a Commission of Inquiry into tax administration and governance at SARS headed by Judge Robert Nugent (hereafter, the Nugent Inquiry). In its report, the Nugent Inquiry has concluded that under Moyane's leadership the organisational structure of the institution had been remodelled to "the benefit of delinquent taxpayers and the disadvantage of major taxpayers who try to comply." In detail, Nugent spells the various deleterious effects of Moyane's decisions:

"The Large Business Centre (LBC)⁸² as it had existed was eviscerated to the detriment both of governance and revenue collection. The restructuring of the organisation displaced some 200 managerial employees from their jobs, many of whom ended up in positions that had no content or even job description, and in exasperation skilled professionals left. Others remain in supernumerary posts with their skills and experience going to waste. Customs was adversely affected.... Measures to counter criminality were rendered ineffective and those who trade illicitly in commodities like cigarettes operate with little constraint."⁸³

These findings support the analysis that political influence in SARS and law enforcement services, such as the Hawks, have played a crucial role in staying investigations into players alleged to be in the illicit trade. For example, the case against Adriano Mazzotti, which was dropped in 2014, was likely due to the political influence he had in his dealings with the Zuma family. The damage to the Large Business Centre likewise affected the Revenue Service's ability to curtail corporate tax evasion.

Testimony at this inquiry has revealed the impact on the response to illicit tobacco in particular. Staff at the Rev-

DO 'SIN TAXES' ENCOURAGE SMUGGLING?

While big tobacco companies claim that high taxes encourage black market activity, research has shown that illicit markets are more prevalent in countries where legal cigarettes are cheaper.¹ Moreover, the high prices of cigarettes are largely due to the industry itself increasing prices rather than tax imposed on the products.² Between 2000 and 2006, a low tax policy in Brazil failed to curb the illegal market, part of the reason being the tobacco industry's decision to increase prices while benefiting from tax cuts.³ In South Africa, although reporting a decrease in smoking, both tax revenue and legitimate tobacco industry profits increased after 1993.⁴ The effect of tax increases on the legitimate industry is mostly benign and demonstrates a positive impact on public health and tax revenue. As to whether it influences growth in illicit activity, this is negligible. Established smuggling networks and weak state institutions tend to play a bigger role in stimulating the illicit trade than tax.⁵

¹ Joossens and Raw, "From cigarette smuggling to the illicit trade."

² Joossens and Raw, "From cigarette smuggling to the illicit trade."

³ Hana Ross, "Controlling illicit tobacco trade: International experience," Economics of Tobacco Control Project, School of Economics, University of Cape Town and Tobacconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago, May 28, 2015, <http://tobaccoecon.org/publications/reports/>.

⁴ Malan and Leaver, "Political Change," 121.

⁵ Joossens and Raw, "From cigarette smuggling to the illicit trade."

enue Service testified that once it focused on curbing the illicit cigarette trade, the collection of excise on to-

⁸² This was designed to provide a 'one-stop' service to large corporate taxpayers, from which about 30 percent of revenue is collected.

⁸³ Office of the Presidency, Report of the Commission of Inquiry Tax Administration and Governance by the South African Revenue Service, by Commissioner Judge Robert Nugent, December 14, 2018. A copy can be found on <http://www.thepresidency.gov.za/report-type/commission-inquiry-tax-administration-and-governance-sars>

bacco rose, and once the High-Risk Unit was disbanded this progress was lost, the trend reversed.⁸⁴

Revenue is, however, not the only indicator of the decline of the state response: the other is the lack of prosecution for a number of actors who have been publicly linked, through press exposés, to criminal activity and *prima facie* evidence of corruption.

Even more disheartening, recent analysis suggests that in the gap created by the destruction of SARS capacity, the big multinationals have also become involved in smuggling practices, either under-declaring or leveraging their relationship with subsidiaries in neighbouring countries to smuggle. Under this view, the illicit cigarette market has grown to a size that the ‘independent’ companies do not have the production capacity to meet and their role is being exaggerated by the multinationals. A leading expert on the illicit tobacco trade in South Africa has been quoted in the press saying, “SARS has been weakened to the extent that people are taking chances. I’m confident big industry has become more complicit in the illegal trade.”⁸⁵ TISA denies that their members are involved smuggling, stating that members “declare every single cigarette they produce in or import into South Africa to the South African Revenue Service” and pass regular audits. TISA also argues that sales of members’ product without tax paid can be attributed to the sale of stolen stock or cross-border smuggling. It denies that FITA members do not have production capacity to meet the size of the illicit market and recommends SARS conduct a national audit of total capacity and total production to clarify this issue.

As BAT’s putative debt to the revenue service, and as the practices that led to the dispute are likely to have continued between 2010 and 2018, if BAT is forced to settle its arrears with SARS the liability will now

be much higher. While BAT attributes the destruction of SARS capacity to ‘state capture’ by the smaller illicit manufacturers, it has also benefited from revenue service’s decline. Furthermore, multinationals have a motivation to exaggerate the size of the illicit market in order to fight ‘sin’ tax increases, which they argue encourage smuggling and under-declaring (see Box on sin taxes). This tactic has had moderate success. The WHO recommends that tobacco tax incidence be pegged to at least 70 percent of the retail selling price of tobacco price. Since 1994, South Africa has followed a targeted tax incidence approach which pegged the tax incidence at 52 percent in 2015.⁸⁶ South Africa’s increases in excise on cigarettes have been modest in recent years.⁸⁷

Both the ‘independent’ illicit companies and BAT use the media to propagandize stories that obscure their role, legitimize their activities, and seek to harm their competitors. These stories have ideological veils with strong emotive appeals to issues of key national importance and these are effective in shaping public attitudes about the form the state’s response should take. In the case of TISA, their narrative is that they are upholding the rule of law, creating jobs, and making huge contributions to the fiscus in the face of rampant corruption in the state and criminality on the part of independent manufacturers—they are, in other words, holding the line for South Africa’s progress towards development according to existing policies. This narrative has been pushed with renewed vigour in 2018 in the form of an advertising campaign encompassing prime media advertisements which exhorted South Africans to “#takebackthetax”: these advertisements claim that revenue lost to the illicit trade could be put to use employing ‘corruption investigators’ and could have prevented recent fuel price hikes. The independent manufacturers, as represented by FITA, take the position that they have been unfairly maligned by an unscrupulous, criminal multinational, that the illicit mar-

84 See Appendix 11, Report submitted by Mr Cecil Morden to the Commission of Inquiry, Office of the Presidency, Report of the Commission of Inquiry Tax Administration and Governance by the South African Revenue Service, by Commissioner Judge Robert Nugent, December 14, 2018. A copy can be found on <http://www.thepresidency.gov.za/report-type/commission-inquiry-tax-administration-and-governance-sars>

85 Tamar Kahn, “Tobacco excise revenue plunge shows SARS collection up in smoke,” Business Live, May 29, 2018, <https://www.businesslive.co.za/bd/national/2018-05-29-tobacco-excise-revenue-plunge-shows-sars-collection-up-in-smoke/>.

86 National Treasury of South Africa, “Illicit trade in tobacco products”, presentation to Illicit Tobacco Trade Parliamentary Monitoring Group, Standing Committee on Finance, May 2, 2018.

87 Since 2015, excise in relation to retail price has risen in real terms by about 1 percent per year, according to calculations made by the Economics of Tobacco Control Project at the University of Cape Town, as supplied to the author. However, the National Treasury announced in its 2018 Budget Review that tobacco taxation will be reviewed by looking into (i) increases in tax rates, (ii) uniform tax rates across product categories, (iii) minimum prices, and (iv) taxation of new tobacco products. It is thus possible that tobacco taxation will increase in the coming years, to bring the South African tax levels in line with international standards, as recommended by the World Health Organization and the World Bank. See Republic of South Africa, National Treasury, National Budget Review 2018 (2018), <http://www.treasury.gov.za/documents/national%20budget/2018/review/FullBR.pdf>.

ket is driven by counterfeiters based in other countries, and that they are being punished for supporting racial transformation of business and 'radical economic transformation' of the entire economy. These positions blatantly borrow the language of highly fractious national debates about how South Africa should address inequality and discrimination in order to distract attention from allegedly illegal or unethical practices.

Impact of illicit trade?

Integration with other criminal networks

Since SARS enforcement and investigative capacity was curtailed, there has been a large escalation in competition between the 'independent' companies. This has taken the form of a price war, verbal threats, private legal action by one company to force the closure of a competitor's factory in Lesotho, attempted and successful assassinations, and the vandalism of the machinery of a factory as part of a dispute between two independent companies.⁸⁸ This escalation is driving severe tensions and, according to one smuggler, "It will only stop when someone dies in the industry. Someone is going to get killed. Because the big players are flexing their muscles."⁸⁹

This violence is, for the most part, contained within the industry, but has also spilled out as two players compete for greater access to the Western Cape market, something that has driven them into business arrangements with Cape gang and underworld figures.⁹⁰ It appears these arrangements arose initially when a controversial Cape nightclub owner bought debt attached to a prominent independent cigarette manufacturer, who agreed

to pay him off partially in cigarette stock, which the Cape nightclub owner then sold through his gang-related distribution networks.⁹¹ This then led to an overture by different underworld networks in Johannesburg to enter the Western Cape market through providing cheap stock to rival gangs in the Western Cape. This had fed into violent destabilization of the Cape underworld and flooded poor Cape Town neighbourhoods with cheap, illicit stock.

In Gauteng, one figure has also allegedly drawn on gang networks in Ryger Park to carry out a (failed) assassination of Luis Pestana, in which his bodyguard, Gerard Strydom, himself the boss of a bouncer security network that controls most of the nightclubs on the East Rand of Johannesburg, was shot.⁹² Other hits have also been linked to the illicit cigarette trade.⁹³

The illicit trade is also feeding other criminal markets, albeit indirectly. According to people within the tobacco industry, there has been a steep increase in the hijacking of trucks containing cigarettes.⁹⁴ No one has accused industry players of being behind these hijackings, but informants say that the independent companies buy the stolen stock from the hijackers (as they have the accounting practices to absorb this cheap influx of stock). The ease of moving the stolen goods through the illicit tobacco sector may be fuelling the hijacking phenomenon.

Revenue loss (and Public Health)

As quoted above, figures from TISA suggest that between 2010 and 2016, R27 billion (\$2.2 billion) in revenue has been lost to the illicit cigarette trade. These figures are disputed, on the basis that TISA methodology for

⁸⁸ Interviews with former cigarette smugglers A and B, Johannesburg, April 23 and 25, 2018, and May 4, 2018; interview with independent cigarette manufacturer B, Johannesburg, April 24, 2018.

⁸⁹ Interview with independent cigarette manufacturer A, Johannesburg, April 25, 2018.

⁹⁰ Interview with law-enforcement official, Johannesburg, April 25, 2018; interview with former cigarette smuggler A, Johannesburg, April 23, 2018.

⁹¹ This anecdote highlights something that is often mentioned by informants, though our research uncovered no concrete evidence for it, which is that illicit cigarettes are also used in the laundering of other dirty money.

⁹² Interview with independent cigarette manufacturer A, Johannesburg, 25 April 2018. The assassination of a former bouncer in Johannesburg in 2015 also has been linked to the illicit cigarette trade. See Jeanette Chabalala, "Former business partner of Kebble killer shot dead," News 24, February 15, 2017, <https://www.news24.com/SouthAfrica/News/former-business-partner-of-kebble-killer-shot-dead-20170215>.

⁹³ Angelique Serrao and Caryn Dolley, "Underworld, tobacco and drug war sparks shootings and protests, News24, December 5, 2017, <https://www.news24.com/SouthAfrica/News/underworld-tobacco-and-drug-war-sparks-shootings-and-protests-20170512>.

⁹⁴ Interview with independent cigarette manufacturer B, Johannesburg, April 24, 2018; interview with independent cigarette manufacturer A, Johannesburg, April 25, 2018.

measuring lost excise is flawed and because it does not take account of all tax revenue that can be lost through illegal behaviour. Nevertheless, the loss of revenue to the country could be close to or higher than TISA's estimate and therefore represents a significant loss to the fiscus.

The impact of revenue loss from excise taxes is twofold. Obviously, this deprives the government of money for its general budget, but the 'sin taxes' from which most of this revenue should derive are also supposed to offset the costs of treating citizens who have smoking-related diseases such as lung cancer. Currently, 20 percent of the population age fifteen or older are smokers. The World Health Organisation (WHO) suggests a benchmark for a successful transition to the smoking 'end game' is to reduce smoking to 5 percent or less of the population. In South Africa, the low cost of illicit cigarettes is believed to be a major driver of continued smoking. According to Hana Ross, principal researcher of the Economics of Tobacco Control Project at the University of Cape Town, "if South Africa starts to control the illicit market, we would see a huge change in behaviour with many people trying to quit (and some succeeding), many smokers reducing the number of cigarettes they smoke in a day, and many young people not starting to smoke."⁹⁵

Corruption

Arguably the most severe impact of the illicit trade has been how it has fuelled the corruption of individuals within the state and how this, in turn, has contributed to the destruction of state capacity to investigate the illicit economy or prosecute serious commercial crimes. Many within the industry maintain that high-level corruption was not necessary to conduct business. Ac-

cording to one former cigarette smuggler, "you don't need high-level corruption" for smuggling. "You just need the people looking at production sheets, and tip-offs about raids."⁹⁶ However, as players in the industry amassed large amounts of wealth, the scrutiny from the state increased, as did their ability to corrupt people at high levels within the government. As both these phenomena increased—the visibility of the industry and the scrutiny of the state—more laws needed to be broken and investigations had to be halted.

For example, Yusuf Kajee is said to have involved Edward Zuma in ATM, because Kajee has a conviction for tax evasion (related to his involvement in Delta tobacco, before ATM was set up) and so was ineligible for a state license to manufacture cigarettes.⁹⁷ Kajee reportedly made regular payments to a private account, the proceeds from which were used for upgrades to Jacob Zuma's private homestead in Nkandla.⁹⁸ Kajee denies that he made any payments to Jacob Zuma or that his relationship to Edward Zuma was improper. Additionally, at the time that the SARS HRIU was destroyed, it was investigating the industry and was set to take away fifteen licences (more than the number of 'independent' companies, so it is likely that one or more of the multinational tobacco companies also would have been threatened with a licence revocation).⁹⁹ Since then, none of these companies have had their licences threatened and no progress has been made in the cases of tax evasion launched by SARS against BAT and the 'independent' companies.

This corruption does not only affect the response to illicit tobacco but has also weakened state capacity to deal with any illicit trade.

⁹⁵ Interview with Hana Ross, Principal Researcher of the Economics of Tobacco Control Project Cape Town, May 6, 2018.

⁹⁶ Interview with former cigarette smuggler A, Johannesburg, April 23, 2018.

⁹⁷ Pauw, The President's Keepers, 2017. A contemporaneous discussion of SARS 2010-2014 investigation of Kajee and ATM can be found in media reports from the time, which include excerpts of leaked legal correspondence between ATM and SARS. For example, see Amanda Khoza, "Sars nails Zuma's son over fraud," Sunday Independent, February 16, 2014, <https://www.iol.co.za/news/politics/sars-nails-zumas-son-over-fraud-1647788>.

⁹⁸ Pauw, The President's Keepers, 2017.

⁹⁹ Interview with law-enforcement official, Johannesburg, April 25, 2018

2: IDENTIFYING AND SUPPORTING ‘VIRTUOUS’ AND REFORM-MINDED ACTORS

This paper is intended to address the question of how ‘virtuous’ or reform-minded actors can respond to the illicit trade in tobacco in South Africa and Zimbabwe. As a starting point, we need to carefully assess what exactly requires a response. The mainstream narrative in South Africa about the illicit trade focuses almost exclusively on the loss of excise tax to the fiscus because of under-declaration. But we argue that the response should also address: the corruption that allows and is also fuelled by illicit trade; the underworld links between the tobacco industry and individuals suspected to be running extortion rackets or trafficking in narcotics; and the broader range of costs to the state due to illicit practices in the tobacco trade, including cross-border tax dodging. An additional discrete objective could be stopping misinformation about the illicit tobacco trade, which obscures the public health consequences of smoking and distorts debates about how to best achieve the twin (and sometimes contradictory) aims of reducing the number of smokers in South Africa and maximising the economic benefits of the tobacco industry to the country. A holistic reform effort would consider all of these aspects of the trade’s harmful impact.

One should also ask whether the bulk of reform efforts should be focused on South Africa, because without the South African market, the incentives for illicit cigarette production and smuggling in the region fall drastically. In our opinion, this should be the case. This calculation might also be different if there was a political opening in Zimbabwe which provided a tailwind to reform efforts—currently the opposite situation pertains.

Indications are that, since South Africa’s change of president, the government wants to be seen to be cracking down on illicit tobacco. The National Treasury, in its annual budget speech, outlined three key measures it

would be moving towards: maintaining increases in the so-called ‘sin tax’, mandating plain packaging for cigarette packs, and implementing a ‘track and trace system.’ The acting head of SARS, Mark Kingon, has made several strong statements in the press about reviving a strong focus on the illicit economy, with a particular emphasis on illicit cigarettes.¹⁰⁰ In May 2018, the scale and impact of the illicit cigarette trade was discussed in Parliament. Public statements issued in 2018 on the illicit cigarette trade indicated a renewed push from law enforcement to tackle the issue. Industry players also confirmed this impression. According to one tobacco industry representative, “my impression is that they [the government] are sweeping the floor clean and it is going to be harder to buy protection.”¹⁰¹

The National Treasury and the Revenue Service are crucial actors. National Treasury sets the excise level for tobacco products and plays a powerful role in shaping how government will balance the need to reduce smoking while also ensuring maximum tax compliance. The crimes at the heart of this trade also fall directly under the mandate of the South African Revenue Service, which must dedicate skills and resources to both improve the integrity of the customs system and investigate complex financial arrangements like transfer pricing and tax-base erosion. The United Nations Economic Commission for Africa has argued that BEPS offences constitute a grave problem for developing countries and that they should be considered as part of the broader agenda against illicit financial flows. They are, however, very difficult for developing countries to tackle:

“[While] the schemes involved are similar to those used in criminal activities...what prevents some of their activities being exposed as tax evasion is mainly because multinational companies can back up what they do with opinions from tax

¹⁰⁰ Jan Cronje, “SARS to re-establish teams to probe illicit tobacco trade,” Fin 24, May 24, 2018, <https://www.fin24.com/Economy/sars-to-reestablish-teams-to-probe-illicit-tobacco-trade-20180524>.

¹⁰¹ Interview with tobacco industry representative, Johannesburg, April 24, 2018.

advisers that make it difficult to establish the intent necessary for a criminal offence. Given that the base erosion and profit shifting schemes are often very complex, involving convoluted circumventions of complex tax provisions in various jurisdictions that are often shrouded in tax haven jurisdiction, it becomes difficult for revenue authorities to challenge their legality in a court.”¹⁰²

For South Africa to pursue such cases will require a large and long-term investments of skills and time.

While many key staff left the revenue service under Moyane’s rule, an independent inquiry is now investigating a wide range of governance issues in the organization, in what is seen as a step towards repairing it.¹⁰³ Indeed, there appears to be high-level political support for other law enforcement bodies to act against the people who were linked to high-profile corruption scandals during the Zuma era, which will also involve the National Prosecution Agency and Police Service in curbing illicit activities.

Some of the figures linked to the illicit cigarette trade—like Adriano Mazzotti and Yusuf Kajee—are prominent in the roll call for the post-Zuma clean up. According to recent media reports, SARS has obtained warrants to seize Mazzotti’s assets for alleged underpayment of tax debts.¹⁰⁴ There is high public appetite for conviction and the seizure of assets, an appetite that can best be summarized as a thirst for retribution after the years of waste and decline under the Zuma administration. There are obvious opportunities with this kind of political tailwind, and as mentioned, the state appears to be moving on them already.¹⁰⁵ However, a strong note

of caution should be issued. While these motives currently align with public interest in many cases, they do not represent a careful and holistic assessment of where intervention should lie. For example, the directors of GLTC, Simon Rudland and Ebrahim Adamjee, the figures who are widely alleged to be most prolific and powerful in the illicit cigarette trade, have never been linked to Zuma, and until recently enjoyed a very low public profile. Since TISA’s renewed advocacy on the illicit trade, GLTC has been more prominent in the debate, but again in a fashion that represents the interests of ‘Big Tobacco’ and not a strategic assessment of where most revenue is lost, or damage is done to state institutions.

Likewise, multinational players such as BAT need to be treated with the same scrutiny as smaller players who have been more tainted by Zuma-era scandals. According to one former law enforcement official: “If you want to look at the industry, look at it as a whole. You need to put equal pressure on the industry, otherwise it’s like a water bed, and if you push down on one side, it will balloon on the other.”¹⁰⁶ Current interventions do not tackle complex cross-border financial crimes allegedly committed by multinationals. In addition, the state seems to be moving into the same relationship with BAT that led to co-option of the ITTT team and the abuse of state resources preceding the scandal around the alleged corporate espionage by BAT against its competitors. The symptoms of this lie in TISA’s prominent role in the parliamentary hearings on illicit tobacco, supported by comments made by interviewees for this study.¹⁰⁷ Worryingly, the tobacco industry still appears to exert a particular and substantial influence on the South African state. There has been strong industry pushback, from all quarters, on the new legislation.

102 United Nations Economic Commission for Africa, Base erosion and profit shifting in Africa: Reforms to facilitate improved taxation of multinational enterprises (Addis Ababa: Economic Commission for Africa, 2018), <https://www.uneca.org/publications/base-erosion-and-profit-shifting-africa-reforms-facilitate-improved-taxation>.

103 Kyle Cowan, “SARS inquiry gets off to cracking start with Gordhan evidence,” Fin 24, June 26, 2018. <https://www.fin24.com/Economy/sars-inquiry-gets-off-to-cracking-start-with-gordhan-evidence-20180626>.

104 Daniel Friedman, “Sars seizes EFF funder Mazzotti’s property over R70m debt,” The Citizen, February 19, 2019, <https://citizen.co.za/news/south-africa/breaking-news/2086536/sars-seizes-eff-funder-mazzottis-property-over-r70m-debt/>; “SARS moves against controversial businessman Mazzotti over multi-million rand tax debt,” Fin 24, February 19, 2019, <https://www.fin24.com/Economy/sars-moves-against-controversial-businessman-mazzotti-over-multi-million-rand-tax-debt-20190219>.

105 Jason Burke, “Ramaphosa set to purge cabinet of Zuma cronies in war on corruption,” The Guardian, February 17, 2018, <https://www.theguardian.com/world/2018/feb/17/cyril-ramaphosa-purge-zuma-cronies-south-africa-corruption>.

106 Interview with law-enforcement official, Johannesburg, April 25, 2018.

107 Interview with former law-enforcement official 2, Cape Town, May 1, 2018; interview with security provider for tobacco industry, Johannesburg, April 25, 2018; interview with tobacco industry representative, Johannesburg, April 24, 2018.

If one sets aside more informal forms of influence in South Africa, the legal and political basis for an effective response appears to be good. South Africa is a signatory to the leading international protocol on regulating the cigarette industry—the Protocol to Eliminate Illicit Trade in Tobacco Products—which is published by the WHO Framework Convention on Tobacco Control. The aim of the protocol is to:

“secure the supply chain of tobacco products, through licensing, due diligence and record keeping, and requires the establishment of a global tracking and tracing regime that will allow Governments to effectively follow up tobacco products from the point of production to the first point of sale. In order for it to be effective, the Protocol provides for intensive international cooperation including on information sharing, technical and law enforcement, cooperation, mutual legal and administrative assistance, and extradition.”¹⁰⁸

However, the government has not ratified this protocol.¹⁰⁹ South Africa has, however, made progressive moves to adhere to the WHO guidelines on tobacco control, the most recent being those announced by Treasury in the 2018 budget speech.

Looking outside of law enforcement and political action on corruption and organized crime, we also need to consider the role of civil society. There are actors outside the state who have important roles to play, such as academia, the health department and public health advocates, and industry platforms with an interest in limiting the illicit economy.

Health Minister Aaron Motsoaledi has made a strong stand against the tobacco industry, promising stricter

legislation to reduce the number of smokers, including of e-cigarettes.¹¹⁰

A draft Tobacco Bill is out for comment, which will include regulation on e-cigarettes, a 100 percent restriction on smoking indoors and further restrictions on outdoor smoking, and the removal of advertising at place of sale and of vending machines. The Department of Health has set up a Tobacco Task Team with includes representative from Basic and Higher Education, labour organisations, and civil society associations which advocate around health problems such as cancer, heart disease and diabetes which are linked to smoking.

Academic institutions can provide an objective and independent view of what is happening in the market and introduce perspectives that may be neglected by government or commercial actors, such as how tax or price changes impact the poor at the household level, or scientific evidence of the links between proposed or actual policy changes and behaviour change. Advocacy groups like the National Council Against Smoking also try to raise the profile of the public health harm caused by tobacco in the debate.

Lastly, the actions taken by neighbouring countries are still important. An obvious consequence of greater enforcement in South Africa (and so the elimination of the opportunities for under-declaration there) is that factories will relocate to outside of the country’s borders. (According to our sources, prior to around 2002 foreign countries were the predominant sources of illicit cigarettes sold in South Africa.) Zimbabwe will remain the best location for illicit production, due to the proximity to tobacco supply chains and because the major players in the illicit cigarette trade are already embedded there, with the political connections and logistical systems they need to be successful.

¹⁰⁸ “The Protocol to eliminate illicit trade in tobacco products is live!” World Health Organization, June 28, 2018, <http://www.who.int/fctc/mediacentre/press-release/protocol-entering-into-force/en/>.

¹⁰⁹ Ratification requires a meeting between the Ministry of Health and Ministry of Finance which, at the time of writing, had not yet happened.

¹¹⁰ Stefni Herbert, “Motsoaledi says he ‘hates’ tobacco industry, vows stricter legislation,” Health24, March 7, 2018, <https://www.health24.com/News/Public-Health/motsoaledi-says-he-hates-tobacco-industry-vows-stricter-legislation-20180307>

3: IDENTIFYING TOOLS FOR RESPONSE: LEGAL, POLICY AND TECHNOLOGICAL INSTRUMENTS TO COMBAT THE ILLICIT ECONOMY

A key objective of this paper is to assess the opportunities for improving the response to illicit trade and diminishing its negative impacts on the economies of South Africa and Zimbabwe, and the functioning of their state institutions.

In Zimbabwe, it is notable that scanners on its side of the border, plus barcode readers and sniffer dogs on the South African side of the border, have been effective at discouraging truck drivers in Zimbabwe from small- and medium-scale smuggling by changing their risk calculation. Zimbabwe also has legislation to address the illicit tobacco trade: the Finance Act (Chapter 23:04), Customs and Excise Act (Chapter 23:02), and Criminal Law (Codification and Reform) Act (Chapter 9:3).¹¹¹ However, the political situation in Zimbabwe is currently unfavourable for supporting an effective and fair anti-corruption drive, which would be a necessary pre-condition to tackling the highly organized, politically connected cartels that undertake large-scale smuggling, even if there was a clear technological gap. But given the primacy of South Africa to the cigarette market, the question of fronting a comprehensive legal, political, and technologically adequate response is considered primarily for this jurisdiction.

The WHO outlines several tax administration measures that can be implemented to better monitor and ensure compliance with tax law in the tobacco industry.¹¹² We consider the prospects for each measure in South Africa:

The use of licenses: South Africa already requires companies to seek licenses to produce tobacco products. The effectiveness of the license system appears to rest on the integrity of the vetting system. As described above, Yusuf Kajee's co-option of Edward Zuma into his tobacco company appears to have removed a legitimate obstacle to him being awarded a production license (which Kajee denies). As this gambit was successful, the problem does not appear to be whether licenses are required but whether they are awarded and withdrawn impartially.

Physical Controls inside factories: For ensuring compliance around domestic production, some countries place emphasis on conducting physical controls, which often involve the stationing, full time, of a tax official at factories. It is already SARS practice to visit factories and to physically check for compliance. The tobacco industry is pushing for this approach to be renewed and is a major thrust of the state's strategy to curb illicit production. It is easy to see why, as it has been hugely unsuccessful in the past. Measures for mitigation notwithstanding (such as frequent rotation and surprise visits), the degree of contact between officials and business owners gives rise to many opportunities for fraud and corruption and requires a robust solution which can withstand such opportunities.

Audits and other checks on individual and corporate tax compliance: SARS has units in place to pursue non-compliant tax payers through audits and other measures, as well as public commitments to address the growth of the illicit economy through its tax and customs mandate. This was part of the work the enforcement capacity in SARS was pursuing against figures in the tobacco trade, and formed part of the investigations which had led to them threatening fifteen companies with license revocations as well as large bills for unpaid tax. These tools are undoubtedly effective when pursued rigorously and independently.

Requiring tax stamps: Since the 1970s the South Africa state has required a mark (referred to as a 'diamond stamp,' since it is a diamond-shaped embossed mark obtained through mechanical pressure on the cigarette pack) to be affixed to every pack of cigarettes to indicate excise has been paid. This system is widely considered to be ineffective by a wide range of people in the tobacco industry, as the stamp can be easily counterfeited and SARS does not have good control over their issue. More sophisticated stamping technologies could be used, accompanied with more sophisticated monitoring technology in place at production facilities, such as banderol-based stamps.

¹¹¹ Tobacco Institute of Southern Africa, Measures being pursued by the Zimbabwean government to curb illicit tobacco trade, November 25, 2014, http://www.tobaccosa.co.za/wp-content/uploads/TISA_AIT_Conference_2014-Day_2-Zimbabwe.pdf.

¹¹² World Health Organization, "WHO Technical Manual on Tobacco Tax Administration," 2010, <http://apps.who.int/bookorders/anglais/detart1.jsp?codlan=1&codcol=15&codcch=786&content=1>.

Such stamps carry multi-level security features as a protection against counterfeiting and carry unique codes to enable traceability. These require producers and importers to place orders for stamps via a secure connection to a government authority, who verifies and then approves the order. Such systems enable traceability across the distribution chain.

In its 2017 Budget Review, the National Treasury announced that secure track and trace solutions should be introduced for tobacco products. Accordingly, Article 17 of the Tax Administration Laws Amendment Act (2016) has been modified to mandate the marking, tracking, and tracing of domestic and imported tobacco products.

Among experts interviewed for this study, track and trace systems received the broadest acceptance from actors within the tobacco industry and those who regulate or study it. These systems were seen as technical measures that could improve compliance. The implementation of a track and trace system, if it were impossible to tamper with, would guarantee that everything manufactured in South Africa would be automatically reported to a central database for full and accurate accounting. This would improve upon current dysfunctional systems because track and trace systems remove human intervention. “You can’t bribe computers,” as one informant put it. With a good and tobacco-industry independent track and trace system, “there would be no direct contact between people looking at numbers and people generating them.”¹¹³

There is also evidence that track and trace systems have been effective in curbing illicit tobacco trade in other countries. When Brazil introduced a track and trace system (secure banderol-based stamps), it led to a rise in excise tax collection of \$100 million in 2008. (In a telling development, the illicit market in Brazil has not disappeared as smuggled illicit cigarettes from Paraguay have filled the place of domestic illicit production. In Paraguay, a prominent political figure is profiting from the illicit cigarette trade). In California, a mixture of the implementation of a banderol-based tax stamp using track and trace technology and other measures to increase compliance led to a drop in tax evasion of 37 percent.¹¹⁴ In Africa, Kenya also provides an example of a country where these measures have helped to curb illicit trade.

Several informants felt it was important that industry *not* be involved in the choice of technology for the track and trace system. This is the approach required by the WHO which argues against all self-control systems and instructs contact with the Tobacco industry to be limited to that strictly necessary for implementation. Both TISA and FITA are, however, lobbying for close consultation on the form that track and trace systems take. Likewise, implicit in the success of a track and trace system is the restitution of SARS. Having a track and trace system operated by a decimated tax administration would not work. Hiring new tax officials and strengthening the capacity and ethics inside SARS are important administrative measures, without which any accounting system would be compromised.

In the same vein, high-level political support for cigarette manufacturers will also need to be withdrawn. The crucial policies and laws to ensure this lie in different direction: combating corruption and ensuring the separation of personal interests from the exercise of public office. This means strengthening the performance of the Financial Intelligence Centre, the Public Protector’s Office, and the use of the Public Financial Management Act. This infrastructure is in place and has been effective in the past—the test will lie in the Ramaphosa government’s willingness to use it.

The assessment of the opportunities to address the illicit trade is, therefore, in the greater scheme of things favourable. There are a range of state and non-state actors in South Africa that can contribute to the response. A democratic framework has the potential to hold people committing criminal acts to account, while there are key policy and technological interventions which could reduce the difficulties the state faces regarding detection and monitoring. The key ingredient will be the political will to prioritize this issue and enact a full and impartial response. The political arena, unfortunately, also is where prospects for success may sour.

With credit to Mafaro Kasipo and Michael McLaggan for research inputs, and Marco Magrin for research assistance

This working paper was supported through a grant from SICPA SA.

¹¹³ Interview with academic, Cape Town, May 6, 2018.

¹¹⁴ California State Board of Equalization (27/06/2007), cited in WHO Technical Manual on Tobacco Tax Administration (Geneva: World Health Organisation, 2010).

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(202) 463-7226, www.AtlanticCouncil.org