WINNING THE WAR ON TOBACCO BLACK MARKET

A Strategic Policy Paper Addressing
Key Challenges to Overcome Illicit Trade

DATAMETRICS RESEARCH
AND INFORMATION CENTRE

ABOUT US

Datametrics Sdn Bhd (Datametrics) is a Malaysian-based Think Tank committed to perform research and advocacy for a multitude of topics such as economics, social policy, political strategy, and technology. Established in 2021, Datametrics endeavours to undertake research that is independent, innovative and relevant in a professional manner.

Our team comprises experts from diverse backgrounds, with a common purpose of promoting better outcomes for the country.

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Today, Pankaj is a well-followed newspaper columnist and commentator specialist in developments in corporate Malaysia, capital market investment and the economy.

He is sought after by journalist and corporate personalities for his thoughts and opinion on economic and investments trend and developments taking place in Malaysia. His analysis has been published in major newspapers in Malaysia. He is also a consultant and trainer in the areas of corporate finance and investments for multinational corporations and public listed companies in Malaysia.

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Steve started his career in quantitative marketing research in the United Kingdom. He became the Managing Director of Synovate Malaysia in 2001 and led the merged entity now known as Ipsos Malaysia until 2014.

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Dexter has 17 years of experience in the healthcare / pharmaceutical industry with a 360° coverage of the industry, cutting across industry stakeholders (from doctors, nurses, pharmacists & educators) and supply chain industries (medical universities, hospitals, GPs and pharmacies).

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His strong instinctive views in opportunities and threats have enabled him to align companies' strategic focus effectively to achieve financial goals.

EXECUTIVE SUMMARY

- Malaysia has experienced a significant shift in the tobacco industry as illicit trade today has the dominant market, controlling a market with RM8bil in revenue, resulting in the government losing out billions of Ringgit in uncollected taxes.

- Malaysia's strategy to raise excise duties have not been met with the correspondent reduction in the consumption of tobacco products but instead, due to lack of enforcement, illicit trade saw a significant rise.

- For every 10% increase in excise duty, the incidence of illicit trade increases by 2% percentage points, and the government suffers a loss of income via excise duty alone amounting to RM254mil.

- Malaysia's move to cut the prevalence of smoking has not produced the desired results as the measures put in place were ineffective.

- Malaysia also suffers from a low wage structure which has resulted in lower-income groups seeking alternatives to legalized tobacco products.

- The government needs to find a solution for the tobacco industry to reduce the price gaps between legal and illicit products, enhanced enforcement activities, raise wages, and attract multinationals to invest in Malaysia via FDIs, which will create employment, both direct and indirect.

1.0 INTRODUCTION

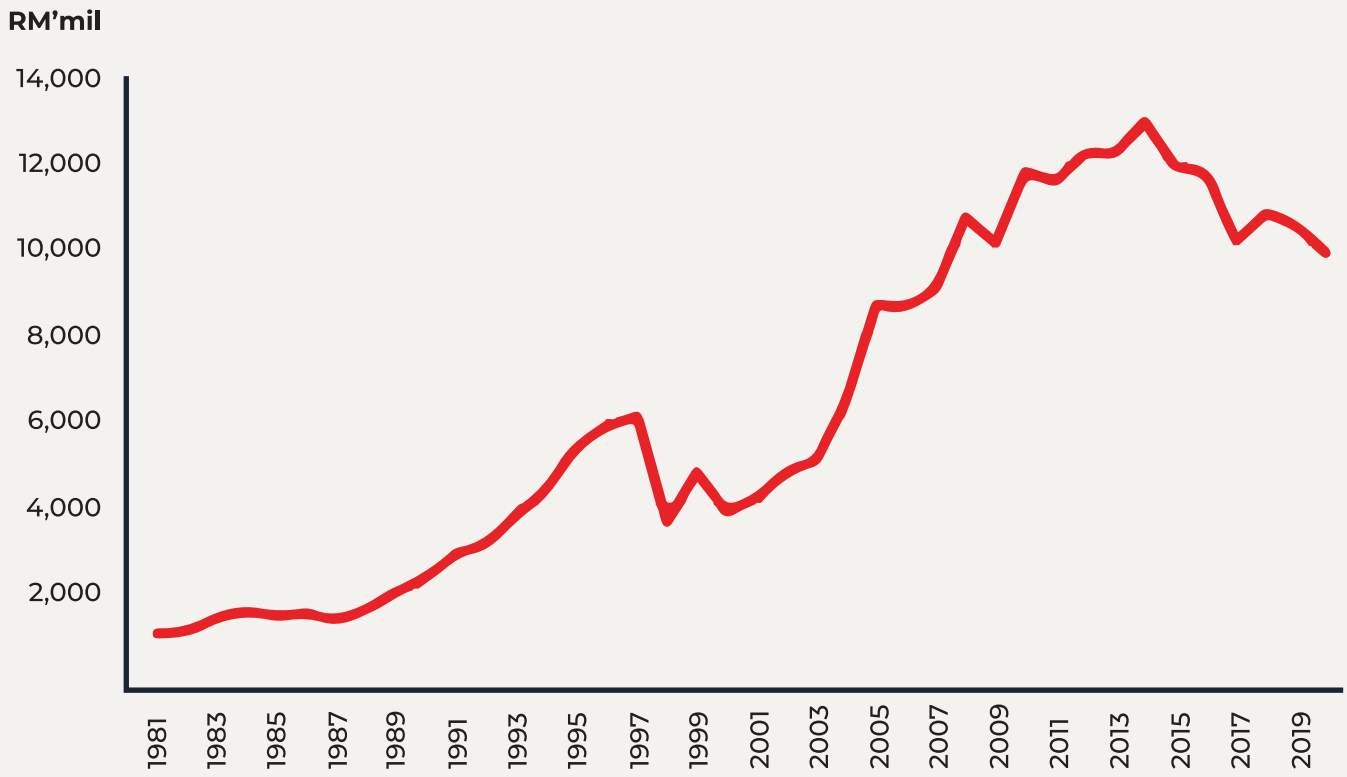
Malaysia's battle with illicit trade has been a long-drawn affair, but measures taken over the years have not shown the desired results. The key measures deployed by the government include raising the excise duties for tobacco products, amendments of legislation to allow stricter enforcement and punishment within the ambit of the law, designation of specific ports for transshipment of tobacco products, and special labels on tobacco products. Not be missed, to tackle the demand side of the equation, the government introduced anti-smoking campaigns, product labels that depict serious health consequences as a result of smoking habits and limiting access from the point of sale to those above 18 years of age as well as packaging that comes only in the form of a larger quantity. Despite all these measures, the prevalence of illicit trade remains high, and close to every six out of ten cigarettes that are sold in the market today remains illicit cigarettes.

The purpose of this paper is multi-prong, but in broad categories, it will discuss the current status of the illicit trade market, how tobacco control policies implemented over the years impacted market dynamics in terms of demand and supply, what are the factors that fuel the growth of illicit trade, the economic impact of growing illicit trade market and solution to the current predicament faced by the government. In essence, this paper attempts to provide a viable, win-win solution for all stakeholders in tackling illicit trade and making the tobacco industry more vibrant.

2.0 THE ECONOMICS OF ILLICIT TRADE

There is a significant economic impact due to the rise of illicit trade. Not only the government is losing out in terms of tax revenue due to the higher prevalence of illicit trade, but there are also secondary impacts from the rising trend of illicit trade. Figure 1 shows the trend in government's revenue when it comes to excise duties between 1980-2020 and as can be seen from the chart, the government's revenue started to ease from 2014 onwards when it peaked at almost RM13 billion and this fell to just under RM10 billion in 2020.

Figure 1: Malaysia's Revenue from Excise Duty (1981 – 2020)

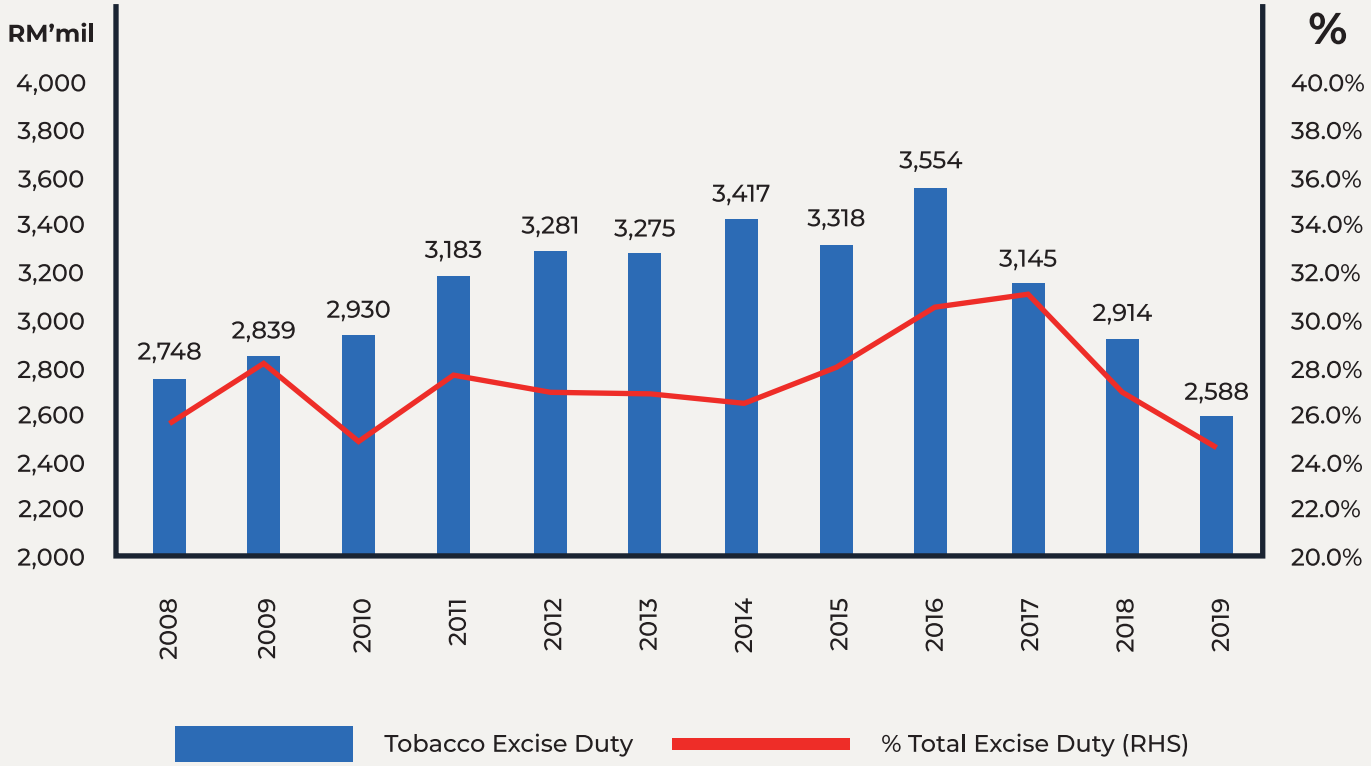


Source: Bank Negara Malaysia Monthly Statistical Bulletion

2.1 Collection of Tobacco Excise Duties On the Decline

What is even more interesting from the chart above is that over the last 40 years, the government has collected some RM250 billion from excise duties alone, and half of the amount of RM125 billion was collected in the last 11 years, i.e. between 2010 and 2020. While not all excise duties collected by the government is related to tobacco, the government also collects excise duties on other goods too and this includes excise duty on beer/stout, cider and perry, rice wine, mead, un-denatured ethyl alcohol, brandy, whisky, rum and tafia, gin, motor vehicles, motorcycles, playing cards, and mahjong tiles. From the definition, it can be seen that excise duties collected from the sale of motor vehicles and motorcycles are perhaps the largest component of excise duty collection, followed by tobacco and liquor-related products. Figure 2 shows the trend in tobacco excise duties collected by the government between 2008-2019.

Figure 2: Tobacco Excise Duty Collection (2008-2019)



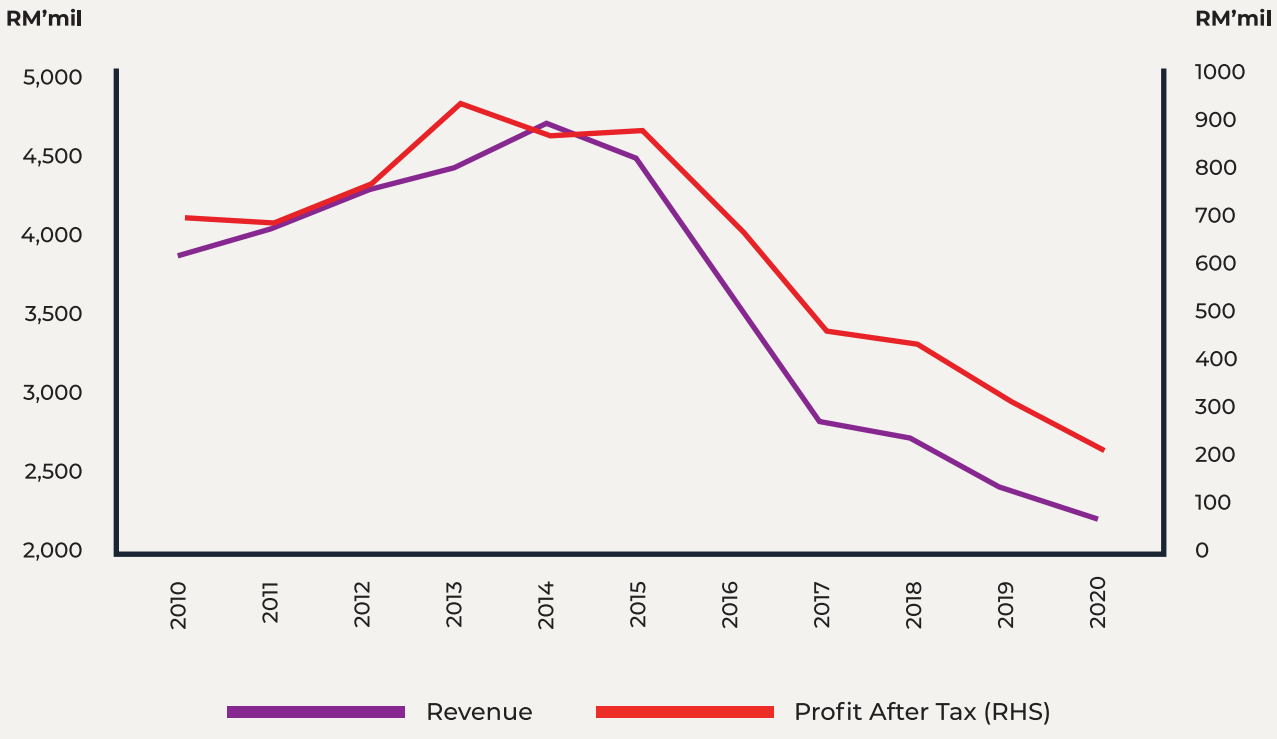
Source: Ministry of Finance, Malaysia

A look at the breakdown from various items that are subjected to excise duties, tobacco excise duties as a percentage of total excise duties collected ranged between 24.9% and 30.4% between 2008 and 2016. The year 2016 was also the year whereby tobacco excise duties peaked at about RM3.55bil. However, as the government embarked on a mission to raise tobacco excise duties from 2013 onwards and peaked in 2016 with the imposition of RM400 per 1,000 cigarettes. Thereafter, the government's excise duty collections went downhill and in just three years, collection plummeted by almost a billion ringgit to RM2.59bil in 2019.

2.2 Impact Felt Across the Industry

To see the impact on an individual company, an analysis of one of Malaysia's major tobacco company was undertaken and the trend over the last few years basically shows that all the metrics that defines the industry shows the efforts carried out by the government has been counter-productive. The company is referred to in this report as "Company A". Figure 3 shows Company A's revenue and profit after tax between 2010 and 2020 and it can be seen that both its revenue and earnings peaked in 2014 and 2013 respectively.

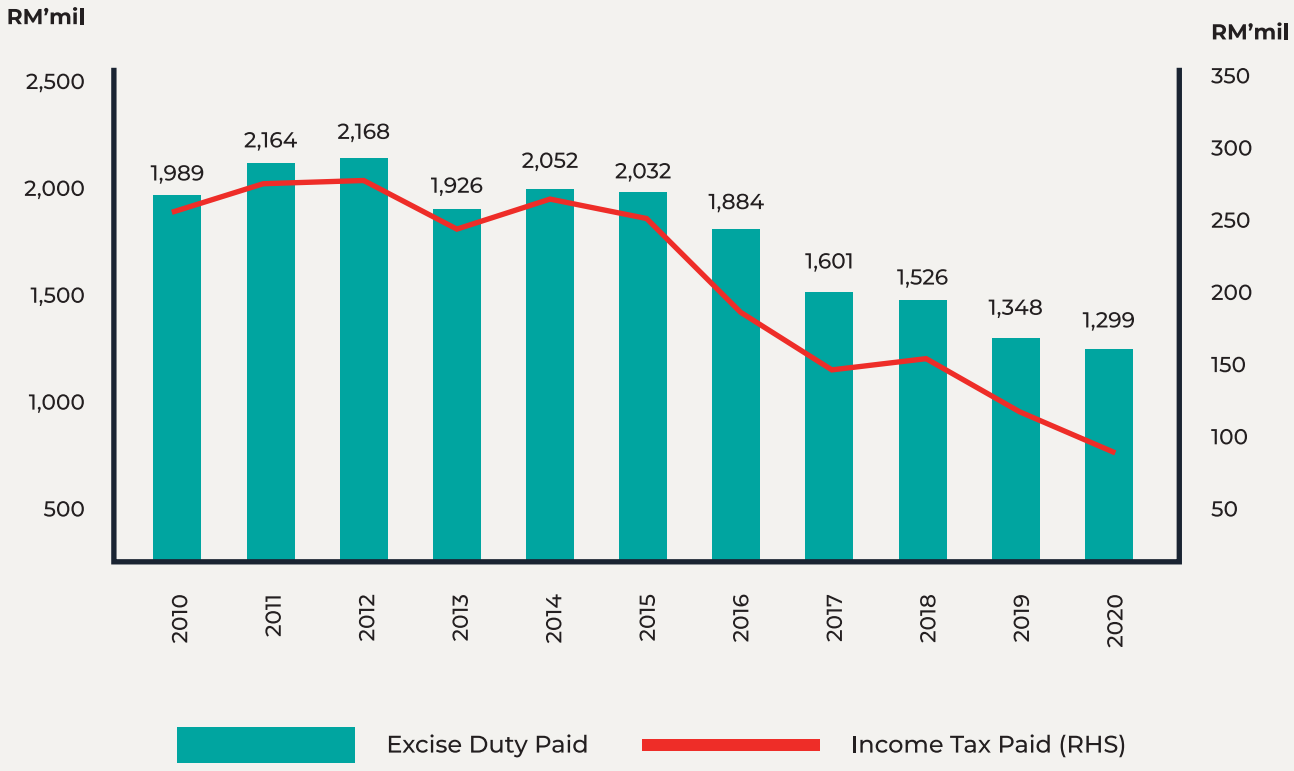
Figure 3: "Company A" – Revenue and Net Profit Trend (2010-2020)



Source: Company A's Annual Report

When compared to the company's peak revenue of almost RM4.8bil in 2014, the company's revenue in 2020 was less than half of it, falling to just RM2.3bil. At the same time, net earnings, which peaked at RM973mil in 2013, plunged 75% to just RM242mil last year. Naturally, with revenue and profits falling, the company's contribution in the form of income tax and excise duties too would have dropped. An analysis of that shows that the government has lost out in terms of tax collection due to the steep hike in the excise duties over the years. Figure 4 shows Company A's income tax and excise duties that it has paid between 2010 and 2020.

Figure 4: "Company A" – Income Tax and Excise Duty Payments to the Government (2010-2020)



Source: Company A's Annual Report

3.0 ANALYSIS OF CURRENT TOBACCO POLICIES

The increase in illicit trade over the years can be traced back to the government's National Strategic Plan For Tobacco Control 2015-2020 (NSPTC), when it outlined the various incentives that the government intends to undertake to control tobacco usage and consumption. In that report, several key concerns were highlighted with an acronym MPOWER. The key strategies were defined as follows:

M **Monitor tobacco use and prevention policies**

P **Protect people from tobacco smoke**

O **Offer help to quit tobacco use**

W **Warn about the dangers of tobacco**

E **Enforce bans on tobacco advertising, promotion and sponsorship**

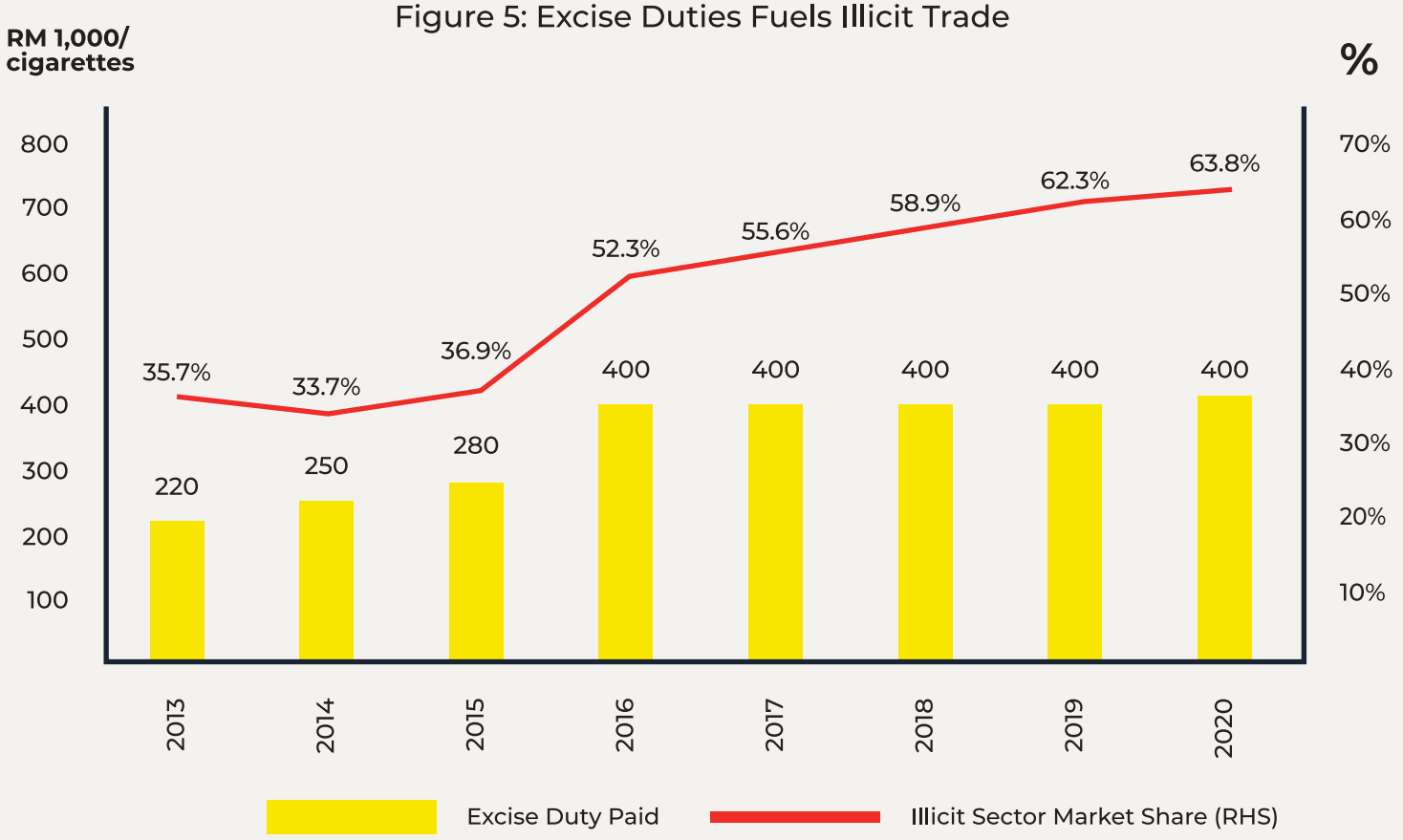
R **Raise taxes on tobacco**

Among the objectives that were identified in the 2016 report was to reduce the prevalence of smoking to 15% by 2025 and to 5% by 2045. At the same time, the NSPTC also defined the timeline for various incentives as well as key indicators to be achieved during the implementation stage. A total of 26 strategies were recommended by the NSPTC and the last one was in relation to raising tobacco taxes where the target was to have excise duties as a percentage of the retail selling price of cigarettes at a massive 75%, starting in 2015.

Hence, the government embarked on a massive exercise to raise tobacco taxes and this was in the form of higher excise duties for every 1,000 cigarettes. Even before 2015, the government had already initiated an early move by raising the taxes from RM220 per 1,000 cigarettes in 2013 to as much as RM280 per 1,000 cigarettes in 2015. In 2016, the government made a huge quantum leap with a 42.9% jump in excise duties, i.e. from RM280 per 1,000 cigarettes to as much as RM400 per 1,000 cigarettes.

While this naturally caused the retail cigarettes prices to jump, it also had an undesired consequence of a higher incidence of illicit trade. According to the Illegal Cigarette Study in Malaysia, which is a report commissioned by The Confederation of Malaysian Tobacco Manufacturers (CMTM), the incidence of illicit trade, which was only 33.7% in 2014, jumped to 52.3% by 2016 and have since only gone higher and higher. By the end of 2020, illicit trade accounted for as much as 63.8%. Figure 5 summarizes the impact of the hike in excise duties and the correspondent increase in illicit trade:

Figure 5: Excise Duties Fuels Illicit Trade

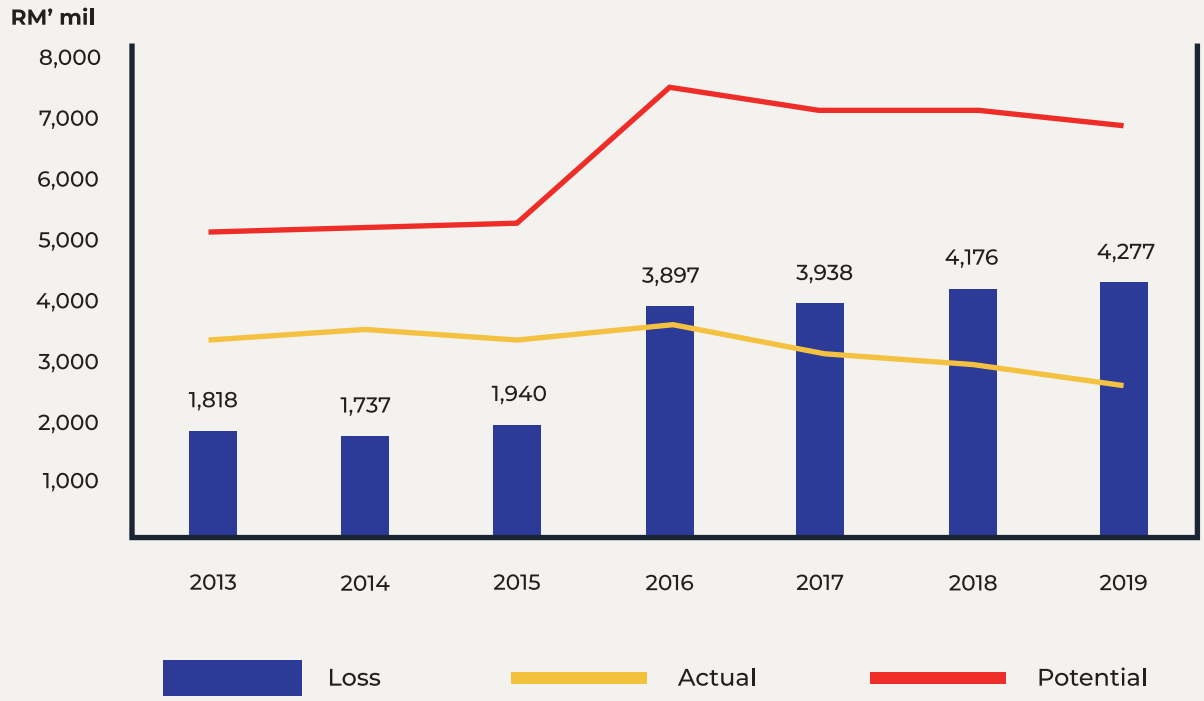


Source: CMTM

3.1 Staggering losses to the Government on Uncollected Excise Duties

Given the above data, from both the level of illicit trade and the actual tobacco excise duties collected by the government, one can estimate the actual loss of revenue to the government due to the rising trend of illicit trade. Figure 6 shows the potential losses arising from uncollected excise duties have been on a rising trend and this has now gone up to as much as RM4.28bil as at end of 2019, from just RM1.74bil as at end of 2014, a staggering increase of 2.5-fold.

Figure 6: Uncollected Excise Duties Is Rising (2013 – 2019)



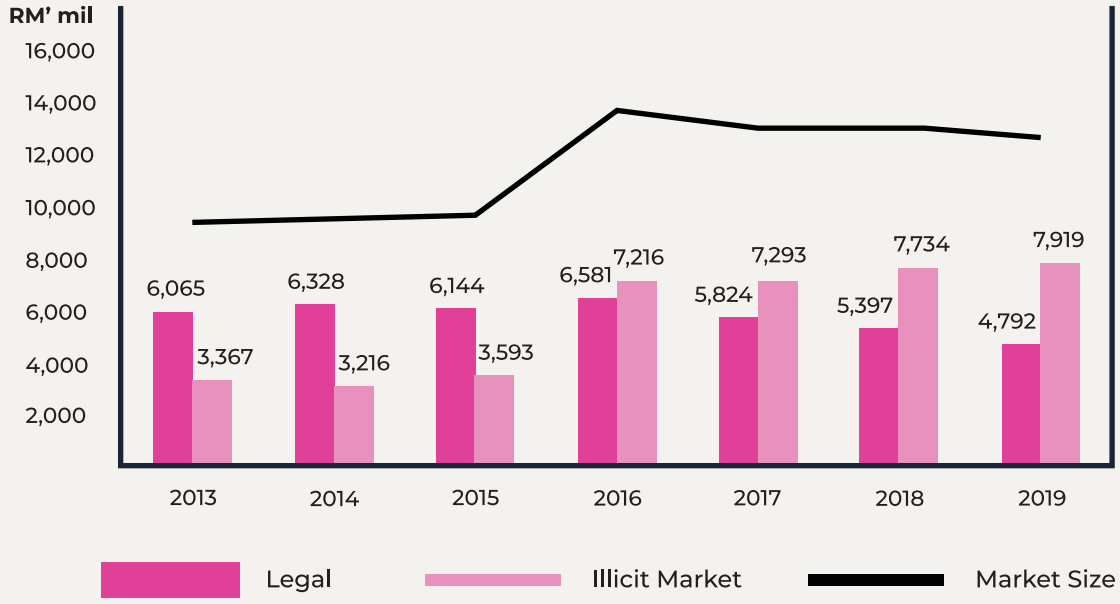
Source: MoF, CMTM, extrapolated figures

Other than excise duties that the government losses out due to the rise in illicit trade, the government also losses out on income tax that is not paid by these illegitimate business operations. Historically, excise duties make up about 90% of the total taxes collected from the tobacco market and hence we can also estimate the income tax that is lost from the increase in contrabands in the market. Based on extrapolated data, the uncollected income tax is estimated at RM475mil in 2019. Hence, the government's overall direct tax loss is approximately RM4.75bil in 2019 alone due to the activities carried out by these peddlers.

3.2 Illicit Tobacco Is A RM8.0bil Industry

As taxes paid by tobacco companies is about 60% of revenue, of which some 50% is in the form of excise duty and another 10% in the form of income taxes, the RM4.75bil total tax losses calculated from the above data suggest that the contraband has a market size of approximately RM7.92bil or almost RM8bil. Figure 7 summarizes the trend of the Malaysian tobacco industry.

Figure 7: The Malaysian Tobacco Industry (2013 – 2019)



Source: MoF, CMTM, extrapolated figures

3.3 Strong Correlation Between The Rise in Illicit Trade and Loss of Government Revenue

From the above analysis, one can easily conclude that there is indeed a strong correlation between the rise in illicit trade and the losses that the government suffers due to uncollected excise duties as well as potential income taxes to be paid if the incidence of illicit trade is tackled and reduced. If one were to analyze the data from 2013 to 2016, when excise duties were raised from RM220/1,000 cigarettes to RM400/1,000 cigarettes or an increase of 81.8%, the intensity of illicit trade jumped from 35.7% in 2013 to as high as 52.3% in 2016, a jump of 16.6 percentage points. At the same time, revenue lost from uncollected taxes rose from RM1.82bil in 2013 to RM3.9bil in 2016, an increase of RM2.08bil.

In summary, for every 10% increase in excise duty, the incidence of illicit trade increases by 2% percentage points, and the government suffers a loss of income via excise duty alone amounting to RM254mil.

3.4 NSPTC Has Recommended Several Strategies

As explained earlier in terms of tobacco policies under NSPTC, there are also key strategies recommended from the report, and among them are:

- To introduce Tobacco & Smoking Control Act by 2016
- To expand non-smoking public places like rest areas, public parks, hotels, and restaurants
- To introduce quit smoking services in a more consistent and integrated manner
- To enforce a ban on tobacco advertising, promotion, and sponsorship
- To tackle illicit trade by introducing minimum standard price and tobacco products without pictural health warnings

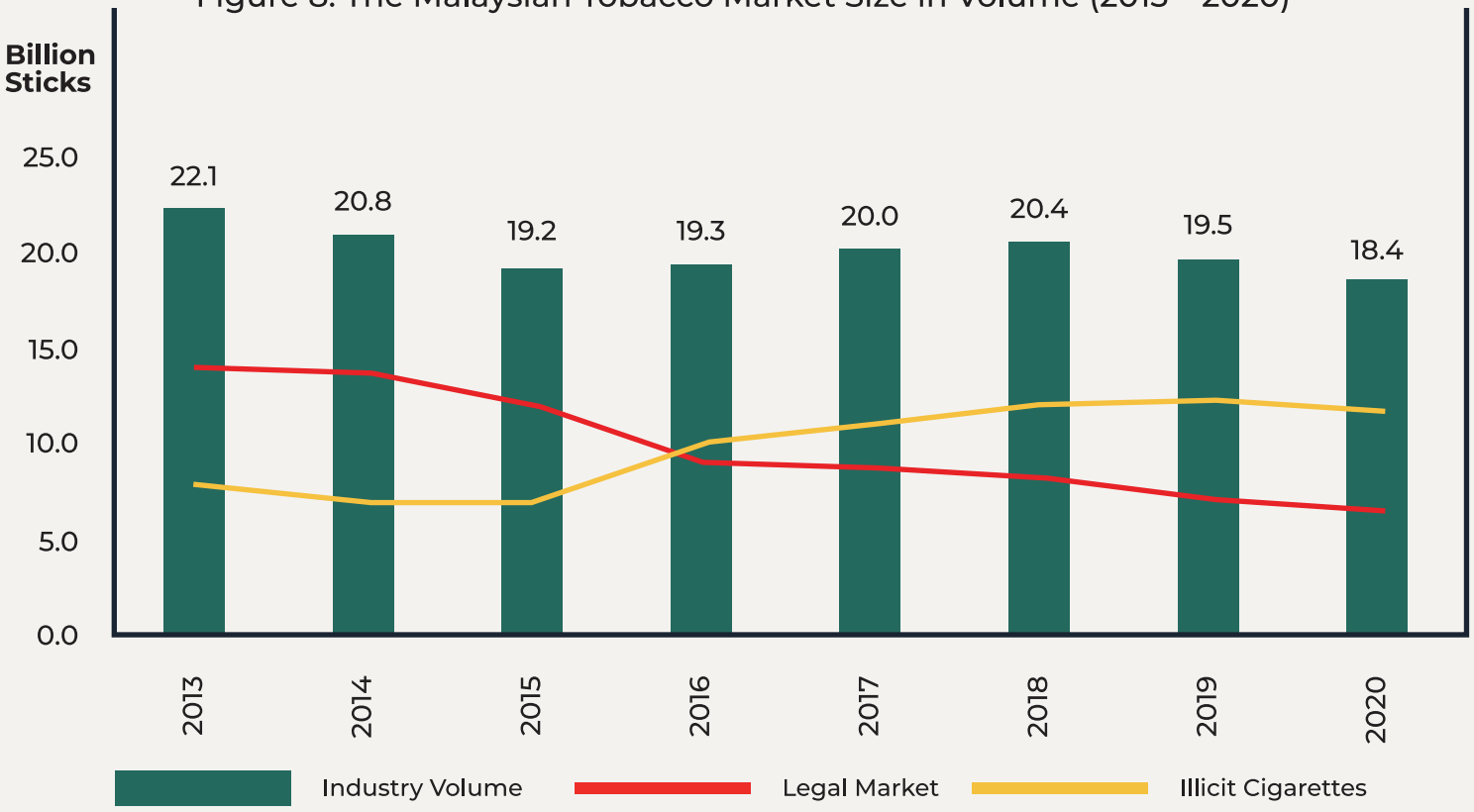
Most of the legislative amendments related to tobacco consumption have been confined under the Food Act, 1983 and under The Control of Tobacco Product Regulations, which were issued under the Act. These regulations defined mostly, among others, smoke-free environments; tobacco advertising, promotion and sponsorship; and tobacco packaging and labelling. The government, to-date, has not issued a bill that will tackle issues related to tobacco products as recommended in the NSPTC.

Based on a research paper presented by Khazanah Research Institute in 2018 entitled “Tobacco Control: Curbing the Craving” due to the negative implication on smoking to society and the cost associated with it, governments impose regulations on tobacco to tackle some of the market failures. According to the report, for example, governments may implement taxation on tobacco products, which may serve to deter smoking habits. That report even quoted a study done by Ross and Al-Sadat (2007), where it was estimated that a 5.9% increase in cigarette prices would reduce consumption by 3.4%.

Additionally, taxing tobacco products can increase public revenue, which may be used to cover the increased healthcare costs incurred by smokers. Confining smoking in certain areas may limit exposure to second-hand smoke. Graphic health warnings and restrictions on the advertising of tobacco products may counter the effects of the marketing tactics used by the tobacco industry.

However, the reality is smoking demand is rather inelastic and hence any price increase will not deter smokers from kicking the habit but rather the hike in prices, due to the higher taxes imposed, will result in demand shifting towards either cheaper substitutes or towards products that are smuggled in. Figure 7 explains this phenomenon. Taking the hike in excise duties as explained in Figure 5, which saw cigarette prices too raised by some 40% across the board, the market demand was relatively flat at about 19.3 billion sticks in 2016 against 19.2 billion in 2015. It was only in the last two years we see some reduction in overall market size as there has been a shift among smokers towards e-cigarettes. Figure 8 summarizes the total size (including legal and illicit) of the Malaysian tobacco market in the volume of cigarettes sold.

Figure 8: The Malaysian Tobacco Market Size in Volume (2013 – 2020)



Source: CMTM

Malaysia's effort in tackling tobacco consumption with the efforts put forward since 2015 via the NSPTC has shown some results but they were mostly insignificant. Based on the various annual update from the National Health and Morbidity Survey between 2015 and 2019 and the Global Adult Tobacco Survey (GATS) in 2011, Figure 9 summarizes current number of smokers and preva-

Figure 9: Malaysia's Smoking Prevalence

Year	No of Smokers (millions)	Smoking Prevalence (%)
2011	4.75	23.1
2015	5.00	22.8
2019	4.80	21.3

Source: GATS, NHMS 2015, NHMS 2019

The overall prevalence of current smokers aged 15 years and above had reduced slightly from 23.1% in 2011 to 22.8% in 2015 and 21.3% in 2019 based on The National Health and Morbidity Survey (NHMS). At the same time, the usage of e-cigarettes or vape use has increased from almost nothing to 4.9% by 2019.

In conclusion, it can be said, that despite the efforts to curb smoking prevalence has more or less not produced the desired results.

4.0 CONTRIBUTING FACTOR THAT FUEL GROWTH OF ILLICIT TRADE

Besides the excise duties, which have a direct impact on the retail price of tobacco products sold in the market, other contributing factors have fueled the growth of illicit trade and the primary factor here is enforcement.

Before the tabling of the Budget 2021 last year, the government did not have a policy of transshipment of tobacco products and this was one of the methods used by tobacco smugglers to bring untaxed products into the local market. Hence, with the five designated ports now earmarked for transshipment purposes, it is believed that efforts are being put in place to address contraband tobacco products. However, since the announcement was made, while some positive results have been seen, the designation of the five ports in no way stops smuggling activities altogether. Furthermore, as Malaysia has a huge coastal line, various unmanned coastal drop-off points have become new hotbeds for tobacco smuggling activities. In addition, even the various legitimate entry points have their own issues. This includes custom officers who are part of the overall scheme of things, or at port entries where high-tech equipment simply does not function at a critical time, which allows smuggling activities to be carried out.

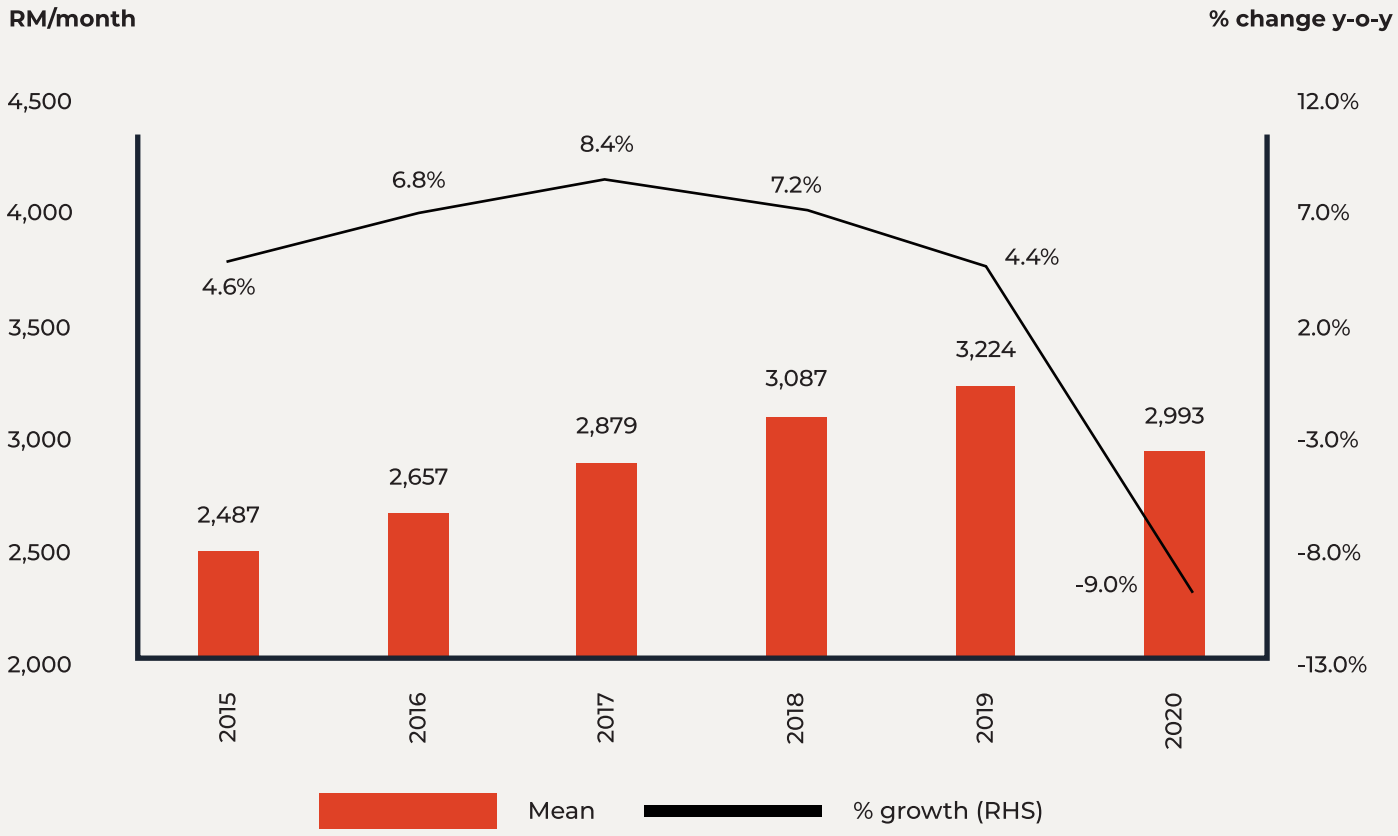
As consumer demand is relatively inelastic, the expensive nature of legitimate supplies has allowed demand to shift to the relatively cheaper alternatives that are smuggled in. The vast network established over the years can reach out throughout the nation helps consumers seek illegal supplies via the retail network.

4.1 Low wages leads to growing demand for contraband cigarettes

While enforcement is one aspect to weed out smuggling activities, it is also a question of the price gap between the legal and illicit trade cigarettes in the market. Hence, while enforcement is a factor in terms of the growth of the illicit trade, it is just one of the factors. The price differential and the low wages that Malaysians in general have is another factor. For example, a pack of illegal cigarettes, which may only cost between RM4 and RM6 per box, is less than half the price of an average pack of legal cigarettes priced at about RM16 per pack. This makes it attractive to consumers especially among the B40 due to the low-income nature of our households.

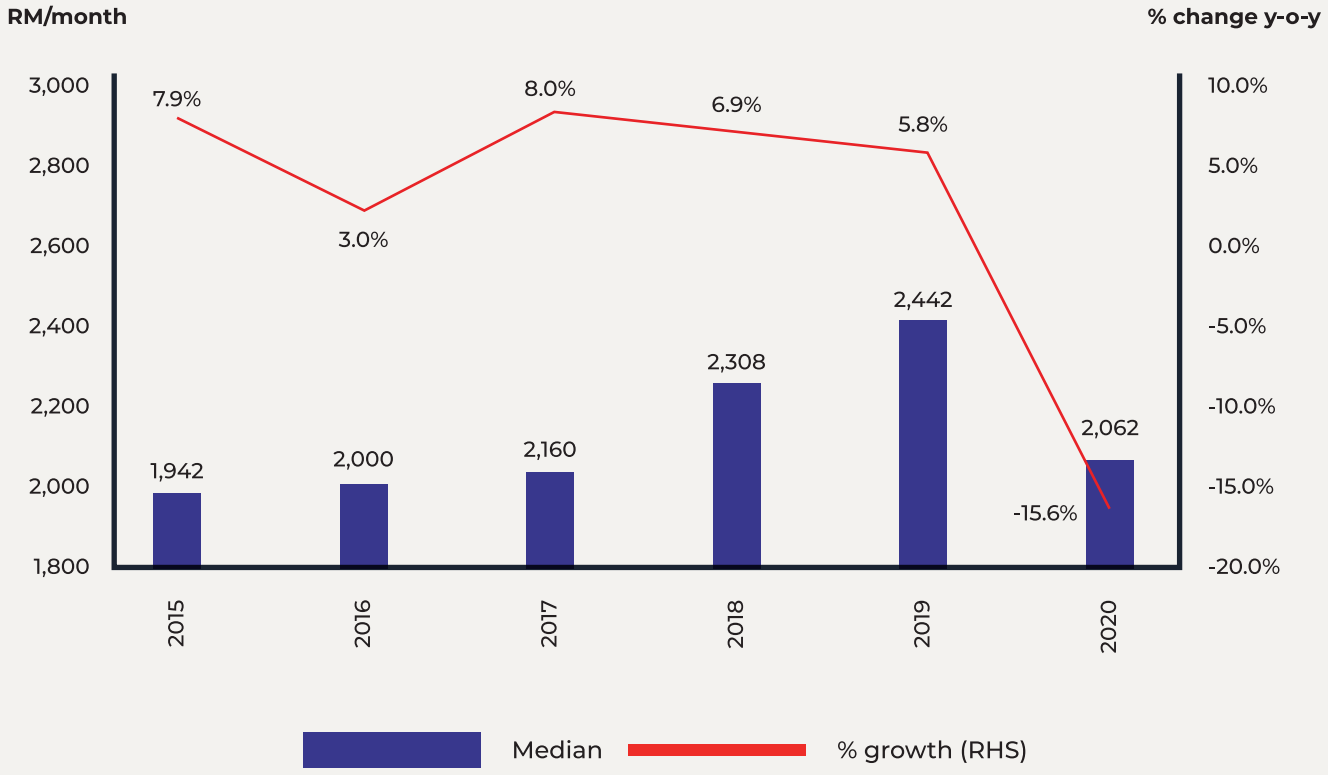
This is also made worse in the last 1-2 years due to the pandemic which has resulted in a significant downward shift of income levels. According to the Department of Statistics, Malaysia (DOSM), in its July 2021 report, the mean monthly salary and wages for 2020 fell by 15.6% and 9% y-o-y to RM2,933 and RM2,062. The trend of Malaysia's mean salary and wages is shown in Figure 8 and Figure 9 respectively.

Figure 10: Malaysia's Mean Monthly Salary and Wages (2015 – 2020)



Source: DOSM

Figure 11: Malaysia's Median Monthly Salary and Wages (2015 – 2020)



Source: DOSM

Based on the above data, assuming a pack of legal cigarette cost on the average of RM16 and a person who is a smoker, smokes approximately 20 boxes per month or about 13-14 sticks per day, his/her monthly expenditure will be approximately RM320, which translates to 15.5% of the median salary and wages in 2020 and 10.9% of the mean income. This was significantly lower in 2019 when the amount spent on buying similar supplies cost about 9.9% and 13.1% of the mean and median income respectively.

However, if the same individual spends only RM4.50 per box on a contraband supply, it only represents 3.1% and 4.4% of the mean and median income in 2020 and even lower in 2019 at 2.8% and 3.7% respectively. Hence, due to the low wage structure in Malaysia, illicit cigarettes are affordable to consumers while the legitimate ones are costly, and can be a significant portion of monthly take-home pay.

Another contributing factor to the demand equation related to wages is Malaysia's current low minimum wage structure, which is fixed at RM1,200 for urban areas and RM1,100 for other localities. Assuming the same example of above whereby a legitimate 20-pack cigarette is sold for RM16 per box, this translates to about 26.7% of the urban minimum wage earner and as much as 29.1% for the non-urban minimum wage earner. This is a significant expenditure for those at the bottom of the rung when it comes to wages and naturally, they will seek much cheaper alternatives.

4.2 Market Survey Studies Shows Impact of Illicit Trade Rises Due to Political and Economic Impact from Covid-19

A recent survey conducted by The Green Zebra (TGZ) found that 78% of the Malaysian population believe the illegal trade including contraband cigarettes are a threat during the Covid-19 pandemic while the recent uncertain political situation is perceived to be helping illegal cigarettes to flourish in the country as 81% of those surveyed thought so.

Almost all Malaysians continue to be concerned about the impact of Covid-19 as some 94% agreed to the question. As can be seen from the trend in salary and wages as seen in Figure 10 and Figure 11, many Malaysians have been personally impacted by Covid-19 too as the survey results showed 37% agree as they have experienced lower salaries, while 7% of those surveyed went into unemployment. Another 9% are concerned about their current job status as there is an element of uncertainty about their jobs. Hence, it can be said that Covid-19 and the political situation have contributed to significant impact to impact to the unemployment rate aside from direct consequences, with some 53% of those surveyed being impacted.

This is also seen from another question that was posed to the respondents as more than three-quarters of Malaysian adults expect unemployment to increase over time, with many felt insecure about their job prospects.

Based on the survey, it was not a surprise to see that 53% of smokers are switching to illegal cigarettes, smoking them either regularly or occasionally as part of their repertoire. Almost all Malaysians agree as 90% thought that higher levels of poverty do facilitate illegal activities.

5.0 SECONDARY ECONOMIC IMPACT OF GOVERNMENT'S MEASURES

The Malaysian tobacco industry has had its ups and downs but since the implementation of higher excise duties, especially from 2012 onwards, we have observed that some of the manufacturing capabilities, especially among the larger cigarette manufacturers came to a halt, and workers were given a Voluntary Separation Scheme or VSS.

The first to bite the bullet was Philip Moris (Malaysia) Sdn. Bhd. (PMM) when it decided to restructure its manufacturing operations as it increase production of processed tobacco for export and discontinue local cigarette manufacturing in October 2012. According to PMM's managing director, Tarkan Demirbas, the combination of increasing costs related to cigarette manufacturing and the continued high level of the illicit cigarette trade in Malaysia were key drivers for the decision to discontinue local cigarette production. That restructuring exercise eliminated about 220 full-time jobs related to cigarette manufacturing.

Following that, British American Tobacco (M) Bhd (BAT Malaysia) was the next to shut operations as in March 2016, BAT announced that it would close its cigarette-making facility in Petaling Jaya, Selangor, by the second half of 2017, which resulted in some 230 staff being laid-off.

JT International Bhd (JTI) was the next to do so. In May 2017, JTI announced that it will end its manufacturing operations in Malaysia. The closure saw some 270 people made redundant and production of JTI's tobacco products were then outsourced to other JTI facilities.

According to JTI, the Malaysian tobacco industry has reached an extremely challenging operating environment and that was one of the main reasons behind the group's decision to close its plant. It added that the decision was taken after an extensive review of how it supplies its products to its consumers and the operating environment in Malaysia. There is even consequential impact from these plant closures as businesses that depend on the tobacco industry were also forced to shut down. Here we saw Tien Wah Press Holdings Bhd announced that it was shutting down its printing business in Petaling Jaya. The plant produces, among other things, rotogravure printing specializing in cigarette cartons, and BAT was one of its major customers.

5.1 Severe Economic Loss Due to Plant Closures

According to a report published by Oxford Economics in June 2019 entitled "The Economics of Illicit Tobacco Trade in Malaysia", at the peak of the tobacco industry in 2013 and before the implementation of the hike in excise duties, the total GDP contribution of the sector was RM0.83bil based on 2017 prices. Of this amount, RM386mil is directly related to the industry while RM330mil and RM116mil are deemed to be indirectly related and induced respectively.

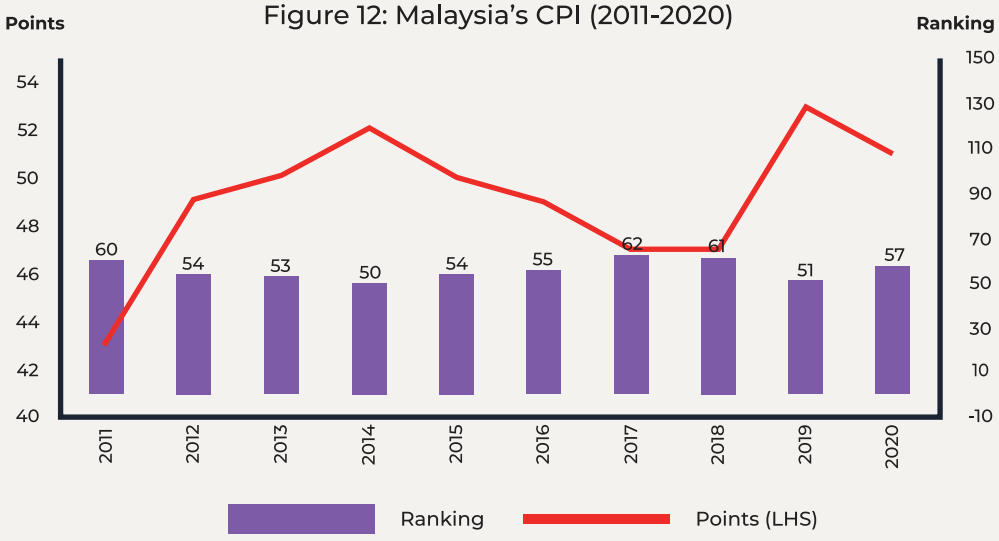
With the plant closures, jobs too were lost and according to the same report, it was estimated the two plants owned by BAT and JTI supported around 5,750 jobs in Malaysia, of which 600 were direct employment at the two factories and nearly 3,600 jobs sustained by the RM500 million spent by the two factories with local suppliers. In addition, it was found that almost 1,600 jobs were supported via the wage-related consumer spending of all those employed by the factories and in their supply chains.

5.2 Malaysia's ranking in Transparency International's CPI Has Plummeted

Transparency International is an independent, non-governmental and non-partisan organization committed to the fight against corruption. In its 2020 report published in January 2021, Malaysia's score has deteriorated to 51 points in 2020, on a scale from 0 (perceived to be highly corrupted) to 100 (perceived to be very clean) compared to 53 points in 2019. Malaysia's ranking in the CPI also deteriorated from 51 in 2019 to 57 in 2020 among the 180 countries surveyed. The overall trend of Malaysia's position globally is shown in Figure 12.

According to the report, among the possible reasons for this deterioration was continued cases of abuse of power and corruption by public official despite a crackdown by the Malaysian Anti-Corruption Commission (MACC).

Figure 12: Malaysia's CPI (2011-2020)



Source: Transparency International

6.0 SOLUTIONS IN TACKLING ILLICIT TRADE

With the issues highlighted in this report, it is now pertinent to address the identified problems. **The key to the sustainability of the tobacco industry is to tackle the rising level of illicit trade and there are few methods to address this.**

First, as we have seen, the increase in excise duties has made the price of legal cigarettes beyond the reach of the vast majority of the market. The illicit traders benefit the most as the market size has increased close to RM8bil in size, while the government is the biggest loser due to uncollected taxes to the tune of almost RM5bil. According to the same survey carried out by TGZ, an overwhelming majority of Malaysians or some 84% of respondents want the government to recover the RM5bil annual loss to Malaysian taxpayers caused by the illegal cigarette black market. There is a strong belief that during these uncertain times, the government needs to support via more financial aid to employees and employers and protect people and businesses from illegal activities. Compared to one year ago, more Malaysians (54% vs. 30% one year ago) now believe that the government needs to do more to help people and businesses.

However, currently, many Malaysians or some 57% of respondents are not too confident about the government's ability to tackle black market activities. Malaysians would like to see lost revenue from illegal cigarettes invested into areas such as health and education as top priorities.

Malaysian by and large wants the government to tackle illicit trade and this can be seen from the survey results that were carried out where the vast majority of Malaysians or 91% believe that clamping down on illegal cigarettes would be in the public interest. In addition, most or 87% of them surveyed also believe that the lost taxes from illegal activities would strengthen Malaysia's economy.

Another interesting finding from the TGZ survey was the widespread belief in the population (among smokers and non-smokers alike) that the legal cigarette industry should be protected from the illegal trade, and that the availability of low cost, illicit cigarettes is likely to encourage more people to smoke – and especially the younger population.

Hence, the government needs to formulate a strategy to address illicit trade and this has to be from the enforcement angle. While in Budget 2021, the government has designated five key ports as transshipment points for the trading of tobacco products, it has not stopped smuggling activities. The government needs to step up enforcement at these ports to ensure they act as pure transshipment hubs and not the point of entry for illicit trade. Another form of enforcement is also needed to tackle the entry of contrabands at various landing points on the coastal lines of the nation. There need to be concerted efforts, not only from the customs but also the navy by deploying our vast seagoing vessels to tackle the trade. The government should also enforce the laws more strictly at the retail point of sale as most of the illicit products are sold via these outlets. One of the ways is to impose a stricter legislative move and to carry out nationwide clean-up of illicit cigarettes that are sold in the market.

Second, is the issue of affordability. The rise in excise duties has caused a significant increase in prices of the legal products sold in the market, which has created a widening gap between what is sold as contraband cigarettes and the legally available products. This has also caused the surge in demand for illicit products and due to lack of enforcement carried out, not only at the various legal entry points but also at coastal lines, the black market has mushroomed to the extent it has now a dominant position in the market.

As explained earlier on the costly cigarette price, according to the survey that was carried out by TGZ most people think that the high price of legal cigarettes is exacerbating the overall situation, with 89% agreeing that the price gap is also propelling smokers towards the black market. In these uncertain pandemic times, affordability is becoming a key issue for everybody, including smokers, and at lower cost, illicit alternatives become more appealing. Malaysians strongly believe that the government needs to impose strong and clear regulations for the cigarette industry, to allow fair practices.

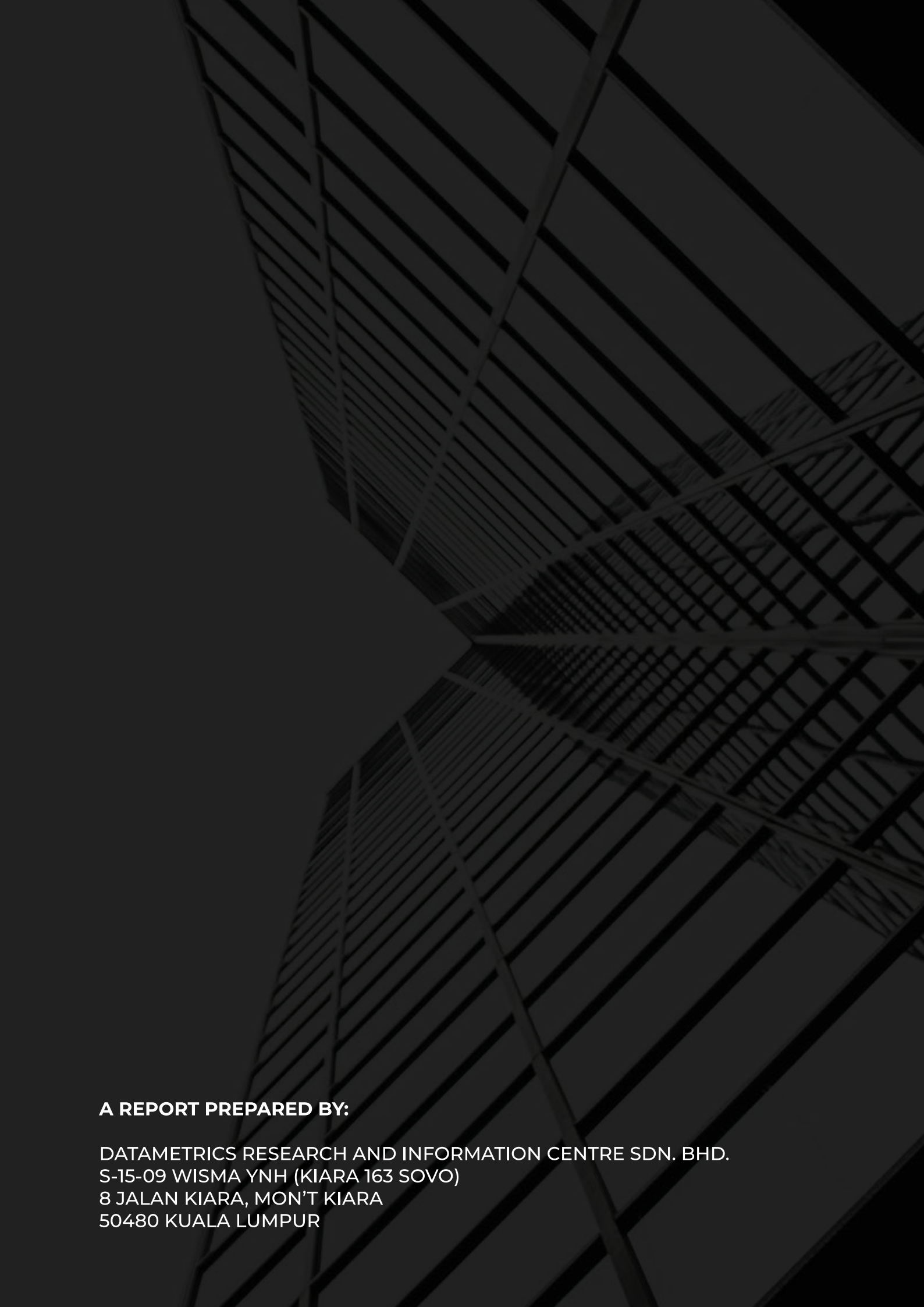
Hence, **one of the immediate steps the government has to take is to reduce the price gaps between legal and illicit trade.** If the average price of a cigarette pack today is RM16 and the illegally sold are just RM4.50 per pack of the 20s, it will naturally drive the demand for the cheaper cigarettes. The government should reduce these duties sky-high duties to narrow the price gaps and at the same time allow the government to generate more revenue from the legal means. After all, for every ten percent (10%) change in excise duties, the resultant change in illicit trade is two percentage points and government can generate at least RM0.25bil in revenue in the form of excise duties.

In relation to the issue of affordability is also related to excise duties and evidence suggests that an increase in excise duties leads to a higher prevalence of illicit trade while losses to the government, due to uncollected taxes increase by RM254mil for every 10% jump in excise duties. Hence, the government must take a stance to impose **a "moratorium on excise duty hike"** to ensure that the government does not lose more tax revenue due to higher excise duties. This will also allow consumers to adjust their consumption pattern towards legally price products as the government takes multiple steps to address the prevalence of illicit trade.

The third is the economic loss that the government suffers not only due to the rise of illicit trade but due to factory closures and loss of direct and indirect employment. This has also caused a loss of confidence among foreign investors to the extent we see our FDI numbers being challenged by developing economies in the region, which among others include Vietnam, Indonesia, and the Philippines. But making **Malaysia a competitive market for the tobacco industry, Malaysia can reduce its reliance not only on imported cigarettes but generate domestic economic activity by spurring investments and creating jobs.** Remember, Malaysia had already seen three tobacco facilities shutdown, and more than 700 direct workers were left unemployed.

Fourth is Malaysia's ranking as a nation that is unable to tackle corrupt activities to the extent that both our ranking and points have declined considerably over the years. Being ranked 57th in the world, Malaysia risk being bypassed by other nations as corruption and rise in illicit trade limits Malaysia's ability to remain competitive. Hence, the government must take **steps to address** corrupt practices as this will not only help Malaysia to improve its international standing but help to tackle illicit trade in the market.

Fifth is the current low wage structure which has made Malaysia left behind in terms of living standards and most Malaysians are struggling to make ends meet. Our relatively low wages also mean that we have serious affordability issues and this is not just limited to consumer goods but also larger and bigger ticket items, especially homeownership. The government must recognize that wages need to be raised and as highlighted by studies done by Khazanah Research Institute (KRI) which called upon the government to increase the minimum wage in Malaysia frequently, either with inflation or with the median wage level as our current current median wage has declined sharply in 2020 to just RM2,062 while our minimum wages are just at RM1,200 in urban areas.



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