

Asia Illicit Tobacco Indicator 2017: Hong Kong

Prepared by Oxford Economics
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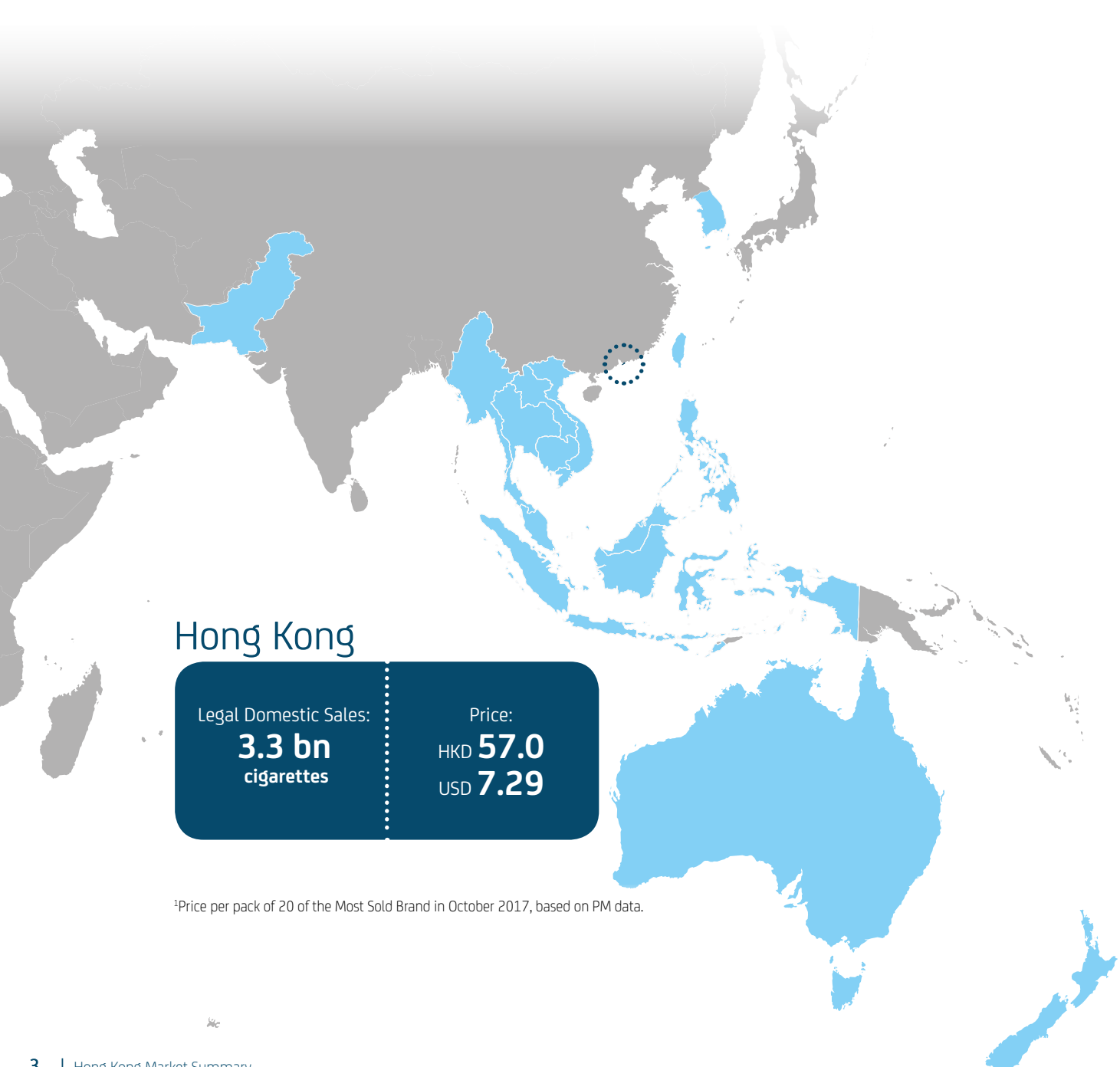
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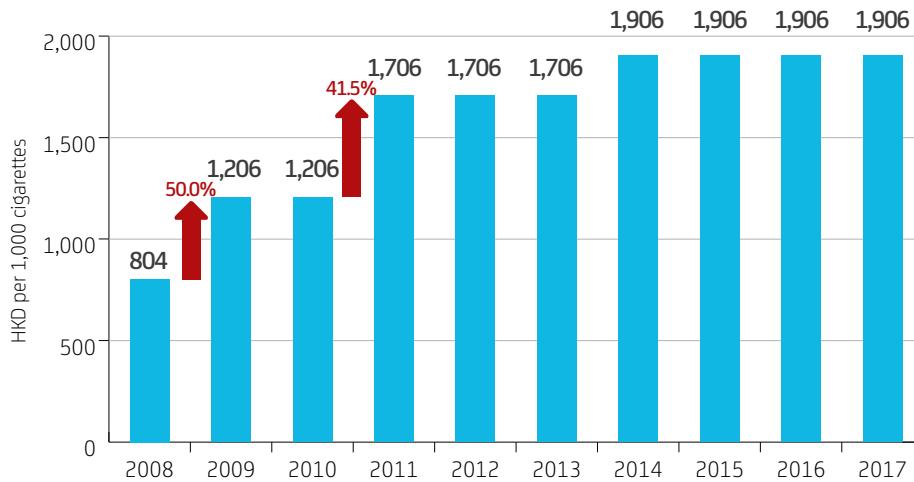
Hong Kong: Legal Domestic Sales

- Legal Domestic Sales, based on duty-paid volumes published by the Hong Kong Customs & Excise Department, were estimated at 3.3 billion cigarettes for calendar year 2017. Legal sales declined by a modest 2% in 2017, returning to 2015 levels.
- Three manufacturers (BAT, JTI, and PM) accounted for nearly 90% of Legal Domestic Sales in Hong Kong.
- Cigarette prices remained stable in 2017 at HKD 57.0 (USD 7.29) per pack of 20 cigarettes, based on the Most Sold Brand.¹
- The last major rise in prices occurred in 2014, when prices rose by around 10% following an increase in the rate of the Excise Tax to HKD 1,906 per 1,000 cigarettes from HKD 1,706. There were no significant changes to Excise Tax or the regulatory landscape implemented in 2017.
- Cigarettes in Hong Kong are more expensive than in other neighbouring markets in North East Asia, including China (USD 1.52), Japan (USD 4.00), Macao (USD 6.21), South Korea (USD 3.99), and Taiwan (USD 4.15).



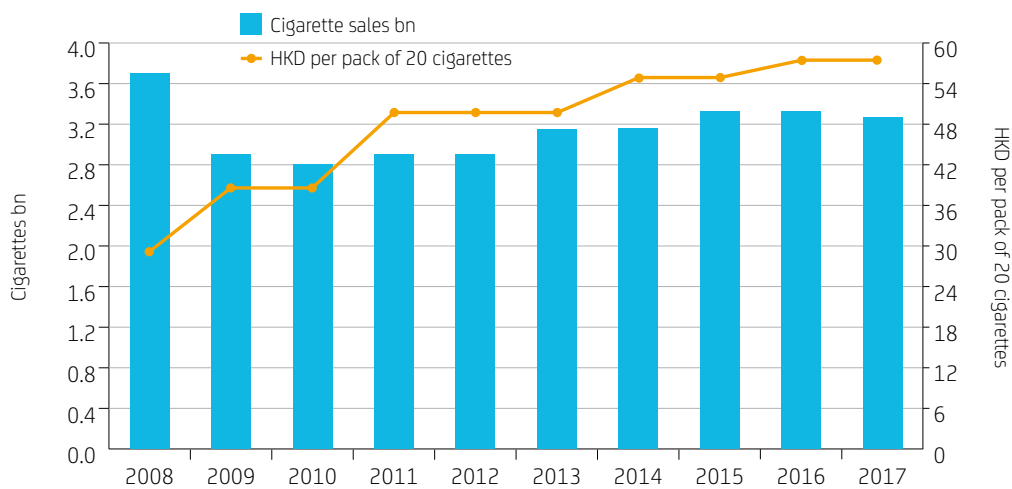
¹Price per pack of 20 of the Most Sold Brand in October 2017, based on PM data.

Hong Kong: Excise duty applied to cigarettes²



Source: Hong Kong Customs & Excise Department and Oxford Economics, based on PM data
²Rate applied in October of each year to the Most Sold Brand.

Hong Kong: Legal Domestic Sales and prices³



Source: Hong Kong Customs & Excise Department and Oxford Economics, based on PM data
³Price of the Most Sold Brand in October of each year.

Hong Kong: Cigarette Consumption

- The results from two Empty Pack Surveys conducted in 2017, combined with data on the volume of duty-paid tobacco sourced from the Hong Kong Customs & Excise Department, were used to estimate the total volume of cigarettes consumed in Hong Kong.¹
- Total Consumption was estimated at 5.0 billion cigarettes in 2017, slightly down on 2016. Of this, an estimated 64.2% was Legal Domestic Consumption, 7.2% was Non-Domestic Legal, and the remaining 28.6% or 1.4 billion cigarettes was Illicit Consumption.
- Illicit Consumption rose by an estimated 2.5% in 2017, partially offsetting the 2.0% decline in Legal Domestic Sales on Total Consumption.
- After registering a substantial decline of more than one-quarter in 2014, Illicit Consumption has remained at a broadly stable and persistent rate of around 28% of Total Consumption for the last four years.
- Compared with the other markets covered by the Asia Illicit Tobacco Indicator, Hong Kong was the fourth largest market in terms of Illicit Incidence.
- Non-Domestic Legal Inflows retained a stable share of 7.2% in Total Consumption in 2017, although volumes declined slightly in comparison with 2016.²
- The Customs & Excise Department remain very active in combatting Illicit Consumption in Hong Kong, targeting both the domestic market and transshipment activity. Total seizures in 2017 were valued at HKD 168 million, a similar level to that achieved in 2016, with notable cases including a seizure of Contraband cigarettes worth HKD 8.2 million in July, hidden on shipping containers believed to be destined for Taiwan, and a HKD 7 million haul of cigarettes intended for domestic sale in November.³
- Furthermore, the Customs & Excise Department continue to pursue a targeted approach, such as the territory-wide operation “Hammer” in September 2017, which focused on storage and distribution activities and netted illicit cigarettes with a street value of HKD 750,000.⁴

Hong Kong: Composition of cigarette consumption

	2012		2013		2014		2015		2016		2017		% change 2016-17
	Cigarettes bn	%	Cigarettes bn	%	Cigarettes bn	%	Cigarettes bn	%	Cigarettes bn	%	Cigarettes bn	%	
Legal Domestic Consumption (LDC)	2.9	56.7	3.1	58.6	3.0	63.7	3.2	62.8	3.3	65.3	3.2	64.2	-3.2
Legal Domestic Sales (LDS)	2.9	–	3.1	–	3.1	–	3.3	–	3.3	–	3.3	–	-2.0
Outflows of domestic duty-paid cigarettes	-0.0	–	-0.0	–	-0.1	–	-0.1	–	-0.0	–	-0.1	–	216.2
Total Non-Domestic Inflows (ND)	2.2	43.3	2.2	41.4	1.7	36.3	1.9	37.2	1.8	34.7	1.8	35.8	1.6
Non-Domestic Legal (NDL)	0.4	7.4	0.4	7.9	0.4	8.3	0.4	8.0	0.4	7.2	0.4	7.2	-1.8
Non-Domestic Illicit	1.8	35.9	1.8	33.6	1.3	28.0	1.5	29.1	1.4	27.5	1.4	28.6	2.5
Domestic Illicit	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	n/a
Total Consumption	5.1	100.0	5.4	100.0	4.8	100.0	5.1	100.0	5.1	100.0	5.0	100.0	-1.5
Total Illicit Consumption	1.8	35.9	1.8	33.6	1.3	28.0	1.5	29.1	1.4	27.5	1.4	28.6	2.5

Source: Oxford Economics

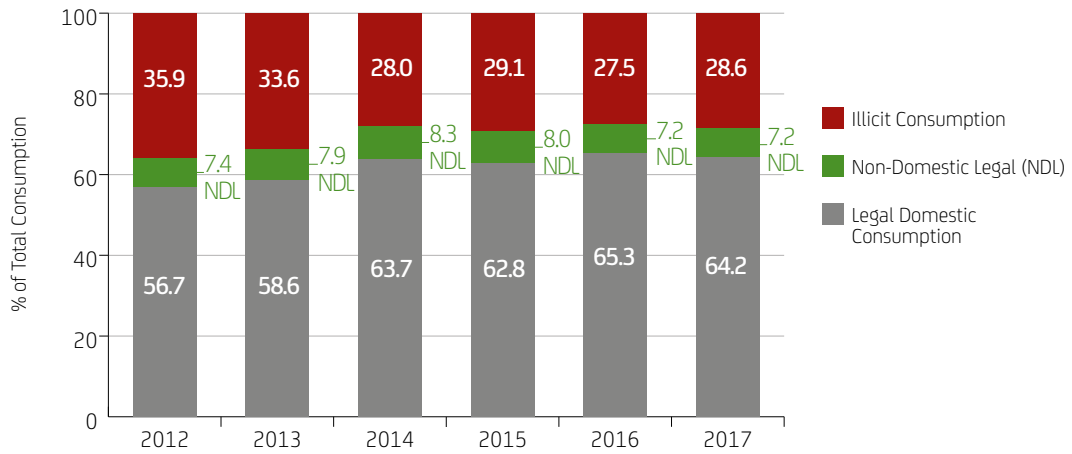
¹Empty Pack Surveys were undertaken in 2017 Q2 and 2017 Q4. See Report methodology for more details.

²Non-Domestic Legal Inflows estimated using passenger data, Smoking Prevalence in tourists' country/market of origin, and the passenger duty-free personal import allowance limit.

³Hong Kong Customs & Excise Department.

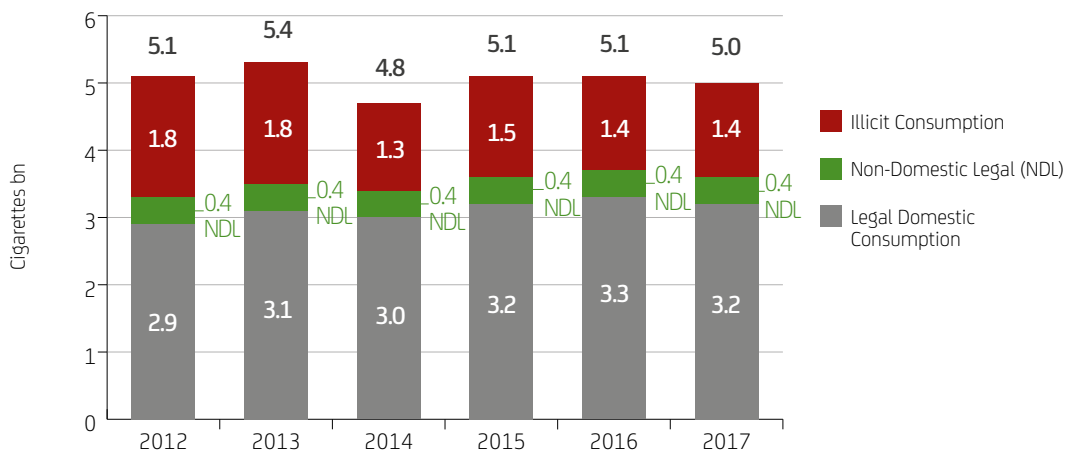
⁴ibid.

Hong Kong: Composition of cigarette consumption (% of Total Consumption)



Source: Oxford Economics

Hong Kong: Composition of cigarette consumption (number of cigarettes)



Source: Oxford Economics

Hong Kong: Government Finances

- Hong Kong levies a single unit-specific Excise Tax rate of HKD 1,906 per 1,000 cigarettes. The Excise Tax rate was last raised in February 2014, from HKD 1,706 per 1,000 to the current rate (equivalent to an increase of 11.7%). There is no GST or VAT in place.
- Revenues from Excise Tax on cigarettes declined for the second consecutive fiscal year in 2017/18, posting a modest fall of 1.1% in comparison with fiscal year 2016/17. In the process, revenues fell below HKD 6 billion for the first time since fiscal year 2013/14.
- The decline in revenues occurred against a backdrop of a 7.0% increase in the volume of Legal Domestic Sales over the same fiscal year period.¹
- A pick-up in Illicit Consumption generated a higher estimated Tax Loss in fiscal year 2017/18. The total Tax Loss was estimated at HKD 2.8 billion, rising by 11.8% in comparison with fiscal year 2016/17.²
- In conjunction with the decline in actual revenues, the rise in Illicit Consumption helped to push the estimated Tax Loss as a share of total potential revenues back above 30% after briefly dipping below this threshold in fiscal year 2016/17.

Hong Kong: Actual government revenues and estimated Tax Loss

	2012/13 fiscal year		2013/14 fiscal year		2014/15 fiscal year		2015/16 fiscal year		2016/17 fiscal year		2017/18 fiscal year		% change in local currency 2016/17- 2017/18
	HKD bn	USD mn	HKD bn	USD mn	HKD bn	USD mn	HKD bn	USD mn	HKD bn	USD mn	HKD bn	USD mn	
Actual revenue from excise duties on tobacco	5.3	678	5.8	754	6.1	783	6.5	843	6.0	773	5.9	760	-1.1%
Estimated number of illicit cigarettes purchased (cigarettes bn)	2.0		1.9		1.3		1.5		1.3		1.5		11.8%
Estimated Tax Loss from Illicit Consumption	3.3	429	3.2	419	2.5	328	2.9	377	2.5	320	2.8	356	11.8%
Lost excise revenue	3.3	429	3.2	419	2.5	328	2.9	377	2.5	320	2.8	356	11.8%
Excise Tax Loss as % of potential total Excise Tax revenues	38.7%		35.7%		29.5%		30.9%		29.3%		31.9%		

Source: Hong Kong Customs & Excise Department and Oxford Economics, based on PM data

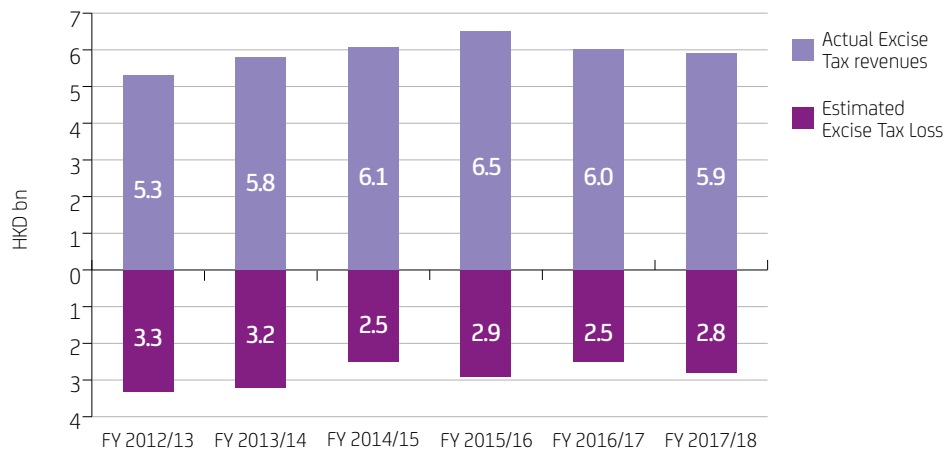
Estimated number of illicit cigarettes purchased adjusted for fiscal year.

Fiscal year runs from April to March.

¹Data from the Hong Kong Customs & Excise Department suggest that while Legal Domestic Sales in the 2017 calendar year declined by 2.0% vs. 2016, when comparing fiscal year data, Legal Domestic Sales rose by 7.0% in 2017/18 vs. 2016/17.

²The estimated number of illicit cigarettes consumed were adjusted for the fiscal year by applying the calendar year Illicit Incidence estimate to the volume of Legal Domestic Sales for the fiscal year. As such, the disparity between calendar year and fiscal year data for Legal Domestic Sales implies a higher growth rate for Illicit Consumption in the fiscal year 2017/18 (+11.8%) compared with the calendar year 2017 (+2.5%).

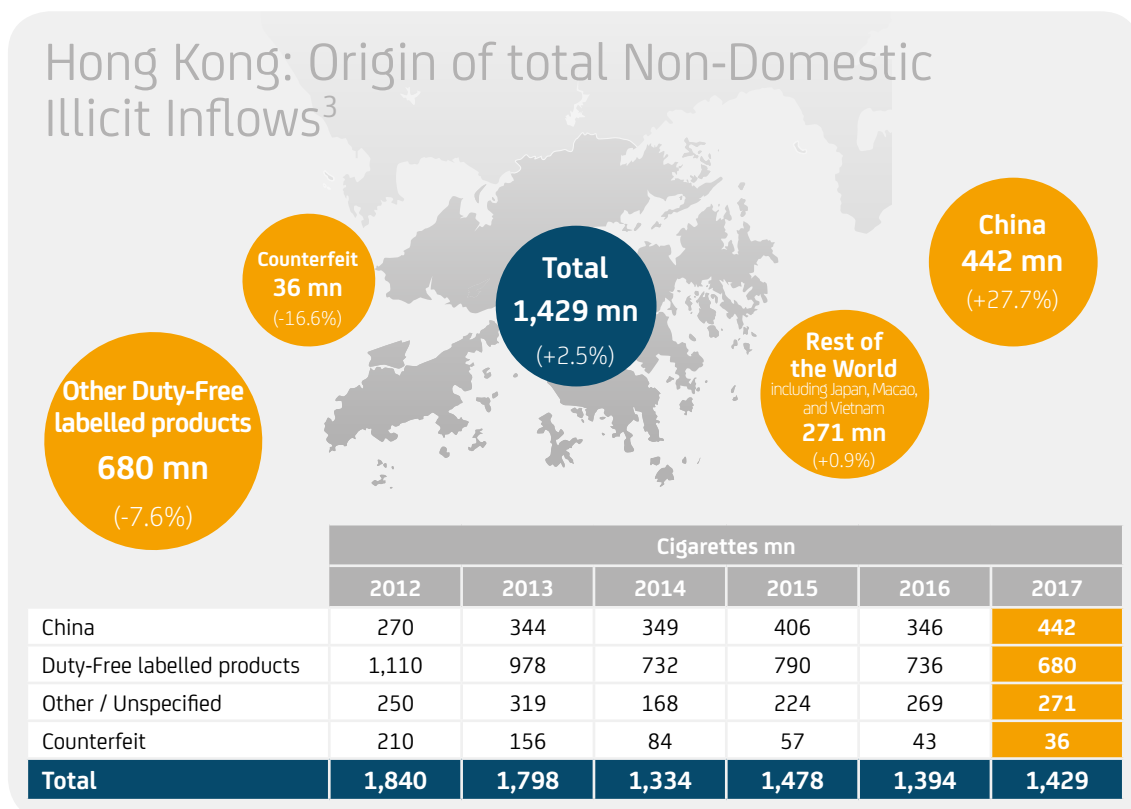
Hong Kong: Actual government revenues and estimated Excise Tax Loss



Source: Hong Kong Customs & Excise Department and Oxford Economics, based on PM data

Hong Kong: Trade Flows

- Given the proximity with China and the high frequency of passenger traffic over land borders, a high proportion of cigarettes consumed in Hong Kong originates abroad. This is despite a relatively low duty-free personal import allowance limit of 19 cigarettes.
- Since the beginning of the Asia Illicit Tobacco Indicator research programme, Non-Domestic Inflows have consistently accounted for more than one-third of Total Consumption in Hong Kong, even when accounting for the sharp decline experienced in 2014.
- Duty-Free labelled products from various markets account for the largest share of illicit Inflows in Hong Kong. Over 60% of total Illicit Consumption was of Duty-Free origin in 2017, a level that has been relatively stable in recent years.¹
- Of the remaining illicit Inflows, cigarettes intended for final retail sale in China accounted for the largest share of the market. When including Chinese Duty-Free labelled products, illicit Inflows from China rose by 27.7% to an estimated 442 million cigarettes in 2017 – the highest level recorded by the Asia Illicit Tobacco Indicator research programme – representing nearly one-third of total Illicit Consumption.
- Other market variants, including Unspecified Market Variant cigarettes, were broadly stable in 2017, rising by just 0.9% to 271 million cigarettes.²
- The volume of Counterfeit cigarettes present in the market continued to decline in 2017, a consistent trend throughout the Asia Illicit Tobacco Indicator research programme. An estimated 36 million Counterfeit cigarettes were consumed in 2017, representing just 2.5% of total Illicit Consumption, a share that has fallen from 11.2% in 2012.
- Analysis of the Empty Pack Survey suggests that the incidence of Non-Domestic cigarettes (legal and illicit) is relatively uniformly dispersed across Hong Kong, although at 37.0%, Non-Domestic Consumption is slightly higher in the New Territories, compared with Hong Kong Island (34.5%), and Kowloon (34.4%).



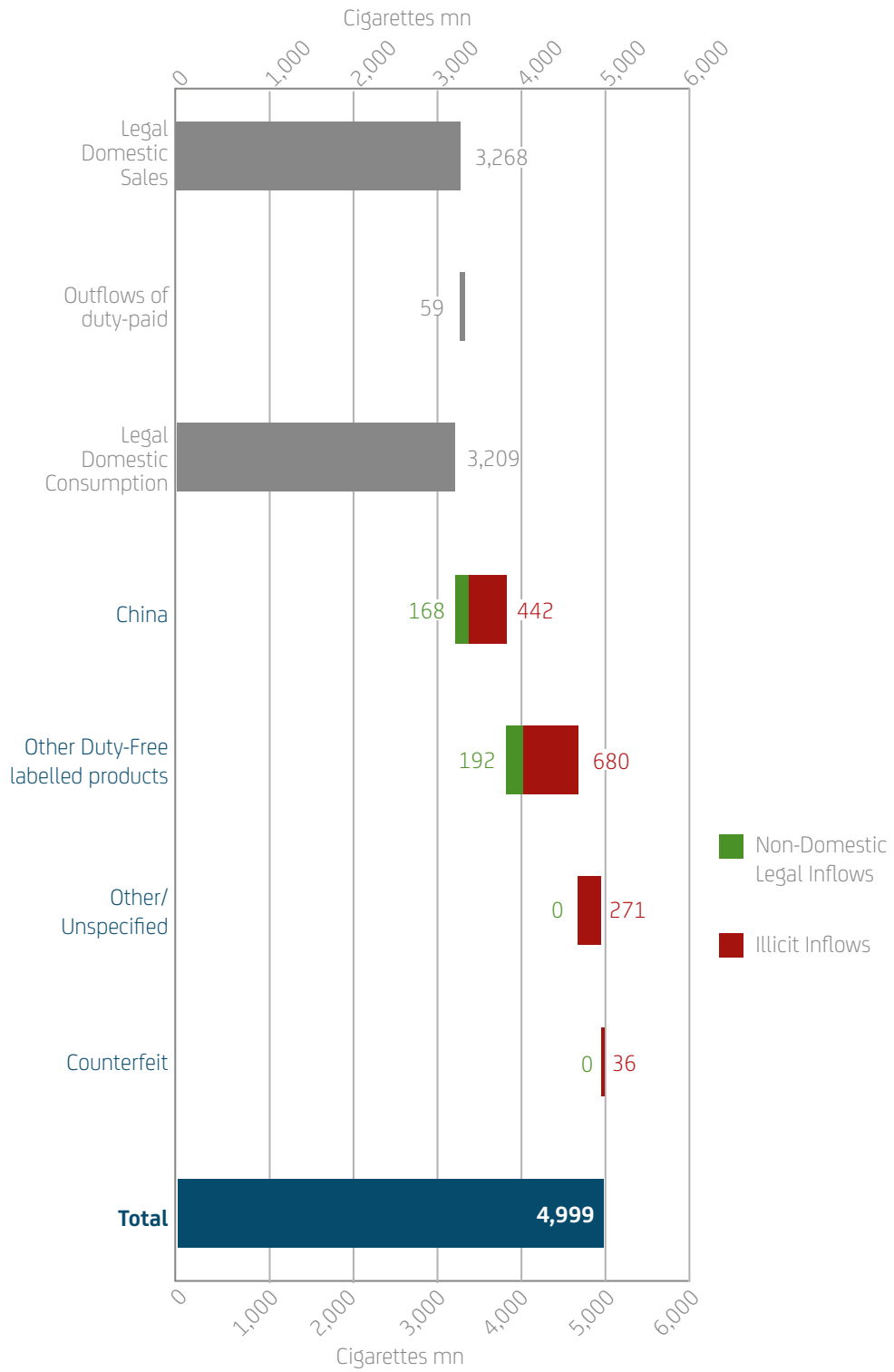
Source: IT Flows Model and Oxford Economics

¹Includes some Counterfeit goods and Chinese Duty-Free products, which are categorised as of Chinese origin for the purposes of the table.

²Unspecified Market Variant refers to cigarette packs that do not bear specific market labelling or Duty-Free labelling. As such the intended market is not known. "Double Happiness", "Esse", and "Zhong Nan Hai" were the primary Unspecified Market Variant brands identified in 2017.

³Figures in brackets reflect % change from 2016.

Hong Kong: Consumption breakdown 2017

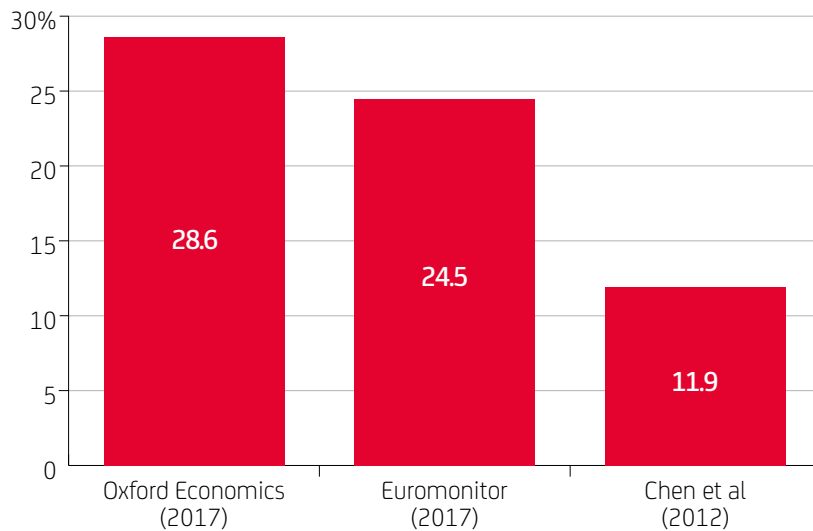


Source: IT Flows Model and Oxford Economics

Hong Kong: Other Estimates

Source	Comment
Comparing consumption estimates with LDC ("bottom up" approach)	Using data on Smoking Prevalence and average daily consumption of cigarettes, plus UN population data, a "bottom up" estimate of cigarette consumption can be made which can then be compared with LDC. This approach yields an estimate for Total Consumption that is below LDC, implying no evidence of substantial Illicit Consumption. The source for Smoking Prevalence and average daily cigarette consumption is the Hong Kong Thematic Household Survey Report No. 64, compiled by the Census and Statistics Department, 2017.
Chen J, McGhee SM, Townsend J, et al. Tob Control, 2014. Retrieved via http://www.ncbi.nlm.nih.gov/pubmed/25566812	Total Consumption is estimated through a "bottom up" approach, including estimates of both domestic consumption and visitor consumption. Illicit Consumption is subsequently estimated as the difference between Legal Domestic Sales, sourced from Hong Kong Customs & Excise, and Total Consumption, allowing for Non-Domestic Legal Inflows from inbound visitors and returning domestic residents. Based on this approach, the authors estimate Illicit Consumption of between 8.2% and 15.4% in 2012.
Euromonitor Passport, 2018	Euromonitor estimates an Illicit Incidence of 24.5% in 2017. The methodology, sampling, and coverage are unknown, so it is difficult to assess the robustness of this estimate.

Hong Kong: Alternative estimates of Illicit Consumption



Hong Kong: Data Sources

	Primary source	Calculation	Comments
Legal Domestic Sales (LDS)	Sales of Duty-Paid Tobacco, sourced from the Hong Kong Customs & Excise Department.	—	—
Outflows of domestic duty-paid cigarettes	Empty Pack Survey data in other markets included in this Report.	Empty Pack Survey data in other markets used to identify the presence of packs bearing Hong Kong market-specific labelling (e.g., health warnings, tax stamps, etc.).	Outflows of domestic duty-paid cigarettes to other markets are estimated at around 59 million cigarettes, with a large presence identified in Thailand, as well as Australia, Macao, and New Zealand.
Legal Domestic Consumption (LDC)	—	Legal Domestic Sales minus Outflows of legal sales.	Outflows of duty-paid cigarettes refer only to Outflows to other markets included in this Report.
Total Non-Domestic Inflows (ND)	—	Sum of Non-Domestic Legal and Non-Domestic Illicit.	—
Non-Domestic Legal (NDL)	—	Estimated using passenger data, smoking rates, and passenger duty-free personal import allowance.	Maximum theoretical amount an individual can carry across a border. Passenger data from the Immigration Department.
Non-Domestic Illicit	Empty Pack Surveys.	Based on Empty Pack Surveys plus OE estimates.	Estimates derived from the average of Empty Pack Surveys conducted in 2017 Q2 and 2017 Q4. See Report methodology for more details.
Domestic Illicit		Zero under-declaration of domestically produced cigarettes.	There is assumed to be no under-declaration of domestically produced cigarettes. Based on market intelligence and analysis of seizure data, Counterfeit cigarettes identified in the Empty Pack Survey were assumed to be Inflows to Hong Kong.
Total Illicit Consumption		Sum of Non-Domestic Illicit and Domestic Illicit.	—
Total Consumption	—	Legal Domestic Sales minus Outflows of domestic duty-paid cigarettes, plus estimated Non-Domestic Legal consumption, plus estimated Illicit Consumption.	The IT Flows Model estimate of consumption is 5.0 billion cigarettes for 2017.
Total Tax Loss	—	Total Illicit Consumption multiplied by the prevailing Excise Tax rate.	See Report methodology for more details.

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