

Asia Illicit Tobacco Indicator 2017: Pakistan

Prepared by Oxford Economics
September 2018



OXFORD
ECONOMICS

Disclaimer

The Asia Illicit Tobacco Indicator 2017 Report (the “Report”) on the illicit tobacco trade in selected Asian markets (including Australia and New Zealand) has been prepared by Oxford Economics (OE). OE enjoyed academic freedom and full editorial control of the Report. We are grateful for the inputs and data received from public sector and industry stakeholders.

OE prepared the Report in accordance with specific terms of reference agreed between Philip Morris International Management SA, an affiliate of Philip Morris International (PM), and OE. Financial support for the Report was provided by PM. OE assume all responsibility for the Report analysis, findings, and conclusion. The terms of reference under which OE were engaged by Philip Morris International Management SA are detailed in the Asia Illicit Tobacco Indicator 2017 Methodological Overview Report, available to download via the following link illicittobacco.oxfordeconomics.com

Pakistan: Legal Domestic Sales

- Legal Domestic Sales were estimated at 45.1 billion cigarettes in 2017, falling by 7.4% in comparison with 2016.
- Legal sales have now fallen in every year since the beginning of the Asia Illicit Tobacco Indicator research programme in 2012. As a consequence, the total volume of Legal Domestic Sales in 2017 was nearly 30% lower than in 2012.
- PM and BAT account for nearly all Legal Domestic Sales in Pakistan.
- The government has steadily increased the Federal Excise Duty (FED) rate over the past decade, from PKR 352 per 1,000 cigarettes in 2008 to PKR 1,649 per 1,000 at the beginning of 2017 (based on the Most Sold Brand). This is equivalent to an annual average rate of increase of nearly 19%.
- In July 2017, the government amended the structure of the FED by introducing a new third tier covering low-cost cigarette brands in an effort to encourage producers of illicit tobacco to formalise in the market.
- The price of the Most Sold Brand was PKR 48.0 (USD 0.46) per pack of 20 cigarettes in October 2017. Prior to the introduction of a new third tier FED in July 2017, the price of the Most Sold Brand was PKR 72.0 (USD 0.69) per pack of 20 cigarettes. However, the Most Sold Brand was repositioned into the new low-tax-tier following the restructure, resulting in a decline in the applicable FED to PKR 800 per 1,000 cigarettes from PKR 1,649. As a consequence, the price of 20 cigarettes of the Most Sold Brand declined by one-third.¹

Pakistan

Legal Domestic Sales:

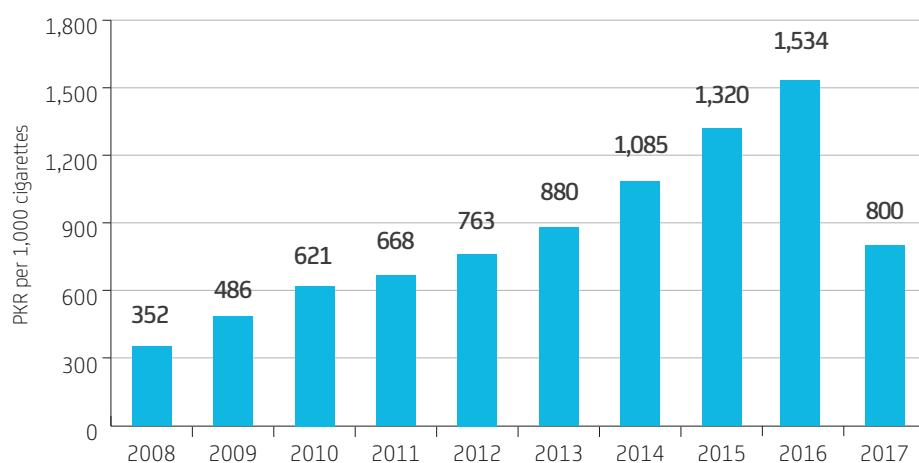
45.1 bn
cigarettes

Price:

PKR **48.0**
USD **0.46**

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

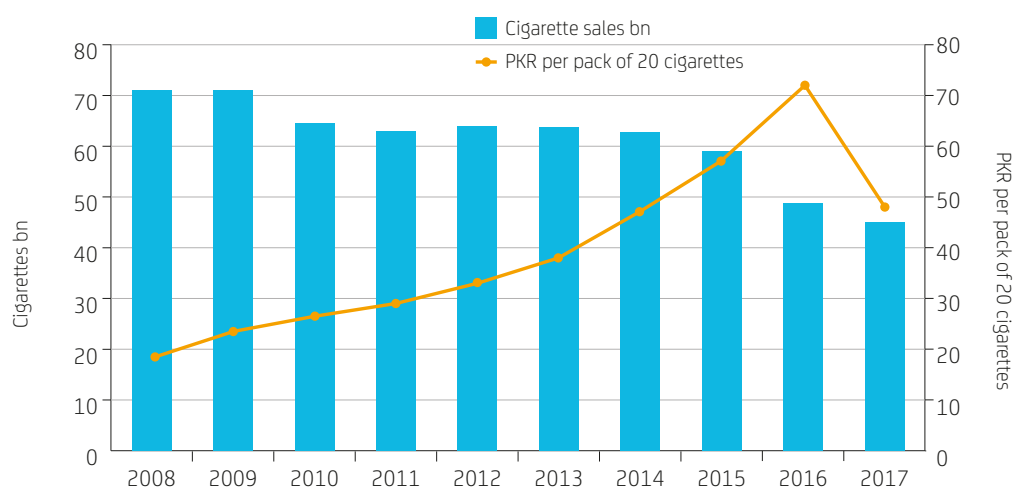
Pakistan: Excise duty applied to cigarettes²



Source: Oxford Economics based on PM data

²Rate applied in October of each year to the Most Sold Brand. The decline in the rate of Excise Tax applicable to the Most Sold Brand followed the introduction of a low-tax tier in the Federal Excise Tax Duty structure in July 2017.

Pakistan: Legal Domestic Sales and prices³



Source: Oxford Economics based on PM data

³Legal Domestic Sales based on calendar year. Price per pack of the Most Sold Brand in October of each year. The Most Sold brand is a low-priced brand that was subject to a reduced rate of Federal Excise Tax following the introduction of a three-tiered Excise Tax structure in July 2017.

Pakistan: Cigarette Consumption

- The results from an Empty Pack Survey and Nielsen Retail Audit data were combined with IMS data on Legal Domestic Sales to estimate Total Consumption of cigarettes in Pakistan.¹
- Total Consumption (legal and illicit) was estimated at 77.8 billion cigarettes in 2017, falling by 10.3% in comparison with 2016. Of this, an estimated 58.0% was Legal Domestic Consumption, 0.1% was Non-Domestic Legal, and the remaining 41.9% was estimated to be Illicit Consumption. Illicit Consumption continued to be primarily composed of Domestic Illicit cigarettes in 2017. Domestic Illicit accounted for nearly three-quarters of all illicit cigarettes consumed 2017.
- Illicit Consumption declined by an estimated 14.0% in 2017 to 32.6 billion cigarettes, underpinned by an 11.4% decline in Domestic Illicit and a 20.5% fall in Non-Domestic Illicit. This is the first time since 2013 that Illicit Consumption has fallen in Pakistan.
- The decline in Illicit Consumption coincides with a series of regulatory and enforcement initiatives aimed at reducing the volume of illicit cigarettes consumed in Pakistan. In January 2017, the Federal Board of Revenue (FRB) constituted a joint committee for the monitoring, vigilance, and scrutiny of the cigarette/tobacco sector in response to the rise in Illicit Consumption, and in recognition of the links between tobacco smuggling and financing terrorism.² The committee, known as the Inland Revenue Enforcement Network (IREN), was tasked with monitoring and developing strategies to combat the illegal cigarette trade. In the first year of operation, IREN seizures amounted to 1.63 billion non-duty-paid cigarettes and raw tobacco.
- In July 2017, the FED was restructured with the introduction of a third low-tax-tier in an attempt to encourage producers of illicit tobacco to formalise and become better regulated. This has yielded some early success, with analysis of Nielsen Retail Audit data indicating that the incidence of Domestic Illicit Consumption declined by 4 percentage points in the six-month period immediately following implementation (July-December 2017).

Pakistan: Composition of cigarette consumption³

	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)	64.0	74.4	63.7	77.1	62.7	74.6	59.0	68.6	48.7	56.2	45.1	58.0	-7.4
Legal Domestic Sales (LDS)	64.0	—	63.7	—	62.7	—	59.0	—	48.7	—	45.1	—	-7.4
Outflows of domestic duty-paid cigarettes	-0.0	—	-0.0	—	-0.0	—	-0.0	—	-0.0	—	-0.0	—	-8.9
Total Non-Domestic Inflows (ND)	3.2	3.7	3.5	4.3	3.6	4.3	6.2	7.2	10.7	12.4	8.5	11.0	-20.6
Non-Domestic Legal (NDL)	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	-27.6
Non-Domestic Illicit	3.0	3.5	3.4	4.2	3.5	4.2	6.1	7.1	10.6	12.3	8.5	10.9	-20.5
Domestic Illicit	18.8	21.9	15.3	18.6	17.7	21.1	20.8	24.2	27.3	31.5	24.2	31.1	-11.4
Total Consumption	86.0	100.0	82.6	100.0	84.0	100.0	86.0	100.0	86.7	100.0	77.8	100.0	-10.3
Total Illicit Consumption	21.8	25.3	18.8	22.8	21.2	25.2	27.0	31.3	37.9	43.7	32.6	41.9	-14.0

Source: Oxford Economics

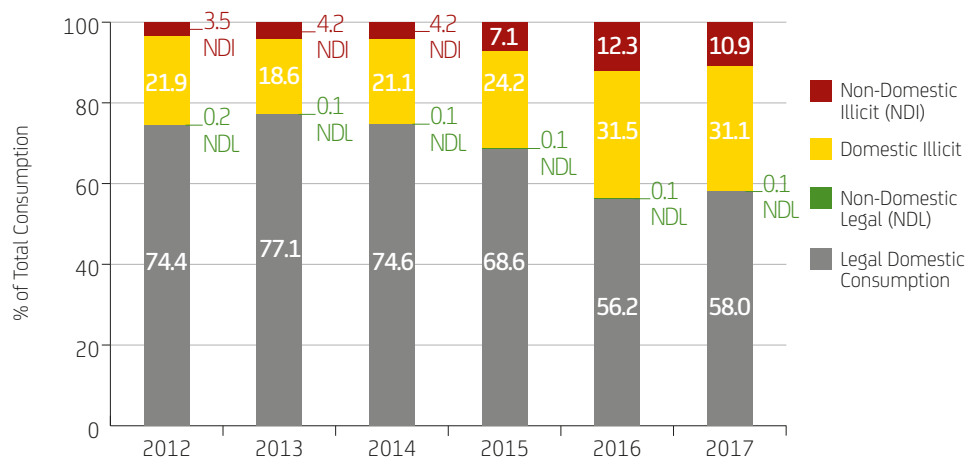
2012 results for Non-Domestic Illicit based on 2011 Q4 Empty Pack Survey. 2013 results for Non-Domestic Illicit based on 2014 Q1 Empty Pack Survey.

¹The Empty Pack Survey was undertaken in 2017 Q4, while the Retail Audit provides data for each month in 2017. By comparing sales based on the retail audit with duty-paid volumes sourced from the Pakistan Federal Board of Revenue, this Report estimated the volume of domestically-produced cigarettes where the appropriate excise rates were not paid. See Report methodology for more details.

²See <https://www.thenews.com.pk/print/84069-Rs900-bn-smuggling-prone-11-items-cause-Rs300-bn>

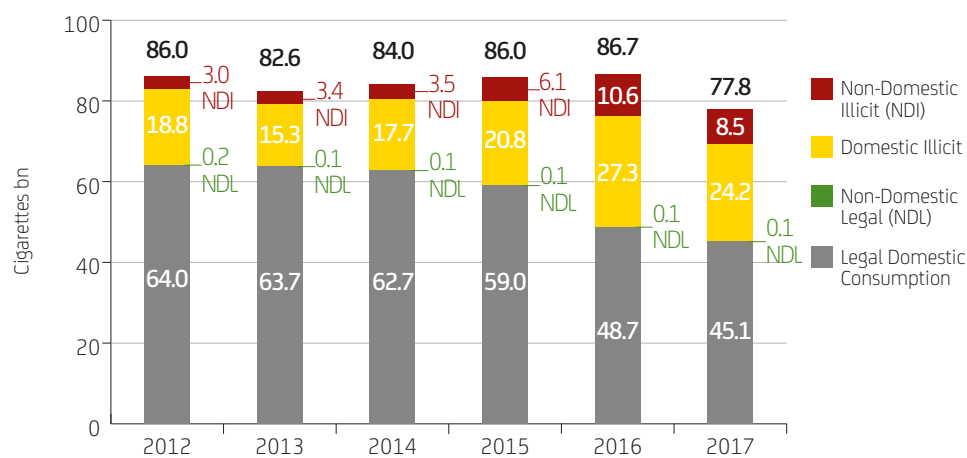
³It is understood that increases in the FED result in substantial "trade loading" activity in Pakistan. Legal Domestic Sales, which is estimated in this Report using manufacturers' shipments rather than retail sales, will include this inventory accumulation. But given that changes to the FED are usually implemented at the beginning of the fiscal year, this does not have a material impact on estimates of Legal Domestic Sales for the calendar year. However, trade will have stockpiled inventory in anticipation of the December 2016 increase in the FED, and subsequently unwound this inventory at the beginning of 2017, impacting calendar year estimates of Legal Domestic Sales for 2016 and 2017. Due to a lack of data, it is not possible to account for this behaviour, and so it is noted that this Report will have overestimated actual Legal Domestic Sales and Total Consumption volumes in 2016, and hence underestimated Legal Domestic Sales and Total Consumption volumes in 2017.

Pakistan: Composition of cigarette consumption (% of Total Consumption)



Source: Oxford Economics

Pakistan: Composition of cigarette consumption (number of cigarettes)



Source: Oxford Economics

Pakistan: Government Finances

- Pakistan operates a multi-tiered Excise Tax system whereby cigarettes are classified based on the retail selling price net of gross sales tax.
- The FED was amended in 2017 by reintroducing a three-tiered structure (previously two-tiered). From July 2017, cigarettes retailing at a price equivalent to PKR 4,500 per 1,000 cigarettes or above incurred a FED of PKR 3,740 per 1,000 cigarettes; cigarettes packs selling at between PKR 2,925 and PKR 4,500 per 1,000 cigarettes incurred a FED of PKR 1,670; and packs retailing below PKR 2,925 per 1,000 cigarettes incurred a FED of PKR 800.
- Prior to this, a two-tiered structure was in operation, whereby the FED was set at PKR 3,705 per 1,000 cigarettes for high-tax-tier cigarettes with a retail price above PKR 4,400 and PKR 1,649 per 1,000 cigarettes for low-tax-tier cigarettes.
- GST is applicable and levied at a rate of 17.0%.
- Actual government revenues were estimated to have increased by 8.3% in fiscal year 2017/18, underpinned by an acceleration in Legal Domestic Sales, which rose by an estimated 73.9% over the same period.¹
- The Tax Loss associated with Illicit Consumption was estimated at PKR 59.3 billion (USD 538 million) in fiscal year 2017/18, falling by 11.5% in comparison with 2016/17. The rise in Illicit Consumption in the fiscal year, underpinned by rising Legal Domestic Sales,² was offset by a decline in the weighted-average Excise Tax rate, owing to the introduction of a new low-tax-tier in the FED structure.³
- The Excise Tax Loss as a share of total potential Excise Tax revenues declined to 37.7% in fiscal year 2017/18, from 43.6% the previous fiscal year. This was broadly consistent with the decline in Illicit Incidence estimated in calendar year 2017.

Pakistan: 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 ⁴		% change in local currency 2016/17- 2017/18
	PKR bn	USD mn	PKR bn	USD mn	PKR bn	USD mn	PKR bn	USD mn	PKR bn	USD mn	PKR bn	USD mn	
Actual revenue from excise duties on tobacco	61.7	637	71.4	693	81.9	807	90.4	867	66.1	631	71.6	651	8.3%
Estimated number of illicit cigarettes purchased (cigarettes bn)	22.8		18.8		21.4		24.3		27.5		37.5		36.4%
Estimated Tax Loss from Illicit Consumption	26.9	275	26.2	253	36.3	358	51.9	497	66.9	638	59.3	538	-11.5%
Lost excise revenue	20.9	214	20.1	194	27.9	275	39.8	382	51.2	488	43.4	394	-15.2%
Lost GST revenue	5.9	61	6.1	59	8.4	83	12.1	116	15.7	150	15.9	144	0.9%
Excise Tax Loss as % of potential total Excise Tax revenues	25.3%		22.0%		25.4%		30.6%		43.6%		37.7%		

Source: Pakistan Federal Board of Revenue and Oxford Economics based on PM data

Fiscal years run from July to June. Estimates for fiscal year 2016/17 have been updated in this Report based on revised data.

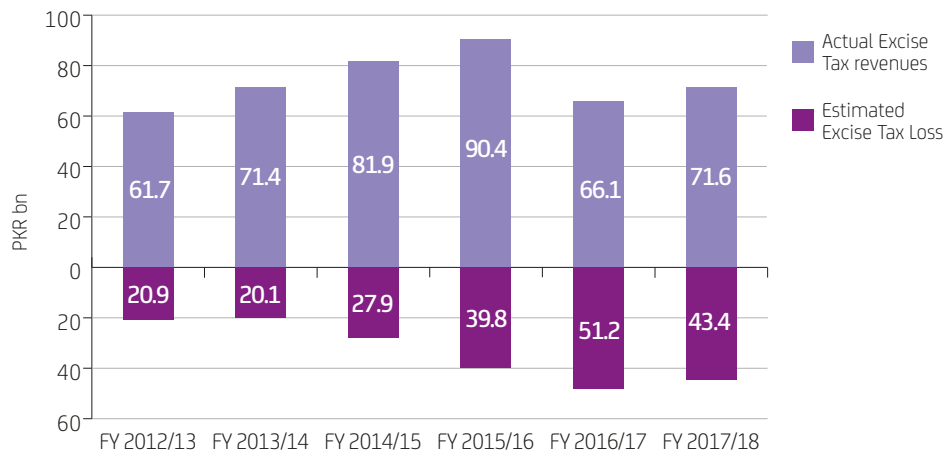
¹While Legal Domestic Sales declined by 7.4% in calendar year 2017, legal sales were estimated to have increased by 73.9% in fiscal year 2017/18.

²The number of illicit cigarettes purchased for the fiscal year was estimated by comparing fiscal year and calendar year Legal Domestic Sales data. As such, while calendar year estimates of Illicit Consumption indicate a decline in comparison with 2016, fiscal year estimates indicate a sharp rise in volume, underpinned by increased Legal Domestic Sales.

³With the introduction of a third tier in the Excise Tax structure, the weighted average Excise Tax rate in Pakistan, used to estimate the Tax Loss from Illicit Consumption, declined by nearly 38% in fiscal year 2017/18.

⁴Estimates covering actual government revenues and estimated Tax Loss for fiscal year 2017/18 were derived based on extrapolating from actual data for July 2017-March 2018.

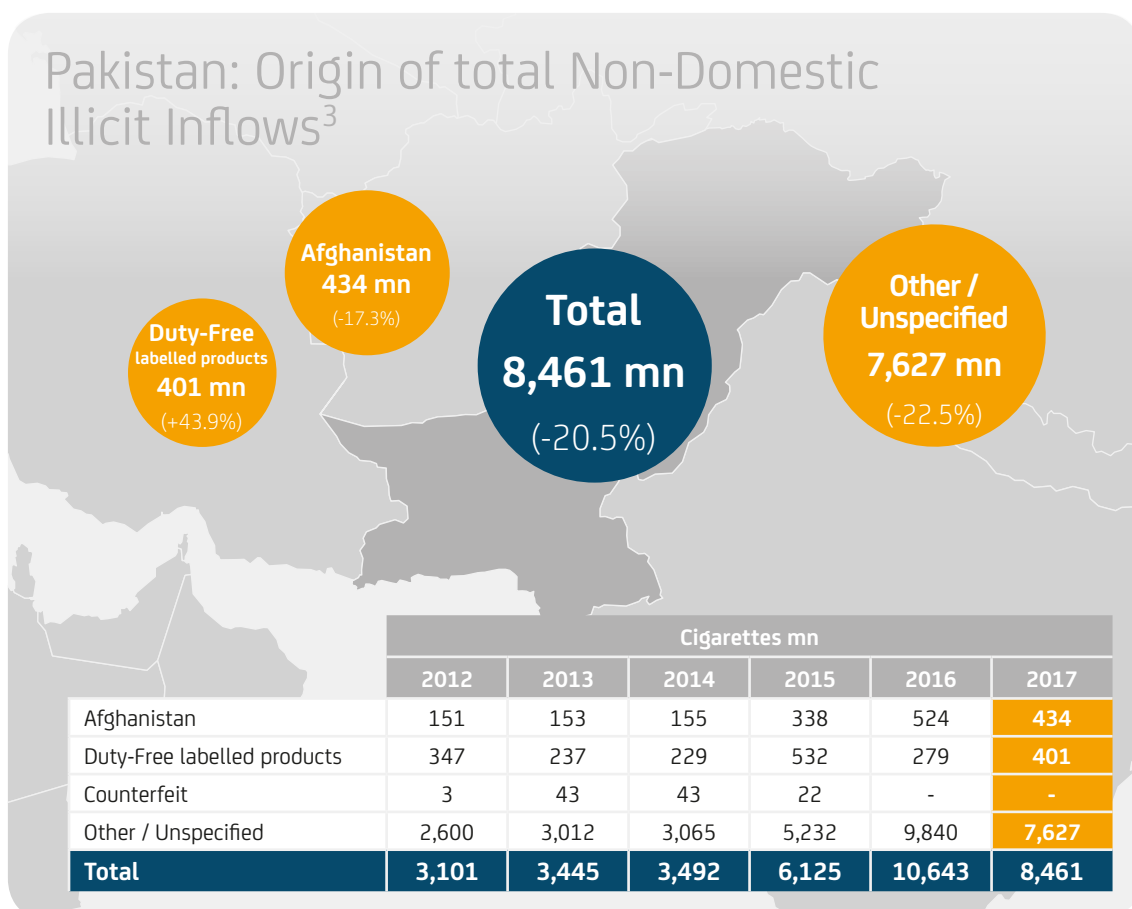
Pakistan: Actual government revenues and estimated Excise Tax Loss



Source: Pakistan Federal Board of Revenue and Oxford Economics based on PM data

Pakistan: Trade Flows

- Illicit Consumption of cigarettes in Pakistan was primarily composed of Domestic Illicit Consumption in 2017. Non-Domestic Illicit Consumption accounted for just over one-quarter of Total Illicit Consumption, equivalent to 8.5 billion cigarettes. Since the beginning of the Asia Illicit Tobacco Indicator research programme, this share has never increased above 30%.
- Overall, Non-Domestic Illicit Inflows declined by more than 20% in 2017, partially reversing some of the sharp rise in consumption experienced in 2016, but still significantly above previous years.
- The large majority of Non-Domestic Illicit Consumption was composed of Unspecified Market Variant products, an observation consistent with previous years. The most prevalent brands of Unspecified Market Variant cigarettes found in the Empty Pack Survey included “Pine” – which accounted for 46.5% of total Inflows – “Dunhill”, and “Benson & Hedges”.¹
- In total, over 85% of Non-Domestic Illicit was composed of Unspecified Market Variant products. However this share declined from 2016 following the 43.9% increase in the volume of Duty-Free labelled products. The Duty-Free labelled products were primarily of European and South Asian origin, consistent with the profile of inbound visitor arrivals by destination.
- The number of cigarettes entering Pakistan from Afghanistan declined by 17.3% in 2017, after rising by more than 50% in the previous year. However, the volume of Non-Domestic Illicit Inflows from Afghanistan is likely to be much higher than this, with anecdotal evidence suggesting that Afghanistan is a significant transit market for Contraband cigarettes entering Pakistan, including Unspecified Market Variant brands such as “Pine”.²
- No Counterfeit cigarettes were again identified by the Empty Pack Survey in 2017.



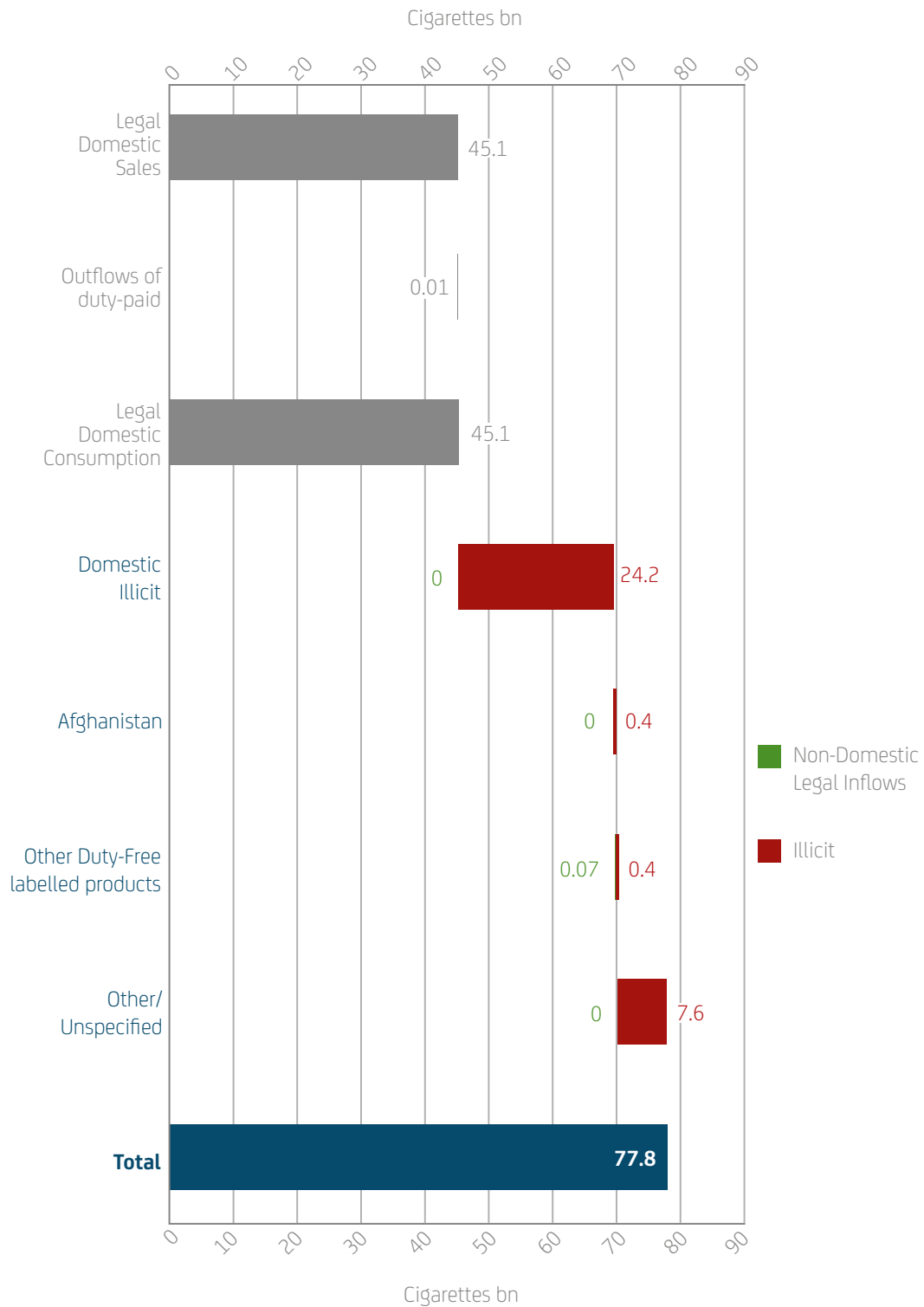
Source: IT Flows Model and Oxford Economics

¹Unspecified 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.

²See Nielsen (2015), The Challenge of Illicit Trade in Cigarettes: Impact and Solutions for Pakistan <http://customsnews.pk/wp-content/uploads/2015/09/Illicit-Tobacco-Trade.pdf>

³Figures in brackets reflect % change from 2016.

Pakistan: Consumption breakdown 2017

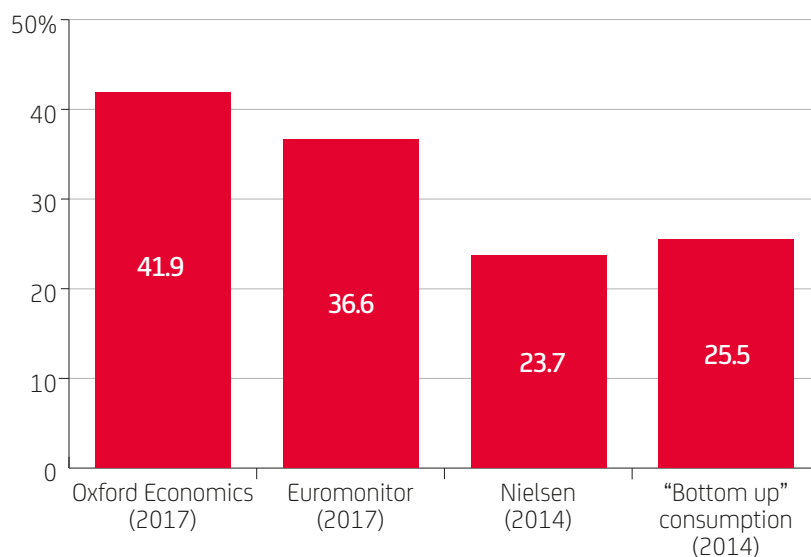


Source: IT Flows Model and Oxford Economics

Pakistan: 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 the Illicit Incidence of 25.5%, or around 21.5 billion cigarettes (based on 2014 LDC). The source for Smoking Prevalence is the WHO FCTC 2018 report (based on the Global Adult Tobacco Survey, 2014), and daily cigarette consumption data comes from Consumer Survey data for 2017.
Euromonitor Passport, 2018	Euromonitor estimates an Illicit Incidence of 36.6% in 2017. The methodology, sampling, and coverage are unknown, so it is difficult to assess the robustness of this estimate.
Nielsen (2015), The Challenge of Illicit Trade in Cigarettes: Impact and Solutions for Pakistan. Retrieved via http://customnews.pk/wp-content/uploads/2015/09/Illicit-Tobacco-Trade.pdf	Based on analysis of the retail audit conducted in 2014, Nielsen found an Illicit Incidence of 23.7% in Total Consumption.
Industry majors, via Business Recorder, 2017	Industry estimates suggested that 40% of cigarettes sold in Pakistan were non-duty-paid in 2016. This was in line with our estimate for 2016, which found that 43.7% of Total Consumption was illicit. The same analysis suggested that the Tax Loss due to Illicit Consumption was PKR 47 billion, again close to our estimate of Tax Loss for 2016.

Pakistan: Alternative estimates of Illicit Consumption



Pakistan: Data Sources

	Primary source	Calculation	Comments
Legal Domestic Sales (LDS)	Actual shipments for PM and BAT brands based on industry exchange (PM volume is based on tax-paid shipments and BAT volume is based on factory clearance).	—	—
Outflows of domestic duty-paid cigarettes	Empty Pack Survey data in other markets covered in this Report.	Empty Pack Survey data in other markets used to identify the presence of packs bearing Pakistan market-specific labelling (e.g., health warnings, tax stamps, etc.).	Limited number of Pakistan Market Variant cigarettes identified in other markets covered in this Report.
Legal Domestic Consumption (LDC)	—	Legal Domestic Sales minus Outflows of legal sales.	Limited Outflows of duty-paid cigarettes, so Legal Domestic Sales and Legal Domestic Consumption closely aligned.
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 UNWTO and OE Tourism Model.
Non-Domestic Illicit	Empty Pack Survey.	Based on Empty Pack Survey plus Pakistan retail audit and OE estimates.	Estimate derived from the 2017 Q4 Empty Pack Survey. Estimated illicitly imported Non-Domestic cigarettes are relatively modest as a share of consumption. See Report methodology for more details.
Domestic Illicit	Nielsen Retail Audit.	Based on augmentation of retail audit.	Illicit cigarettes in Pakistan are mostly domestically produced with a 74.1% share in Total Illicit Consumption.
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 77.8 billion cigarettes for 2017.
Total Tax Loss	—	Total Illicit Consumption multiplied by the weighted average tax rates (Excise Tax and GST).	See Report methodology for more details.

**OXFORD ECONOMICS
(HEADQUARTERS)**

Abbey House, 121 St Aldates
Oxford, OX1 1HB, UK

Email: mailbox@oxfordeconomics.com

Tel: +44 1865 268900

LONDON

Broadwall House, 21 Broadwall
London, SE1 9PL, UK

NEW YORK

5 Hanover Square, 8th Floor
New York, NY 10004, USA

SINGAPORE

6 Battery Road
#38-05
Singapore 049909

illicittobacco.oxfordeconomics.com

www.oxfordeconomics.com