
Levant Illicit Tobacco 2019



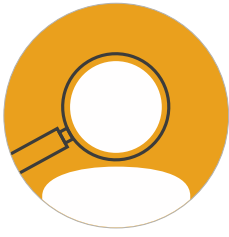
Prepared by Oxford Economics
March 2020



Disclaimer

The Levant Illicit Tobacco Report 2019 (the “Report”) 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 industry stakeholders.

OE prepared the Report in accordance with specific terms of reference agreed between Philip Morris Products SA (PM), JT International SA (JTI), British American Tobacco ME DMCC (BAT), and OE. Financial support for the Report was provided by PM, JTI, and BAT. OE assume all responsibility for the Report analysis, findings, and conclusion.



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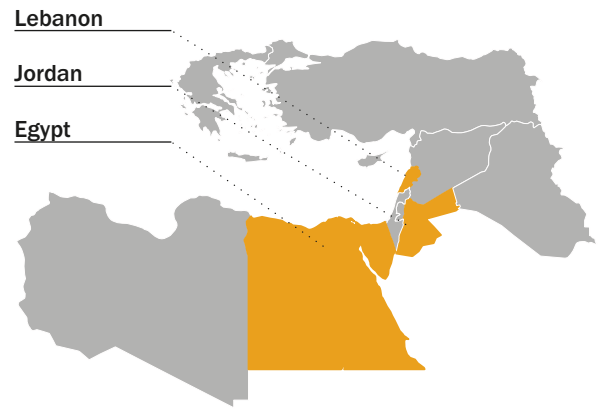
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METHODOLOGY





Methodology: Scope



This Report provides an overview of the nature of illicit trade in cigarettes across three markets in the Levant region: Egypt, Jordan, and Lebanon. It establishes estimates of Illicit Consumption in each market and the impact it has on government tax revenue. To this end, the purpose of this Report is to:

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- Establish and validate Illicit Incidence levels, reviewing and refining estimates using available sources such as Empty Pack Surveys (EPS).
 - Estimate the volume of Illicit Consumption, including where possible a breakdown by Market Variant.
 - Estimate the annual government Tax Loss from indirect taxes on cigarettes including Excise Tax, Earmarked Tax, and VAT as applicable.
-

Our study makes use of the latest available data, including full-year estimates for cigarette sales and EPS data from 2016 to 2019. As such, the Report provides insights into the developments of both Illicit Consumption and Total Consumption over time.



Methodology: Overview

Oxford Economics developed an Illicit Trade Flows Model to estimate the size and scale of Illicit Consumption in Egypt, Jordan, and Lebanon:

- Estimates of **Legal Domestic Sales (LDS)** were derived through a combination of In-Market Sales (IMS) data, retail audits, and industry market intelligence.
- With zero inter-market movement of cigarettes identified, LDS was assumed to equal **Legal Domestic Consumption (LDC)** in each market.¹
- EPS's were used to establish robust estimates of the incidence of Non-Domestic Inflows. Incidence levels were applied to LDC to estimate the volume of total Non-Domestic consumption.
- Estimates of the volume of **Non-Domestic Legal** consumption in each market were derived using passenger data, Smoking Prevalence rates, and passenger duty-free personal import allowance limits.
- The estimates of Non-Domestic Legal were netted off the volume of total Non-Domestic to derive an estimate for **Non-Domestic Illicit** consumption.
- Disaggregated EPS data were used to provide a breakdown of Non-Domestic Illicit i.e., Counterfeit, Contraband, and Non-Domestic Illicit with Unspecified Market Variant, also known as "Illicit Whites".
- **Domestic Illicit** is assumed to be negligible in each market based on EPS data and industry market intelligence.²
- **Total Consumption** is finally derived as the sum of LDC, Non-Domestic Legal and Non-Domestic Illicit.
- Weighted-average Excise, Earmarked and VAT tax rates—estimated using cigarette prices, LDS, and the prevailing tax systems in each market—were applied to Illicit Consumption to estimate the Tax Loss.
- Throughout this Report, figures presented in tables and charts may not add up due to rounding.

¹ This Report only considers Outflows to other markets included in the Levant Illicit Tobacco Report. Furthermore, only packs that are identified as coming from a specific market through pack markings are attributed as a Market Variant. Cigarettes where the market of intended retail is unknown, such as packs produced for export with generic pack markings, or cigarettes of Unspecified Market Variant, are not considered as part of this analysis. As such, the estimated volume of Outflows of legal sales to other markets is likely to under-represent the true volume of Outflows.

² It is understood however that in some markets, cigarettes are manufactured and distributed in the domestic market despite being designated for export, and are therefore recorded as Non-Domestic Illicit in the EPS.





Methodology: Empty Pack Surveys

SURVEY DESIGN

- Manufacturers commission an independent research agency to conduct an EPS.
- The agency determine a sampling plan for each market, including the sample size and choice of population centres.
- Quota's for collection in each population centre are designed to be proportional to its population size to ensure the sample is statistically representative of the market.
- Collection dates are chosen to avoid public holidays or special events that may distort the results.

FIELD WORK

- Population centres are divided into sectors (North, South, East, West, Central), and neighbourhoods are selected at random to survey. Locations such as sports stadium and train stations are excluded.
- From a pre-defined starting point, collectors follow a fixed route to ensure all neighbourhood's are surveyed.
- Discarded cigarette packs from streets and public bins are collected, covering all brands without bias. Homes and workplaces are excluded.
- Neighbourhoods are revisited as many times as necessary until collection quotas are fulfilled.

PACK ANALYSIS

- Empty packs are shipped to a central location, where they are bagged, cleaned, and the details of each pack recorded. Individual pack characteristics are used to determine the intended market of final retail sale of each pack.
- Product experts from the participating manufacturers review their packs in order to identify the presence of Counterfeit cigarettes.
- The final results are provided to Oxford Economics for further analysis.

Methodology: Glossary

BAT British American Tobacco.

bn Billion.

CIF Cost, Insurance, and Freight.

Contraband Genuine product that has been bought in a low-tax market and which exceeds the legal border limits, or is acquired without payment of taxes for export purposes to be illegally re-sold (for financial profit) in a higher-priced market. There are generally two types of Contraband: Bootlegging and wholesale smuggling.

Counterfeit Cigarettes that are illegally manufactured and sold without permission of the trademark rights holder.

Customs Duty Duty payable when a good enters a country from overseas.

Domestic Illicit Cigarettes that are legally produced by trademark rights holder to be illegally sold and consumed in the same market.

Duty-Free Purchases made outside the domestic market that have no state, local, or provincial taxes, import duties, or any other type of taxation added, and are subject to purchase volume restrictions.

Earmarked Tax Taxes whose revenues are reserved for a specific group or use.

Empty Pack Survey (EPS) Independent research agencies collect empty cigarette packs discarded by smokers in public places and record brands and Market Variants.

Excise Tax An indirect tax on the consumption of certain goods. Excise Taxes on cigarettes can be either specific, i.e., expressed as a monetary amount per quantity/weight of the product; ad-valorem, i.e., expressed as a proportion of the value of a product; or a combination of both.

FTC The WHO Framework Convention on Tobacco Control.

FDI Foreign Direct Investment.

Illicit Consumption Consumption of Non-Domestic Illicit (Counterfeit, Contraband, and Non-Domestic with Unspecified Market Variant cigarettes) and Domestic Illicit cigarettes or loose tobacco. Typically, taxes applicable in the market where illicit cigarettes/ tobacco are consumed are not paid.

Illicit Whites Cigarettes that are usually produced legally in one market, primarily for smuggling. While they may also be exported legally from some countries, they are smuggled across borders during their transit to the final market of sale where they have no legal distribution and are sold without payment of tax.

IMF International Monetary Fund.

In-Market Sales (IMS) Primary source of Legal Domestic Sales volumes.

Inflows/Outflows Inflows of Non-Domestic product into a market/ Outflows of product from a market.

Illicit Trade Model Model developed for this Report to estimate Illicit Consumption in markets and trade flows between the markets included in this Report.

JTI Japan Tobacco International SA.

LHS Left Hand Side.

Legal Domestic Consumption (LDC) Defined as Legal Domestic Sales net of Outflows.

Legal Domestic Sales (LDS) Sales of genuine domestic tax-paid product through legitimate, domestic channels.

Market Share The proportion of total market sales, expressed as a percentage, accounted for by a particular company, product, or brand.

Market Variant Term used to designate the market in which a pack of cigarettes was initially intended to be sold. To be sold in a given market, a pack has to bear the required labelling (e.g., health warning) and potentially a tax stamp or a banderol. The EPS methodology estimates the incidence of packs by Market Variant. As such, packs that do not bear the health warning and/or stamp required in the given market are considered Non-Domestic.

Most Sold Brand (MSB) Cigarette brand variant with the largest annual legal sales volume in a given market.

mn Million.

Non-Domestic Product that was not originally intended for the market in which it is consumed.

Non-Domestic Illicit Counterfeit, Contraband, and imports of other illicit cigarettes.

Non-Domestic Legal Product that is brought into the market legally by consumers, such as during a cross-border trip, subject to duty-free allowance.

Oxford Economics Tourism Model A comprehensive data set of tourism metrics covering 190 countries and 20 years of detailed historical data.

PM Philip Morris Products SA.

pp Percentage points.

RHS Right Hand Side.

RSP Retail Sales Price.

Smoking Prevalence The percentage of smokers in the total adult population.

Tax Loss Government revenues that are lost due to tobacco tax (Excise Tax, including Earmarked Taxes, and VAT/GST/ sales tax) that is not paid on illicit cigarettes.

Total Consumption Total Consumption of legal and illicit cigarettes in a market or 3 markets included in this Report.

UN The United Nations.

Unspecified Market Variant Unspecified Market Variant refers to cigarette packs that do not bear specific market labelling or Duty Free labelling. The intended market is not known.

VAT Value-Added Tax.

WHO World Health Organisation.

EXECUTIVE SUMMARY





Executive Summary:

An environment for illicit trade

Social, political, and economic environment

Economic growth has suffered through bouts of regional instability—with the Syrian conflict weighing on confidence and activity in neighbouring Jordan and Lebanon, and leading to large inflows of refugees. IMF-supported reform programs continue to support macroeconomic stability in Jordan and Egypt, but the need for fiscal austerity will negatively impact household incomes across Egypt, Jordan, and Lebanon. Egypt is expected to remain the fastest growing economy, but also the poorest.

Civil unrest has been a feature in Egypt, Jordan, and Lebanon—although to varying degrees—amid dissatisfaction with authorities and high levels of perceived corruption.¹ The highly partisan political system in Lebanon stands out as particularly volatile, while in Jordan, King Abdullah retains strong popularity which provides for a more stable political outlook.

Enforcement, border control, and regulatory framework

Both Egypt and Lebanon perform poorly in global benchmarks comparing government effectiveness, regulatory quality and rule of law.² Jordan's legal framework is more efficient by comparison, and recent Customs Law amendments have strengthened penalties and enforcement powers in the fight against illicit trade.

The performance of trade handling and border control is held back by poor infrastructure and inefficient customs procedures—further complicated by long international borders with conflict-ridden states.³ In Lebanon, there are an estimated 124 illegal crossings with Syria that are frequently used to smuggle illicit goods,⁴ while the inhospitable nature of Western Egypt makes policing the border with Libya almost impossible.⁵

International and domestic cooperation

All three countries are yet to sign the WHO Protocol to Eliminate Illicit Trade in Tobacco Products, although Egypt has taken steps to more closely align with the protocol directives. In Jordan and Lebanon, domestic coordination and anti smuggling efforts have intensified in recent years in recognition of the important contribution of legitimate tobacco taxes on government revenues in both countries.

Nominal GDP per capita
in Egypt was

USD **2,800**

in 2018, around
1/3 of Lebanon and
2/3 Jordan

Jordan performs
better than

68%

of all countries in the
world on corruption
perceptions

Lebanon ranks below

74%

of all countries in the
world for government
effectiveness

1 Transparency International: Corruption Perceptions Index.

2 The World Bank: Worldwide Governance Indicators.

3 The World Bank: Logistics Performance Index.

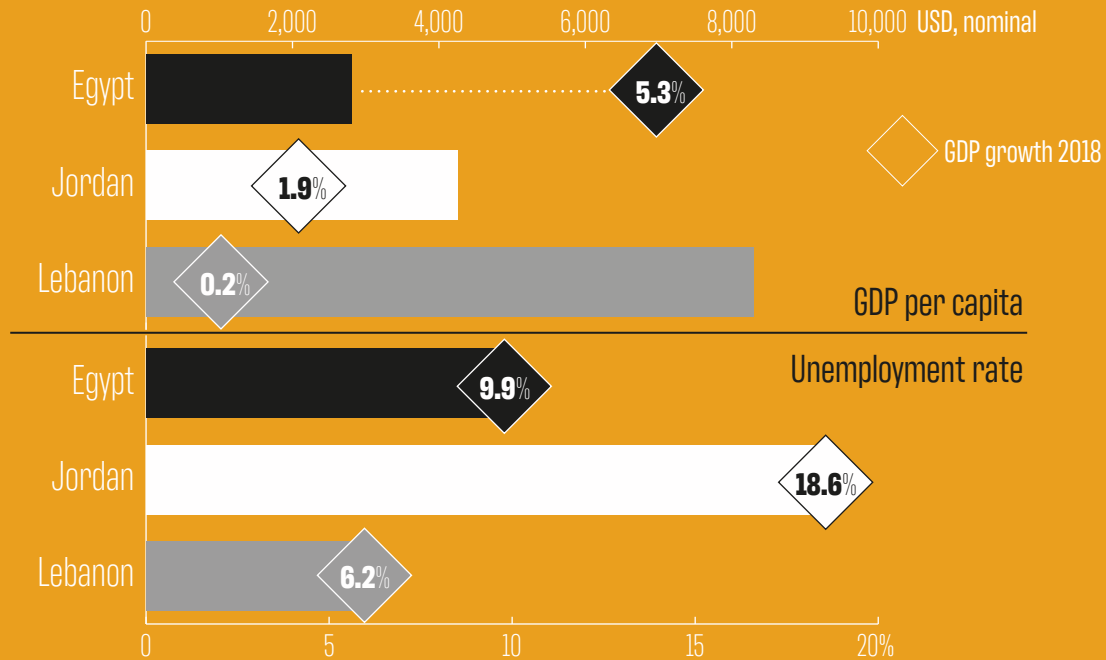
4 Finance Minister Ali Hassan Khalil, via <https://aawsat.com/english/home/article/1777726/124-illegal-border-crossings-between-lebanon-syria-increase-deficit>.

5 See <https://www.atlanticcouncil.org/blogs/menasource/nato-countries-should-help-egypt-mitigate-security-challenge-near-libyan-border/>.



Executive Summary: An environment for illicit trade

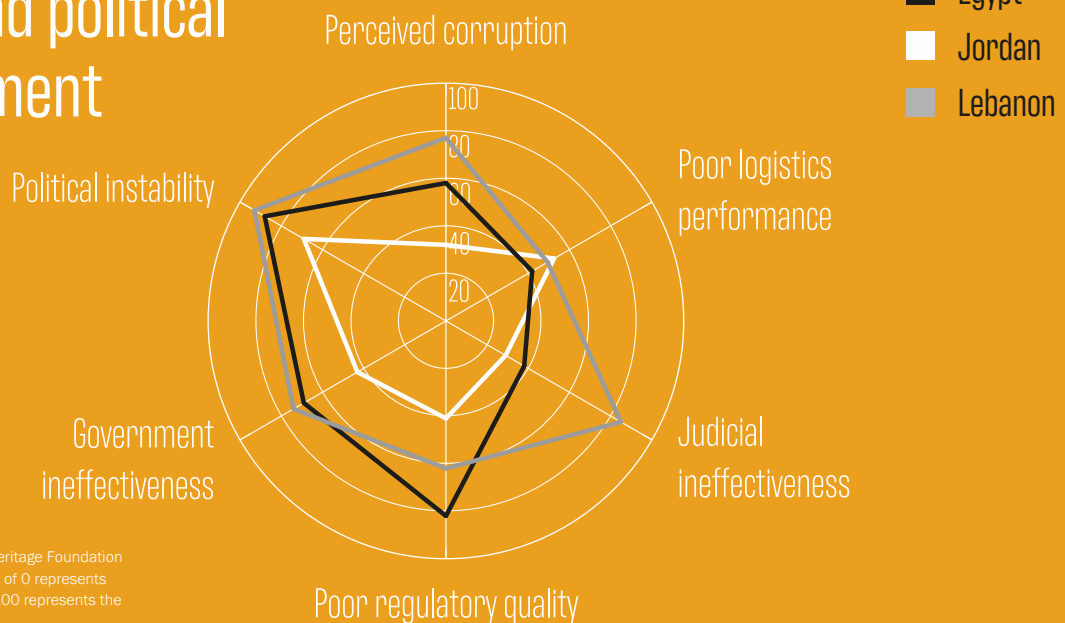
Economic environment 2018



Source: Oxford Economics/Haver Analytics — More details for each market — presented in market summaries

Economic growth in Egypt has consistently outperformed both Lebanon and Jordan in recent years, yet it remains the poorest economy.

Social and political environment



Source: World Bank/Transparency International/Heritage Foundation
Scores are based on global ranking, where a score of 0 represents the top ranked and best performing country, and 100 represents the lowest ranked and worst performing country.

Lebanon represents the riskiest market across the majority of social and political risk benchmarks.



Executive Summary: Legal Domestic Sales

- **Egypt is the largest market included in this Report. LDS in 2018 was estimated at 84.8bn cigarettes**, rising steadily over recent years. Sales are primarily composed of brands within the low-value price segment, underpinned by the brand “Cleopatra”—manufactured by the state-owned company Eastern Tobacco—which is the Most Sold Brand (MSB) in Egypt. The Retail Selling Price (RSP) of “Cleopatra” cigarettes was USD 0.90 per pack of cigarettes in 2018 and 2019.¹ Eastern Tobacco is the only licenced cigarette manufacturer in Egypt.
- **LDS in Jordan was estimated at 11.6bn cigarettes in 2018, falling by 4.0% in comparison with 2017.** Two international manufacturers account for over 80% of LDS: JTI and PM. A decline in affordability of cigarettes—underpinned by a sharp rise in prices—as well as an influx of Syrian refugees, has supported a trend of increasing consumption of low-value cigarette brands in recent years.² In total, 56% of LDS was composed of low-value brands in 2018, up nearly 10pp from 2014. A pack of the MSB of cigarettes cost USD 2.82 in 2018—higher than most neighbouring markets including Iraq and Syria—increasing the incentive for cross-border smuggling. Both are major origin markets for Non-Domestic Inflows according to the EPS.
- **An estimated 10.0bn cigarettes were legally sold in Lebanon in 2018, with LDS rising by 8.3% in comparison with 2017.** The state-owned manufacturer Regie Libanaise de Tabacs et Tombacs (RLTT)—also responsible for regulating the industry and overseeing anti-smuggling activities—accounted for nearly two-thirds of total LDS in 2018. LDS have undergone a dramatic shift in composition in recent years, with low-value brands accounting for nearly 70% of LDS in 2018, up from just one-quarter in 2010. In 2018, the MSB was a low-value brand, with a RSP of USD 0.49 per pack. The RSP of the cheapest available brand, at just USD 0.33 per pack, was over 85% lower than the premium-value brand—one of the largest levels of price disparity evident across the Levant region and a key driver behind the recent trend of consumer downtrading in Lebanon.

Low-value brands
account for

72%
of total LDS in Egypt³

In Jordan it requires

6.5%
of annual income to
purchase 100 packs
of the MSB

The RSP of the cheapest
brand is

14%
of the premium brand
in Lebanon

¹ For the purposes of this Report, a pack consists of 20 cigarettes. Data from the WHO report on the global tobacco epidemic 2019.

² Based on the “Relative Income Price” (RIP), a measure of affordability that considers the amount of per capita income required to purchase 100 packs of the MSB of cigarettes.

In Jordan, the RIP rose to 6.5% in 2018, up from 4.1% just 5 years prior.

³ Low, mid, and premium value price segments based on industry definitions.



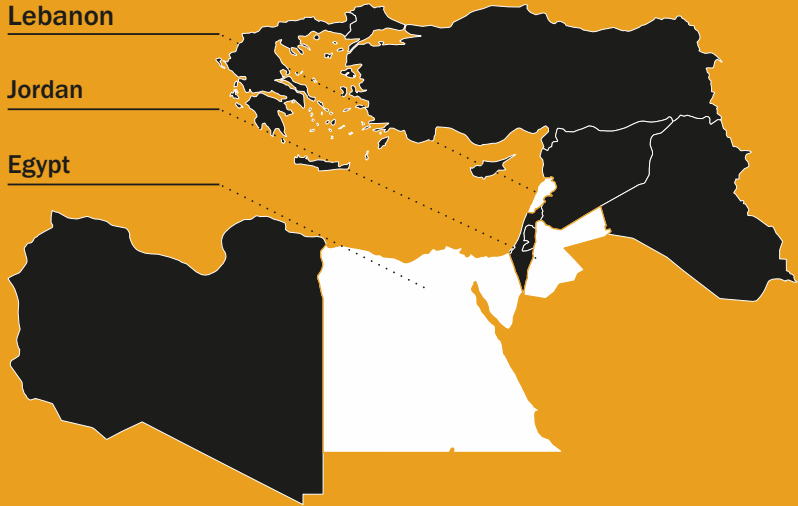
Executive Summary:

Markets

Lebanon

Jordan

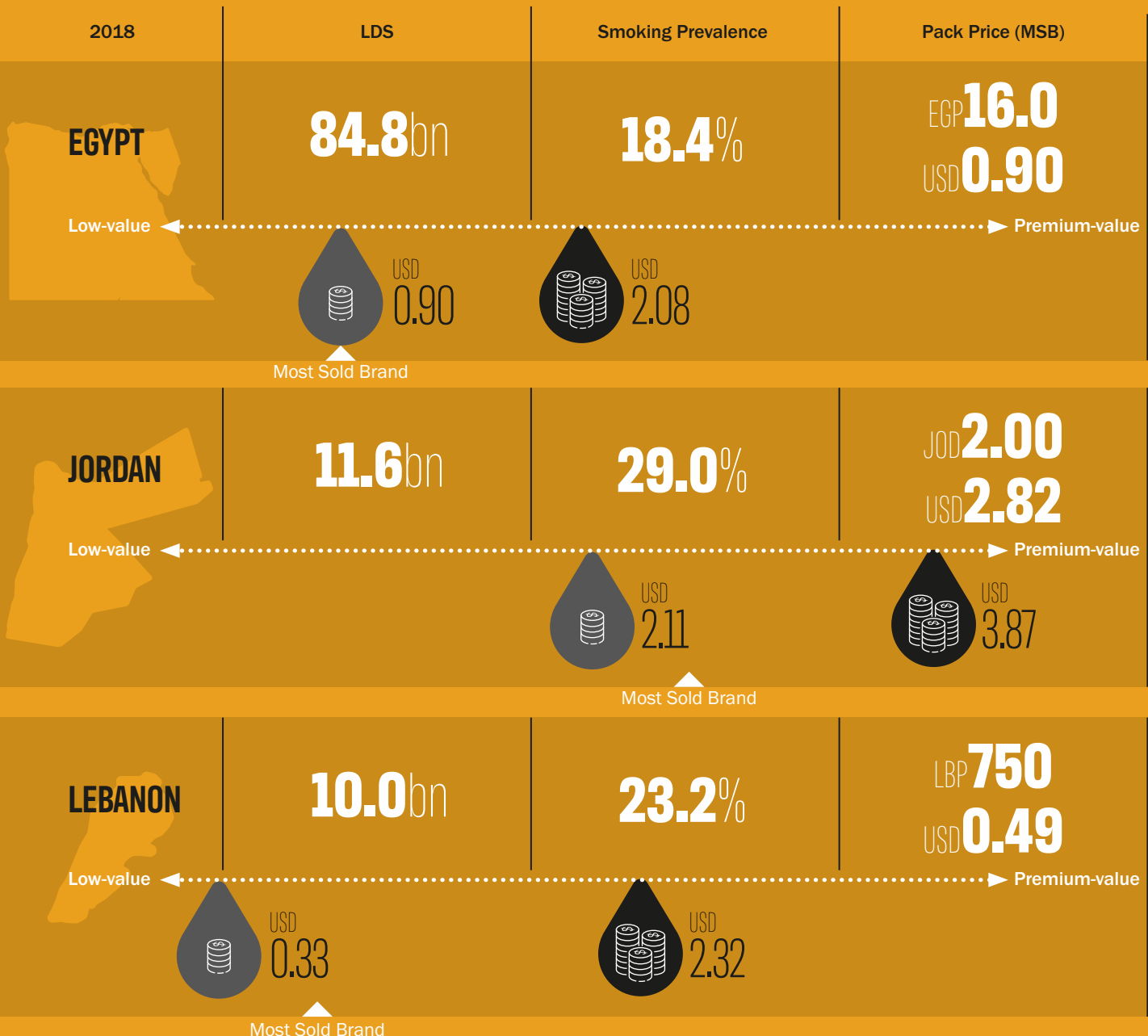
Egypt



Cheapest brands (USD)



Most expensive brands (USD)



Source: Oxford Economics based on industry data, Euromonitor, RLTT, and the WHO report on the global tobacco epidemic 2019.



Executive Summary: Cigarette Consumption

Of the three markets included in this Report, **Egypt is significantly the largest in terms of Total Consumption**. An estimated 88.3bn cigarettes were consumed in 2018 in Egypt, six times more than in Jordan (12.6bn) and Lebanon (14.2bn). However, on a per capita basis, cigarette consumption in Egypt is below that in Jordan and Lebanon, owing to a relatively lower Smoking Prevalence rate of 18.4%. **Per capita consumption is highest in Lebanon.**

Egypt also displays the lowest level of Illicit Consumption of the three markets. **In total, an estimated 3.5bn illicit cigarettes were consumed in Egypt in 2018, representing 3.9% of Total Consumption**. This is underpinned by the low RSP of cigarettes in Egypt, reducing the incentive for cross-border smuggling. However, Illicit Consumption has increased in recent years, a trend that continued at the beginning of 2019. Analysis of the **2019 Q1 EPS indicates that Illicit Incidence rose to 6.4%**, representing a 5.7pp increase in less than 2 years from 0.7% in 2017.

Illicit Consumption has also risen in Jordan over the period for which this Report covers. **In 2018, Illicit incidence was 7.0% in Jordan, equating to nearly 900 million illicit cigarettes consumed**. This represented an increase of more than one-third in comparison with 2017, equivalent to an increase in illicit incidence of 1.9pp. Moreover, the **2019 EPS data (Q1 and Q3) indicate a very dramatic further rise in Illicit Consumption**, an observation that coincided with the re-opening of international borders with neighbouring countries Iraq and Syria. In total, an estimated 27.3% of Total Consumption in the first three quarters of 2019 was of illicit origin, which equates to many more illicit cigarettes consumed than in the previous three years combined.

In Lebanon, Illicit Incidence has consistently exceeded 20% for the three years covered by this Report, peaking at 25.9% in 2018. **This is equivalent to nearly 3.7bn illicit cigarettes, or more than one-in-every-four cigarettes consumed in the year**. This has steadily risen over the three year period, up from 21.9% in 2016, prompting the RLTT to launch the First National Conference Against Illicit Trade in 2018—an initiative encouraging different public and private sector bodies to collaborate and tackle illicit trade.¹ Illicit Consumption is estimated to have increased again in 2019, with analysis of the 2019 Q2 EPS indicating a rise in Illicit Incidence to 28.1%.

¹ See <https://www.rltt.com.lb/Article/291/the-first-national-conference-against-illicit-trad/en>.

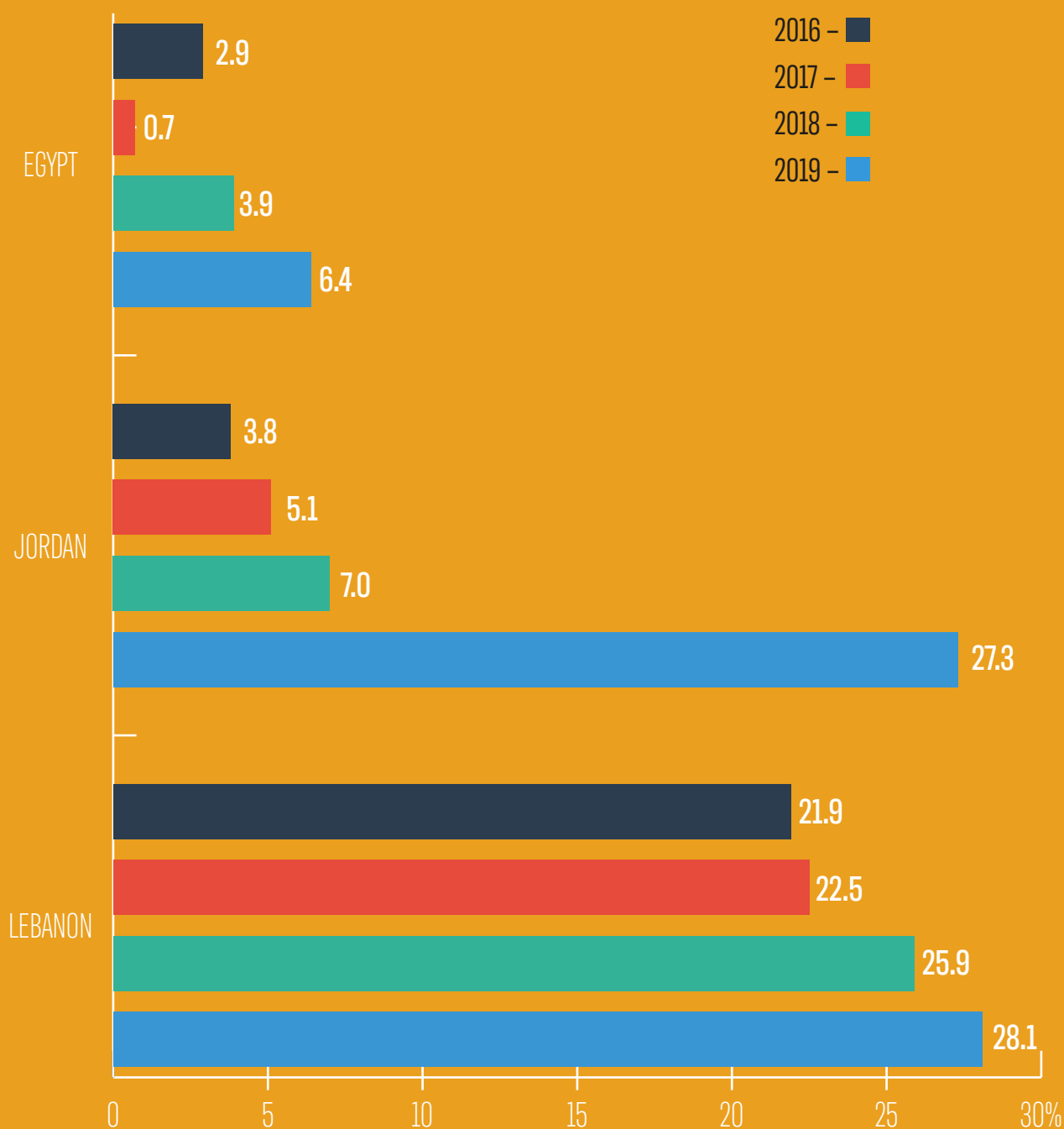
In 2018, an estimated
3.5bn
illicit cigarettes were
consumed in Egypt

Illicit Incidence in Jordan
rose by
20.3pp
in 2019

Illicit Incidence in
Lebanon rose to
25.9%
in 2018



Illicit Incidence (% of Total Consumption)



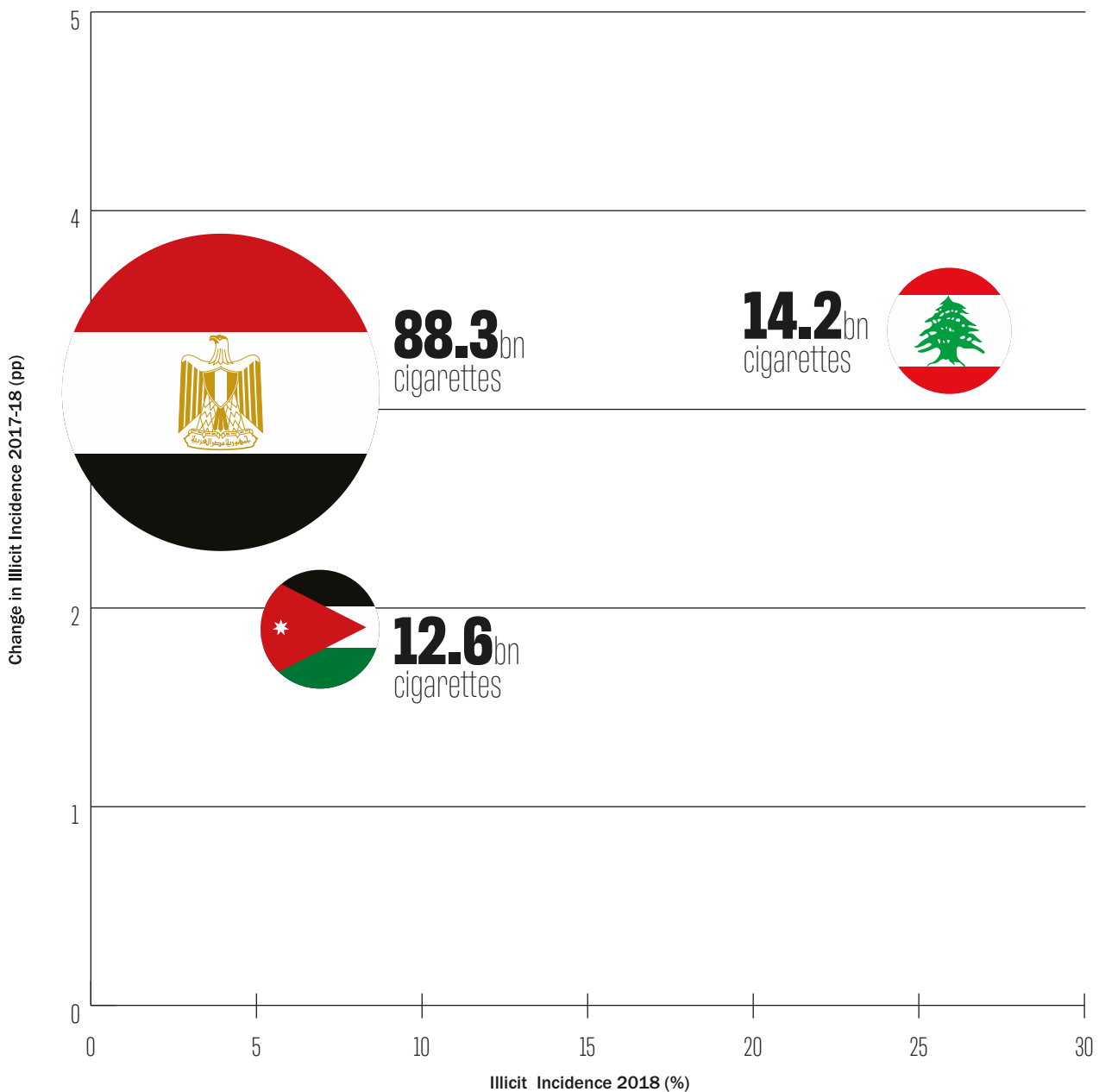
Illicit Incidence has steadily risen across all markets since 2016, with Jordan experiencing significant growth in 2019.

Source: Oxford Economics
2019 Q1 data was available for Egypt. 2019 Q2 data was available for Lebanon, and 2019 Q1 and Q3 data was available for Jordan.



Market size and Illicit Incidence, 2018

Size of bubble indicates volume of Total Consumption in 2018¹



Source: Oxford Economics
Based on 2018 data, the latest full year for which data is available in all markets.



Executive Summary:

Illicit Trade Flows

Illicit Consumption in the three markets included in this Report is composed entirely of non-domestic cigarettes that are not originally intended for the market of final retail and/or where the applicable tax has not been paid.¹

Results from the EPS's are analysed to provide a breakdown of Illicit trade flows into four primary categories:

- **Unspecified Market Variant:** Nearly 45% of total illicit Inflows across Egypt, Jordan, and Lebanon were identified as Unspecified Market Variant in 2018. This means that the intended market of final retail was unknown. In Egypt, nearly 96% of Illicit Consumption was Unspecified Market Variant, underpinned by the growing popularity of the 'Pine' brand, which has entered the market and attained significant Market Share since 2017.
- **Contraband:** There was also significant consumption of Contraband cigarettes across the three markets, accounting for a further 40% of total Illicit Consumption. In Lebanon, nearly 2.9bn Contraband cigarettes were consumed in 2018, the majority of which were identified as Iraq Market Variant cigarettes. 'Elegance' was the most prevalent Iraq Market Variant Contraband brand of cigarettes identified in the EPS data, consumed in large quantities in both Jordan and Lebanon.
- **Duty-Free labelled products:** Cigarettes initially intended for Duty-Free retail, but consumed in quantities exceeding levels that would be expected given the prevailing purchase volume restrictions, were identified in Jordan and Lebanon.² In Jordan, over three-quarters of Illicit Consumption was composed of Duty-Free labelled products.
- **Counterfeit:** A small volume of Counterfeit cigarettes were identified in Jordan and Lebanon only. In both markets, Counterfeit cigarettes represented less than 1% of Total Consumption.³

In 2018, an estimated

3.3bn

illicit Unspecified Market Variant cigarettes were consumed in Egypt

Iraq Market Variant cigarette brands accounted for

64.3%

of Illicit Consumption in Lebanon in 2018

Duty-Free labelled products accounted for

75.8%

of total Illicit Consumption in Jordan in 2018

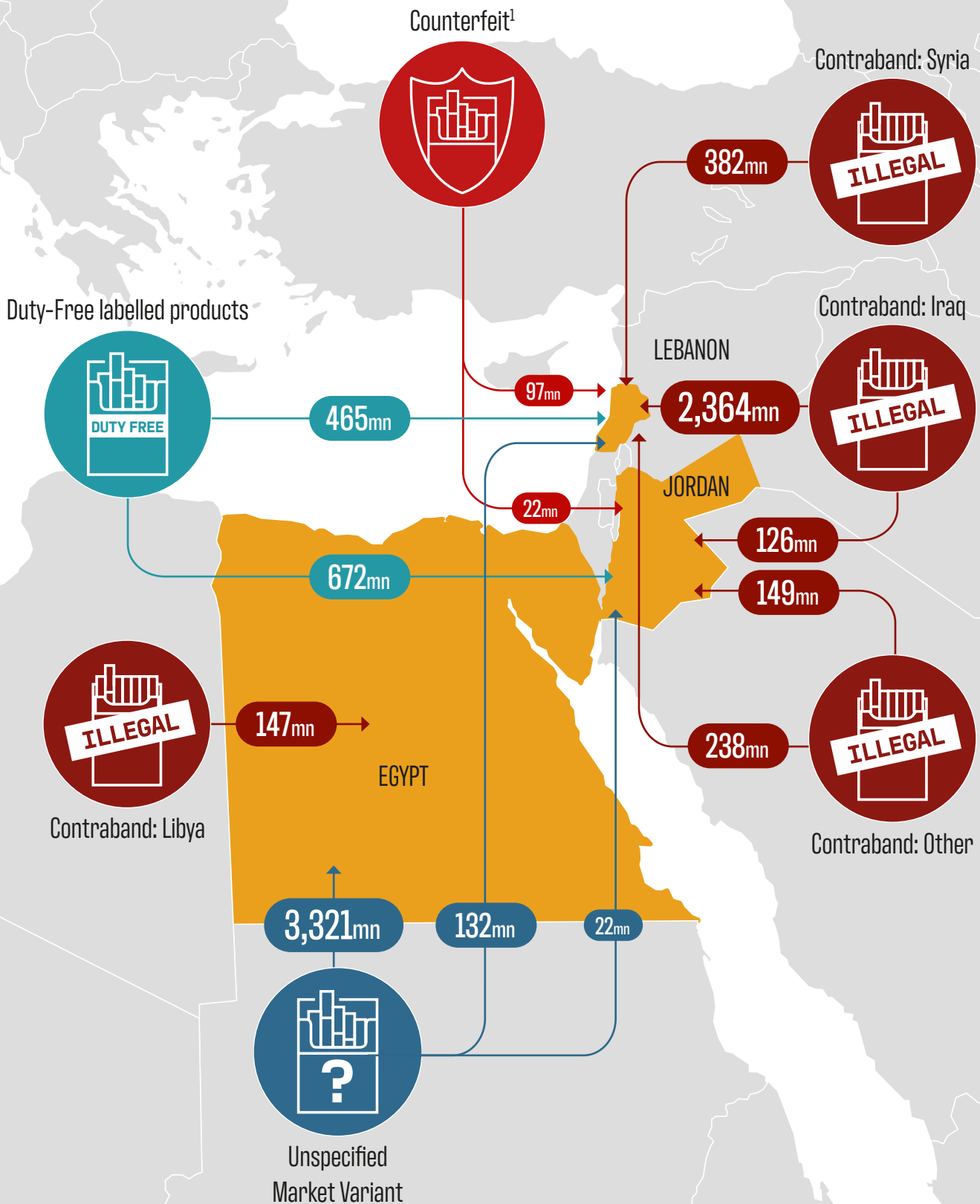
¹ It is assumed that there was zero Domestic Illicit Consumption across all three markets.

² Estimates of the volume of Non-Domestic Legal consumption in each market were derived using passenger data, Smoking Prevalence rates, and passenger duty-free personal import allowance limits.

³ Cigarette packets collected during the EPS are forensically analysed by the participating companies only to identify Counterfeit products, and may therefore underestimate the true volume of Counterfeit consumption.



Executive Summary: Illicit Trade Flows in Levant Markets



¹ origin unknown.



Executive Summary:

Combatting Illicit Trade: A contribution from TRACIT¹

Illicit Trade: an overview

Illicit trade is a global phenomenon with numerous manifestations and implications. It comprehends a broad scope of illegal activities and serious crimes, ranging from organized crime, corruption, money laundering, financing of terrorist organizations, human trafficking, etc. From a business perspective, illicit trade undermines the sustainability of legitimate industries such as pharmaceuticals, tobacco, alcohol, entertainment content, petroleum, fishing, forestry, agri-foods, diamonds and pesticides—just to name a few.

The damaging impact of illicit trade finds expression at many different levels: it exposes consumers to poorly made, unregulated products; drains GDP; robs governments of tax collections; clogs legitimate trade routes and internet bandwidth; etc. Above all, the socio-economic impacts of illicit trade present significant deterrence to achieving all 17 of the United Nations Sustainable Development Goals.

As such, illicit trade presents a major and growing policy challenge worldwide. It has grown well beyond the capabilities of individual governments and individual companies, and now demands a sustained, coordinated response.

Global Policy Recommendations

TRACIT has elaborated a set of **Global Policy Recommendations** that we encourage governments worldwide to consider as measures for strengthening their capabilities to mitigate illicit trade across all sectors vulnerable to illicit trade. These are derived from four categories, which we think underpin good government regulation of illicit trade: (i) government policy, (ii) supply and demand, (iii) transparency and trade, and (iv) customs environment.

In brief, the Recommendations focus on the following topics: 1. Commit to illicit trade related treaties; 2. Tighten controls on money laundering; 3. Eliminate corruption; 4. Rationalize tax policy; 5. Strengthen the customs environment; 6. Strengthen law enforcement efforts; 7. Protect Intellectual Property (IP); 8. Enhance interagency cooperation; 9. Improve governance of Free Trade Zones; 10. Report and share statistical data across borders.

¹ The Transnational Alliance to Combat Illicit Trade (TRACIT) is a private sector initiative to mitigate the economic and social damages of illicit trade by strengthening government enforcement mechanisms and integrating supply chain controls across industry sectors most impacted by illicit trade. TRACIT draws from industry strengths and market experience to build habits of cooperation between business, government, and the diverse group of countries that have limited capacities for regulatory enforcement. Connecting and mobilizing businesses across industries, sectors, and national borders makes it possible to achieve results more effectively than any single actor can accomplish alone. TRACIT works in 12 illicit trade sectors: Agri-food, Alcohol, Counterfeit and Piracy, Fisheries, Forestry, Petroleum, Pharmaceuticals, Precious Metals and Gemstones, Pesticides, Tobacco, Human Trafficking and Wildlife.



Specific Policy Recommendations to tackle illicit trade in tobacco products in the Levant Region

The historical background and current geopolitical situation in the Levant region dramatically influence the countries' capabilities to tackle illicit trade in tobacco products. In addition, there are substantial economic and regulatory drivers that make illicit trade in tobacco products alluring for criminal organizations. TRACIT considers that the Levant countries may consider the following measures to curb illicit trade in tobacco products:

- 1. Ratify and commit to the full implementation of the Protocol to Eliminate Illicit Trade in Tobacco Products:** This modern instrument contains specific provisions to fill the regulatory gaps that enable illicit trade in tobacco. In addition, it includes full-fledged legal basis to promote international cooperation between countries. A coordinated implementation of the Tobacco Protocol would dramatically increase the region's capabilities to tackle the problem, with complementary benefits to mitigating other forms of illicit trade in the region.
- 2. Strengthen law enforcement efforts:** Any sound strategy to curb illicit trade of any kind, including tobacco products, requires effective implementation of criminal laws. To this end, it is crucial to provide law enforcement agencies with the necessary resources, tools and capabilities to fulfil their mandate.
- 3. Eliminate corruption:** Corruption poses structural challenges to economic and social development, as it can divert resources beneficial to the wider economy; erode the effectiveness of rule of law; generally, unravel the social fabric of impacted economies; provoke instability; and undermine competition in global markets. It is thus critical that policies and controls targeted at preventing corruption contribute to reinforcing integrity in the global supply chain.
- 4. Improve governance of Free Trade Zones:** FTZs are entry and exit hubs, where a wide range of activities happen. But many FTZs have become vulnerable to criminal activity including the production of illicit tobacco. This is also the case in the Levant Region, where production of cheap whites is reported in the Zarqa (Jordan) and Al Fujairah (UAE) FTZs. TRACIT has intensively contributed to the development of the OECD Guidance for enhancing transparency in FTZs, and calls for a coordinated action aimed at identifying FTZs, evaluating government capabilities to implement the existent standards and working towards their implementation.



Executive Summary:

Taxation

The approach to cigarette taxation differs across the three Levant markets covered by this Report, although there are some similarities in the overall structure:

- Each market applies a mixed Excise Tax system that varies according to the RSP of cigarettes. In Egypt and Lebanon, the system includes both specific and ad-valorem components, while in Jordan a multi-tiered specific structure is applied.
 - Customs Duties are also applicable across all three markets. In Jordan and Lebanon, this varies according to the level of processing.
 - LDS in Jordan and Lebanon are subject to VAT rates of 16% and 11% respectively. There is no sales tax applied to cigarettes in Egypt.
 - Egypt is the only market to have implemented an Earmarked Tax—the revenues from which are channelled towards improving student and national health insurance coverage.
-

Cigarette prices in **Jordan are subject to the highest level of taxation as a share of the RSP**. In 2018, the total tax burden accounted for over 80% of the price of a pack of the MSB of cigarettes. This is closely followed by Egypt with a tax share of 77% of the RSP. In Lebanon, the share is closer to 46%.¹

The high share of taxation in Jordan and Egypt is mirrored by the relative **importance of cigarette taxation as a source of revenue for the government in these markets**. In 2018, LDS of cigarettes generated an estimated USD 983mn in Excise Tax revenues in Jordan, more than 15% of total central government tax revenues for the year.² In Egypt, an estimated USD 3.3bn was raised by Excise and Earmarked Tax in 2018, which represented nearly 9% of government revenues from taxation.³

Excise Taxes have risen in all three markets in recent years. In Egypt, the Excise Tax rate was increased in late-2017 as part of fiscal consolidation efforts, part of a wider economic reform program supported by the IMF. A new Earmarked Tax was also introduced in mid-2018 to help fund a new comprehensive national health insurance plan. In Jordan, the Excise Tax rate was increased in January 2018 as part of a major IMF-recommended fiscal reform package aimed at reducing the public deficit and controlling debt levels. In Lebanon, Customs Duties on imported cigarettes and tobacco were increased in the 2019 budget, while the rate of VAT was increased in 2018 (although this was offset by a reduction in the ad-valorem component of the Excise Tax rate).

An increasing trend of consumer downtrading to lower-value cigarette brands (implying a lower tax yield per cigarette) has squeezed the impact of rising taxes on government revenues. This is particularly evident in Jordan and Lebanon.

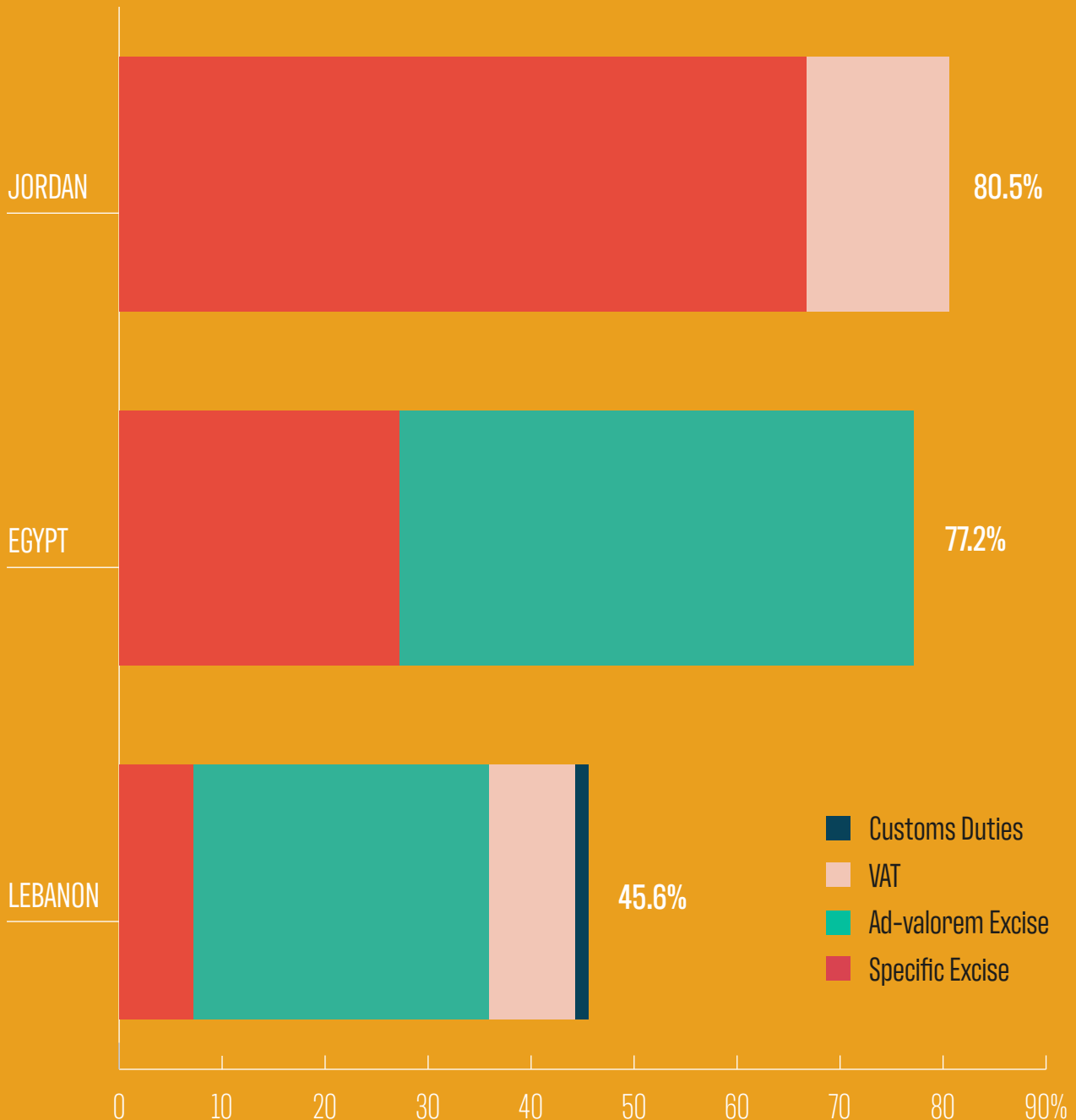
¹ Data from the WHO report on the global tobacco epidemic 2019.

² Ministry of Finance, Jordan/Haver Analytics and Oxford Economics calculations.

³ Ministry of Finance, Egypt/Haver Analytics and Oxford Economics calculations.



Tax share of cigarettes RSP in 2018¹



Both Jordan and Egypt apply tax shares greater than the 75% recommended by the WHO.

Source: WHO report on the global tobacco epidemic 2019.
1 Based on the Most Sold Brand.



Executive Summary: Government Finances

Illicit Consumption generates a Tax Loss for governments. This is **particularly important for markets such as Egypt and Jordan, where a narrow tax base means that tobacco taxation constitutes an important component of annual government revenues.**

In this Report, we estimate the Tax Loss by applying a weighted average tax rate to the total volume of illicit cigarettes consumed each year.

Egypt experienced the largest overall Tax Loss in 2018, despite registering the lowest Illicit Incidence, due to the significantly larger size of the domestic market. **In total, an estimated USD 134mn in government revenues was lost to Illicit Consumption in 2018 in Egypt.** This was equivalent to 3.9% of total potential Excise Tax revenues for the year. Results from the 2019 Q1 EPS suggest that the Tax Loss will have risen further in 2019.

In Jordan, the Tax Loss in 2018 was estimated at USD 91.6mn, rising by nearly 50% in comparison with 2017. When considering Excise Tax only, the Tax Loss represented 7.1% of total potential Excise Tax Losses for the year. **This is anticipated to have risen significantly in 2019 following a sharp increase in Illicit Consumption.** And given that tobacco taxation represented a significant component of overall government revenues, this represents an important development given ongoing efforts to reduce the fiscal deficit, with government debt expected to reach 97% of GDP in 2019.

The Tax Loss in Lebanon was estimated at USD 77.1mn in 2018. With a stable tax rate in recent years, the Tax Loss has risen broadly in line with the increase in Illicit Consumption over the same period. Despite registering the lowest loss in value terms compared with Egypt and Jordan, the **Excise Tax Loss as a share of total potential Excise Tax revenues is much higher at nearly 27% in 2018.** As such, reducing Illicit Consumption would lead to a notable boost in government revenues in Lebanon. However, analysis of the 2019 Q2 EPS suggests that both Illicit Incidence and Tax Loss increased in 2019.

In Egypt, an estimated

USD **134**mn

of tax revenue was
lost due to Illicit
Consumption in 2018

Tax Loss in 2018 rose by

45.6%

in Jordan

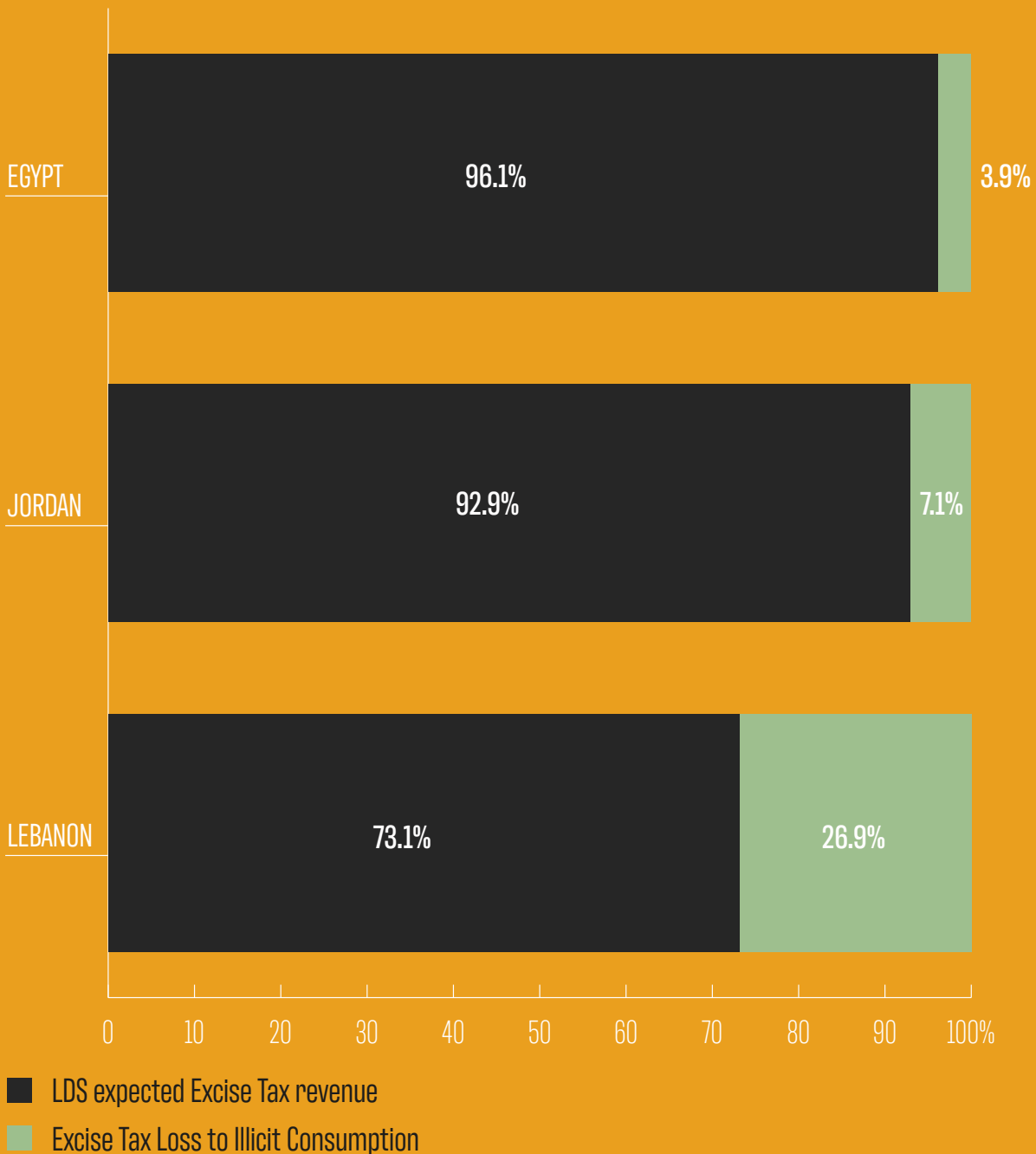
Excise Tax Loss in
Lebanon amounted to

26.9%

of total potential Excise
Tax revenues in 2018



Tax Loss to Illicit Consumption in 2018 (% of total expected Excise Tax revenue)



In 2018, the Tax Loss from Illicit Consumption represented an estimated USD 304mn in the three Levant markets.

DASHBOARD





Executive Summary: Dashboard

| % Total Consumption (unless otherwise stated) | EGYPT | | | JORDAN | | | LEBANON | | |
|---|-------|------|-------|--------|------|------|---------|------|------|
| | 2016 | 2017 | 2018 | 2016 | 2017 | 2018 | 2016 | 2017 | 2018 |
| Legal Domestic Consumption | 97.0 | 99.3 | 96.0 | 95.1 | 93.7 | 91.7 | 74.1 | 73.3 | 70.3 |
| Total Non-Domestic Inflows | 3.0 | 0.7 | 4.0 | 5.0 | 6.3 | 8.3 | 25.9 | 26.7 | 29.7 |
| of which: Non-Domestic Legal | 0.1 | 0.1 | 0.1 | 1.1 | 1.2 | 1.3 | 3.9 | 4.2 | 3.8 |
| of which: Illicit Consumption | 2.9 | 0.7 | 3.9 | 3.8 | 5.1 | 7.0 | 21.9 | 22.5 | 25.9 |
| Total Consumption (cigarettes bn) | 84.8 | 85.2 | 88.3 | 12.8 | 12.9 | 12.6 | 12.8 | 12.6 | 14.2 |
| Tax losses (USD mn) | 111.2 | 17.7 | 134.5 | 44.8 | 62.9 | 91.6 | 60.8 | 60.7 | 77.1 |

- Increasing trend from previous year
- Declining trend from previous year

MARKET SUMMARIES



EGYPT





Egypt:

An environment for illicit trade

Social, political, and economic environment

Egypt is one of the fastest growing economies in the Levant region, but also one of the poorest. Authorities have made strong progress on reform—supported by the IMF—improving macroeconomic stability and boosting investment and exports.

But households have struggled with severe austerity and high inflation, and poverty rates have risen in recent years. Unemployment remains stubbornly high, particularly among younger generations.

Growing dissatisfaction in the political regime has become increasingly apparent, leading to recent bouts of social unrest, reflecting frustrations with increasing poverty and alleged corruption—Egypt ranks 105th of 180 countries in Transparency International's 2018 Corruption Perceptions Index.¹

Enforcement, border control, and regulatory framework

The government is hoping to attract increased Foreign Direct Investment (FDI) through business regulatory reform, however World Bank indicators suggest regulatory quality has been moving in the opposite direction. Egypt is also in the bottom third globally in terms of the perceived effectiveness of its government.²

Egypt compares more favourably in terms of trade handling and border control, placing comfortably in the top 50% of countries globally.³ However, this has deteriorated in the last two years. And the inhospitable environment in Western Egypt makes it difficult to effectively police the long border with Libya, where insecurity and civil conflict provide suitable conditions for illegal cross-border activity.⁴

International and domestic cooperation

While not currently party to the WHO Protocol to Eliminate Illicit Trade in Tobacco Products, authorities have in the past shown a commitment to join, and in late-2018 implemented measures that closely align with the protocol directives. Egypt was further selected as one of 15 countries to receive support under the WHO Framework Convention on Tobacco Control 2030 project.⁵ It is also party to the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances.

GDP per capita in 2018

2,800
USD (nominal)

Egypt's regulatory quality ranks in the bottom

18%
of global countries

Logistics performance Index rank

67
out of 160 countries in 2018, down from 49 in 2016

1 Transparency International: Corruption Perceptions Index.

2 The World Bank: Worldwide Governance Indicators.

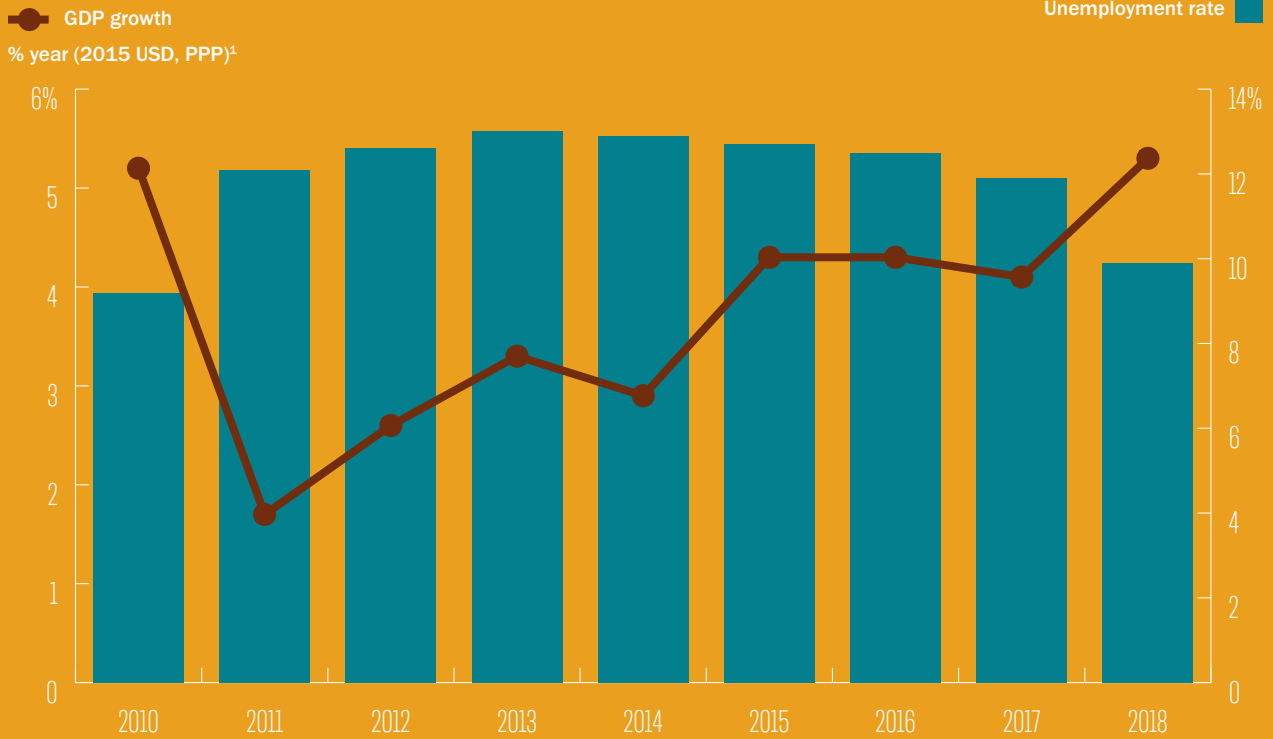
3 The World Bank: Logistics Performance Index.

4 See <https://www.atlanticcouncil.org/blogs/menasource/nato-countries-should-help-egypt-mitigate-security-challenge-near-libyan-border/>.

5 The 2030 project provides direct support to countries demonstrating "considerable motivation to advance tobacco control".

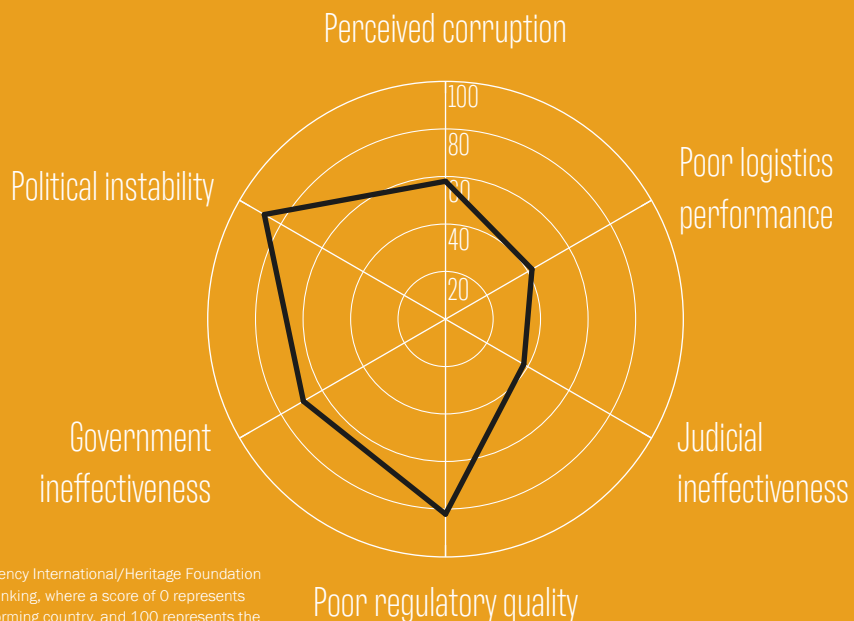


Egypt: Economic environment



Source: Oxford Economics/Haver Analytics

Egypt: Social and political environment



Source: World Bank/Transparency International/Heritage Foundation
 Scores are based on global ranking, where a score of 0 represents the top ranked and best performing country, and 100 represents the lowest ranked and worst performing country.

1 GDP growth is presented in constant Purchasing Power Parity (PPP) terms—which adjusts nominal data for differences in relative prices of goods & services across countries, and removes the impact of inflation and changes in exchange rates over time, so providing a better cross-country comparison of the standard of living over time.



Egypt: Legal Domestic Sales

LDS in Egypt were estimated at 84.8bn cigarettes in 2018, representing a modest rise of 0.3% from 84.6bn in 2017.¹

Three manufacturers accounted for over 98% of all LDS in 2018: Eastern Tobacco, PMI, and BAT. The Egyptian state-owned company Eastern Tobacco—the only licensed cigarette manufacturer—accounted for over 70% of LDS, underpinned by the success of the brand ‘Cleopatra’, the MSB in Egypt. Other international manufacturers produce their brands via Eastern Tobacco (who manufacture their brands domestically), while imports are minimal.²

In 2018, **around 72% of LDS was composed of brands within the low-value price segment**, a share that has remained relatively constant over the last 5 years.

Cigarette prices have **doubled over the last five years (based on the MSB) to EGP 16.0 (USD 0.90) per pack** in 2018, up from EGP 8.00 per pack in 2014.³ This has been primarily driven by rising Excise Tax rates over the same period.

In **late 2017, the Egyptian parliament approved an increase in Excise Tax** as part of wider public finance reforms aimed at reducing the budget deficit. And in **mid-2018, a new Earmarked Tax was introduced**, designed to raise revenues for a new comprehensive healthcare system. Cigarettes prices rose by a cumulative 28% as a consequence of these reforms.

Prices also rose following the devaluation in the EGP in late-2016 as the central bank allowed the currency to float freely after previously being pegged to the USD. This increased production costs due to rising prices of imported tobacco (the EGP depreciated by more than 110% peak-to-trough against the USD).

The affordability of cigarettes has remained stable over the last five years however, as measured by the Relative Income Price, with nominal household incomes rising broadly in line with cigarette prices since 2014.⁴

Legal Domestic Sales

84.8^{bn}
cigarettes in 2018

Cigarettes prices rose by

100[%]
over 2014-18

Taxes accounted for

77.2[%]
of retail prices in 2018

¹ Average of estimates provided by the industry.

² This is confirmed through a comparison of LDS and import data for cigarettes from the UN Comtrade Database, which suggests that imports accounted for less than 3% of LDS in 2018 (assuming a tobacco content of 0.8 grams per cigarette).

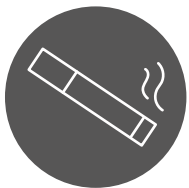
³ WHO report on the global tobacco epidemic 2019. For the purposes of this report, a pack consists of 20 cigarettes unless stated otherwise.

⁴ The Relative Income Price is defined as the proportion, expressed as a percentage, of nominal GDP per capita required to purchase 100 packs of the MSB of cigarettes (converted to a pack of 20 where applicable) in a particular market.



Egypt, 2018 Population:¹

98.4^{bn}



Smoking Prevalance:²

18.4%



Tax share of RSP:³

77.2%



Pack Price (MSB):

EGP 16.0 / USD 0.90



Low-value Brand:

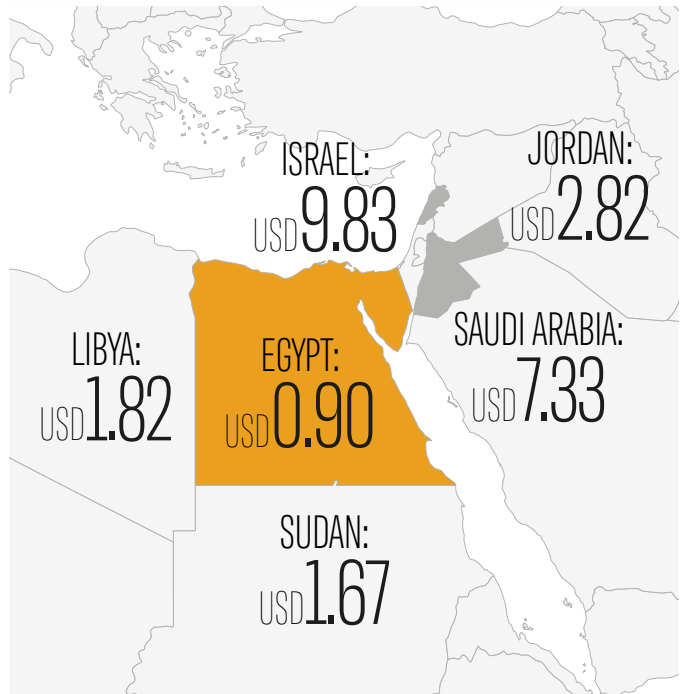
USD 0.90

Premium-value Brand:

USD 2.08



Comparison of MSB cigarette prices⁴



1 United Nations World Population Prospects/Haver Analytics.

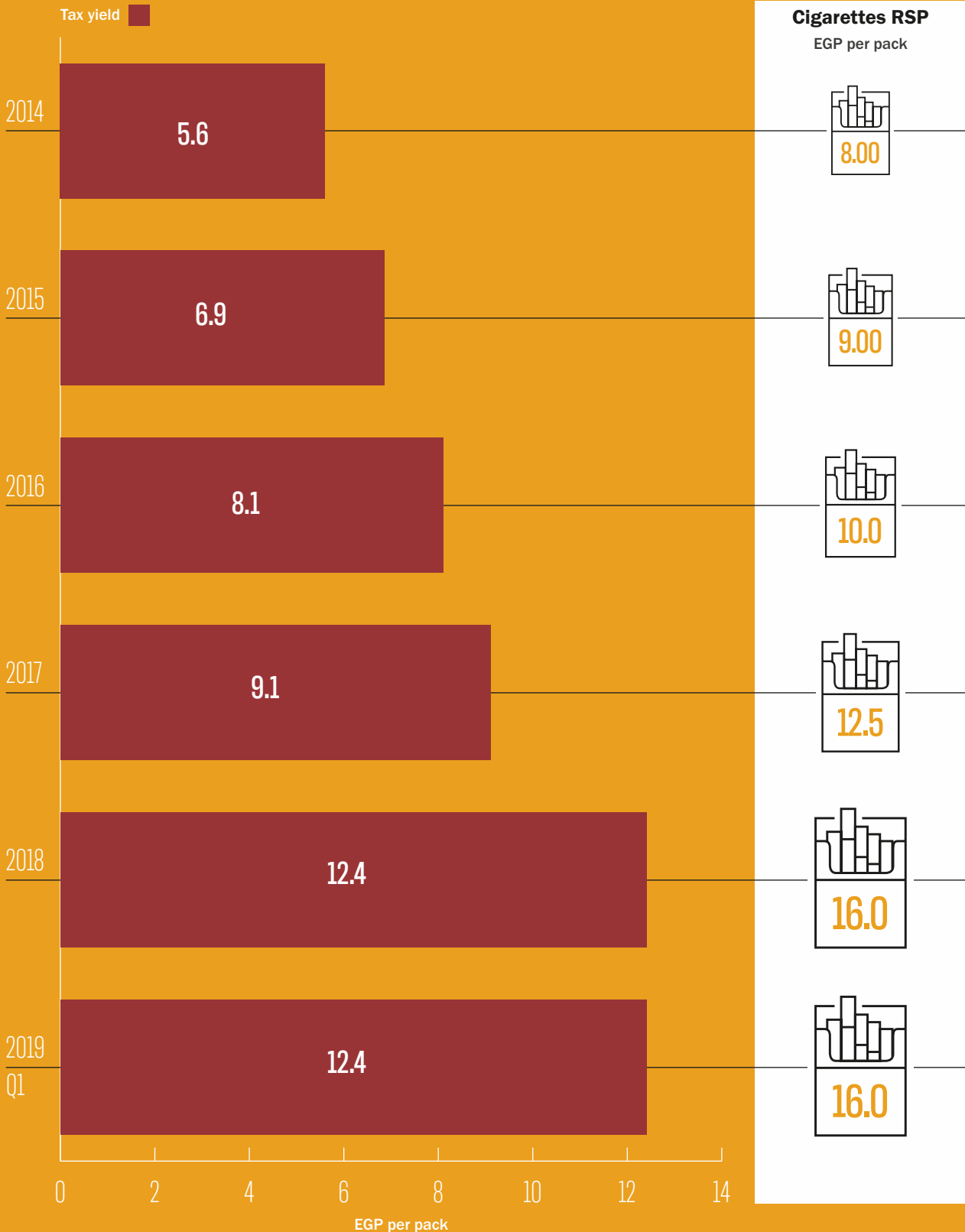
2 WHO report on the global tobacco epidemic 2019, based on daily tobacco smokers aged 15-69.

3 WHO report on the global tobacco epidemic 2019.

4 ibid.



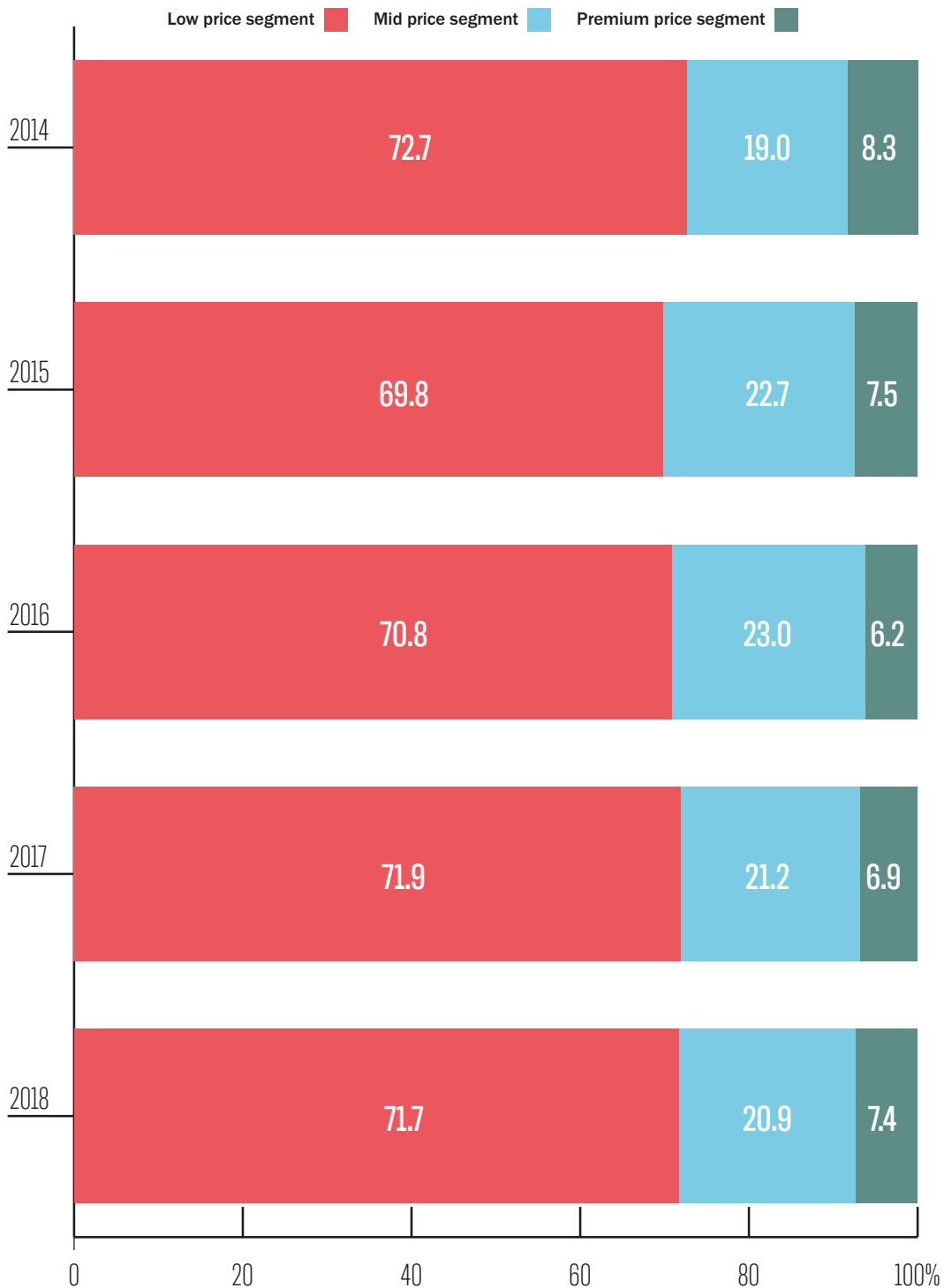
Egypt: Cigarettes RSP and taxes



Source: Oxford Economics based on industry data.
Based on the MSB in October of each year, with the exception of 2019, which is the rate applied in January.



Egypt: Legal Domestic Sales by price segment (% of total)





Egypt: Cigarette Consumption

Total Consumption of cigarettes in Egypt was estimated at 88.3bn in 2018, up 3.7% from the previous year.¹ This represented an increase of 4.1% from 2016—the first year for which we have data.

Analysis of the EPS indicates that the majority of cigarettes consumed are composed of LDC, averaging over 97% of Total Consumption over 2016-2018.

By contrast, **Illicit Consumption is relatively low in Egypt.** This is partly underpinned by the low RSP of cigarettes in Egypt, with the MSB retailing at a lower price than neighbouring markets, reducing the incentive for cross-border smuggling.

However, after falling to a low of 0.7% of Total Consumption in 2017, Illicit Incidence rose to 3.9% in 2018 and 6.4% in 2019 Q1, **representing a 5.7pp increase in less than two years.**

In volume terms, **Illicit Consumption was estimated at 3.5bn cigarettes in 2018, a six-fold increase from 2017.**

Furthermore, the 2019 Q1 EPS suggests that this pattern has continued and that Illicit Consumption will trend higher again in 2019. **Our estimates suggest that nearly 1.2bn illicit cigarettes were consumed in 2019 Q1.** This is equivalent to more than one-third of the volume of Illicit Consumption for 2018 as a whole, and more than double the volume consumed in 2017.

Illicit Consumption in Egypt is assumed to be entirely composed of Non-Domestic Illicit Inflows. It is understood that there is minimal Domestic Illicit production—growing tobacco is illegal in Egypt.

Total Consumption

88.3bn
cigarettes in 2018

Illicit Incidence of

3.9%
in 2018

Illicit incidence rose by

5.7pp
from 2017 to 2019 Q1

¹ The results from EPS's were combined with industry data on the volume of LDS to estimate the total volume of cigarettes consumed in Egypt between 2016 and 2019 Q1. EPS's were undertaken in 2016 Q4, 2017 Q4, and 2019 Q1. 2018 estimates based on the average of the 2017 Q4 and 2019 Q1 EPS's.



Egypt: Composition of cigarette consumption

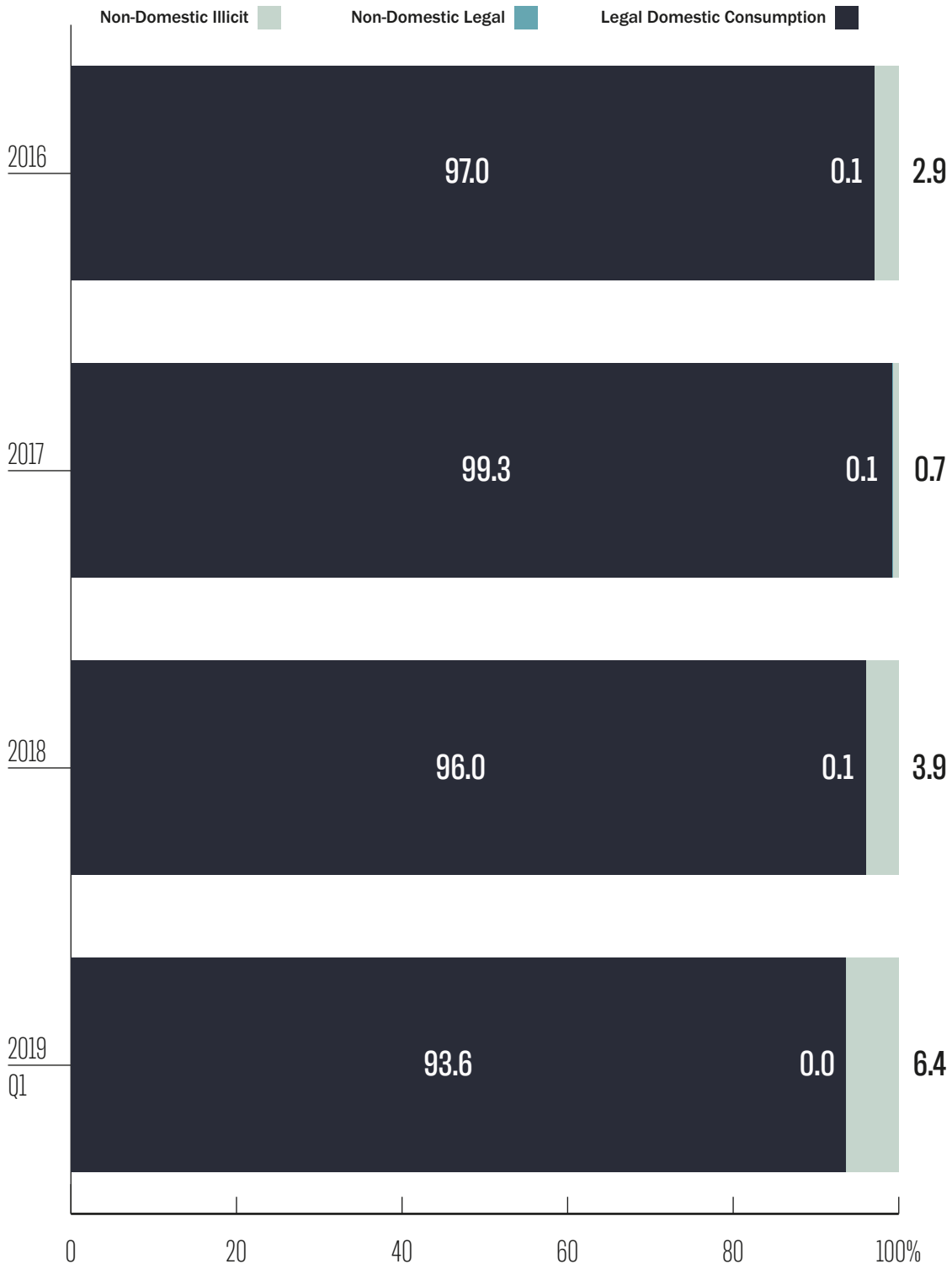
| | 2016 | | 2017 | | 2018 | | % change 2017-2018 | 2019 Q1 | |
|----------------------------------|------------------|-------|------------------|-------|------------------|-------|-----------------------|------------------|-------|
| | Cigarettes bn | % | Cigarettes bn | % | Cigarettes bn | % | | Cigarettes bn | % |
| Legal Domestic Consumption (LDC) | 82.3 | 97.0 | 84.6 | 99.3 | 84.8 | 96.0 | 0.3 | 17.5 | 93.6 |
| Total Non-Domestic Inflows (ND) | 2.5 | 3.0 | 0.6 | 0.7 | 3.5 | 4.0 | 463.4 | 1.2 | 6.4 |
| Non-Domestic Legal (NDL) | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | -16.2 | 0.0 | 0.0 |
| Non-Domestic Illicit | 2.5 | 2.9 | 0.6 | 0.7 | 3.5 | 3.9 | 517.7 | 1.2 | 6.4 |
| Domestic Illicit | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | N/A | 0.0 | 0.0 |
| Total Consumption | 84.8 | 100.0 | 85.2 | 100.0 | 88.3 | 100.0 | 3.7 | 18.7 | 100.0 |
| Total Illicit Consumption | 2.5 | 2.9 | 0.6 | 0.7 | 3.3 | 3.9 | 517.7 | 1.2 | 6.4 |

Source: Oxford Economics
 Figures may not sum due to rounding.

- Increasing trend from previous year
- Declining trend from previous year



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



Source: Oxford Economics



Egypt: Illicit trade flows

In total, an estimated 4.0% of Total Consumption was estimated to have originated through Non-Domestic channels in 2018.

The large majority of these Inflows, equivalent to nearly 3.5bn cigarettes, were estimated to be illicit, with only 53mn cigarettes or 0.1% of Total Consumption estimated as being of legal origin.¹

Nearly 96% of Non-Domestic Illicit Inflows were designated as being of Unspecified Market Variant—meaning that they do not bear specific market or Duty-Free labelling such that the intended market of retail sale can not be identified.

Two brands accounted for the vast majority of Unspecified Market Variant Inflows—‘Pine’ and ‘Karelia’.

The sharp rise in Non-Domestic Illicit Inflows in early-2019 was underpinned by the **significant presence of the brand ‘Pine’ in the 2019 Q1 EPS**—accounting for nearly two-thirds of total Illicit Inflows—having not been identified in the 2016 Q4 or 2017 Q4 EPS’s. In total, ‘Pine’ attained a Market Share of over 4% of Total Consumption in early 2019.

While the 2019 Q1 EPS included an expanded city-level coverage in Egypt, the majority of ‘Pine’ cigarettes were identified in cities included in the previous surveys, including Alexandria, Cairo, El-Mansoura, and Sohag, suggesting **that ‘Pine’ cigarettes have entered the market and attained significant Market Share since 2017.**

Zero Counterfeit products were identified in any of the EPS’s conducted since 2016.²

Unspecified Market Variant brands equalled

95.8%
of total illicit Inflows
in 2018

An estimated

3.5bn
illicit cigarettes were
consumed in 2018

‘Pine’ total Market Share of

4.2%
in 2019 Q1

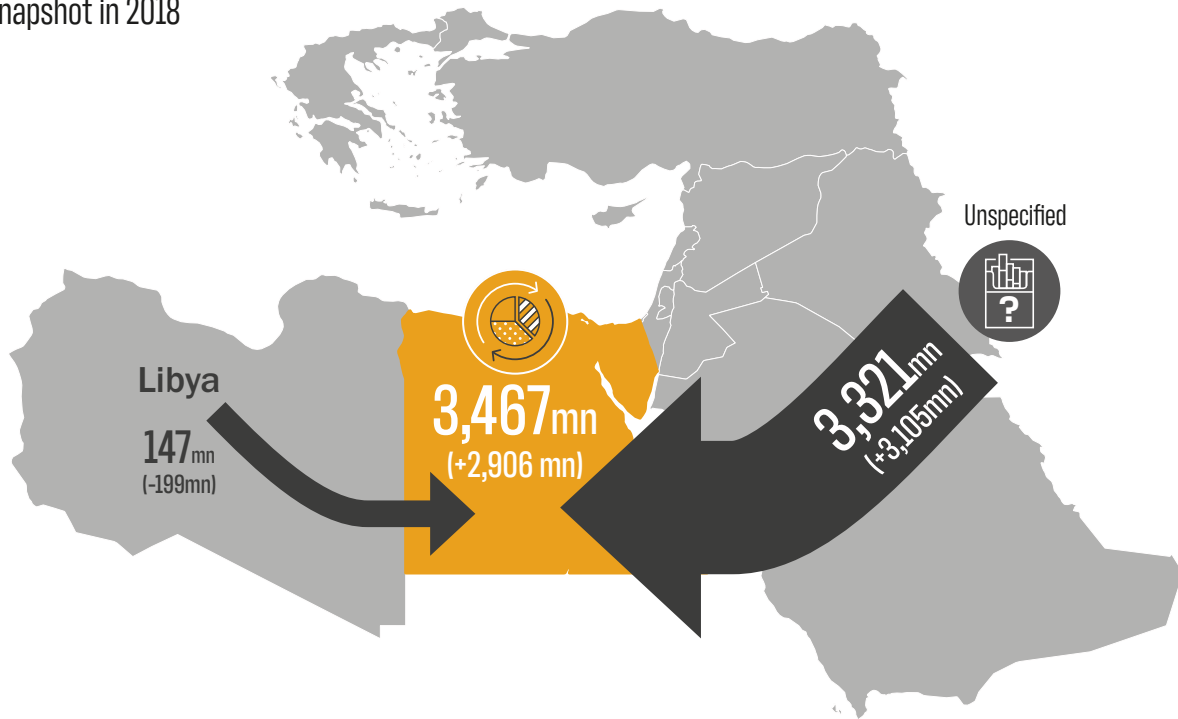
¹ Estimated using passenger data, Smoking Prevalence in tourists’ country/market of origin, and the duty-free personal import allowance limit. Egypt permits a duty-free personal import allowance of 200 cigarettes.

² Cigarette packets collected during the EPS are forensically analysed by the participating companies only to identify Counterfeit products, and may therefore underestimate the true volume of Counterfeit consumption.



Egypt: Origin of total Non-Domestic Illicit Inflows, 2018

Snapshot in 2018



| Three year trend | Cigarettes (mn) | | |
|-----------------------------|-----------------|------|-------|
| | 2016 | 2017 | 2018 |
| Libya | | 345 | 147 |
| Duty-Free labelled products | 612 | | |
| Unspecified | 1,878 | 216 | 3,321 |
| Total | 2,490 | 561 | 3,467 |

Source: Oxford Economics



Egypt: Government Finances

Egypt applies a **mixed Excise Tax system composed of both specific and ad-valorem components.**

The ad-valorem component is comprised of a rate of 50% charged on the RSP of cigarettes.

The specific component is calculated according to three tiers that vary based on the RSP, last increased in November 2017:

- For a RSP of below EGP 900 per 1,000 cigarettes, the specific rate is EGP 175 per 1,000;
- For a RSP of between EGP 901 and 1,500 per 1,000 cigarettes, the specific rate is EGP 275 per 1,000;
- For a RSP of 1,501 EGP per 1,000 cigarettes or above, the specific rate is EGP 325 per 1,000.

Cigarettes are also subject to two Earmarked Taxes; EGP 5 per 1,000 cigarettes to fund a student health insurance program, and EGP 37.5 per 1,000 cigarettes designated towards a national health insurance plan. The later was introduced in July 2018.

A Customs Duty equivalent to EGP 100 per kg of “net” weight (including paper, filters etc.) is charged on imported cigarettes. There is no VAT or GST applicable to the sale of cigarettes. **In total, taxes account for 77.2% of the RSP in Egypt, based on the MSB.**¹

In 2018, **estimated revenues from LDS of cigarettes rose by nearly one-quarter to EGP 58.6bn** (USD 3.3bn). This was underpinned by a rise in the tax rate applicable to cigarettes—with LDS remaining broadly stable in comparison with 2017. Tobacco taxes account for around 8.6% of total state government revenues from taxes.²

An **estimated EGP 2.4bn (USD 134mn) of Excise Tax revenues were lost due to Illicit Consumption in 2018.** This was equivalent to 3.9% of total potential Excise Tax revenues, representing a significant rise in comparison with 2017. Preliminary results suggest that **the Tax Loss continued to rise in 2019**, underpinned by rising levels of Illicit Consumption.

Total Excise Tax revenues of
EGP 58.6bn
from LDS in 2018

Tax Loss estimated at
EGP 2.4bn
in 2018

Excise Tax Loss equalled
3.9%
of total potential
Excise Tax revenues

¹ WHO report on the global tobacco epidemic 2019.

² Ministry of Finance, Egypt/Haver Analytics.



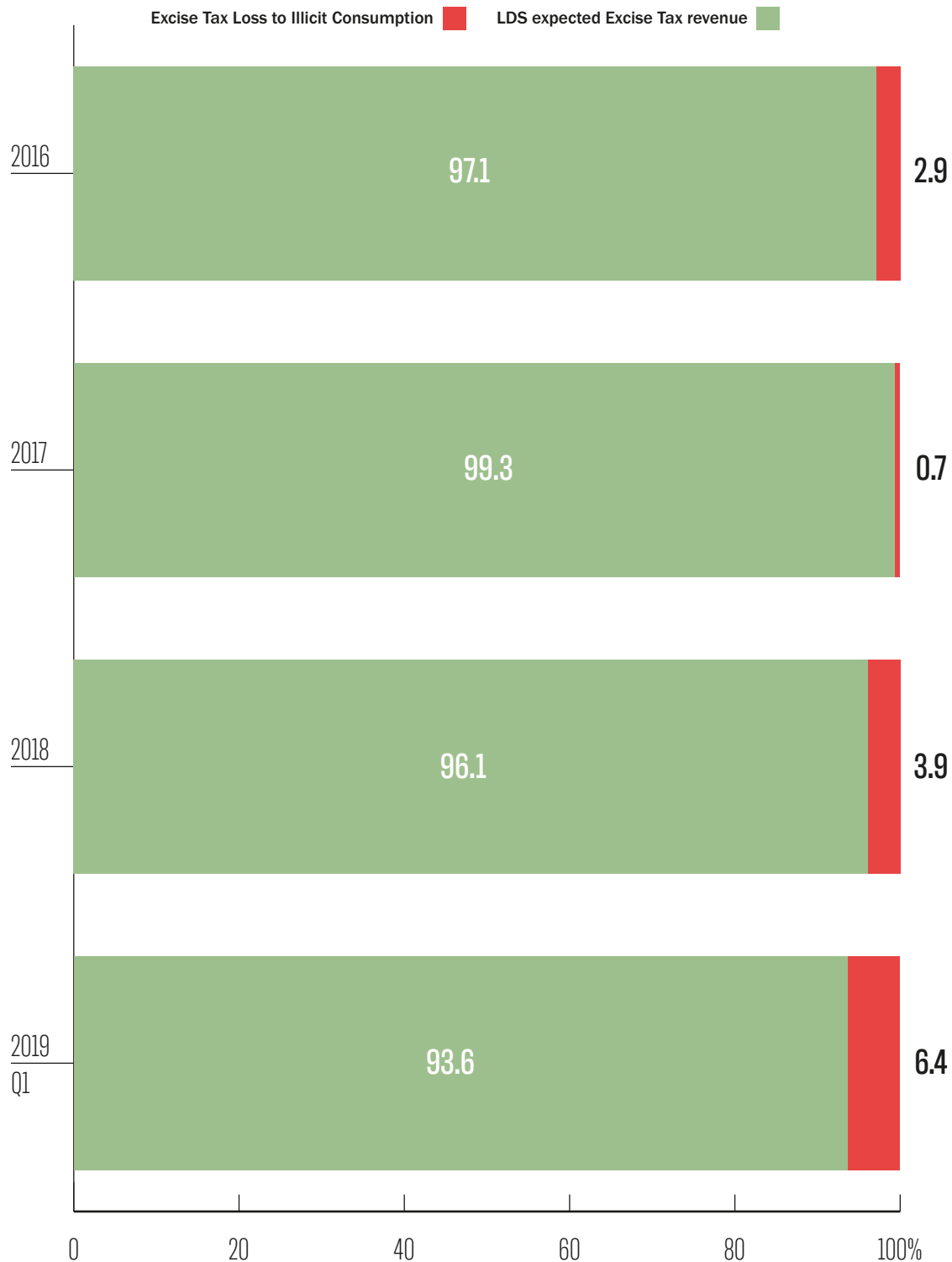
Egypt: Expected tax revenue and estimated Tax Losses

| | 2016 | | 2017 | | 2018 | | % change in local currency 2017-2018 |
|--|------------|------------|------------|-------------|------------|------------|---|
| | EGP bn | USD bn | EGP bn | USD bn | EGP bn | USD bn | |
| Actual Excise Tax revenue from LDS of cigarettes | 37.0 | 3.7 | 47.7 | 2.7 | 58.6 | 3.3 | 22.8 |
| Estimated number of illicit cigarettes purchased (cigarettes bn) | 2.5 | | 0.6 | | 3.5 | | 517.7 |
| Estimated total Tax Loss from Illicit Consumption | 1.1 | 0.1 | 0.3 | 0.02 | 2.4 | 0.1 | 656.8 |
| Lost Excise Tax revenue | 1.1 | 0.1 | 0.3 | 0.02 | 2.4 | 0.1 | 656.8 |
| Excise Tax Loss as % of potential total Excise Tax revenues | 2.9 | | 0.7 | | 3.9 | | |

Source: Oxford Economics based on industry data



Egypt: Tax Loss to Illicit Consumption (% of total expected Excise Tax revenue)





Egypt: Data Sources

| | Primary source | Calculation | Comments |
|--|---|---|--|
| Legal Domestic Sales (LDS) | Average of industry estimates. | — | — |
| Outflows of domestic duty-paid cigarettes | EPS data in other markets covered in this Report. | EPS data in other markets used to identify the presence of packs bearing Egypt market-specific labelling (e.g., health warnings, tax stamps, etc.). | As Outflows based on EPS data from other markets covered in this Report, figures presented likely underestimate total Outflows. |
| Legal Domestic Consumption (LDC) | — | LDS minus Outflows of legal sales. | Zero identified Outflows of duty-paid cigarettes, so LDS equals LDC. |
| Total Non-Domestic Inflows (ND) | — | Sum of Non-Domestic Legal and Non-Domestic Illicit. | — |
| Non-Domestic Legal (NDL) | — | Estimated using passenger data, adult smoking rates, and passenger duty-free personal import allowance. | Maximum theoretical amount an individual can carry across a border. Passenger data from the UNWTO/Ministry of Tourism and the OE Tourism Model. |
| Non-Domestic Illicit | EPS. | Based on EPS and OE estimates. | Estimates derived from 2016 Q4, 2017 Q4, and 2019 Q1 EPS. 2018 estimates estimated based on an average of the 2017 Q4 and 2019 Q1 EPS. |
| Domestic Illicit | — | There is assumed to be no under-declaration of domestically produced cigarettes. | While it is recognised that some Non-Domestic Illicit cigarettes may actually be manufactured domestically, this cannot be determined through analysis of the EPS. |
| Total Illicit Consumption | — | Sum of Non-Domestic Illicit and Domestic Illicit. | — |
| Total Consumption | — | LDS minus Outflows of domestic duty-paid cigarettes, plus estimated Non-Domestic Legal consumption, plus estimated Total Illicit Consumption. | The IT Flows Model estimate of Total Consumption is 88.3bn cigarettes for 2018. |
| Total Tax Loss | — | Total Illicit Consumption multiplied by the applicable weighted average tax rates (including Excise, Earmarked, and VAT/GST/sales tax). | — |

JORDAN





Jordan:

An environment for illicit trade

Social, political, and economic environment

Despite periodic outbreaks of civil unrest, political risk is low compared with regional peers, with Jordan enjoying relative stability under the popular King Abdullah. Tackling corruption remains a priority for the government. And while implementation has been slow, Jordan still ranks in the best performing one third of countries in a global benchmark on perceived levels of corruption.¹

Regional instability has weighed on the economy in recent years—undermining confidence, and hitting trade and tourism flows—while high unemployment and the weak fiscal position remain major concerns. Commitment to an IMF reform programme should support rising incomes, although growth is also contingent on easing regional tensions, and the country still relies heavily on foreign aid. An estimated 1.4mn Syrian refugees (18% of the population)² add to social tensions and put a large strain on public resources and infrastructure.

Enforcement, border control, and regulatory framework

Jordan ranks slightly above the global average in a World Bank assessment of regulatory quality and government effectiveness,³ while the legal framework is considered efficient—even though the system as a whole is slow.⁴ Customs Law amendments in recent years have strengthened penalties for illicit trade and given the Attorney General greater powers of enforcement—powers which were exercised in high-profile raids conducted by the Jordan Customs Department (JCD) in recent years.

Jordan's performance in trade handling and border control has deteriorated, weighed down by a relatively inefficient customs process.⁵ A long border with conflict-ridden countries provides further complications for border control.

International and domestic cooperation

Anti smuggling efforts have intensified, particularly against illicit tobacco, in recognition of the importance of legitimate sales on government finances. This has involved greater domestic cooperation between securities agencies and the JCD, and has included public awareness campaigns. However, Jordan is currently not a signatory of the WHO Protocol to Eliminate Illicit Trade in Tobacco Products.

GDP per capita in 2018

4,300
USD (nominal)

Jordan performs better than

68%

of all countries in the world on corruption perceptions

Logistics performance Index rank

84

out of 160 countries

1 Transparency International: Corruption Perceptions Index.

2 EU Institute for Security Studies, 2016.

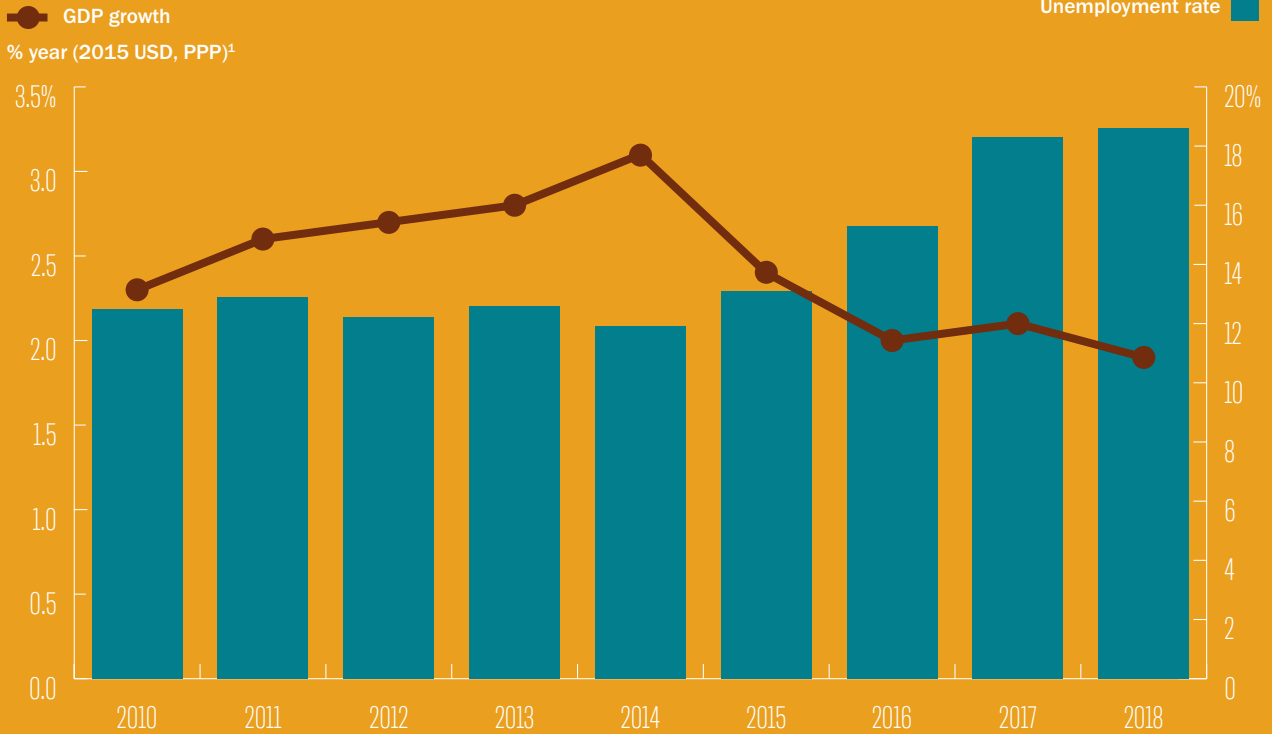
3 The World Bank: Worldwide Governance Indicators.

4 World Economic Forum Global Competitiveness Index 2019 edition.

5 The World Bank: Logistics Performance Index.

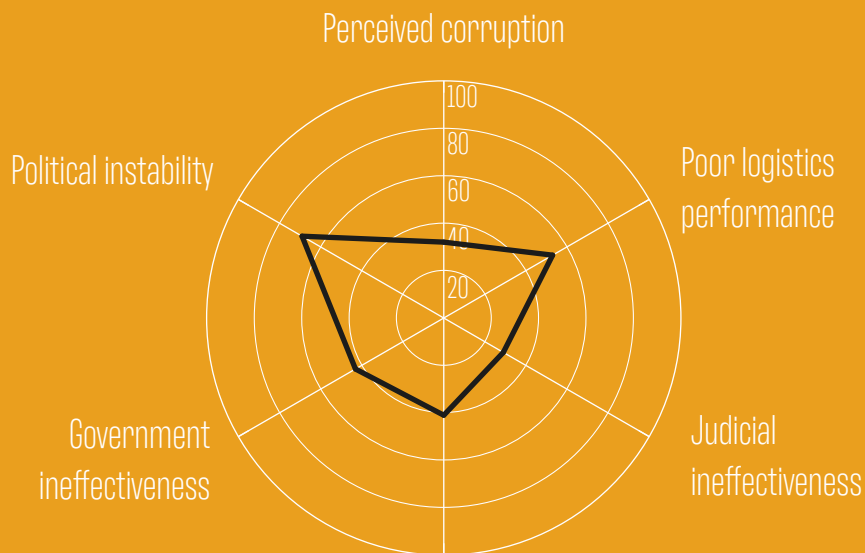


Jordan: Economic environment



Source: Oxford Economics/Haver Analytics

Jordan: Social and political environment



Source: World Bank/Transparency International/Heritage Foundation
Scores are based on global ranking, where a score of 0 represents the top ranked and best performing country, and 100 represents the lowest ranked and worst performing country.

1 GDP growth is presented in constant Purchasing Power Parity (PPP) terms—which adjusts nominal data for differences in relative prices of goods & services across countries, and removes the impact of inflation and changes in exchange rates over time, so providing a better cross-country comparison of the standard of living over time.



Jordan: Legal Domestic Sales

LDS in Jordan were estimated at nearly **11.6bn cigarettes in 2018**, falling by 4.0% in comparison with 2017.¹ Two major international tobacco manufacturers dominate the market: JTI and PMI, together representing over 80% of LDS.

The breakdown of LDS indicates a **rising trend in consumption of lower-value cigarette brands**, which accounted for nearly 56% of consumption in 2018, up from 47% in 2014.

This is partly driven by affordability. A **pack of the MSB of cigarettes has increased by 66.7% over the past 5 years**,² during a period of deteriorating economic conditions whereby household incomes have been squeezed by rising unemployment. This is illustrated by the increase in the Relative Income Price: it required approximately 6.5% of per capita income to purchase 100 packs of the MSB in 2018, up from 4.1% in 2014.³

In addition, significant inflows of Syrian refugees, who display a strong preference towards lower-value cigarette brands, have supported this trend.

Cigarette prices last rose in January 2018 following an increase in Excise Tax, which contributed towards an increase of one-third in the cost of a pack of the MSB.

This tax increase was implemented as part of a wider package of tax reform aimed at increasing government revenues—tobacco taxation is one of the largest contributors to the budget.

Taxes account for over 80% of the RSP in Jordan—one of the highest rates evident across the Levant region.⁴

The MSB of cigarettes cost JOD 2.00 (USD 2.82) per pack in 2018. This was higher than the MSB in Iraq—a major source of Non-Domestic Inflows according to the 2019 EPS—which retailed at USD 0.42 per pack. Retail prices in Jordan are also higher than in many other neighbouring markets including Jordan, Lebanon, and Syria.⁵

Legal Domestic Sales

11.6^{bn}
cigarettes in 2018

Cigarettes prices rose by

66.7%
over 2014-18

Taxes accounted for

80.5%
of retail prices in 2018

1 Average of estimates provided by the industry.

2 For the purposes of this report, a pack consists of 20 cigarettes unless stated otherwise.

3 The Relative Income Price is defined as the proportion, expressed as a percentage, of nominal GDP per capita required to purchase 100 packs of the MSB of cigarettes (converted to a pack of 20 where applicable) in a particular market.

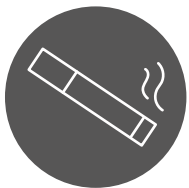
4 WHO report on the global tobacco epidemic 2019.

5 *ibid.*



Jordan, 2018 Population:¹

10.0mn



Smoking Prevalance:²

29.0%



Tax share of RSP:³

80.5%

Comparison of MSB cigarette prices⁴



Pack Price (MSB):

JOD 2.00 / USD 2.82



Low-value Brand:

USD 2.11

Premium-value Brand:

USD 3.87



1 United Nations World Population Prospects/Haver Analytics.

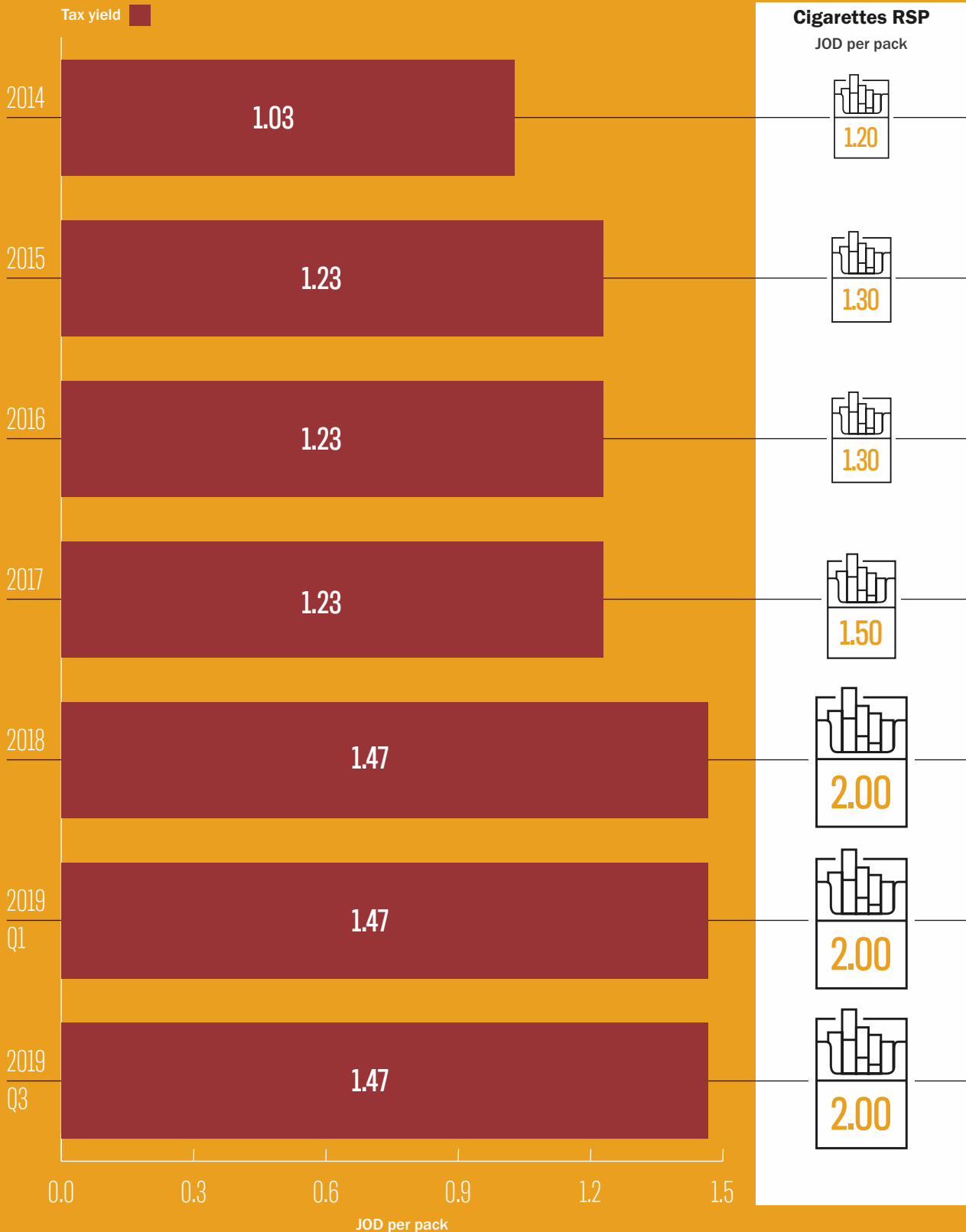
2 WHO report on the global tobacco epidemic 2019, based on daily tobacco smokers aged 18+.

3 WHO report on the global tobacco epidemic 2019.

4 ibid.



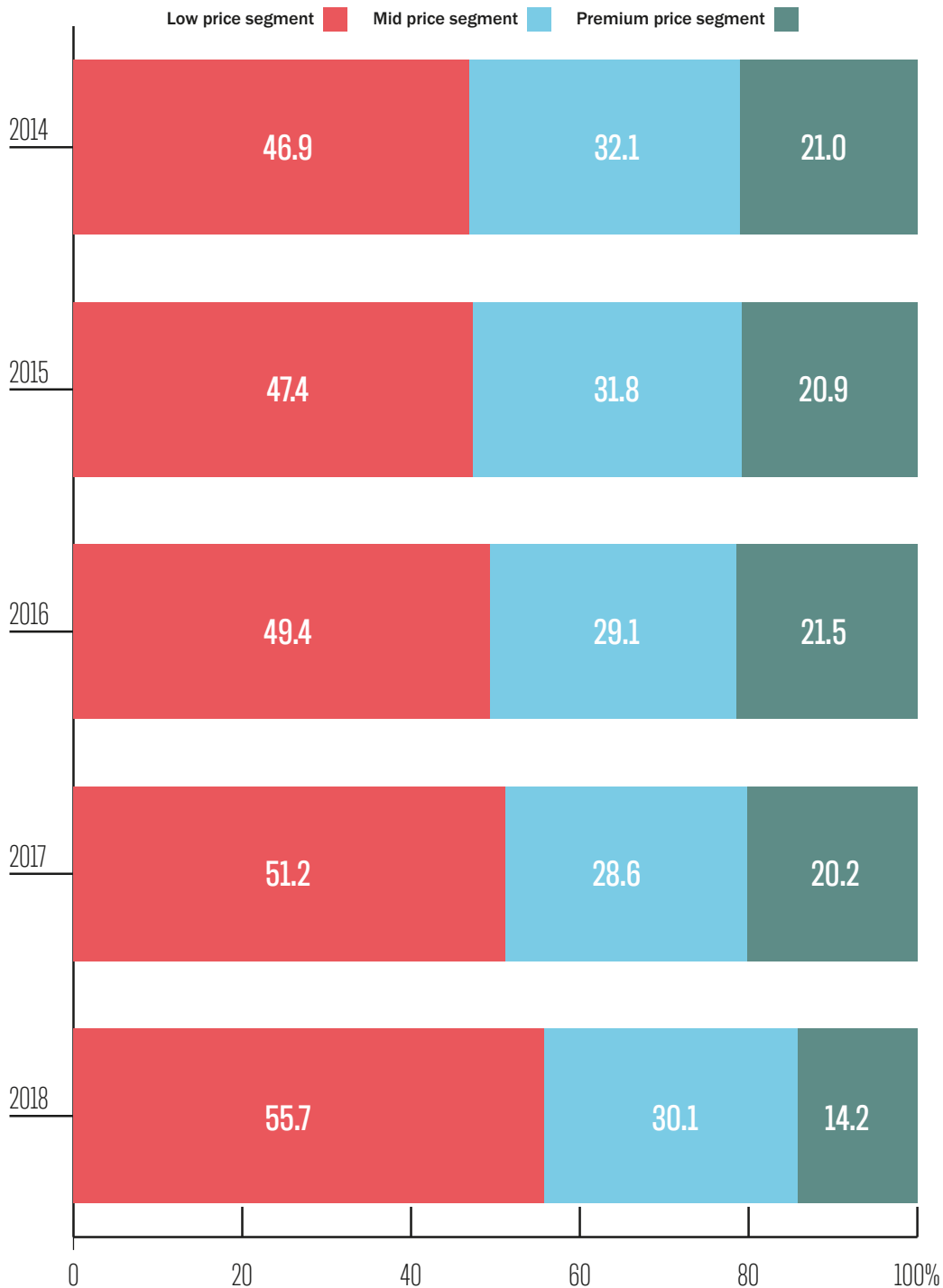
Jordan: Cigarettes RSP and taxes



Source: Oxford Economics based on industry data
 Based on the MSB in October of each year, with the exception of 2019, which is the rate applied in January.
 Tax yield includes Excise Tax and VAT.



Jordan: Legal Domestic Sales by price segment (% of total)





Jordan: Cigarette Consumption

Total Consumption of cigarettes in Jordan was estimated at 12.6bn in 2018, falling by 1.9% in comparison with 2017.¹

The decline in Total Consumption was underpinned by falling LDS. However, this was partially offset by rising Non-Domestic Inflows over the same period.

The incidence of Non-Domestic Inflows rose to 8.3% in 2018 from 6.3% in 2017. This was primarily driven by rising Non-Domestic Illicit Inflows, with legal Non-Domestic Inflows representing a small and relatively unchanged component of Total Consumption (just 1.3% in 2018).²

Total Illicit Incidence rose to 7.0% in 2018, almost doubling in the two years for which we have data. In volume terms, this represented 887mn illicit cigarettes consumed in the year, compared with 488mn in 2016.

Illicit Consumption is anticipated to have risen again in 2019, with the 2019 Q1 and Q3 EPS reports indicating an average Non-Domestic Incidence of 28.6%, a 20.3pp increase in comparison with 2018.

The sharp rise in Non-Domestic Inflows apparent in 2019 **coincided with the re-opening of international borders with neighbouring countries** Iraq (August 2018) and Syria (October 2018) for people and goods transport after both were closed three years prior.

The highest level of Non-Domestic Incidence was evident in the city of Irbid—the closest city to the Syrian border included in the analysis—reporting an average Non-Domestic Incidence of 52.6% in the 2019 Q1 and Q3 EPS.

In total, **Illicit Incidence is estimated to have risen to 27.3% for the first three quarters of 2019**, while the volume of illicit cigarettes consumed during this period was significantly higher than the previous three years combined.

Total Consumption
12.6^{bn}
cigarettes in 2018

An estimated
887^{mn}
illicit cigarettes were
consumed in 2018

Illicit incidence rose to
7.0[%]
in 2018³

¹ The results from EPS's were combined with industry data on the volume of LDS to estimate the total volume of cigarettes consumed in Jordan between 2016 and 2019 Q3. EPS's were undertaken in 2016 Q2 and Q4, 2017 Q2 and Q4, 2018 Q2 and Q4, and 2019 Q1 and Q3.

² Estimated using passenger data, Smoking Prevalence in tourists' country/market of origin, and the duty-free personal import allowance limit. Jordan permits a duty-free personal import allowance of 200 cigarettes.

³ 2018 represents the more recent full year for which we have data.



Jordan: Composition of cigarette consumption

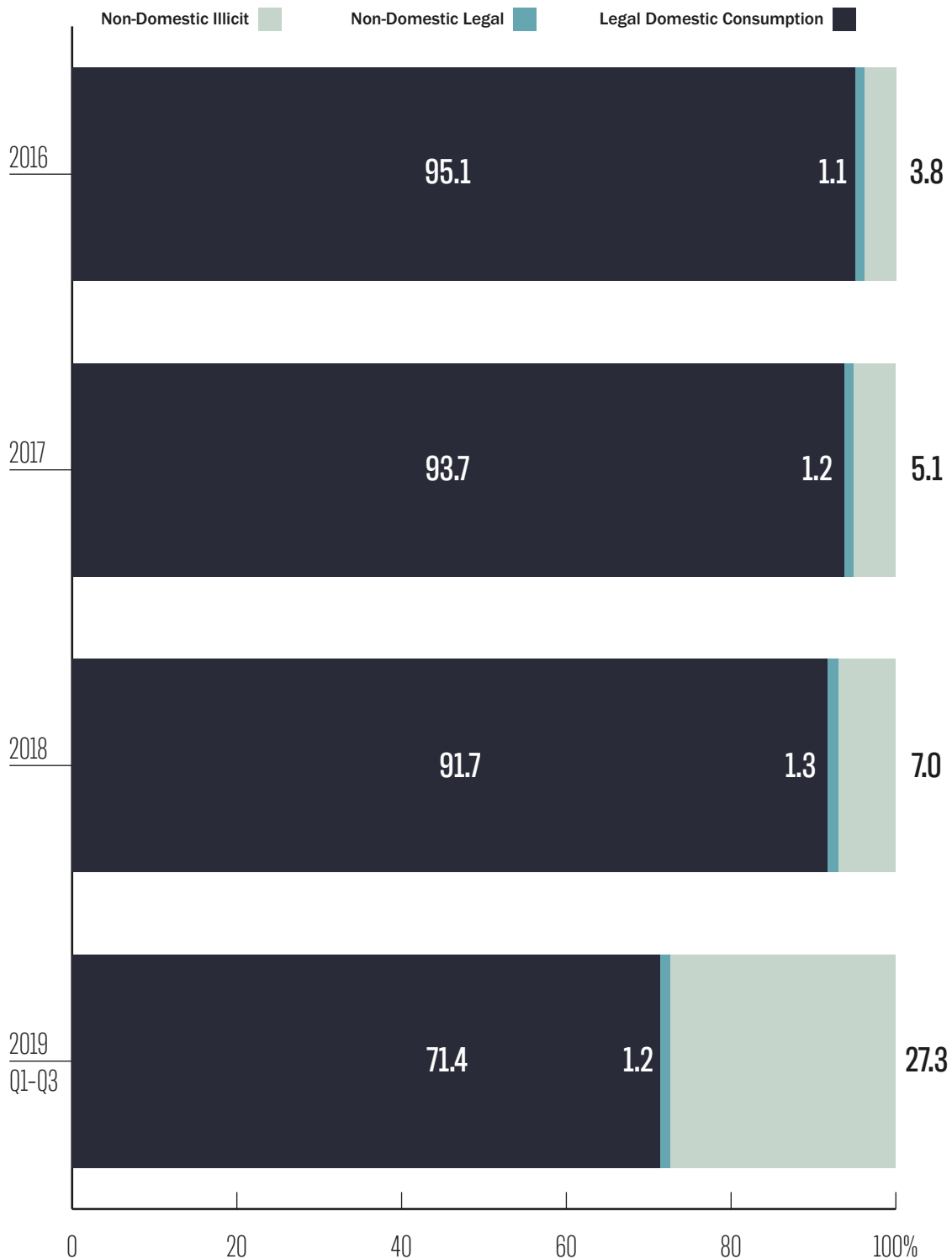
| | 2016 | | 2017 | | 2018 | | % change 2017-2018 | 2019 Q1-Q3 | |
|----------------------------------|------------------|------------|------------------|------------|------------------|------------|-----------------------|------------------|-------------|
| | Cigarettes bn | % | Cigarettes bn | % | Cigarettes bn | % | | Cigarettes bn | % |
| Legal Domestic Consumption (LDC) | 12.1 | 95.1 | 12.1 | 93.7 | 11.6 | 91.7 | -4.0 | 8.6 | 71.4 |
| Total Non-Domestic Inflows (ND) | 0.6 | 5.0 | 0.8 | 6.3 | 1.0 | 8.3 | 29.2 | 3.4 | 28.6 |
| Non-Domestic Legal (NDL) | 0.1 | 1.1 | 0.2 | 1.2 | 0.2 | 1.3 | 6.3 | 0.1 | 1.2 |
| Non-Domestic Illicit | 0.5 | 3.8 | 0.7 | 5.1 | 0.9 | 7.0 | 34.5 | 3.3 | 27.3 |
| Domestic Illicit | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | N/A | 0.0 | 0.0 |
| Total Consumption | 12.8 | 100.0 | 12.9 | 100.0 | 12.6 | 100.0 | -1.9 | 12.0 | 100.0 |
| Total Illicit Consumption | 0.5 | 3.8 | 0.7 | 5.1 | 0.9 | 7.0 | 34.5 | 3.3 | 27.3 |

Source: Oxford Economics
 Figures may not sum due to rounding.

 Increasing trend from previous year



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



Source: Oxford Economics



Jordan: Illicit trade flows

The majority of illicit cigarettes in 2018 were labelled as Duty-Free Market Variant brands (more than three-quarters). But despite being identified as Duty-Free in the EPS, our analysis suggests **that these brands do not enter the market through legitimate Duty-Free channels.**

Iraq Market Variant brands also represent a significant component of illicit (14.3% of total illicit Inflows in 2018), more than doubling in volume from 2017.

Data from 2019 indicates a sharp rise in Illicit Consumption. **This is driven by an increase in consumption of the cigarette brand 'Elegance', which experienced a rise in Market Share from an average of 1.0% of Total Consumption in 2017-18 to over 13.0% in 2019 Q1-Q3.**

While 'Elegance' is identified as an Iraq Market Variant brand in the EPS,¹ it is understood to be **manufactured for export by a company based in Jordan.**

This suggests that a large volume of these products remain in the domestic market despite being designated for export.

Around 22mn Counterfeit cigarettes were consumed in 2018, having risen from 10mn in 2017 and zero in 2016.² The issue of counterfeiting cigarettes hit national headlines following a series of raids conducted by the JCD in July 2018 which discovered several illegal production facilities across Jordan, implicating numerous high profile businessmen and some government officials.³

The JCD remains active following the re-opening of international borders and subsequent rise in Illicit Consumption. Amendments to the Customs Law in June 2018 and April 2019 have strengthened enforcement powers and provided increased punishments for individuals engaged in smuggling activity.

Duty-Free labelled products equalled

75.8%

of total illicit Inflows in 2018

Products of Iraq Market Variant equalled

14.3%

of total illicit Inflows in 2018

Market Share of 'Elegance' rose by

12pp

in 2019

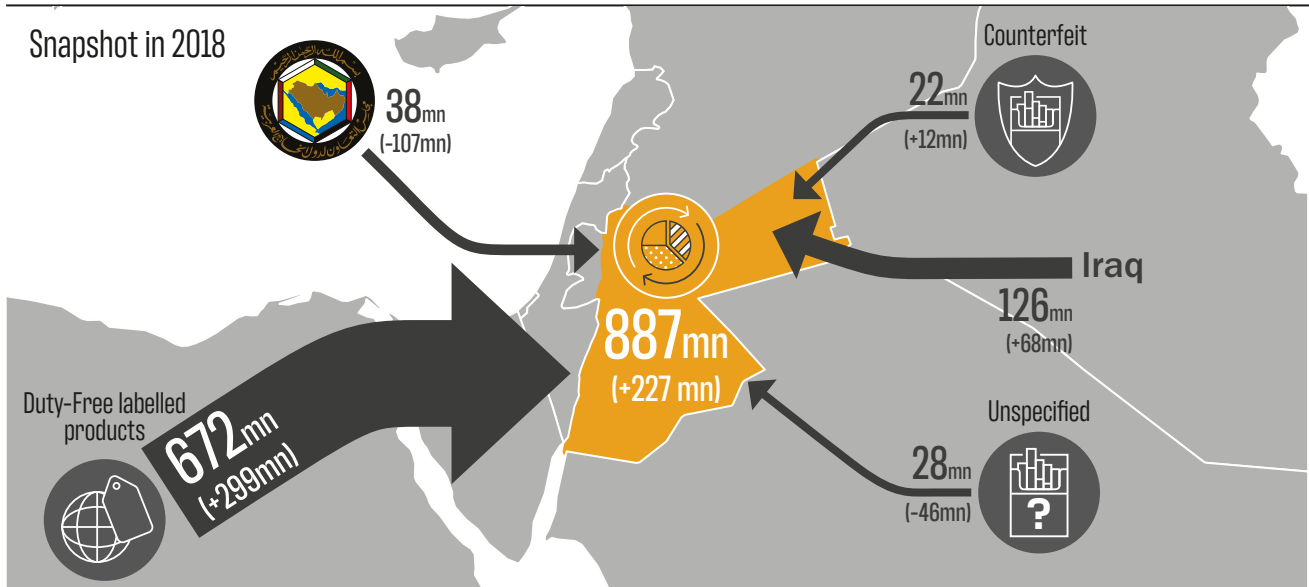
¹ Based on the specific market labelling of the cigarette packets collected in the EPS.

² Cigarette packets collected during the EPS are forensically analysed by the participating companies to identify Counterfeit products.

³ This incident provided further evidence that there was Domestic Illicit production in Jordan despite not being evident through analysis of the EPS.



Jordan: Origin of total Non-Domestic Illicit Inflows, 2018



| Three year trend | Cigarettes (mn) | | |
|--|-----------------|------------|------------|
| | 2016 | 2017 | 2018 |
| Iraq | | 58 | 126 |
| Gulf Cooperation Council (GCC) markets | 188 | 145 | 38 |
| Duty-Free labelled products | 195 | 373 | 672 |
| Counterfeit | | 10 | 22 |
| Other/Unspecified | 105 | 74 | 28 |
| Total | 488 | 659 | 887 |

Source: Oxford Economics



Jordan: Government Finances

Jordan **applies a multi-tiered specific Excise Tax system on cigarettes, which varies according to the RSP.**

Firstly, all cigarettes are subject to a fixed rate of JOD 0.570 per pack regardless of the RSP, a rate that was last increased in January 2018 from JOD 0.482 per pack. Secondly, a multi-tiered rate is applied on top. This starts at JOD 0.545 per pack with a RSP of JOD 1.50 or below, and gradually rises by 2.2 piastre with every 5 piastre or JOD 0.05 incremental increase in the RSP up to a maximum rate of JOD 1.315 per pack with a RSP of JOD 3.25 or above.

VAT is applicable to the sale of cigarettes at a nominal rate of 16% of the RSP. Customs Duties are also applied, depending on the level of processing. Raw tobacco is subject to a 45% duty on the CIF price,¹ cut filler is subject to a 75% duty, while a rate of 150% is applied to finished products.

In 2018, an estimated JOD 697mn (USD 983mn) in Excise Tax revenue was generated from LDS. This is equal to more than 15% of central government tax revenues for 2018.²

Government revenues have gradually risen over the last three years for which we have data, however the ongoing trend of consumers downtrading to lower-value brands of cigarettes (implying a lower tax yield per cigarette, all else being equal) will have squeezed revenues.

In total, an estimated **JOD 65.0mn (USD 91.6mn) Tax Loss resulted from Illicit Consumption in 2018** (Excise Tax plus VAT). The total Tax Loss rose by 45.6% in comparison with 2017.

As a share of total potential Excise Tax revenues, the Excise Tax Loss represented 7.1% in 2018.

The Tax Loss is anticipated to have risen dramatically in 2019. Based on data for the first three quarters of the year, we estimate that **Excise Tax Loss as a share of total potential Excise Tax revenues rose to 27.7%, nearly four-times the level recorded in 2018.**

Total Excise Tax revenues of
JOD 697mn
from LDS in 2018

Tax Loss estimated at
JOD 65.0mn
in 2018

Excise Tax Loss equalled
7.1%
of total potential
Excise Tax revenues

¹ Cost, Insurance, and Freight (CIF).

² Ministry of Finance, Jordan/Haver Analytics.



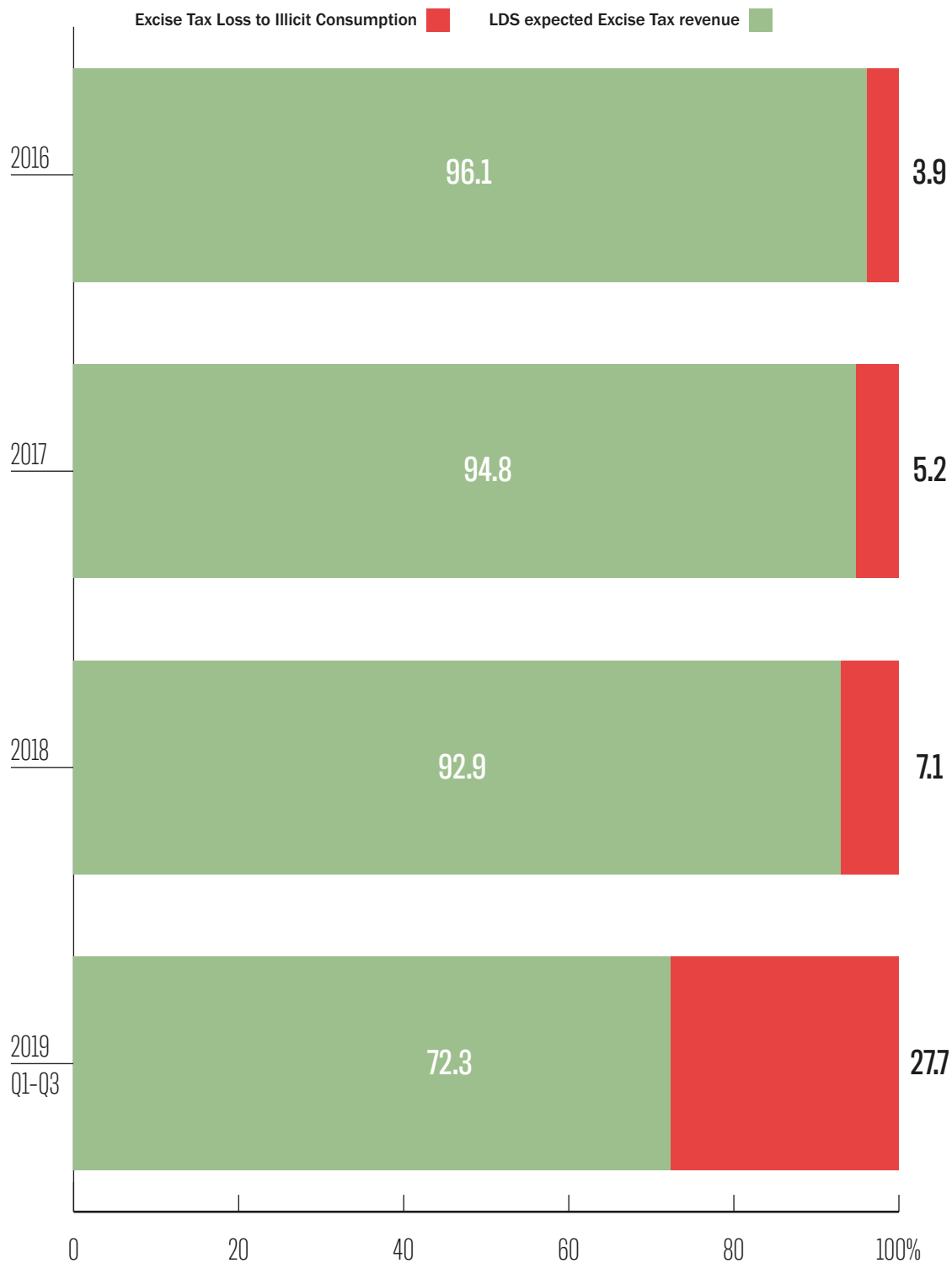
Jordan: Expected tax revenue and estimated Tax Losses

| | 2016 | | 2017 | | 2018 | | % change in local currency 2017-2018 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|---|
| | JOD mn | USD mn | JOD mn | USD mn | JOD mn | USD mn | |
| Actual Excise Tax revenue from LDS of cigarettes | 651 | 918 | 673 | 949 | 697 | 983 | 3.5 |
| Estimated number of illicit cigarettes purchased (cigarettes bn) | 0.5 | | 0.7 | | 0.9 | | 34.5 |
| Estimated total Tax Loss from Illicit Consumption | 31.8 | 44.8 | 44.6 | 62.9 | 65.0 | 92.6 | 45.6 |
| Lost Excise Tax revenue | 26.2 | 36.9 | 36.8 | 51.8 | 53.3 | 75.2 | 45.1 |
| Lost VAT revenue | 5.6 | 7.9 | 7.9 | 11.1 | 11.6 | 16.4 | 47.7 |
| Excise Tax Loss as % of potential total Excise Tax revenues | 3.9 | | 5.2 | | 7.1 | | |

Source: Oxford Economics based on industry data



Jordan: Tax Loss to Illicit Consumption (% of total expected Excise Tax revenue)



Source: Oxford Economics



Jordan: Data Sources

| | Primary source | Calculation | Comments |
|--|---|--|--|
| Legal Domestic Sales (LDS) | Average of industry estimates. | — | — |
| Outflows of domestic duty-paid cigarettes | EPS data in other markets covered in this Report. | EPS data in other markets used to identify the presence of packs bearing Jordan market-specific labelling (e.g., health warnings, tax stamps, etc.). | As Outflows based on EPS data from other markets covered in this Report, figures presented likely underestimate total Outflows. |
| Legal Domestic Consumption (LDC) | — | LDS minus Outflows of legal sales. | Zero identified Outflows of duty-paid cigarettes, so LDS equals LDC. |
| Total Non-Domestic Inflows (ND) | — | Sum of Non-Domestic Legal and Non-Domestic Illicit. | — |
| Non-Domestic Legal (NDL) | — | Estimated using passenger data, adult smoking rates, and passenger duty-free personal import allowance. | Maximum theoretical amount an individual can carry across a border. Passenger data from the UNWTO/Ministry of Tourism and Antiquities, and the OE Tourism Model. |
| Non-Domestic Illicit | EPS. | Based on EPS and OE estimates. | Estimates derived from 2016 Q2 and Q4, 2017 Q2 and Q4, 2018 Q2 and Q4, and 2019 Q1 and Q3 EPS's. |
| Domestic Illicit | — | There is assumed to be no under-declaration of domestically produced cigarettes. | While it is recognised that some Non-Domestic Illicit cigarettes may actually be manufactured domestically, this cannot be determined through analysis of the EPS. |
| Total Illicit Consumption | — | Sum of Non-Domestic Illicit and Domestic Illicit. | — |
| Total Consumption | — | LDS minus Outflows of domestic duty-paid cigarettes, plus estimated Non-Domestic Legal consumption, plus estimated Total Illicit Consumption. | The IT Flows Model estimate of Total Consumption is 12.6bn cigarettes for 2018. |
| Total Tax Loss | — | Total Illicit Consumption multiplied by the applicable weighted average tax rates (including Excise, Earmarked, and VAT/GST/sales tax). | — |

LEBANON





Lebanon:

An environment for illicit trade

Social, political, and economic environment

The political environment is dysfunctional and fractious, comparing poorly in global benchmarks on political stability and government integrity.¹ Corruption is high, and the security environment is challenging due to instability in neighbouring Syria.²

The economic outlook has deteriorated sharply in recent years, weighed down by weak confidence amid high public debt, a large current account deficit, and a lack of implementation of growth-enhancing reforms. In purchasing power parity terms, GDP per capita has been in steady decline. The deepening economic crisis was a key catalyst to the eruption of anti-government protests towards the end of 2019.

Social conditions also remain challenging—weak growth and political paralysis have prompted widespread social unrest, while Lebanon hosts an estimated 1.5mn Syrian refugees (¼ of the population),³ placing an increasing strain on limited domestic resources.

Enforcement, border control, and regulatory framework

A World Bank assessment of regulatory quality, as well as judicial effectiveness and the rule of law, highlight weaknesses in the level of governance in Lebanon.⁴

Lebanon's trade logistics⁵ are ranked at the global mid-point—although this has fallen in recent years amid deteriorating infrastructure quality—and policing the border is difficult with an estimated 124 illegal border crossing points between Lebanon and Syria that are used to frequently smuggle illicit goods such as electronics, clothing, and consumer goods.⁶

International and domestic cooperation

The First National Conference on Illicit Trade was held in 2018, with public and private sector representatives agreeing to a set of recommendations aimed at strengthening coordination and enhancing enforcement mechanisms against illicit trade.

Lebanon is party to international treaties such as the Arms Trade Treaty and the UN Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, but has not ratified the WHO Protocol to Eliminate Illicit Trade in Tobacco Products.

GDP per capita in 2018

8,300
USD (nominal)

Lebanon ranks in the bottom

25%

in the world on perceptions of corruption

Lebanon ranks below

74%

of all countries in the world for government effectiveness

1 The World Bank: Worldwide Governance Indicators.

2 Transparency International: Corruption Perceptions Index.

3 EU Institute for Security Studies, 2016.

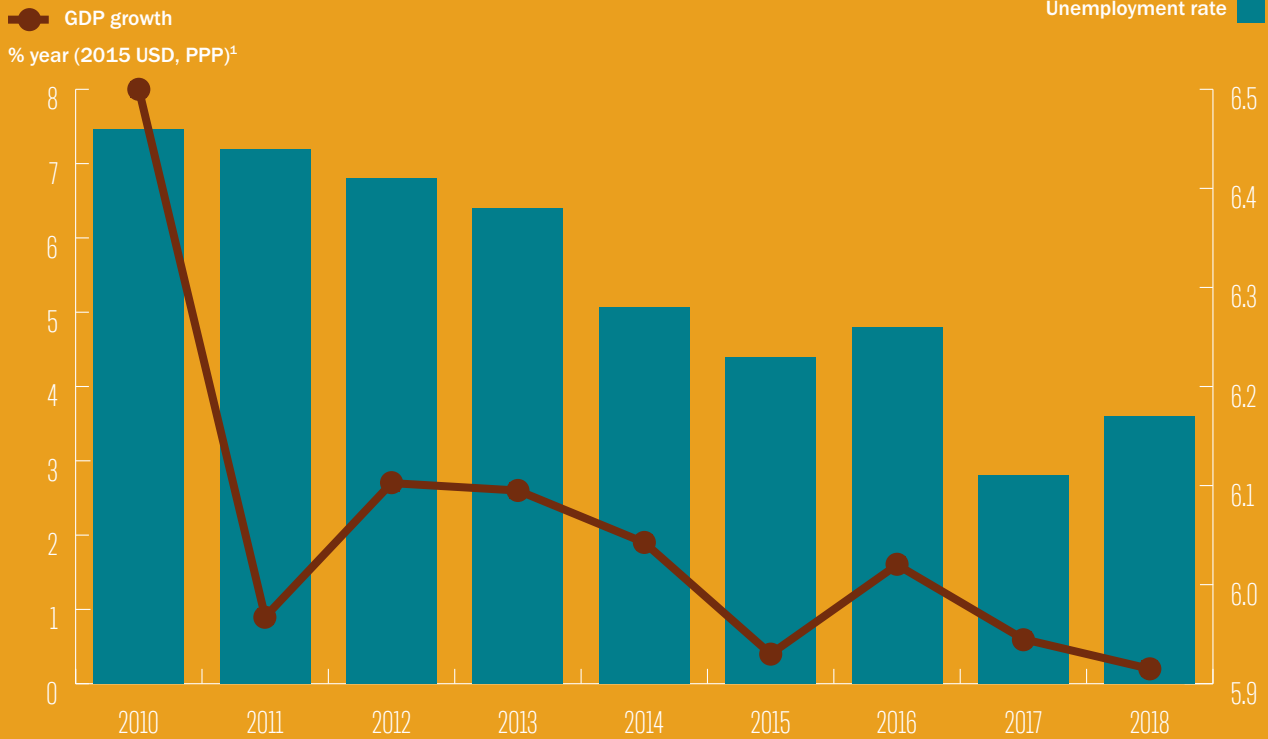
4 The World Bank Worldwide Governance Indicators.

5 The World Bank: Logistics Performance Index.

6 Finance Minister Ali Hassan Khalil, via <https://aawsat.com/english/home/article/1777726/124-illegal-border-crossings-between-lebanon-syria-increase-deficit>

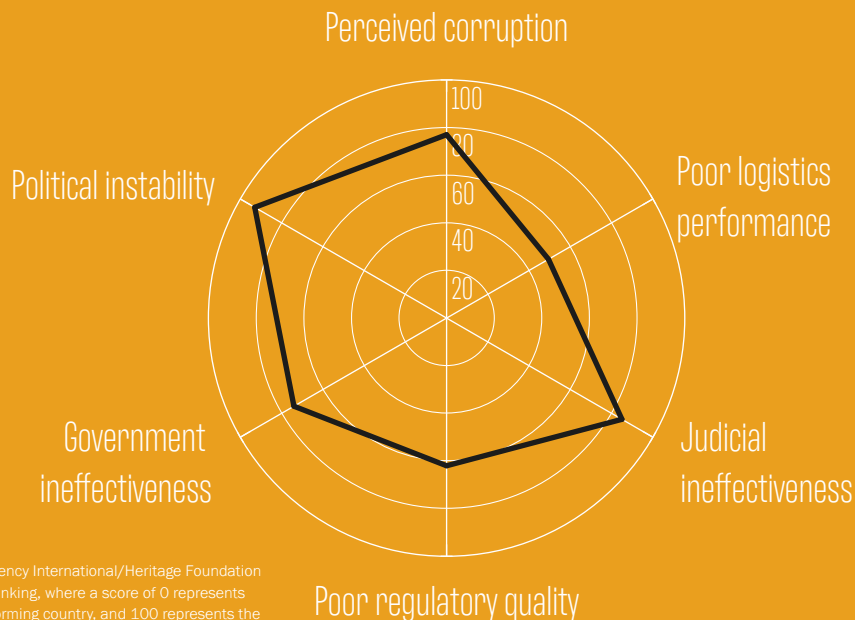


Lebanon: Economic environment



Source: Oxford Economics/Haver Analytics

Lebanon: Social and political environment



Source: World Bank/Transparency International/Heritage Foundation
Scores are based on global ranking, where a score of 0 represents the top ranked and best performing country, and 100 represents the lowest ranked and worst performing country.

¹ GDP growth is presented in constant Purchasing Power Parity (PPP) terms—which adjusts nominal data for differences in relative prices of goods & services across countries, and removes the impact of inflation and changes in exchange rates over time, so providing a better cross-country comparison of the standard of living over time.



Lebanon: Legal Domestic Sales

LDS were estimated at nearly 10.0bn cigarettes in Lebanon in 2018.¹ After falling modestly in 2017, LDS rose by 8.3% in 2018.

The state-owned tobacco manufacturer RLTT accounted for over 60% of LDS in 2018. The rest of the market was composed of the main international tobacco manufacturers: PMI, JTI, Imperial, and BAT.

RLTT is also responsible for regulating the tobacco industry and oversees all anti-smuggling activities, while acting as the exclusive agent granting permits to sell tobacco products domestically and manufacturing some international brands domestically.

The MSB of cigarettes cost LBP 750 (USD 0.49) per pack in 2018. This is higher than many neighbouring countries including Iraq, a major source of Non-Domestic Inflows, where the MSB costs USD 0.42 per pack.²

The market for cigarettes in Lebanon is primarily composed of low-value brands, accounting for nearly 70% of LDS in 2018. This has risen from just over 45% in 2014.

This share has increased dramatically in recent years—rising from just over one-quarter in 2010—during a period that coincided with a large influx of refugees fleeing the Syrian Civil War.

The **large price discrepancy between low-value and premium-value cigarette brands** has also supported this trend of consumer downtrading—the RSP of the cheapest brand in Lebanon is just 14% of the RSP of premium-value brands (one of the largest levels of price disparity evident across the Levant region).³

Average cigarette prices weighted across the different market segments have declined in recent years as a result of the growth in consumption of low-value brands. **This has led to a decline in the weighted average tax yield per pack of cigarettes.**

Legal Domestic Sales

10.0bn
cigarettes in 2018

Low-value brands
accounted for

68.7%
of LDS 2018

The RSP of the cheapest
brand is

14%
of the premium RSP

¹ Average of estimates provided by the industry.

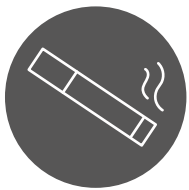
² Euromonitor Passport—Tobacco in Lebanon (2019), RLTT, and WHO report on the global tobacco epidemic 2019. For the purposes of this report, a pack consists of 20 cigarettes unless stated otherwise.

³ WHO report on the global tobacco epidemic 2019.



Lebanon, 2018 Population:¹

6.9mn



Smoking Prevalance:²

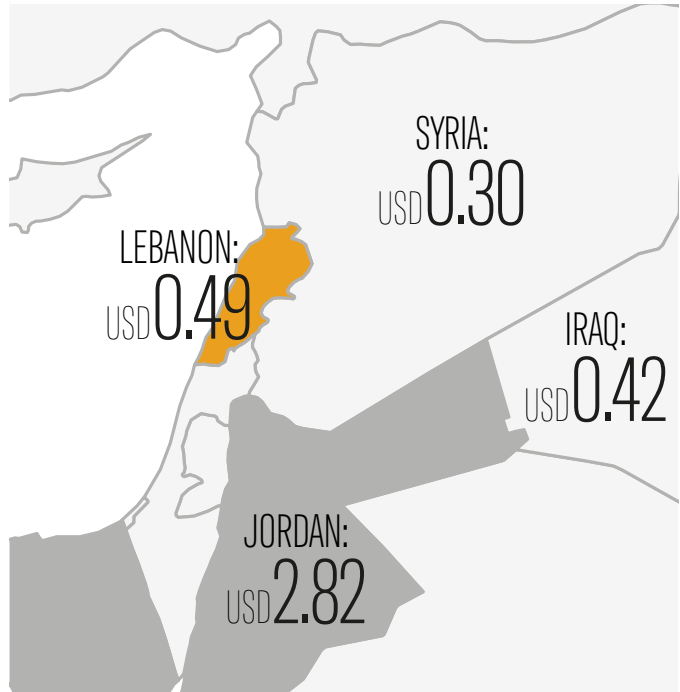
23.2%



Tax share of RSP:³

45.6%

Comparison of MSB cigarette prices⁴



Pack Price (MSB):

LBP 750/USD 0.49



Low-value Brand:

USD 0.33

Premium-value Brand:

USD 2.32



¹ United Nations World Population Prospects/Haver Analytics.

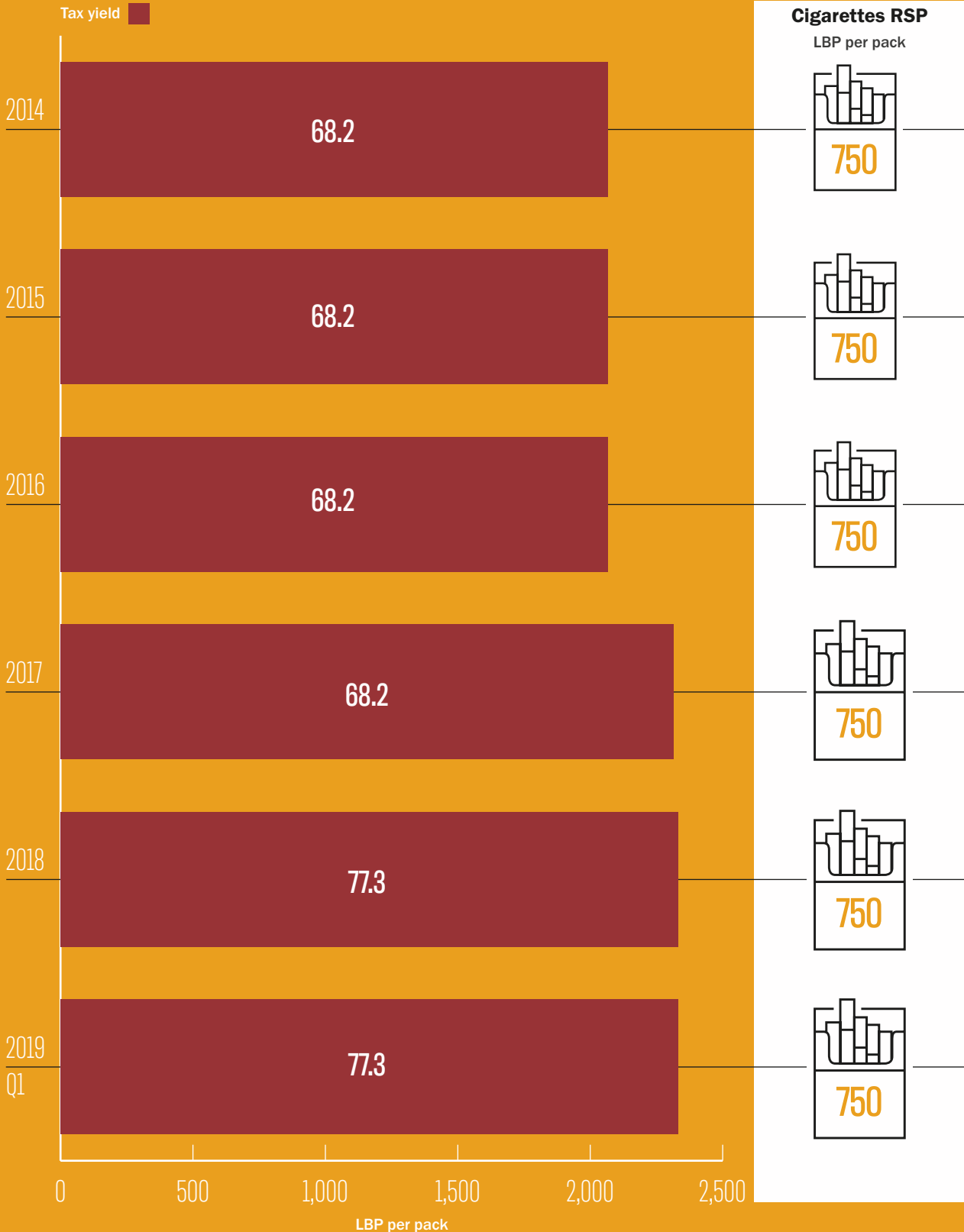
² WHO report on the global tobacco epidemic 2019, based on daily tobacco smokers aged 18-69.

³ WHO report on the global tobacco epidemic 2019.

⁴ Euromonitor Passport—Tobacco in Lebanon (2019) and RLTT.



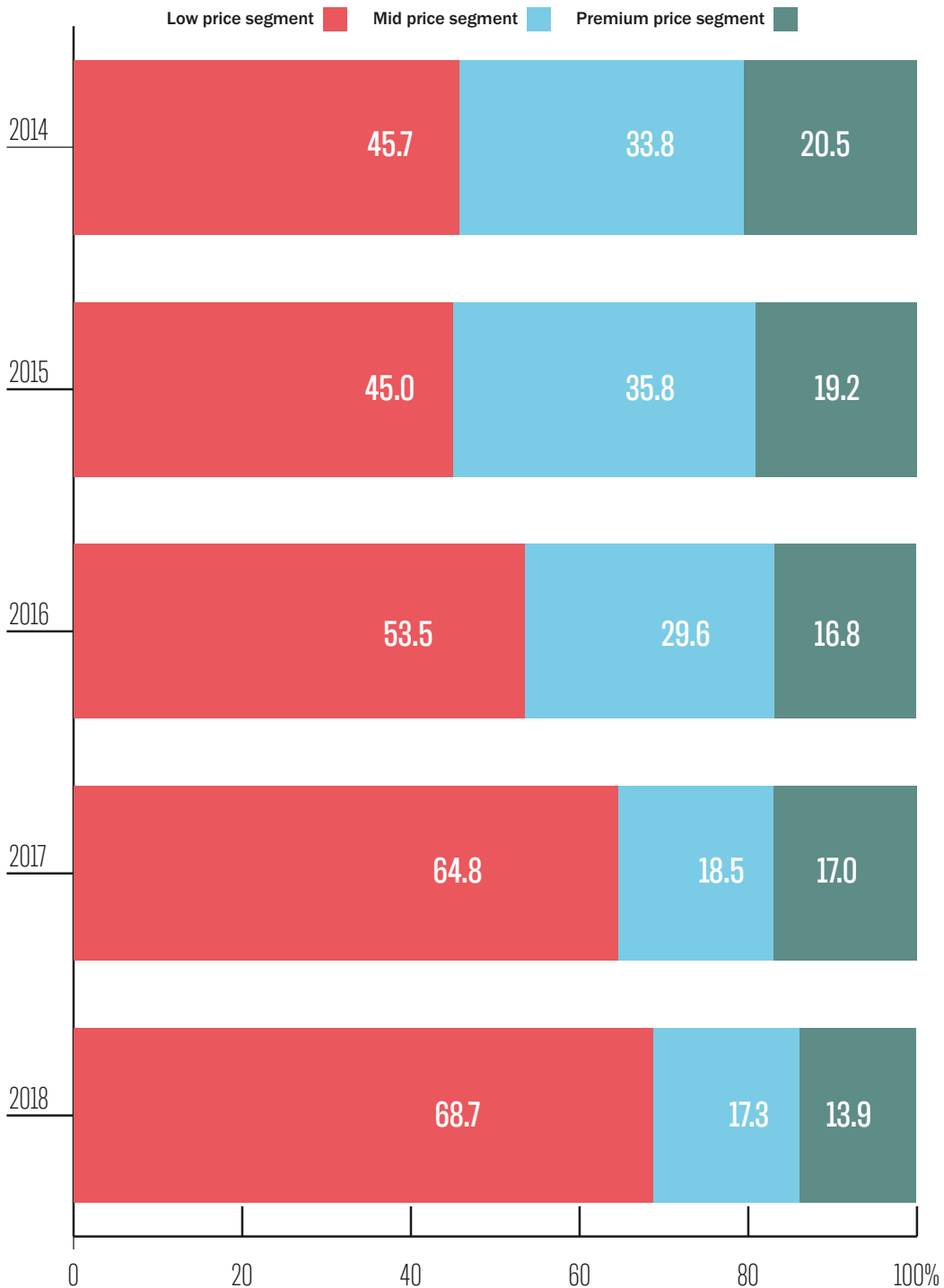
Lebanon: Cigarettes RSP and taxes



Source: Oxford Economics based on industry data
Based on the MSB in October of each year, with the exception of 2019, which is the rate applied in January.
Tax yield includes Excise Tax and VAT.



Lebanon: Legal Domestic Sales by price segment (% of total)





Lebanon: Cigarette Consumption

Total Consumption of cigarettes in Lebanon was estimated at 14.2bn in 2018. This represented an increase of 13.0% in comparison with 2017.¹

The increase in Total Consumption—equivalent to an additional 1.6bn cigarettes consumed during the year—was underpinned by a combination of both rising LDS and greater Non-Domestic Inflows.

Nearly 30% of all cigarettes consumed in 2018 were of non-domestic origin.

Of this, around 540mn non-domestic cigarettes or an estimated 3.8% of Total Consumption originated through legal channels.

The remainder, equivalent to **more than one-in-four cigarettes consumed throughout the year, was estimated to be of illicit non-domestic origin.** In total, an estimated 3.7bn illicit cigarettes were consumed in 2018, representing 25.9% of Total Consumption.

After remaining steady in 2017, **Illicit Consumption rose by more than 30% in 2018**, up from 2.8bn cigarettes previously. This corresponds to a 3.4pp rise in Illicit Incidence. Furthermore, the Q2 2019 EPS indicates that this trend continued in 2019, with the Illicit Incidence rising to 28.1%, up by more than 2pp in comparison with 2018.

It is assumed that there is no Domestic Illicit production in Lebanon, and so all illicit cigarettes are of non-domestic origin.

The prevalence and growth of illicit cigarette consumption in Lebanon was integral to the launch of the First National Conference Against Illicit Trade in March 2018—an initiative spearheaded by RLTT to encourage security, judiciary, military, and administrative agencies in Lebanon to join forces and tackle illicit trade.

This initial meeting generated a series of recommendations to act upon, aiming for adoption within five years. These included (I) raising inter-departmental coordination; (II) raising public awareness; (III) updating legislation; (IV) enhancing monitoring; and (V) supporting the national industry.²

Total Consumption
14.2^{bn}
cigarettes in 2018

Illicit Incidence rose to
25.9%
in 2018

Illicit Consumption
rose by
30.3%
in 2018

¹ The results from EPS's were combined with industry data on the volume of LDS to estimate the total volume of cigarettes consumed in Lebanon between 2016 and 2018. EPS's were undertaken in 2016 Q1 and Q3, 2017 Q1 and Q3, and 2018 Q2.

² See <http://www.rttt.com.lb/Article/291/the-first-national-conference-against-illicit-trade/en>



Lebanon: Composition of cigarette consumption

| | 2016 | | 2017 | | 2018 | | % change 2017-2018 | 2019 Q2 | |
|----------------------------------|------------------|-------------|------------------|-------------|------------------|-------------|-----------------------|------------------|-------------|
| | Cigarettes bn | % | Cigarettes bn | % | Cigarettes bn | % | | Cigarettes bn | % |
| Legal Domestic Consumption (LDC) | 9.5 | 74.1 | 9.2 | 73.3 | 10.0 | 70.3 | 8.3 | 3.0 | 68.6 |
| Total Non-Domestic Inflows (ND) | 3.3 | 25.9 | 3.4 | 26.7 | 4.2 | 29.7 | 26.0 | 1.4 | 31.4 |
| Non-Domestic Legal (NDL) | 0.5 | 3.9 | 0.5 | 4.2 | 0.5 | 3.8 | 2.7 | 0.1 | 3.3 |
| Non-Domestic Illicit | 2.8 | 21.9 | 2.8 | 22.5 | 3.7 | 25.9 | 30.3 | 1.2 | 28.1 |
| Domestic Illicit | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | N/A | 0.0 | 0.0 |
| Total Consumption | 12.8 | 100.0 | 12.6 | 100.0 | 14.2 | 100.0 | 13.0 | 4.4 | 100.0 |
| Total Illicit Consumption | 2.8 | 21.9 | 2.8 | 22.5 | 3.7 | 25.9 | 30.3 | 1.2 | 28.1 |

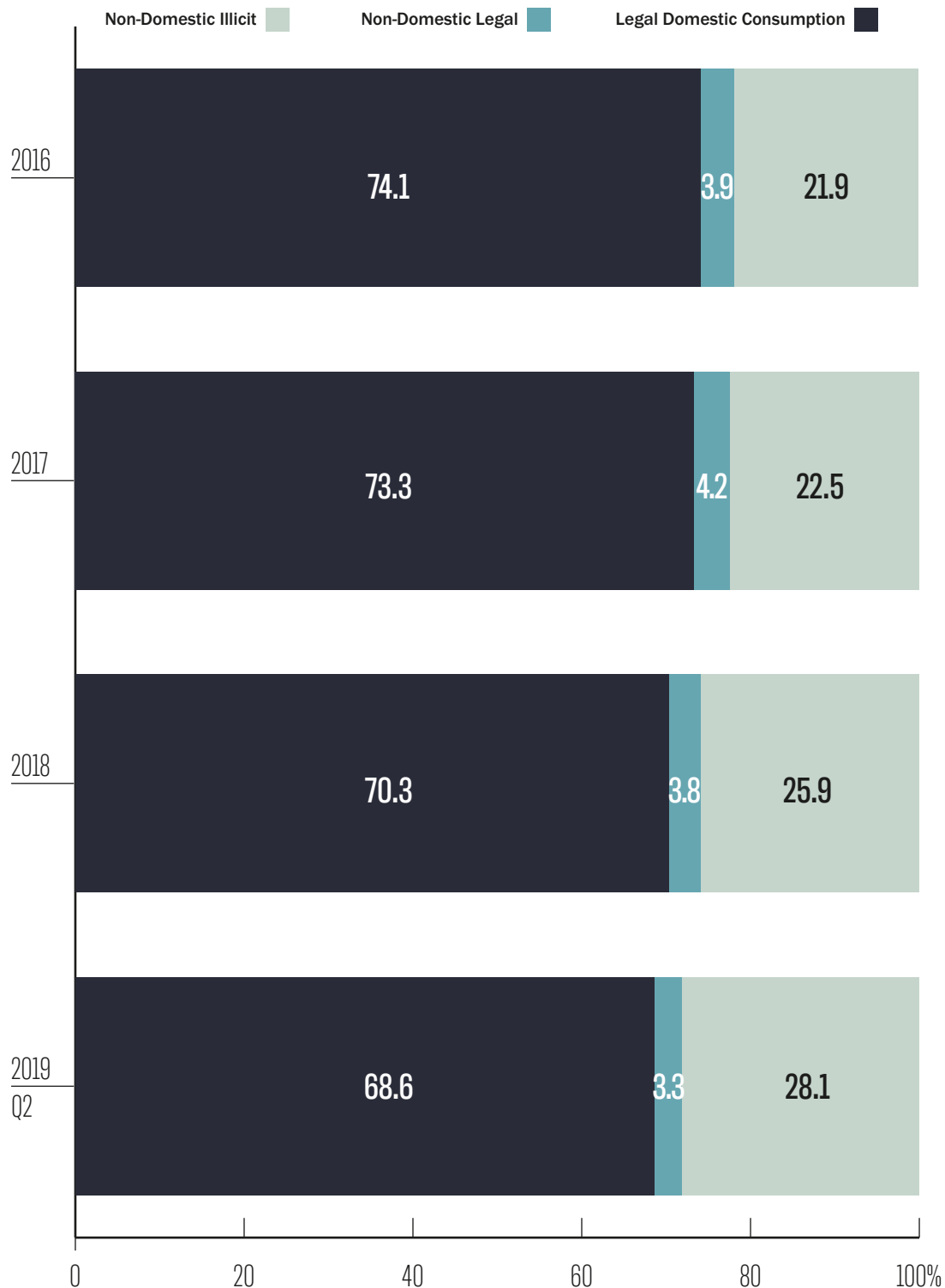
Source: Oxford Economics
 Figures may not sum due to rounding.



Increasing trend from previous year



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



Source: Oxford Economics



Lebanon: Illicit trade flows

EPS's conducted in Lebanon indicate a high incidence of Non-Domestic Inflows over the three years for which we have data. In 2018, Non-Domestic Inflows represented 29.7% of Total Consumption.

When subtracting Inflows of Non-Domestic Legal cigarettes,¹ we **estimate that nearly 3.7bn Non-Domestic Illicit cigarettes were consumed in 2018.**

The majority of Non-Domestic Illicit Inflows were identified as Iraq Market Variant cigarettes. In total, **over 64% of Illicit Consumption was composed of Iraqi products, following a 20% increase in their consumption in 2018.**

In total, around 50% of the total increase in Illicit Consumption in 2018 was driven by rising Inflows of Iraq Market Variant brands.

The largest brand of Non-Domestic Inflows from Iraq was 'Elegance'—based on analysis of the 2018 Q2 EPS—representing nearly two-thirds of total Non-Domestic Inflows of Iraq Market Variant cigarettes. This is equivalent to a Market Share in Total Consumption of more than 11%.

The other major contributor to rising Illicit Consumption was an **increase in Inflows of brands labelled as Duty-Free Market Variant, representing 12.6% of illicit Inflows.** But despite being identified as Duty-Free in the EPS, our analysis suggests **that these brands do not enter the market through legitimate Duty-Free channels.**

Syria Market Variant brands represented a further 10.4% of Total Illicit Consumption, following an increase in consumption of over 33% in 2018. The increase in presence of Syria Market Variant brands coincided with the reopening of the last remaining official Lebanon-Syria border in December 2017 following a five-year closure.

Counterfeit cigarettes represented a relatively small component of Total Illicit Consumption at just 2.6% in 2018.² However, the prevalence of Counterfeit cigarettes rose significantly after registering a negligible volume in both 2016 and 2017.

An estimated

3.7bn

illicit cigarettes were consumed in 2018

Products of Iraq Market Variant equalled

64.3%

of total illicit Inflows in 2018

Market Share of 'Elegance'

11.1%

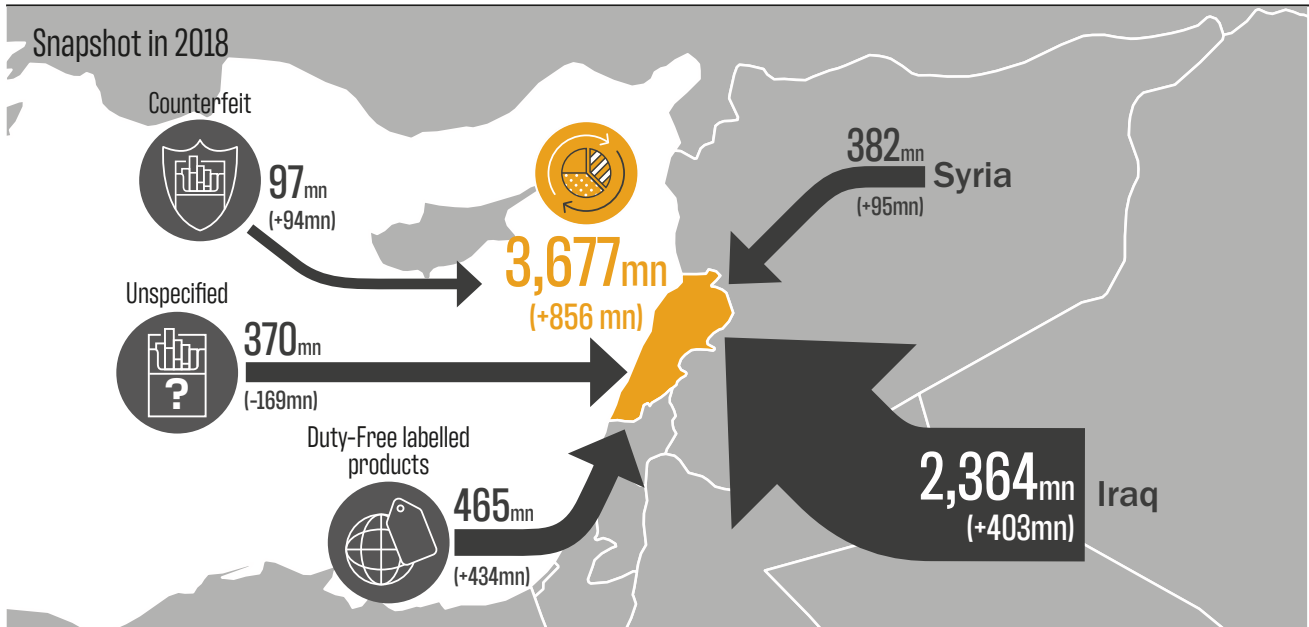
in 2018

1 Estimated using passenger data, Smoking Prevalence in tourists' country/market of origin, and the passenger duty-free personal import allowance limit. Lebanon permits a duty-free personal import allowance of 800 cigarettes.

2 Cigarette packets collected during the EPS are forensically analysed by the participating companies to identify Counterfeit products.



Lebanon: Origin of total Non-Domestic Illicit Inflows, 2018



| Three year trend | Cigarettes (mn) | | |
|-----------------------------|-----------------|-------|-------|
| | 2016 | 2017 | 2018 |
| Iraq | 1,342 | 1,961 | 2,364 |
| Syria | 628 | 287 | 382 |
| Duty-Free labelled products | 175 | 31 | 465 |
| Counterfeit | 4 | 3 | 97 |
| Other/Unspecified | 652 | 539 | 370 |
| Total | 2,801 | 2,821 | 3,677 |

Source: Oxford Economics



Lebanon: Government Finances

Lebanon applies a **multi-tiered, mixed Excise Tax system, which varies according to the RSP of cigarettes.**

All cigarettes are subject to a specific Excise Tax rate equivalent to USD 9.20 per 1,000 cigarettes for local products and USD 16.2 per 1,000 cigarettes for imports (increased from USD 9.20 per 1,000 in February 2017).

In addition, cigarettes are also subject to an ad-valorem component equivalent to 47% for cigarettes with a price of LBP 2,250 per pack of 20 cigarettes or above, or 39% for all other cigarettes, based on the CIF price.¹

A nominal VAT rate of 11% is applied to the RSP, last increased in January 2018 by 1pp as part of government legislation to fund public sector wage increases. The increase in VAT was offset by a reduction of 2pp in the ad valorem component of Excise Tax for all price segments.

Customs Duties are also applied—last increased in the 2019 Budget—equivalent to 116% for imported cigarettes and 38% for imported tobacco, again based on the CIF price.

In 2018, estimated Excise Tax revenues from LDS of cigarettes amounted to LBP 241.8bn (USD 160.4mn). This represented an increase of 4.3% in comparison with the previous year.

The trend of consumer downtrading means that the increase in estimated Excise Tax revenues was lower than the 8.3% rise in LDS over the same period, with the average tax yield per cigarette falling over this period.

Rising Illicit Inflows have increased the estimated Tax Losses from Illicit Consumption (Excise Tax plus VAT). In total, an **estimated LBP 116.2bn (USD 77.1mn) was lost due to Illicit Consumption in 2018.**

After remaining relatively stable in 2017, Tax Losses rose by 27.1% in 2018, broadly in line with the rise in Illicit Consumption. And based on the 2019 Q2 EPS, Tax Losses are expected to have increased further in 2019, driving by rising volumes of Illicit Consumption.

Total Excise Tax revenues of

LBP **242**bn
from LDS in 2018

Tax Loss estimated at

LBP **116**bn
in 2018

Estimated Tax Loss
rose by

27.1%
in 2018

¹ Cost, Insurance, and Freight (CIF).



Lebanon: Expected tax revenue and estimated Tax Losses

| | 2016 | | 2017 | | 2018 | | % change in local currency 2017-2018 |
|--|-------------|-------------|-------------|-------------|--------------|-------------|---|
| | LBP bn | USD mn | LBP bn | USD mn | LBP bn | USD mn | |
| Actual Excise Tax revenue from LDS of cigarettes | 233.6 | 155.0 | 231.7 | 153.7 | 241.8 | 160.4 | 4.3 |
| Estimated number of illicit cigarettes purchased (cigarettes bn) | 2.8 | | 2.8 | | 3.7 | | 30.3 |
| Estimated total Tax Loss from Illicit Consumption | 91.7 | 60.8 | 91.4 | 60.7 | 116.2 | 77.1 | 27.1 |
| Lost Excise Tax revenue | 69.2 | 45.9 | 71.1 | 47.1 | 89.2 | 59.2 | 25.5 |
| Lost VAT revenue | 22.6 | 15.0 | 20.4 | 13.5 | 27.0 | 17.9 | 32.5 |
| Excise Tax Loss as % of potential total Excise Tax revenues | 22.8 | | 23.5 | | 26.9 | | |

Source: Oxford Economics based on industry data



Lebanon: Tax Loss to Illicit Consumption (% of total expected Excise Tax revenue)



Source: Oxford Economics



Lebanon: Data Sources

| | Primary source | Calculation | Comments |
|--|---|---|--|
| Legal Domestic Sales (LDS) | Average of industry estimates. | — | — |
| Outflows of domestic duty-paid cigarettes | EPS data in other markets covered in this Report. | EPS data in other markets used to identify the presence of packs bearing Lebanon market-specific labelling (e.g., health warnings, tax stamps, etc.). | As Outflows based on EPS data from other markets covered in this Report, figures presented likely underestimate total Outflows. |
| Legal Domestic Consumption (LDC) | — | LDS minus Outflows of legal sales. | Zero identified Outflows of duty-paid cigarettes, so LDS equals LDC. |
| Total Non-Domestic Inflows (ND) | — | Sum of Non-Domestic Legal and Non-Domestic Illicit. | — |
| Non-Domestic Legal (NDL) | — | Estimated using passenger data, adult smoking rates, and passenger duty-free personal import allowance. | Maximum theoretical amount an individual can carry across a border: Passenger data from the UNWTO/Ministère du Tourisme, and the OE Tourism Model. |
| Non-Domestic Illicit | EPS. | Based on EPS and OE estimates. | Estimates derived from 2016 Q1 and Q3, 2017 Q1 and Q3, 2018 Q2, and 2019 Q2 EPS's. |
| Domestic Illicit | — | There is assumed to be no under-declaration of domestically produced cigarettes. | While it is recognised that some Non-Domestic Illicit cigarettes may actually be manufactured domestically, this cannot be determined through analysis of the EPS. |
| Total Illicit Consumption | — | Sum of Non-Domestic Illicit and Domestic Illicit. | — |
| Total Consumption | — | LDS minus Outflows of domestic duty-paid cigarettes, plus estimated Non-Domestic Legal consumption, plus estimated Total Illicit Consumption. | The IT Flows Model estimate of Total Consumption is 14.2bn cigarettes for 2018. |
| Total Tax Loss | — | Total Illicit Consumption multiplied by the applicable weighted average tax rates (including Excise, Earmarked, and VAT/GST/sales tax). | — |

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