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Paper for the House Committee meeting on 12 June 2009

**Report of the Bills Committee
on Dutiable Commodities (Amendment) Bill 2009**

Purpose

This paper reports on the deliberations of the Bills Committee on Dutiable Commodities (Amendment) Bill 2009 (the Bill).

Background

Proposal contained in the 2009-2010 Budget

2. In the 2009-2010 Budget Speech delivered on 25 February 2009, the Financial Secretary announced to increase tobacco duty rates by 50% with immediate effect for public health reasons. More specifically, the duty on cigarettes was increased from \$0.804 per stick to \$1.206 per stick. The duty rates on other tobacco products (namely cigars, Chinese prepared tobacco, and all other manufactured tobacco except tobacco intended for the manufacture of cigarettes) were also increased by the same percentage.

Justifications for tobacco duty increase

3. The Administration last increased tobacco duty in 2001-2002. Government statistics show that price is a key factor influencing tobacco consumption and smoking prevalence. According to the Administration, smokers are picking up the habit at an earlier age and smokers, especially young smokers, are smoking more cigarettes. In addition, there is also an increase in duty-paid cigarettes from around 3.5 billion sticks in 2007 to about 3.8 billion sticks in 2008.

4. According to the Administration, the increase in tobacco duty is to strengthen tobacco control efforts to protect public health, and in response to repeated calls from the community for further increase of tobacco duty to discourage smoking. The increase is also aimed at reducing the long-term

disease burden for Hong Kong. According to a local study, the annual costs of diseases caused by tobacco, including direct medical costs, long-term care costs and productivity loss arising from active smoking and passive smoking, amount to about \$5.3 billion.

Public Revenue Protection Order 2009

5. In order to give immediate effect to increase the duty rates on tobacco, the Chief Executive, after consultation with the Executive Council, made the Public Revenue Protection Order 2009 (the Order) under section 2 of the Public Revenue Protection Ordinance (Cap. 120) on 25 February 2009. The Order came into force at 11 a.m. on 25 February 2009. With a four-month temporary effect, the Order will lapse on 25 June 2009.

The Bill

6. The Bill, introduced into the Legislative Council on 13 May 2009, implements the 2009-2010 Budget proposal of increasing the duty rates on tobacco by 50%. The Bill seeks to –

- (a) amend Part II of Schedule 1 to the Dutiable Commodities Ordinance (Cap. 109) to increase the rates of duty on various types of tobacco by 50%; and
- (b) bring the Bill into operation with retrospective effect from 11 a.m. on 25 February 2009 as the Order, under which the increase has already taken effect, took effect from that time.

The Bills Committee

7. At the House Committee meeting held on 15 May 2009, Members formed a Bills Committee to scrutinize the Bill. The membership list of the Bills Committee is in **Appendix I**.

8. Under the chairmanship of Hon CHAN Kin-por, the Bills Committee has held two meetings with the Administration. The Bills Committee has received views from the public on the Bill at one of these meetings. A list of the deputations which have given views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

Impact of tobacco duty increase on illicit cigarette activities

9. Hon Albert CHAN has expressed serious doubt about the effect of the

increase in tobacco duty on tobacco consumption and smoking prevalence, as he considers that the increase has only prompted smokers to switch to consuming illicit cigarettes, thus stimulating smuggling activities of illicit cigarettes. He and some other members such as Hon Vincent FANG and Hon WONG Ting-kwong have expressed concern that many illicit cigarettes are counterfeit cigarettes which pose even more serious harm to health than smoking genuine cigarettes. Hon Albert CHAN considers that the Administration has failed to take effective enforcement actions against the smuggling and sale of illicit cigarettes, and there are signs that illicit cigarette activities have become more rampant after the increase in tobacco duty. He has given examples of illicit cigarette sellers dropping leaflets listing brands and prices in mailboxes, and providing phone-order services for buyers. He has queried that the new measure cannot achieve its desired effect but only provides impetus to smuggling and sale of illicit cigarettes.

10. The Administration has informed the Bills Committee that since the levying of the new tobacco duty as announced in the Budget, the Customs and Excise Department (C&ED) has been closely monitoring illicit cigarette activities at the entry points and on the street level, and has strengthened its enforcement actions against different aspects of illicit cigarette activities, including smuggling, storage, distribution and peddling. According to the Administration, as a result of its enhanced enforcement effort, C&ED detected 955 cases involving smuggling, storage, distribution or peddling of illicit cigarettes in the first four months of 2009. The Administration has highlighted that although the number of cases has increased as compared with the same period in the past two years, there has not been significant change in the quantity of illicit cigarettes involved (see table below). The Administration has also stressed that according to C&ED's intelligence analysis and observation, there is no sign that illicit cigarettes activities have become more rampant.

	<i>2007 (Jan-Apr)</i>	2007	<i>2008 (Jan-Apr)</i>	2008	<i>2009 (Jan-Apr)</i>
No. of cases (smuggling, distribution, storage and peddling of illicit cigarettes)	638	1 819	461	1 601	955
No. of arrest	481	1 446	350	1 207	715
Quantity of cigarettes seized (million sticks)	26	109	22.5	73	25

11. Hon CHAN Kin-por and Hon WONG Ting-kwong have requested the Administration to give an undertaking that it will take robust enforcement actions against illicit cigarette activities, as they consider that there are incentives for such activities to increase if the sale price for illicit cigarettes has

really risen significantly as advised by some deputations. The Administration has advised that C&ED will continue to devote sufficient resources to enhance enforcement against illicit cigarette activities at all fronts. Tactically, with enhanced intelligence collection, C&ED will not only crack down on the smuggling sources, but will also conduct intensive operations against retailing and peddling of illicit cigarettes. C&ED will also spare no effort in monitoring and combating the sale of illicit cigarettes through phone order leaflets.

Impact on tobacco consumption and smoking prevalence

12. Regarding the concern about the effectiveness of the tobacco duty increase in reducing tobacco consumption and smoking prevalence, the Administration has informed the Bills Committee that the smoking cessation hotlines operated by the Department of Health (DH) (including the Tung Wah Group of Hospitals (TWGHs) smoking cessation programme funded by DH), the Hospital Authority (HA), as well as the University of Hong Kong have all recorded a significant increase in the number of calls received since the announcement of tobacco duty increase by 50% on 25 February 2009. According to DH and TWGHs, the daily average number of callers seeking smoking cessation information increased six-fold from 24 (between January to 25 February 2009) to 141 persons (between 26 February to end March 2009). Among these, the total number of calls made by youngsters aged below 20 increased from six to 40 on a daily basis, representing an increase of over 400%. The total number of calls handled between 26 February to end March 2009 (4 782) has already exceeded that handled in the whole year of 2008 (4 335).

13. The daily average number of enquiries received by HA's Smoking Counselling and Cessation Programme increased from 13 (between January to 25 February 2009) to 46 (between 26 February to end March 2009), representing a 350% increase. As for the Youth Quitline run by the University of Hong Kong, the total number of calls increased by more than 220% from 30 (between January to 25 February 2009) to 98 (between 26 February to May 2009).

14. While the Administration has concluded from these statistics that the increase in tobacco duty is a strong impetus for smokers to quit smoking, Hon Albert CHAN is of the view that the increase in number of calls is insignificant compared to the smoking population of 600 000 in Hong Kong. He has criticized the Administration for failing to conduct an assessment on the social and economic impacts of the increase in tobacco duty before its introduction and highlighted its impact on the livelihood of cigarette retailers, particularly, the newspaper hawkers..

15. The Administration has advised that the decision to increase the tobacco duty was made having considered different relevant factors. The Administration has made reference to international and local researches which

show that cigarette price is a key factor influencing tobacco consumption and smoking prevalence. These research findings include the World Bank's report in 1999 which has pointed out that, on average, a price increase of 10% is expected to reduce demand for cigarettes by about 4% in high-income countries and by about 8% in low- and middle-income countries. A nation-wide research conducted by the Chicago University has also shown that a price increase of 10% is expected to bring about a reduction in the population of young smokers by over 6%, and a reduction of adult smokers by about 3% to 5%. The World Health Organization's Framework Convention on Tobacco Control which took effect in 2005 has also pointed out that "the Parties recognize that price and tax measures are an effective and important means of reducing tobacco consumption by various segments of the population, in particular young persons."

16. The Administration has also advised that, according to government statistics, the smoking prevalence rate in Hong Kong (the proportion of daily cigarette smokers among the population aged 15 and above) went down every time after a significant duty increase. In 1983, after a 300% increase in tobacco duty, the smoking prevalence rate dropped to 18.7% in 1984, down from 23.3% in 1982. In 1991, after a 100% increase in tobacco duty, the smoking prevalence rate dropped to 14.9% in 1993, as compared to 15.7% in 1990.

Impact of tobacco duty increase on the sale of duty-free and duty-paid cigarettes

17. Hon Albert CHAN has expressed concern that the tobacco duty rate increase may lead to upsurge in the sale of duty-free cigarettes, which will only reduce tax revenues but has no effect on tobacco consumption and smoking prevalence. He has pointed out that the business of cigarette retailers have also been seriously affected as a result of the price increase of duty-paid tobacco products. He has enquired about the relevant sale figures for assessment of the impacts of the increase in tobacco duty.

18. The Administration has advised that the monthly average sales of duty-free cigarettes (sold by duty free shops in Hong Kong control points and those in Luohu, Huanggang, Macau and Futian) for the two months preceding the tobacco duty increase (i.e. January and February) was 157.57 million sticks. After the increase of tobacco duty rates on 25 February 2009, the average monthly sales for March and April 2009 was 155.62 million sticks, which was similar to that for the period just before the duty increase and that (154.75 million sticks) for the same period last year. The duty potential of the duty-free cigarettes sold in March and April 2009 was \$375 million.

19. The Administration has advised that C&ED does not collect retail statistics of cigarettes, but has provided the changes in duty-paid quantity of cigarettes in the first four months of 2008 and 2009, as given below –

	2008		2009	
	Duty-paid Quantity (million sticks)	Decrease (%)	Duty-paid Quantity (million sticks)	Decrease (%)
Jan - Feb (monthly average)	560.45	-	462.74	-
Mar - Apr (monthly average)	68.93	88	106.14	77

The figures show that the monthly average duty-paid quantity of cigarettes in March and April 2009 decreased by 77% as compared with that of January and February 2009. For the same period in 2008, a decrease of 88% was recorded. The Administration has explained that it has been common for tobacco traders to increase their stock of duty-paid cigarettes before the Budget. As a result, the quantity of duty-paid cigarettes usually drops significantly in the one or two months after the Budget. The Administration has advised that it is therefore not appropriate to draw any conclusion from the figures at this stage.

Impact on newspaper hawkers

20. Members in general have expressed grave concern about the impact of the tobacco duty rate increase on the livelihood of newspaper hawkers, who claim that their monthly incomes have decreased by a few thousands dollars due to a drop in the sale of duty-paid cigarettes. The Administration has advised that it is in active discussion with the trade to explore possible ways to improve their business environment, such as permitting sale of additional commodities other than those specified in the relevant licence and enlarging the proportion of stall area designated for selling additional commodities, provided that no adverse impact will thus be posed to environmental hygiene. The Administration has indicated that it is also prepared to consider the trade's suggestion on advertising at the stalls. Members have requested the Administration to provide a timetable for working out concrete proposals on such new measures. As the Administration is still waiting for the trade's input on the new proposals, it is not in a position to provide a timetable at this juncture but has confirmed that the Food and Environmental Hygiene Department will continue to maintain its dialogue with the hawker representatives and will actively consider their proposals upon receiving them.

Resources for smoking cessation

21. Hon Tanya CHAN has expressed concern about the adequacy of the allocation of resources for smoking cessation and whether the additional tax revenue from tobacco duty will be used for setting up a dedicated fund for

smoking cessation services.

22. The Administration has advised that the revenues from tobacco duty, similar to other tax revenues, will be credited to the General Revenue. The Administration will then make appropriate allocation of resources based on actual requirements for expenditure through the annual Resource Allocation Exercise. The Administration has pointed out that more financial resources has been devoted every year to tobacco control in recent years. The provision for publicity and education programme on smoking prevention and cessation for 2009-2010 will be \$33.7 million, including \$11.5 million for the Hong Kong Council on Smoking and Health, \$17.2 million for Tobacco Control Office, \$5 million for the provision of a three-year pilot community-based smoking cessation programme launched by TWGHs since January 2009. Under the programme, four smoking cessation centres are established throughout the territory to provide free smoking cessation services. There will also be tailor-made smoking cessation programmes for young smokers.

Policy on duty rates

23. Hon Albert CHAN has questioned the policy of increasing duty rates on tobacco products on the one hand and reducing the duty rates on alcoholic beverages on the other. He considers that alcoholic beverages are no less harmful than tobacco products to the society, and the present policy allows the rich to enjoy cheaper wines while the poor are required to pay for expensive cigarettes. The Administration has advised that it attaches importance to the prevention and control of alcohol misuse. The Steering Committee on Prevention and Control of Non-communicable Diseases chaired by the Secretary for Food and Health, comprising medical professionals, social workers and other key stakeholders, has set up a working group to deliberate on and oversee the overall strategy for the relevant work.

Resumption of Second Reading debate

24. The Bills Committee supports the resumption of the Second Reading debate on the Bill at the Council meeting on 17 June 2009.

Committee Stage amendments

25. The Administration and the Bills Committee have not proposed any Committee Stage amendments.

Follow-up actions by the Administration

26. At the request of the Bills Committee, the Administration has undertaken to provide the following information within six months to one year

after the enactment of the Bill to the relevant Panels for follow-up discussion -

- (a) a progress report on the effectiveness of the Administration's efforts in combating illicit cigarette activities (paragraphs 9-11);
- (b) statistical figures on changes in the number of smokers in Hong Kong (paragraphs 12 -16);
- (c) sale figures of duty-free cigarettes and the duty potential of the duty-free cigarettes sold (paragraphs 17-19); and
- (d) measures taken to increase the business opportunities of newspaper hawkers in order to address their concern on the impact brought about by the increase in cigarette duty on their livelihood (paragraph 20).

Advice Sought

27. Members are invited to note the deliberations of the Bills Committee.

Council Business Division 1
Legislative Council Secretariat
11 June 2009

**Bills Committee on Dutiable Commodities
(Amendment) Bill 2009**

Membership list

Chairman	Hon CHAN Kin-por, JP
Members	Hon Andrew CHENG Kar-foo Hon Albert CHAN Wai-yip Hon Vincent FANG Kang, SBS, JP Dr Hon Joseph LEE Kok-long, JP (since 30 May 2009) Hon Alan LEONG Kah-kit, SC (since 30 May 2009) Hon WONG Ting-kwong, BBS Hon Tanya CHAN
	(Total: 8 Members)
Clerk	Ms Joanne MAK
Legal Adviser	Mr Kelvin LEE
Date	30 May 2009

**Bills Committee on Dutiable Commodities
(Amendment) Bill 2009**

**List of deputations/individuals who have submitted views to the Bills
Committee**

1. Asian Consultancy on Tobacco Control, Hong Kong
2. Dr Amy CHAN Kit-ling
3. Professor Sophia CHAN Siu-chee, Head, Department of Nursing Studies, The University of Hong Kong
4. Circle K
5. Clear the Air
6. Coalition of Hong Kong Newspaper and Magazine Merchants
7. Department of Community Medicine and School of Public Health, The University of Hong Kong
8. Health Group of Democratic Party
9. Hong Kong Council on Smoking and Health
10. Hongkong Newspaper Hawker Association
11. Life Education Activity Programme
12. Modern China Restaurant
13. Ms. Yolanda NG Yuen-ting, Wan Chai District Councillor
14. Philip Morris Asia Limited
15. The Society of Hospital Pharmacists of Hong Kong
16. Tobacco Association of Hong Kong