



## Illicit Trade in Tobacco Products Need Not Hinder Tobacco Tax Policy Reforms and Increases

One of the most effective and cost-effective measures to reduce tobacco use is the use of price and tax measures to reduce demand.<sup>1</sup> Higher taxes that lead to higher tobacco product prices have been proven to improve public health, increase government revenue, and reduce the macro economic burden associated with tobacco use.<sup>2</sup>

A primary point of opposition to increasing tobacco taxes is the fear that increases in tobacco taxes will result in illicit trade and undermine tobacco control efforts. The policy brief summarizes five key arguments regarding illicit trade:

### 1. The tobacco industry uses illicit trade to argue against tax increases, arguing that increases in tobacco taxes will lead to increases in illicit trade, which, in turn, will undermine public health and fiscal policy objectives.

The tobacco industry publicly expresses concern about the impact illicit trade has on the amount, stability, and predictability of governmental excise tax revenues. The industry offers its “expertise” to help governments establish “optimal” excise tax rates and structures. However, common industry tactics include (but are not limited to):

- Participating in large-scale tax evasion by orchestrating cigarette smuggling into a country to pressure governments into lower tobacco taxes
- Supplying international brands via illegal channels as a market entry strategy
- Citing the presence of illegal tobacco to demand less stringent tobacco control policies and/or to prevent tobacco tax increases
- Establishing credible front groups to give the impression of widespread independent support for its fight against illicit trade
- Making deals with governments to control illicit trade

### What is Illicit Trade?

The WHO FCTC defines illicit trade as “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase, including any practice or conduct intended to facilitate such activity.” Illegal methods of circumventing taxes are called tax evasion, as they intend to evade paying all or some tobacco taxes. These include smuggling, counterfeit cigarettes, illicit white cigarettes, and unbranded tobacco. Tax avoidance, on the other hand, occurs through legal mechanisms and may often only be available as a result of poor policy and or administration. These include cross-border shopping, forestalling, and manipulation of product attributes. It is important to recognize that while there is a distinction between tax evasion and tax avoidance, they are often exploited for the same purpose: to reduce tax liability, and both undermine public health and fiscal policy objectives.

## 2. The tobacco industry exaggerates the scale and extent of illicit trade as a means of advocating against tobacco tax increases.

Another commonly employed tactic by the industry is to generate estimates of the size of the illicit market and commission studies by various commercial entities and front groups to do the same. These estimates systematically overstate the extent of illicit trade, to use the presence of illegal tobacco trade to fight tobacco control policies, including tobacco tax increases.

Independent estimates are nearly always lower than industry estimates and tax compliance of tobacco is similar to that of other tax lines.

## 3. Taxes and prices are not the key driver and determinant of illicit trade; many other factors are more likely to be causal.

Contrary to industry arguments, academic studies show that the illicit cigarette market is relatively larger in countries with low taxes and prices while relatively smaller in countries with higher cigarette taxes and prices.

Research shows that non-price factors are much more important determinants of the size of the illicit tobacco market. These include strength of governance; quality of tax administration; strength of the regulatory framework; government commitment or willingness to control illicit activities; social acceptance of illicit trade; availability of informal distribution networks; and to some extent, geography.

## 4. Even in the presence of illicit trade, increases in tobacco taxes reduce tobacco use and raise revenues.

There are many examples where substantial increases in tobacco taxes were not accompanied by increases in illicit trade. The White Paper describes several examples where illicit trade was measured before and after tax increases and showed no increases in illicit trade. For example:

- Turkey substantially increased its tobacco tax in January 2013 and the size of the illicit cigarette market remained stable five months after the tax increase.<sup>3</sup>
- The Mongolian government increased the imported tobacco tax by 30% in May 2017. However, the share of packs without a tax stamp declined after the increase.<sup>4</sup>
- In South Africa, higher tobacco taxes in the 1990s resulted in a relatively small increase in the illicit cigarette market, but also in a lower smoking prevalence and a doubling of excise tax revenue.<sup>5</sup>
- Since 2007, the tobacco excise tax in Brazil has been increasing faster than inflation. This has been accompanied by the implementation of a track and trace system as well as other administrative and enforcement measures. As a result, smoking prevalence and consumption of illegal cigarettes has declined.<sup>6</sup>

## 5. If governments are concerned about the levels and/or extent of illicit trade, there are many policy, administrative, and enforcement measures that they can take to reduce illicit trade, even while increasing tobacco taxes.

Governments in many countries are interested in addressing illicit trade. There are public health, economic, and safety-related incentives to deal with the illicit tobacco market that go beyond a pure revenue recovery motivation. Recently, several countries have responded to the illicit trade by focusing on technological solutions, such as implementation of track and trace systems (T&T). A targeted criticism by the tobacco industry is the costs related to implementation. Cost estimates of the most comprehensive country-level solution are around US\$ 0.02 per pack/mark.<sup>7</sup> Given the relatively low unit cost of a T&T and the financing options, even LMICs can implement it.

Globally, the WHO FCTC Protocol to Eliminate Illicit Trade in Tobacco Products outlines strategies of measures to reduce and prevent illicit trade in tobacco products, including: controlling the supply chain; addressing unlawful conduct; criminal offenses through enforcement; and promoting international cooperation.

## References

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## About Tobacconomics

Tobacconomics is a collaboration of leading researchers who have been studying the economics of tobacco control policy for nearly 30 years. The team is dedicated to helping researchers, advocates and policymakers access the latest and best research about what’s working—or not working—to curb tobacco consumption and the impact it has on our economy. As a program of the University of Illinois at Chicago, Tobacconomics is not affiliated with any tobacco manufacturer. Visit [www.tobacconomics.org](http://www.tobacconomics.org) or follow us on Twitter [www.twitter.com/tobacconomics](https://www.twitter.com/tobacconomics).