

# SMUGGLING



## Highlights:

- Smuggling and illicit trade result in \$40 to \$50 billion dollars in lost global government revenue.
- The fear of smuggling causes governments to keep taxes low and spend additional monies to control smuggling.
- Smuggling and illicit trade increases the consumption of tobacco products due to lower prices; smuggled products are less expensive than legal products, while the “legitimate” products become cheaper through tax reductions.
- Smuggling usually represents 100% tax evasion, as most smuggled cigarettes have not had tax paid on them, and the tobacco industry is largely complicit in the trade of illegal cigarettes.
- Illicit trade, smuggling, and contraband are not the result of high taxes, but rather of fraud, corruption and weak enforcement.

### INB on ILLICIT TRADE:

Recognizing the international nature of tobacco smuggling and illicit trade, and the cooperation necessary to address it, the Conference of the Parties of the FCTC launched negotiations for a supplementary treaty to combat illicit trade in tobacco products. The COP has set 2010 as the goal for completing the negotiations.

## An International Problem:

The smuggling of cigarettes occurs in most areas of the world. Since it is a cross-border issue, successful counter-measures often require intergovernmental cooperation.<sup>1</sup> Smuggling creates health issues, as both the lower-priced smuggled cigarettes and the lowered taxes on “legitimate” products encourage people to smoke more, which in turn increases health damage caused by smoking.

While a small number of cigarettes are smuggled by international travellers or leak through duty-free portals, the vast majority of cigarettes smuggled internationally are those on which no tax has been paid. In fact, most smuggling does not involve exploiting the differential between high-tax and low-tax markets, but rather involves cigarettes which escape taxation in their country of origin because they are labelled as being for export, but which are then smuggled back into the original country or otherwise sent somewhere other than their intended market.

## Who Pays the Price?

*In most cases, the main beneficiary of the cigarette smuggling and illicit trade is the established tobacco industry, which has been heavily implicated in the facilitation of smuggling and illicit trade worldwide. In addition to discouraging governments from lowering taxes, smuggling is used by the tobacco industry to force entry into closed markets, such as countries with a state-owned monopoly. Most smuggled cigarettes are bought legally from tobacco companies, and smuggled cigarettes that are destroyed represent an increased market for the companies, which thus sell a higher volume. In addition, lower prices increase sales, again benefitting the tobacco industry. Governments not only lose the revenue that the taxes paid on legitimate sales would have generated, they also lose potential revenue from higher taxes that are not implemented for fear of exacerbating the smuggling problem. This ultimately reduces the money governments have available for state-funded health care and programs to help smokers quit.<sup>2</sup>*

*In recent years, some markets have seen the emergence of manufacturers whose entire operations are illegal (i.e. unregistered, underground factories). Some of these have succeeded in taking market share from established tobacco companies.*

## Canadian Lessons Learned:

Throughout the 1980s and early 90s, tobacco smuggling in Canada was only a minor problem despite repeated tax increases; however, starting in 1992 the incidence of smuggling increased dramatically.<sup>3</sup> It involved massive exports of brand-name cigarettes from Canada (and in one case, shifting production of a “Canadian” brand to Puerto Rico) which were then smuggled back into the country. Tobacco smuggling was thus triggered by the tobacco industry’s decision to ship massively into non-existent export markets and to supply US wholesalers who were involved in smuggling into Canada. It is important to highlight that contraband cigarettes became a problem not because of high taxes *per se*, but because of the industry’s decision to embark on a high-risk but profitable “export” strategy in order to force taxes back down. On July 31, 2008, Rothmans, Benson & Hedges and Imperial Tobacco Canada, two tobacco companies active in Canada, pleaded guilty to the production and distribution of contraband cigarettes between 1989 and 1994 to avoid paying taxes. The criminal fines and civil penalties agreed to by the two companies total C\$1.15 billion.<sup>4</sup> Canada’s third big company, JTI-Macdonald, still faces criminal charges, as well as civil suits that have driven it into bankruptcy protection.

The dramatic rise in youth consumption that followed the 1994 tax rollback eventually led the Canadian government to take strong contraband-control measures and restore tobacco taxes to their previous levels. These measures – including an export tax on Canadian-made cigarettes – have been effective in preventing large tobacco companies from re-entering the contraband market. However, recently there has been a proliferation of small, illegal manufacturing operations just across the Canada-US border, which now have substantial market share in Canada.

### A Solution?

While the industry benefits financially from smuggling, the costs of smuggling are usually borne by governments—and by individual smokers sickened or killed by smoking cheaper smuggled cigarettes. Any solution, then, should place the burden of paying for the problem on the industry, not on governments or individuals. This can be achieved through international cooperation and a system that forces the industry to prove that all exported cigarettes have indeed arrived in the country of destination and by paying a bond to government that covers the tax that would have been paid if the cigarettes were sold locally. Fines to companies for smuggled cigarettes can also be set high enough to provide a true deterrent to smuggling. No single country can stop the problem of smuggling, but all countries should have the incentive to cooperate and to ensure that the industry foots the bill.

### REFERENCES:

- <sup>1</sup> Jha P, Chaloupka FJ. Curbing the Epidemic: Governments and the Economics of Tobacco Control. Washington: The World Bank; 1999.
- <sup>2</sup> Arnott D, Joosens L, Bianco E, Assunta M, Ogwel A. Smuggling treaty could reduce tobacco toll. *The Lancet*; 371: 458-460, 2008.
- <sup>3</sup> Sweanor D, Martial LR. The Smuggling of Tobacco Products: Lessons from Canada. Canada: Non-Smokers Rights Association/Smoking and Health Action Foundation; 1994.
- <sup>4</sup> Schneider, J. Imperial, Rothmans Agree to Pay C\$1.15 Billion Over Smuggling. *Bloomberg News*: <http://www.bloomberg.com/apps/news?pid=20601082&sid=aypl.NwNN6rM&refer=canada>

### RESOURCES:

World Health Organisation, Framework Convention on Tobacco Control  
<http://www.who.int/gb/fctc/>  
Action on Smoking and Health, UK  
[http://www.ash.org.uk/ash\\_r7ykwjrj.htm](http://www.ash.org.uk/ash_r7ykwjrj.htm)  
The Centre for Public Integrity, Tobacco Underground  
<http://www.publicintegrity.org/investigations/tobacco/pages/introducti>  
The Framework Convention Alliance  
<http://www.fctc.org>  
[http://www.fctc.org/index.php?option=com\\_content&view=section&layout=b](http://www.fctc.org/index.php?option=com_content&view=section&layout=b)  
Article Progress in combating cigarette smuggling:  
<http://tobaccocontrol.bmj.com/cgi/rapidpdf/tc.2008.026567v1>