

# Tobacco taxes, illicit trade and plain packaging

THE TAXATION OF tobacco is a core policy mechanism for reducing cigarette smoking. Evidence shows that the greater the tobacco tax increase, the lower the cigarette consumption. National revenue agencies, such as Customs, collect enormous amounts of cigarette taxes every year through import duties, value-added tax (VAT) and excise taxes. These taxes fund vital government services.

Estimates of the quantity of revenue collected from tobacco taxes for the five members of the United Nations Security Council alone in 2011 was over 60 billion US dollars according to data from the World Health Organization (WHO): United States (US) – 33.28 billion; France – 14.87 billion; United Kingdom (UK) – 14.07 billion; Russian Federation – 2.41 billion; and China – 0.54 billion (based on currency conversions carried out in April 2015).

The illicit trade in tobacco can negatively impact efforts to reduce smoking because it can lower the price of cigarettes. Accordingly, the causes of illicit trade and the available policy options are of great interest to policymakers. Obtaining data and scientifically measuring illicit trade is challenging as there can be various contributing factors. Moreover, smugglers and counterfeiters do not supply researchers with data.

Extensive peer-reviewed research has shown that taxation is not the primary contributor to the illicit trade in tobacco. Indeed, many countries with high cigarette taxes have low illicit trade rates – for example, Sweden and the UK – while many countries with low cigarette taxes have high illicit trade rates.

Luk Joossens from the Belgian Foundation against Cancer and the Association

of European Cancer Leagues, based in Brussels, Belgium, is an international expert on tobacco control who has advised, among others, the World Bank, the European Commission and the WHO. Robert Ireland, the WCO Head of Research and Communications, conducted the following written interview with Mr. Joossens.

## *What is your analysis of the main causes of the illicit tobacco trade?*

Illicit trade is the outcome of classic demand and supply: demand by smokers for cheaper or specific tobacco products, which are perceived as better quality and not available on the domestic market, and supply by legal and illegal tobacco manufacturers looking for more profit, more sales, and increased market shares, or to penetrate new markets, facilitated by corruption, the presence of criminal networks, and weak government enforcement capacity.

Smokers' use of illicit tobacco is related to price and availability. The demand for illicit tobacco products is strongly influenced by reduced prices, often 30% to 50% cheaper than legal products. In addition, supplying the illicit market is attractive to companies and traders because of the low cost of manufacturing – as low as five US cents a pack in Paraguay – and the potential gains to be made when selling products without paying any tax.

It is crucial to note, however, that the solution to this problem is not to lower tax levels. Although a high tax margin may provide the initial incentive to smuggle, data shows that it is not the only factor. Other important factors include the ease and cost of operating in a country, industry participation, how well crime networks are organized, the likelihood of

being caught, the punishment if caught, corruption levels and so on.

Estimates of the illicit trade from 84 countries in 2007 have shown that the proportion of illicit trade in the cigarette market is lower overall in high-income countries than in low-income countries. Corruption has been shown to be a strong predictor of levels of tobacco smuggling, with inadequate laws and law enforcement as well as geography also playing a role. Price levels do not predict levels of illicit trade.

## *What policy options for reducing the illicit tobacco trade do you recommend?*

Combating smuggling is creating obstacles for illicit traders. The incentive for traders is the financial gain; the disincentive is the range of obstacles to making these gains. A mix of policies should be recommended to achieve this goal. In the UK, the gains are high, but so too is the number of obstacles. Cigarette prices in the UK are among the highest in the world, but the illicit cigarette market was reduced from 21% in 2000 to 9% in 2012.

The UK strategy included a wide range of measures designed to curb illicit trade such as the deployment of additional Customs officers, specialist investigators and intelligence staff, more X-ray scanners, tougher sanctions and penalties, a public awareness campaign, supply chain legislation, confiscation of proceeds and international cooperation using overseas intelligence officers.

The global scope and multifaceted nature of the illicit tobacco trade requires a coordinated international response and improved global regulation of the legal tobacco trade. Countries should be encouraged to ratify the Protocol to Eliminate the Illicit Trade in Tobacco Products (ITP).



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The ITP has been negotiated as a supplementary treaty to the WHO Framework Convention for Tobacco Control (FCTC).

The ITP has three parts: measures to control the supply chain, to improve law enforcement and to enhance international cooperation. Adopted in November 2012, it will enter into force on the 90<sup>th</sup> day following the 40<sup>th</sup> ratification of the Protocol. So far, 54 Parties to the WHO FCTC have signed the Protocol, and seven countries have ratified it.

***Counterfeit cigarettes are one component of the illicit trade in tobacco. Are these cigarettes more dangerous to smoke than genuine cigarettes?***

Counterfeit cigarettes are not a standard and uniform product. They do not respect specific rules or obey regulations. Some counterfeits are made of 'good quality tobacco' and some may include musty raw tobacco processed with sulphur and carbamide to look better. Focusing on the hazardous chemicals in counterfeit cigarettes may result in 'regular' cigarettes being seen as safe, even though they kill half of all regular users, contain 70 carcinogenic

chemicals, and are responsible for 6 million premature deaths each year.

Both genuine and counterfeit cigarettes are extremely toxic products. There are no safe cigarettes and there is no safe level of smoking. For instance, in 1989, the US Surgeon General's report listed just a few of the elements people typically consume when smoking genuine cigarettes: carbon monoxide, tar, argon, nicotine, methane, acetaldehyde, acetic acid, hydrogen cyanide, formic acid, isoprene, nitrogen oxides, phenols, ethylene, acrylonitrile, glycerol, acrolein, ammonia, formaldehyde, benzene, acetylene, styrene, tobacco-specific nitrosamines, anthracene, arsenic, cadmium, chrysene, benzopyrene, vinyl chloride, and radioactive polonium.

***Ireland and the UK have joined Australia in adopting laws on plain (standardized) packaging of cigarettes, and France is in the process of doing so. The WHO has stated that "the implementation of standardized tobacco product packaging represents a legitimate and effective tobacco control measure" and "is in accordance with international legal***

***obligations under the WHO FCTC." As other countries consider similar legislation, it is an important subject for Customs' cognizance, especially any impact on revenue collection and illicit trade. What are your thoughts?***

Tobacco companies have argued that standardized packaging will result in falling prices that in turn will increase the consumption of tobacco. However, evidence from Australia does not show falling prices; rather, price rises have continued over and above tax increases. There is some evidence of trading down towards cheaper brands, but this appears to be a continuation of an ongoing market trend.

Plain packaging was introduced in Australia in December 2012. In 2012, the market share for premium cigarette brands in Australia was 16.9% and in March 2014, after a major tax hike in 2013, 15.1%. This is not a dramatic shift. In many high-tax cigarette countries, value packs become more popular and premium brands lose market share.

Tobacco companies have claimed that plain packaging would result in more illicit trade, because copying and counterfeiting

would be easier. Again, the evidence so far shows that the percentage of smokers using unbranded ‘chop-chop’ tobacco remains at very low levels – only 0.2% regular use by smokers in 2014 – and that an increase in the counterfeit trade never happened.

In November 2013 the UK Government commissioned an independent review led by Sir Cyril Chantler into the public health effects of standardized packaging of tobacco. The review stated that they had “seen no convincing evidence to suggest that standardized packaging would increase the illicit market.” Chantler noted that in Australia “hardly any counterfeit standardized packages have been found to date.” Furthermore, a representative of one of the Australian tobacco manufacturers informed Sir Cyril’s team that his company had seen a reduction in counterfeit products following the introduction of standardized packaging in that country.

In addition, in its 2013-2014 annual report, Australian Customs and Border Protection reported decreases from 2012-13 to 2013-14 in several illicit cigarette trade indicators: level of tobacco seized – down from 183 to 178 tonnes; number of cigarettes seized – down from 200 to 147 million sticks; and duty evaded – down from 151 to 139 million Australian dollars.

*What does your analysis reflect about the impact of plain packaging of cigarettes?*

So far, the Australian experience is a success story. The main objective was to make tobacco products less attractive and it worked. For instance, school-based surveys of students aged 12-17 in 2011 and 2013 in Australia show that the removal of branding and the uniformity of the pack appearance have increased negative pack ratings and decreased positive ones. As result of a comprehensive tobacco control policy, daily smoking decreased from 15.1% in 2010 to 12.8% in 2013. There was no price war, and no collapse of prices, no loss of market share for small shops, no increase in unbranded illicit tobacco, and even a decrease in cigarette counterfeiting.

*The possibility exists that plain packaging might increase price competition between tobacco sellers, leading to lower*

**Cigarette plain packaging milestones**

November 2011	Australia passes plain packaging law.
August 2012	The High Court of Australia finds by a 6-1 majority that the plain packaging law is constitutional and not an “acquisition of property,” following a lawsuit filed by JT International and British American Tobacco Australasia Limited.
December 2012	Australia’s plain packaging law takes effect.
April 2014	The report of the independent review undertaken by Sir Cyril Chantler, “Standardized Packaging of Tobacco,” is published in the UK.
March 2015	Ireland passes plain packaging law.
March 2015	The UK passes a plain packaging law covering England.
March 2015	Tobacco Control, which belongs to the British Medical Journal Publishing Group, publishes 14 peer-reviewed papers on plain packaging.
April 2015	The French National Assembly approves plain packaging.
May 2016	Plain packaging laws scheduled to take effect in England, France and Ireland.

*prices. What should governments do in such situations, if anything?*

A price war cannot be ruled out, because it is the responsibility of tobacco companies to set prices. If tobacco companies want to launch a price war, nobody can prevent them. In many countries, the government cannot regulate prices, but can increase taxes to annul the effect of the price reduction. This will not lead to an increase in smuggling if tax enforcement and tax administration is strengthened.

*From a technical perspective, are plain packages easier to counterfeit than regular packs?*

All visible features and all packs are easy to counterfeit. The quality of counterfeit cigarette packs has substantially improved from the 1990s, making it, in some cases, very difficult to distinguish counterfeit from genuine cigarette packs.

In their 2015 report on plain packaging, HM Revenue and Customs in the UK summarized their findings on counterfeiting as follows: “Currently the quality of counterfeit packaging varies from poorly produced packets to those that are virtually indistinguishable from their genuine counterparts. However, while the introduction of standardized packaging would seem to simplify the counterfeiters’ task, current proposals suggest that future packets would remain complex, with a range of security measures that would present challenges to organized criminal groups, at least in the short term.”

Luk Joossens, an international expert on tobacco control employed by the Belgian Foundation against Cancer and the Association of European Cancer Leagues, has a Bachelor’s degree (Licence) in sociology from the University of Leuven (1972) and a Master’s degree (Maitrise) in sociology from the Sorbonne in Paris (1972). He has authored and co-authored many published peer-reviewed papers, including Joossens, L., and M. Raw (2012), “From cigarette smuggling to illicit tobacco trade,” Tobacco Control 21: 230-4; Joossens, L., and M. Raw (2008), “Progress in combating cigarette smuggling: Controlling the supply chain,” Tobacco Control 17: 399-404; and Joossens, L., and M. Raw (1998), “Cigarette Smuggling in Europe, Who Really Benefits?,” Tobacco Control 7: 66-71. Mr. Joossens also wrote a 2012 Cancer Research UK report entitled “Smuggling, the tobacco industry and plain packs.”

The introduction of plain packaging will not make a difference for counterfeiters: it will remain business as usual.

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