

# Taxation and illicit trade

## Fact sheet 4

The tobacco industry has claimed that high taxes drive smuggling and has sometimes argued successfully to governments that they should not increase tobacco tax because this will increase the level of smuggling. The argument is that smugglers will smuggle into a country where they can make the highest profit, and that these are the countries where tax is a high proportion of the price, leaving a large margin to reduce the price (by evading tax) and still retain a profit. In fact the overall level of smuggling is generally higher in countries that have lower cigarette prices (generally also countries also with a lower tax rate) than in countries that have high prices.

Although a high tax margin may provide the initial incentive to smuggle, the data show that it is not the only factor. Other important factors include the ease and cost of operating in a country, industry participation, how well organized crime networks are, the likelihood of being caught, the punishment if caught, corruption levels and so on.<sup>1</sup>

While illicit trade is an outcome of demand and supply, the tobacco industry has consistently focused on the demand side to explain the illicit trade and argues that illicit trade arises because of high taxation.

Analyses by the World Bank have shown that high levels of illicit tobacco products are linked more closely to corruption and tolerance of contraband sales.<sup>2</sup>

The global trade in illicit tobacco products occurs in low tax as well as high tax jurisdictions, results from a lack of control on cigarette manufacturing and the movement of cigarettes across international borders, and is run by criminal organizations with sophisticated systems for distributing smuggled cigarettes. Illicit trade is more common in low-income than in high-income countries.<sup>3</sup>

Research in central and eastern Africa shows that cigarette smuggling in this region is not caused by differences in tax levels but is the result of weak state capacity, high levels of corruption and the activities of rebel groups. Although cigarette prices in these countries are low (US\$ 0.60 per pack for the most popular brand), the easy evasion of taxation fuels the smuggling by traders and accounts for the high levels of smuggling in these low-income countries.<sup>4</sup>

Experience from a high tax country (United Kingdom) has shown that it is possible to increase taxes without undesired consequences, if a policy to

### Relationship between legal price and illicit trade in 2007

World Bank income group	Average legal price of a pack of cigarettes (US\$)	Average percentage of illicit cigarette market
Low income	1.13	16.8
Middle income	1.89	11.8
High income	4.89	9.8

Source: Joossens L, Merriman D, Ross H, Raw M. The impact of eliminating the global illicit cigarette trade on health revenue. *Addiction*. 2010;105:1640–95.

combat illicit trade has been put in place. In the period 2000–2014, cigarette prices more than doubled in the United Kingdom,

while smoking prevalence and illicit trade decreased and tobacco excise revenues increased.

### Cigarette price and its impact on the illicit market, revenue and smoking prevalence in the United Kingdom in the period 2000–2014

Year	Price pack of cigarettes (£) (1)	Illicit cigarette market in % (2)	Tobacco excise revenues (billion £)(2)	Smokers % (3)
2000	3.88	21	7.6	27
2002	4.39	16	8.0	26
2004	4.65	15	8.1	25
2006	5.05	15	8.2	22
2008	5.44	13	8.2	21
2010	6.13	9	9.1	20
2012	7.09	9	9.7	20
2014	8.47	Not yet available	Not yet available	18

Source: (1) Tobacco Manufacturers' Association; (2) HM Revenue and Customs; (3) Action on Smoking and Health

- <sup>1</sup> Jha P, Chaloupka F, editors. Tobacco control policies in developing countries. Oxford: Oxford University Press; 2000.
- <sup>2</sup> Merriman D, Yurekli A, Chaloupka FJ. How big is the worldwide cigarette-smuggling problem? In: Jha P, Chaloupka FJ, editors. Tobacco control in developing countries. Oxford: Oxford University Press; 2000.
- <sup>3</sup> Joossens L, Merriman D, Ross H, Raw M. The impact of eliminating the global illicit cigarette trade on health revenue. *Addiction*. 2010;105:1640–95.
- <sup>4</sup> Titeca K, Joossens L, Raw M. Blood cigarettes: cigarette smuggling and war economies in eastern and central Africa. *Tob Control*. 2011;20:226–32.

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