

Tobacco Smuggling and the Economy

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<http://www.tobaccoevidence.net>

1. Varieties of Tobacco Smuggling

- **Legal tax avoidance**
- **Bootlegging**
- **Wholesale smuggling (tax evasion)**

Legal tax avoidance

(strictly speaking not smuggling)

- **Cross border shopping (no resale)**
 - **Business trips**
 - **Tourist trips**
- **Duty Free Sales (regulated, small % of total sale)**

Bootlegging

- Purchase of tax paid cigarettes in low-priced area for **resale** in higher priced area.
- Any price differential (tax induced or otherwise) provide an incentive for bootlegging.
- Between neighboring areas
- Involves relatively **small quantities**
- **Low level** of technology and organization often involved

Wholesale smuggling

- **No tax** (or duty) paid
- Probably accounts for very **large** component of all tobacco smuggled worldwide.
- May involve transport of goods over long **distances**.
- **Quantities** involved tend to be large.
- **Sophisticated** capital-intensive transport methods (e.g. speedboats) sometimes used.
- May involve diversion of **in-transit** goods.

2. Estimates of smuggling for 1995 (% of domestic sales, experts' opinion)

Country	Estimate of smuggling as a percentage of 1995 domestic sales by expert sources	Country	Estimate of smuggling as a percentage of 1995 domestic sales by expert sources
Argentina	14	Latavia	39
Austria	15	Lithuania	30
Azerbaijan	13	Malaysia	18
Bangladesh	38	Myanmar	53
Belgium	7	Nepal	1
Belarus	23	Netherlands	8
Brazil	15	Pakistan	30
Bulgaria	15	Philippines	19
Cambodia	37	Poland	15
China	4	Romania	20
Columbia	30	Russia	6
Czech Republic	7	Korea Republic	9
Estonia	16	Singapore	2
France	2	Slovakia	3
Germany	10	Spain	15
Greece	8	Sri Lanka	10
Hong Kong	10	Sweden	2
Hungary	5	Taiwan	14
India	1	Thailand	11
Indonesia	5	UK	2
Ireland	4	Ukraine	5
Italy	12	Uzbekistan	11
Kazakhstan	17	Vietnam	28

Best estimate:
Smuggling
represent
6 to 8.5%
of total
consumption

3. Motivations for Tobacco Smuggling

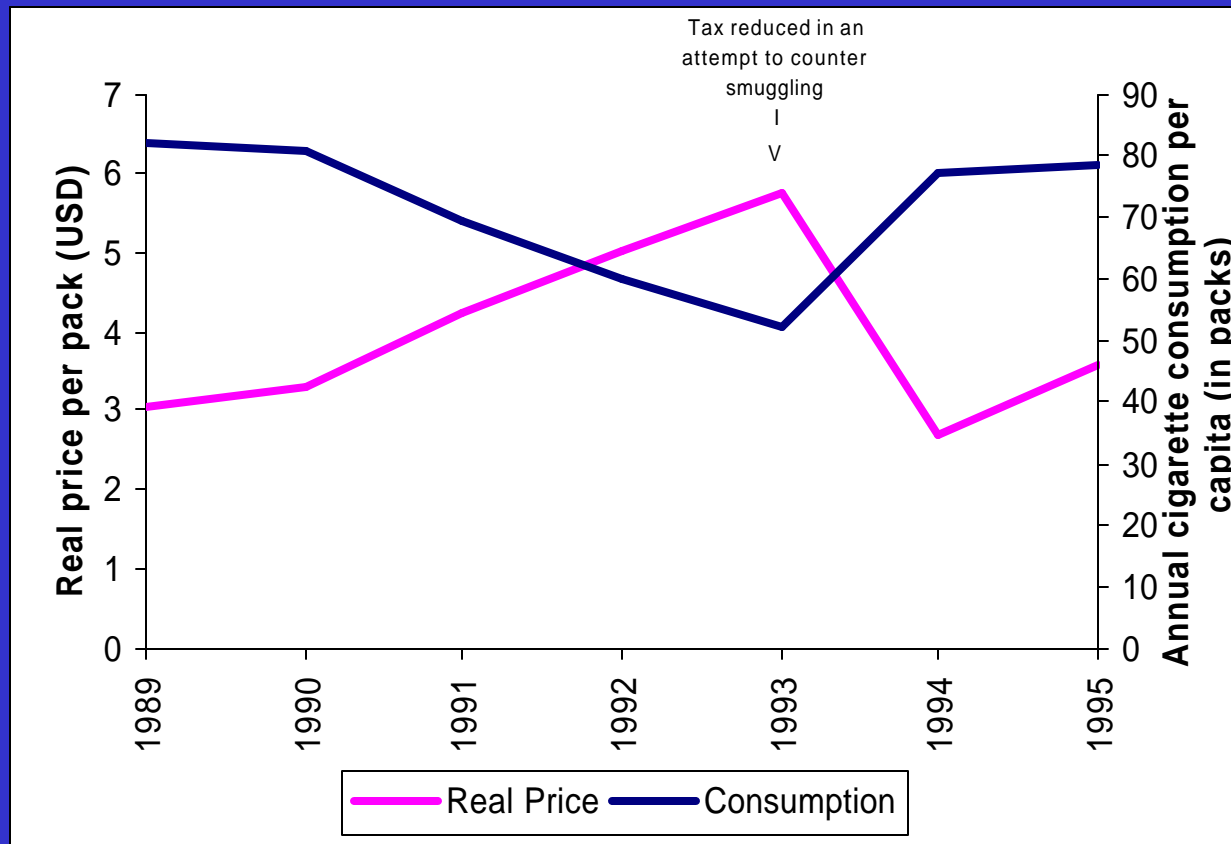
- **Incentives** to smuggle: Profit-Maximization
 - Price differentials (taxes or pricing-to-market)
 - Unemployment or low-wage legal employment
 - Corrupt (or easily evaded) border controls
 - Distribution infrastructure (e.g. street vendors)
- **Deterrence** (how difficult it is to smuggle)
 - Certainty versus severity of punishment
 - Moral suasion (public opinion)
- **Undermining government tobacco policy**
 - Low black market price stimulates demand and puts pressure on the government not to raise taxes
 - Smuggled tobacco “opens” markets that would otherwise be closed to foreign imports

Undermining Government Tobacco Policy

- Smuggled tobacco may:
 - Reduce **revenue** from tobacco taxation
 - Undermine **health warnings**
 - Undermine restrictions on **sales to minors**
- **Smuggling does not reduce the impact of tax increases** on smoking behavior, therefore higher taxes will improve public health even in the presence of smuggling.

4. Smuggling and Consumption: Canada Lower Cigarette Tax in Response to Smuggling

Real price of cigarettes and annual cigarette consumption per capita, Canada, 1989-1995

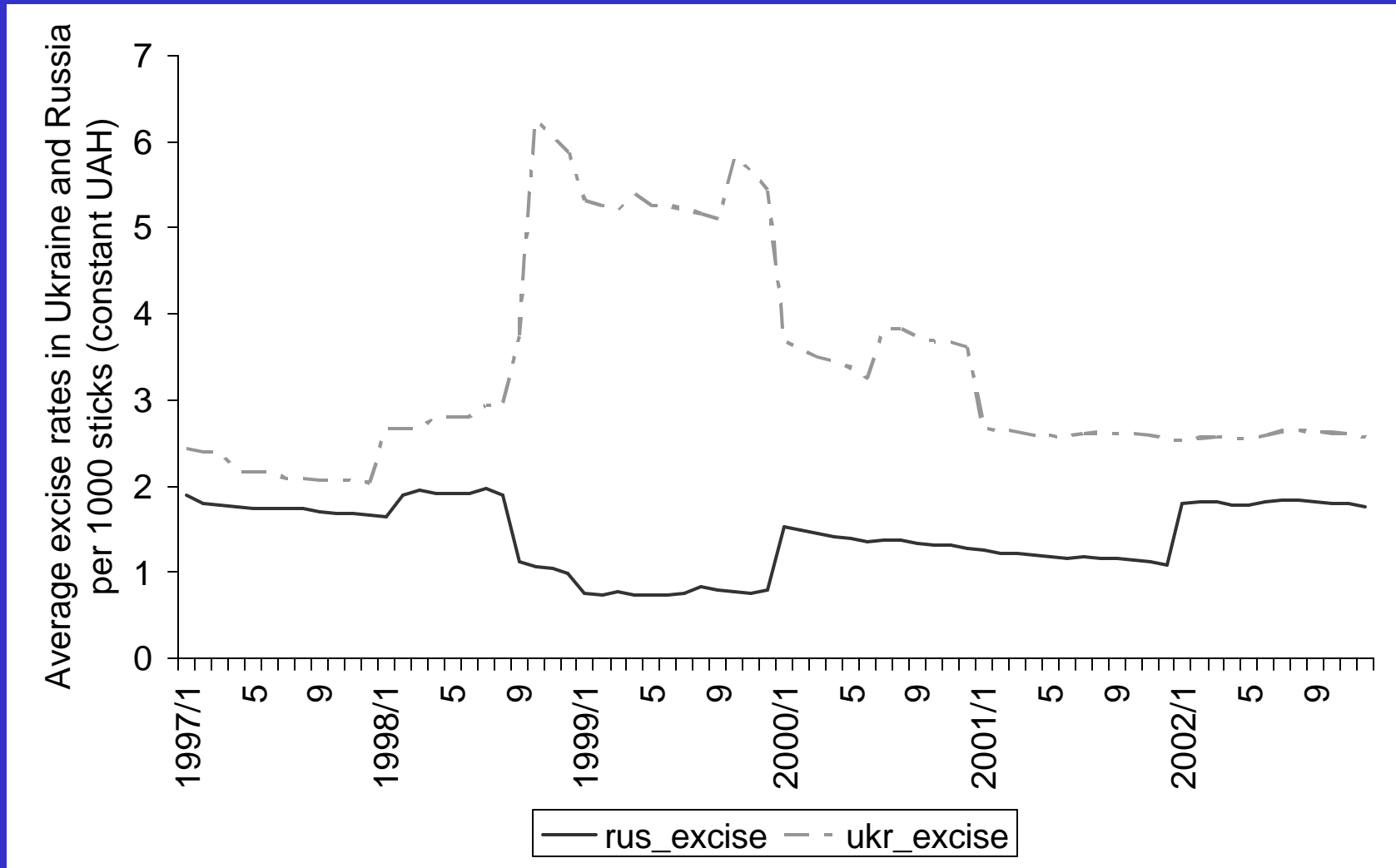


Source: Jha and Chaloupka, 1999

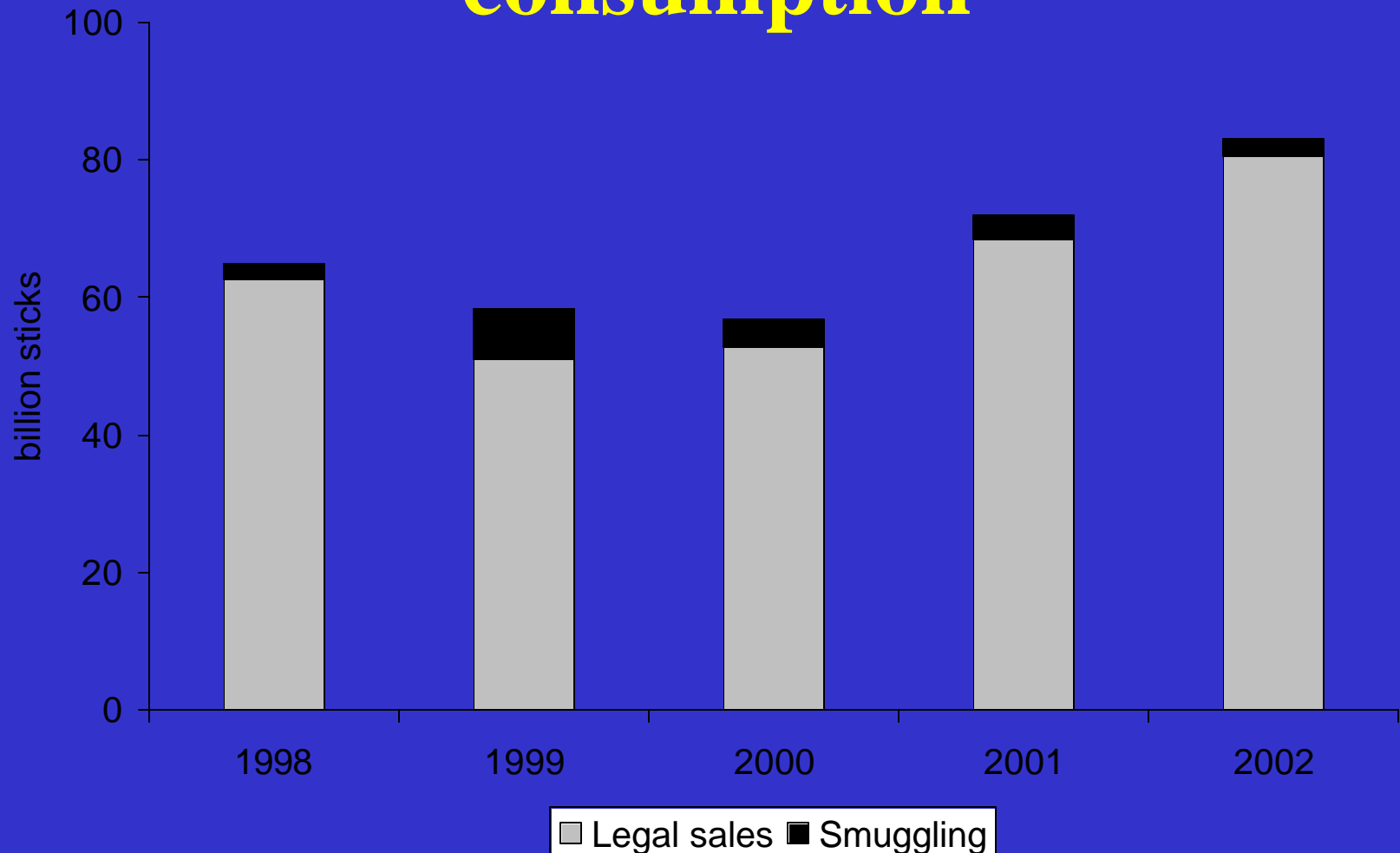
Estimating smuggling in Ukraine

Results show moderate effect of taxation on smuggling contrary to the industry's arguments: 10% tax increase will lead to 0,7% increase in smuggled cigarettes on the market

Excise rates in Ukraine and Russia



Estimated total cigarette consumption



5. Methods to Control Tobacco Smuggling

- **Reduce benefits** from smuggling
 - Price harmonization
 - Penalize firms that use smuggling to increase market share
 - Inform political debate
- **Increase cost** of smuggling
 - Strengthen border controls
 - Increase certainty and severity of punishment

Summary

- Countries **do not need** to make a choice between higher cigarette tax revenues and lower cigarette consumption
 - Higher tax rates can achieve both
- **Effective measures to control smuggling** exist
 - Focus on large container smuggling
 - Prominent local language warnings and tax stamps
 - Increase penalties
 - Licensing and tracking of containers
 - Increase export duties or bonds
- **Multilateral tax increases** help combat smuggling