

# **TAXATION, ILLICIT TRADE IN TOBACCO PRODUCTS AND FINANCE OF TERRORISM**

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# **"Taxation, Illicit Trade in Tobacco Products and Finance of Terrorism"<sup>1</sup>**

## **Executive Summary**

The sharp decline in oil prices alongside an appreciating US dollar has resulted in a "double whammy" for oil-exporting nations, including the GCC. Given their high dependence on oil exports for government revenue, countries face massive losses. To address the volatility and vulnerability of oil revenue and address fiscal sustainability the GCC countries will need to prioritize fiscal reform and put in place policies to diversify the sources of government revenue, as well as revise expenditure plans. This could happen through a reduction in fossil subsidies alongside the introduction of taxes. Current discussions focus on the introduction of value added taxes and increasing trade tariffs and taxes on consumption of tobacco and alcohol among others.

This White Paper addresses two important issues relevant to imposing and increasing excise taxes on tobacco: (a) the need to avoid sudden, large tax hikes that would lead to an increase in illicit trade and (b) as a result provide financing to organised crime groups (OCGs) and terrorist organisations operating in or out of the Middle East region. The vastness of the illicit trade network is evident in the fact that trade in illicit (and untaxed) tobacco recently became the fourth-largest global tobacco business by volume, just behind British American Tobacco, Philip Morris International and Japan Tobacco International.

The GCC countries currently have relatively low illicit penetration rates, but are wedged between the tobacco industry's established smuggling centres. Tariff and tax induced price differentials along with the lack of secure borders within the Middle East are a major driver of illicit trade. We find that an increase in ad-valorem taxes could lead to a massive spread (of more than USD 1 million per container) in cigarette prices between the lowest and highest markets across the region: a definite incentive for a surge in illicit trade.

This policy paper puts forward a GCC action plan to impede illicit trade growth. This multi-pronged approach includes both legal and regulatory measures, alongside tax and capacity building. These include:

- (i) Support the GCC countries to become members of the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP)
- (ii) Assist the GCC in developing common standards to comply with the ITP through a track and trace solution
- (iii) GCC policy harmonisation and coordination to introduce domestic excise taxes
- (iv) Gradual implementation of excise tax introduction and tax increases
- (v) Invest in the build-up of taxation capacity and administration
- (vi) Use modern technologies for tax administration including digital fiscal markers
- (vii) Develop Public-Private-Partnerships to ensure compliance

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<sup>1</sup> The viewpoints and proposals in this White Paper are the authors' own. Phillip Morris International (PMI) provided support for the research for this White Paper.

## The Oil Price tsunami & need for fiscal reform

Oil exporters are facing a major macroeconomic shock as a result of the sharp decline in oil prices since June 2014. For the GCC countries oil revenues represent some 85 per cent of overall revenues and around 70% of export revenues<sup>2</sup>. Export earnings are expected to be some \$287 billion lower in 2015, an external shock equivalent to 21% of GDP. Except for Kuwait and Qatar, all GCC countries face average budget deficits of 7.9% of GDP, a big swing from the fiscal surplus of 4.6% of GDP in 2014 (Source: IMF). In addition, the GCC countries face pressure from their peg to the US dollar that has appreciated some 15 per cent against major countries (EU, Japan and others). The resulting real exchange appreciation implies a loss of competitiveness for the GCC, which hurts their non-oil sectors including manufacturing, tourism and other services, a major element of their diversification strategies.

While the financial buffers from past oil revenues are providing GCC nations with short-term relief, policy adjustment is required. Over the medium term, budget consolidation is required to ensure fiscal sustainability, to preserve resources for future generations and to develop new policy tools for economic management. This can take the form of expenditure reduction, increased revenues or a combination. The sharp fall in oil prices provides a timely opportunity to remove fossil fuel subsidies in the GCC and to adjust the prices of public utilities (electricity, water, transport) to reflect underlying full costs. Letting domestic oil prices reflect international prices would free up substantial budgetary resources for economic and social development. While reducing subsidies and introducing more efficient pricing of public utilities provides budget consolidation by cutting wasteful expenditures, the GCC countries must reduce their over-reliance on oil revenue through greater revenue diversification. To address the volatility and vulnerability of oil revenue and address fiscal sustainability the GCC countries will need to prioritize fiscal reform and put in place policies to diversify the sources of government revenue.

The current macroeconomic situation and unfavourable prospects for oil highlight the necessity of revenue diversification and fiscal reform. Revenue diversification policies should be directed not only at mobilizing non-oil revenue in the short run, but providing a long-term fiscal base. The GCC are challenged to develop new sources of revenue that grow with their economies and that show elasticity with respect to national income and expenditure. The GCC need new policy tools (a) for economic management; (b) for fiscal sustainability in order to reduce vulnerability to oil price volatility and decline in oil prices; (c) to strengthen international competitiveness and economic integration; and (d) to compensate for declining trade tax revenues as a result of compliance with WTO commitments and obligations under bilateral trade agreements such as the FTAs (of Bahrain and Oman) with the US and other parties.<sup>3</sup>

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<sup>2</sup> This varies across the GCC – from as low as 30.5% for UAE to as high as 86.2% and 83.1% for Kuwait and Saudi Arabia respectively. (IMF)

<sup>3</sup> Bahrain and Oman have Free Trade Agreements with USA: rates for tobacco will be eliminated in 2016 (Bahrain) and 2019 (Oman). The “*standstill*” provision forbids increasing the current rates, as referred to in Article 2.3 (1) in both FTA.

## **Revenue Diversification Means Broad-Based Taxes & Excise Taxation**

In a recent policy White Paper entitled "[GCC Fiscal Reform: Oil, Government Revenue, Excise Taxes & the Tobacco Market](#)", the case was made for (a) the introduction of a GCC broad-based tax in the form of a value-added tax (VAT) on consumption at a low rate (e.g. 5%); (b) Need for an agreement between the GCC countries to introduce excise taxes on tobacco consumption as a policy tool to increase tobacco prices for health reasons and to raise revenue; (c) the introduction of domestic excise taxes on tobacco in the form of a specific nominal excise duty to be introduced in each GCC member state consisting of a fixed amount per 1,000 cigarettes or equivalent units of other tobacco products; (d) GCC policy harmonisation: the introduction of tobacco excise taxes should be applied uniformly (including on domestic production), preferably equally and in synchronized manner across countries in order to prevent arbitrage opportunities and illicit trade or smuggling. (e) The building of tax capacity in the form of tax revenue authorities to implement the fiscal reform, monitor and collect revenue, and (f) the process of implementation of the new tax structure should be gradual to mitigate tax avoidance and tax evasion that undermine the effectiveness of tax policies, encourage illicit trade and result in less revenue for governments and cheaper street prices for smokers (particularly price sensitive youth) and increased tobacco use.

Plans for the introduction of VAT were well advanced but were shelved with the onset of the Great Financial Crisis. Policy discussions have recently been re-initiated to introduce VAT along with a large increase in customs duties (a 100% increase) on tobacco products. This policy paper addresses two important issues related to imposing excise taxes on tobacco: (a) the need to avoid sudden, large tax hikes that would lead to an increase in illicit trade and; (b) as a result, provide financing to organised crime groups (OCGs) and terrorist organisations operating in or out of the Middle East region. The use of money laundered proceeds from the illicit trade of tobacco and other high value products such as oil to finance terrorism is a matter of grave concern given the growth of terrorist organisations such as Daesh, Al Nusra, Al Qaeda and their spread across the region from the Maghreb to the Mashreq and the Gulf. Given its increasingly insecure borders and growing number of terrorist organisations, the Middle East is increasingly fertile ground for illicit tobacco trade as a source of money laundering and terrorism financing. Raising tobacco taxes results in issues of security, money laundering and the finance of terrorism and should involve the competent authorities along with ministries of finance and customs authorities.

### **Taxation & Illicit trade**

Illicit trade<sup>4</sup> covers a multitude of activities. The Financial Action Task Force<sup>5</sup> (FATF)

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<sup>4</sup> The components that fall under this heading ranges from contraband (genuine tobacco products that are produced for lawful distribution in their market of intended destination but are illegally diverted to another market) to illicit whites (products that are generally legally produced in a market primarily to be smuggled into another market where they have limited or no legal distribution) and counterfeits (products that are manufactured without the permission of the trademark rights holder). Economists mostly refer to the circumvention of taxes, and prefer to use the terms tax avoidance (legal methods of circumventing tobacco taxes ie. cross-border shopping, duty-free shopping, tourist shopping etc.) and tax evasion (illegal methods for circumventing tobacco taxes ie. small and large-scale smuggling, counterfeiting, illicit manufacturing).

<sup>5</sup> <http://www.fatf-gafi.org/>

has, in 2012<sup>6</sup>, added tax crimes to the list of predicate offences underlying money laundering. It defines illicit tobacco trade as “the production, import, export, purchase, sale, or possession of tobacco goods which fail to comply with legislation”. The components that fall under this heading range from contraband, to illicit whites and counterfeits. The FATF report highlights that illicit trade in tobacco poses a significant vulnerability to generate proceeds in support of organised crime and terror organisations given the relatively low risks of detection of the smuggling activity and relatively low likelihood in linking the smuggling activity to terror organisations, OCGs or suspects.

Recent literature found evidence that cigarette smuggling helped rebel groups to finance their activities, illustrated through examples from the war economy in the Eastern part of the Democratic Republic of Congo<sup>7</sup>. FATF (2015) conducted an extensive study into how ISIL is financed, identifying the various sources of funding, its movement and use of funds, while highlighting a number of new and existing measures to disrupt ISIL financing, including :

- Request countries to proactively identify individuals and entities for inclusion in the UN Al Qaida Sanctions Committee list.
- Share practical information and intelligence at an international level, both spontaneously and on request, to effectively disrupt international financial flows.
- Suppress ISIL’s proceeds from the sale of oil and oil products, through a better identification of oil produced in ISIL-held territory.
- Detect ISIL fundraising efforts through modern communication networks (social media).

There is no direct reference to smuggling of tobacco as a means of funding (this would fall under the source “illicit proceeds from the occupation of territory”) in this report. However, various international organizations including the UN (UNTOC, UNCAC), WCO have studies confirming this phenomena and expert evidence<sup>8</sup> is plenty, including that of funding of Daesh (via cigarette smuggling).

## **Illicit Tobacco Trade**

Cigarettes being highly taxed, easy to transport, with a high value relative to their volume and a high reward for risk ratio from illicit trade are among the world’s most illegally trafficked goods. Historically, the illicit trade in tobacco products consisted predominantly of large-scale smuggling<sup>9</sup> of genuine cigarettes of well-known brands. In

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<sup>6</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Illicit%20Tobacco%20Trade.pdf> (Reference in Bibliography)

<sup>7</sup> <http://tobaccocontrol.bmj.com/content/20/3/226.abstract>

<sup>8</sup> <http://www.foreignaffairs.com/articles/142403/louise-shelley/blood-money>

<http://www.spiegel.de/international/business/terror-expert-shelley-speaks-of-islamic-state-business-model-a-1011492.html>

<sup>9</sup> The other prevalent method of smuggling is bootlegging: “bootlegging” was used in the nineteenth century to refer to the smugglers’ practice of hiding bottles in their boots. The term is used here to describe the smuggling activities of individuals who illegally import small quantities of products. It involves, for instance, the purchase of cigarettes and other tobacco products in low tax jurisdictions in amounts that exceed the

recent years this has greatly reduced and has been supplemented by steady growth in the smuggling and sale of illicit whites and counterfeit cigarettes, widening the scope of illicit trade. Technology is also opening new avenues with cigarette tax evasion via the internet rapidly growing in the past decade.<sup>10</sup>

The trade in illicit (and untaxed) tobacco recently became the fourth-largest global tobacco business by volume, just behind British American Tobacco, PMI and Japan Tobacco International<sup>11</sup>. According to Euromonitor, illicit trade in cigarettes is the biggest illegal trade in a legal product in terms of value and second only to illegal drugs in terms of revenue generated by smugglers. Experts estimate that the global retail value of the illicit trade in tobacco products may now be comparable in size to the cocaine market<sup>12</sup> (USD 81 billion from illicit in tobacco products vs. 85 billion from cocaine). Euromonitor (2013) estimates that one in every 10 cigarettes lit up in the world was illicit (some 570 billion sticks), valued collectively at almost US\$40 billion, with an equivalent tax loss to global governments<sup>13</sup>. The report further reveals that global illicit trade in cigarettes grew by 5% to reach a penetration of 9.5% globally. However, excluding China - where consumption of illegal cigarettes declined by 3% in 2013 - world volumes rose by 9% with an illicit penetration rate of 12%. Figure 1 shows the extent of illicit cigarette trade internationally. Apart from tax induced price differentials other factors such as the prevalence of corruption, lack of security, absence of rule of law and enforcement and lack of international cooperation are also contributory factors to illicit trade. Additionally, indirect effects of the rise in illicit trade is that the legitimate industry (consisting of manufacturers, wholesalers and retailers) lose sales, revenues and subsequently jobs to illicit trade and the informal sector.

In the Middle East, Iraq, Jordan, Libya and Tunisia were among the top 10 countries for tobacco tax evasion in 2012 (Source: PMI). In addition, given its insecure borders and growing number of terrorist groups, the Middle East is now fertile ground for illicit trade as a source of money laundering and terrorism financing. The GCC countries currently have relatively low illicit penetration rates, but are wedged between the tobacco industry's established smuggling centres in the Middle East/ North Africa/ Former Soviet Union and the burgeoning tobacco markets in the Indian subcontinent. They are surrounded by countries with illicit penetration rates in excess of 20%, with countries experiencing war, violence and turmoil (Libya, Syria, Iraq, Sudan, Yemen) having penetration rates of 30% and above. With deteriorating security across the region, we can expect growing illicit trade and higher penetration rates.

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limits set by customs regulations for resale in high tax jurisdictions. In general, bootlegging involves transporting cigarettes over relatively short distances.

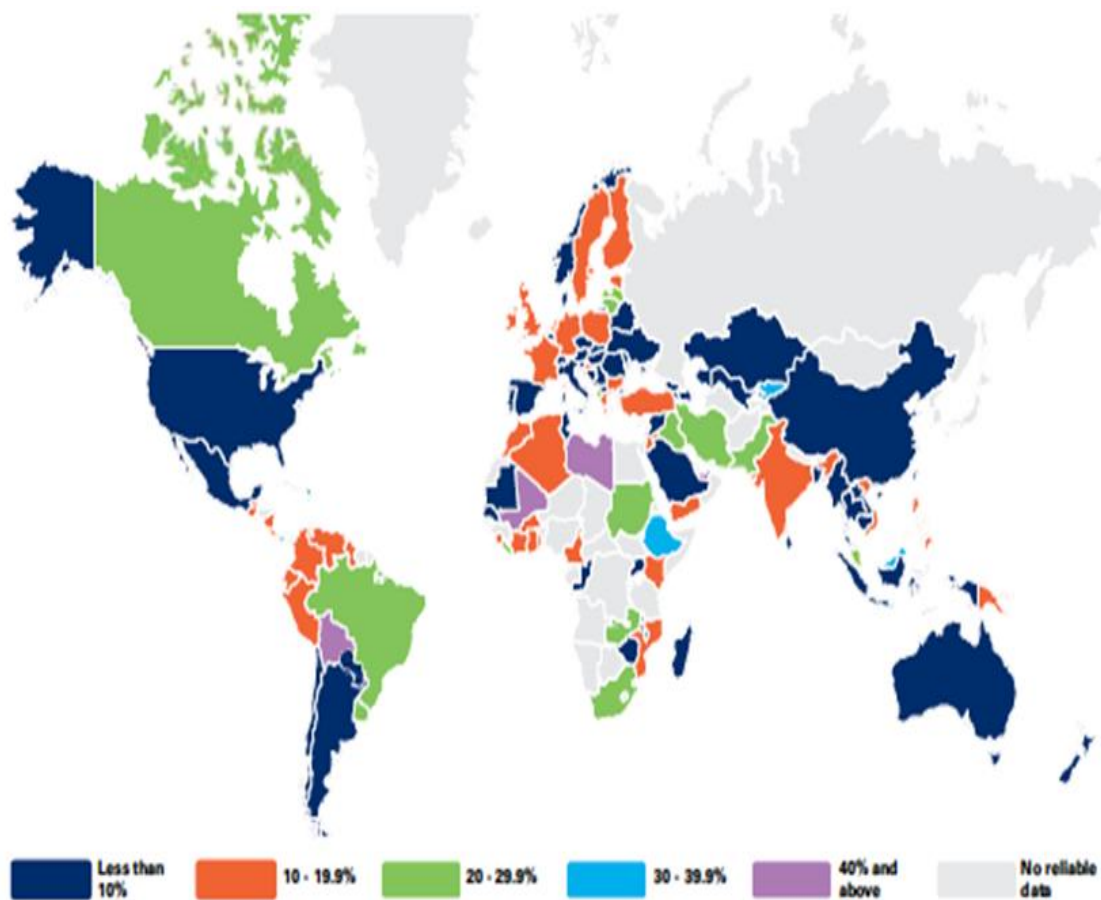
<sup>10</sup> A recent study showed the increased sensitivity within the US and Canada from cigarette smuggling over the Internet which has lessened the revenue generating potential of cigarette tax increases significantly. ("Source: Goolsbee, A, M., Lovenheim, and J. Slemrod. (2010): "Playing with Fire: Cigarettes, Taxes, and Competition from the Internet", *American Economic Journal: Economic Policy*, Vol 2(1), pp 131-54)

<sup>11</sup> <http://www.ft.com/intl/cms/s/0/3d6c0676-2bd5-11e1-b194-00144feabdc0.html?siteedition=intl#axzz3bDlicxVq>

<sup>12</sup> Transcrime (2012): Crime proofing the policy options for the revision of the tobacco Products Directive, January, pg. 22.

<sup>13</sup> <http://www.euromonitor.com/illicit-trade-in-tobacco-products-2013/report>

**Fig. 1 Share of illicit cigarette trade by country**



Source: KPMG

Tariff and tax induced price differentials along with the lack of secure borders within the Middle East are a major driver of illicit trade. A large, sudden increase in tobacco taxes across the GCC as is being currently envisaged. This would widen the price gap compared to lower-priced nations like Iraq, Libya and Yemen and would drive highly lucrative illicit trade across the borders – especially given the insecure borders. A further factor that facilitates illicit trade in the region is the creation of “illicit whites” within the Free Zones<sup>14</sup> of the region.

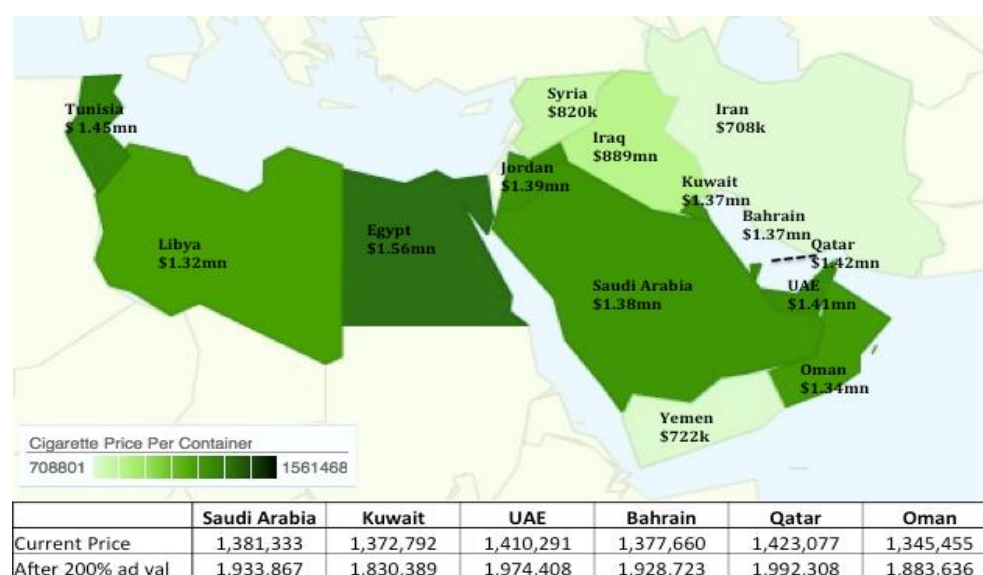
Figure 2 below shows the current price of a container (at current exchange rates) for a premium brand across the Middle East along with a simulation of prices if a 100% ad valorem increase in taxes is imposed in the GCC. There is massive variation in cigarette prices per container across the region. This varies from a low of USD 700k+ in Iran to a high of around USD 1.5mn+ in Egypt, with the GCC nations ranging towards the higher end of the spectrum. The increase in ad-valorem taxes would lead to a massive spread in cigarette prices – more than USD 1 million (per container) between the lowest and highest– across the region. This spark is likely to ignite a surge in illicit trade.

<sup>14</sup> Page 19 in the ITIC report, available at <http://www.iticnet.org/images/AIT/English-FirstEd-TheIllicitTradeinTobaccoProductsandHowtoTackleIt.pdf>

## Taxation & Illicit Tobacco Trade in the GCC

Table 1 provides estimates of the size of the illicit tobacco market in the GCC countries were taxes to be raised. The simulation exercise provides conservative estimates of how much money could be made by OCG and terrorists if illicit tobacco penetration rates increased by 25%, 50%, 100% in each of the GCC countries as a result of increasing taxes. The data used include consumption by country, i.e. number of containers per year and growth of consumption per annum. Market growth and containers estimates were provided by PMI. Illicit trade share for Saudi Arabia and UAE were taken from Joossens estimates<sup>15</sup> (at 5% and 25% respectively).

**Fig. 2 Cigarette prices in the MENA region, in USD per container, selected countries**



Source: PMI. Note: Value for Syria is as of 2009.

**Table 1. Estimates of profits generated with rise in illicit trade by 25%, 50% and 100%**

(Profits in USD mn)		Y1	Y2	Y3
25% increase in illicit trade	KSA	114	121	128
	UAE	164	171	179
50% increase in illicit trade	KSA	137	145	153
	UAE	197	205	214
100% increase in illicit trade	KSA	182	193	205
	UAE	263	274	286

Source: NS&A calculations using PMI data.

<sup>15</sup> [http://smokefreepartnership.org/IMG/pdf/PPT\\_11.pdf](http://smokefreepartnership.org/IMG/pdf/PPT_11.pdf)



## **A GCC Action Plan to Tax Tobacco while Combating Illicit Tobacco Trade & Countering Terrorist Finance**

What should governments do to combat illicit trade and the threat of contributing to the financing of terrorism? Governments setting tax rates should take into account levels of socio-economic development, the average consumer's purchasing power and tax rates in neighbouring countries. The World Customs Organization (WCO<sup>16</sup>) states it succinctly "where goods are highly taxed, easily portable and penalties remain relatively light for smuggling, transnational criminal organizations will take advantage of any weaknesses in customs, revenue or other border controls to amass profits". International experience from developed countries shows that large tax hikes are likely to lead to the emergence or growth of illicit trade (see Appendix on case studies) and as a result typically do not result in achieving the objectives of generating higher revenue and curtailing consumption. These problems are compounded in countries with insecure borders and weak enforcement.

Given the above, what can the GCC countries do to (a) increase tobacco taxation to raise revenue and address health concerns, but (b) avoid encouraging illicit trade in tobacco? The proposed 'Action Plan' has two sets of recommended policy actions in order to satisfy the potentially conflicting objectives of raising revenue while combating illicit trade and the financing of terrorism: (a) Legal and regulatory, (b) Tax and capacity building. These include:

### **(A) Legal & Regulatory Measures**

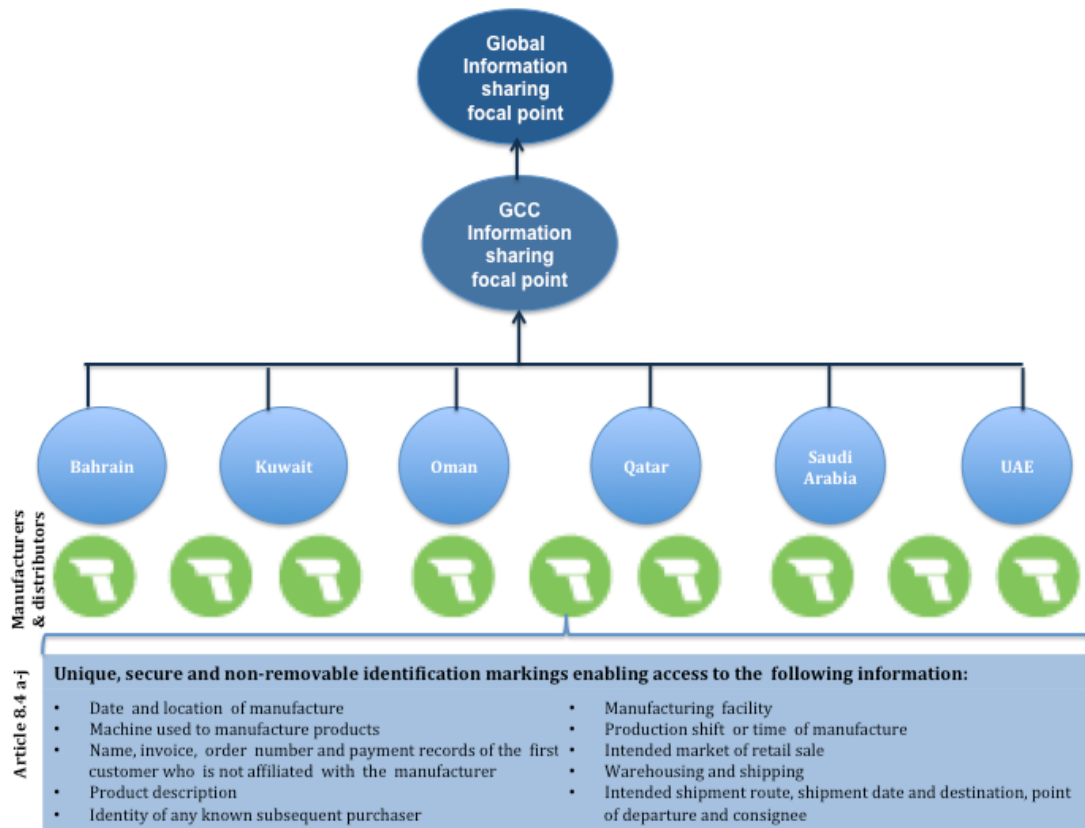
1. **Support the GCC countries to become members of the Protocol to Eliminate Illicit Trade in Tobacco Products (ITP).** While the GCC and the majority of Arab countries have signed onto the WHO FCTC, only a handful of countries notably Iran, Kuwait, Qatar, Syria, Tunisia, Turkey and Yemen have signed on to the ITP to Eliminate Illicit Trade in Tobacco Products<sup>17</sup>. An important step is to ensure that all GCC countries ratify and take effective steps to comply with the ITP as it provides an important framework for national action. Accepting the ITP should be supplemented by interagency cooperation and information sharing by the GCC countries through enhancing cooperation and mutual administrative assistance between Customs authorities and Suspicious Transaction Reports amongst Financial Intelligence Units.
2. **Assist the GCC in developing common standards to comply with the ITP,** since it is the first international agreement addressing all main forms of illicit (smuggling, counterfeit, illicit whites) and tax and duty evasion. Specifically, it is proposed that the GCC countries develop and implement a **common GCC tracking and tracing solution** to ensure the sharing of information through a common GCC system. The chart below provides a model where information from national track and trace systems would be shared between the GCC countries. Tracking means monitoring and recording the route taken by tobacco products through the supply chains by means of systems and technology, while tracing is the power of identifying back the main steps of a product

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<sup>16</sup> Illicit Trade Report 2013, available at: <http://bit.ly/1nGB3U6>

<sup>17</sup> [https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=IX-4-a&chapter=9&lang=en](https://treaties.un.org/pages/ViewDetails.aspx?src=TREATY&mtdsg_no=IX-4-a&chapter=9&lang=en)

along the supply chain. International experience and best practice suggests that effective track and trace systems depend on implementing open standards, involve using existing business processes, industry cooperation and systems provider competition<sup>18</sup>.



3. **GCC policy harmonisation and coordination to introduce domestic excise taxes.** .
- Multilateral (WTO) & bilateral trade agreements constrain the GCC countries from raising the common external tariff on cigarettes and other tobacco products, thereby restricting the ability of the GCC to raise prices to reduce tobacco consumption and smoking incidence, while increasing government revenue from tobacco taxation. Absent reform, tobacco tax policy is likely to be forced in directions contrary to GCC government objectives. As it stands now, import duties discriminate against imported products and free trade agreements usually require participating countries to gradually phase them out. As import duties are phased out, governments lose the revenues they generate. Supplementing import duties with excise taxes can compensate for these revenue losses. Specific excise taxes –which tax quantities and volumes- maximise the revenue from tobacco taxes by reducing the gap in prices between premium and low priced alternatives. Our previous research recommended that a specific nominal excise duty be introduced in each GCC member state consisting of a fixed amount per 1,000 cigarettes or equivalent units of OTP. Such a policy reform would simultaneously reduce consumption (*in accord with the objectives of Health Ministries*), gradually raise prices towards relevant international benchmarks and

<sup>18</sup> KPMG (2014): Track and Trace – Approaches in Tobacco

substantially increase revenues (*satisfying the objectives of Finance Ministries*) for governments. To avoid introducing additional distortions, the specific excise duty should apply equally to imports and domestic production, including that originating in Free Zones (regardless of source of origin). Importantly, any significant increase in the tax burden needs to be accompanied by countries' stringent levels of enforcement capability and strategy for tackling illicit trade.

4. **Gradual implementation of excise tax introduction and tax increases** to avoid encouraging the development & growth of illicit trade in tobacco and the use of the proceeds to finance terrorism. For example, a 100% tax increase could be staggered over a 5-year period that would allow the authorities to assess success in implementation of the policy change and build the necessary effective administration and enforcement. The excise duty rate should be harmonised, introduced in synchronised manner and preferably be the same in all member states to prevent market fragmentation, avoid arbitrage and tax avoidance/evasion through sourcing from low excise tax jurisdictions. The size and speed of tax increases could also affect the level of illicit trade with sudden large increases resulting in a move away from duty paid cigarettes and encouraging smuggling and illicit trade.
5. **Invest in the build-up of taxation capacity and administration.** Given their substantial natural resources & financial wealth, the GCC countries have not invested in building tax capacity and administration. Implementing VAT and excise taxes will require tax administration agencies and trained personnel. Effective enforcement requires skilled resources and tools, with officials skilled in audit and investigative techniques, able to use IT tools, implement track & trace systems, analyse data sources and ability to analyse and assess tax declarations.
6. **Use modern technologies for tax administration** including the introduction of digital fiscal markers for tobacco and other products based on digital open standards.
7. **Develop Public-Private-Partnerships (PPP)** to ensure compliance with new taxes and the objectives of revenue raising and combat illicit trade in tobacco products and potential financing of terrorism. The tobacco industry should propose voluntary Memoranda of Understanding (MOUs) to governments and concerned authorities. In response, governments should encourage and be open towards participation with the private sector, to combat illicit trade. . Key elements covered should include information sharing and assistance in: (i) assessing and measuring levels and sources of illicit trade; (ii) exchange of data; (iii) tracking and tracing of tobacco products and ingredients, equipment and finished illicit tobacco products and; (iii) analysis and destruction of seized goods. Leading tobacco manufacturers and the GCC countries could cooperate in the **establishment of a GCC anti-fraud agency** (similar to the EU's anti-fraud agency (OLAF)) to combat illicit tobacco trade.

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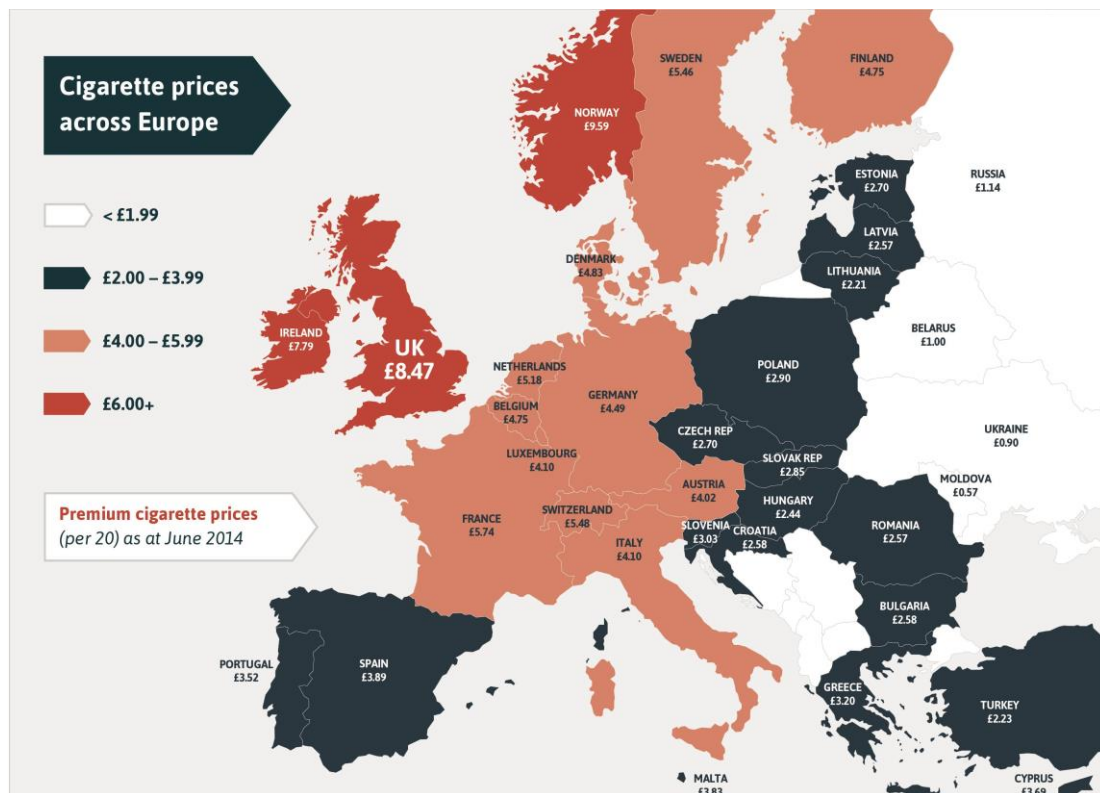
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## Appendix: Some Case Studies on Lessons from Tobacco Taxation

### Case Studies of Tobacco Taxation

There are many examples where tax-induced price differentials as well as large tax hikes (case studies mentioned below) have led to the development and growth of illicit tobacco trade. A common lesson can be drawn from all of these experiences: increasing excise levels without regard for consumers' purchasing power is detrimental to the tobacco market, undermines the sustainability of government revenues, and is likely to result in the development of large, unregulated illicit markets.

The map below shows the price of a pack of 20 cigarettes in the EU Members states. Significant profit (and by extension a tax loss experienced by the government) can be made from purchasing genuine duty-paid cigarettes in Lithuania, transporting them to any of the most expensive jurisdictions (prices at GBP 6+ or about USD 10) and sell them for a discounted price.



Source: Tobacco Manufacturers Association. <http://www.the-tma.org.uk/tma-publications-research/facts-figures/eu-cigarette-prices/> (Note: 1 GBP = 1.7034 USD in June 2014)

In the US, several states have increased state cigarette tax rates more than 100 times since 2003. The most recent edition of the publication "Cigarette Taxes and Cigarette Smuggling by State" finds that smuggled cigarettes make up substantial portions of cigarette consumption in many states, and greater than 20 percent of consumption in fifteen states. Smuggling rates jumped substantially in Illinois after hikes in state and county excise tax rates, from 1.1 percent of consumption as per 2012 data to 20.9

percent in 2013. This is likely related to the fact that the Illinois state cigarette tax rate was hiked from \$0.98 to \$1.98 in mid-2012. (Source: <http://taxfoundation.org/article/cigarette-taxes-and-cigarette-smuggling-state-2013-0>)

A recent empirical study found that in **Canada**, each additional dollar in final applicable taxes raises the propensity to resort to consuming contraband cigarettes by 5.1 percent while tax cuts explain in the range of 17 percent a smoker's decision to stop regularly consuming smuggled cigarettes (Source: Ouellet, J.F, M. Restuccia, et. Al. (2012): "The Impact of Cigarette Tax Reduction on Consumption Behavior: Short-And Long-Term Empirical Evidence from Canada". Available at: [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1611822](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1611822))

**Italy** and **Japan** have implemented excise increases during 1995-2010 with a lesser sudden impact on the affordability of cigarettes. These have seen cigarette affordability declines over the period but their gradual nature has mitigated any adverse consequences. Therefore, despite a doubling of excise duties, the illicit sector in Italy has remained small, while industry reports no illicit market in Japan. (Source: Cooper, A., D. Witt (2012): "The linkage between tax burden and illicit trade of excisable products: the example of tobacco" Available at: [http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper\\_Witt.pdf](http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper_Witt.pdf))

In **Ireland**, the excise rate was raised by 76 percent from 2000 to 2009, from EUR148 to EUR261 per 1,000 cigarettes. Consequently, the price of a packet of 20 premium cigarettes rose from EUR4.83 in 2000 to EUR8.45 in 2009 when the excise tax incidence reached 62 percent. This resulted in the illicit market in Ireland increasing from 0.5 billion cigarettes in 2005 to 1.8 billion in 2010 & illicit cigarette market share grew from 8 percent in 2005 to 30 percent in 2010. However, during the 2000-09 period, excise revenues did not grow and remained flat. Consequently, no excise increase was made in 2010. (Source: Cooper, A., D. Witt (2012): "The linkage between tax burden and illicit trade of excisable products: the example of tobacco" Available at: [http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper\\_Witt.pdf](http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper_Witt.pdf))

Between 2000 and 2005, **Singapore's** government increased excise duty on cigarettes from SGD150 per 1,000 cigarettes to SGD 352 (the highest in Asia) – an average increase of 19 percent a year, with the excise tax incidence reaching close to 65 percent in 2005. Since 2005, there has been no excise increase and the city-state reported illegal trade of around 22 percent in 2006. Though there were no increases in excise taxes during 2007-11, the increased enforcement levels resulted in a reduction of illegal trade to 15.9 percent. (Source: Cooper, A., D. Witt (2012): "The linkage between tax burden and illicit trade of excisable products: the example of tobacco" Available at: [http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper\\_Witt.pdf](http://www.worldcustomsjournal.org/media/wcj/-2012/2/Cooper_Witt.pdf) ; PMI).

In the **UK**, illicit tobacco rose by 2000 to a very high level: Customs & Excise estimates were that 21 percent of cigarettes in the UK market were illicit, costing the Government more than £3 billion a year in lost revenue. However, coordinated enforcement action in the UK and at European level led to a lower level of illicit trade amidst rise in tobacco tax revenues. While the UK average for consumption of illicit cigarettes currently is about 10 per cent of the total, in London it has risen to one in five and in cities such as

Nottingham and Ipswich one in three (Source: FT, Ash factsheet available at [http://ash.org.uk/files/documents/ASH\\_122.pdf](http://ash.org.uk/files/documents/ASH_122.pdf)).

**Vietnam** witnessed an excise tax increase in 2006, which led to a subsequent increase in illicit cigarette volume: from 600 million packs in 2006 to 636 million packs in 2007 and 731 million packs in 2008. This compares to 495 million packs in 2005 and 300–400 million packs between 1998 and 2004 (Nguyen MT, R Denniston et al. (2014): “The Empirical Analysis of Cigarette Tax Avoidance and Illicit Trade in Vietnam, 1998-2010”, *PLoSone*, Volume 9 (1), pp. e87272- e87272).