

- Scale of the problem
- Different types of illicit trade
- Smuggling and taxes
- Tobacco smuggling as a commercial activity
- Impact of illicit trade on society
- What can be done to counter smuggling?
- Government strategy
- EU Agreements
- FCTC

# Tobacco smuggling

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## Scale of the problem

It is estimated that 11.6% of all internationally traded cigarettes are smuggled, equivalent to 657 billion cigarettes a year, causing losses to government revenue worldwide of US\$40.5 billion.<sup>1</sup> Smuggling reduces the overall price, increases demand, undermines national tobacco tax policies and, as a result, harms health by increasing tobacco use.

By the late 1990s, cigarette smuggling in the UK had reached epidemic proportions: according to tobacco industry estimates 25%-30% of the total market was made up of illegally imported cigarettes<sup>2</sup> although Customs & Excise estimated the figure to be no more than 21%.<sup>3</sup> Tobacco smuggling was costing the Government more than £3 billion a year in lost revenue.<sup>4</sup>

Action by HM Revenue & Customs (formerly Customs & Excise) since 2000 has helped reduce the proportion of smuggled cigarettes to about 11% of the UK market.<sup>5</sup> Whilst there has been less progress in reducing the trade in illicit hand-rolled tobacco: for the financial year 2008-09 it is estimated that just under half (49%) of hand-rolling tobacco smoked in Britain was smuggled. The estimated revenue loss for tobacco fraud and smuggling in the UK ranged from £1.1bn - £3bn in 2008-09.<sup>5</sup>

## Different types of illicit trade

Illicit trade in tobacco products occurs through large scale smuggling, bootlegging and counterfeit or other illegal manufacturing.<sup>6</sup>

**Large scale smuggling** involves the illegal transportation and distribution of large consignments of tobacco products, usually with no tax being paid. Tobacco companies and criminal networks are often complicit in this type of operation. Sometimes the scheme involves forged transit documents and tax stamps, in other cases, corrupt customs agents or other officials are involved.

**Bootlegging** refers to the smuggling activities of individuals or small gangs who illegally import small quantities of products. Examples include the purchasing of tobacco in low tax countries in amounts that exceed limits set by customs regulations, for resale in high tax jurisdictions.

**Illegal manufacturing** refers to the production of cigarettes contrary to law. The laws may be tax or licensing laws that restrict the manufacture of tobacco products. Counterfeit tobacco production is a form of illegal manufacturing in which manufactured products bear a trademark without the consent of the owner of the trademark. Typically the counterfeit product is made to appear almost identical to the legitimate product.

### **“White van trade” is not the main problem**

The trade in contraband cigarettes is dominated by large-scale container fraud: as many as 10 million cigarettes can be hidden in containers which are disguised to give the appearance of carrying legitimate products such as food or furniture. This is very different from the popular perception of cigarette smuggling, namely the “white van trade” in which small scale operators exploit cross-Channel tax differentials but pay duty in, say, Belgium or France. Cigarettes obtained legally in lower-taxed countries and consumed in the UK account for about 9% of the total cigarette market. However, hand-rolling tobacco makes up a significant proportion of tobacco imported illegally into the UK from mainland Europe: in 2008-09 illicit market share was estimated to be 45% - 53% of the total market.<sup>7</sup>

### **Counterfeit tobacco**

In addition to the smuggling of genuine UK manufactured cigarettes, which remains a serious problem, there has been a significant rise in the smuggling of counterfeit cigarettes in recent years. In 2001/02 15% of large seizures of cigarettes made by Customs officers were counterfeit.<sup>8</sup> By 2007/08 this had risen more than three-fold to 51%.<sup>7</sup>

Most counterfeit cigarettes, which may be almost indistinguishable from the genuine article, are manufactured in the Far East and Eastern Europe and are smuggled into the UK in large quantities, predominantly as maritime freight. As the supply chain is entirely illicit, there are no legitimate manufacturers with whom the government can work to restrict supply. However, as counterfeit products undermine brand integrity and directly affect tobacco industry profits, the manufacturers have an interest in trying to curb this market.

### **Smuggling and taxes**

It is frequently claimed by the tobacco industry that high taxes cause smuggling. However, the difference in duty levels between neighbouring states is only a minor driver of smuggling. The economic driver of most smuggling is the difference between the duty paid and duty not paid price, since taxes account for a high proportion of the retail price of tobacco products in all countries.

Cutting tobacco tax cannot solve the problem of smuggling. Even if all countries levelled exactly the same level of taxes and had identical prices, smuggling would still continue at a large scale. In Europe until recently the highest levels of smuggling were found in countries with some of the lowest taxes (Spain and Italy).<sup>9</sup> Furthermore, the burden of illicit trade falls mainly on lower income countries: The total illicit cigarette market in high income countries is 9.8% compared to 16.8% in low income countries.<sup>1</sup> It has been estimated that if the global illicit trade were eliminated, governments would gain at least \$31 billion, and from 2030 onwards would save over 160,000 lives a year.<sup>1</sup>

### **Tobacco smuggling as a commercial activity**

Large-scale smuggling involves criminal organisations with a sophisticated system of distributing tobacco at a local level. Criminals are aided by the lack of control of the international movement of tax-free cigarettes. All of the major multinational tobacco companies have been implicated in smuggling activities and have been the subject of several legal cases to determine the extent of their involvement.<sup>10</sup> In the 1990s around 80% of smuggled tobacco entering the UK consisted of UK-manufactured cigarettes or hand-rolling tobacco that had been diverted onto the black market and smuggled back into the UK, usually via large containers purporting to contain other consumer goods. Although this type of activity still accounts for the majority of illegally-traded tobacco, in recent years there has been a dramatic growth in counterfeit product, partly in response to tighter controls on the trade of legally manufactured cigarettes.

Tobacco companies have used smuggling as a distribution channel to launch new brands, to enter new markets and fight price wars with their competitors. Once one company is involved, the others risk losing market share if they do not effectively ‘compete’ to have their brands represented in illegal markets. The major companies seek to maximise their performance in the whole system – legal and illegal and they exploit the lack of law enforcement to do so. As the former deputy chairman of BAT, Kenneth Clarke MP, said: “*Where any government is unwilling to act or their efforts*

*are unsuccessful, we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market.”<sup>11</sup>*

### **Impact of Illicit trade on society**

Smuggled tobacco may be sold on the black market at up to half the price of legitimate products thus undermining the use of tax to raise the price of tobacco. Increasing the price of tobacco above the rate of inflation is recognised as the most effective means of reducing tobacco consumption.<sup>12</sup> Poorer people are more likely to be tempted by cheaper prices, and access to smuggled tobacco therefore undermines efforts to quit smoking, exacerbating health inequalities. Research commissioned by ASH found that one in four of the poorest smokers buys smuggled tobacco compared to one in eight of the most affluent.<sup>13</sup>

Other research has shown that four times more people die from the effects of smuggled tobacco than from all illicit drugs combined. Furthermore, researchers estimated that eliminating smuggling could lead to an overall fall in the number of cigarettes smoked by around 5 per cent, resulting in 4,000 fewer premature deaths.<sup>14</sup>

### **What can be done to counter smuggling?**

In March 2000, the UK Government announced a package of measures designed to curb smuggling.<sup>15</sup> These included the deployment of 1000 additional Customs officers; additional specialist investigators and intelligence staff; additional x-ray scanners; tougher sanctions and penalties; and a public awareness campaign. In addition, packs of cigarettes and hand-rolling tobacco sold for consumption in the UK are now required to carry a duty-paid mark. Through this campaign, Customs & Excise succeeded in breaking up 43 smuggling gangs and reduced Cross-Channel smuggling by 75% in 2000/2001.<sup>3</sup> In 2003-04, the illicit market in cigarettes fell to 16%.<sup>16</sup>

### **Government Targets**

Previously, HMRC was set a target to reduce the illicit market share for cigarettes to no more than 13% and to reduce the amount of illicit hand-rolled tobacco (HRT) by 1,200 tonnes – equivalent to around 20% of the market – by 2007/08. The target on cigarettes has been achieved but smuggled HRT still accounts for about half of the total market.<sup>5</sup> No new targets have been set but ASH has recommended that a new target be set for a reduction in the illicit market share of cigarettes to 5% by 2012-13 and to 3% by 2015-16. For hand-rolling tobacco, ASH believes new targets should be set as a percentage of market share (as for cigarettes) rather than tonnage: to 33% by 2012-13 and to 25% by 2015-16.<sup>17</sup>

### **Government Strategy**

In 2006 the Chancellor announced new measures to further strengthen the anti-smuggling strategy.<sup>16</sup> These included working with tobacco manufacturers to tighten controls along the supply chain. Specifically, the companies signed new Memoranda of Understanding (MoUs) with government which required them to cease supplying customers where they fail to demonstrate product control; to put in place controls of raw materials and machinery to prevent them becoming available to counterfeiters; and to share information with Revenue and Customs. However, the MoUs relied on co-operation by the tobacco industry and were not legally enforceable. Subsequently, the measures have been enshrined in law and the Finance Act 2006 makes it a legal duty for tobacco manufacturers not to facilitate smuggling. Those who fail to take sufficient steps to prevent their products being smuggled face fines of up to £5 million.<sup>18</sup>

In 2008 the Government announced that the UK Border Agency and HM Revenue & Customs would work together on a new strategy to tackle smuggling.<sup>19</sup> While HMRC retains overall responsibility for the collection and enforcement of tobacco duties and for the detection and disruption of illicit tobacco inland, the UK Border Agency is responsible for detecting and seizing smuggled tobacco at the UK border and for arresting those suspected of tobacco smuggling. The two agencies share responsibility for reducing revenue losses.

In April 2011 HMRC and the UK Border Agency launched a new plan to tackle

tobacco smuggling,<sup>20</sup> building on the 2008 strategy. Key elements of the plan include increasing criminal intelligence and investigation resources deployed on tobacco fraud by 20% to prosecute more of those involved in smuggling at all levels; introducing new technology, intelligence and detection capability; pursuing proceeds of crime and applying new powers of assessment and penalties; and reducing the minimum indicative levels for personal imports to 800 cigarettes and 1 kg hand-rolling tobacco in the autumn, bringing the UK into line with all other EU Member States.

### European Union Agreements

Anti-smuggling measures have been further strengthened by legally-binding agreements between the European Union and all the major multi-national tobacco companies: Philip Morris International, Japan Tobacco International, BAT and Imperial Tobacco. These agreements arose out of a lawsuit filed by the European Commission against the companies over the smuggling of cigarettes into the European Union. Philip Morris International (PMI) was the first company to enter an agreement with the EU in 2004 in return for the European Commission dropping the legal action.<sup>21</sup> The agreement requires the company to approve contractors and provide customs with online information so that Customs can directly trace back any PMI smuggled cigarettes to the purchaser who originally bought them from PMI. In addition, Philip Morris will be required to pay 100% of all taxes due on any genuine products that are seized by customs. For further details see: [PMI agreement](#) Japan Tobacco International signed a similar agreement in 2007<sup>22</sup> while BAT and Imperial Tobacco signed agreements in 2010.<sup>23</sup> Initially the UK was not a signatory but the Government has now joined the other 26 Member States in becoming a party to the binding agreements.<sup>24</sup>

### Framework Convention on Tobacco Control

Because smuggling is a global problem, concerted action at the international level is also required. This will be achieved through a protocol under the Framework Convention on Tobacco Control which is currently under negotiation. The draft text includes the following measures: overt and covert marking of tobacco products so that they can be tracked from manufacturer to point of sale; obligations on manufacturers to control the supply chain of their own goods; licensing of participants within the supply chain to ensure that they can be monitored effectively and have their licences revoked if they are found to be dealing in illicit products. Enhanced law enforcement measures will also be part of the protocol such as co-operation in investigation and prosecution of offences, information sharing and mutual legal assistance. All of these measures will help governments to collaborate to overcome illicit trade.<sup>25</sup>

A cost benefit analysis of implementing the illicit trade protocol has revealed that it could reduce smuggling in the UK by up to 80%. The measure could also save 760 lives a year and could be worth £5.7bn to the UK in net present values.<sup>26</sup>

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