Transparency and Truth

TOBACCO TAXATION: THE MISLEADING ARGUMENT OF ILLICIT TRADE

FACTSHEET

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Increasing tobacco taxation is one of the most effective measures for reducing tobacco consumption, particularly among young people, while also increasing government revenue. In opposing such measures, the tobacco industry regularly claims that they would encourage illicit trade. Yet the evidence shows that this argument does not stand up to scrutiny: taxation levels are not the main driver of illicit trade, which can be effectively curbed through appropriate control measures. Even when accounting for a substantial increase in the share of untaxed cigarettes in Switzerland, tax revenues can still rise significantly.

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ILLICIT TRADE: A REAL PROBLEM, BUT NOT AN INEVITABLE CONSEQUENCE OF TAXATION

Illicit tobacco trade is both a public health and public finance issue. By offering cheaper products, illicit trade can increase accessibility and undermine the impact of fiscal policies aimed at reducing consumption. This also leads to losses in tax revenue and can fuel corruption and organised criminal networks. A landmark international study, based on data collected around 2007 in 84 countries, estimated that 657 billion cigarettes were consumed illicitly each year, representing 11.6% of the total consumption covered by the study (1).

In Switzerland, independent data enabling a precise estimate of the scale of illicit trade remain limited. Official data primarily provide information on customs seizures (some of which are destined for other countries, particularly France) (2). A 2015 study found that 43% of people who smoke in Switzerland had purchased untaxed cigarettes[a] during the previous six months, mainly abroad or from duty-free shops. Only 9.4% reported having purchased cigarettes "on the street" in Switzerland (3).

Some frequently cited estimates are based on studies funded or commissioned by the tobacco industry itself (4). The reliability of these studies is highly contested: a systematic review of 35 industry-funded estimates found that 31 were higher than independent estimates and identified significant methodological and transparency limitations (5).

Most importantly, the price or the level of taxation alone is not sufficient to explain the scale of illicit trade. Other factors play a major role, including governance and corruption, the effectiveness of tax and customs controls, supply chain monitoring, sanctions, and the presence of criminal networks. **By strengthening enforcement mechanisms, countries such as the United Kingdom and Canada have succeeded in increasing both taxes and tax revenues while simultaneously reducing illicit trade** (6).

By strengthening enforcement mechanisms, it is possible to increase tobacco taxes while reducing illicit trade.

The behaviour of manufacturers also contradicts their claims. **While they present tax-related price increases as a factor in illicit trade, manufacturers themselves raise prices to increase profit margins**. Since 2013, increases in cigarette prices in Switzerland have resulted from decisions by manufacturers and not from tax increases (7).

THE TOBACCO INDUSTRY'S INVOLVEMENT IN ILLICIT TRADE

Today, the major multinationals present combating illicit trade as a priority. British American Tobacco (BAT) and Philip Morris International (PMI), in particular, emphasise supply-chain security as well as product traceability and authentication. They also stress the need for cooperation between the industry, governments, customs authorities, and law enforcement agencies (8, 9).

Yet **the historical involvement of multinational tobacco companies in illicit trade is well documented**. Research based on internal industry files has shown the role of major tobacco multinationals, including PMI, BAT, and Japan Tobacco International, in smuggling networks used to penetrate closed markets, establish their brands and subsequently facilitate their legal entry (10-13).

Research published in *Tobacco Control* also estimated that cigarettes produced by multinational tobacco companies account for around two-thirds of the global illicit cigarette market (14).

[a] Untaxed cigarettes include cigarettes purchased legally abroad or from duty-free shops, as well as cigarettes purchased illegally on the black market.

The tobacco industry itself has contributed to the expansion of illicit trade, as documented in internal records and several legal proceedings.

The industry's involvement has been documented through several legal proceedings and agreements with authorities (15): an agreement concluded with the European Commission in 2004 (16), a judgement handed down in the United States in 2006 under the federal RICO Act (Racketeer Influenced and Corrupt Organisations Act) (17), and criminal proceedings brought in Canada (18), which resulted in guilty pleas in 2008 and 2010.

WHY DOES THE INDUSTRY RAISE THE THREAT OF ILLICIT TRADE?

Increasing tobacco taxation is one of the most effective measures for reducing consumption. By raising prices and making products less affordable, it helps to prevent young people, who are especially price-sensitive, from taking up smoking (19).

A price increase introduced by a manufacturer can raise its revenue per pack; a tax increase, on the other hand, raises the share of the price collected by the government. **The industry therefore seeks to preserve its room for manoeuvre on prices and resorts to various pricing strategies to protect its sales and profits** (20). It thus has a direct economic interest in limiting tax increases.

In this context, illicit trade is a particularly useful argument: it allows an effective public health measure to be presented as a threat to government revenue. The WHO explicitly identifies illicit trade as one of the arguments used by the industry and emphasises that these claims often rely on an overestimation of the role of taxation in this issue (21, 22).

HIGHER TAXES, HIGHER REVENUE, EVEN WITH MORE CIGARETTES ESCAPING TAXATION

The illicit trade argument also suggests that a tax increase could prove counterproductive for public finances by diverting a share of sales away from the taxed market. Yet the Federal Council's projections show the opposite (23). **In a scenario where the total tax burden on cigarettes rises to 75% of the retail price, the Federal Council estimates additional revenue of around CHF 645 million per year, despite an expected 26% decline in consumption and the assumption that the share of untaxed cigarettes will double, from 12.5% to 25%.** Thus, even under a particularly unfavourable scenario, the gains to the federal budget remain substantial.

+ CHF 645 million per year

in additional tax revenue, even if the share of untaxed cigarettes in Switzerland doubles, particularly due to cross-border shopping.

INCREASING TAXES AND REDUCING ILLICIT TRADE: IT IS POSSIBLE

Presenting tax increases and efforts to combat illicit trade as mutually exclusive creates a false dilemma. **International experience shows that higher taxation can go hand in hand with a reduction in illicit trade, provided it is accompanied by effective enforcement measures**.

In Switzerland, it is therefore essential to combine regular and substantial tax increases with measures to combat illicit trade: supply chain controls, independent tracking and tracing systems, effective customs and tax enforcement, deterrent sanctions, and international cooperation.

These principles are at the heart of the WHO Protocol to Eliminate Illicit Trade in Tobacco Products (24), which emphasizes, in particular, that tracking and tracing responsibilities must not be delegated to the tobacco industry.

Illicit trade is a real problem but must not be used as a pretext for abandoning effective taxation. Switzerland must act on both fronts: regularly increasing tobacco taxes to reduce consumption and increase public revenue, while also strengthening efforts to combat illicit trade.

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