



# CAUSES & CONTROL OF ILLICIT TOBACCO

SECOND EDITION – 2019



ALVAREZ & MARSAL

---

## Table of Contents

---

|  |           |
|--|-----------|
| <b>1.</b> Purpose of This Report                                       | <b>01</b> |
| <b>2.</b> Executive Summary  | <b>02</b> |
| <b>3.</b> Background   | <b>04</b> |
| <b>4.</b> Relationship Between Tobacco Tax Policy and Illicit Trade    | <b>08</b> |
| <b>5.</b> Role and Limits of Enforcement                               | <b>20</b> |
| <b>6.</b> Allegations of Tobacco Industry Involvement in Illegal Trade | <b>24</b> |
| <b>7.</b> Overall Conclusions  | <b>31</b> |
| Appendices   |           |
| <b>I.</b> Glossary of Terms  | <b>32</b> |
| <b>II.</b> Bibliography  | <b>33</b> |
| <b>III.</b> Data Sources Used in A&M's Analysis                        | <b>36</b> |

---

## 1 Purpose of This Report

---

The adverse health effects of traditional tobacco products are well understood, and that debate is over. However, the debate about the relationship between high and increasing taxes on legitimate tobacco products and the development of the illicit tobacco trade and organized crime has many protagonists and is not over. This is an important issue given the broad and adverse impacts of illicit activity, ranging from lost tax revenue, to undermining health objectives, to targeting underage smokers, and to the funding of organized crime and terrorist activities. Intergovernmental organizations such as the World Customs Organization (WCO), the World Health Organization (WHO), the Organization for Economic Co-operation and Development (OECD), the Financial Action Task Force (FATF) and international organizations such as Europol and INTERPOL are rightly focused on this issue. Global alignment and collaboration are critical to understanding the causes of the problem and identifying proper solutions.

In this second edition of our report, we aim to present an objective view of causes of the illicit tobacco trade based on the latest available evidence and drawing on informed positions taken by governments, regulators, tobacco control activists and the tobacco industry.

Our hope is that by gaining a better understanding of, and clearly identifying and explaining the root causes of illicit trade, the focus of governments, regulators, enforcement and other influential stakeholders will shift from the long-running debate about the causes of illicit trade to tackling the problem in a unified way. This should enable all stakeholders to address more effectively illicit demand stimuli and supply development and should result in more focused, cost-efficient and effective preventative measures being adopted. Only through such alignment and a shift toward more effective action can illicit trade growth be controlled and, where possible, reversed to the benefit of governments, legitimate businesses, consumers and society.

---

**Lawrence Hutter**  
Managing Director  
Alvarez & Marsal

---

## 2 Executive Summary

---

### Relationship Between Tobacco Tax Policy and Illicit Trade

Based on analysis of 32 countries, including the world's most important cigarette markets (excluding China) and all U.S. states where data is available, the affordability of legitimate tobacco products emerges as a principal driver of the illicit tobacco trade. Both the multi-country analysis and the pan-U.S. analysis reveal a strong correlation between the percentage of disposable income (PDI) required to purchase cigarettes and illicit trade as a proportion of total tobacco consumption. Similarly, an analysis of alcoholic beverages, arguably the closest product category to tobacco, also shows a strong relationship between illicit consumption and affordability.

Affordability is determined by retail pricing and disposable income\*. Alvarez & Marsal's (A&M's) analysis shows that while disposable income changes have played a role in affordability declines, particularly during the economic crisis, the principal cause has been retail price increases, with rising taxation being the main driver of the extent and pace of those price increases. We conclude, therefore, that tobacco tax increases have been a key driver of growth in the illicit tobacco trade.

Furthermore, examination of the dynamics of tax and price increases indicates that jurisdictions that experience sudden affordability declines, usually caused by substantial tax increases, and/or have easy access to lower-priced alternative products from other markets, are more susceptible to growth in illicit trade. For example, Malaysia now has one of the highest levels of illicit tobacco trade worldwide after a 37 percent excise increase in 2015 fueled a 46 percent rise in illegal volume over just two years. Latvia, which has relatively good affordability, still has relatively high illicit consumption because it borders lower-priced Russia and Belarus. Brazil is similarly impacted by easy access to illicit supply from Paraguay.

The analysis also demonstrates the importance of enforcement in controlling illegal markets. A&M has created a composite index comprising the degree of regulatory enforcement and the effectiveness of criminal justice systems and administrative provisions in controlling illicit trade. This country-by-country comparison shows that in markets where enforcement is strong, the scale of illicit trade is typically more controlled. Conversely, where enforcement is weak, the scale of illicit trade tends to be high, even if tax levels are relatively low. Moreover, an examination of countries with similar levels of affordability shows that the scale of illicit trade is greater in countries with weaker enforcement and smaller in countries with stronger enforcement.

\* In this analysis, the affordability index represents the percentage of personal disposable income (PDI) per capita per day required to purchase one pack of cigarettes at the weighted average price (WAP).

---

## Accusations of Tobacco Industry Involvement in Illegal Trade

Accusations of major tobacco companies benefitting from illicit trade go back nearly two decades, when illegal trade was comprised mainly of genuine contraband product. Since then, the operating environment has changed significantly for many industries, including tobacco, with tougher regulation and greater concern by the industries themselves for brand reputation and business model sustainability. The composition of illicit trade has also changed dramatically in recent years, moving from genuine contraband product toward counterfeit and “illicit whites.”

In fact, in 2017 the European Anti Fraud Office (OLAF) reported seizure of more than 1 billion cigarettes over the last two years, more than 90% [...] were ‘cheap whites’ (i.e. [...] brands not associated with any of the major international tobacco producers).<sup>1</sup> These products are typically produced for smuggling into countries where there is no prior legal market for them. Major tobacco companies are now clear net losers from illicit trade, which cannibalizes or erodes volumes and profits from legally sold products.

Our research suggests the interests of governments, regulators, law enforcement and major international tobacco companies – those operating globally in a variety of markets – are now aligned regarding illicit trade. This is reflected in major tobacco companies proactively sharing information with national and international law enforcement, implementing self-enforcing commitments and establishing memoranda of understanding (MoUs)

with national governments to combat the illegal trade. Tobacco companies have made significant investments in the development and implementation of anti-illicit trade (AIT) measures and compliance programs. These include programs to protect their supply chains, such as “know your customer” and “know your supplier,” goods-in-transit security programs, robust anti-money laundering policies and the monitoring of market shipment volumes known as Legitimate Market Demand (LMD) reporting.

The World Health Organization (WHO), which is focused on achieving better health throughout United Nations member countries, states in Article 5.3 of its Framework Convention on Tobacco Control (FCTC)<sup>2</sup> that “[i]n setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.” Our research suggests the FCTC and the Protocol to the FCTC to Eliminate Illicit Trade in Tobacco Products should not inhibit appropriate collaboration around controlling illicit trade where the interests of policymakers and major tobacco companies are aligned.

There are several cases in which such collaboration has succeeded in halting and rolling back illicit trade. However, these efforts can only be successful if tobacco taxation policies and enforcement strategies go hand in hand with a clear understanding of the significant impact affordability has on illicit trade.



**While in the past tobacco companies have faced accusations of benefitting from illicit trade, using it to maintain or create share for their brands, approaches have changed markedly in recent years and given the rise of counterfeit and illicit white products, the major manufacturers are now net sufferers from illicit trade...**

*Euromonitor International<sup>8</sup>, in the context of why illicit trade matters to tobacco manufacturers*

---

### 3 Background

---

According to the OECD, “[t]he illicit trade in tobacco is perhaps the most widespread and most documented sector in the shadow economy.”<sup>3</sup> Euromonitor International estimates that global illicit penetration of total sales reached 10.3 percent in 2017 (excluding China) resulting in lost tax revenues of around \$40 billion.<sup>4</sup>

In Europe, counterfeit volumes increased by 9 percent in 2017,<sup>5</sup> with Eastern Europe’s illicit volumes alone growing by 7.6 percent thereby reversing a downward trend in the previous year.<sup>6</sup> In Russia, rapidly increasing taxes and prices combined with declining personal disposable income (PDI) in the last couple years have resulted in deteriorating affordability and a significant rise in illicit trade. According to market research and industry modelling, the share of illicit trade in Russia more than tripled from 1.6 to 5.4 percent between 2016 and 2017, and the most recent analyses suggest it will have reached around 9 percent in 2018. Overall, European counterfeit and contraband (C&C) consumption accounted for 44.7 billion cigarettes in 2017 and comprised 8.7 percent of total consumption.<sup>5</sup>

The Asia Pacific region experienced an 8.1 percent increase in illicit volume in 2017 (excluding China) and accounts for more than half of all illegal cigarettes consumed worldwide.<sup>6</sup> In Australia, illicit trade grew in volume by 7 percent in 2016, accounting for 8.9 percent of total cigarette sales in that country.<sup>6</sup> Both Australia and South Korea ranked in the top 10 globally in 2017 for illicit trade growth, contributing to the Asia Pacific region’s overall increase.<sup>6</sup>



**The trade in counterfeit and diverted cigarettes and illicit whites resembles and sometimes intersects with the trade in drugs and humans. Ignored by many law enforcement agencies, illicit cigarette trade provides an ideal funding source for states, corrupt officials, criminals, and terrorists.”**

U.S. House Financial Services Committee<sup>7</sup>

---



---

In 2012, Australia became the first country to adopt plain packaging laws, which require the removal of all brand imagery – including logos and trademarks – from cigarette packages. Such regulations are intended to minimize the influence of brand attraction on consumers as a driver of demand. However, they may also make it more difficult for consumers to distinguish between legal brands, illicit whites and counterfeit products. Over the past five years, plain packaging laws have also taken effect in New Zealand, France, the United Kingdom, Norway and Ireland, with other countries considering similar legislation.<sup>6</sup> In both Europe and Asia, illicit whites continue to gain share and in 2017 they comprised one-third of Europe’s total C&C volumes.<sup>5</sup>

In the U.S., illicit trade primarily takes the form of cross-state border resale of genuine product (“smurfing”), which has also been increasing.<sup>8</sup>

The OECD, the United Nations (U.N.) Security Council investigative body and national enforcement agencies around the world report that illicit trade in tobacco has become a major security challenge and is being increasingly used to fund terrorism.<sup>9</sup>

---

“

**Illicit tobacco provides a significant revenue stream to illicit actors... fuels transnational crime, corruption and terrorism. So, for these reasons... the report declared that the global illicit trade in tobacco poses a threat to national security.”**

U.S. Helsinki Commission on Security and Cooperation in Europe<sup>10</sup>

---

“

**[Terrorist] involvement can also be indirect, as is the case for certain forms of smuggling, particularly cigarettes, a source of major profit for Al-Qa’ida operatives and Islamic Maghreb (AQIM), either by levying taxes or facilitating their transport.”**

Center for the Analysis of Terrorism<sup>11</sup>

---

“

**Whilst drug smuggling appeared to be one of the most common means of financing terrorist organizations in previous decades, the counterfeiting or smuggling of legal goods have been their fastest growing source of revenue for approximately ten years.”**

Center for the Analysis of Terrorism<sup>11</sup>

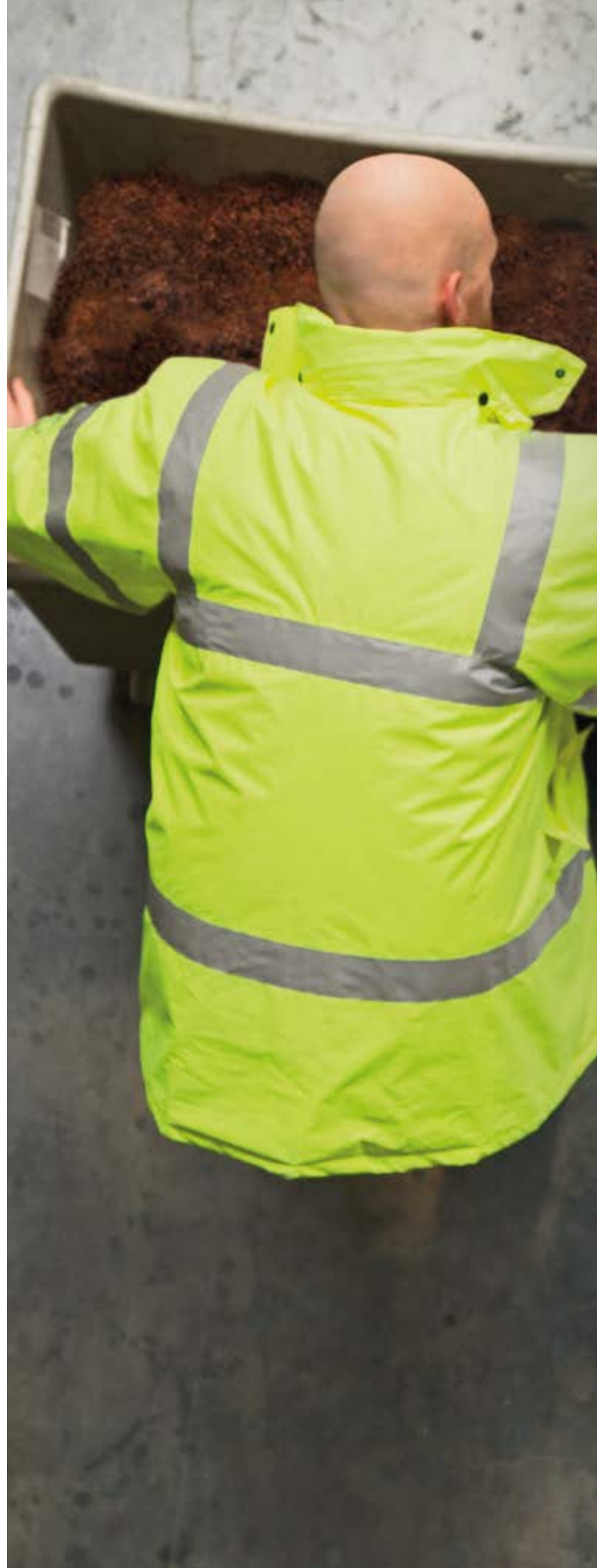
---

Illicit trade also results in easier and earlier access to tobacco for young people. For example, 55 percent of children aged 14 and 15 in northeast England who smoke say they buy illegal tobacco products, and 73 percent say they have been offered illegal tobacco at some point.<sup>12</sup> Survey evidence also suggests that lower socio-economic groups have a significantly higher smoking propensity and susceptibility to illicit product than higher socio-economic groups.<sup>13</sup> In fact, people who use illicit tobacco products smoke, on average, two extra cigarettes per day compared to those who use legal products.<sup>14</sup>

The debate about the relationship between high and increasing taxes on tobacco, illicit trade and organized crime crystallizes around two core issues:

- a. The relationships between tobacco tax policy, enforcement and illicit trade
- b. Allegations of involvement of the tobacco industry itself in illegal trade, which may deter governments and regulators from collaborating with the industry

A&M has conducted an analysis of the root causes of illicit trade and has assessed whether motivation exists for involvement of the tobacco companies in illicit trade. We have also considered statements made by the WHO and tobacco control organizations as hypotheses to be tested in order to provide evidence from which an objective view can be determined.







---

“

**Conflicts in the Middle East and North Africa are making smuggling [tobacco] a very profitable source of income for terrorist groups because of the penetrable borders.”**

*European Economic and Social Committee<sup>15</sup>*

---

---

## 4 Relationship Between Tobacco Tax Policy and Illicit Trade

---

Tobacco control groups' allegations about the relationship between tobacco tax policy and illicit trade are characterized by statements such as:

*"... the experience from many countries shows that there is no direct correlation between high tobacco taxes and smuggling."*

WHO, 2015<sup>16</sup>

*"Tobacco taxes are not the primary reason for cigarette smuggling and cigarette tax avoidance."*

WHO, World No Tobacco Day (WNTD), 2015<sup>17</sup>

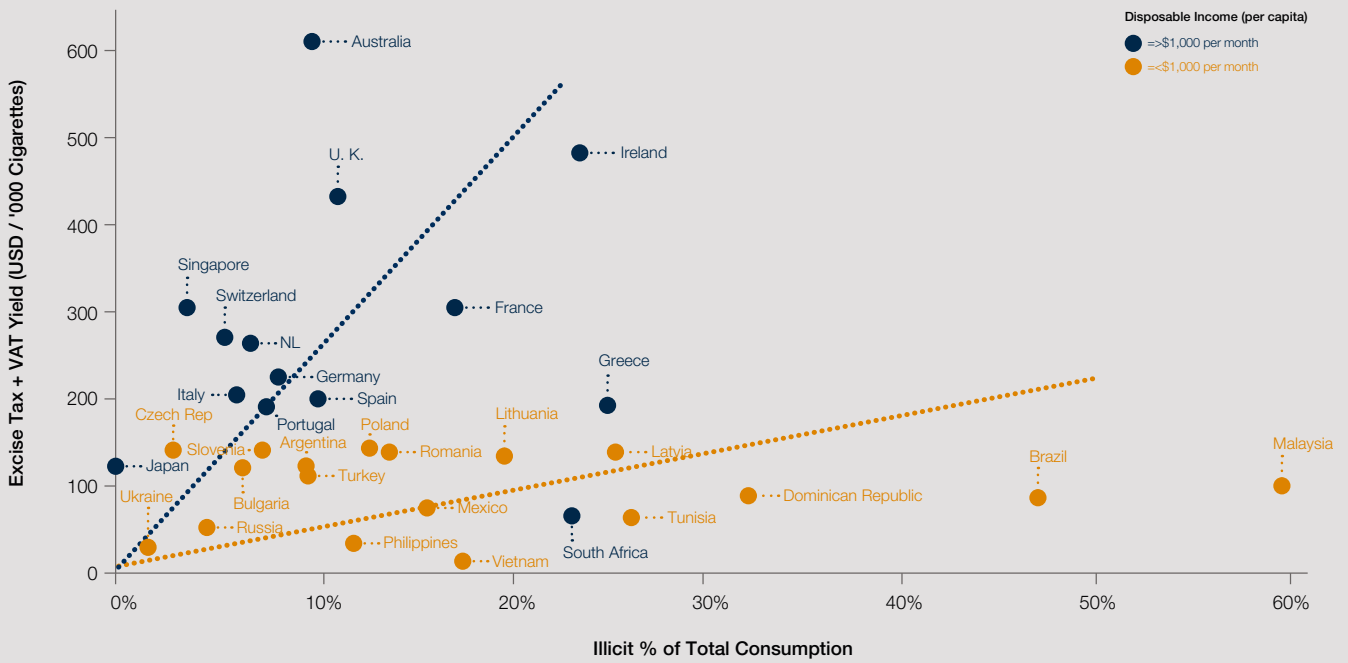
However, A&M's analysis presents strong evidence that rapid reductions in affordability driven by changes in taxation have a significant influence on illicit trade levels worldwide.

### Global Multi-Country Analysis

First, we examined the correlation between the tax yield in U.S. dollars per thousand cigarettes and the percentage of total consumption that is illicit for a representative set of countries from around the globe that account for 43 percent and 50 percent of global cigarette volume and retail value respectively, excluding China. At first glance, the results show no apparent overall correlation. However, once differences in disposable income levels are considered and countries are grouped accordingly, a relationship between tax yield and illicit consumption emerges. This suggests that taxation is a factor that influences the level of illicit trade (Figure 1).

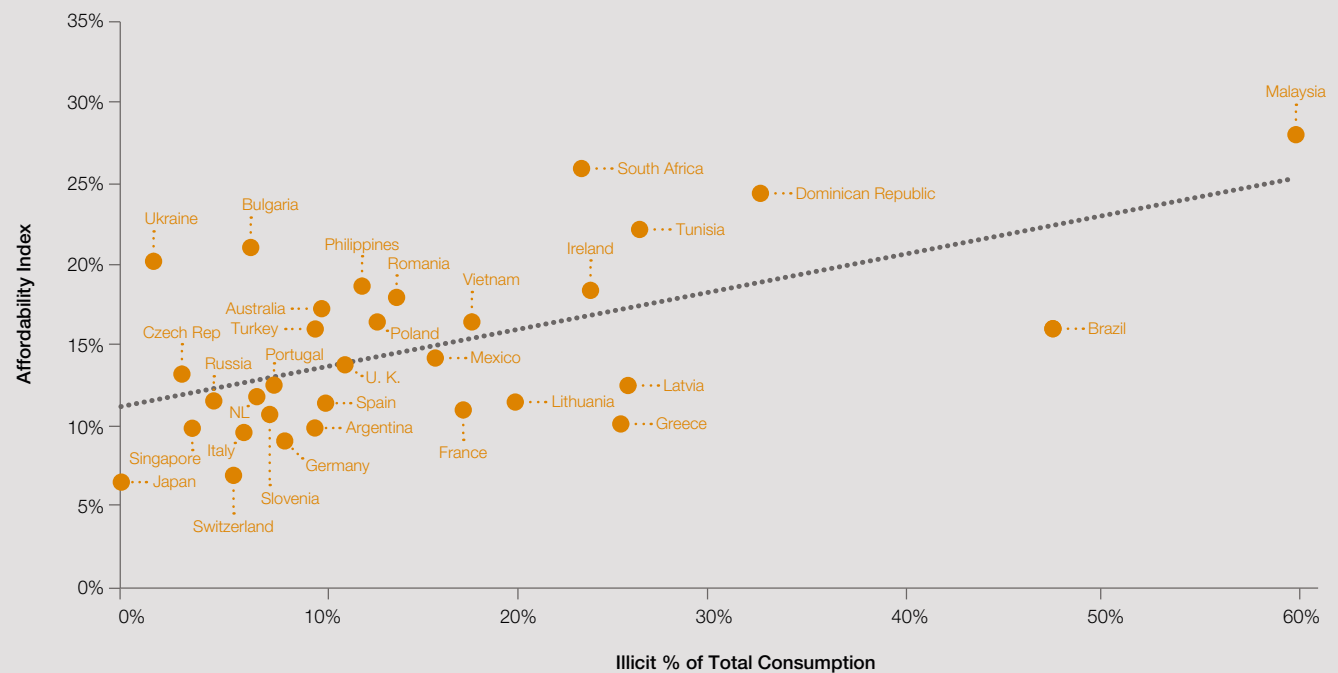
Given these observations, for each of these countries we calculated an affordability index represented by the percentage of average Personal Disposable Income (PDI) per capita per day required to buy a pack of 20 legal cigarettes at the weighted average price (WAP) and then examined the relationship between this measure and the illicit proportion of total consumption. The analysis shows a good positive correlation of 57 percent (Figure 2). As previously noted, Brazil and Latvia have particularly high levels of illicit trade relative to affordability due to heightened supply-side factors, with Brazil impacted by illicit imports from Paraguayan suppliers and the Baltics being close to lower-priced Russia and Belarus. Greece's relatively high level of illicit trade may have been triggered by income reduction following the 2010 debt crisis and high tax increases. Even though the affordability index remains relatively low, legal market share can be difficult to regain once illegal trade is established. In Asia, Malaysia's illicit trade volume is approaching 60 percent, rising dramatically over the past two years after a 37 percent excise increase in 2015.

**Figure 1: Total Tax Yield vs. Illicit Trade (2017)**



Source: Euromonitor International for illicit trade data, Tobacco 2017 Edition; European Commission Excise Duty Tables; A&M Analysis; JTI Analysis

**Figure 2: Affordability vs. Illicit Trade (2017)**



Source: Euromonitor International for illicit trade data, Tobacco 2017 Edition; European Commission Excise Duty Tables; A&M Analysis; JTI Analysis

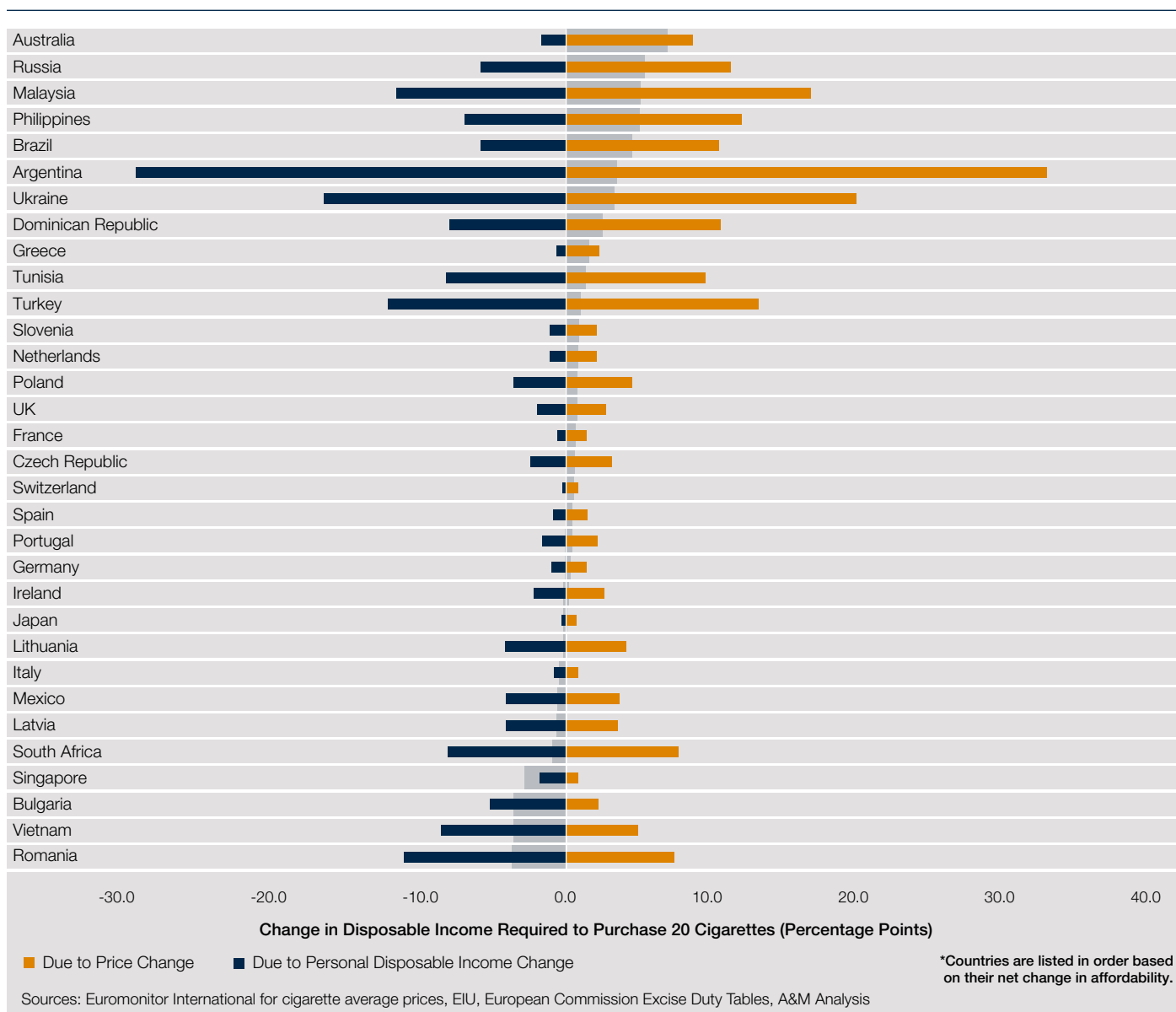
This analysis strongly suggests that the tipping point at which a smoker switches to illicit product is significantly influenced by the affordability of legal product and the availability of illicit alternatives.

Cigarette affordability depends on both the retail price and disposable income. A&M has dissected the impacts of these two elements on changes in cigarette affordability over the period 2012-2017. Figure 3 lists countries in order of their net change in affordability during that time frame. This analysis shows that, while personal disposable income (PDI) has continued to rise, in most countries the increase in price of cigarettes has been greater than the increase in PDI.

Therefore, while growth in PDI has helped temper the impact of the rising cost of cigarettes on affordability, affordability overall has still declined. Furthermore, A&M analysis shows a 98 percent correlation between the level of taxation and the level of retail prices (Figure 4).

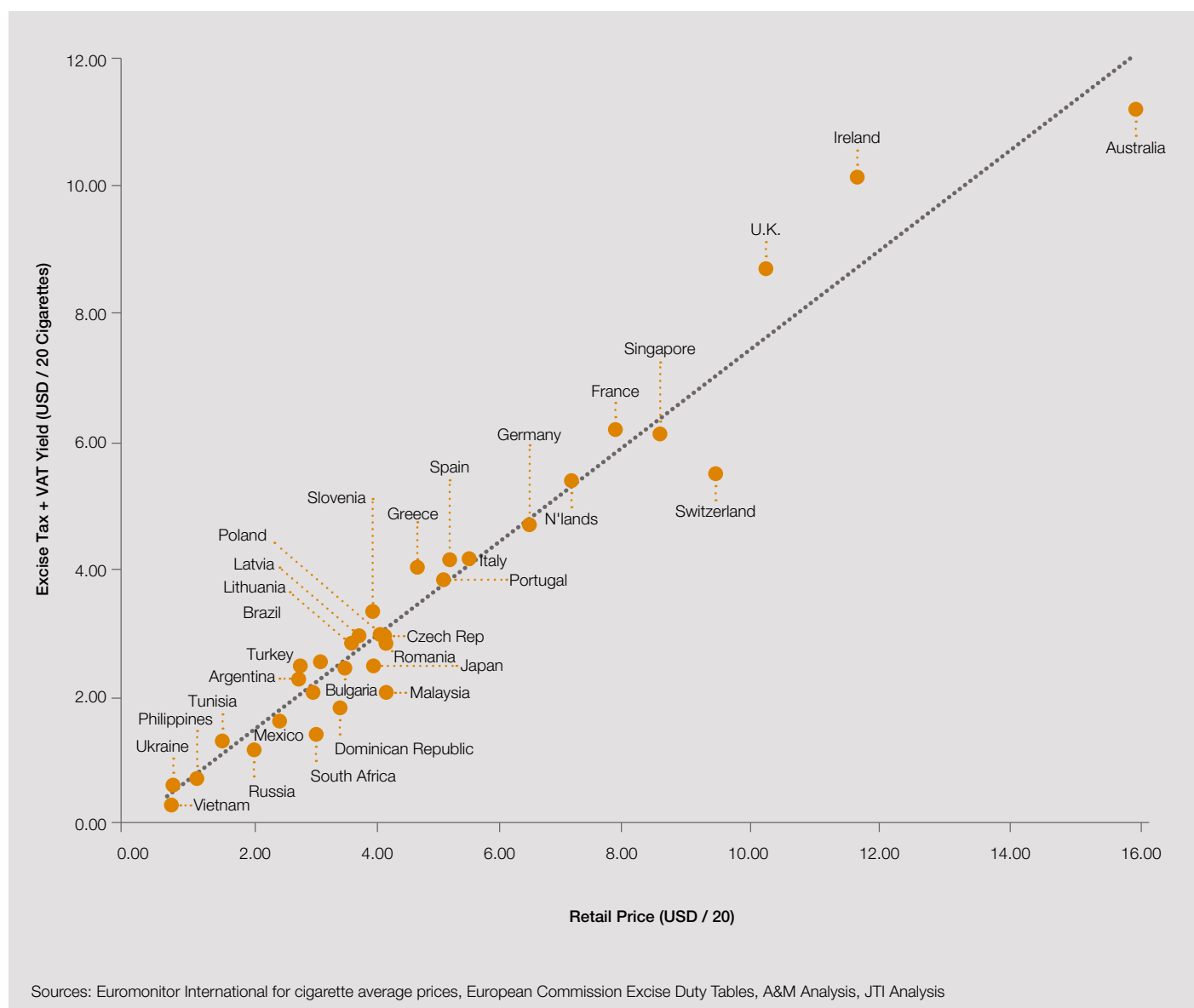
The overall conclusion is that illicit trade primarily arises due to affordability pressures, which are in turn mainly driven by the impact of taxation on retail pricing.

**Figure 3: Affordability Pressure (2012–2017)**





**Figure 4: Taxation vs. Retail Price (2017)**

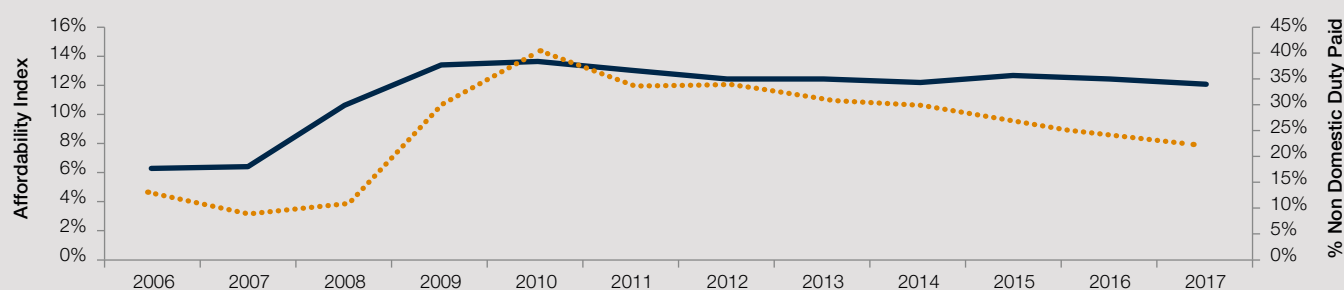


**We also examined the historical development of affordability and non-domestic duty paid (NDDP)\* or illicit trade across a sample of countries.**

**Eastern European EU countries** experienced rapid deteriorations in cigarette affordability during the late 2000s due to EU legislation requiring a minimum excise tax rate of €64 per thousand cigarettes. Consequently, these countries experienced rapid growth in illicit trade.



**Figure 5: Latvia**



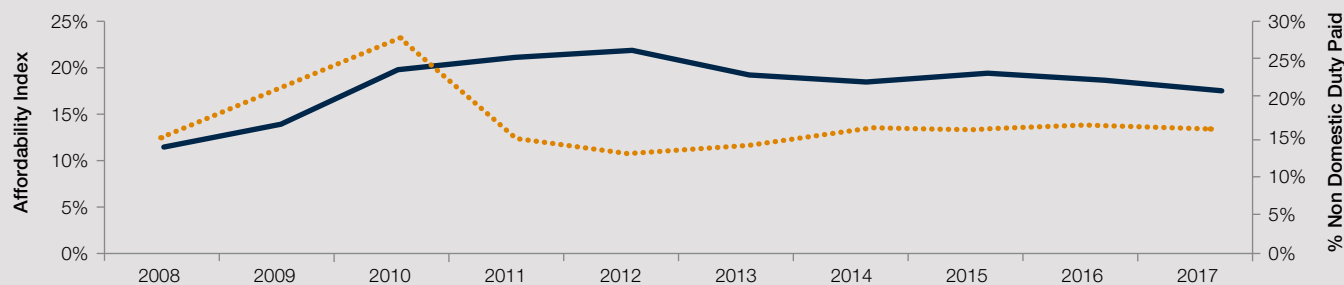
Rapid deterioration in affordability due to tax-driven price increases occurred in parallel with NDDP growing from 13 percent to 41 percent of total consumption between 2008 and 2010. Cross-border smuggling of cheap cigarettes from neighboring Russia and Belarus compounded the problem. Between 2010 and 2017, affordability stabilized and NDDP leveled out, albeit remaining at one of the highest levels in the EU.

Source: EIU, KPMG Project Star / Project Sun, European Commission Excise Duty Tables

— Affordability Index      ..... NDDP%



**Figure 6: Romania**



Tax-driven price increases rapidly reduced affordability over a two-year period, and NDDP approached 30 percent in 2010. Since then, more moderate tax increases, coupled with a very strong focus on enforcement have succeeded in reducing NDDP.

Source: EIU, Novel Research, European Commission Excise Duty Tables

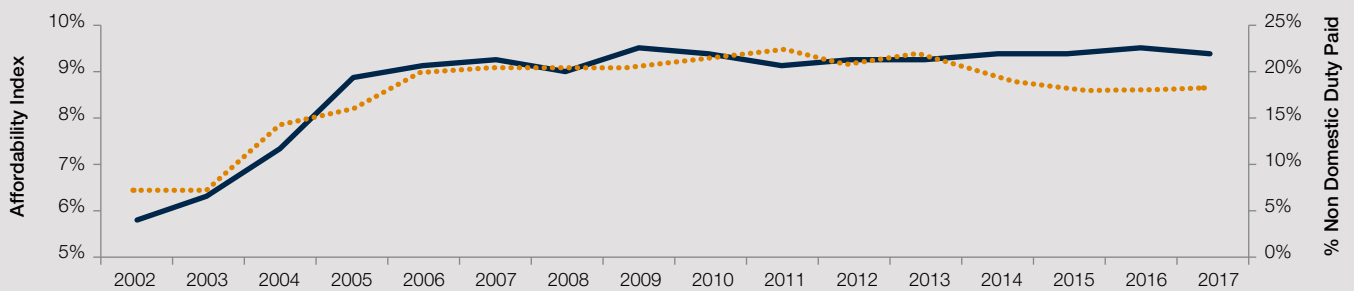
— Affordability Index      ..... NDDP%

\*In the EU, cross-border shopping for personal consumption is legal. We have included this legal NDDP in our analysis because it reflects consumer reactions to tax and price increases, and it also impacts government revenue collections in countries of consumption.

Western European countries have experienced less drastic changes in cigarette affordability, but the same relationship with illicit trade is evident.



Figure 7: Germany



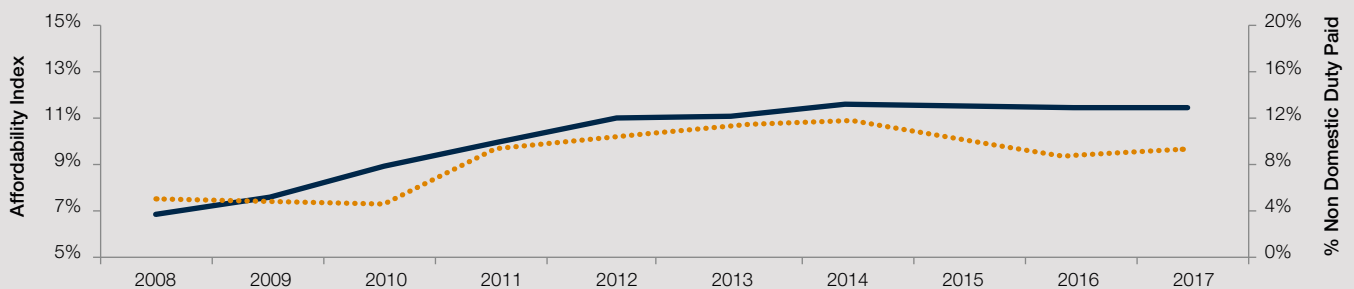
Germany has been impacted by inflows primarily from its eastern neighboring countries encouraged by high tax-driven price increases between 2002 and 2005 fueling NDDP growth from 7 percent to 20 percent of total consumption. When Germany revised its tax policy and adopted more gradual tax increases planned over five years, the NDDP reduced and stabilized.

Source: EIU, DZV/IPSOS, German Statistics Office

— Affordability Index    ..... NDDP%



Figure 8: Spain



Large tax increases between 2010-2012 drove up cigarette retail prices. This, coupled with negative income development due to growth of unemployment and the overall economic crisis, reduced affordability. NDDP increased between 2010-2014. In 2015, affordability improved and NDDP declined, though 2017 saw a slight uptick.

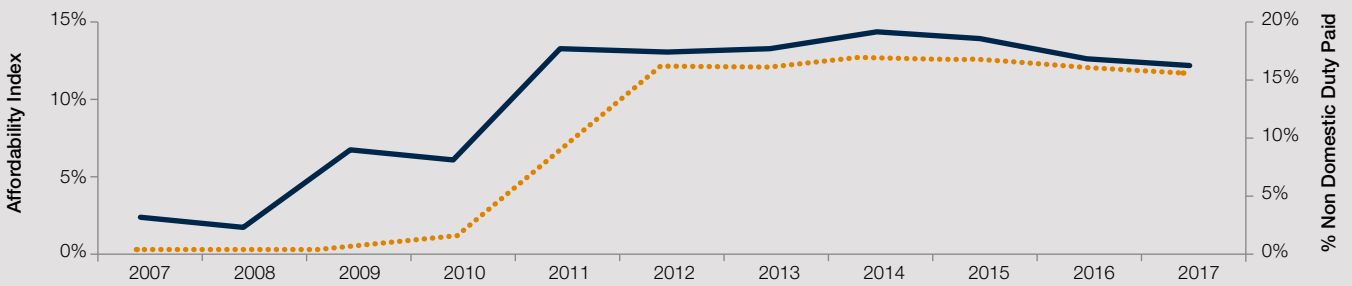
Source: EIU, KPMG Project Star / Project Sun, European Commission Excise Duty Tables

— Affordability Index    ..... NDDP%

**Outside of Europe** the same historical relationship between affordability deterioration and illicit trade is also evident.



**Figure 9: Mexico**



In Mexico, a 34 percent excise tax increase in November 2010 resulted in a 27 percent retail price increase, compared to an inflation rate of 3 percent. The increased affordability pressures caused a sharp increase in illicit trade, which has remained high.

Source: EIU, Industry Modeling

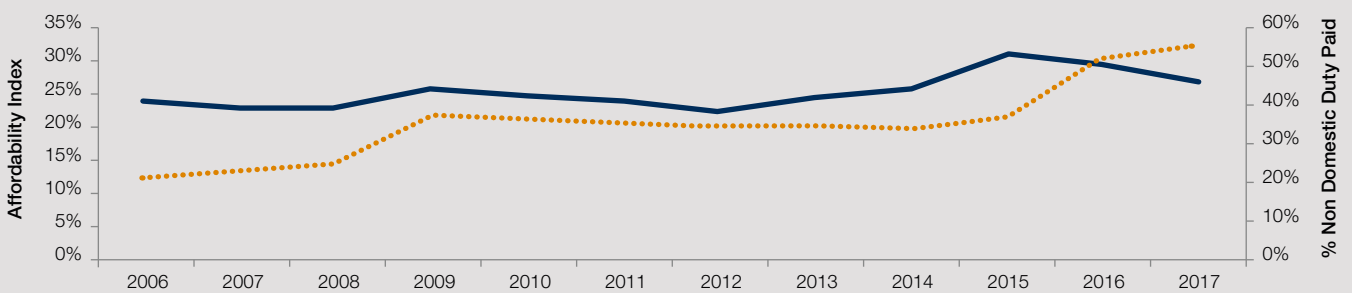
— Affordability Index      ..... NDDP%







Figure 10: Malaysia



Malaysia is one of the most pressured countries in terms of cigarette affordability and has historically had high levels of illicit consumption. Most recently, a 37 percent excise tax increase in November 2015 caused the NDDP to further grow in 2016 and 2017 reaching an estimated level of nearly 55 percent despite a tax freeze allowing a (partial) recovery of affordability.

Source: EIU, Empty Pack Surveys

— Affordability Index    ..... NDDP%

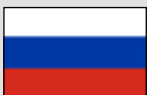
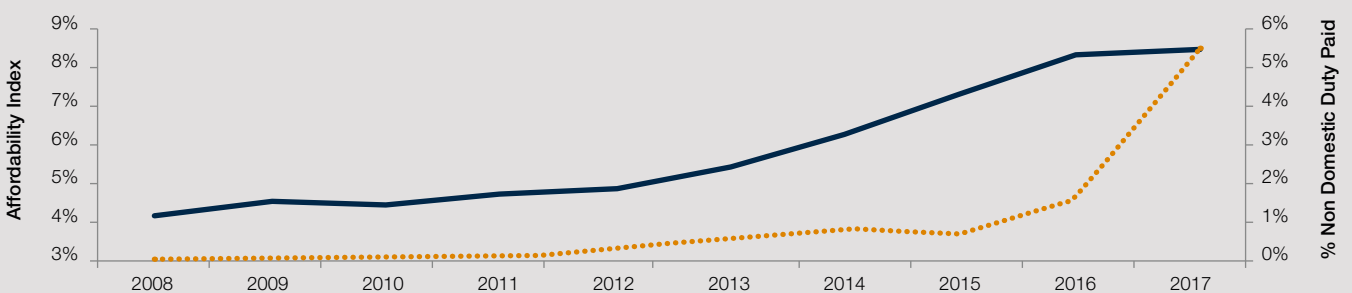


Figure 11: Russia

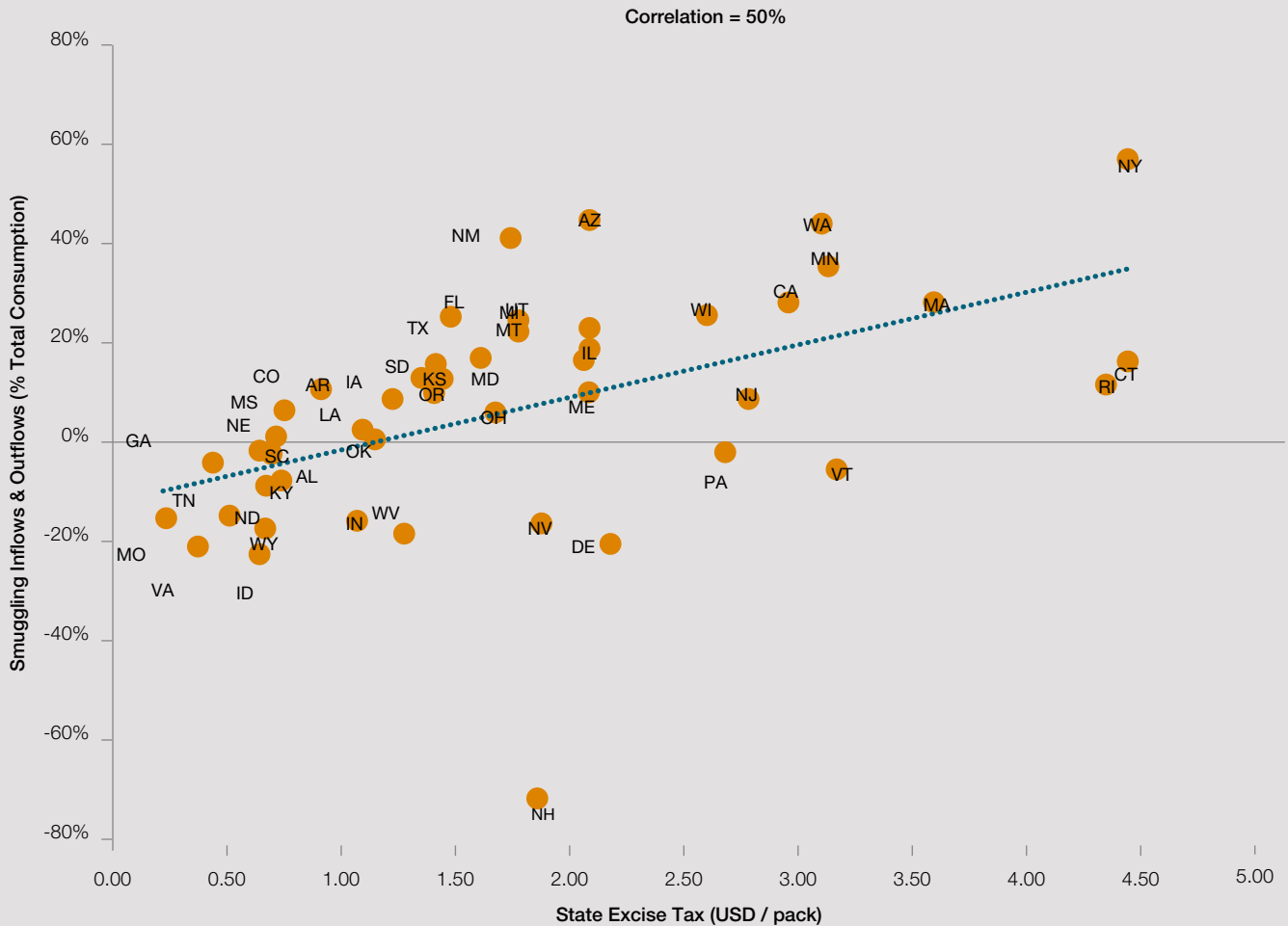


Due to increasing tobacco excise tax in recent years, affordability has rapidly deteriorated and price gaps have widened between neighboring countries in the Eurasia Economic Union (EAEU) and other sources of NDDP product. Combined with historically easy cross-border shipments, particularly with Belarus, illicit trade in Russia jumped from nearly non-existent levels to 5.3 percent in 2017. It's estimated to have reached around 9 percent of consumption in 2018.

Source: EIU, Empty Pack Surveys, Industry Modeling

— Affordability Index    ..... NDDP%

**Figure 12: U.S. Cigarette Smuggling and State Excise Tax (2017)**



Sources: CDC, Tax Foundation, A&M Analysis

### U.S. Analysis by State

Due to very wide differences between U.S. states in taxation and retail pricing of cigarettes as well as disposable income, analysis of illicit trade inflows and outflows must be carried out at the state level to be meaningful. A&M has therefore conducted a detailed examination of the 47 states for which consistent data is available. The analysis shows that, within the U.S., there is a reasonably good correlation of 50 percent between the degree of state cigarette smuggling and state excise tax rates (Figure 12) and an even stronger correlation of 60 percent between cigarette smuggling and affordability (Figure 13).

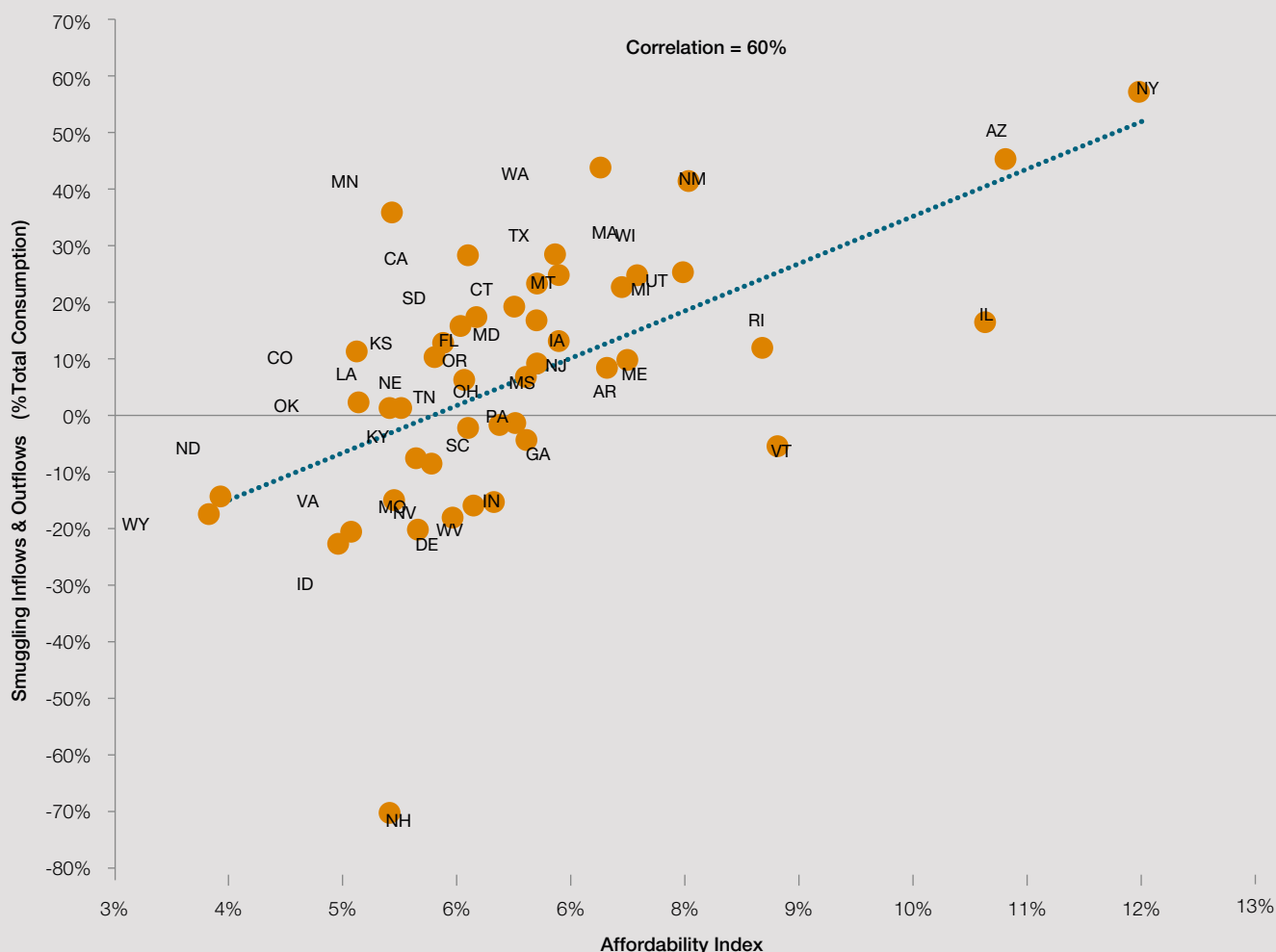


**Given the relationship between higher cigarette tax rates and higher smuggling, policymakers should consider these issues when determining whether a cigarette tax increase is appropriate.”**

**Scott Drenkard**

Director of State Projects for the Tax Foundation<sup>18</sup>

**Figure 13: U.S. Cigarette Smuggling and Affordability (2017)**



Sources: Sales Tax Handbook, Tax Foundation, Bureau of Economic Analysis, A&M Analysis

Illegal inflows of tobacco products can be heavily impacted by wide price gaps between neighboring jurisdictions. In the U.S., wide state-by-state price gaps created by different tax levels fuel smuggling even in states where affordability is good. For example, Massachusetts, which has a relatively low affordability index at around 7 percent, has a significant level of inbound smuggling at around 22 percent because of its proximity to states with lower tax rates, such as New Hampshire, which has the highest level of outbound smuggling in the U.S. at 72 percent. In New York, almost 60 percent of cigarettes consumed bear tax stamps from outside the state.<sup>19</sup>

Similar effects can be seen in Europe between neighboring countries with wide price gaps. For example, in Germany, the availability of lower taxed – and therefore cheaper – cigarettes in nearby Poland and the Czech Republic drive cross-border shopping. While intra-EU NDDP products may be legally brought from one member state to another (assuming they were purchased only for personal consumption), this can still have a significant impact on tax revenues for destination countries. For example, while Germany's illegal tobacco consumption is estimated to be only 4.6 percent, its total NDDP is quite high at 16.7 percent.<sup>5</sup>



### Illicit Alcohol in Europe

By way of analogy, the same relationship between affordability and illicit trade across countries is seen with alcoholic beverages, the closest comparable product to tobacco.<sup>20</sup> Low affordability driven by alcohol duties has a correlation of 71 percent with the level of non-duty paid alcohol consumption (Figure 14). The highest rates of non-duty paid alcohol consumption in Europe are in low-income Eastern European countries and in the highly taxed Scandinavian countries.

This analysis emphasizes that, regardless of product, changes in affordability are a major driver of growth in illicit trade. As we have explored in this report, in the case of tobacco, affordability changes have been primarily driven by retail price changes caused by tax increases.

Governments acknowledge a link between illicit tobacco trade and high taxation.

“

**The principal cause of the smuggling, of course, is the high level of duty in the U.K., which not only has the world's most expensive cigarettes apart from Norway but is raising their price rapidly.”**

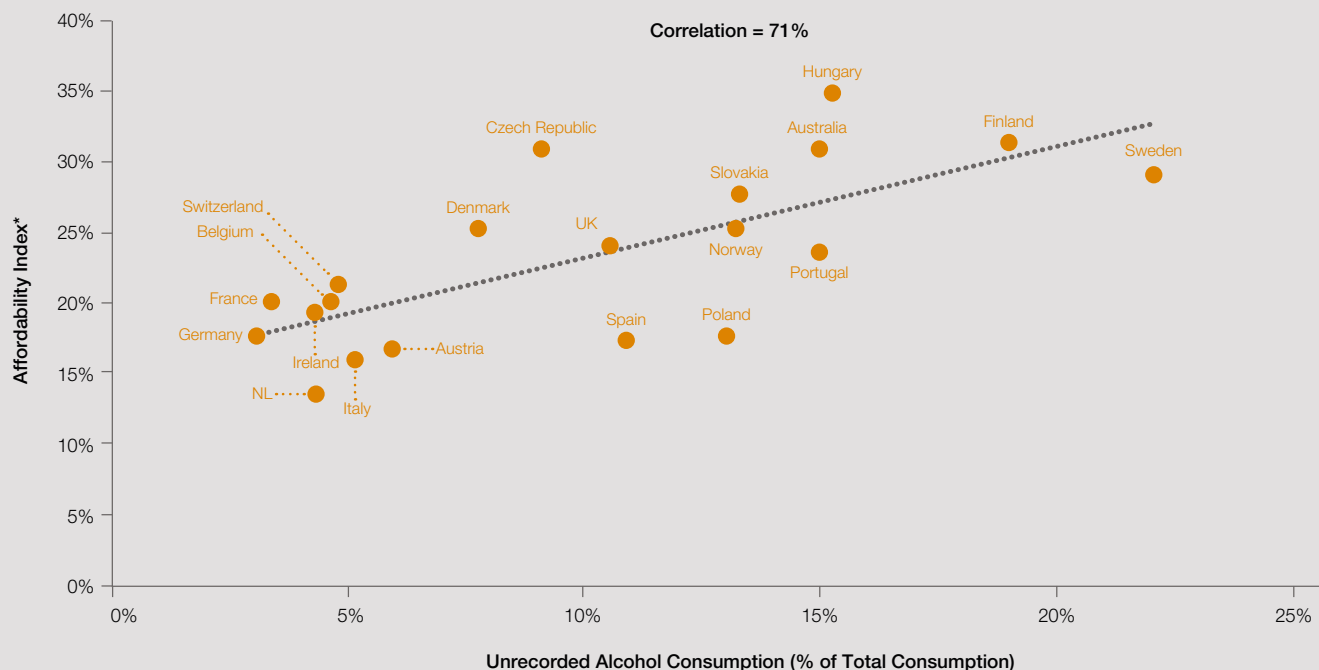
The Taylor Report to the U.K. Chancellor of the Exchequer (1999)<sup>21</sup>

“

**The U.K. has some of the highest tobacco taxes in the world with huge profits to be made (from smuggling)... U.K.'s tobacco duty escalator will see the real price of tobacco products continue to increase — ongoing incentive to smuggle remains very high.”**

HMRC (2013)<sup>22</sup>

**Figure 14:** Affordability and Non-Duty Paid Alcohol Consumption in Europe



Source: WHO, OECD, Global Alcohol Prices, A&M Analysis

\*The affordability index in this instance is based on the percentage of disposable daily income per capita required to buy 70 centiliters (approx. 24 ounces) of alcohol.



**Every country with high tobacco taxes has an illegal tobacco problem. Ireland, which has exceptionally high tobacco taxes and tobacco prices, has a significant problem.”**

**Assistant Secretary**  
Revenue Commissioners Oireachtas  
Health Committee Hearing (2014)<sup>23</sup>



**In our assessment, we are not only looking at increasing duties on cigarettes, but also the effect of taxation on illicit cigarettes... The lower-income group will turn to illicit cigarettes if prices of cigarettes get too expensive.”**

**Datuk Seri Dr. D Dzulkefly Ahmad**  
Malaysian Health Minister (2018)<sup>24</sup>

---

## 5 Roles and Limits of Enforcement

---

Strength of enforcement is another factor influencing illicit trade. However, to be effective enforcement must be coupled with appropriate, moderate tax policies, otherwise its ability to tackle smuggling is weakened and the problem is almost impossible to control.

### Global Multi-Country Analysis

We have approximated the level of enforcement per country by creating a composite index comprising the degree of regulation\* and the effectiveness of the criminal justice and administrative systems, two separate indices compiled by the World Justice Project and used in the calculation of its Rule of Law Index.<sup>25</sup> This analysis demonstrates that:

- a. Enforcement tends to be strongest in more developed countries, where tax rates and tax burdens also tend to be higher (Figure 15, upper right cluster)
- b. There is a clear link between the level of enforcement and the level of illicit trade as a proportion of total consumption — lower levels of enforcement tend to yield higher levels of illicit trade (Figure 15, lower left cluster)
- c. Where affordability is pressured and/or enforcement is weak, higher levels of illicit trade occur (Figure 16, upper left cluster). By way of contrast, where affordability is less pressurized and enforcement is stronger, lower levels of illicit trade result (Figure 16, lower right cluster)

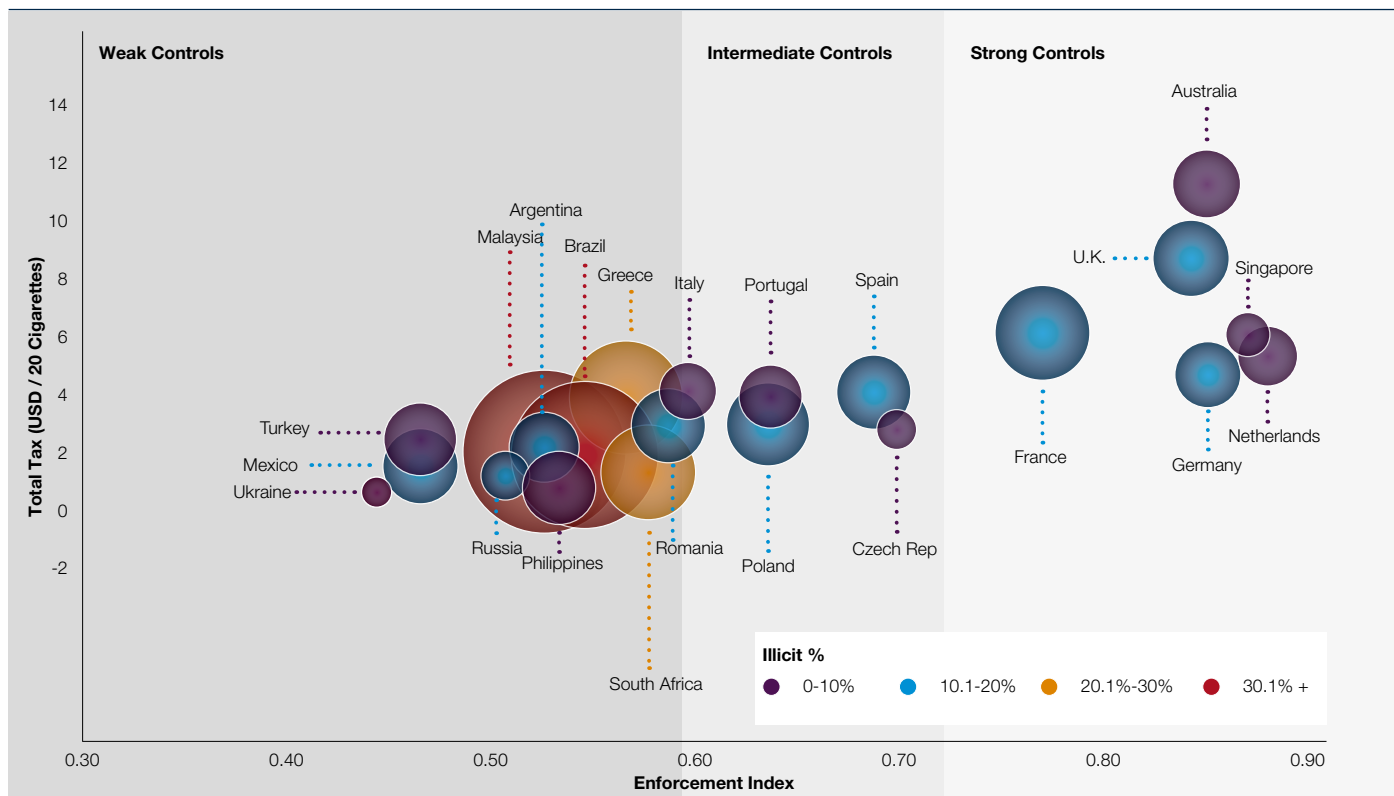
It's important to note that, even with strong enforcement measures in place, the fiscal policies of neighboring countries can still impact a nation's level of illicit or NDDP trade. Expanding on the example of Germany in the previous chapter, toward the end of 2007 border controls between Germany and its eastern neighbors, Poland and the Czech Republic, were suspended when the latter two nations joined the Schengen agreement. This change coupled with prices in Germany being €2 more per

pack than in Poland or the Czech Republic, led to a rise in cross-border shopping and growth in the German NDDP from 16 percent in 2005 to 20 percent in 2008.

Track-and-trace (T&T) systems that record the movement of legitimate tobacco products are often presented as a possible support to enforcement efforts in participating countries. As such, the EU's Tobacco Products Directive of 2014 provides for an EU-wide system to be in place by May 2019, and results from its implementation could be visible by the end of this year. The WHO's FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (the Protocol) also includes T&T requirements as part of its obligatory implementation timetable. However, while these systems may help to control genuine tobacco products produced by legitimate manufacturers in countries that choose to ratify the Protocol, they cannot help to control illicit whites, counterfeit products or other products manufactured for illicit consumption (that will remain easily acquirable by retail outlets). For countries like Greece where, according to Empty Pack Surveys (EPS), more than 20 percent of all illicit cigarettes are counterfeit, T&T systems will likely have a limited impact on illicit trade. In the Philippines, where EPS shows 90 percent of illegal cigarettes are counterfeit, they may have no useful impact. Ultimately, T&T systems need to be widespread and interoperable to be most effective, but track-and-trace will never be a silver bullet that can solve the problem of illicit trade.

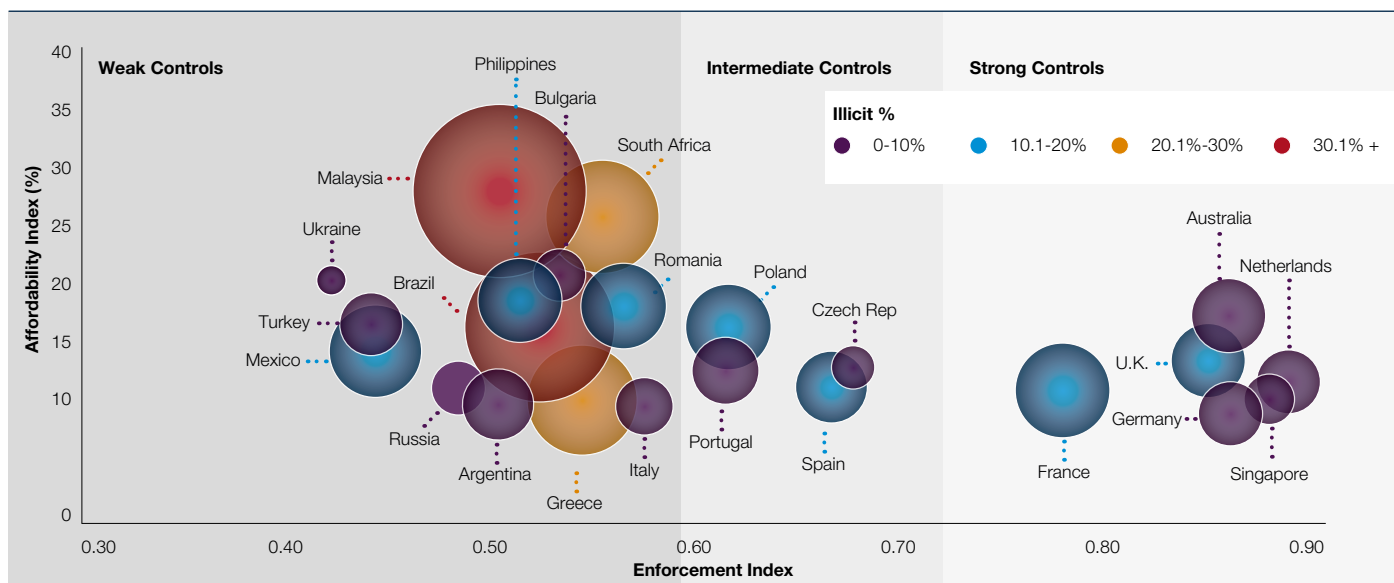
\*The World Justice Project measures the extent to which regulations are fairly and effectively implemented and enforced by evaluating whether regulations and administrative provisions are enforced effectively and whether they are applied and enforced without improper influence by public officials or private interests. They also consider whether administrative proceedings are conducted in a timely manner, without unreasonable delays, whether due process is respected in administrative proceedings and whether there is no expropriation of private property without adequate compensation.<sup>25</sup>

**Figure 15: Enforcement and Illicit Trade**



Sources: Euromonitor International for illicit trade data, Tobacco 2017 Edition; European Commission Excise Duty Tables; A&M Analysis

**Figure 16: Affordability vs. Enforcement**



Sources: World Justice Project; Euromonitor International for illicit trade data, Tobacco 2017 Edition; EIU; European Commission Excise Duty Tables; A&M Analysis



### Case Study: AIT Strategy, Fiscal Policy and Illicit Trade in the U.K.

In the U.K., an excise duty annual “escalator” of 5 percent<sup>26</sup> above inflation between 1996-97 and 1999-2000 coincided with an increase in cigarette smuggling from 3 percent of total consumption to 18 percent, with a projection to reach 36 percent by 2003-04 if no action was taken (Figure 17).<sup>27</sup> In response, in 2000-01 the U.K. government halted the escalator in favor of excise increases in line with inflation and concurrently implemented several AIT strategies. These included the introduction of fiscal marks; heightening of interception, seizures and asset confiscations; increased penalties including criminal prosecutions with up to a seven-year sentence; financial wrongdoing penalties of up to 70 percent of the duty due; civil actions including winding up orders and bankruptcy; prohibitions on sales for up to six months; withdrawal of hauliers' licenses; and improved public awareness. These strategies were supported by an investment of £209 million over three years into Her Majesty's Revenue and Customs (HMRC) staffing and technology.<sup>28</sup>

Over the next decade, the U.K. also strengthened cooperation with tobacco manufacturers, collaborated with overseas partners and international organizations, expanded HMRC's focus to include hand-rolling tobacco, increased the network of

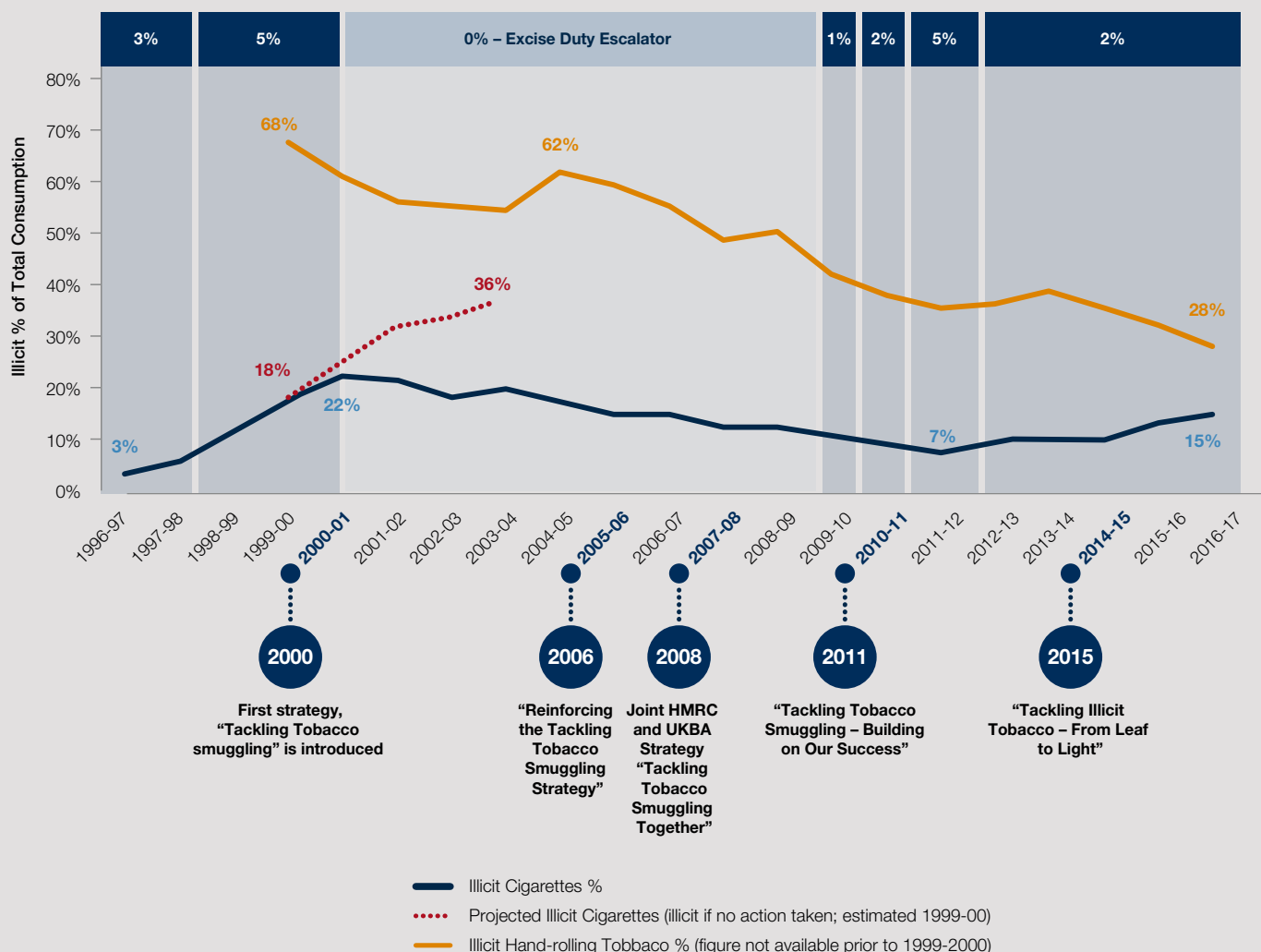
Fiscal Crime Liaison Officers, and introduced new technology and detection capabilities.<sup>27,28</sup>

These enforcement efforts, combined with the policy of increasing taxation only in line with inflation, helped reduce illicit cigarette consumption from 22 percent in 2000-2001 to approximately 8 percent by 2011-2012, while illicit hand-rolling tobacco reduced from 68 percent of total hand-rolling consumption to approximately 40 percent in the same time frame (Figure 16). Despite this decline, in 2010 the British government decided to reintroduce the tax escalator policy with the public-health aim of discouraging tobacco use.

While illicit hand-rolling tobacco continues to decline in volume, illicit cigarette consumption appears to once again be rising. In October 2018, the government announced plans for the creation of a nationwide Anti-Illicit Trade (AIT) Group to address this growth while the escalator continues to increase duty rates on tobacco products by two percentage points above inflation through the end of the current Parliament. The AIT Group will comprise senior officials from all parts of the U.K. and is charged with developing a national strategy for tackling illicit trade.<sup>29</sup>



**Figure 17: Impact of “Tackling Tobacco Smuggling” Strategy on Illicit Trade**



Source: HMRC Tobacco Gap Estimates for 2016-2017, A&M Analysis

### Conclusion on the Relationship Between Enforcement and Illicit Trade

Strong enforcement and AIT strategies can help to minimize illicit trade, if they are combined with moderate fiscal policies.

At the end of the day, high tobacco taxation is the primary driver of illicit trade because high taxes cause higher retail prices and can reduce affordability if disposable income levels are evolving at a slower pace or in a different direction.

They can also widen price gaps between higher-income/higher-taxed countries and lower-income/lower-taxed countries. These conditions create demand for more

affordable alternatives and open doors for smugglers to address and profit from this demand. While strong enforcement and AIT strategies can help to control illicit trade, they cannot tackle the problem alone. They are most effective when combined with fiscal policies that balance taxation with affordability.



## 6 Allegations of Tobacco Industry Involvement in Illegal Trade

A variety of allegations, coming mainly from tobacco control groups and nongovernmental organizations (NGOs) focused on public health, have been made about the way in which tobacco companies treat illegal trade. For example:

*“The tobacco industry covertly and overtly supports the illegal trade...”*

WHO<sup>16</sup>

*“Parties need to be aware that the tobacco industry’s efforts to address the illicit trade, and to establish partnerships with governments in implementing the Protocol, are in breach of both the WHO FCTC and with the Protocol... It is noteworthy that the texts of these two international instruments (the WHO FCTC and the Protocol) acknowledge that the interests of the tobacco industry and the interests of tobacco control are irreconcilable and that partnerships between government and tobacco industry should be avoided. In fact, to ensure that tobacco industry interference was contained and public health interests prevailed, the Parties approved the Guidelines to Implement Article 5.3, on protecting tobacco control policies from interference by the tobacco industry.”*

FCTC Secretariat<sup>30</sup>

*“Growing evidence indicates that the TTCs (Transnational Tobacco Companies) remain involved in the illicit trade or are at best failing to secure their supply chains as required by the agreements.” -*

Joossens et al<sup>31</sup>



The majority of these allegations of tobacco companies benefitting from illicit trade reference issues going back two decades or more. The basis for these allegations predates the rapid change in the composition of illicit trade toward illicit whites and counterfeit as well as the significant compliance reforms, investments into supply chain controls and AIT programs undertaken by major tobacco companies since then.

A recent Euromonitor International report<sup>8</sup> states, in the context of why illicit trade matters to tobacco manufacturers, that tobacco companies are now clear losers from illicit trade. “While in the past tobacco companies have faced accusations of benefitting from illicit trade, using it to maintain or create share for their brands, approaches have changed markedly in recent years and, given the rise of counterfeit and illicit white products, the major manufacturers are now net sufferers from illicit trade... As a result, manufacturers have begun to look at the “retrieval” of volumes from the illicit trade as a business expansion opportunity in its own right.”

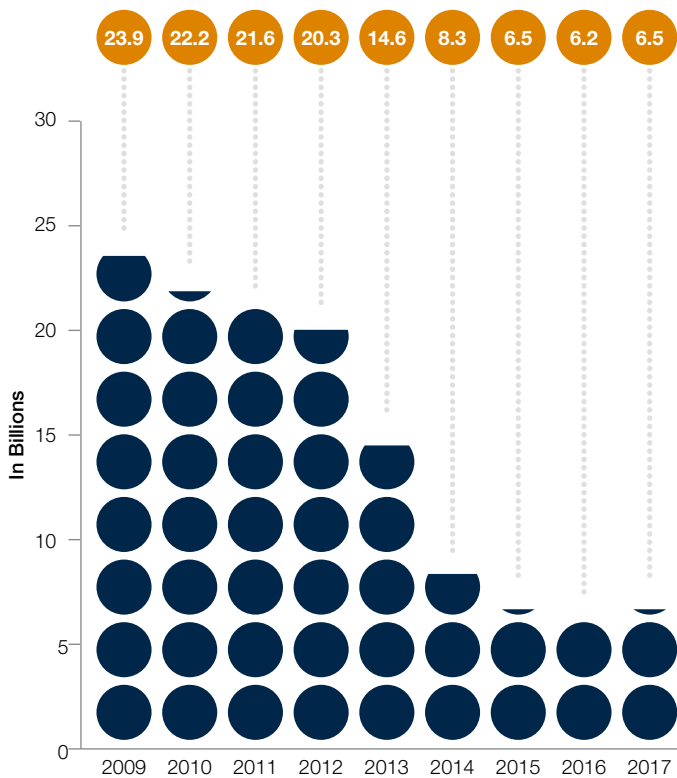
The composition of illicit trade has shifted in recent years away from contraband and toward counterfeit and illicit whites. For example, in the EU, while contraband volume has been declining, illicit white and counterfeit volume has been increasing. As previously noted, counterfeit volumes in Europe increased by 9 percent in 2017, accounting for a total of 4 billion cigarettes and 9.2 percent of total illicit volume. Illicit whites comprised approximately one-third of total illicit volume in Europe that same year.<sup>5</sup>

Industry complicity in illicit trade would be irrational at this stage. Major tobacco companies have no economic interest in either counterfeit or illicit whites, which erode volumes and profits from their legally sold products. Furthermore, France, the U.K., Germany and Italy were the destinations for close to 60 percent of EU contraband volume in 2016. In 2017, France had the highest illicit volume, and the U.K. experienced the highest increase in counterfeit and contraband (C&C) consumption.<sup>5</sup> As these four countries are significant sources of profit for the major tobacco companies, these contraband flows of genuine product, which are intended for lower-cost countries outside the EU, cannibalize legal brand volumes and undermine their overall profitability, given the price difference between source and higher-taxed destination countries.

In a 2017 interview with Euractiv.com that addressed tobacco smuggling as a major source of organized crime, OLAF Director Policy Margarete Hofmann indicated that cooperation and a combination of resources is required to properly address the issue of illicit trade.

“We are currently reviewing what worked and what needs to be strengthened in the fight against illicit tobacco trade,” she commented. “What is already clear is that the illegal market is changing constantly and that we need the right mix of tools, together with reinforced cooperation at all levels, to tackle these new challenges. Clearly, to continue being successful in fighting customs fraud in the context of a global marketplace, enforcers have an acute need for information of potential investigative interest coming from a multitude of sources.”<sup>32</sup>

**Figure 18: EU Sourced Illicit Product  
“(Contraband and Counterfeit)”**



Source: KPMG Project Sun 2017, A&M Analysis

### Collaborating to Fight Illicit Trade

Agreements between the four major tobacco companies and the EU appear to have succeeded in reducing EU sourced illicit product by some 75 percent between 2009 and 2017 (Figure 18).

These agreements require tobacco companies to:


- make annual payments to fund anti-illicit measures with additional fines payable if genuine contraband product is seized in sufficient quantities;
- ensure tobacco quantities supplied are commensurate with legitimate local market demand;
- adopt measures to ensure sales are made to legitimate customers only; and
- develop and implement track and trace systems to monitor product flow through the supply chain.

The agreement with PMI expired in 2016 and was not renewed following calls from tobacco control groups to the European Parliament, not because it was deemed inefficient. Quite to the contrary. The effectiveness of agreements between major tobacco companies and the EU was highlighted by OLAF in a statement to the U.K. House of Lords Select Committee in July 2013: “... the agreements that we have with the major tobacco companies are working and are effective. We are certainly very much better off with them than we would have been without them. They are – as we have already implied – setting a model for what we would hope to see in a future regime, also through the Tobacco Products Directive and through the Framework Convention on Tobacco Control (FCTC) agreement...”<sup>33</sup>

In her 2017 interview with Euractiv.com about the impact of tobacco smuggling on illicit trade, Ms. Hofmann of OLAF also emphasized the effectiveness of these agreements stating, “Under the anti-fraud agreements between the EU, the member states and the four major tobacco manufacturers... cooperation, on the whole, has been effective. For example, the prevalence of PMI contraband on the illicit EU tobacco market dropped by around 85 percent from 2006 to 2014.”<sup>32</sup> This is an important achievement.

Legitimate tobacco companies view the prevention of illicit trade as a major business priority and have made significant investments in developing and implementing AIT measures and compliance programs. For example, Japan Tobacco International (JTI) has agreed to around 50 AIT MoUs with government agencies in 33 countries around the world. These MoUs call for a close working relationship between the public and private sectors to combat the illegal tobacco trade.<sup>34</sup> As part of these agreements, JTI has trained more than 7,000 police and customs officers to help them distinguish fake from genuine cigarettes, and it is committing to train an additional 30,000 enforcement officers over the next few years. Major tobacco companies have also invested in establishing sizeable teams and codes of conduct to ensure requirements stipulated in cooperative agreements and MoUs are met (Figure 19). JTI’s AIT group is a global team of more than 50 people, including former law enforcement officials, customs agents, lawyers and intelligence officers.<sup>34</sup>

**Figure 19: AIT Programs Established by Major Tobacco Companies**

| Program Name   | Program Description  |
|--|--|
|  <p><b>Know Your Customer</b></p>                       | <p>Policies to ensure tobacco companies will (a) only do business with and supply product to customers who have a reputation for honesty and integrity and are not involved in the diversion of product into the illegal trade, and (b) only supply product that meets fiscal, legal and regulatory requirements of the intended retail market</p> |
|  <p><b>Know Your Supplier</b></p>                       | <p>Policies to ensure that tobacco company suppliers are known for honesty and integrity (e.g., that a warehouse or trucking company will not illegally sell goods) and does not engage in providing materials, machinery or services to illegal trade operators</p>   |
|  <p><b>Security Programs</b></p>                       | <p>Measures that specifically lower the risk of product theft during transportation, thereby reducing the likelihood of genuine stolen product entering into the legal market</p>  |
|  <p><b>Anti-Money Laundering</b></p>                  | <p>Policies to mitigate the risks of tobacco products being used by money launderers as instruments in financial systems</p>   |
|  <p><b>Legitimate Market Demand</b></p>               | <p>Monitor market and volume developments to ensure products are only supplied in quantities commensurate with legitimate market demand and consumption in the intended market of retail sale</p>  |
|  <p><b>Detection of Genuine Product Diversion</b></p> | <p>Product seizure investigation and track and trace capabilities, which enable the tobacco companies and law enforcement to detect where genuine products could become diverted from legitimate supply chains into unintended markets</p>   |
|  <p><b>Cooperation with Government</b></p>            | <p>Cooperative partnerships (e.g., with EU member states) and memoranda of understanding (MoUs) with law enforcement agencies</p>  |

While both self-driven and cooperative efforts have been highly successful in reducing illicit tobacco trade, especially in genuine products, a global approach to the fight against illicit trade is now being taken under the aegis of the WHO. In September 2018, with a required 40 ratifications, its FCTC Protocol to Eliminate Illicit Trade in Tobacco Products (the Protocol) officially came into effect. The Protocol, an international treaty with the objective of eliminating all forms of illicit trade in tobacco products, requires in its provisions, inter alia, government-controlled tracking and tracing systems at the national and international levels and the licensing of all manufacturers, importers and exporters of tobacco products or manufacturing equipment. It also contains a recommendation to consider fining of tobacco companies for discovery of contraband product worldwide.<sup>35</sup>

In implementing these new obligations, governments and the industry will have to coordinate closely. However, there is strong pressure against governments collaborating with industry in the fight against illicit trade. Article 5.3 of the FCTC states that “[i]n setting and implementing their public health policies with respect to tobacco control, Parties shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.” Contrary to the interpretation of some entities, Article 5.3 does not prohibit governments from engaging with industry in the fight against illicit trade and, with respect to the objectives of the Protocol, governments and major tobacco companies are aligned in the aim to eliminate illicit trade. As with any other industry, legitimate tobacco companies possess knowledge, resources and expertise that are unique and can be successfully brought to bear in the fight against illegal tobacco.<sup>36</sup> Moreover, our interpretation of the Protocol is that it does not set or implement public health policy. As such, it should not be used as a pretext to inhibit the necessary collaborations to fight illicit trade which is damaging for all legitimate stakeholders.

In evaluating the best solutions to tackle illicit trade, countries should closely examine the causes of their own illicit tobacco trade, which may be influenced by local factors such as price and tax gaps with neighboring countries, population density near the border, income distribution, affordability levels, attractiveness of the market to smugglers and enforcement capabilities. In this analysis, governments should work closely with all stakeholders, including established industry players who have global experience in identifying the causes of and potential solutions to illegal trade.

### Case Studies: AIT Successes

Major tobacco companies have recorded some notable successes in the fight against illicit trade. For example, between 2015 and September 2018, information supplied by JTI to law enforcement authorities across the globe led to the seizure of over five billion cigarettes or grams of illegal tobacco (equivalent to the annual cigarette volume of Sweden or Denmark), raids of 135 illegal factories and storage depots and the removal of over 15,000 links to illicit trade advertisements.<sup>34</sup>

As is demonstrable from the past, the most effective solutions to tackle illicit trade have involved collaboration and coordination between governments (e.g., fiscal policy, regulation, enforcement), the health community (e.g., educational campaigns<sup>37</sup>) and industry (e.g., intelligence, expertise, “no ID, no sale”). Such collaborative efforts have, for example, succeeded in halting and rolling back illicit trade in the U.K. and Romania (Figure 20).<sup>27,28,38,39</sup>

**Figure 20**



EUBAM: European Union Border Assistance Mission to Moldova and Ukraine

SELEC: Southeast European Law Enforcement Center



## Conclusion on the Allegations of Involvement of Tobacco Companies in Illegal Trade

Despite the industry reforms implemented over recent years, tobacco manufacturers are still viewed as part of the problem rather than part of the solution.

However, it is evident from the changing mix of illicit trade, and from major tobacco companies' extensive AIT programs and cooperative successes, that the interests of governments, regulators, law enforcement and industry are increasingly aligned against illicit trade.

The statements made by the FCTC Secretariat that the interests of major legitimate tobacco companies and the interests of tobacco control are irreconcilable in the area of illicit trade seem not to be well-founded, and their interpretation of the WHO FCTC and its Article 5.3 may hinder achievement of its objectives.

Article 5.3 of the WHO FCTC does not prohibit governments from interacting with tobacco companies. It just requires that the parties "protect policies from commercial and other vested interests of the tobacco industry." As such, this appears to A&M to be a moot point because the vested interests of the major tobacco companies and governments are aligned on this issue.

In practice, interaction with the tobacco industry will undoubtedly be necessary to establish and implement effective supply chain control mechanisms. Article 8.13 of the Protocol<sup>35</sup> states that interaction between the competent authorities and the tobacco products sector should be limited "to the extent strictly necessary in the implementation of [track and trace]," which suggests that the Protocol anticipates at least some interaction and recognizes the importance of cooperation between the industry and governments.

It has already been demonstrated earlier in this report that a major economic driver of illicit trade is tobacco taxation and the resulting pressure on affordability. This generates both demand for cheaper illicit product from financially pressured smokers and profit incentives for smugglers. Therefore, the goal of eradicating illicit trade will always be a challenge. The role of reasonable tax policy can be supported by appropriate levels of enforcement as a means of tackling the trade in illicit tobacco.





---

## 7 Overall Conclusions

---

The evidence appears conclusive that increasing levels of tobacco taxation have been the principal catalyst for growth in illicit trade, which is not surprising. Tax increases have been the main cause of increased pressure on the affordability of cigarettes for smokers who may seek cheaper and, if necessary, illegal products instead of quitting. Widely differing levels of tobacco taxes across markets generate attractive profit opportunities for smugglers. Furthermore, the evidence suggests that the root causes of illicit trade are not unique to tobacco, since the same relationship between affordability and illicit trade exists in the alcoholic beverage industry. Therefore, the impact of tax policies on affordability as a driver for illicit trade needs to be clearly understood. In addition to reasonable tax policy, effective enforcement measures are key to mitigating the risk of illicit tobacco growth. Efforts to contain and combat the illicit trade in tobacco need to be consistently applied because, if they are not, illicit trade can escalate rapidly and can then be difficult to eradicate once supply routes have become established.

Despite the continuing distrust of tobacco companies among some policy formulators, there seems to be merit in including major, legitimate tobacco companies in the debate

on illicit tobacco control, as long as interactions with them are conducted in a transparent manner. Their business objectives regarding illicit trade are aligned with those of policymakers and, given their specific sector expertise and global experience, they should be encouraged to provide information, insights and views on the practicalities and enforceability of the FCTC Protocol provisions and any other anti-illicit trade measures contemplated by governments.

Given the global nature of the illicit trade in tobacco, the involvement of organized crime<sup>3,40,41</sup> and its role in funding terrorism<sup>9</sup>, successfully combating illicit trade is critically important and can only be achieved through a coordinated effort involving all key stakeholders including policymakers, regulators, fiscal authorities, law enforcement agencies, public health professionals and legitimate tobacco companies. This effort also requires alignment behind a common recognition of the problem (and its roots) and a clear campaign to eliminate the illicit tobacco trade, which, the evidence suggests, goes hand in hand with other criminal activities.

Only through such collaboration can effective and executable measures be implemented and any potential unintended consequences be identified and avoided.

---

## Appendices

---



### I. Glossary of Terms

- **Affordability Index:** Percentage of personal disposable income per capita per day required to purchase one pack of cigarettes, most commonly referring to the weighted average price (WAP).
- **Contraband:** Genuine products diverted from the legitimate supply chain and sold in a country different than the intended market of retail sale and without domestic duty paid in the country to which the products are diverted.
- **Counterfeit:** Illegal manufacturing where product bears a trademark without the owner's consent.
- **Illicit Trade:** Commonly defined as "the act of importation, exportation, handling or possession of goods in violation of the law. Usually done to evade duties and taxes." Illicit trade in tobacco products comes in different forms and permutations.
- **Illicit Whites:** Tobacco products manufactured legitimately in one country for the sole purpose of being smuggled and sold in another country.
- **Non-Domestic Duty Paid (NDDP):** Products on which taxes in the country of consumption have not been paid. NDDP includes both legal cross-border and all illegal trade.
- **Personal Disposable Income (PDI):** The amount of money available to individuals or households for spending after taxes and deductions.
- **Smurfing:** Breaking large transactions into smaller ones that are harder to detect in an effort to evade government scrutiny or regulatory requirements.
- **Tracking and Tracing:** Systematic monitoring and recreation by competent authorities or any other person acting on their behalf of the route or movement taken by items through the supply chain.
- **Weighted Average Price (WAP):** Total value of cigarettes based on the retail selling price including all taxes, divided by the total quantity of cigarettes sold.

---

## II. Bibliography

1. OLAF (European Anti-Fraud Office). "Cigarette Smuggling: Focused Enforcement and New Tools." December 2017. <[https://ec.europa.eu/anti-fraud/media-corner/news/12-05-2017/cigarette-smuggling-focused-enforcement-and-new-tools\\_en](https://ec.europa.eu/anti-fraud/media-corner/news/12-05-2017/cigarette-smuggling-focused-enforcement-and-new-tools_en)>
2. "World Health Organization. WHO Framework Convention on Tobacco Control. 2005 <<http://apps.who.int/iris/bitstream/handle/10665/42811/9241591013.pdf>>"
3. OECD. "Illicit Trade: Converging Criminal Networks." April 2016. <<http://dx.doi.org/10.1787/9789264251847-en>>
4. Euromonitor International. Passport. "Illicit Trade in Tobacco Products 2018." November 2018.
5. KPMG. Project Sun 2017: A Study of the Illicit Cigarette Market in the European Union, Norway and Switzerland.
6. Euromonitor International, Passport: Tobacco. Data extracted February 2018.
7. The Terrorism and Illicit Finance Subcommittee, House Financial Services Committee. "Exploring the Financial Nexus of Terrorism, Drug Trafficking, and Organized Crime." 20 March 2018.
8. Euromonitor International. Passport. "Illicit Trade in Tobacco Products 2013."
9. OECD. FATF Report. "Illicit Tobacco Trade." (Pages 37 and 38.) 2012. <<https://www.fatf-gafi.org/media/fatf/documents/reports/Illicit%20Tobacco%20Trade.pdf>>
10. U.S. Helsinki Commission on Security and Cooperation in Europe. "A Hazy Crisis: Illicit Cigarette Smuggling in the OSCE Region." 19 July 2017.
11. Center for the Analysis of Terrorism. "Illicit Trade and Terrorism Financing." December 2016.
12. North East Illegal Tobacco Survey. 2017.
13. Bräuninger, Michael. "Tobacco Taxes and Health Inequalities: Facts and Myths." Economic Trends Research (ETR). July 2015. <<http://economic-trends-research.de/2015/10/tobacco-taxes-and-health-inequalities-facts-and-myths/>>
14. "Smoking: Illicit tobacco, Action on Smoking & Health." May 2016. <<http://ash.org.uk/wp-content/uploads/2016/05/Illicit.pdf>>
15. OLAF. "Illicit Cut Tobacco is a Significant and Growing Market." April 2018.
16. World Health Organization. "Illegal Trade of Tobacco Products. What You Should Know to Stop It." 2015. <<https://www.who.int/campaigns/no-tobacco-day/2015/brochure/en/>>
17. World Health Organization, WNTD. "Now Is the Best Time to Raise Taxes on Tobacco, FCA Factsheet." 2015.
18. Byrne, John Aidan. "Why New York's High Tobacco Taxes Cost the State Billions." New York Post. January 2017. <<https://nypost.com/2017/01/29/new-yorks-high-tobacco-taxes-are-costing-the-state-billions/>>
19. Tobacco Tax Foundation. "Cigarette Taxes and Cigarette Smuggling by State." 2015. <<https://taxfoundation.org/cigarette-tax-cigarette-smuggling-2015/>>
20. Institute of Economic Affairs. "Drinking in the Shadow Economy." 2012. <<https://iea.org.uk/publications/research/drinking-in-the-shadow-economy>>
21. UK Government. Taylor Report on Tobacco Smuggling. 24 July 2012. <<https://www.gov.uk/government/publications/taylor-report-on-tobacco-smuggling>>
22. HMRC. U.K. Strategy for Tackling Tobacco Smuggling. 2013.

- 23.** Oireachtas Health Committee Hearing (Ireland). Assistant Secretary, Revenue Commissioners. 23 January 2014. <<https://www.oireachtas.ie/parliament/media/committees/healthandchildren/Public-Health-SPT-Bill--Vol-1.pdf>>
- 24.** Carvalho, Martin and Hemananthani Sivanandam, Rahimy Rahim, Tarrence Tan. "Smokers May Turn to Illicit Cigs." The Star. November 2018. <<https://www.thestar.com.my/news/nation/2018/11/01/smokers-may-turn-to-illicit-cigs-dzulkefly-use-of-contraband-will-increase-if-prices-get-too-expensi/>>
- 25.** The World Justice Project. <<http://worldjusticeproject.org/>>
- 26.** Campaign for Tobacco-Free Kids. "Tobacco Tax Success Stories, United Kingdom." October 2012. <[https://www.tobaccofreekids.org/assets/global/pdfs/en/success\\_UK\\_en.pdf](https://www.tobaccofreekids.org/assets/global/pdfs/en/success_UK_en.pdf)>
- 27.** "HMRC. "Tackling Illicit Tobacco: From Leaf to Light, The HMRC and Border Force Strategy to Tackle Tobacco Smuggling." 2015. <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/418732/Tackling\\_illicit\\_tobacco\\_-\\_From\\_leaf\\_to\\_light\\_\\_2015\\_.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418732/Tackling_illicit_tobacco_-_From_leaf_to_light__2015_.pdf)>"
- 28.** "HMRC. ""Tackling Tobacco Smuggling - Building on our Success, a Renewed Strategy for HMRC and UK Border Agency." April 2011. <[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/398461/Tackling\\_tobacco\\_smuggling\\_-\\_building\\_on\\_our\\_success.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/398461/Tackling_tobacco_smuggling_-_building_on_our_success.pdf)>"
- 29.** Her Majesty's Treasury. "Budget 2018." <<http://prod-upp-image-read.ft.com/e1f39282-db9a-11e8-9f04-38d397e6661c>>
- 30.** World Health Organization. WHO Framework Convention on Tobacco Control (FCTC) Secretariat. "The Tobacco Industry and the Illicit Trade in Tobacco Products." 2016.
- 31.** Joossens, L; AB Gilmore, M Stoklosa and H Ross. "Assessment of the European Union's Illicit Trade Agreements with the Four Major Transnational Tobacco Companies." 2015.
- 32.** Michalopoulos, Sarantis. "EU Anti-Fraud Official: Tobacco Smuggling is 'Major Source' of Organised Crime." Euractiv.com. February 2017. <<https://www.euractiv.com/section/trade-society/interview/olaf-official-tobacco-smuggling-major-source-for-organised-crime/>>
- 33.** "The Select Committee on the European Union Home Affairs, Health and Education. Inquiry on "Enhanced Scrutiny: EU Cigarette Smuggling Strategy" Revised Transcript. July 2013. <<https://www.parliament.uk/documents/lords-committees/eu-sub-com-f/tobaccosmuggling/cOLAForal.pdf>>"
- 34.** JTI Analysis.
- 35.** World Health Organization. Protocol to Eliminate Illicit Trade in Tobacco Products. 2013. <[http://apps.who.int/iris/bitstream/10665/80873/1/9789241505246\\_eng.pdf?ua=1&ua=1](http://apps.who.int/iris/bitstream/10665/80873/1/9789241505246_eng.pdf?ua=1&ua=1)>
- 36.** OECD. "Illicit Trade: Converging Criminal Networks." 2016. Pages 158 and 159.

- 37.** National Research Council. “Understanding the US Illicit Tobacco Market: Characteristics, Policy Context and Lessons from International Experiences.” 2015. Chapter 5.
- 38.** JTI. “Protocol of Collaboration Between JTI and the Romanian Border Police Cooperation, Press Release.” August 2013. <<http://www.agerpres.ro/ots/2013/08/08/jti-a-semnat-un-protocol-de-cooperare-cu-politia-de-frontiera-16-01-00>>
- 39.** “Protocol of Collaboration Between the Tobacco Industry and the Romanian Customs, Press Release.” September 2014.
- 40.** “Interpol. Trafficking in Illicit Goods and Counterfeiting Casebook. 2014. <<http://www.interpol.int/Crime-areas/Trafficking-in-illicit-goods-and-counterfeiting/Trafficking-in-illicit-goods-and-counterfeiting>>”
- 41.** Interpol. “Countering Illicit Trade in Tobacco Products: A Guide for Policymakers.” June 2014. <<http://www.interpol.int/News-and-media/Publications/Guides-manuals/Countering-Illicit-Trade-in-Goods-A-Guide-for-Policy-Makers-June-2014>>
- 42.** Euromonitor International. Passport. “Illicit Trade in Tobacco Products.”
- 43.** Euromonitor International. “Global Tobacco: Key Findings Part 1 – Cigarettes – A Challenging Future.” July 2016.
- 44.** KPMG. Project Sun: A Study of the Illicit Cigarette Market. June 2016.
- 45.** European Commission. Eurobarometer No. 385. “Attitudes of Europeans Toward Tobacco.” 2012. <[http://ec.europa.eu/public\\_opinion/archives/ebs/ebs\\_385\\_en.pdf](http://ec.europa.eu/public_opinion/archives/ebs/ebs_385_en.pdf)>
- 46.** Research conducted for Beyond Smoking Kills. 2008.
- 47.** European Commission. “Expiry of the Agreement with Philip Morris International.” July 2016. <[https://ec.europa.eu/commission/2014-2019/georgieva/announcements/expiry-agreement-philip-morris-international\\_en](https://ec.europa.eu/commission/2014-2019/georgieva/announcements/expiry-agreement-philip-morris-international_en)>
- 48.** Imperial Brands. GRI Sustainability Report. 2015
- 49.** Imperial Brands. Exane Illicit Trade Presentation. September 2015. <[http://www.imperialbrandsplc.com/content/dam/imperial-brands/corporate/investors/presentations/conferences/Exane%20Illicit%20Trade%20Presentation\\_Slides.pdf.downloadasset.pdf](http://www.imperialbrandsplc.com/content/dam/imperial-brands/corporate/investors/presentations/conferences/Exane%20Illicit%20Trade%20Presentation_Slides.pdf.downloadasset.pdf)>
- 50.** Euromonitor International. “Global Tobacco: Key Findings Part 1 – Cigarettes – Disruption and Continuity.” August 2018.
- 51.** World Health Organization. “First Session of the Meeting of the Parties.” October 2018. <<http://www.who.int/fctc/secretariat/head/statements/2018/opening-remarks-mop1-head/en/>>

### III. Data Sources Used in A&M's Analysis

- Bureau of Economic Analysis (<https://www.bea.gov/data/income-saving/personal-income-by-state>).
- Center for Disease Control & Prevention (<https://www.cdc.gov/statesystem/excisetax.html>).
- Economist Intelligence Unit (EIU).
- Euromonitor International, Tobacco 2017 Edition.
- European Commission Excise Duty Tables 2018 ([https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/excise\\_duties/tobacco\\_products/rates/excise\\_duties-part\\_iii\\_tobacco\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/excise_duties/tobacco_products/rates/excise_duties-part_iii_tobacco_en.pdf)).
- European Commission Excise Duty Tables, Prior Years (<https://circabc.europa.eu/faces/jsp/extension/wai/navigation/container.jsp>).
- Global Alcohol Prices (Various Primary Sources).
- HMRC Tobacco Gap Estimates for 2016-17 ([https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/654490/HMRC-tobacco-tax-gap-estimates-2017.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/654490/HMRC-tobacco-tax-gap-estimates-2017.pdf)).
- KPMG Project Star/Sun ([https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2018/07/project\\_sun\\_executive\\_summary\\_2018.pdf](https://assets.kpmg.com/content/dam/kpmg/uk/pdf/2018/07/project_sun_executive_summary_2018.pdf)).
- OECD (<http://www.oecdbetterlifeindex.org/topics/income/>).
- Sales Tax Handbook (<https://www.salestaxhandbook.com/cigarette-tax-map>).
- Tax Foundation (<https://taxfoundation.org/cigarette-tax-cigarette-smuggling-2015/>).
- WHO: Global Status Report on Alcohol and Health 2014 ([http://apps.who.int/iris/bitstream/handle/10665/112736/9789240692763\\_eng.pdf;jsessionid=33B5786888192A91F98E14D703A4428C?sequence=1](http://apps.who.int/iris/bitstream/handle/10665/112736/9789240692763_eng.pdf;jsessionid=33B5786888192A91F98E14D703A4428C?sequence=1)).
- World Justice Project (<http://data.worldjusticeproject.org/>).

---

## Important Notice

---

This booklet has been prepared by Alvarez & Marsal Corporate Performance Improvement LLP (“A&M”) and was commissioned by JT International SA (“JTI”) on the terms and conditions set out in a letter of engagement dated 29th August 2018 between A&M and JTI. A&M’s information sources, limitations to sources, as well as the scope and limitations of A&M’s work are set out in this booklet. A&M has not performed an exhaustive review or sought to test the reliability of the information drawn from such sources by comparison with other evidence. A&M has, however, taken measures to confirm as far as practical that the information presented in this booklet is consistent with the sources referenced. A&M’s conclusions expressed in this booklet are based on our analysis of the facts available to us subject to the limitations set out above and do not represent an endorsement of any specific policy decisions or statements. This booklet is not suitable to be relied on by any party wishing to acquire rights or assert any claims against A&M (other than JTI to the extent agreed in the engagement letter) for any purpose or in any context.

While this booklet will be made available to third parties, such disclosure shall not in any way or on any basis alter or add to or extend A&M’s duties and responsibilities to JTI. Furthermore, such disclosure shall not imply A&M accepts or causes any duty of care or other responsibility to any third party other than JTI to be accepted by A&M. To the fullest extent permitted by law, A&M will not accept any liability or responsibility in connection with this booklet to anyone except JTI to the extent as agreed in the engagement letter.

In particular, but without limitation, this booklet has not been prepared for the benefit of any other manufacturer or distributor of tobacco products, any government agencies, organizations, groups or persons working in the public or private health sector, monitoring the tobacco sector or publishing about it, providing goods or services to any parties or government agency being part of or dealing with the tobacco sector or any government agency, organization, group or person who might have another interest in the matters discussed herein, regardless whether commercial or in any other form.

---

## Euromonitor International Disclaimer

---

Information in this report cited as being sourced from Euromonitor International is from independent market research carried out by Euromonitor International Limited but should not be relied upon in making, or refraining from making, any investment decision.

Research and analysis for this report was supported by A&M’s Global Insight Center.



## ABOUT ALVAREZ & MARSAL

Companies, investors and government entities around the world turn to Alvarez & Marsal (A&M) when conventional approaches are not enough to make change and achieve results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services.

With over 3500 people across four continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, help organisations transform operations, catapult growth and accelerate results through decisive action. Comprised of experienced operators, world-class consultants, former regulators and industry authorities, A&M leverages its restructuring heritage to turn change into a strategic business asset, manage risk and unlock value at every stage of growth.

Follow A&M on:



To learn more, visit: [alvarezandmarsal.com](http://alvarezandmarsal.com)

# ALVAREZ & MARSAL