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# How big was the global illicit tobacco trade problem in 2006?

## Summary

- Approximately 5 767 billion cigarettes were sold globally in 2006.
- Based on the most recent data, it is estimated that the global illicit cigarette trade was 10.7% of total sales, or 600 billion cigarettes, in 2006.
- Losses of revenue from illicit tobacco trade could represent a loss to government revenue of \$US 40 to 50 billion annually.

## The different types of illicit tobacco trade

Illicit trade in tobacco products occurs through large scale smuggling, bootlegging, and counterfeiting and illegal manufacturing:<sup>1</sup>

- Large-scale organized smuggling involves the illegal transportation, distribution and sale of large consignments of cigarettes and other tobacco products, generally avoiding all taxes. Large-scale smuggling of this nature often involves industry complicity and organised crime networks.
- Bootlegging refers to the smuggling activities of individuals or small gangs who illegally import small quantities of products. It involves, for instance, the purchase of cigarettes and other tobacco products in low tax jurisdictions in amounts that exceed the limits set by customs regulations, for resale in high tax jurisdictions. Significant price differentials between jurisdictions create incentives for bootlegging.
- Illegal manufacturing refers to the production of cigarettes contrary to law. The laws in question may be taxation laws or other laws (such as licensing or monopoly related laws) that restrict the manufacture of tobacco products. Counterfeit tobacco production is also a form of illegal manufacturing, in which the manufactured products bear a trademark without the consent of the owner of the trademark.

## Estimates of cigarette smuggling

In 2000 a report commissioned by the World Bank estimated that between 6% and 8.5% of global cigarette consumption was smuggled.<sup>2</sup>

<sup>1</sup> Joossens L, Combating the illegal tobacco trade from a public health perspective, presentation at the first meeting of the WHO expert committee on the illicit tobacco trade, Geneva, September 2006.

The 6% estimate was based on import and export statistics and was mainly an estimate for large-scale smuggling. The 8.5% estimate was based on estimates of smuggling (bootlegging and large-scale smuggling) as a percentage of 1995 domestic sales by using different expert sources.<sup>3</sup>

In order to estimate the size of the illicit tobacco trade, some recent estimates of the illicit trade from different sources have been compiled, and the number of illicit cigarettes as a percentage of the cigarette sales in 2006 calculated.

### **Cigarette sales in 2006**

Morgan Stanley estimated global cigarette consumption to be 5 539 billion cigarettes in 2005.<sup>4</sup> According to Altria's 2006 annual report, 5 763 billion cigarettes were sold in 2006, of which Philip Morris (International and USA) sold 1 015 billion cigarettes. British American Tobacco's (BAT) 2006 annual report does not directly provide a figure for global cigarette sales, but states that China makes up 35% of global cigarette sales. Cigarette sales in China have been estimated at 2 020 billion cigarettes in 2006.<sup>5</sup> If Chinese sales constituted 35% of global sales, total global sales in 2006 would have been 5 771 cigarettes. The estimate used here of 5 767 billion cigarettes in 2006 is the median between these two estimates. This figure does not include cigarettes sold duty free or the sales of other tobacco products such as hand rolling tobacco and bidis.

### **Recent estimates of the illicit tobacco trade**

Estimates on illicit tobacco trade are seldom precise and some caution is necessary. The source of the estimate is important. The authors of the 2000 World Bank report acknowledged that tobacco industry experts may have an incentive to exaggerate the smuggling problem (in order to lobby for reduced taxation of the product) while public health advocates may have an incentive to understate the size of the smuggling problem. An additional problem is that the estimates of the illicit cigarette trade are expressed in different ways: sometimes as a percentage of the cigarette sales based on tax records, sometimes as a percentage of the cigarette consumption or the cigarette market. There is also no standard definition of cigarette consumption or cigarette market. The term consumption and cigarette market has been used to refer to the following different data sets:

- the tax recorded sales,
- the tax recorded sales plus the illegal sales,
- the tax recorded sales and the legal cross border sales in neighbouring countries,
- the tax recorded sales, the illegal sales and the legal cross border shopping sales.

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<sup>2</sup> David Merriman, Ayda Yurekli & Frank Chaloupka, 'How Big is the Worldwide Cigarette Smuggling Problem?', in *Tobacco Control in Developing Countries*, Editors Prahata Jha and Frank Chaloupka, Oxford University Press, 2000, pp 365 – 392.

<sup>3</sup> *ibid*

<sup>4</sup> Morgan Stanley, What's changed? Industry View: Tobacco. January 30, 2007, p18.

<sup>5</sup> Taco Tuinstra, Miracle or mirage, *Tobacco Reporter*, March 2007, p 6.

Global cigarette consumption often refers to cigarettes manufactured legally by the tobacco industry, which do not include illicitly manufactured cigarettes, but include the legally manufactured cigarettes which are diverted to the illicit market.

The most recent estimates of illicit tobacco trade from a number of countries around the world are listed here, with the source of the estimate identified.

- Based on in-depth analysis of data collected, a European Commission study estimated that, in 2004, total market penetration of illicit trade represented approximately 8% to 9% of the EU-25 tobacco market.<sup>6</sup> The European Commission report noted also that the illicit market share in the new EU Member States - Estonia, Hungary, Lithuania, Poland, Slovakia - goes (way) beyond the EU-25 average.<sup>7</sup>
- The 2005 annual report of the World Customs Organization observed in 2004/5 “substantial increase in the number of seizures and related quantities particularly in the Eastern and Central European region are remarkable.”<sup>8</sup>
- Tobacco industry estimates suggest that 15%-20% of cigarettes sold in Poland come from the black market. A survey of the Cancer Epidemiology & Prevention Division of Warsaw in 2004 suggests that only 11% of smokers could have bought cigarettes on the black market in Poland.<sup>9</sup>
- Illicit markets have been slightly reduced or stabilized, albeit at very high levels, in Albania (50–40%), Bosnia and Herzegovina (45–35%) and the Former Yugoslav Republic of Macedonia (30–35%).<sup>10</sup>
- The Regional Office for Europe of the World Health Organisation estimates that 30% of cigarettes consumed in Uzbekistan and 20% to 30% in the Russian Federation are smuggled. The Russian Federation remains the main illicit European market, as measured in volume.<sup>11</sup>
- The growing discrepancy in official statistics and reported tobacco use in Canada suggests that 10% of cigarettes smoked in 2005 were untaxed.<sup>12</sup>
- According to the Ministry of Finance, counterfeit, illicit manufacturing and smuggled products represented 30% of the total cigarette market in Brazil in 2005.<sup>13</sup>
- The tobacco trade journal “World Tobacco” estimates the smuggling and counterfeit trade in Argentina to be between 15% and 20% of the domestic market.<sup>14</sup>

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<sup>6</sup> KPMG, Study on the collection and interpretation of data concerning the release for consumption of cigarettes and fine-cut tobacco for rolling of cigarettes, December 2005. Unpublished report commissioned by the European Commission.

<sup>7</sup> *ibid*

<sup>8</sup> World Customs Organization, WCO Report: Customs and Tobacco 2005, Brussels, July 2006.

<sup>9</sup> Gumkowski J, Prezwozniak K, Zatonski W, Cigarette smuggling in Poland: tobacco industry views and smokers behaviours, presentation at the 13<sup>th</sup> World Conference on Tobacco or Health, Washington, 13 July 2006.

<sup>10</sup> World Health Organization, The European Tobacco Control Report 2007, Copenhagen 2007.

<sup>11</sup> *ibid*

<sup>12</sup> Physicians for a smoke-free Canada, Warning signs about cigarette smuggling, Ottawa, December 2006.

<sup>13</sup> Fish-Menezes M, The illegal cigarette market in Brazil, presentation at the first meeting of the WHO expert committee on the illicit tobacco trade, Geneva, September 2006.

<sup>14</sup> Raguzzi A, Contraband chimera choking industry, World Tobacco, March 2005, p 24.

- In 2004, 14% of the cigarettes sold in Colombia were smuggled or counterfeit.<sup>15</sup>
- According to Pakistan customs, the illegal tobacco trade represented 17% of cigarette sales in Pakistan in 2005.<sup>16</sup>
- The tobacco trade journal “Tobacco Journal International” estimates that over a quarter of total cigarette consumption in Iran is illicit.<sup>17</sup>
- The Vietnam Institute of Economics estimated cigarette smuggling in Vietnam at 10%.<sup>18</sup>
- The tobacco industry estimates that smuggling and counterfeit trade made up 21% of the cigarette market in Malaysia in 2002.<sup>19</sup>
- According to euromonitor, contraband cigarette trade in China decreased from 8.5% in 1999 to 4% in 2004. There is no clear explanation whether the decrease refers only to smuggling or also to counterfeit trade. According to trade sources, 99% of foreign cigarettes sold in China are smuggled.<sup>20</sup> The Tobacco Merchants Association, the documentation centre for tobacco companies worldwide, estimates smuggling in China at 190 billion cigarettes in 2004. Again no clear explanation, whether smuggling would refer also to counterfeit trade.<sup>21</sup> The estimate for the illicit cigarette trade in China of British American Tobacco was 5%- 12% in 2004.<sup>22</sup> China is by far the biggest producer of counterfeit cigarettes. China’s State Tobacco Monopoly Administration announced in January 2007 that it had seized 9.07 billion counterfeit cigarettes in 2006.<sup>23</sup> The production of counterfeit cigarettes can be estimated at least 90 billion cigarettes, taking into account the hypothesis<sup>24</sup> that the seized cigarettes would represent 10% of the production. An estimate for the illicit trade for China will always remain difficult, but considering its high counterfeit production, the illicit cigarette trade could be estimated at 8%.
- Smuggled cigarettes are estimated to have accounted for more than 14% of total consumption of cigarettes in India in 2004.<sup>25</sup>
- The Tobacco Institute of South Africa states that 20% of the total South Africa market is illicit.<sup>26</sup>

The estimates of illicit cigarette trade in 2004-2005 identified above are far higher than the estimates listed in the 2000 World Bank report for the year 1995. This could

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<sup>15</sup> Euromonitor International, Country market insight, Columbia, May 2005, pp 6-7.

<sup>16</sup> Arslan Subuctageen, Illegal tobacco trade in Pakistan, presentation at the first meeting of the WHO expert committee on the illicit tobacco trade, Geneva, September 2006.

<sup>17</sup> Milenkovic Z, A Persian market of contradictions, Tobacco Journal International, January 2007, pp 90-91.

<sup>18</sup> Nguyen Thi Thanh Ha and al, Cigarette smuggling in Vietnam: problems and solutions, Hanoi, March 2005.

<sup>19</sup> Rejab I, Zain Z, The modus operandi of cigarette smuggling in Malaysia, SEATCA, June 2006.

<sup>20</sup> Euromonitor International, Tobacco in China, May 2005, pp 6-7.

<sup>21</sup> The Tobacco Merchants Association, World cigarette Guide. Trends in cigarette smuggling by selected countries, revised 1 October 2006, Princeton.

<sup>22</sup> British American Tobacco, Guide to fighting illicit trade, Anti illicit trade unit, London, September 2005.

<sup>23</sup> Xinhua News Agency, 9 billion fake cigarette seized in 2006, January 11, 2007.

<sup>24</sup> The hypothesis that the seized cigarettes would represent 10% of the production was also mentioned in the KPMG report commissioned by the European Commission. See footnote 6.

<sup>25</sup> Euromonitor International Country market insight, India, March 2005, p 7.

<sup>26</sup> Ajam K, R2bn lost every year to fake cigarettes, Saturday Star, August 12 2006.

be explained by the increase of counterfeit trade and illicit manufacturing over recent years.<sup>27</sup> An exact figure of the illicit cigarette trade would be difficult to provide.

Based on the most recent data, it can be estimated that the market share of illicit trade in the different regions of the world is:

- North America (414 billion cigarettes in 2005, or 5% illicit trade, explained by the main market in North America, USA, having lower illicit trade problems)
- Latin America (295 billion cigarettes in 2005, or 20% illicit trade, explained by the main market in Latin America, Brazil, having an estimate of 30%);
- Europe (869 billion cigarettes in 2005, or 9% illicit trade, explained by the main market, EU, having an estimate of 8-9% and other parts of Europe probably having higher estimates);
- CIS (497 billion cigarettes in 2005, or 20% illicit trade, explained by the main market, the Russian Federation, having estimates between 20% and 30%);
- Africa and the Middle East (414 billion cigarettes in 2005, or 15% illicit trade, using the median of 15% between estimates of 10% and 20%);
- Asia (3050 billion cigarettes in 2005, or 9% illicit trade, largely explained by illicit trade in China, estimated at 8%).

Based on the regional estimates, the global illicit cigarette trade would be 594 billion cigarettes in 2005 or 10.7% of total sales in 2005. A 10.7% estimate of the illicit cigarette trade applied to 2006 cigarette sales would represent at least 600 billion cigarettes.

### **The losses in government revenue.**

The losses in revenue as a result of illicit tobacco trade are enormous, but vary widely among countries. Taxes (excise duties and VAT), for instance, on a pack of Marlboro on January 1 2007 vary between \$US 0.85 in China to \$US 8 in the United Kingdom.<sup>28</sup> In the EU the estimate for lost revenue is around \$US 4 a cigarette pack. Losses are lower in other regions of the world. Based on an estimate of the loss in revenue of \$US 4 per pack (VAT, excise and import duties) in the high income countries (100 billion illicit cigarettes) and an estimate of the loss in revenue of \$US 0.75 per pack (VAT, excise and import duties) in the low and middle income countries (500 billion illicit cigarettes), this represents an annual loss of approximately \$US 39 billion globally. The figure of \$US 39 billion does not take into account the losses of revenue as result of illicit trade in other tobacco products, such as hand rolling tobacco or bidis. UK customs & Excise, for instance, estimates the loss of revenue of hand rolling tobacco in 2004-5 in the UK alone to have been \$US 1.6 billion.<sup>29</sup> Losses of revenue from illicit tobacco trade could represent a loss to government revenue of \$US 40 to 50 billion annually.

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<sup>27</sup> Report of the European Anti-Fraud Office, Period 1 July 2004-31 December 2005, Brussels, 2006, p 47.

<sup>28</sup> European Commission, Excise Duty Tables. Part III – Manufactured Tobacco, Directorate General Taxation and Customs Union, Brussels, January 2007 and Philip Morris International, Marlboro Price in January 2007 for selected countries, Total Tax in January 2007. Unpublished data.

<sup>29</sup> HM Revenue & Customs, Annual report 2005-6, London, p 76.