

# TOBACCO AND BORDERS: DEATH MADE CHEAPER



## KEY POINTS

- 1 More cigarettes are traded than any other single product, some trillion cigarettes passing international borders each year.
- 2 Price increases have been a highly successful way of helping people become non-smokers: UK budget changes to tobacco duty have saved lives and prevented much serious illness.
- 3 From the second half of the 1990s, the impact of tax increases in the UK on tobacco consumption was greatly reduced when cigarettes began to be smuggled into this country on a massive scale.
- 4 Smuggling hits Government revenue but also undermines health and health inequalities goals by making cheap cigarettes available to the poorest people.
- 5 The reduction of overall smoking prevalence, and particularly prevalence among disadvantaged groups, is being undermined by the widespread availability of cheap tobacco.
- 6 A quarter of all cigarettes and three-quarters of all hand-rolling tobacco consumed in this country have avoided UK taxes and duties.
- 7 Other undesirable effects include: law and order and social problems, which arise from the concentration of criminals in certain areas – particularly Dover and East Kent; and the creation of building blocks for organised crime networks and financial support for other serious criminal activity.
- 8 Legal cross-border shopping from low tobacco duty countries accounts for 8–10% of the cigarette market.
- 9 The number of smokers choosing to smoke hand-rolled tobacco, instead of cigarettes, as a way to save money is increasing: 57% of hand-rolled tobacco is smuggled and a further 14% is purchased outside the UK.
- 10 The illicit street price of the most popular UK brands of cigarettes is typically £2.50 – the legal price for the same brand is around £4.89.
- 11 Tobacco is a uniquely dangerous product: tough action to control its traffic across borders will save lives.

**A quarter of all cigarettes and three-quarters of all hand-rolling tobacco consumed in this country have avoided UK taxes and duties.**



The tobacco market in the UK is made up of six broad sectors:

**CIGARETTES**

**DUTY PAID**  
split into premium price, mid-price, low and ultra-low price

**SMUGGLED**  
counterfeit or tobacco industry

**CROSS-BORDER SHOPPED**

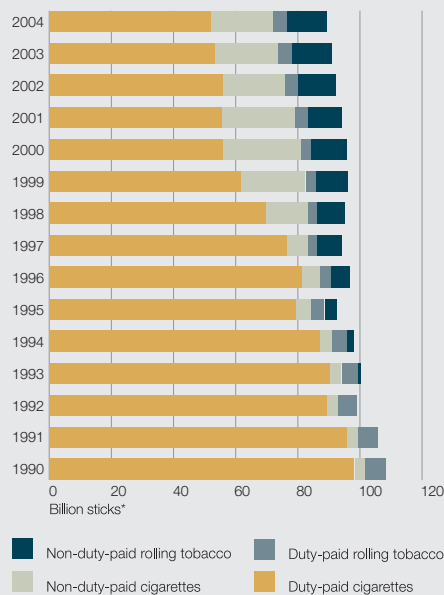
**HAND-ROLLING TOBACCO**

**DUTY PAID**

**SMUGGLED**

**CROSS-BORDER SHOPPED**

**Figure 1**  
Increase in the use of cheap cigarettes (United Kingdom)



\*Billion cigarettes consumed each year by UK smokers.  
Rolling tobacco converted to cigarettes @ 0.6g per cigarette.  
Source: Morgan Stanley Equity Research

Every year, 106,000 people in the UK die from smoking-related disease. Smoking is a major cause of cancer and cardiovascular disease. The difference in smoking rates across socio-economic groups explains around half the health inequalities across these groups. Smoking is the main cause of preventable death and ill health. The devastation caused by smoking is the reason why it is a public health priority. The cost of tobacco is inextricably linked to whether a person is likely to start, stop or relapse his or her smoking habit: the higher the price, the lower the demand. The recent rise in low-price cigarettes, smuggled tobacco and legally bought low-price tobacco products from nearby countries presents a real public health challenge.

This section of the Annual Report looks at how the price of tobacco in the UK, a crucial public health lever in reducing smoking rates, has been changed by the balance of this market over recent years. As a result, the impact of UK tax and duty rates in affecting consumption for many smokers has been significantly blunted.

The tobacco market in the UK is made up of six broad sectors:

- cigarettes (duty paid – split into premium price, mid-price, low and ultra-low price)
- cigarettes (smuggled – counterfeit or tobacco industry)
- cigarettes (cross-border shopped)
- hand-rolling tobacco (duty paid)
- hand-rolling tobacco (smuggled)
- hand-rolling tobacco (cross-border shopped).

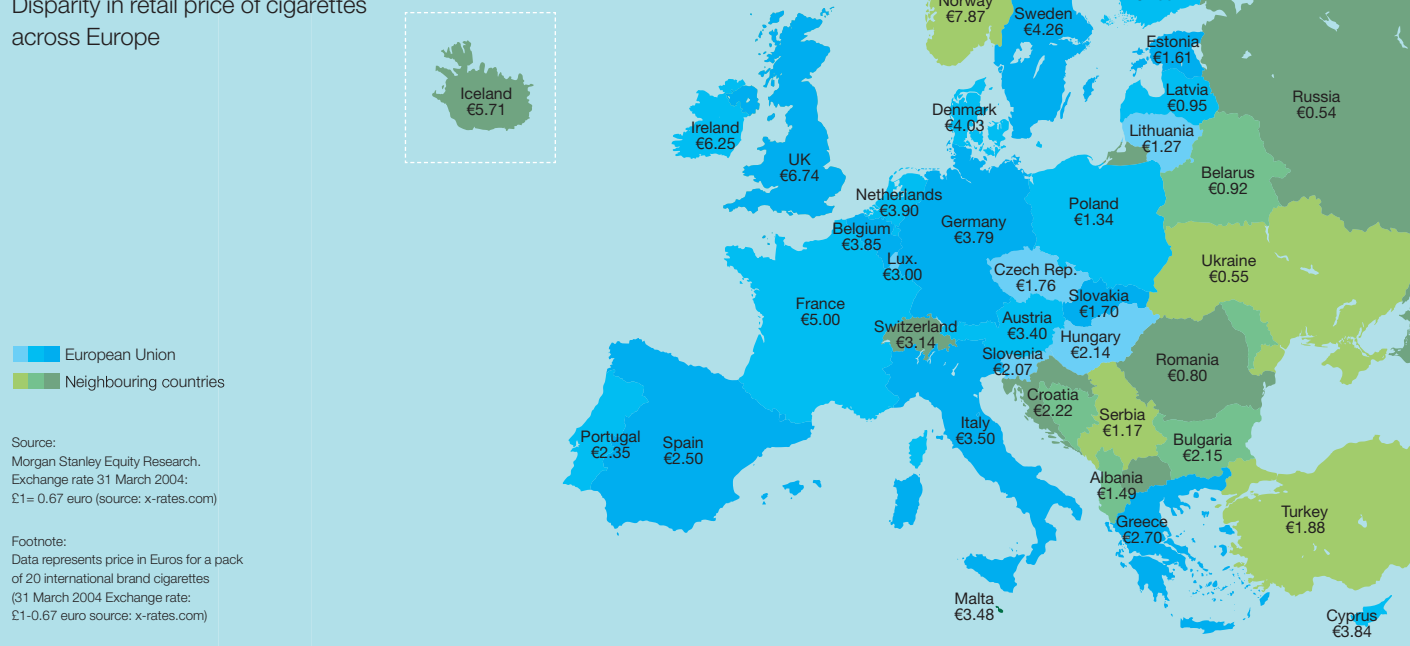
**The United Kingdom context**

In the United Kingdom, smuggling of tobacco used to be confined to low-level cross-Channel smuggling of hand-rolling tobacco. More recently, smuggling of cigarettes has dramatically increased. Around 75% of smuggled cigarettes are transported by freight and ‘roll-on roll-off’ lorries, with the remainder largely smuggled in vehicles through the Channel ferry ports and the Channel Tunnel (the so-called ‘white-van’ trade).

Figure 1 shows how the market has changed over the past 30 years.

**Figure 2**

Disparity in retail price of cigarettes across Europe



The key changes for non-duty-paid tobacco – cigarettes and ‘roll your own’ – have come in the last six years. This has halted the UK Government’s push on price as a key measure to reduce consumption.

In response, the Government created the *Tackling Tobacco Smuggling* strategy (March 2000), which focuses on tackling the trade in smuggled cigarettes. While this has successfully reversed the increase in the numbers of cigarettes smuggled each year, these cigarettes still make up around 15% of the UK cigarette market. Moreover, these cigarettes are massively cheaper (about half the price) of the legal market and the strategy does not cover legal cross-border shopped cigarettes from low-duty countries (see Figure 2), which make up a further 8–10% of the cigarette market.

Recently, the use of ‘roll your own’ or hand-rolling tobacco has dramatically increased as it is another way for smokers to avoid the impact of higher cigarette prices (see Figure 3). The current Tackling Tobacco Smuggling strategy does not focus on hand-rolling tobacco.

For example, in 1998 a 50g pack of hand-

rolling tobacco cost £1.80 in Belgium but £7.80 in the UK, and an estimated 5,000 tonnes of hand-rolling tobacco were smuggled from Belgium to the UK in that year alone.

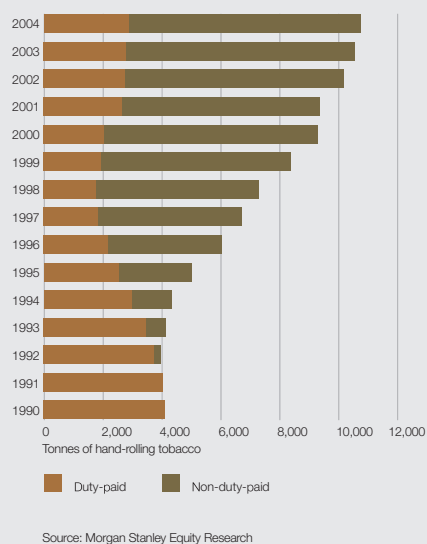
Cheap cigarettes, either manufactured or hand-rolled, are also most likely to be consumed by poorer people, the people most affected by health inequalities.

### **Tobacco control – the problem of cheap tobacco**

The 10.5 billion cigarette sticks successfully smuggled into the UK market last year, and the further 6.5 billion sticks cross-border shopped, lost the UK Government £3.1 billion of revenue. Indeed, of all the cigarettes smoked in the UK in financial year 2003/04, around a quarter (24%) were unaffected by UK price measures – bypassing possibly the most effective way of controlling smoking rates.

The problem with hand-rolling tobacco is even worse. Increasing numbers of smokers have been downtrading from more expensive cigarettes to cheaper hand-rolling

**Figure 3**  
Increased use of hand-rolling tobacco (United Kingdom)



tobacco. Its attractiveness is that little of this is affected by UK tax or duty. In 2003/04, 57% of hand-rolling tobacco in the UK was smuggled, while a further 14% was cross-border shopped. Therefore, of all the hand-rolling tobacco smoked in the UK last year, nearly three-quarters (71%) was unaffected by UK price measures – again bypassing possibly the most effective way of controlling smoking rates.

### Cross-border shopping

In 2002, the indicative limits on cross-border shopping to the UK from the European Union were increased following pressure from the European Commission. An individual can now bring 3,200 cigarettes or 3 kg of hand-rolling tobacco into the UK without paying any UK tax or duty. This is around six months supply for a 20-a-day smoker. Tobacco is a uniquely dangerous product (it kills one in two users when used as intended), yet the current rules in the European Union seek to treat the movement of it across borders by consumers as though it were the same as many other products.

According to the latest figures from the European Commission, the price of a packet of cigarettes in the most popular category in Spain is £1.36. The equivalent in the UK is £4.89. A holidaymaker to Spain can legally bring back 160 packs. With cheap flights

available, an English smoker might save, legally, over £1,000 in tax and duty with two trips a year. As well as a ready source for personal consumption, the temptation to sell on such large amounts can prove hard to resist.

Recent European Union enlargement has resulted in even lower priced cigarettes becoming available making the differential in prices even more stark. In Latvia, for example, the price of a packet of cigarettes in the most popular price category is 36p; in Poland it is 83p (although limits on cross-border movement for these new Member States are currently set at 200 until their tax/duty systems are in line with European Union rules). In countries geographically close to the European Union, such as Russia and the Ukraine, the price of a premium brand packet of 20 cigarettes in 2004 was 37p and 38p respectively.

### Counterfeiting

The expansion in illegally smuggled tobacco industry-manufactured products from the mid-1990s created a new market. As work by HM Revenue and Customs, in conjunction with the tobacco industry, has reduced the amount of smuggled industry manufactured tobacco making its way into the UK, so the counterfeiters stepped in to supply the markets that had been created.



In 2003/04, 54% of cigarettes seized in the UK were counterfeit, a 260% increase in only two years.

The problem with counterfeit cigarettes is not what is in them, but that they are now the prime source of cheap cigarettes in the UK. Counterfeit cigarettes typically come from illegal factories in Eastern Europe and the Far East, predominantly China. It has been estimated that, in 2002, 190 billion counterfeit cigarettes were manufactured in China. Worryingly, the Treasury Select Committee commented in March 2005:

'We were surprised to learn during our visit to China, the largest source of counterfeit cigarettes destined for the UK, that there was only one UK customs officer, based in Hong Kong, to cover the whole country. We were also surprised to discover that, until our visit, there had been no meetings between UK Customs and the State Tobacco Monopoly Administration, the agency charged with tackling cigarette counterfeiting in China.'

#### **UK influence on international action**

The price of tobacco products and the nature of the UK tobacco market is dependent on worldwide factors, as well as European Union rules. There are opportunities coming up which will provide a focus for tackling the issues raised here.

#### **The Framework Convention on Tobacco Control**

The Framework Convention on Tobacco Control came into effect in February 2005. The first Conference of Parties (countries that have ratified the convention) is planned for February 2006. It is expected that one of the first protocols under the convention will focus on illicit trade. Illicit trade in tobacco is a worldwide problem. The European Union and all 25 Member States could prioritise action in this area and work with other signatories to the convention to produce a comprehensive and effective protocol to end the worldwide trade in tobacco smuggling. The UK could use its Presidency of the European Union to lead the development of a strong common European Union position for the negotiations.

#### **The review of the European Union directive on tobacco tax**

In 2006, the European Union is due to review its tobacco tax directive. This is an opportunity to set a framework for reducing the difference in tax rates between all Member States while continuing to push up prices. The UK could aim to increase the minimum price allowed for tobacco products across the European Union by increasing the specific (fixed amount of) duty, as well as use the review to question the illogical and health-damaging cross-border shopping allowance for tobacco.

#### **Taxation and smuggling**

Most countries apply taxes to tobacco products to raise government revenue and to create a disincentive to smoking. Taxation has been one of the most effective health policy measures for reducing tobacco consumption. Smuggling results in less revenue for governments and undermines taxation as an effective health policy to curb consumption.



## TWO TYPES OF SMUGGLING

### BOOTLEGGING

### LARGE-SCALE ORGANISED SMUGGLING



Publicly, the tobacco manufacturers oppose tax increases. Their rationale has been that higher taxes are an incentive for smuggling and reduce legal, but not total, sales. The reality is that the tobacco companies benefit from smuggling: average tobacco prices are reduced and hence demand increases. Tobacco is an addictive substance and cheap, smuggled cigarettes encourage people to keep smoking when otherwise they might stop. When smuggled cigarettes are tobacco industry-manufactured, the tobacco manufacturers and wholesalers are still being paid for these sales, thus benefitting further from smuggling.

There are two types of smuggling:

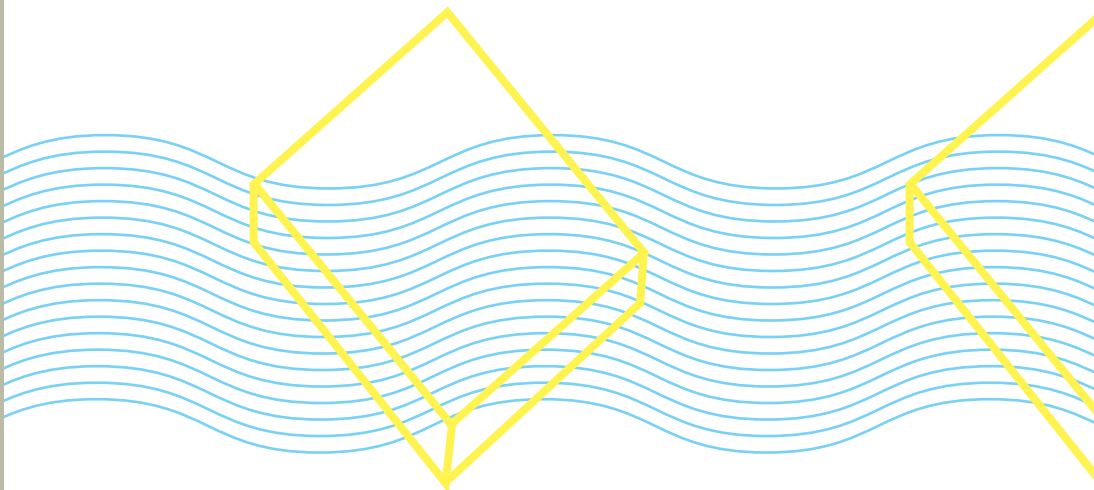
- **bootlegging** – essentially the old-fashioned style of smuggling. It is encouraged by differentials in the price of tobacco products between neighbouring countries, states or provinces. Duty-paid products are purchased in a low-tax area, transported to a high-tax area and sold illegally;
- **large-scale organised smuggling** – characterised by the involvement of criminal organisations, a relatively sophisticated system for distributing smuggled cigarettes locally and few controls on the international movement of tax-free cigarettes.

Tax-free cigarettes most often enter the illicit market while ‘in transit’. Transit is a concession system aimed at facilitating international trade, which allows the temporary suspension of customs duties, excise and Value Added Tax payable on goods originating from and/or destined to a

third country, while goods are transported through a defined customs area. Cigarettes legitimately move through the ‘in-transit’ regime without bearing tax until they reach their end market, where tax is payable. However, many cigarettes simply fail to arrive at their final destination, having been bought and sold on the black market by unofficial traders.

When cigarettes are smuggled, taxes are evaded and the black market price is lower. While avoidance of taxes may be the key motivation for smuggling, smuggling cannot be explained by tax levels alone. Spain and Italy, which have relatively low tobacco taxes and prices, have historically had the biggest problem in the European Union with smuggled tobacco. This lends weight to the theory that environmental factors also have a strong influence: a willing market, the culture of street selling, the presence of local organised crime networks, an active black market and general levels of national or local corruption.

The duty-paid market in the UK has also seen a real change since 1997. As price has increased, a new market in ultra-low and low/economy-price cigarettes has expanded. The ultra-low price share of the cigarette market increased from 15% in 1997 to 35% in 2004; the low-price share rose from 15% to 22%. Rather than quitting in the face of price rises, smokers had an alternative route to maintain their addiction without paying more. They could also trade down to hand-rolling tobacco. This expansion in ultra-low/economy-price brands again dents the health impact made by price rises.



## ACTION RECOMMENDED

- 1 The Government should use its Presidency of the European Union (and its health inequalities theme) to promote a comprehensive and effective protocol for the Framework Convention on Tobacco Control to end the trade in tobacco smuggling worldwide.
- 2 The Government should set a more challenging target for reducing smuggled cigarettes and extending its smuggling strategy to hand-rolling tobacco.
- 3 The Government should use its influence within the European Commission and with other Member States to address cross-border shopping for tobacco products, with the aim of reducing the limits to 200 cigarettes or 250g of hand-rolling tobacco.
- 4 The Government should look urgently at how to create a tax/duty system for tobacco that minimises the opportunity to avoid the impact of price rises by trading across to another tobacco product (e.g. hand-rolling tobacco).
- 5 Better information systems should be developed to provide high-quality data on smuggling, tax-free imports and cross-border trade.
- 6 The Government should produce a strategy to combat counterfeit tobacco products.
- 7 The Government should use its maximum influence on the European Union 2006 review of its tobacco tax directive to reduce the difference in tax rates between Member States (including combining the 'fixed amount' of duty).
- 8 The new Serious Organised Crime Agency (SOCA) should be given the challenge of breaking the tobacco-smuggling criminal gangs.