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FACTSHEET

The illicit tobacco trade in the MERCOSUR countries

A major new report from the Centro de Investigacion de la Epidemia de Tabaquismo in Uruguay shows the extent of the illicit trade in tobacco in the MERCOSUR countries, Argentina, Brazil, Paraguay and Uruguay.

The Southern Common Market (MERCOSUR) was established in March 1991, via the Treaty of Asuncion, by Argentina, the Federal Republic of Brazil, the Republic of Paraguay and the Republic of Uruguay. Decisions are reached by consensus decision of all four countries. MERCOSUR covers an area of 11,863,000 km2 and has a total population of 246 million people.

The report, compiled by economist Alejandro Ramos, based on reports by experts throughout the MERCOSUR region, estimates the total size of the illicit market in the region in 2007 as 45 billion sticks (cigarettes) every year. Most of the illegal production is centred in Paraguay, and about nine in ten illicit cigarettes are consumed in Brazil. In addition, another 30 billion cigarettes leave the MERCOSUR region for other countries, often through Panama or Aruba. If the total of illicit trade in cigarettes around the world is about 600 billion sticks a year this would mean that about 12.5 per cent of the trade comes from the MERCOSUR region.

Paraguay

Paraguay in particular has seen sharp growth in the tobacco industry over the last twenty years. In 1993 there were only three tobacco companies in the country, by 2007 there were as many as twenty-five firms importing tobacco and cigarettes and forty exporting.

The report provides powerful evidence of extensive production of cigarettes in Paraguay for the illicit market.

The table below shows the small scale of “legal” tobacco manufacturing in Paraguay, which accounts for less than 3.5 per cent of total industrial value-added.

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Tobacco sectoral value added, 2006

	000's USD	per cent
Tobacco and beverages	164,336	13,51
Tobacco	41,084	3.38
Total industrial	1,216,363	100,00

Source: Based on data from the National Accounts, Central Bank of Paraguay

However, figures on the production capacity of the tobacco industry in Paraguay show a far larger industry than the official figures suggest.

Production capacity for primary and secondary processing

Number of firms	Activity	Annual capacity (number of sticks)
6	Tobacco primary processors	63,900,000,000
26	Cigarette manufacturers	154,701,780,000
1	Cigar factory	240,000 units

Source: Ministry of Industry and Trade, Paraguay, 2004

In 2006, Paraguay imported nearly 40 million kilos of tobacco leaf and raw tobacco and waste, from which no less than 60 billion cigarettes could be produced. This amount is in line with the primary manufacturing capacity indicated above. However, the 26 factories listed as cigarette producers would, according to the Ministry of Industry and Trade, have production capacity close to the cigarette consumption of Brazil over an entire year.

The report estimates that the total industrial value-added of the illegal cigarette industry in Paraguay at about $542.5 million, or 13 times the "official" value-added as estimated in the National Accounts of the Central Bank.

Brazil

The total volume of the domestic Brazilian cigarette market (both legal and illegal) is estimated at seven billion packs of 20 sticks, or 145 billion cigarettes.

Souza Cruz (BAT) has a 78 per cent share and Philip Morris a 13 per cent share of the market for legal Brazilian cigarettes. Between them the two multinational subsidiaries dominate 91 per cent of the legal market. In 2006, there were also 14 other local tobacco manufacturing companies with nine per cent of the legal market. The size of the illegal market is hard to evaluate; some observers put it at 30 per cent of total sales.

In the 1990s, Souza Cruz cigarettes were frequently manufactured in Brazil, exported to neighbouring countries and then reintroduced illegally to Brazil, avoiding domestic taxes in a process called “triangulation”. Cigarettes were also often produced for export but in fact sold in the domestic market. More recently, after struggles between the industry and the Brazilian Government over a 150 per cent export tax on cigarettes, the “triangulation” method has declined, but the illegal market is still well established. The illegal market is well established in Brazil.

Competition for the lower-priced segment of the tobacco market is fierce and the confused legal situation regarding small companies is driving new schemes for avoiding paying taxes on at least a portion of production.

Recently small producers have been prosecuted by the authorities for owning factories in Brazil and Paraguay, producing in Brazil, labelling products as coming from Paraguay, and then claiming that they had been illegally imported to Brazil by third parties.

Argentina

Argentina has a domestic market of about 40 billion cigarettes. The market is dominated by two multinationals with factories in Argentina: Philip Morris (Massalin Particulares), with about 70 per cent of the market; and BAT (Nobleza Piccardo) with about 26 per cent of the market. The remaining four per cent is shared between nine small start-up companies.

Since 2000, both BAT and PM have renewed agreements with Argentina’s Ministry of Economy on minimum tax payments. This scheme establishes a target floor for tax payments through a cigarette tax rate of 75 per cent on the retail price of the best-selling brands. These agreements were endorsed by government decrees and so became mandatory for the entire tobacco sector, placing a burden on small companies selling cheaper cigarettes. Small companies complain they are unable to “cross subsidize” lower-priced cigarettes as they do not produce more expensive brands on which more tax would be paid.

The position of the manufacturers was strengthened after 2001 by favourable court decisions that overturned their obligation to comply with the agreement between tobacco multinationals and the government. To confront this threat, the multinational companies launched cheap-priced brands in an attempt to recover market share.

Today, the situation of small firms in Argentina is similar in some respects to their Brazilian counterparts. In both countries, small firms are owned by domestic operators and capital, they are active in the market for low-priced cigarettes, are verging on illegality and they attempt to persuade courts to rule in their favour concerning non-payment, or reduced payment, of taxes.

Uruguay

In Uruguay, the leading cigarette firm, Montepaz SA, is domestically owned and has about 70 per cent of the legal domestic market.

Philip Morris entered the Uruguayan market in 1979 by buying a local company (Abal Hnos. SA). It owns a cigarette factory and imports some of its international brands. Its market share is around 25 per cent of the domestic market for cigarettes. There are virtually no exports. British American Tobacco (BAT) began manufacturing cigarettes in Uruguay in 1997. Unable to increase its low market share of six per cent, it ceased manufacturing in 2003. It serves its current market share of under four per cent by importing brands from Argentina.

Montepaz exports both cigarettes and cut tobacco to Paraguay, where it also owns a factory. The cigarette main brands exported are “Calvert” and “Broadway”, not sold in the domestic market. In 2006, Montepaz exported about 2.5 billion cigarettes, mostly to Paraguay, twice its domestic sales in Uruguay, and three million kilogrammes of tobacco raw material. It is likely that a substantial proportion of these exports are then resold to “operators” in Paraguay, who then move them to Brazil.

Foreign trade statistics from Paraguay show these cigarettes imports from Uruguay to be practically the only cigarettes imported by Paraguay from MERCOSUR countries.

Conclusions

The report makes it clear that illicit trade in tobacco is damaging both the MERCOSUR economies and public health. For example, in Paraguay if tax could be collected on illicit production, the government could expect to benefit by at least $130 million a year. In total, the possible tax losses to MERCOSUR governments may be at least $600 million a year.

The report makes a series of recommendations to fight the illicit trade in the region. They include:

- Classifying the contents of cigarettes, such as nicotine, as addictive substances;
- Imposing stiffer penalties for the repetition of smuggling offenses by individuals or companies and for Government and public officials involved in criminal activities related to illicit trade;
- Introducing rules for the immediate destruction of illegally imported cigarettes;
- Creating new specialized means for public prosecutors and judicial courts to deal with organized crime and wholesale smuggling, devoting to the illicit cigarette trade the same highly qualified and well-trained officers who track down and deal with drug trafficking and money laundering;
- Revising regulations regarding merchandise passing through free trade, transit and free ports in order to reduce under-declaration and false declarations;
- Improving intelligence and coordination among Customs bureaus and other law enforcement agencies in the four countries; and
- Promoting the creation within MERCOSUR of an anti-fraud and corruption organisation covering all countries.

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