

Case Studies in Illicit Tobacco Trade: United Kingdom

Background

The illicit trade in tobacco includes illegal methods of manufacturing, selling, or buying real or counterfeit tobacco without paying tobacco taxes. In the United Kingdom (UK) the sale of illicit tobacco products was estimated in the year 2000 to have caused a loss of £3 billion in tax revenue.

The tobacco industry has often argued that increases in tobacco taxes lead to increases in illicit trade. While tax and price differences in neighboring countries/regions may increase the incentives for illicit trade, the UK experience shows that a comprehensive tobacco control strategy can increase government revenues through higher tobacco taxes, achieve significant reductions in smoking, and successfully reduce levels of illicit trade.

A crucial component of the UK's tobacco control policy has been high tobacco taxation, which the state has implemented as both a public health and a revenue-generating measure. Following a series of tax increases, the illicit tobacco trade increased rapidly in the 1990s. This trend was due, in particular, to the well-documented tobacco manufacturer practice of increasingly producing and exporting cigarettes in volumes much greater than the known demand in their stated markets. These products were then smuggled into the UK with no duty paid.

UK Efforts to Reduce Illicit Trade

In response to the magnitude of the problem, law enforcement authorities in the UK first implemented a tobacco action plan in 2000 and updated the plan in 2006, 2008, and 2011. Each revision to the laws was made in response to new challenges that arose as the illicit tobacco supply adapted to the regulatory changes. Tobacco taxes continued to increase during those years as well. The UK's illicit tobacco strategy is based on the principle that smuggling is an enforcement issue, rather than an issue caused by high tobacco prices.

The UK's overall tobacco action over the years has included¹⁻⁵:

- Systematically assessing the size of the illicit market and refining the methodology used to assess the size of that market;
- Creating a new agency, the UK Border Agency, which works with revenue and customs, treasury, the health department, and local governments;
- Deploying overseas intelligence officers, whose role is to intercept and seize contraband before it enters the UK;
- Reducing the rewards from smuggling by increasing criminal and civil sanctions;
- Adding 1,000 more customs officers and additional x-ray scanners to increase enforcement;

- Marking cigarettes and hand-rolled tobacco products destined for the domestic market with a prominent statement “UKDUTYPAID”;
- Placing covert anti-counterfeiting markings on cigarette packs allowing authorities to instantly verify the authenticity of a product on retailers’ shelves;
- Making it harder for criminals to source tobacco products; and
- Disrupting the supply and distribution chains of illegal tobacco products.

Following the implementation of the UK’s overall strategy, and public pressure in response to parliamentary hearings, exports of cigarettes to places like Andorra—believed to be a major transit point for cigarettes bound for smuggled reentry into the UK—declined sharply.

Tobacco Taxes and Illicit Trade in the UK

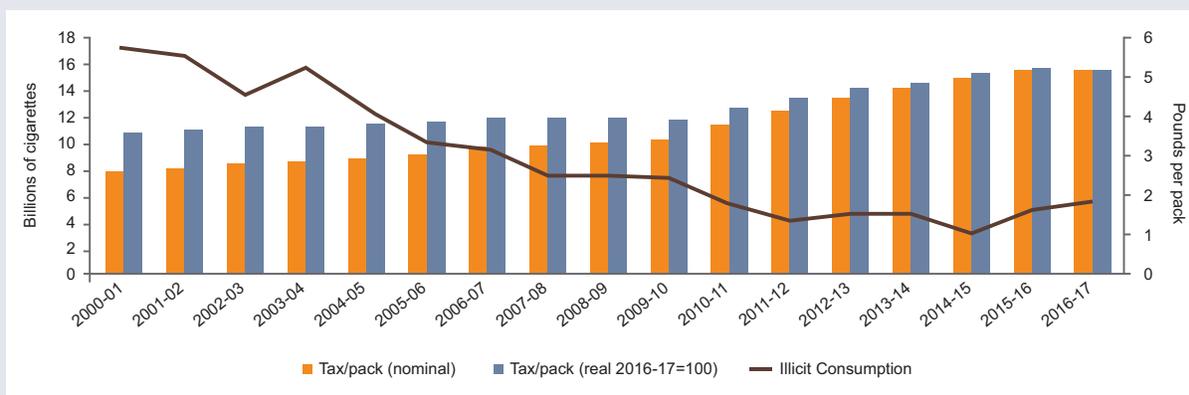
The UK has accompanied its pro-health tobacco tax policy with many other comprehensive tobacco control policies, such as clean indoor air laws and tobacco marketing restrictions. As tobacco taxes were increased steadily at a

specified rate equal to or greater than inflation, consumption of illicit cigarettes dropped from 17 billion in 2000-01 to 5.5 billion in 2016-17.

Figure 1 shows that while cigarette taxes in the UK increased, the illicit share of the market steadily decreased. The data shows that the taxes per pack of cigarettes increased sharply during the last few years, reducing overall consumption. Because overall consumption dropped significantly, the share of the illicit market appears to have increased during the last few years, however, the volume of illicit cigarettes consumed actually declined.

Additionally, price increases between 2006 and 2009 were driven almost equally by tax increases (responsible for 52% of the total price increase) and by the industry price strategy (responsible for 48% of the total price increase). Consumption of illicit cigarettes also fell from 10 billion cigarettes in 2006 to 7.5 billion cigarettes in 2009. Because illicit consumption in the UK dropped, and because the tobacco industry itself raised prices of cigarettes, it cannot argue that increases in taxes or increases in prices drive illicit trade in tobacco.

Figure 1
Tobacco taxes and illicit market share



Based on data from HM Revenue and Customs and Office for National Statistics.
(Note: The share of the illicit market (brown line) appears to have gone up in recent years because overall consumption dropped significantly as a result of higher taxes and other tobacco control policies)

The UK experience shows that contrary to the tobacco industry's argument, increases in tobacco taxes are not the reason for increases in the illicit trade in tobacco. When accompanied by comprehensive tobacco control laws, illicit trade in tobacco can be controlled and reduced, in spite of higher taxes, through improved tax administration and enforcement of tax laws.

Conclusion

Countries around the world can learn from the UK experience. Governments can successfully

raise revenues and reduce smoking prevalence even in the presence of illicit trade through strong governance and enforcement measures. The more comprehensive and coordinated the approach, the more effective it is in addressing the problem of illicit trade in tobacco. Countries can also use the Illicit Tobacco Trade Protocol, the first legally binding instrument adopted under the World Health Organization's Framework Convention on Tobacco Control, as a coordinated international response to the problem of illicit tobacco trade.

References

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Suggested Citation

Blecher E. Case Studies in Illicit Tobacco Trade: United Kingdom. Tobacconomics Fact Sheet. Chicago, IL: Tobacconomics, Health Policy Center, Institute for Health Research and Policy, University of Illinois at Chicago, 2019. www.tobacconomics.org

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This publication is funded by Bloomberg Philanthropies.

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Tobacconomics is a collaboration of leading researchers who have been studying the economics of tobacco control policy for nearly 30 years. The team is dedicated to helping researchers, advocates and policymakers access the latest and best research about what is working—or not working—to curb tobacco consumption and its economic impact. As a program of the University of Illinois at Chicago, Tobacconomics is not affiliated with any tobacco manufacturer. Visit www.tobacconomics.org or follow us on Twitter www.twitter.com/tobacconomics.