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ISSUE BRIEF

Role of the Tobacco Industry

Although tobacco use has declined in recent decades, worldwide more than one billion people still regularly uses tobacco, including many who purchase cigarettes outside legal markets. Illicit tobacco markets can deprive governments of tax revenue and undermine public health efforts to reduce tobacco use. To answer a number of questions about the illicit tobacco market, a committee of experts appointed by the National Research Council and Institute of Medicine conducted a study and released its findings in the report *Understanding the U.S. Illicit Tobacco Market*.

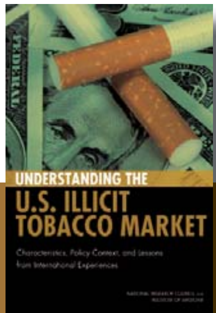
One subject addressed in the report is whether and to what degree the tobacco industry has been involved in the illicit tobacco market. While there is evidence that companies have facilitated the smuggling of legally manufactured cigarettes at a global level in the past, there is no evidence that the industry is currently supporting the illicit trade in the United States.

Involvement at Global Level

The involvement of the tobacco industry in the illicit market is complicated. Although counterfeit cigarettes result in financial losses for tobacco companies, the industry can still benefit from other aspects of the illicit tobacco trade, such as by abetting the smuggling of legally manufactured cigarettes as a way of introducing a company's products to new markets or to lower the price, thus expanding its share in existing markets.

Tobacco companies at a global level have been complicit in the smuggling of legally manufactured cigarettes. Studies of internal industry documents, along with legal investigations and agreements, have shown that tobacco companies promoted and facilitated such smuggling in order to circumvent import bans, high tax rates, and duty fees on legal imports; gain a competitive advantage over other cigarette companies; and create pressure on governments to reduce cigarette taxes and duty fees or to not increase them. Evidence suggests that in the recent past, the tobacco industry was complicit in the illicit trade in Asia, Eastern Europe and the former Soviet Union, Africa, Canada, Latin America, and the European Union.

The tobacco industry's role in facilitating the smuggling of legally manufactured cigarettes in Europe has also been brought to light through investigations conducted by the European Union. In November 2000, as a result of its investigations, the European Union sued Philip Morris International and several other tobacco manufacturers, alleging that they were smuggling cigarettes into Europe. In exchange for dropping all charges, Phillip Morris International and the European Union reached an agreement, in 2004, stipulating a $1 billion



payout over 12 years and repayment of all duty required on seizures of the company's products. The European Union negotiated similar agreements with Japan Tobacco International, British American Tobacco, and Imperial Tobacco Limited in 2007 and 2010. The agreements—reinforced by the threat of litigation—have been credited with cutting off the supply of illicit cigarettes in Spain and Italy and reducing consumption of illicit tobacco products in those countries from 15 percent of all cigarettes purchased in the 1990s to 1 to 2 percent in 2006.

No Evidence of Domestic Involvement

Although there may be a lag in detection, there is no evidence that the tobacco industry presently contributes to the domestic illicit trade in the United States. Enforcement officials from Virginia and New York City told the study committee that tobacco companies had been helpful in providing training and other assistance to combat the illicit trade. In addition, major tobacco firms have taken direct legal action against U.S. sellers of counterfeit products, which cost cigarette companies financially and with respect to infringement of trademarks and other intellectual property.

Industry Estimates of the Size of the Illicit Market

One of the tobacco industry's principal arguments against higher taxes on cigarettes and more stringent regulatory changes is that such measures will fuel the growth of the illicit tobacco market. However, industry-sponsored estimates of the size of the illicit market tend to be inflated and have been subject to numerous critiques on several issues: the methodological approach used and its transparency; the treatment or neglect of evidence; inconsistencies with estimates from academic or other studies; and nondisclosure of the source of funding. For example, the industry's reliance on litter or empty pack surveys, used to estimate the magnitude of nondomestic and counterfeit cigarettes, may lead to inflated estimates of illicitly traded tobacco because of urban sampling bias and the inclusion of legal consumption that appears illicit because of tourism or commuting patterns.

This brief is based on the report *Understanding the U.S. Illicit Tobacco Market: Characteristics, Policy Context, and Lessons from International Experiences,* available from the National Academies Press (http://www.nap.edu). The study was sponsored by the U.S. Food and Drug Administration. Any findings, conclusions, or recommendations expressed in this publication are those of the study committee and do not necessarily reflect those of the sponsor.