Understanding the U.S. Illicit Tobacco Market

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ISSUE BRIEF

Enforcement

Although tobacco use has declined in recent decades, globally more than one billion people still regularly use tobacco, including many who purchase cigarettes outside legal markets. Illicit tobacco markets can deprive governments of 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.*

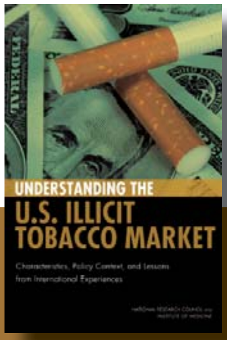
Among the topics discussed in the report are policy interventions, including law enforcement efforts, that can be used to reduce the size of illicit tobacco markets. Enforcement efforts in the United States are currently weak and uneven across states, the report concludes, but there are options for strengthening them.

Bootlegging Accounts for Most of U.S. Illicit Market

Currently the U.S. illicit tobacco market consists almost exclusively of bootlegging—buying cigarettes in low-tax states such as Virginia and selling them in high-tax states such as New York without paying taxes on the sale. The portion of the total U.S. tobacco market represented by illicit sales has grown in recent years and is now between 8.5 percent and 21 percent. This represents between 1.24 to 2.91 billion packs of cigarettes annually and between $2.95 billion and $6.92 billion in lost gross state and local tax revenues. Illicit tobacco consumption is distributed unevenly across states, accounting for as much as 45 percent of the tobacco market in high-tax states and playing a lesser role in other states.

Current Enforcement Efforts Weak and Uneven

In the United States, several federal laws are designed to discourage the illicit tobacco trade, such as the Contraband Cigarette Trafficking Act, Prevent All Cigarette Trafficking Act, and the Family Smoking Prevention and Tobacco Control Act. The laws are enforced by a range of agencies, including the U.S. Departments of Justice, Treasury, and Homeland Security. Although many laws governing the illicit tobacco trade are federal, the impacts of the illicit trade—in terms of lost tax revenue—are borne by states and cities. States and local jurisdictions have enacted their own laws and enforcement efforts, but little systematic data exist about them.



Understanding the U.S. Illicit Tobacco Market

Characteristics, Policy Context, and Lessons from International Experiences

NATIONAL RESEARCH COUNCIL *AND* INSTITUTE OF MEDICINE

So far, enforcement efforts against the illicit tobacco market have been a low priority in the United States; overall, the limited available evidence suggests that tobacco smugglers currently face little risk of detection and prosecution. Because the illicit tobacco trade has been nonviolent, it is generally treated as an economic rather than a criminal problem. Law enforcement efforts to investigate the illicit trade tend to be weak and uneven, and criminal prosecution of those involved is a very low priority for prosecutors.

However, in an era of shrinking budgets, states—particularly high-tax "destination" states—appear to have good reason to uncover and prevent the illegal trade in order to collect the taxes they are owed. One effort to do so was undertaken in 2011 by New York City, which launched the Tobacco Task Force to combat increasing illicit sales by retail outlets. The task force inspects licensed cigarette retailers, arrests those found in violation of tobacco laws, and issues civil fines to collect lost revenues. The city also passed a 2013 law that increases penalties and fines for retailers who evade tobacco taxes or sell cigarettes without a license. It is too soon, however, to determine whether the new law and task force will have a deterrent effect on the state's illegal trade. Even low-tax "source" states have reason to make some effort to discourage smuggling. For example, officials in low-tax Virginia believe that the illicit tobacco trade harms the state's interests because it could bring criminal enterprises and attendant crime to the state. In addition, traffickers may set up fictional retail businesses to buy cigarettes and then fail to pay even source-state sales taxes on cigarettes, as well as failing to pay taxes in the destination state.

Because cigarette bootlegging by its nature crosses state boundaries, however, state efforts to enforce their own tax laws are weakened by the difficulty of coordinating efforts across state lines—a challenge that suggests a key role for federal action.

Coordinating State Efforts

The federal government could promote the coordination of enforcement efforts across states and jurisdictions in ways that it has done for other interstate crimes such as gun crimes and drug trafficking. The federal government could also support collaboration among various agencies and other anti-smoking stakeholders to address tobacco smuggling.

Efforts to enforce laws against tobacco bootlegging in the United States face challenges that are significant but not insurmountable. Regulatory approaches—such as requiring cigarette packages to have encrypted "tracking and tracing" markings—could support enforcement efforts, helping law enforcement agents identify points at which tobacco products are diverted into illicit markets.

Comprehensive approaches that use a variety of policy, regulatory, and enforcement strategies have been used successfully by other nations to significantly reduce the size of their illicit tobacco markets. For example, Spain was able to reduce the share of its illicit market from 15 percent in 1995 to 2 percent in 2001 through licensing and control measures, enforcement efforts, and legal agreements. Canada reduced the illicit share of its market from nearly 30 percent in the early 1990s to between 7.6 percent and 14.7 percent in 2010 through sweeping intervention efforts, including licensing, tax stamps, enforcement, tax harmonization, tribal tax revenue agreements, legal agreements with tobacco manufacturers, and public education campaigns.

A more in-depth discussion of enforcement options can be found in 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.