

Testimony of David Sweanor

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My background. I led efforts to use tax-based cigarette price increases as a public health tool in Canada starting in the 1980s and worked to bring such policies to the US and elsewhere. Among other things, I was the primary author of the 1996 WHO World No-Tobacco Day materials on the economics of tobacco and a co-author of a 2015 New England Journal of Medicine commentary on the importance of differential taxes for differential risks. For decades I have been actively involved in studying, monitoring, and litigating on, the global illicit cigarette trade.

The price of tobacco products is a dominant driver in their use. Cigarette taxation has been, by far, the most powerful tool used to date in reducing cigarette consumption. Higher prices result in reduced smoking. Differential taxation of different tobacco/nicotine products also significantly spurs movement between types of products. But differential prices between licit and illicit products also spurs contraband. The countries of eastern Europe are a particular concern as a source for illicit trade due in part to significant price differentials with the countries of the European Union.

The illicit traffic in tobacco products (ITTP) is a public-health issue, a public-safety issue, and a drain on public revenue. Cigarette tax increases can be a 'triple win', benefiting public health while raising revenue and being popular. By contrast, the illicit trade is a 'triple loss', adding to health burdens, augmenting criminality and reducing revenue.

ITTP is substantial. While accurate numbers are hard to establish, because of both the inherent difficulties in measuring illicit activities and the frequent lack of interest in quantifying the problem, ITTP currently appears to generate billions of dollars per year in illicit earnings, and an even larger volume of taxes not paid.

Understanding the business model. Profitable smuggling depends on a significant profit margin between cost of acquisition plus cost of doing business (including the likely penalties and probability of apprehension) and the selling price.

Cigarettes are inexpensive to manufacture (1-2 cents per stick) and the market for them is huge; measured in the hundreds of billions of dollars and over a billion customers worldwide. Due to high manufacturer margins and high taxes licit products sell at a huge multiple of manufacturing costs, creating the enormous profit potential for illicit products. Effective interventions need to focus on changing the business viability of this trade.

Within OSCE countries the business conditions for this illicit trade can be particularly favorable. Cigarettes can relatively easily enter the illicit category; the costs and overall risks of the trade are often manageable and there is a very large and high-price market easily accessible in the European Union.

Changing the business viability. Measures such as impediments to acquiring manufacturing machinery and supplies can raise the price of manufacturing illicit cigarettes. As will measures

that constrain the supply of untaxed cigarettes, such as the agreements the European Union reached with international tobacco companies as a result of civil RICO actions launched in the United States.

Measures that increase the likelihood of apprehension, such as effective product track and trace technology, cooperation with businesses harmed by ITTP and greater resources for enforcement can combine with significant penalties to raise the cost of engaging in the business.

Finally, reducing the potential selling price of illicit cigarettes further constrains the viability of the contraband business.

Working with consumers rather than against them. Too many efforts to counter illicit trade see the consumers of these products simply as part of the problem. There is much to be gained by working with them.

Most smokers wish not to be smoking, but are held in the market by issues that include addiction, self-medication and a lack of knowledge and availability of viable alternatives. The lack of alternatives to cigarettes for dependent smokers creates the basis for the lucrative market for illicit products. This makes illicit cigarettes different than most consumer products with an illicit market in that the purchasers express a strong desire to stop using the product in question. That in turn gives a huge opportunity to those seeking to reduce the illicit demand.

The enormous harm to health from cigarettes is caused not from the nicotine nor the tobacco, but from the inhalation of the products of combustion. Thus, if we did far more to facilitate access to, and provide non-misleading information about, non-combustion alternatives to cigarettes we could give the consumers of illicit cigarettes a far better alternative. Such products already exist in the form of smokeless tobacco, medicinal nicotine, vaping and heat-not-burn products, with tremendous scope for ever better alternatives. Given the ability to use policy measures to set relative taxation, marketing, product standards, etc. the licit products that are massively less dangerous could be facilitated to out-compete illicit cigarettes, driving them from the market. We are already witnessing this in many markets where vaping is displacing contraband cigarettes.

By combining these efforts to raise the cost of acquiring and dealing in the ITTP category, and facilitating market forces in replacing the consumer market for such goods, we can more effectively control the ITTP market. We can do it in a way that respects consumer rights, the rule of law and the power of market forces while stemming criminality and greatly improving health.

Concrete steps include:

- 1) **Greater resources to monitor and control ITTP within the United States.**

- 2) **The use of existing laws, including RICO actions, to battle illicit trade. For European and Eurasian countries, action by the US to ensure that foreign governments can access RICO remedies for loss of revenue to international criminals, and stronger efforts to prevent money laundering through the US, would be major positive steps.**
- 3) **Greater resource allocation to battling ITTP globally. Such law enforcement can be expected to more than pay for itself while combatting crime and protecting health.**
- 4) **Differentiate taxation so that licit non-combustion alternatives to cigarettes are both a better health and better economic choice than illicit cigarettes. Currently US funded anti-tobacco groups are doing the opposite – campaigning globally for measures that discourage smokers from switching to less hazardous products, thus making illicit cigarettes a more likely option for the nicotine dependent.**
- 5) **Far greater access to reduced risk products that are a viable alternative to cigarettes. The FDA should be facilitating rather than constraining the entrance of such products onto the market, and sharing the resulting expertise globally.**
- 6) **National and international efforts to adequately inform smokers of the range of low risk alternatives to cigarettes and the differentials in risk compared to smoking cigarettes. The CDC could move from an abstinence-only ‘tobacco free world’ orientation to one focused on reducing both health risks and illegality.**