

PERSONALLY SPEAKING

Number 12

June 2005

COUNTERFEIT AND BOOTLEG CIGARETTES

Edward J. O'Boyle, Ph.D.

Mayo Research Institute

In deciding whether to support Governor Blanco's proposed \$1 increase in the Louisiana tax on a pack of cigarettes readers of the *NewsStar* should take into account two problems that were not addressed in Wiley Hilburn's column in last Sunday's paper. First, there is a serious world-wide problem of counterfeit and bootleg cigarettes. Second, there is a related problem in the United States of counterfeit state tax stamps. Some background information is instructive.

Nearly seven million metric tons of tobacco, valued at approximately \$20 billion, are grown annually around the world. More than five trillion cigarettes are manufactured every year, principally in Brazil, China, India, Turkey, and the United States. Hundreds of chemicals are used in the production of cigarettes to make the smoke easier to inhale and to reduce the amount of tobacco in each cigarette. Today manufacturers are using more reconstituted tobacco because it is easier to add chemicals and to include leaf stems and dust that in the past had been discarded.

On a global basis, tobacco kills almost five million persons every year. If consumption continues to increase the annual death toll is estimated to reach 8.4 million by 2020, with more than 70 percent of those deaths in developing countries [WHO 2003, pp.102, WHO 2002, p.1].

Counterfeit cigarettes are manufactured in several different countries including Indonesia, Vietnam, Russia, Philippines, and United Arab Emirates. China is considered the primary source of counterfeit cigarettes [JTI, p.1-2; BBC, p.2]. In London, counterfeit cigarettes are known to contain more tar, nicotine, and carbon monoxide than standard cigarettes and are being bought by 10-to-14-year olds because they are cheaper [BBC, pp.1-2].

In addition to counterfeit cigarettes there are two other types of contraband cigarettes: unaccounted exports and bootleg cigarettes. There are no official data on the volume of contraband cigarettes worldwide and therefore the only figures available are at best estimates. Unaccounted exports are exports which are not recorded as imports and are presumed to be smuggled. In 2001 unaccounted exports represent perhaps as much as three percent of world cigarette production [JTI, pp.1-2].

Bootlegging increasingly is directed by terrorist organizations and organized crime elements and is difficult to control [JTI, p.1; U.S. Senate, p.1]. It occurs when large quantities of cigarettes are purchased in a low-tax jurisdiction and shipped to a high-tax

jurisdiction for resale, allowing the bootlegger to appropriate the difference. In California in 2002, the state tax on a pack of cigarettes was \$.87; in the neighboring state of Nevada, the tax was \$.35 [State Board, p.7]. On a million packs, the bootlegger incentive is \$520,000.

Counterfeiting also involves counterfeit cigarette tax stamps and directly impacts the revenues the state expects to generate from the higher tax on cigarettes and in turn on the adequacy of this revenue stream to support higher teacher salaries in Louisiana.

The higher taxes that have been imposed on retail cigarettes in order to discourage cigarette smoking have opened the doors to bootleggers and counterfeiters. And even though no reliable information on the extent of global counterfeiting is available, it is clear from the number of customs seizures in different countries and the volume of seized counterfeit cigarettes that this is a growing and lucrative international trade.

Increasing the Louisiana tax on cigarettes makes it more profitable for undesirables to operate in State and introduces the additional hazard to smokers of counterfeit cigarettes that likely are even more toxic than standard cigarettes. In the extreme, higher cigarette taxes can indirectly supply additional funds to drive terrorist organizations. In deciding to support the Governor Blanco's proposal, be wary of the law of unintended consequences.

References

- BBC News. "Warning Over Fake Cigarettes," July 11, 2002, <<http://news.bbc.co.uk/1/hi/england/2123054.stm>> (December 2003).
- JTI. "Facts & Figures About Contraband," <http://www.jti.com/english/corp_responsibility/anti_contraband/facts_and_figures_about_contraband.as...> (December 2003).
- State (California) Board of Equalization. "State Legislative Bill Analysis: SB 1849," August 2002, draft document.
- United States Senate. "Kohl, Hatch Introduce Bill to Halt Contraband Cigarette Trafficking Linked to Terrorist Funding," June 3, 2003 <<http://www.senate.gov/~kohl/press/060303.html>> (December 2003).
- World Health Organization 2002. "Illicit Tobacco Trade Contributes to Global Disease Burden," Press Release/WHO 62, New York: July 4, 2002.
- World Health Organization 2003. "Tobacco: The World Health Organization's Response" <http://www.who.int/whr/media_centre/factsheet2/en/print.html> (December 2003).

Edward J. O'Boyle is Senior Research Associate with Mayo Research Institute. Since he completed his doctorate in economics from Saint Louis University in 1972, Dr. O'Boyle has been specializing in economic research and analysis increasingly from the perspective of the human person engaged in everyday activities both as a unique individual and as a community member. In January 2004 the Association for Social Economics conferred on Dr. O'Boyle its prestigious Thomas Divine Award for lifetime contributions to social economics and the social economy.
