

CONFRONTING ILLICIT TOBACCO TRADE:



WORLD BANK GROUP

A GLOBAL REVIEW OF COUNTRY EXPERIENCES

CHILE: TACKLING THE ILLICIT TOBACCO TRADE

TECHNICAL REPORT OF THE WORLD BANK GROUP
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CHILE

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Tackling the Illicit Tobacco Trade

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Chapter Summary

Although smoking prevalence in Chile has reduced over the past decade, consumption of tobacco products remains very high. Chile's tobacco taxation levels have been increasing since 2010 and currently represent about 70-75 percent of the price of the most sold brand. Cigarette real prices have been increasing well above such tax increases. Data on cigarette tax-paying sales over this period confirm that, as cigarette price increased, sales of cigarettes decreased. A recent survey in the metropolitan area of Santiago found that the prevalence of illicit cigarette among smokers was 10.9 percent, in contrast to industry estimates of 24 percent.

Chile ratified the WHO's FCTC in June 2005. Although Chile has not ratified the Protocol to Eliminate Illicit Trade in Tobacco Products, it soon plans to implement Track and Trace systems, which would give the Inland Revenue Service a rapid means of distinguishing illicit cigarette packs. In addition to this forthcoming system, it is recommended that Chile implements a comprehensive, integral policy to curb illicit trade, including the ratification of the Protocol and coordination with neighboring countries on tobacco illicit trade.

There is also an urgent need to produce independent information on the extent of tobacco illicit trade, its characteristics and its implications on Chile's internal tobacco market. It is also

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recommended that penalties for the illicit trade of tobacco products be increased, in parallel with greater enforcement of these measures. Other suggested steps include adopting stronger measures to address the entry of tobacco products via the duty-free zone of Iquique (close to the Bolivian and Peruvian borders), and greater controls on Chile's sizable duty-free allowances, which include no limitations on the number of trips per day (or month).

1. Tobacco Consumption and Regulation

Consumption of Tobacco

The average per capita consumption of tobacco products in Chile is among the highest in the world. This health epidemic has a high toll in human lives and economic resources. Tobacco is directly responsible for more than 16,000 annual deaths in Chile, equivalent to more than 18 percent of all deaths (Pichón-Riviere et al. 2014). Treating tobacco-related diseases implies a financial burden on the health system of more than Ch\$1 trillion (roughly US\$1.8 billion). Tobacco consumption also accounts for at least 285,000 lost disability-adjusted life years, 19 percent of the annual total.² Studies in numerous countries show that, among people who die in middle age (ages 30–69), smokers die an average of 10 years earlier, while, overall, smokers lose an average of 20 years of life with respect to nonsmokers (Jha and Peto 2014).

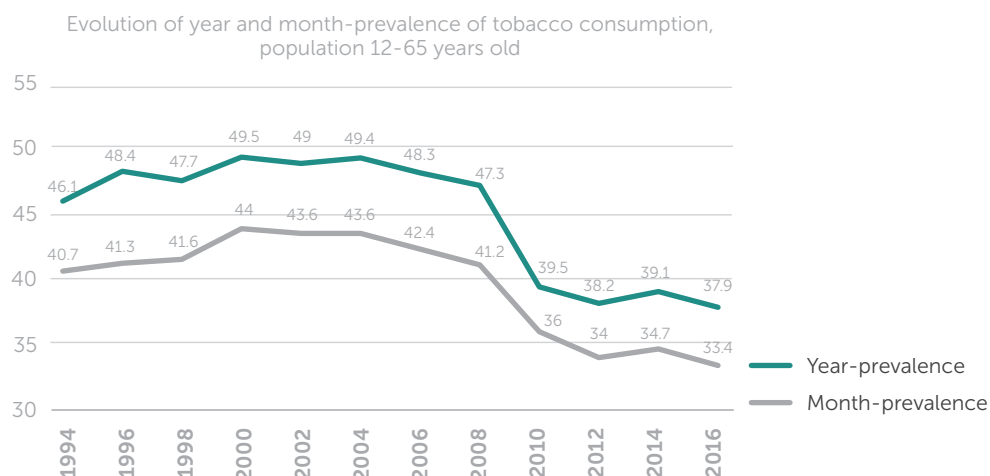
Until 2006, the share of the population aged 12–65 who reported they had smoked during the previous year was high and stable, at around 48 percent (Figure 1). The share among this age-group who reported they had smoked during the previous month was also high and stable, at around 43 percent. Consumption was concentrated in manufactured cigarettes, more than 90 percent of total consumption; the rest represented roll-your-own tobacco.³ After 2006, trends in both past-month and past-year smoking showed a clear declining trend, though the trends seemed to have stabilized since 2012. Past-year prevalence had fallen to 38 percent by 2016 (a decrease of 10 percentage points in 10 years). Past-month prevalence had fallen to 33 percent, also a decrease of 10 percentage points in a decade.

The progress in the reduction of tobacco use has been substantial, but the current levels of use are still elevated among high-income countries, a category Chile joined about a half-decade ago, but also among the countries in the region. Chile is only second to Bolivia in the Americas in smoking prevalence, more than twice the regional average and well above the global average (Table 1).

² See GBD Results Tool (database), Global Burden of Disease Study 2016, Global Health Data Exchange, Institute for Health Metrics and Evaluation, Seattle, <http://ghdx.healthdata.org/gbd-results-tool>.

³ See Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

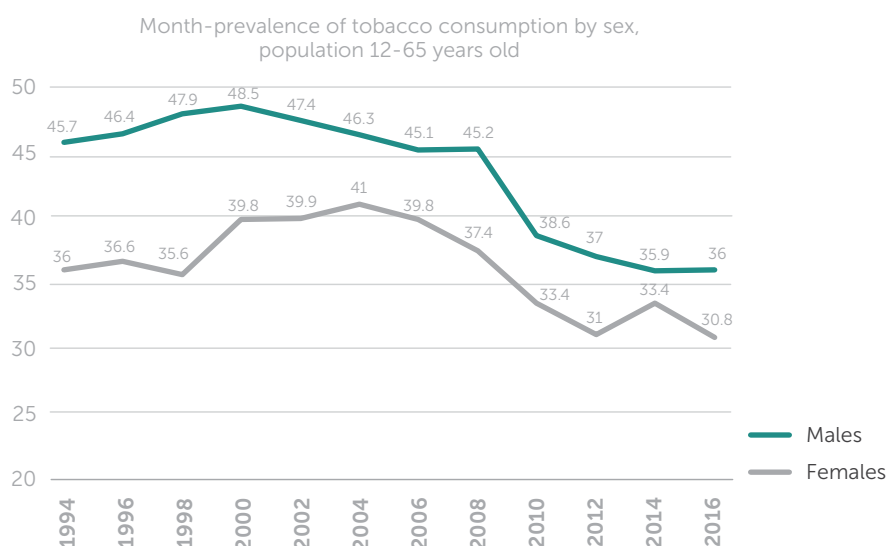
Figure 1. Trends in the Prevalence of Tobacco Consumption, Ages 12–65, Chile, 1994–2015



Source: Calculations based on Use of Drugs in General Population Surveys in Chile; see Observatorio Chileno de Drogas 2017.

Note: Month-prevalence refers to the share of the age-group that reported they had smoked during the previous month. Year-prevalence is the corresponding share with reference to the previous year.

Figure 2. Past-Month Tobacco Consumption, by Sex, Ages 12–65, Chile, 1994–2015



Source: Calculations based on Use of Drugs in General Population Surveys in Chile; see Observatorio Chileno de Drogas 2017.

Table 1. Age-Standardized Smoking Prevalence, Ages 15 and Over, Americas, Circa 2016

COUNTRY	VALUE
Bolivia (Plurinational State of)	38.9
Chile	37.9
Cuba	35.2
Suriname	25.2
Argentina	22.0
United States of America	21.9
Jamaica	17.0
Uruguay	17.0
Canada	14.3
Mexico	14.2
Brazil	14.0
Dominican Republic	13.8
Paraguay	13.3
Haiti	13.0
Costa Rica	11.9
Bahamas	11.8
El Salvador	10.7
Colombia	9.1
Barbados	8.2
Saint Kitts and Nevis	8.0
Ecuador	7.2
Panama	6.2
Regional average	16.9
Global average	21.9

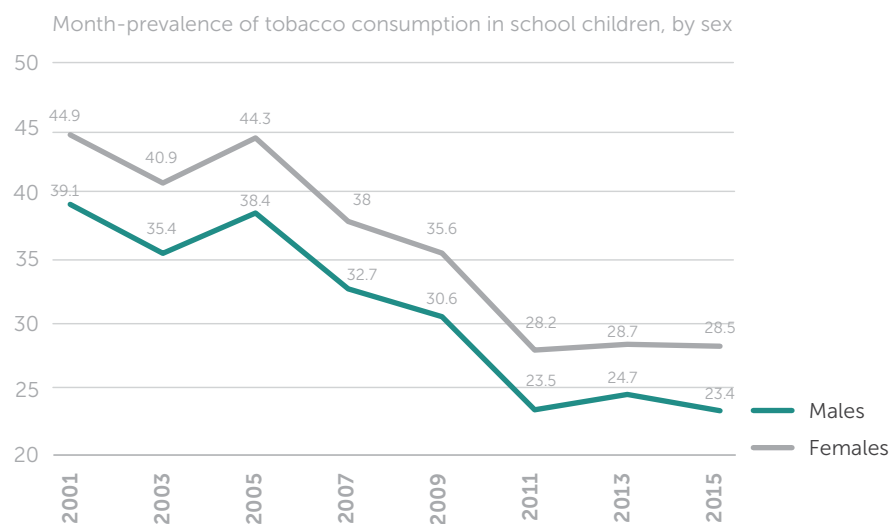
Source: Calculations based on data of "Maternal Mortality Country Profiles," GHO (Global Health Observatory) (database), World Health Organization, Geneva, http://www.who.int/gho/maternal_health/countries/en/.

One of the more striking characteristics in the Chilean case is the high prevalence of smoking among women, the highest in the region (Drope and Schluger 2018). Currently at 31 percent, the rate shows the same trend as the prevalence among men, that is, high and stable until 2006 and then declining. The gap in smoking between the sexes has decreased considerably (Figure 2).

No single explanation exists for the high prevalence of smoking among women. The reasons often given are linked to women's empowerment, such as greater female participation in the labor market—still one of the lowest such participation rates in the region—and the associated rise in disposable incomes. However, no study has yet been conducted to probe this issue.

The high smoking prevalence is even more striking among young women. Data on smoking among children ages 12–17 indicate that, although rates have been decreasing since 2005, the past-month prevalence of smoking is consistently greater among girls than among boys (Figure 3). In 2015, the prevalence was 28.5 percent versus 23.4 percent, respectively. This pattern of consumption is rare in developing or developed countries (Drope and Schluger 2018).

Figure 3. Past-Month Tobacco Consumption, by Sex, Ages 12–17, Chile, 2001–15

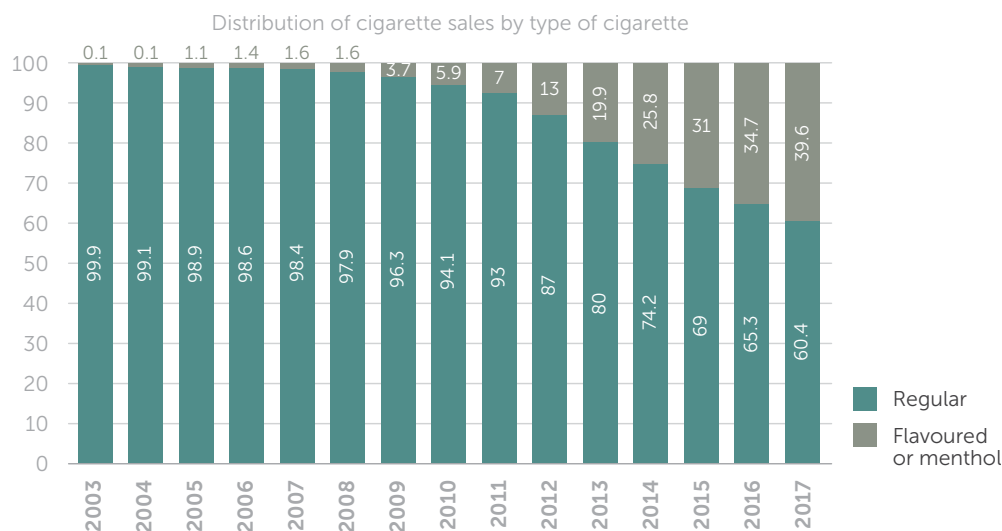


Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

This pattern of consumption has likewise not been thoroughly studied, and there are no clear explanations. One possible contributory factor might be the introduction of products that are targeted mostly at young women, such as flavored and scented cigarettes. These products represented only 6 percent of the cigarette market in 2010, but account for almost 40 percent today (Figure 4). A recent study finds that the consumption of flavored cigarettes is inversely associated with age and significantly more likely among women, even if the prices of these products are substantially higher than the prices of more standard products (Paraje and Araya 2017).

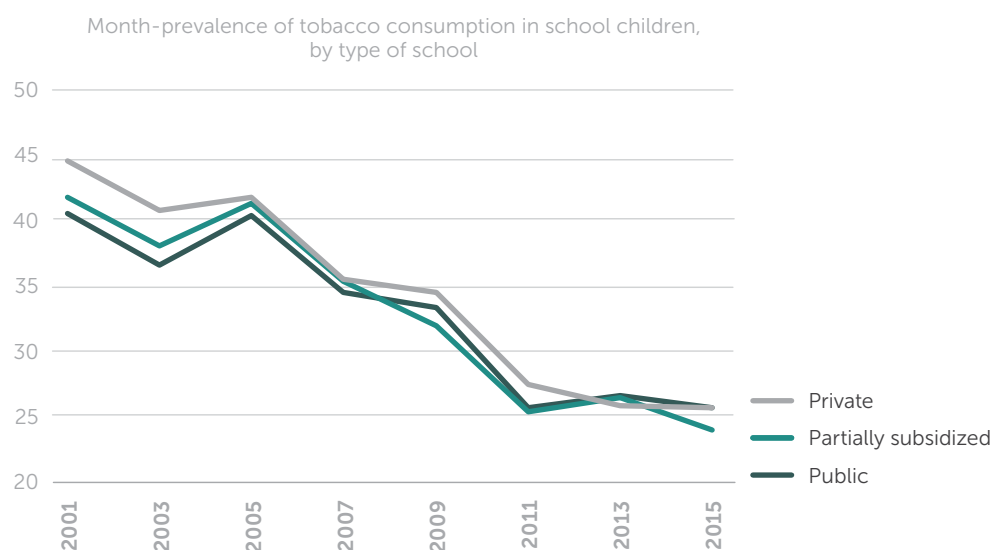
The fact that the market share of flavored cigarettes has been expanding rapidly despite the relatively higher prices also points to a singular feature of the Chilean market: smoking prevalence is at least as considerable among better-off groups as among the less well off. This can be investigated through smoking among school-age children, for example. In Chile,

Figure 4. Distribution of Cigarette Sales, by Type of Cigarette, Chile, 2003–17



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Figure 5. Past-Month Tobacco Consumption, by School Type, Ages 12–17, Chile, 2001–15



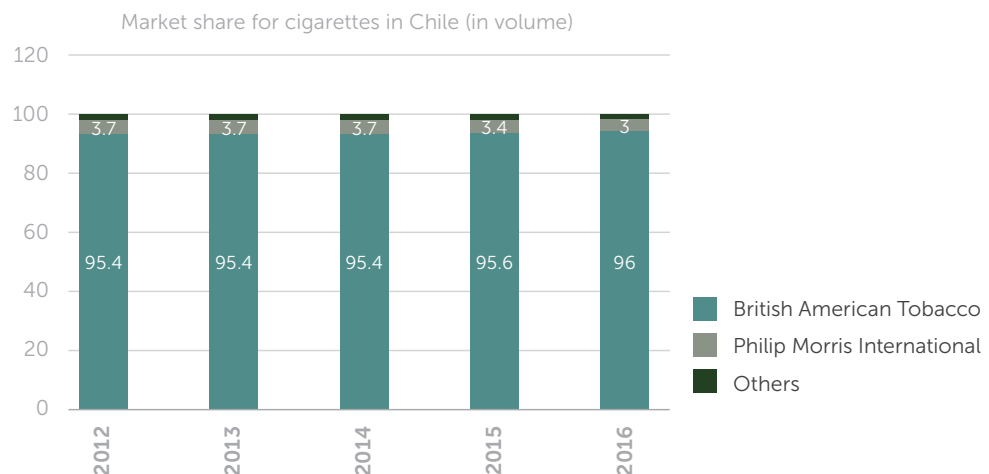
Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

socioeconomic status can be approximated by the type of school attended. Students at public schools are typically from low- and lower-middle income households, while students at partially subsidized schools are often from middle-income households, and students at private schools are usually from high-income households. During most years in 2001–15, smoking prevalence among children ages 12–17 at private schools was as high as or higher than the rates among the corresponding children in public schools (Figure 5). This is different from the situation in, for instance, neighboring Argentina, which is at a similar per capita income, or in the United Kingdom, where children from less affluent backgrounds exhibit higher smoking rates (Linetzky et al. 2012; Taylor-Robinson et al. 2017).

Market Structure

The only sources of information on the market structure of tobacco products in Chile are international consulting firms. One such firm is Euromonitor International, which provides a detailed account of the market structure among companies selling taxed cigarettes in Chile (Figure 6). This market is completely dominated by British American Tobacco (BAT), which enjoys a market share that is above 95 percent by volume. The second most important player is Philip Morris International, with no more than 4 percent of the taxed market, while the rest is distributed among minuscule players.

Figure 6. Cigarette Market Shares, by Volume, Chile, 2012–16

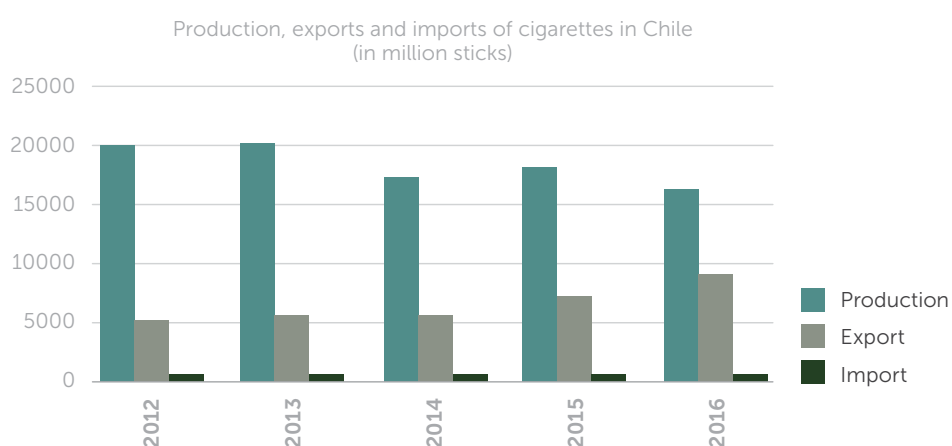


Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

BAT Chile produces for the internal market and also exports more than half of its domestic production. It shows a clear trend of shrinking production and expanding exports, which represented only 25 percent of total production in 2012 (Figure 7). In 2015, BAT Chile exported cigarettes to 17 countries, including Argentina, Colombia, Peru, the United States, Uruguay, and República Bolivariana de Venezuela.

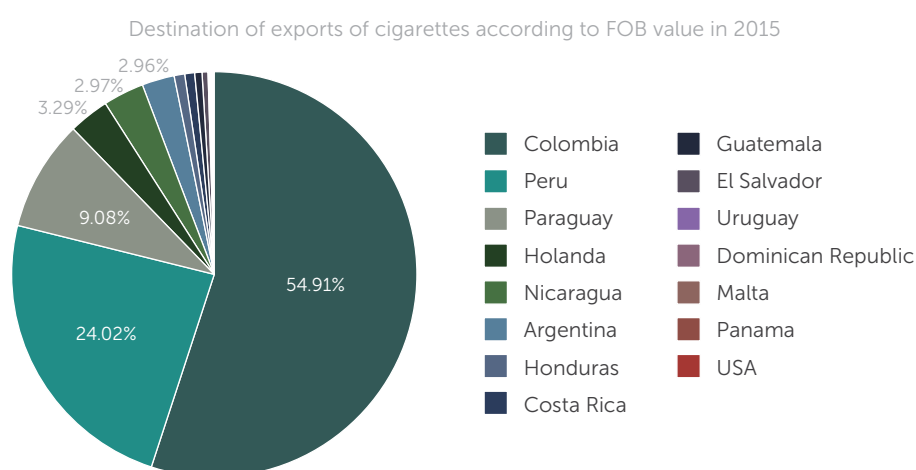
“All of the company’s cigarettes that are sold in duty-free outlets in Latin America and the majority of its cigarettes sold in duty-free outlets in Europe are produced in Chile,” affirms Euromonitor International.⁴

Figure 7. Production, Exports, and Imports, Cigarettes, Chile, 2012–16



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Figure 8. Export Destinations, Cigarettes, by Free on Board Value, Chile, 2015



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

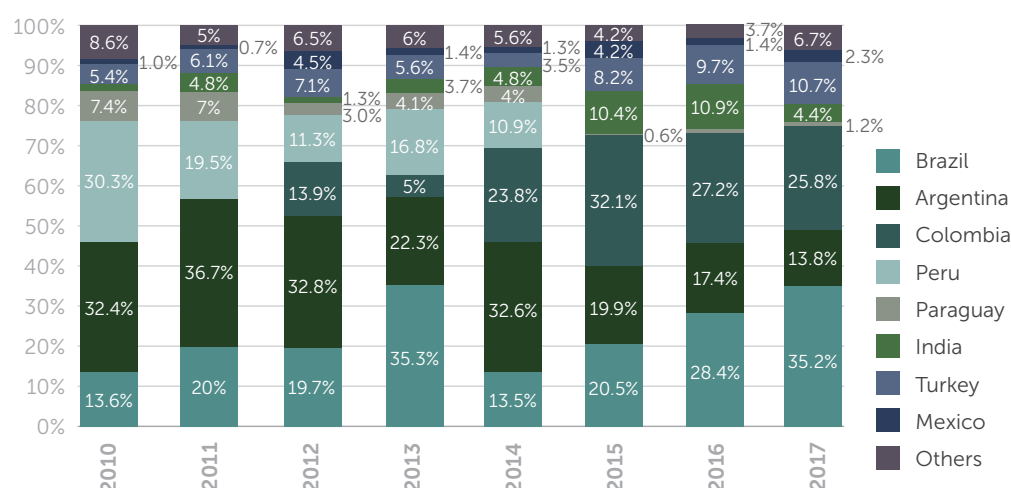
⁴ See “British American Tobacco Chile SA,” Tobacco (Chile), Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

Among the main destinations in 2015, more than half the cigarette exports of Chile went to Colombia, while almost a quarter went to Peru (Figure 8). More than 95 percent of total exports went to only five countries, including Paraguay, which produces sufficient tobacco to supply its own domestic market and which is often indicated as a source of illegal cigarettes. All the exports are produced by BAT Chile.

In 2015, almost 84 percent of all imported cigarettes, including cost, insurance, and freight documentation, were imported by Philip Morris International, presumably to supply the internal market, of which Philip Morris International accounts for only 4 percent, while 16 percent were imported by BAT.

Several countries account for the imports of tobacco products, of which cigarettes represent an average of about 30 percent. More than 90 percent of annual imports are provided by eight countries, most of them within Latin America (Figure 9). Argentina and Brazil have traditionally been the main sources. Both countries are among the top 19 growers of tobacco, with no less than 40 percent of total imports into Chile in 2015 and a peak of 58 percent in 2013. Among the other countries, there has been a visible change in the share of imports. For instance, Peru was an important exporter to Chile until 2014 (an average import share of 18 percent), but its share in imports fell to almost zero beginning in 2014. Meanwhile, imports from Colombia started expanding rapidly in 2014. Countries outside the region, such as India and Turkey, have raised their shares recently, especially after 2014. There is no obvious explanation for any of these changes.

Figure 9. Imports of Tobacco Products, by Country of Origin, Chile, 2010–17

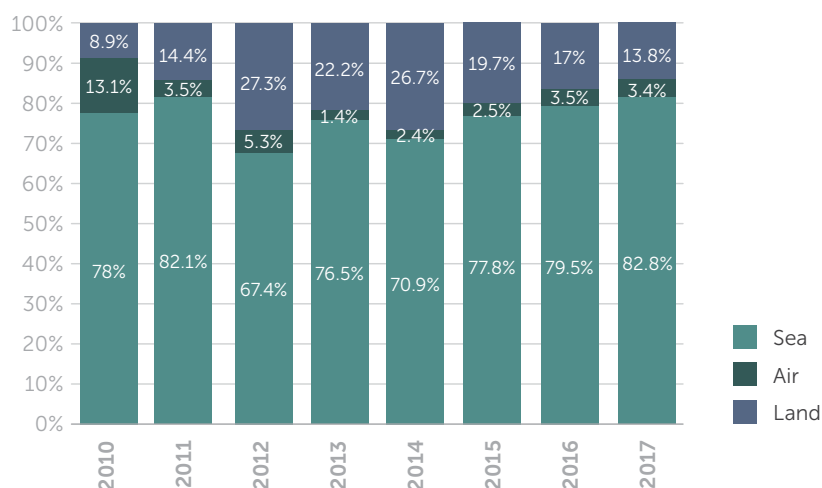


Source: Calculations based on data of the National Customs Service.

Notes: Import valuation includes cost, insurance, and freight.

In the distribution of imports of tobacco products by means of transport, sea transport is by far the most important, representing from around 65 percent to 83 percent of all imports by

Figure 10. Imports of Tobacco Products, by Means of Transport, Chile, 2010–17



Source: Calculations based on data of National Customs Service.

Notes: Import valuation includes cost, insurance, and freight.

value (Figure 10). Land transport, mostly from Argentina, Brazil, and Paraguay, accounted for between 9 percent and 27 percent of imports by value.

Regulatory Context

Chile signed the Framework Convention on Tobacco Control (FCTC) of the World Health Organization (WHO) in September 2003 and ratified it in June 2005. The ratification of the FCTC implied a clear change in the regulation of tobacco products in the country.

The earliest legislation on tobacco products dates to Decree-Law 828 in 1974, which lays out the conditions under which tobacco should be grown and commercialized. The legislation assigned the Servicio de Impuestos Internos (Internal Revenue Service, SII) the mandate to monitor and raise revenue on sales of tobacco products. Law 19,419 of October 1995 banned advertising for tobacco products that targets minors (aged under 18), introduced health warnings on cigarette packaging, and prohibited smoking in closed spaces, such as elevators, classrooms, and public offices. In addition, restaurants, hotels, bars, and other such establishments, though they were not required to have them, were to indicate clearly any smoking and nonsmoking areas they might have.

After the ratification of the FCTC, Law 20,105 was enacted in May 2006 to adapt Chilean legislation to certain provisions of the convention. In particular, the law barred all tobacco advertising in the media, including radio, television, and newspapers, except at points of sale, which, moreover, were required to be of a type and dimensions defined by the Ministry of Health. All sales and promotions among minors were forbidden, as was the sale of tobacco products within 100 meters of primary and secondary schools. The sale of cigarettes in

packs of fewer than 10 cigarettes or of loose cigarettes was also prohibited. The Ministry of Health designed health warnings that were required to cover at least 50 percent of cigarette packs. The law likewise forbade the use of terms such as light, soft, and low tar on tobacco packaging. The law tightened regulations on smoking in educational institutions, public buildings, buses, airports, and so on. Public places such as restaurants, casinos, and bars were now required to provide separate areas for smokers.

Law 20,660 of February 2014 prohibits tobacco advertising targeted indirectly at children, such as the exhibition of smoking on television during hours when children's programs are being aired. The law also extends the definition of nonsmoking area to cover, for instance, patios with temporary roofs and similar structures, and it forbids smoking in any closed area, including those that would have been allowed as designated smoking areas under the previous law. The new law requires tobacco companies to issue public notification of any expenditures by agreement with other public or private companies. Tobacco companies must likewise provide detailed information about meetings and activities of any kind with public officials.

Parliament is considering a modification of the new law that would completely ban additives, such as menthol, chocolate, vanilla, and so on, prohibit advertising at the point of sale, impose a health warning that would cover 100 percent of the cigarette pack, and ban smoking in locations in which children are likely to be present, such as public parks and beaches. The new initiative has already been approved by the Senate. Though the Lower Chamber has been delaying debate, and the government has not introduced the legislation as a priority, the Health Commission of the Lower Chamber has unanimously recommended that the bill be taken up.

Licensing

Two government entities are charged with authorizing the sale of tobacco products for the domestic market. The first is the Ministry of Health, which must be informed by tobacco producers (or importers) about the components and additives included in tobacco products to be sold on the domestic market. The producers and importers must notify the ministry about the quantity and quality of ingredients and substances used in the treatment of tobacco products (Law 20,660). In practice, the Division of Healthy Public Policies and Health Promotion of the Ministry of Health is the licensing authority for tobacco products.

The second government entity that authorizes the sale of tobacco products is the SII, which collects tobacco tax revenue. Producers and importers of tobacco products must register with the SII to be able to sell their products in the domestic market (Decree Law 828 of 1974). Though tobacco growers do not have to pay the taxes on tobacco, they must supply regular information on planted area and harvests.

Because tobacco taxes are paid to the SII directly by the tobacco producers or importers, there is no licensing requirement among retailers.

Taxes on Tobacco Products

Tobacco taxes have been collected in Chile at least since 1974, when an ad valorem tax was imposed on packs of cigarettes (at a rate of 57 percent), cigars (40 percent), and loose tobacco (40 percent). The tax base was the retail price, including the tax. In practice, this means that tobacco companies have to notify the SII on the prices at which they will sell tobacco products to final consumers and that these prices will be the same throughout the country. The rates were subsequently changed frequently (Table 2). The change in the rate in 1998 was the last one before the ratification of the FCTC. It was also the first under a democratic government and therefore had to be approved by Parliament. The previous rates had been fixed under the dictatorship of Pinochet.

Table 2. Ad Valorem Tax Rates on Tobacco, Chile, 1974–2014

Percentage of retail price, plus the tax

YEAR	CIGARETTES, PER PACK OF 20	CIGARS	LOOSE TOBACCO
1974	57.0	40.0	40.0
1975	62.0	40.0	62.0
1977	57.0	40.0	57.0
1978	26.0	42.9	42.9
1982	52.9	26.0	52.9
1995	55.4	46.0	52.9
1998	50.4	51.0	47.9
2010	62.3	52.6	59.7
2012	60.5	52.6	59.7
2014	30.0	52.6	59.7

In 2010, four years after the ratification of the FCTC and with the stated purpose of funding the reconstruction of part of the country that had been devastated by a severe earthquake, Parliament approved an increase in the tobacco tax rate, and, for the first time, introduced a specific tax on individual cigarettes. Such specific taxes are automatically indexed in Chile to the projected monthly inflation rate, which is fixed by the SII. The value of the specific tax was set at 0.0000675 monthly tax units per cigarette, which was Ch\$2.5, around US\$0.005, at the exchange rate at the time.⁵ In 2012, when the tobacco tax was again changed by Parliament, aside from the new tax rate on packs of cigarettes, the specific tax on individual cigarettes was doubled to 0.0001288 monthly tax units, about Ch\$5.1, or US\$0.01. In 2014, though the ad valorem tax on packs of cigarettes was cut appreciably, the specific tax was

⁵ Monthly tax units are units of value defined in real terms for tax purposes. They are changed according to expected inflation, as projected

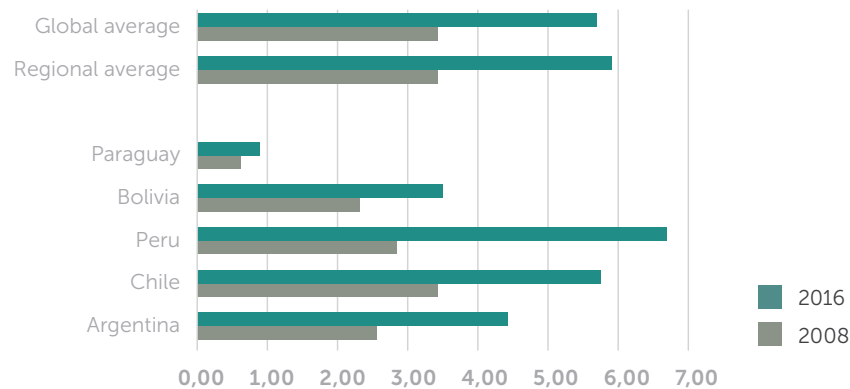
raised by a factor of more than 8, to 0.00103 monthly tax units, about Ch\$43.7, or US\$0.074, the equivalent of US\$1.48 a pack, at the exchange rate at the time.⁶ The reliance on specific rather than value added excises, the increases in real taxes, and the indexation of the taxation to inflation, if not to affordability to take account of increases in per capita income as well, are all consistent with current international best practice distilled by the World Bank (Marquez and Moreno-Dodson 2017).

The price of a pack of 20 cigarettes of the most widely sold brand jumped in real terms in Chile between 2008 and 2016, but not above the average increase in the WHO region of the Americas (Figure 11). Indeed, the price was also similar to the global real price estimated by WHO. Around 2008, the most widely sold brand of cigarettes in Chile was more expensive than the corresponding brands in neighboring countries, plus Paraguay. By 2016, the brand in Chile was the second most expensive behind the top brand in Peru.

While the tax share of the most widely sold brand in Chile was well above the regional and global averages in 2008 and 2016, it never reached the 75 percent threshold suggested by WHO as a minimum tax share for tobacco (Figure 12). Indeed, in both years, the second largest corresponding tax share after Argentina was in Chile, though the real prices in Argentina were lower.

Figure 11. Most Widely Sold Brand, by Price, Chile and Neighbors, 2008 and 2016

U.S. purchasing power parity (PPP) dollars per pack of 20



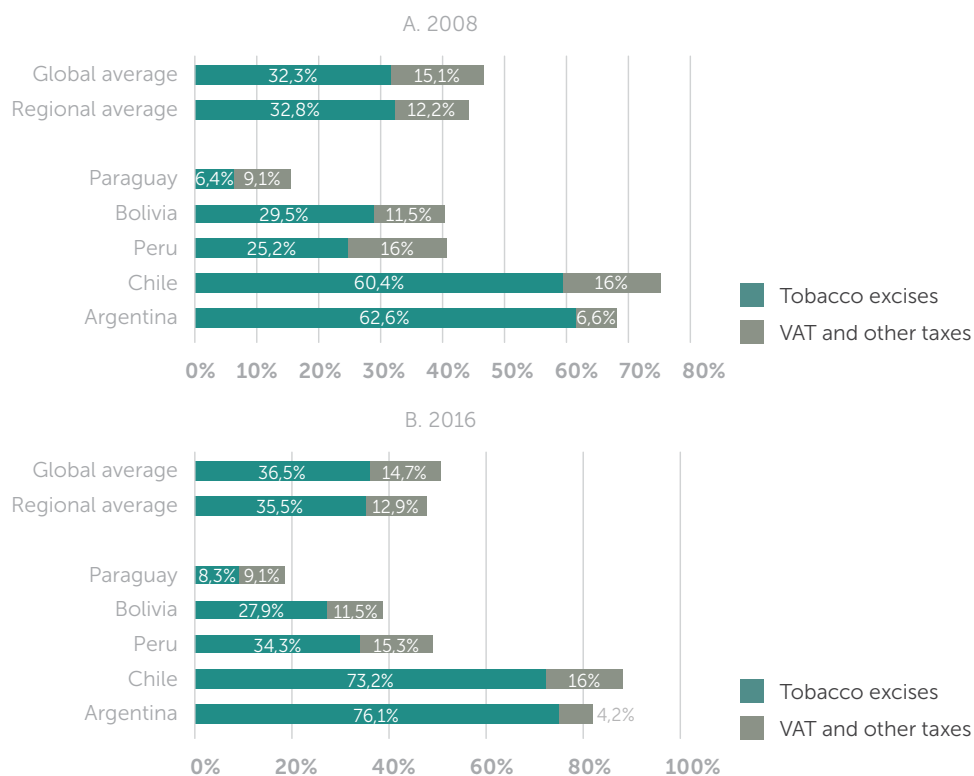
Source: Calculations based on data of TFI (Tobacco Free Initiative) (database): Taxation, World Health Organization, Geneva, <http://www.who.int/tobacco/economics/taxation/en/index1.html>.

Consequences of Regulatory and Tax Changes

Figure 13 depicts the changes in regulations and taxes since 1990, when democracy was restored and Parliament began once more to debate bills. The pace of the changes in regulations and taxes sped up after Chile ratified the FCTC in June 2005. According to

⁶ The value of the monthly tax unit at the time of the tax change was Ch\$42,431.

Figure 12. Most Widely Sold Brand, by Tax Share, Chile and Neighbors, 2008 and 2016



pack of 20, percent

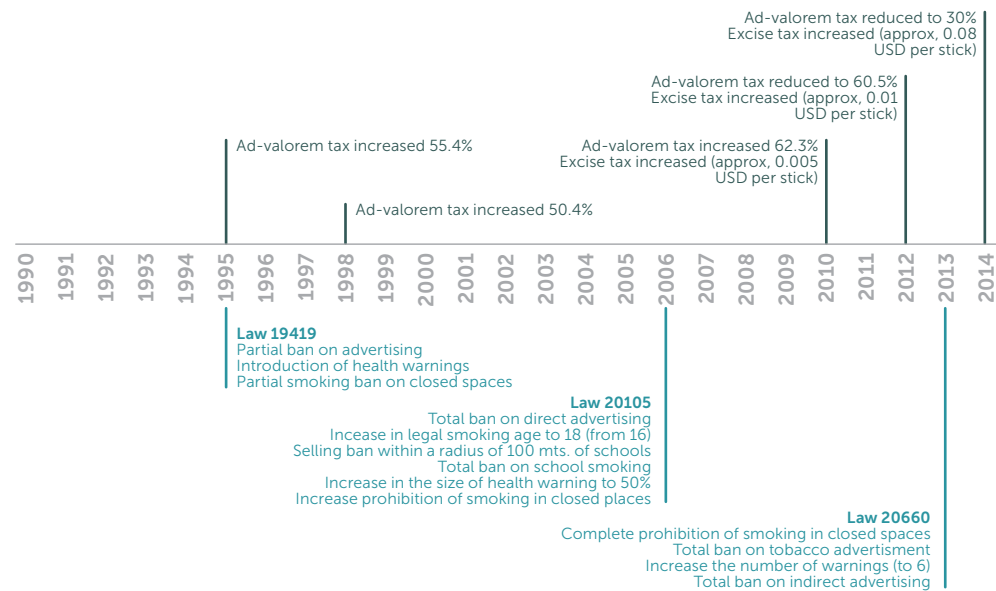
Source: Calculations based on data of TFI (Tobacco Free Initiative) (database): Taxation, World Health Organization, Geneva, <http://www.who.int/tobacco/economics/taxation/en/index1.html>.

WHO, through these changes, the government of Chile is fulfilling most dimensions of the MPOWER measures, except for the O (policies aiding in quitting smoking), on which the country is considered not to have progressed much, and the E (enforcement of bans on tobacco advertising, promotion, and sponsorship), on which it is considered to have achieved intermediate progress, mainly because it has not prohibited advertising at the point of sale (PAHO 2016).⁷

It is clear from Figure 13 that a number of policies were implemented in a short time, which renders an econometric assessment of the impact of these policies almost impossible. At least one study has attempted to measure the effect of the 2006 smoking ban in schools (Feigl et al. 2015). It finds that the ban was effective in reducing smoking prevalence among students, though it did not affect smoking intensity among the smokers. These results must be taken

⁷ MPOWER = M)onitor tobacco use and prevention policies. (P)rotect people from tobacco smoke. (O)ffer help to quit tobacco use. (W)arn about the dangers of tobacco. (E)nforce bans on tobacco advertising, promotion, and sponsorship. (R)aise taxes on tobacco. See TFI (Tobacco Free Initiative) (database): MPOWER, World Health Organization, Geneva, <http://www.who.int/tobacco/mpower/en/>.

Figure 13. Changes in Tobacco Regulation and Taxation, Chile, 1990–2014



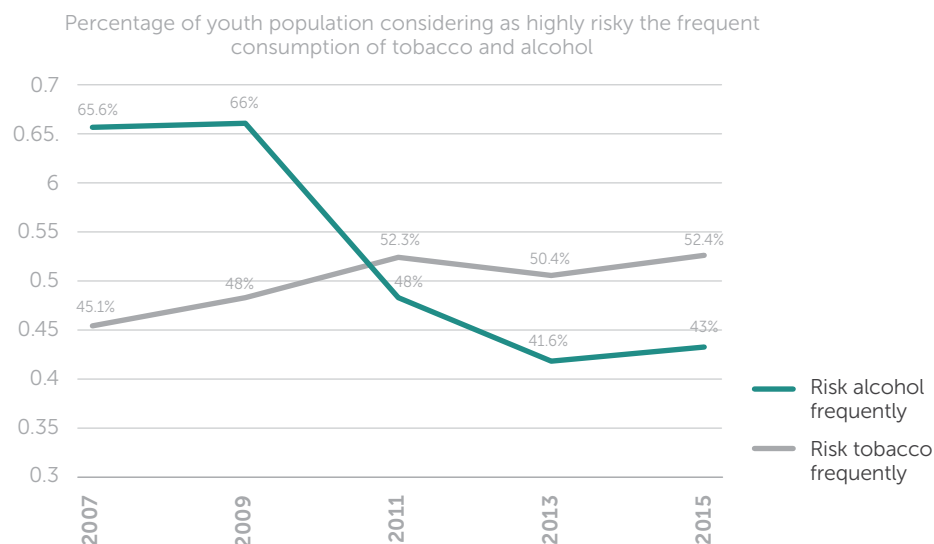
with extreme care, however, because the study does not consider changes in taxes and prices during the period of analysis. It is quite likely that the effect of the ban is overestimated.

There are other, indirect indicators of the effectiveness of these policies on the population, especially youth. One such indicator is the perception that there is a health risk associated with the frequent consumption of certain substances. Figure 14 shows trends in the perceptions among school children of a high risk to health from tobacco and alcohol, the two most frequently consumed harmful substances. It highlights that, while the incidence of the perception that consuming alcohol represents a health risk declined, the corresponding incidence of the perception about tobacco increased by 7 percentage points between 2007 and 2011. The increase has been constant at around 52 percent since then. This is a cause for real concern, given that tobacco kills about half of the confirmed users. Meanwhile, alcohol control policies are mild in Chile; apart from restrictions on sales to minors, there is little regulation.

Figure 15 shows trends in the real price of cigarettes and cigarette affordability. The real price is estimated as the ratio of the cigarette component of the consumer price index and the overall consumer price index. Affordability is the ratio between the general nominal wage index and the cigarette component of the consumer price index. These data are compiled monthly by the National Statistics Institute.

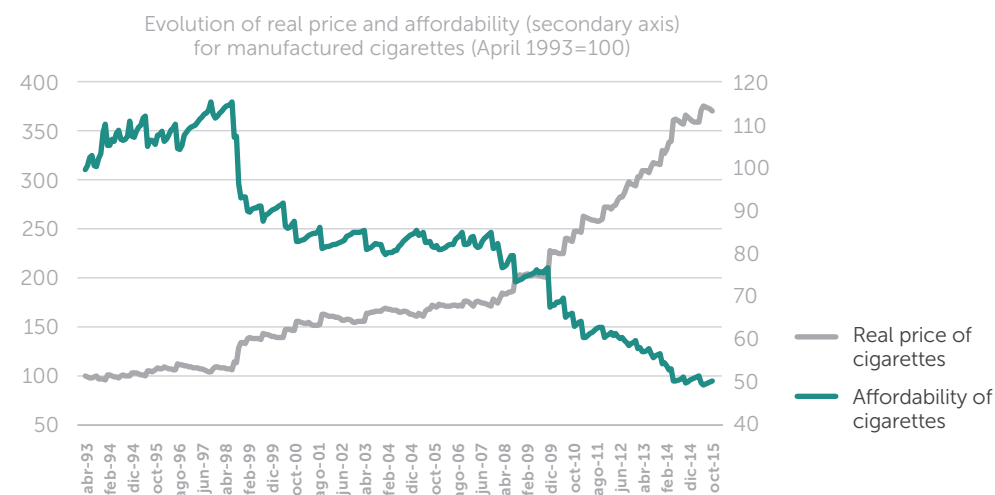
The real price of cigarettes rose by more than 280 percent between April 1993 and December 2017. Attributing this huge increase only to increases in the tobacco tax would be a mistake. Between April 1993 and May 2010, when the first substantial rise in the tobacco

Figure 14. Youth Who Say Use of Tobacco or Alcohol Is Risky, Chile, 2007–15



Source: Calculations based on Use of Drugs in School Children Population Surveys in Chile; see Observatorio Chileno de Drogas 2016.

Figure 15. Price and Affordability, Manufactured Cigarettes, Chile, 1993–2015



April 1993 = 100

Source: Calculations based on data of the National Statistics Institute.

tax in decades was implemented to finance reconstruction in the country, the real price of cigarettes increased by 100 percent. This was entirely the result of a profit-maximization decision by the monopolist producer, BAT Chile, and, during this time, there was no mention by the company of the illicit trade in cigarettes.

Between May 2010 and December 2017, the real price of cigarettes rose by 91 percent. During this time, BAT Chile pointed out repeatedly that the increase in the tobacco tax was responsible for the expansion in the market for contraband cigarettes (BAT Chile 2014). It is untenable to claim that only tax-driven price increases are responsible for contraband, while profit-maximizing price increases bear no responsibility.

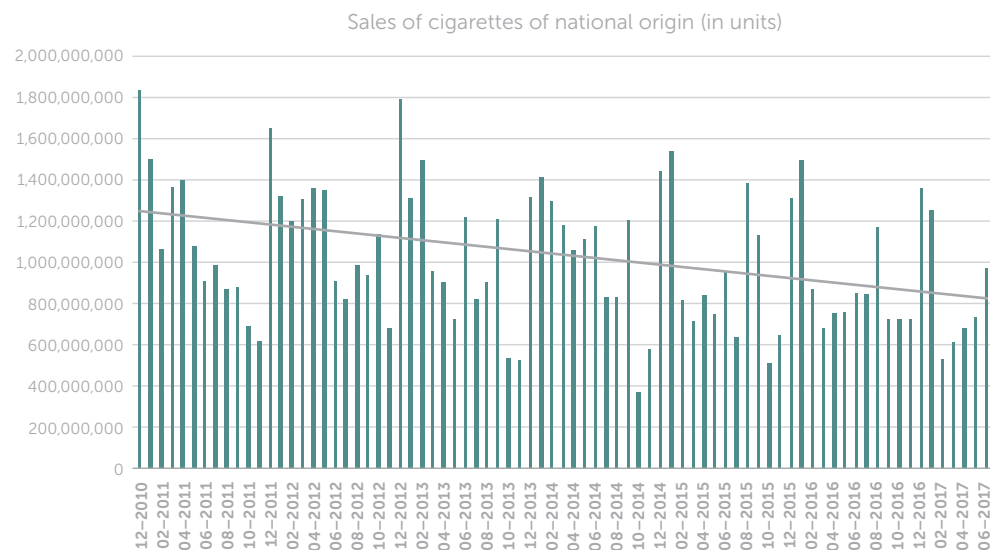
Figure 15 also shows that cigarette affordability decreased steeply during the period, especially beginning in mid-1998 with the onset of the Asian crisis. Thus, affordability fell by 23 percent between April 1993 and May 2010 and by 33 percent from May 2010 to December 2017.

Though no econometric analysis has been conducted on the impact that price changes had on consumption, these changes, plus the changes in regulation, are most likely behind the fall in smoking prevalence among school children and across the general population. Evidence on Latin America shows that a 10 percent rise in prices is associated with a decline in consumption of about 3 percent, which increases to 4 percent over the long run (Guindon, Paraje, and Chaloupka 2015). These results are similar to elasticities reported on Chile, though the study presenting them has econometric limitations (Debrott Sánchez 2006).

Data on cigarette sales that are taxed confirm that, as cigarette prices rise, legal sales of cigarettes decline. Figure 16 shows a clearly declining trend in such sales since the end of 2010. (No government data on cigarette sales existed before then).

Figure 17 shows trends in tobacco tax revenues in real terms in 1993–2017. The figure shows that tobacco tax revenue increased steadily until 2015, but then declined slightly in 2016–17. The rise in the ad valorem tax and the real price of tobacco were behind the increase in revenues (see Figure 15). That revenues fell in 2016–17 is more surprising. This may be attributed

Figure 16. Sales of Cigarettes of National Origin, Units, Chile, 2010–17

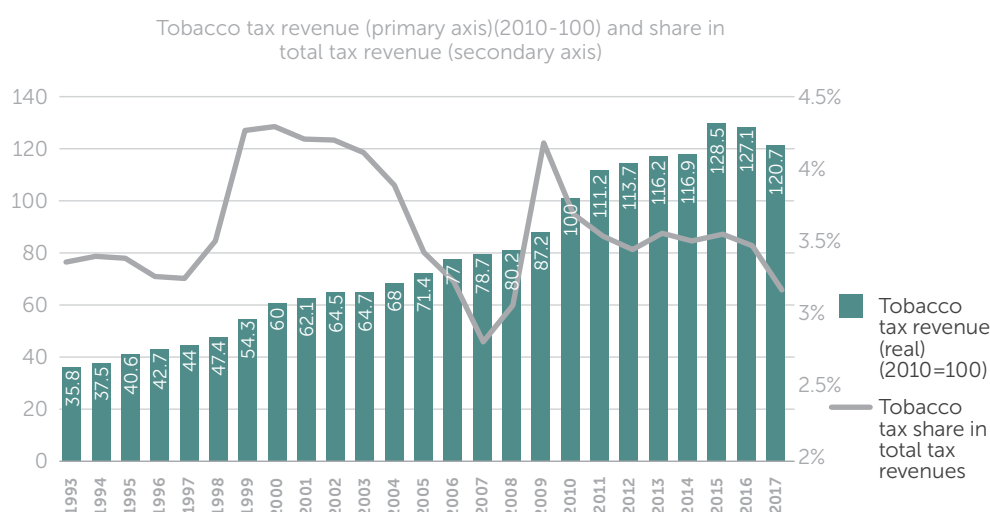


Source: Calculations based on data of the SII.

to shrinkage in cigarette consumption (consistent with the data in Figure 16), to an expansion in the illicit trade in cigarettes, or to a combination of both (see below). It is clear in any case that, despite the decline in legal sales in 2010–17, tobacco tax revenues generally rose.

In terms of relative revenue, Figure 17 shows that, despite recent increases, tobacco taxes have fluctuated between 3 percent and 4 percent of total tax revenue. Even the jump in the specific tax on individual cigarettes in 2014, which implied a nominal price increase of about 15 percent-20 percent, did not alter this pattern.

Figure 17. Share of Tobacco Tax Revenue in Total Taxes, Chile, 1993–2017



Source: Calculations based on data of the SII.

2. The Illicit Trade in Tobacco Products

Context

Chile extends over more than 4,200 kilometers from north to south and shares, with Argentina, one of the longest borders in the world. Nonetheless, the country is relatively isolated by natural barriers. In the east, the Andes, the tallest mountain range in the world outside Asia, covers much of the interior. The west is bounded by the Pacific Ocean. In the north, one of the driest deserts in the world abuts Bolivia and Peru. The south is broken up by numerous lakes and rivers and extends into frigid Antarctica. These natural barriers restrict travel and commerce and mean that the points of entry into the country are relatively few.

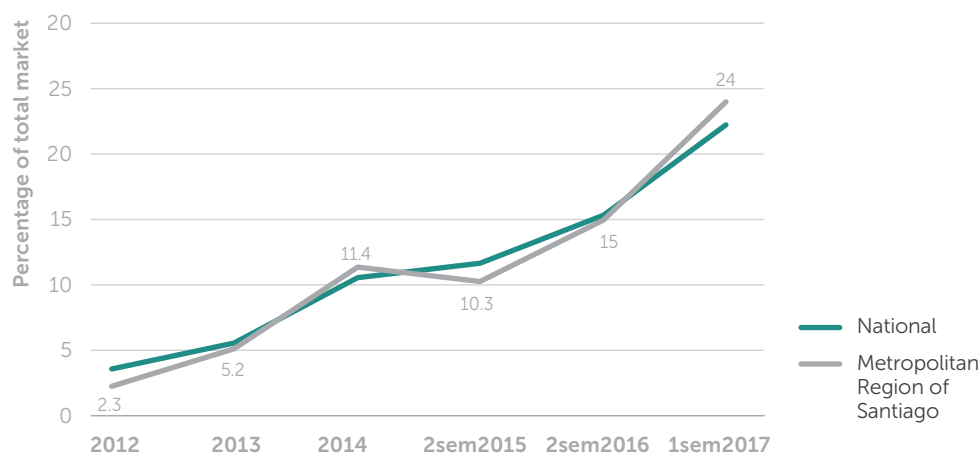
By the nature of the phenomenon, relatively little is known about the illicit trade across the borders of Chile, including the illicit trade in cigarettes, the main tobacco product involved. Until recently, the debate has been dominated by the data produced by the tobacco

industry, especially BAT Chile. BAT Chile has linked a presumably explosive increase in the illicit trade in cigarettes to the rise in the tax on tobacco (see above). Yet, the truly impressive rise in the real price of cigarettes in recent years has been dominated by the decision of BAT Chile to raise its prices, which preceded any appreciable tax increase. As is usual in monopolistic markets, BAT Chile has raised its prices at a pace to outstrip the rise in prices associated with the tax increase. Indeed, the average pass-through of the tax increase was 1.12 between 2010 and 2017 (Delipalla and O'Donnell 2001; Paraje, Araya, and Drope 2018).

According to BAT Chile, the market share of illicit cigarettes expanded by a factor of more than six from 2012 to the first half of 2017, from 3.6 percent to 22.3 percent (Figure 18). BAT Chile claims that, in the Metropolitan Region of Santiago (where about 40 percent of the total population of the country lives), the penetration of the illicit trade in cigarettes grew from 2.3 percent in 2012 to 24.0 percent in the first half of 2017. It also claims that the illicit trade in cigarettes accounts for tax evasion to the tune of US\$500 million a year.⁸

The claim made by BAT Chile that the tax increase is behind the rise in the illicit trade is untenable, because the real price of cigarettes started to climb rapidly at least as early as 1999, almost 10 years before of the main change in the tobacco tax (see Table 2). Despite the obvious inconsistency, the debate in the press has been dominated by the data of BAT Chile, which regularly publishes reports—widely reproduced in the media—about the role

Figure 18. BAT Chile: Penetration of the Illicit Cigarette Trade, Chile, 2012–17



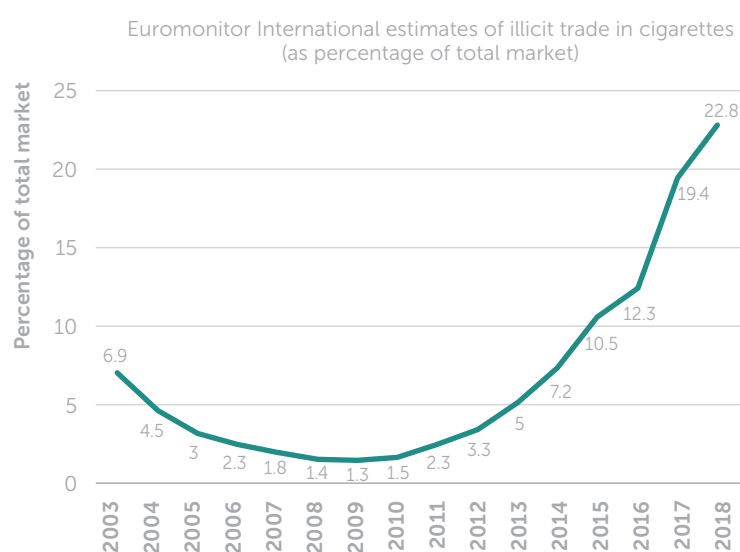
Source: Calculations based on data in “Informes por Industria,” Observatorio de Comercio Ilícito, Cámara Nacional de Comercio, Santiago, Chile. <http://www.observatoriocomercioilicito.cl/estudios/informes-por-industria/#1484577459575-1ef5d87e-6715>.

⁸ See “Informes por Industria,” Observatorio de Comercio Ilícito, Cámara Nacional de Comercio, Santiago, Chile. <http://www.observatoriocomercioilicito.cl/estudios/informes-por-industria/#1484577459575-1ef5d87e-6715>.

of the tax on tobacco in the expansion in the illicit trade.⁹ International consultancy firms also repeat the unfounded claims, which feeds into the debate in the press. The most important example is Euromonitor International, which has produced annual estimates of the penetration of the illicit trade in cigarettes at least since 2003 (Figure 19).¹⁰ According to these estimates, the illicit trade shrank from 6.9 percent to 1.3 percent of the total market in 2003–09 before expanding to 19.4 percent in 2017 and a projected 22.8 percent in 2018.

Euromonitor International explicitly states that “successive increases in tobacco tax, and the resultant increases in the price of cigarettes, remain the main drivers of growth in the illicit trade in cigarettes in Chile.”¹¹ However, between 2003 and 2010, the real price of cigarettes jumped by 43 percent, while affordability declined by 18 percent. Yet, Euromonitor International claims that the illicit trade shrank at this time. This type of inconsistency and the fact that Euromonitor International explicitly acknowledges that its main source of information is the tobacco industry means that Euromonitor International is not a neutral, credible analyst of illicit trade; this is also demonstrated in the case of other countries (Blecher et al. 2015).

Figure 19. Euromonitor International: Illicit Trade in Cigarettes, Chile, 2003–18



Source: Calculations based on data of Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

⁹ See Pérez-Cueto (2017); “Aumenta contrabando de cigarros en nuestro país,” 24horas.cl (November 8, 2013), <http://www.24horas.cl/nacional/aumenta-contrabando-de-cigarros-en-nuestro-pais-927199>; “Comercio ilegal de cigarrillos en Chile creció un 386% en cinco años,” La Tercera (February 1, 2017), Las Condes, Santiago, Chile, <http://www2.latercera.com/noticia/comercio-ilegal-cigarrillos-chile-crecio-386-cinco-anos/.also>.

¹⁰ See Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

¹¹ “Cigarettes in Chile 2016,” Euromonitor International Passport (database), Euromonitor International, London, <http://www.euromonitor.com/>.

More disturbing than the Euromonitor International estimates is the behavior of the government agencies in charge of combating the illicit trade, such as customs, that use BAT Chile estimates in analyses and that echo tobacco industry arguments that higher taxes might be behind the expansion in the illicit trade (National Customs Service 2016).

Studies on the Illicit Trade in Cigarettes in Chile

Independent studies are scarce, though, in the last couple of years, more effort has been undertaken to evaluate trends in the illicit trade in cigarettes. The first study of the illicit trade relied on sales data of BAT Chile (at the time, Chiletobacos SA) for 2002 and compared these data with reported consumption from the 2002 National Survey on Drug Use in the General Population (Debrott Sánchez 2006). The author attributed the gap between the two sets of consumption data to the consumption of illicit cigarettes and estimated the size of the gap at 4.2 percent of the total market. However, it is well known that this type of gap analysis is not appropriate for estimating the size of an illicit market, but only for evaluating trends. The shortcoming arises mainly because user surveys tend to underestimate true consumption (Ross 2015).

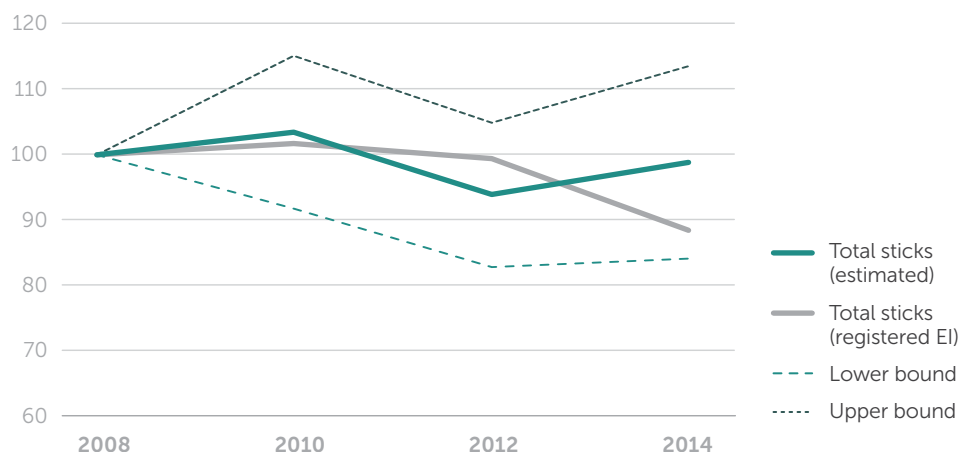
Using a private household survey, another study estimated the extent, in 2011, of the evasion of the tobacco tax, which represents a concept that is related to, but different from illicit trade because tax evasion may also involve undeclared and illegal domestic production (Jorratt 2012). The study found that the evasion of the tobacco tax reached 17 percent of the total tax base, that is, total cigarette consumption. No estimate was offered of the market share of the cigarettes entering the country illicitly from abroad.

A more recent study uses gap analysis to estimate trends in the illicit trade in cigarettes between 2008–14 (Paraje 2018). The study also considers the consumption reported in four waves of the National Survey on Drug Use in the General Population and compares these data with reported cigarette sales (Figure 20). As often occurs in gap analysis, the study assumes that the underreporting of cigarette consumption in surveys is constant across time. It concludes that the trends in the reported consumption are not statistically different—at a 99 percent confidence level—from the trends in the reported sales and that the illicit trade in cigarettes therefore did not change in proportion to the total market over the period. This contradicts the BAT Chile and the Euromonitor International data.

The gap analysis does not supply any information on the size of the illicit market - it cannot distinguish between tax avoidance and tax evasion and cannot determine whether illicit cigarette are counterfeit or contraband.¹² As a result, it is primarily used to detect deviations from the trend, not to estimate the scope of tax avoidance/evasion. However, if the initial estimates of Euromonitor International (indicating that the illicit trade of foreign origin in 2010 represented only 1.5 percent of the total market) are correct, then the illicit market for

¹² Ross, Hana (2015). Understanding and measuring tax avoidance and evasion: A methodological guide

Figure 20. Gap Analysis, Chile, 2008–14



Source: Paraje 2018.

cigarettes in 2014 was not statistically different from that share. Another option is that the true share of the illicit market of both domestic and international origin in 2010 was close to 17 percent. Keeping this share statistically constant for 2014 might imply that the market share of illicit cigarettes of domestic origin is a sizable, about 15.5 percent, if the Euromonitor International estimates are considered accurate.

A recent study conducted independently of the tobacco industry included a survey among smokers (810 respondents) in the Santiago Metropolitan Area in May–June 2017 (Paraje and Araya 2017). It finds the share of illicit cigarettes among the consumption of these smokers is at 10.9 percent, in contrast to the contemporary estimates of BAT Chile of 24 percent (see Figure 18). The study also finds that illicit cigarettes are, on average, cheaper than licit cigarettes, though there are infrequent cases in which licit cigarettes are cheaper than illicit cigarettes (Figure 21).

In addition, the study finds that illicit cigarettes are mostly consumed by men, youth of school age, adults ages 60 or older, the less well educated, and the unemployed or economically inactive (Figure 22). This suggests that illicit cigarettes are mostly consumed by people at relatively lower income. This and the fact that illicit cigarettes are relatively cheaper than licit ones indicate that illicit cigarettes mostly compete in the lower-price segment of the cigarette market.

Characteristics of the Illicit Cigarette Trade

The most comprehensive, up-to-date, government analysis of the illicit trade cigarette has been produced by the National Customs Service (2016). The report includes a thorough description of the main routes and methods used in the illicit trade, though it acknowledges that there are no official estimates on the size of the illicit market and that government

Figure 21. Unit Cigarette Price, by Type of Cigarette, Chile

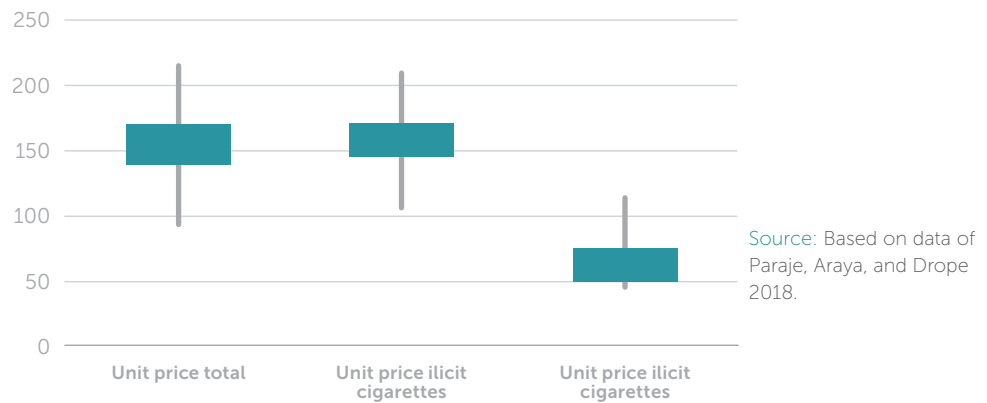
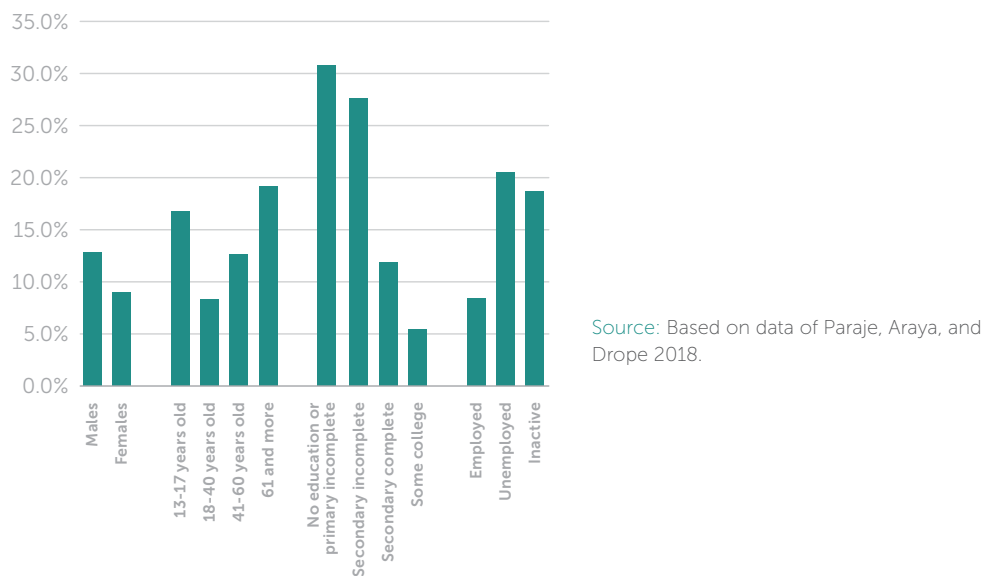


Figure 22. Sociodemographic Characteristics of Illicit-Cigarette Smokers, Santiago, Chile



agencies do not possess studies independent of the tobacco industry. Thus, the report relies on BAT Chile estimates and provides an alternative way of estimating the market that is, however, based on a wrongly applied gap analysis.

The illicit trade in northern Chile originates mainly in Bolivia and Peru. Part of the trade involves the fraudulent use of the legal allowance of up to two cartons of cigarettes per overland trip per adult. The report states that, at the Chile-Peru border, people, mostly women, cross the border several times a day and use the legal allowance each time.

In addition to this petty “ant smuggling” (a term used to describe tax avoidance and tax evasion), clandestine illegal crossings, mostly at the border with Bolivia, involve the large-scale

transport of contraband. At the border with Bolivia, 116 such crossings were recently counted, while there were 50 more at the border with Peru. A 140-year-old rift with Bolivia over the border is responsible for frequent tensions in the relationship between the two countries and makes collaboration on any matter difficult. For instance, Bolivia and Chile do not exchange ambassadors.

Another source of illegal trade is the duty-free zone at Iquique, one of the main ports of Chile. This zone is used as a port of entry for cigarettes, mostly from Asia, that are then re-exported to Bolivia and Peru. The cigarettes never reach those countries, but are redirected into the national market. The same method is used with a share of the cigarettes produced in Chile for export. Free of tobacco excise taxes or value added taxes, these cigarettes are re-transported into Chile using illegal crossings, or they never leave Chile, but are sold illegally on the domestic market.

In central Chile, a small-scale illicit trade likewise involves reliance on the two-carton allowance per adult per trip. In this case, there are no Argentine cities close to the border, and, hence, the number of cigarettes entering using this method is limited. In the case of air travel, the duty-free allowance is an extremely high seven cartons of cigarettes, which facilitates the commercialization of foreign cigarettes. Santiago International Airport is, by far, the main recipient of international travelers, and the number of passengers arriving in Chile by air rose 117 percent in 2001–17. Illicit cigarettes also enter into the country through the main seaports, on board ships mostly from Panama and the United States via the Dominican Republic. By sea, contraband is mostly brought in by concealing the illicit cigarettes in other goods shipments, such as clothing, or by falsifying import declarations, that is, by declaring that shipments contain other goods when, in reality, they contain cigarettes. That this large-scale smuggling is possible simply by misreporting the type of goods that are imported reveals the limited capacity to control imports effectively.

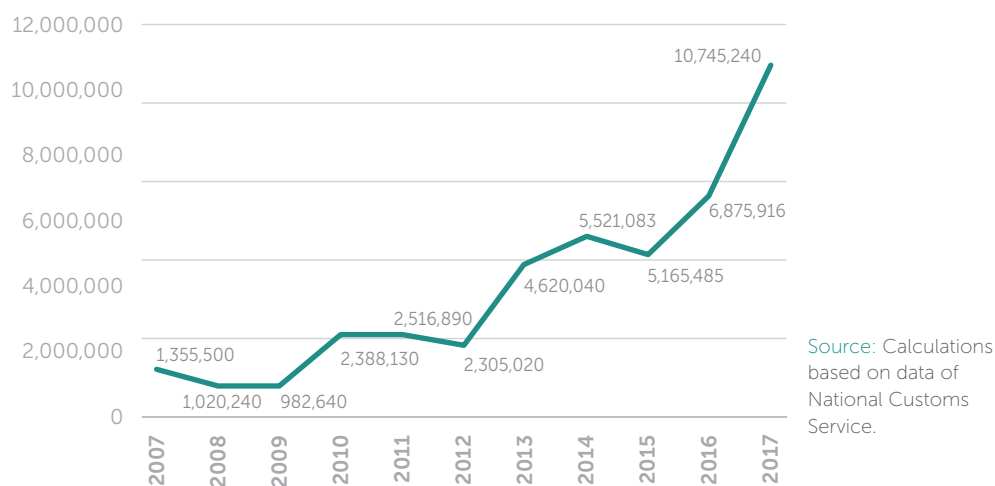
In southern Chile, Argentine cities are much closer, and the main source of illegal cigarettes is small-scale contraband involving the concealment of cigarettes in cars, buses, and clothing. In addition, ant smuggling also occurs.

Annex 1A shows summary tables of the main entry points for illicit cigarettes into Chile, along with information on brands and smuggling methods as reported by the National Customs Service (2016).

Figure 23 illustrates trends in illicit cigarette seizures in Chile. The seizures began to increase rapidly after 2012, growing by more than 500 percent in 2012–17. Though international experts warn against the practice, data on seizures have been used as a proxy for the trends in illicit trade and presented as evidence of expanding illicit trade.¹³ However, seizures of illicit

¹³ "Comercio ilegal." British American Tobacco, Argentina, Córdoba, Argentina (accessed December 27, 2017), http://www.batargentina.com/group/sites/BAT_9YXKEP.nsf/vwPagesWebLive/DO9T5K4G, but see NCI and WHO (2016).

Figure 23. Number of Packs of Cigarettes Seized by Customs, Chile, 2007–17



cigarettes have recently grown at least at a similar rate as seizures of other goods, which points to more effective control at borders, rather than to an increase in the volume of illicit trade (National Customs Service 2017).

The study by the National Customs Service (2016) makes clear a worrying fact: the lack of the technical capacity or the resources to produce independent government studies on contraband, which leads to a reliance on tobacco industry estimates without the ability to gauge accuracy or be critical of analysis. Moreover, it is clear that government agencies in charge of overseeing cigarette markets do not communicate or collaborate together sufficiently, at least on the production of official information.

The lack of technical capacity is clear not only in official reports, but in media reports, where officials repeat tobacco industry estimates, and also from the alliances between public entities and private associations in which the tobacco industry has a prominent role (National Customs Service 2016).¹⁴ Government studies on the illicit trade in cigarettes almost invariably begin by quoting tobacco industry estimates, even though they acknowledge there is no clarity about methodology or the way such estimates are produced.

The lack of technical capacity is made clear by the gap analysis produced by customs to estimate the illicit trade in cigarettes. First, customs uses data on sales provided by BAT Chile, even if official SII data exist on taxed sales (see Figure 16). BAT Chile estimates for 2015 are 3.2 percent lower than the official figures, a bias that would tend to raise the estimates of the illicit trade. Second, customs estimates a theoretical consumption of cigarettes using

¹⁴ One of these is the Illicit Trade Observatory (Observatorio del Comercio Ilícito; website: <http://www.observatoriocomercioilicito.cl/>), which maintains alliances with customs, several branches of the police, the Public Prosecutor's Office, the SII, and so on.

a methodology with no theoretical or empirical validity, given that it assumes arbitrarily the impact several policies, such as a tax increase and smoke-free areas, would have had on consumption. Using theoretical and observed consumption, customs concludes that the illicit trade accounted for 10.4 percent of the market in 2015, close to the BAT Chile estimates. This estimate lacks any validity also because a well-developed gap analysis, not one that is flawed such as the one produced in the customs report, requires at least two points in time to predict trends, not levels, of illicit trade. The report concludes that seized cigarettes constitute 7.7 percent of the illicit market, though seized cigarettes are not part of the market because they were seized, not consumed. Customs estimates the total tax evasion produced by this contraband at US\$220 million. Because the estimates of contraband are flawed, the estimate of tax evasion lacks any validity, though it is close to the BAT Chile estimate of the taxes evaded because of contraband, though BAT Chile provides no information on methodology.

3. Tackling the Illicit Trade in Tobacco Products

International experience shows that it is the quality and enforcement of tax administration, not tobacco taxation, that is the major driver of success in controlling illicit trade (Marquez and Moreno-Dodson 2017; NCI and WHO 2016). The first step to strengthening the quality and enforcement of tax administration is to implement a successful policy to control the illicit trade, that is, to possess a comprehensive national strategy that addresses this issue systematically. This is missing in Chile. Various agencies have distinct approaches, means, and priorities, and there seems to be no substantial coordination among them, apart from some recent efforts to share information. Illicit cigarettes can be purchased in known places around large cities and even on the Internet on well-known trading sites.¹⁵ Investigative journalists have denounced publicly cases of collusion between contrabandists and customs officials who are behind the illegal commercialization of large quantities of cigarettes (Carvajal and Jara 2016).

Though the methods of contrabandists are well known, the activity continues to this day (see Annex 1A). Some efforts have been undertaken by the authorities. In the case of the National Customs Service, an integrated smuggling plan (Plan Integral de Fiscalización) was developed for cigarettes, along with 10 other sectors, groups, or problem areas (mining products, intellectual property, public health, drugs, and so on). The plan has involved the establishment of a network of actors and responsibilities within customs and the formation of working groups among several agencies with shared action plans.

The program has brought about an increase in communication among customs offices on important information obtained during seizures of cigarettes. An initial report is filed within 24 hours of a seizure, and then, within 48 hours, a final report is filed containing

¹⁵ For instance, see Mercado Libre Chile, at <https://www.mercadolibre.cl/>.

all information relating to the incident. Reports are sent to a central office where they are processed, and then they are sent to nearby customs offices. This central office regularly generates a spreadsheet that consolidates all seizure information across customs offices and incorporates data on the most relevant seizures carried out by the other agencies (the National Police and the Investigation Police). This spreadsheet is sent to customs offices on a regular basis to ensure that the entire organization is informed of incidents occurring in various parts of the country.

For inspection and control operations, the plan relies on a handful of regional customs offices in the most highly affected areas, the National Police Force, and the Investigative Police for work outside the customs perimeter. It has established the Organization of Cigarette Smuggling–Integrated Smuggling Plan Technical Meeting to promote the work of the customs departments involved in the program.

The Control Directorate of the National Customs Service uses a suite of risk analysis tools. Risk filters refer to selection criteria or parameters based on risk indicators and involve the review of documents, cargo scanning, and physical examinations to identify risk characteristics. Customs uses these filters to select operations automatically or manually for documentary review, evaluation, or physical examination and to generate customs alerts. This is a dynamic process that requires constant review of the effectiveness of the filters to determine whether they should be maintained or modified.

One central topic in controlling contraband is the penalty associated with, for example, smuggling. It is a basic economic premise that, for certain crimes, such as smuggling, if the expected cost of committing the crime (which depends on probability of detection, probability of conviction, fines, and length of conviction) is smaller than the expected benefits (which depends on the probability of detection and the economic gain associated with the crime), there is an incentive to commit the crime.

In Chile, the penalties associated with smuggling are relatively mild. Currently, an individual smuggling fewer than 25 monthly tax units (about US\$1,850) in goods is punished by the seizure of the goods and a fine from one to five times the value of the goods. If the value of the goods exceeds 25 monthly tax units apart from the seizure and fine (one to five times the value of the goods), the individual may receive up to 40 days in prison. Usually, the time in prison is not effective unless individuals have committed serious crimes before.

The Protocol to Eliminate the Illicit Trade in Tobacco Products

Though the government of Chile ratified WHO's FCTC early, it has not ratified the Protocol to Eliminate Illicit Trade in Tobacco Products. Indeed, the government has not even signed the protocol, despite the fact that many Latin American countries that have cigarette trade with Chile, such as Colombia, Panama, and Uruguay, have either signed or already ratified the protocol.

There is no clear indication about when the protocol will be signed and ratified in Chile, and there is currently no information available on which government department is analyzing any future implementation of the protocol. There are no Parliamentary initiatives nor political discussions regarding the ratification of the protocol despite the constant claims by the tobacco industry about a growing illicit trade.

The Track-and-Trace System

Despite the lack of progress on the protocol, Chilean authorities have decided to implement a track-and-trace system (TTS). However, the reason to implement such a system is related to tighter fiscal control over the tobacco industry with respect to the collection of the tobacco tax rather than to the effective control of illicit trade, as explicitly stated in the laws and regulations on this matter. In other words, the stress is on domestic tax evasion, not smuggling.

The TTS was approved by Parliament during discussions on general tax reform in 2014. The reform substantially raised the specific tax on cigarettes, and lawmakers supported it by extending the supervisory power of the SII over the tobacco industry and by approving the TTS (see Figure 13). Until then, though the SII was generally believed to be one of the most effective tax collection agencies in Latin America, it was informally assumed by SII officials that the capacity they have to audit the tobacco industry's tax declarations was limited (Serra 2003).

The TTS system was approved in September 2014 through Law 20780, on general tax reform, which explicitly stated that the reason for the adoption of the system was to enhance fiscal control over the excise taxes on tobacco. It also stipulated that the Minister of Finance should issue a regulation defining the characteristics of the system. The regulation was published in Decree 19 of the Minister of Finance in January 2015. It defines the TTS as an integral platform housing information on the production, importation, distribution, commercialization, and so on of taxed tobacco products. In addition, it provided that the system should be enabled to identify, mark, and trace taxed tobacco products. According to the regulation, the firm providing the TTS platform could not be associated with the tobacco industry, though the definition of the prohibited relationship was not sufficient to prevent firms connected to the tobacco industry from installing a systems technology developed by the tobacco industry, such as Philip Morris International's Codentify TTS software.

Civil society pressure caused Parliament to amend Law 20780 through Law 20899 (February 2016), which mandated that the Minister of Finance introduce regulations preventing the direct participation of the tobacco industry in the TTS. The main regulation was issued at the end of December 2016 (Decree 1027) and established that the TTS would necessarily have to include devices installed on production lines that would compile information on product types, dates of production, production lines, the quantities produced, and so on. It was left as an option of the SII to tag products with seals, stamps, or other tracking material. Though there was no requirement on the independence of the TTS provider relative to the tobacco industry, there was a public agreement that the firm operating the TTS would be independent.

In March 2017, the SII issued a public tender on the TTS. Contrary to the agreement, there was no provision on the independence of TTS providers from the tobacco industry, and the tender gave 93 percent of the total weighting of bids to economic aspects, and only 7 percent to technical aspects. However, only firms qualifying on the technical aspects would be assessed on the economic aspects.

In August 2017, three firms presented bids. Two had ties with the tobacco industry. One was ATOS, one of the developers of the Codentify software; the other was a firm that provided printing products to the tobacco industry. Civil society and political pressure exerted by some parliamentarians led the SII to reject the bids of these two firms and award the contract to SICPA, a firm not related to the tobacco industry (SII 2018).¹⁶ Because of legal challenges and the lack of the necessary legal authorization for the entire process, no TTS has yet been implemented, though it has been estimated that one should be established by April 2019.

There is no objective evidence that the tobacco industry was involved in the changes, delays, and attempts to interfere in the implementation of the TTS. However, a system that should have been in place by the end of 2015, at the latest, is still being legally challenged. A former director of the SII estimated that delaying the TTS meant a loss of US\$500 million a year in extra revenue and that officials at the Ministry of Finance were not willing or able to overcome the tobacco industry's resistance to the system (Alonso 2017).

The TTS that will be implemented will allow the SII to count the cigarettes produced in the country. It will permit an accounting of the cigarettes sold domestically. This information is available today only through the tax declarations provided by the tobacco industry, and there is currently little capacity to audit these declarations properly. The TTS will also allow the SII to monitor the quantities of cigarettes that are exported and thus not liable for local taxes.

The TTS will consist of a printed seal similar to a QR code on the pack. It will include information on the production line, the date and time of production, the brand, and so on. Cigarettes that are destined for the international market will not be marked, and no information on these will be collected apart from the number produced. This means that round-tripping, whereby the cigarettes end up on the domestic market, will still be possible. The information contained in the printed seal will only be readable using the special devices that will be supplied to SII officials.

One of the main limitations of this method of product identification is that it can be replicated by simply printing a counterfeit code on packs. The only way to discover if seals are being counterfeited is to check each one using the special code readers. Unlike the methods adopted by other countries in the region, such as Argentina, Brazil, Ecuador, and others, this method does not involve stamps of different colors or seals with special inks allowing

¹⁶ See "Trazabilidad a las tabacaleras: El gato cuidando la carnicería," GuidoGirardi website, <http://guidogirardi.cl/tag/trazabilidad/>.

a rapid, bare-eye inspection to check if the product is licit or illicit. In this respect, Chile has chosen a method that, while allowing the collection of information useful in monitoring tax evasion by producers, may fall short in the goal of identifying contraband cigarettes.

4. Challenges and Recommendations in Tackling the Illicit Trade

Chile faces several challenges to tackling the illicit trade successfully. First, the country needs an integrated set of laws and regulations designed to curb the illicit trade in cigarettes. Ratifying the Protocol to Eliminate Illicit Trade in Tobacco Products is certainly a first step in this direction. New legislation improving the policing capabilities of the agencies involved in reducing the illicit trade can be built on the framework provided by the protocol, especially in coordinating with agencies in other countries. The difficult relationship between Bolivia and Chile represents an extra challenge, but the protocol may also facilitate collaboration with countries trading tobacco products with Bolivia.

Second, there is an urgent need to produce more information, independent of the tobacco industry, on the extent of the illicit trade in tobacco, its characteristics, and the related implications for the internal tobacco market. The public discussion on the illicit trade cannot be dominated by the data of the tobacco industry, with no account taken of how these data are produced or that the data tendentiously link trends in the illicit trade with taxes. Public authorities echo these data and misleading conclusions. Independent estimates, whether produced by public entities or commissioned to third parties, should be available regularly to assess the extent of the illicit market and trends in the trade. No serious political effort to tackle the illicit trade can be undertaken without knowledge of the scope of the problem or with misleading ideas about the problem.

Third, the influence of the tobacco industry on policy makers should be contained, as set out in the FCTC. The tobacco industry or private associations and other organizations in which the tobacco industry is prominent maintain regular contacts with government agencies on illicit trade issues. This helps the tobacco industry propagate its questionable data and discourse on the illicit trade across the public sector. There are frequent meetings between tobacco industry executives and government officials; and, as a consequence, important initiatives, such as the implementation of the TTS, were stopped, altered, or delayed.

Fourth, the penalties for illicitly marketing cigarettes and other tobacco products should be drastically augmented. A successful campaign against the illicit trade depends on effectiveness in detecting the illicit act, but also on the penalties for those people who are found guilty. In Chile, the penalties are relatively light. The cost of engaging in smuggling must be raised, not only by increasing the ability of government agencies to detect the illicit trade, but also in punishing illicit traders meaningfully.

Thus, the recommendations for tackling the future development of the illicit trade in cigarettes include the following: to sign and ratify the Protocol to Eliminate Illicit Trade in Tobacco Products; to enforce related policies and initiatives; to reduce the influence of the tobacco industry on policy makers and other officials; to produce independent and verifiable information on the extent of and trends in the illicit trade in cigarettes; and to augment the amount of fines and imprisonment for people convicted of trading in contraband.

Other measures could also be adopted that would have a significant effect on the illicit market for cigarettes:

- » The existence of a duty-free zone in Iquique, one of the main ports of Chile and close to the Bolivian border, is a threat to any meaningful policy aimed at tackling the illicit trade in cigarettes. The zone has often been justified as a tool to foster economic development in a relatively poor area of the country.¹⁷ Even if such an ambition were achievable through a duty-free zone, it is not credible that the cigarette trade would contribute to such a goal. There are no meaningful economic reasons to allow cigarettes to enter the Iquique free zone untaxed.
- » Duty-free allowances should be limited or eliminated. Though duty-free allowances might be justified by the lack of capacity to check every person entering the country or because it is more cost-effective to allow individuals to enter the country with a small amount of certain goods, the allowance could be greatly reduced or eliminated. Permitting a duty-free allowance of up to seven cartons for international air travelers seems excessive, especially because passengers entering the country at the main airport, Santiago International Airport, are extensively checked by the Agriculture Service to block them from bringing in fruits and vegetables. The x-ray scanners used for this purpose at every international airport and even at some land crossings could easily be used to check for larger quantities of cigarettes. The allowance at land crossings—up to two cartons per trip—could be more effectively enforced by limiting the number of times a person can use the cigarette allowance to, for instance, once a month.
- » A regional political approach toward the illicit trade should be considered. Latin American countries with which Chile has regular trade relations, such as Bolivia and Paraguay, are sources of smuggled cigarettes. A successful policy for the control of contraband would be incomplete if it focuses only on the recipient country, especially if the source of these products is known. The relationship with Bolivia is often difficult, and, in the case of Paraguay, the contraband and the counterfeiting industry (not only in cigarettes) are well established and often enjoy substantial political protection. It has even been suggested that a cigarette manufacturing facility owned by a former president of Paraguay may be a source of the illicit trade in cigarettes in other countries (Risatti 2017). High-level meetings in multilateral regional forums, such as the Southern Cone Common Market, could

¹⁷ See "Nuestra Historia," ZOFRI, Zona Franca de Iquique, Iquique, Chile, <https://www.zofri.cl/es-cl/Nosotros/Paginas/Historia.aspx>.

encompass discussions on how to limit or control the illicit trade in all goods, including cigarettes. A more extreme initiative would be to forbid cigarette exports from Chile to countries suspected of not contributing appropriately to controlling the illicit trade, such as Bolivia or Paraguay. The use of the Iquique free-trade zone to re-export foreign cigarettes to these countries could be prohibited given that these cigarettes are often illegally re-transported into Chile or never cross the border at all.

Smoking prevalence rates, including among young people, are so high as to constitute a severe public health epidemic and to merit a more vigorous response. Chileans who continue to smoke will die an average of 20 years prematurely. So, Chile should not allow self-interested and exaggerated underestimates of the illicit trade to stop it from strengthening its tobacco control program.

Annex

Annex A. Illicit Entry of Cigarettes into Chile

Table A.1. Modus Operandi of the Illicit Entry of Cigarettes, Northern Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Chacalluta customs post	Entry of cigarettes at Arica through the misuse of the international traveler allowance, for subsequent collection and sale in Arica or shipment to southern Chile	Cigarettes primarily of Bolivian origin (Bolivian National Customs stamp), involving brands not authorized for sale in Chile	Mainly Carnival, Fox, Jaisalmer, Mensfield, and Pine
Unauthorized border crossings in the Arica and Parinacota Region (XV)	Entry of cigarettes hidden in vehicles.		
Colchane border crossing	Entry of cigarettes in the Tarapacá Region through misuse of the international traveler allowance, for subsequent collection and sale in Iquique or shipment to southern Chile	Cigarettes primarily of Bolivian origin (Bolivian National Customs stamp), involving brands not authorized for sale in Chile	
	Entry of cigarettes hidden in vehicles, primarily buses	Counterfeit cigarettes of Paraguayan origin, which enter Bolivia through unauthorized border crossings and subsequently enter Chile in the same way	
Unauthorized border crossings in Tarapacá Region (I)	Entry of cigarettes by ship, mules (transporters), and cargo trucks, 4x4s, and so on		
Around the Quillagüa internal control point	Breach of the Quillagüa internal control point by means of detours and alternate routes		
	Reshipment processes in which the goods are not reported to the exit customs office and remain in the country illegally		

Source: Calculations based on data of National Customs Service 2016.

Table A.2. Modus Operandi of the Illicit Entry of Cigarettes, Central Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Port of San Antonio	<p>Small number of packs or cartons are hidden among imports of other goods, such as clothing or miscellaneous small items</p> <p>Entry of contraband involving importers bringing in full containers of counterfeit cigarettes</p>	<p>Cigarettes primarily of Chinese origin and Chinese brands presumably for personal consumption</p> <p>Cigarettes primarily from China, Curaçao, Jamaica, Panama, and the United States; unauthorized brands intended for sale in Chile (cigarettes that cannot be identified as counterfeit) and counterfeit cigarettes have been found</p>	Mainly Belmont, Bronco, Cumbia, Derby, Golden, Jaisalmer, Lucky Strike, Marlboro, Montreal, Pocker, Rich, Seneca, Walden
By land, via the Los Libertadores customs post, Andes Customs	<p>Entry via small-scale smuggling, by means of the misuse of passenger allowances</p> <p>Entry by various means of transport, particularly buses, trucks, and passenger vehicles</p>	Various manufacturer brands; authentic cigarettes, with or without authorization for sale in Chile; counterfeit cigarettes	Mainly 357, Blue Point, Brass, Bronco Ultra, Carnival, Eston, Euro, Fox, Lucky Strike, Pall Mall, Rodeo
By land, on trucks to locations in the outskirts of Santiago	From other regions and countries; stored for later distribution and sale in shops not authorized by the SII	Brands authorized for sale in Chile and unauthorized brands have been seized; the former includes some counterfeit cigarettes, whereas the latter involves only authentic cigarettes	Mainly 51, Blue Point, Bronco, Carnival, CJ, Fox, Golden, Hilton, Jaisalmer, Laredo, Marlboro, Melbour, Mensfield, Montreal, Nirvana, Pall Mall, Philip Morris, Pine, Rodeo, Starlite, V8, You
By sea, from Panama and the United States, the latter with transit through the Dominican Republic	Cartons or packs are hidden among imports of other types of goods, such as vehicle roof racks and television antennas	Seized cigarettes not authorized for sale in Chile, mainly of Indian origin	Cumbia, Gold City, Hongmei, Huang Shan, Jaisalmer, Shuangxi
By land, from northern Chile	Trucks loaded with cigarettes from northern Chile, such as Arica and Coquimbo, involving counterfeit cigarettes; the transit return method is used with cigarettes produced in Bolivia	Seized cigarettes not authorized for sale in Chile, mainly of Indian, Korean, and Paraguayan origin	Carnival, Fox, Jaisalmer, Laredo, Nirvana

Table A.2. Modus Operandi of the Illicit Entry of Cigarettes, Central Chile, Cont.

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Seized outside the customs perimeter	Sales in commercial warehouses	Seized cigarettes not authorized for sale in Chile and counterfeit cigarettes	Counterfeit: Belmont, Pall Mall, Viceroy; not authorized for sale: Carnival, Esse, Jalsaimer, Pine Blue
	Clandestine trade	Seized cigarettes that are or are not authorized for sale in Chile, primarily of Argentine, Bolivian, Korean, and Paraguayan origin	Belmont, Blue Point, Carlile, Carnival, Cigar Mojito, Esse Black, Esse Blue, Esse Change, Fox, Hilton, Jalsaimer, Marlboro, Mustang, Pall Mall, Philip Morris, Pine Blue, Pine Green, President, Viceroy

Source: Calculations based on data of National Customs Service 2016.

Table A.3. Modus Operandi of the Illicit Entry of Cigarettes, Southern Chile

ZONE OF ENTRY	SMUGGLING METHOD	CHARACTERISTICS, SMUGGLED CIGARETTES	BRANDS IDENTIFIED
Border crossings: Dorotea, Casas Viejas, Monte Aymond, San Sebastián	Entry of cigarettes in the Magallanes and Chilean Antarctic regions through misuse of international traveler allowances (small scale); cigarettes hidden in vehicle compartments (caletas); cigarettes hidden in luggage and clothing; the goods are stored and shipped to northern Chile	Cigarettes primarily of Argentine origin, both brands that are authorized for sale in Chile and those that are not.	Mostly 357, Belmont, Blue Point, Camel, Lucky Strike, Marlboro, Pall Mall, Philip Morris, Red Point, Viceroy
Unauthorized border crossings: Última Esperanza Province (Puente Lincoman), Tierra del Fuego Province (Las Bandurrias, adjacent estancias)			
Ports of Puerto Montt (for example, Oxxean, Empormontt) and Cardenal Samoré border crossings	Entry at Punta Arenas of cigarettes of Argentine origin that are subsequently transported to the Lakes Region and the rest of the country; storage of Argentine cigarettes in Puerto Natales; direct entry of trucks with cigarettes from Argentina	Cigarettes primarily of Argentine origin, both authorized and unauthorized for sale in Chile	Mostly 357, Baltimore, Belmont, Blue Point, Derby, Melbo, Pall Mall
Futaleufú and Río Encuentro border crossings	Entry of cigarettes of Argentine origin in the Lakes Region for later transport to the rest of the country		

Source: Calculations based on data of National Customs Service 2016.

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“To tackle illicit trade is to tackle accessibility and affordability of tobacco products, to be more effective on the control of the packaging and to reduce funding of transnational criminal activities whilst protecting the governmental revenues from tobacco taxation.”ⁱ

– **Dr. Vera Luiza da Costa e Silva**
Head of the Secretariat of the WHO Framework Convention on Tobacco Control

“Governments around the world must waste no time in incorporating all the provisions of the WHO Framework Convention on Tobacco Control into their national tobacco control programmes and policies. They must also clamp down on the illicit tobacco trade, which is exacerbating the global tobacco epidemic and its related health and socio-economic consequences.”ⁱⁱ

– **Dr. Tedros Adhanom Ghebreyesus, Director-General**
World Health Organization

“Tobacco still remains the biggest avoidable cause of premature death in the EU, and the illicit trade in tobacco facilitates access to cigarettes and other tobacco products, including for children and young adults. In addition, millions of euros in tax revenues are lost every year as a result of the illicit trade.”ⁱⁱⁱ

– **Commissioner Vytenis Andriukaitis**
Health and Food Safety / European Commission

“Given their light weight, small size, and high value, tobacco products are susceptible to fraud through illegal trade, production, and cultivation. . . . Illegal trade is a context-specific activity that has various modus operandi and therefore requires multi-dimensional context-specific solutions.”^{vi}

– **Patrick Petit (Senior Economist) & Janos Nagy (Senior Economist)**
Fiscal Affairs Department / International Monetary Fund

“Effective tobacco tax regimens that make tobacco products unaffordable represent a 21st century intervention to tackle the growing burden of noncommunicable diseases. We are convinced that, working together with WHO and other partners in support of countries, we will be able to prevent the human tragedy of tobacco-related illness and death, and save countless lives each year.”^v

–**Dr. Tim Evans (Senior Director) & Patricio V Márquez (Lead Public Health Specialist)**
Health, Nutrition and Population Global Practice / World Bank Group

