

The Structural Failure of Tobacco and Nicotine Control: A Formal Submission on the Expansion of Illicit Markets and Organized Crime in Australia

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Over several decades, the fields of public finance, tax evasion, the shadow economy and illicit markets have been at the centre of my research interest. I have served as Professor of Economics at Johannes Kepler University of Linz, Austria, and Research Professor at DIW Berlin, Germany. My academic work has focused on the measurement, drivers, and macroeconomic consequences of informal and illicit economic activity, including the interaction between taxation, enforcement capacity, and market substitution.

A substantial part of my research agenda has examined how highly taxed markets respond to sustained increases in statutory rates, and how widening tax wedges can unintentionally stimulate informal supply channels when enforcement and compliance mechanisms do not scale proportionately. This work has been published in leading academic journals and synthesised in major volumes on the shadow economy and public choice. I have also served as advisor to international institutions including the European Commission, the IMF, and the World Bank on matters relating to tax compliance, informality, and regulatory design.

Against that background, I have followed recent developments in Australia with increasing concern: the rapid expansion of illicit tobacco and related organised supply is consistent with the incentive mechanisms documented in the illicit-economy literature, and it signals a growing structural risk to revenue integrity, compliance, and public order. For these reasons, I submit the analysis below to assist the Committee's assessment of the current policy trajectory and its likely implications.

My empirical analysis indicates that over 2014–2024, a A\$0.10 increase in per-stick excise was associated with an 8.78% increase in illicit trade, controlling for GDP growth. Forward projections under current excise momentum imply the illicit share rising to 27.7% by 2028.

This matters because illicit markets display path dependence: once supply chains, retail outlets, and consumer switching are established, reversing them requires persistent and costly disruption and may not fully restore the legal base. Evidence from economic assessments highlights that once illicit trade becomes entrenched, it can be extremely difficult to eradicate.

I therefore recommend a redesign of the excise tax path and the facilitation of legal alternatives by enabling a regulated adult retail framework for e-cigarettes, reducing demand for illicit combustible tobacco.

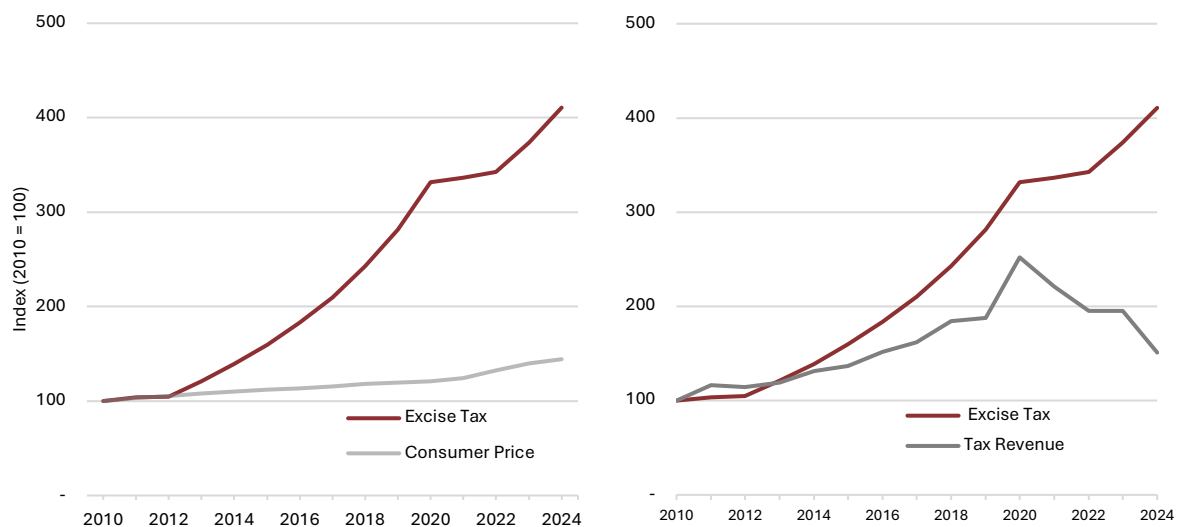
1. Status Quo: Australia has a sizable illicit tobacco problem with widening economic and public-order spillovers

Australia now exhibits clear indicators of substantial displacement from the legal, duty-paid tobacco market into illicit supply. The ATO estimates that, in 2023–24, illicit tobacco consumption amounted to roughly 1,741 tonnes and represented about 25 per cent of all tobacco for sale, with around A\$3.2 billion of combined customs and excise duty theoretically payable being evaded.¹

Fiscal outcomes are consistent with this erosion of the tax base, even as statutory rates continue to rise. Public reporting on Commonwealth budget outcomes indicates tobacco excise revenue has fallen markedly from an earlier peak of around A\$16.3 billion in 2019–20 to around A\$7.4 billion expected in 2024–25 (Figure 1). While tobacco revenue can be affected by timing of import clearances and inventory behaviour, the ATO’s contemporaneous estimate of a rising illicit share provides a coherent explanation for why successive increases in statutory rates may no longer translate into rising receipts.²

The illicit tobacco market has also evolved from a tax-compliance problem into a public-order and organised-crime problem.³ Reporting based on national organised-crime cost assessments describes illicit tobacco as one of the fastest-growing illicit commodity markets and links it to violence and intimidation, with organised crime syndicates associated with more than 200 fire-bombings and multiple homicides since 2023 in the context of illicit tobacco conflicts.^{4,5} The Australian Institute of Criminology’s 2023–24 cost-of-crime assessment situates illicit commodities, including tobacco, within a broader serious and organised crime burden estimated at up to A\$82.3 billion.⁶

Figure 1. Tobacco Excise, Consumer Price, and Tax Revenue Index 2010 - 2024



Source: Cigarette excise tax rates, the consumer price index, and tobacco excise tax revenues are derived from the Australian Taxation Office, the World Bank, Tobacco in Australia.

Spillovers to lawful commerce further demonstrate that the illicit market is generating negative externalities well beyond lost revenue. Evidence submitted to the NSW Parliament documents commercial impacts on affected small businesses, including revenue loss, pressure to compete with

¹ ATO (2025). [Latest estimates and findings for the tobacco tax gap.](#)

² University of Sydney (2025). [Tobacco excise revenue has tanked amid a booming black market.](#)

³ Australian Association of Convenience Stores (2025). [Tobacco and Vapes Bill 2024-25.](#)

⁴ The Guardian (2025). [Illegal tobacco burns \\$3.3bn hole in Australia’s tax revenue, crime agency says.](#)

⁵ Australian Association of Convenience Stores (2025). [Tobacco and Vapes Bill 2024-25.](#)

⁶ Australian Institute of Criminology (2025). [The costs of serious and organised crime in Australia, 2023-2024.](#)

illicit pricing, and heightened safety and intimidation concerns.⁷ These spillovers imply that illicit-market expansion can alter the composition of retail activity over time, as compliant operators face rising risk and shrinking margins relative to illicit-aligned competitors.

2. Mechanism and trajectory: Illicit trade correlates with taxes, and is likely to increase further

The policy setting that matters for incentives is not merely that taxes are high, but that the tax system has repeatedly introduced large and discrete increases that expand the illegal–legal price wedge.⁸ Australia implemented a series of staged 12.5 per cent increases commencing 1 December 2013 with subsequent annual increases on 1 September. More recently, Parliament legislated an additional 5 per cent annual increase for three years starting 1 September 2023, on top of indexation, reinforcing a trajectory of compounded real increases.⁹

The administrative design of indexation matters because it keeps excise tax rates rising with average weekly ordinary time earnings, limiting any natural affordability adjustment that might otherwise reduce incentives for evasion over time (see Figure 1 for a comparison of excise tax rates with CPI).¹⁰ In standard tax-compliance terms, this combination of step increases and persistent indexation increases (or for some years above indexation) the per-unit rent available to illicit suppliers and therefore attracts entry, capital, and organisational capability into smuggling and distribution.

This submission’s central technical pillar relies on an Australia-specific econometric analysis, that establishes a strong link between per-stick cigarette excise increases and the expansion of the illicit cigarette market, coupled with a forward projection quantifying the likely trajectory of illicit market share under continuation of the current excise momentum through 2028.

To estimate the relation between tax and illicit trade, I model the illicit market share as a function of per-stick cigarette excise tax, controlling for GDP growth, so that the remaining association reflects the excise-created incentive to switch to untaxed supply rather than general economic fluctuations. Over the estimation period from 2014 to 2024, a A\$0.10 increase in per-stick excise was associated with an 8.78 per cent increase in illicit trade. This parameter can be interpreted as a reduced-form displacement elasticity capturing the behavioural response of consumers and supply networks to the widening gap between duty-paid and untaxed products. The mechanism is consistent with standard compliance theory: as the statutory wedge rises, the expected private gain from tax evasion increases and attracts both demand-side substitution and supply-side entry, particularly in settings where border and retail enforcement cannot scale proportionately with the size of the wedge.

In addition, EU cross-country data show the same directional pattern: combining Member State cigarette excise tax levels with illicit-share estimates yields a correlation of 0.61 between excise levels and illicit market share, a descriptive association that supports the interpretation that larger tax wedges are associated with greater illicit penetration.

When the estimated excise–illicit relation is combined with a forward-looking scenario, the model indicates that illicit penetration is likely to rise further under a continuation of the current tax trajectory. Specifically, applying the Australia-estimated coefficients to an excise path that maintains recent momentum, that is, the continuation of scheduled above-indexation increases alongside ordinary

⁷ NSW Parliament (2025). [Inquiry into illegal tobacco trade](#).

⁸ Tobacco in Australia (2025). [Facts & Issues](#).

⁹ Parliament of Australia (2023). [Summary of alterations – Excise tariff proposal \(No.1\) 2023](#).

¹⁰ Parliament of Australia (2023). [Summary of alterations – Excise tariff proposal \(No.1\) 2023](#).

indexation and assuming stable aggregate growth of around 1.1 per cent per year, the projection implies that the illicit market share could rise to around 27.7 per cent by 2028.

This projection should be read as a conditional risk assessment rather than a mechanical point forecast: the scenario holds the institutional environment broadly constant while the statutory wedge continues to widen, which is precisely the policy configuration in which displacement into untaxed channels is most likely. Nevertheless, the practical policy message of this scenario is straightforward. If the excise trajectory continues to widen the tax wedge faster than the system can contain illicit supply, Australia risks locking in a higher-illicit steady state in which further real excise increases deliver progressively smaller incremental health gains, while expanding criminal rents and strengthening the commercial viability of organised illicit distribution.

3. Once established, illicit markets are hard to eliminate

A critical risk for the Committee to recognise is that illicit tobacco and nicotine markets display path dependence: once supply networks, retail outlets, and consumer switching habits are established, the market becomes self-reinforcing and therefore costly to unwind. Recent empirical evidence captures this point directly, noting that while enforcement can contain illicit trade, once illicit trade becomes entrenched in a market, it can be extremely difficult to eradicate.¹¹ This dynamic matters for excise design because policy mistakes that expand the illicit base today create future enforcement and governance costs that can persist even if taxes are later moderated.

This aligns with the academic literature. Asllani et al. (2026), emphasise that it is complex and rigid to alter historical levels of informality through interventions targeting individual drivers, because the long-term component (including structural and institutional features such as tax morale and enforcement capacity) is ultimately decisive.¹² Also evidence from Latin America and the Caribbean further supports the logic that historical inequality persistence can define different long-run steady states of the informal economy.¹³

Entrenchment is reinforced by the scale of criminal rents created by the widening wedge, which can finance distribution, corruption, intimidation, and rapid re-entry after seizures. The ATO's tax-gap reporting distinguishes between seizures and undetected illicit tobacco that reaches market, indicating that even substantial interception activity can coexist with a growing flow of illicit product into retail channels.¹⁴ Public reporting drawing on national organised-crime assessments links the illicit tobacco market to violence and intimidation, suggesting that once high rents emerge, competition for control can translate into public-order harms rather than remaining a quiet tax-evasion phenomenon.

International evidence also underscores that illicit supply chains often rely on informality and vulnerable labour conditions, which can reduce costs and increase resilience against enforcement. An OECD analysis finds a robust association between illicit trade in counterfeits and labour exploitation and informality, reinforcing the broader proposition that illicit production and distribution can thrive in low-protection environments and become structurally persistent.¹⁵

¹¹ Oxford Economics (2026). [An economic assessment of the drivers of the illicit cigarette trade in the EU.](#)

¹² Asllani et al. (2026). [Global estimates of informal economies and new insights for 152 countries \(1997-2022\). Economic Analysis and Policy \(89\), 721-741.](#)

¹³ Takanohashi et al. (2025). [The impact of inequality on the informal economy in Latin America and Caribbean with a MIMIC model. Empirical Economics \(69\), 181-211.](#)

¹⁴ ATO (2025). [Latest estimates and findings for the tobacco tax gap.](#)

¹⁵ OECD (2026). [From Fakes to Forced Labour.](#)

4. Recommendations: Redesigning the excise path

The first recommendation is to redesign the excise path away from automatic real escalations that continue widening the illicit–legal wedge while the illicit share remains elevated. More concretely, and based on the latest ITEC estimates, illicit tobacco market share is 55%, and illicit vapes is 95.7% of the e-cigarette market¹⁶ indicating a strongly upwards tendency in illicit market activity. The policy should discontinue further above-indexation uplifts and return to a tax moratorium approach until the illicit tobacco incidence shows a consistent declining trend and possibly continue later via a stable indexation-only regime over an evaluation period. This redesign should be codified as a conditional, metrics-based approach in which any future real increases are explicitly contingent on sustained, measurable reductions in the illicit share as reported in the tax-gap framework, thereby aligning tax policy with administrative feasibility. The underlying logic is that excise can be an effective public-health instrument when enforcement capacity can support compliance, but where illicit penetration is already high, additional real increases are more likely to finance illicit rents and organised supply than to deliver proportionate reductions in consumption.

The second recommendation is to facilitate legal alternatives by enabling a better-regulated adult retail framework for e-cigarettes, designed to shrink demand for illicit tobacco by providing a lawful substitute channel under strong product and age controls. The Committee should recognise that state evidence already describes co-location of illicit tobacco and vaping products in contested retail environments and that these markets interact through shared distribution and retail channels, so a viable legal alternative can reduce foot traffic and profitability in illicit-aligned outlets. A regulated retail model, based on licensing, strict age verification, enforceable product standards, and clear penalties, offers a practical route to preserve public health objectives while reducing the customer base that sustains illicit combustible supply.

Together, these two reforms form a narrow but coherent redesign: the excise path stops mechanically increasing criminal rents through further real escalations, while regulated legal alternatives reduce the size of the illicit customer base and therefore the profitability of illicit distribution. The objective is not to abandon tobacco control, but to restore a feasible sequencing in which price policy does not outrun compliance capacity and thereby unintentionally strengthen organised illicit markets.

Submitted by

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¹⁶ ITEC (2025). [Illicit Tobacco and E-cigarette Commissioner Report 2024-25](#).