PUERTO RICO SUPPLIES GROUP

March 30, 2022

Office of Information and Regulatory Affairs
Office of Management and Budget
Executive Office of the President
Rengifo.gov

Sirs:

Puerto Rico Supplies Group, LLC. (PRSG) hereby appears before OIRA to provide Puerto Rico-specific information on the devastating economic impact of FDA's planned national ban on menthol-flavored cigarettes, due to its significant consequences on Puerto Rico's government tax revenues, over our operations and jobs throughout the economy.

PRSG is the leading consumer goods distributor in the territory of Puerto Rico and one of the largest family-owned businesses in the islands with over 1,000 employees in sales, distribution, manufacturing, and farming.

Seventy-seven years ago, our group's distribution business began mainly as a tobacco and paper distributor, later diversifying into other market segments. Despite efforts to diversify, 50% of our distribution business still depends on cigarette sales, of which 75% pertain to the menthol category. For example, Newport is the #1 brand with a 46% market share contributing $158 million in sales. Banning menthol-flavored cigarettes would literally wipe out half of our distribution business and jobs, while sadly fueling the already alarming illegal trade and, consequently, defeating the very purpose of FDA's planned rule.

Fueling the Black Market

It is no secret that prohibitions fuel illegal trade and black market and so will the menthol ban. In Puerto Rico the black market has historically undermined the legal sale of cigarettes, causing a reduction in the statutory contributory base and the government's excise tax revenues.

Fiscal year 2018 collection rate was 53.4%, representing a $46.4 million loss in revenues for the state. By comparison, by fiscal 2013 an 85.3% historical high was reached, in which the black market accounted for $32 million in lost collections.

Latest government projections for tobacco excise tax collections (FY 2021-22) estimate that revenues will fall 32% a clear signal that black market, contained by the Pandemic, is on the rise again.

As you know, Puerto Rico is the only territory within the customs border of the nation. Our island is less than 30 miles away from the United States Virgin Islands, an American territory not within the nation's customs border, and less than 50 miles away from the British Virgin Islands, the closest foreign jurisdiction. The Dominican Republic is less than 100 miles away from us, and Venezuela only several hundred miles away. The proximity to these diverse jurisdictions has made Puerto Rico a target for the illegal importation of legal and illegal products, as well as the trafficking of humans. The federal government invests huge resources to interdict illegal drugs, illegal trade and human trafficking. PRSG has closely collaborated with ICE and other federal law enforcement agencies in efforts against smuggling of cigarettes. For example, we've collaborated in cases regarding Newport trafficking from the United States Virgin Islands to our island in February 2020. Trafficking is made also from nearby foreign countries, such as the British Virgin Islands' Tortola, Saint Martin and St. Kits, and by air through Copa Airlines introducing cigarettes from Panama, Colombia, and other South American countries.

However, those agencies' priorities are targeting illegal drugs, such as cocaine, and interdicting the trafficking of illegal immigrants, such as Dominicans and Haitians.

The proposed menthol ban, in Puerto Rico's case, will unlikely be accompanied by a Federal allocation of additional resources to ICE, the US Coast Guard and other federal law enforcement agencies.

However, illicit trade not only stems from the abovementioned smugglers. We also battle with the black market created through the National Guard and Coast Guard Exchange (NGX, CGX) stores which sell tax-free Ashford brand made in Germany and Native American cigarette brands from Indian reservations. These are sold at the cheapest prices and below excise tax levels. The unstoppable illegal resale of these brands and smuggling from USVI will not be halted by the FDA as they promise. On the contrary.

While regulatory ban on menthol flavorings "will only address manufacturers, distributors, wholesalers, importers and retailers", the FDA "will not enforce against individual consumer possession or use of menthol cigarettes", fostering black market behavior. As the experience from the European Union suggests, menthol smokers will buy their cigarettes from other sources or convert to regular tobacco cigarettes.

<u>EU Menthol Cigarette Ban Limited Quit Rates</u>

The European Union ban on menthol-flavored cigarettes was made under the assumption that menthol encouraged smoking and that the ban would result in high quit rates. In 2020, the Foundation for a Smoke Free World conducted surveys to measure results. Surveys revealed that the menthol cigarette ban has had limited impact on smoking prevalence in the EU. The data indicates that quit rates among adult menthol cigarette smokers were relatively low, at approximately 8% overall in the post-ban survey. Across the surveyed markets, an average of 40% of respondents indicated that they reduced their menthol cigarette consumption, but either continued or increased their consumption of non-menthol varieties. Thirteen percent of respondents started buying menthol cigarettes from other sources; and another 13% began buying products to manually add a menthol flavor to regular tobacco products.

<u>Costs Will Be Greater than Benefits</u>

A ban on menthol-flavored cigarettes will also signify a strong blow to Puerto Rico tax revenues, since PRSG is the top contributor in taxes contributing over $160 million yearly, equivalent to 1.2% of current total revenues. Gas stations rely significantly on cigarette sales to remain economically viable. In the Gas & Convenience channel, cigarette sales are the second most important category in station sales. Substantial reduction in cigarette sales would put between 700 and 1,400 gas station jobs at risk. At a time that those retail businesses will have to invest hundreds of thousands of dollars each to charge their customers EVs, they could confront a significant drop in revenues.

Businesses in Puerto Rico will confront a bigger impact in rising energy prices than anywhere in the nation. Why the difference? Puerto Rico is the American jurisdiction where the highest percentage of energy generation is sourced by fossil fuels---97%. President Biden's release of oil from US reserves will not benefit Puerto Rico. Although the United States is the main producer in the world, Puerto Rico does not receive these supplies from any of the 50 states due to the Jones Act shipping regulation. Our island, it is probably the jurisdiction where, prior to the invasion of Ukraine, the highest percentage of gasoline supplies was derived from Russia. The Puerto Rico Energy Bureau raised electric rates by 16.8 percent this trimester. The islands' state excise tax on gasoline, 53¢ per gallon, is the highest in the nation.

At this time, the Government of Puerto Rico cannot afford to lose any tax revenues. It is just exiting bankruptcy, after the restructuring of an accumulated central government public debt of more than $72 billion and more than $50 billion in public pension liabilities.

Still unresolved are the bankruptcy proceedings for Puerto Rico's Highways and Transportation Authority (PRHTA) and the Puerto Rico Electric Power Authority (PREPA), which owes nearly $9 billion, the largest debt of any public entity.

Furthermore, our government has not recovered from Hurricane Maria which caused billions of dollars in damages in 2017, as well as a series of powerful earthquakes that struck its southern region starting in late 2019. In 2020 the coronavirus pandemic brought serious public health and economic setback. Now, record-high inflation, surging oil prices and potential food shortages hamper any chance of economic recovery. The Puerto Rico Government depends on cigarette tax revenues which for years have sustained fiscal expenditures.

As for the United States, the Tax Foundation recently estimated that the FDA national ban on menthol-flavored cigarettes will result in a $6.6 billion loss in government revenues the first full year following prohibition. In Puerto Rico, tobacco excise taxes are the highest in the nation and alone make up 40 percent or more of the retail price, making the menthol ban a high cost for federal and state government in revenue losses, with limited benefits in quit rates.

Conclusion

The FDA national ban on menthol-flavored cigarettes, and its application in Puerto Rico, America's largest battleground against illegal importation, will adversely affect in a material way the economy in Puerto Rico, our business, our jobs and of many others in the tobacco retail sector. It is an economically significant regulation, set forth in the worst of times with the global stagflationary shock caused by the war in Ukraine. With a less than optimistic inflation outlook, higher gas prices, continued supply chain problems, our livelihoods as government tax revenues should be protected.