

Combating the illicit trade in tobacco products

Why a protocol to the WHO-FCTC is needed

1. Why do governments need to tackle the illicit trade in tobacco products?

- **Loss of revenue.** Cigarettes and other tobacco products have a high tax value and are easy to handle, transport and divert. According to the European Anti-Fraud Office (OLAF), the tax value of one container load of 10 million cigarettes in 2007 was on average US \$2 million in the EU and US \$6 million in the UK.ⁱ Most of this is potential profit for a smuggler. The revenue losses to governments globally as a result of illicit trade in tobacco products are estimated to be in the order of approximately US \$40 to \$50 billion annually.ⁱⁱ
- **Undermines health objectives.** According to the World Health Organization, 5.4 million people died from tobacco-related diseases in 2006.ⁱⁱⁱ The illicit trade in tobacco products undermines high tobacco taxation policy by making cheaper tobacco products available. This is a critical health problem because evidence shows that increasing the price of tobacco products is one of the most effective ways to reduce tobacco consumption.^{iv}
- **A significant threat to the maintenance of law and order.** There is evidence that illicit trade in tobacco products is carried out by organized transnational criminal groups, and that money gained from illicit trade in tobacco products is used for other serious criminal enterprises, including terrorist operations.^v There are also indications that illicit trade in cigarettes will grow in the future because of the large profits that can be made.^{vi} US official reports indicate that cigarette smuggling is attractive to criminals because it is considered to be relatively low risk crime, with penalties that are lower than the penalties for smuggling illicit drugs.^{vii}
- **A global problem.** Illicit trade in tobacco products poses a threat to all countries. It has been estimated that the global illicit cigarette trade represents approximately 10.7% of global sales, or 600 billion cigarettes annually.ⁱⁱ Even for countries in which smuggled or counterfeit tobacco products are not yet common, illicit trade in tobacco products represents a threat, as this trade is spreading rapidly. Suppression of the financing and growth of transnational organised criminal activity is in the interests of all countries.

2. What is illicit trade in tobacco products?

Illicit trade in tobacco products is any practice or conduct prohibited by law, relating to:

- production
- shipment
- receipt
- possession
- distribution
- sale or
- purchase

of tobacco products, including any practice or conduct intended to facilitate such activity.

3. What are the main types of illicit trade?

Smuggling refers to illegally imported products and illicit manufacturing to illegally manufactured products. There are a number of forms of smuggling and illicit manufacturing of tobacco products. *Large-scale organized smuggling* involves the illegal transportation, distribution and sale of large consignments of cigarettes and other tobacco products. Large-scale smugglers generally avoid all taxes on tobacco products either by diverting them from the legal market while they are in the wholesale distribution chain (where they are carried untaxed), in transit between their country of origin and their official destination, or by smuggling counterfeit products. Tobacco products diverted from the legal market ‘disappear’ in transit, having been bought and sold by unofficial traders, and enter the illicit market in non-official destination countries.^{iv} A second form of smuggling is *small-scale smuggling or ‘bootlegging’*, which involves the purchase, by individuals or small groups, of tobacco products in low tax jurisdictions in amounts that exceed the limits set by customs regulations, for resale in high tax jurisdictions. *Illegal manufacturing* refers to the production of tobacco products contrary to law. The laws in question may be taxation laws or other laws (such as licensing or monopoly related laws) that restrict the manufacture of tobacco products. *Counterfeit* tobacco production is also a form of illegal manufacturing, in which the manufactured products bear a trademark without the consent of the owner of the trademark.

4. What are the causes of illicit trade?

The tobacco industry argues that illicit trade arises because of high taxation, but analyses by the World Bank have shown that high levels of illicit tobacco products are linked more closely to corruption and tolerance of contraband sales. The global trade in illicit tobacco products occurs in low tax as well as high tax jurisdictions, results from a lack of control on the international movement of cigarettes, and is run by criminal organisations with sophisticated systems for distributing smuggled cigarettes.^{iv}

5. What has been the role of the tobacco industry in facilitating the illicit trade?

Large-scale smuggling is mainly the result of large consignments of cigarettes which disappear during their international transport. Tobacco manufacturers have always claimed that they sell their products to first traders, but that they are unable to control the supply chain in order to ensure that the products are sold legally in the country of final destination. In fact international tobacco manufacturers have been heavily implicated in facilitating smuggling operations.^{viii ix x xi} Indeed in 2000, Kenneth Clarke, BAT's Deputy Chairman complained in response to an expose of the company's links to smuggling, that smuggling was caused by high taxes and that, *"where governments are not prepared to address the underlying causes of the problem . . . we act, completely within the law, on the basis that our brands will be available alongside those of our competitors in the smuggled as well as the legitimate market."*^{xii}

Lawsuits against tobacco companies have dramatically changed the export practices of the tobacco companies. In November 2000, the European Community filed lawsuits against Philip Morris and RJ Reynolds for smuggling. The effect of the lawsuits was immediate: seizures of cigarettes in the EU-14 (the then EU countries without the UK) dropped from 4.3 billion in 2000 to 3.1 billion in 2001 and 2.3 billion in 2002.^{xiii} Subsequent to the lawsuits Philip Morris International and Japan Tobacco International concluded anti-contraband and anti-counterfeit agreements with the European Community and 26 of 27 Member States. Elements of these agreements – such as tracking and tracing, control of the supply chain and payments upon seizure of contraband products – are included in the protocol template prepared by the expert group on illicit trade established by the Conference of the Parties to the FCTC (COP).^{xiv} So far, these agreements apply only to two companies and 26 European countries and not to all tobacco companies and countries. More detail on these Agreements can be found in a separate FCA factsheet^{xv}

6. Why is a protocol necessary to tackle illicit trade effectively?

The FCTC recognizes that illicit trade is a cross-border problem that can only be effectively addressed if countries cooperate in doing so, but Article 15, which deals with illicit trade, is not sufficiently detailed or comprehensive to tackle it effectively. The COP has thus decided to commence the negotiation of a protocol on illicit trade.^{xvi} The 152 Parties to the FCTC^{xvii} cover over 80% of the world's population and of tobacco leaf production, 76% of cigarette production, 78% of cigarette consumption, and 70% of cigarette and leaf exporters.^{xviii} This is a truly global network. The adoption, ratification and implementation of a strong protocol by the Parties to the FCTC is critical to tackling the sophisticated international criminal trade in tobacco products, and the direct or indirect involvement of the tobacco industry in this criminal trade.

7. What should a protocol include?

A template for a protocol on illicit trade was developed by an expert group set up by the first session of the COP.^{xix} The second session of the COP recognized the template as a basis for initiating negotiations on a protocol.^{xx} The FCA supports

the template,^{xxi} which includes a comprehensive set of measures, both domestic and international, to tackle the illicit trade. Measures set out in the template include marking of tobacco products so they can be tracked and traced from manufacture to point of sale and illicit products, including counterfeit, can be identified.^{xxii} This would also help determine the point of diversion from the legal to the illicit market. Licensing of participants within the supply chain would ensure they can be monitored effectively and risk losing their license if they are found to be dealing in illicit products. The template also includes obligations on manufacturers to control the supply chain for their products, with serious financial penalties for those that fail to do so. Enhanced law enforcement and international cooperative measures, such as cooperation in investigation and prosecution of offences, information sharing, mutual legal assistance and extradition arrangements would enhance the ability of governments to work effectively together to overcome the illicit trade.

8. What are the costs and benefits of combating illicit trade?

There will be costs associated with the implementation of a protocol on illicit trade in tobacco products. These costs are, however, likely to be massively outweighed by gains to government revenue through increased compliance with taxation laws. In addition, legislation can require the tobacco industry to pay the costs of combating the illicit trade. The costs of introducing the high tech tax stamp system in Brazil in 2007, for instance, have been assessed at US 1.7 cents per cigarette pack.^{xxiii} The costs to the government were minimal, as the law stipulates that the costs are borne by tobacco manufacturers.

The experience of California demonstrates that combating illicit trade results in overall gains to government revenue. Californian authorities made licensing obligatory in the tobacco trade and introduced high tech tax stamps and investigative authority to better control the distribution chain. The costs have been calculated to be US \$9 million per year in return for significant additional tax revenue on cigarettes – an additional US \$75 million was collected between January 2004 and March 2006 as a result of the licensing act and the tax stamps.^{xxiv}

Cost-effective measures to combat illicit trade have also been implemented in Spain, where the market share of smuggled cigarettes decreased from 16% in 1995 to 2% in 2002, while tax revenue from cigarettes more than doubled from €2.3 billion to €5.2 billion in the same period.^{xxv} According to the Spanish Customs authorities, their success was not due to controlling distribution at street level, which is almost impossible, but to reducing the supply into the country at ‘container level’, through intelligence, customs activity and cooperation, and technology.^{xxvi}

9. Would an international agreement to combat illicit trade be restrictive of international trade?

A standardised international system imposing consistent requirements upon tobacco products in different jurisdictions is likely to impose fewer burdens upon free trade than approaches that differ by jurisdiction. In so far as some measures

required to eliminate illicit trade in tobacco products may be restrictive of trade, there are precedents for this in numerous multilateral treaties. For example, the Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition^{xxvii} and the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)^{xxviii} contain provisions, such as import and export licensing requirements, which are contrary to Article XI (quantitative restrictions) of the General Agreement on Tariffs and Trade (GATT).^{xxix} The inclusion of trade restrictive terms in these treaties is premised upon the assumption that exceptions such as those in Article XX of the GATT leave Parties sufficient room to pursue the measures included in these agreements. The Article XX exceptions permit Parties to pursue a range of public policy goals including enforcement of taxation measures and protection of health. In the preamble to the FCTC, the determination of the Parties to the FCTC “to give priority to their right to protect public health” is clearly recognised.

ⁱ European Commission, Contraband and counterfeit cigarettes: frequently asked questions, Brussels, December 14, 2007. available at <http://www.europa.eu/rapid/pressReleasesAction.do?reference=MEMO/07/584&format=HTML&aged=0&language=EN&guiLanguage=en>

ⁱⁱ Framework Convention Alliance, *How big was the illicit tobacco problem in 2006?* Geneva, 2007, available at http://fctc.org/x/documents/HowBigWasTheIllicitTobaccoTradeProblem_2006_English.pdf.

ⁱⁱⁱ WHO Tobacco Free Initiative Tobacco Fact sheet June 2007, available at http://www.who.int/tobacco/framework/cop/facts_and_figures_about_tobacco.pdf

^{iv} World Bank, *Curbing the Epidemic: Governments and the Economics of Tobacco Control*, Washington, DC, 1999, available at <http://www1.worldbank.org/tobacco/reports.htm>.

^v US General Accounting Office (GAO), ‘Terrorist Financing: US Agencies Should Systematically Assess Terrorists Use of Alternative Financing Mechanisms’, Report to Congressional Requesters GAO-04-163, November 2003. available at <http://www.gao.gov/new.items/d04163.pdf>

^{vi} Billingshea, W., ‘Cigarette Trafficking and the Funding of Terrorism’, *The Police Chief*, vol. 71, no. 2, February 2004, available at http://policechiefmagazine.org/magazine/index.cfm?fuseaction=print_display&article_id=226&issue_id=22004

^{vii} US General Accounting Office (GAO), ‘Cigarette smuggling: Federal law enforcement efforts and seizure increasing’, Report to the Chairman and Ranking Minority Member, Committee on Government Reform, House of Representatives GAO-04-641, May 2004, available at <http://www.gao.gov/new.items/d04641.pdf>

^{viii} Joossens, L., Raw, M., ‘How can cigarette smuggling be reduced?’, *British Medical Journal* 321:947-950, 14 October 2000, available online at <http://bmj.com/cgi/content/full/321/7266/947>.

^{ix} Lee, K., Collins, J., ‘“Key to the future”. BAT and smuggling in China’, *Plosmedicine*, July 2006, Vol 3 (3), e228, July 2006.

^x Beelman, M.S., Birnbauer, B., Campbell, D., Marsden, W., Schelzig, E., Sisti, L., *Tobacco Companies Linked to Criminal Organizations in Cigarette Smuggling*, Washington, DC, Center for Public Integrity, available at <http://www.publicintegrity.org/report.aspx?aid=351>.

^{xi} US Department of Justice press release. 22 December 1998. *RJ Reynolds affiliate pleads guilty, pays \$15 million in criminal fines and forfeitures as part of cigarette smuggling operation.* <http://www.usdoj.gov/opa/pr/1998/December/605usa.htm>

^{xii} The Guardian, Thursday February 3, 2000. [BAT exposé: special report](http://www.guardian.co.uk/bat/article/0,,191288,00.html) <http://www.guardian.co.uk/bat/article/0,,191288,00.html>

^{xiii} Source: 2000 cigarette seizure European Anti-Fraud Office and UK Customs & Excise, 2001-2002 seizures European Anti-Fraud Office. European Commission, Contraband and counterfeit cigarettes: frequently asked questions, December 14, 2007. HM Treasury, Tackling fraud and smuggling, 27 November 2001, press release, available http://www.hm-treasury.gov.uk/pre_budget_report/prebud_pbr01/press_notices/prebud_pbr01_presscust1.cfm.

^{xiv} ‘Elaboration of a template for a protocol on illicit trade in tobacco products’ (World Health Organization, Conference of the Parties to the WHO Framework Convention on Tobacco Control, second session, provisional agenda item 5.4.1, A/FCTC/COP/2/9, 19 April 2007) 8, available at http://www.who.int/gb/fctc/PDF/cop2/FCTC_COP2_9-en.pdf.

^{xv} Framework Convention Alliance, “Fact sheet about the EU Agreements with tobacco manufacturers to control the illicit trade in tobacco”, Geneva, 2008.

^{xvi} Conference of the Parties to the WHO Framework Convention on Tobacco Control, Third Report of Committee A, 6 July 2007, A/FCTC/COP/2/22 available at http://www.who.int/gb/fctc/PDF/cop2/FCTC_COP2_22-en.pdf

-
- ^{xvii} WHO Framework Convention on Tobacco Control (FCTC), 16 January, 2008 Parties (Ratifications/Accessions) <http://www.fctc.org/docs/treaty/fca-fctc-ratification-overview-en>
- ^{xviii} WHO Tobacco Free Initiative Tobacco Factsheet, June 2007, available at http://www.who.int/tobacco/framework/cop/facts_and_figures_about_tobacco.pdf.
- ^{xix} Elaboration of Protocols (decision FCTC/COP1(16)) Elaboration of a template for a protocol on illicit trade in tobacco products A/FCTC/COP/2/9. World Health Organization. Geneva, April 2007.
- ^{xx} Conference of the Parties to the WHO Framework Convention on Tobacco Control, Third Report of Committee A, 6 July 2007, A/FCTC/COP/2/22 available at http://www.who.int/gb/fctc/PDF/cop2/FCTC_COP2_22-en.pdf
- ^{xxi} FCA: Comments on the template for a protocol on illicit trade in tobacco products. Framework Convention Alliance. November, 2007 available at <http://www.fctc.org/docs/documents/fca-2007-inb-illicit-trade-inb1-briefing-en.pdf>
- ^{xxii} “Tracking” refers to the ability of competent authorities to systematically monitor the movement of tobacco products from the place of manufacture, through the distribution chain, to the intended market of retail sale, making sure all relevant duties and taxes have been paid. “Tracing” refers to the ability of competent authorities, on the occasion of an audit or a seizure of a genuine product, to recreate the route taken by a tobacco product from the place of manufacture, through the distribution chain, to the point where the product has been diverted into illegal trade channels. (Source: Elaboration of a template for a protocol on illicit trade in tobacco products.)
- ^{xxiii} Personal communication, Marcelo Fish, Ministry of Finance, Brazil, 4th December 2007.
- ^{xxiv} California State Auditor, Implementation of State Auditor’s Recommendations, Audits released in January 2005 through December 2006, Report NO. 2007-406, February 2007, Sacramento, available at <http://www.bsa.ca.gov/pdfs/reports/2007-406.pdf>.
- ^{xxv} Bonilla Penvela, N.J., ‘Evolución del contrabando de tabaco en España, *Prevención del tabaquismo*, 5(2), 127-135, Abril-Junio 2003.
- ^{xxvi} Joossens, L., *Report on smuggling control in Spain*, World Health Organization, 2003, available at http://www.who.int/tobacco/training/success_stories/en/best_practices_spain_smuggling_control.pdf.
- ^{xxvii} *Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition, supplementing the United Nations Convention against Transnational Organised Crime* (opened for signature 2 July 2001, entered into force 3 July 2005).
- ^{xxviii} *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, (opened for signature 3 March 1973, entered into force 1 July 1975).
- ^{xxix} *Marrakesh Agreement Establishing the World Trade Organization* (opened for signature 15 April 1994, entered into force 1 January 1995), annex 1A (*General Agreement on Tariffs and Trade*). With respect to the question of the lawfulness of conditional licensing schemes, see Panel Report, *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, WT/DS90/R, adopted 22 September 1999, paras 5.129 – 5.130 (upheld by Appellate Body Report, WT/DS90/AB/R, DSR 1999:V, 1799).