



International  
Conference on  
Illicit Tobacco  
Trade

### Inside this issue:

- A liability regime that's tried and true 2
- Improving the Chair's Text 4-5
- Taxe à l'exportation 5

### FCA Briefing

Have lunch with a former Trade Minister and a top enforcement officer, in UN Private Dining Room 6/7/8, 1 pm to 3 pm.  
*Full details p. 6.*

## DEATH CLOCK

Since the opening of the first working group for the Framework Convention on Tobacco Control on 25 October 1999,

**11,128,914**

people have died from tobacco-related diseases.  
(At 9 am 31 July 2002)

# ALLIANCE BULLETIN

Framework Convention on Tobacco Control

New York, USA

Issue 25

Wednesday, 31 July

## ICITT serves up tempting hors-d'oeuvre – now for the main course...

**T**he ICITT got off to a fine start as delegates consumed what one ATF official called the 'appetisers' of the first day.

Most notable was a fine presentation by the World Bank that laid out the underlying economics and commerce of tobacco smuggling. It showed that tax harmonisation would be ineffective in tackling smuggling and highlighted the role of the tobacco companies in exploiting weak controls and management of the wholesale distribution system.

Several excellent presentations and interventions from the floor in the afternoon drew the delegates into far more precision and depth than seen at any

point so far in the FCTC process.

Brazil explained a series of measures it has taken to license and control trade in order to deal with its huge smuggling problem and transit trade with Paraguay.

The European Commission made a practical case for traceability as vital tool for law enforcement. Mali spoke of the need for a system of prior notification and consent to regulate the trade.

The task for Wednesday is to build on this solid start and seriously look at the extraordinary measures needed to tackle this extraordinary \$25 billion problem.

Here are five challenges for delegates:

1. Agree to an ambitious definition of tracking and tracing — reflecting the need to track or trace movements through wholesale distribution, not just to identify the original manufacturing plant.
2. Agree that a mandatory licensing scheme is appropriate for large traders handling duty-suspended product — and to allay the fears of many delegates, recognise that a licensing system for retailers is not appropriate for the FCTC.
3. Consider options for a notification and consent system that would ensure that tobacco is only traded when the import, export and transit countries have full details of the consignment, including the point at which duty will be paid.



World Bank economist **Joy de Beyer** explained how, despite smuggling, countries that raise their cigarette taxes increase

*(Continued on page 2)*

# Liability regime for tax losses due to smuggling: learning from other treaties

If cigarette companies had the right incentives, most large-scale smuggling of legally manufactured product would stop very quickly. Given good reasons to protect future government revenue, the companies themselves would take measures to secure the distribution system.

One way to achieve this would be to introduce a liability regime, in which the manufacturer or exporter would remain responsible for the legal sale of the consignment until all excise duties had been paid. This is not such a revolutionary idea — it may be helpful to draw a parallel between the trade in tobacco products and the trade in hazardous waste.

The Basel Convention of 1992 has a number of features that could be incorporated into an anti-smuggling regime for tobacco products. Some of the relevant articles of the Basel Convention include: consent of importing state to the export; duty of care on persons handling the product (4.2.b); licensing of persons involved in the trade; notification of all shipments with prior consent from importers and transit countries; and requirement to insure goods in transit.

The Basel Convention's 1999 protocol on liability and compensation also has useful features that could be adapted for control of smuggling. These include: the objective of ensuring that compensation is paid for damage from accidents or illegal trade; imposing strict liability on the exporter (either the state or company) throughout transit, until the proper result of trade has been achieved (i.e. final disposal); requiring

companies to hold insurance to cover strict liability and requiring each party ensure its courts can handle compensation claims.

The liability regime for trade in hazardous waste builds on the basic 'housekeeping' and security built into the Basel Convention. The Convention secures the distribution and declares exporters responsible for their conduct. The protocol makes them pay if things go wrong.



If this sort of regime can be applied to hazardous waste, why not to tobacco? Some suggest this would be too burdensome. However, unchecked cigarette smuggling is clearly far more burdensome, with one-quarter of traded cigarettes to the black market, the loss of \$25 billion, and the loss of lives resulting from increased consumption.

<u>Characteristic</u>	<u>Hazardous waste</u>	<u>Tobacco products</u>
Legal product	Waste	Cigarettes
Proper result of trade	Sound management of waste	Tax-paid sale to tobacco user
Illegal act	Dumping	Smuggling
Damage from illegal act	Pollution / health	Tax losses / health
Multilateral institution	UNEP / WMO	WHO / WCO
Convention	Basel Convention	FCTC
Liability protocol	Agreed	Possible

...now for the main course

*(Continued from page 1)*

4. Explore mutual assistance and co-operation between customs organisations more thoroughly — the current language of the Chair's text is short on detail, but the World Customs Organisation produced a detailed draft protocol in 2001 that could be adopted by the parties.
5. Formulate a list of options that would change the incentives to tobacco companies and wholesalers to smuggle, so that rather than benefit from it they lose out if their products are diverted to the black market.

# Co-operation and collusion....

***“The issues of contraband cigarette smuggling and counterfeit cigarettes are as great a concern to Philip Morris as they are to governments,”***

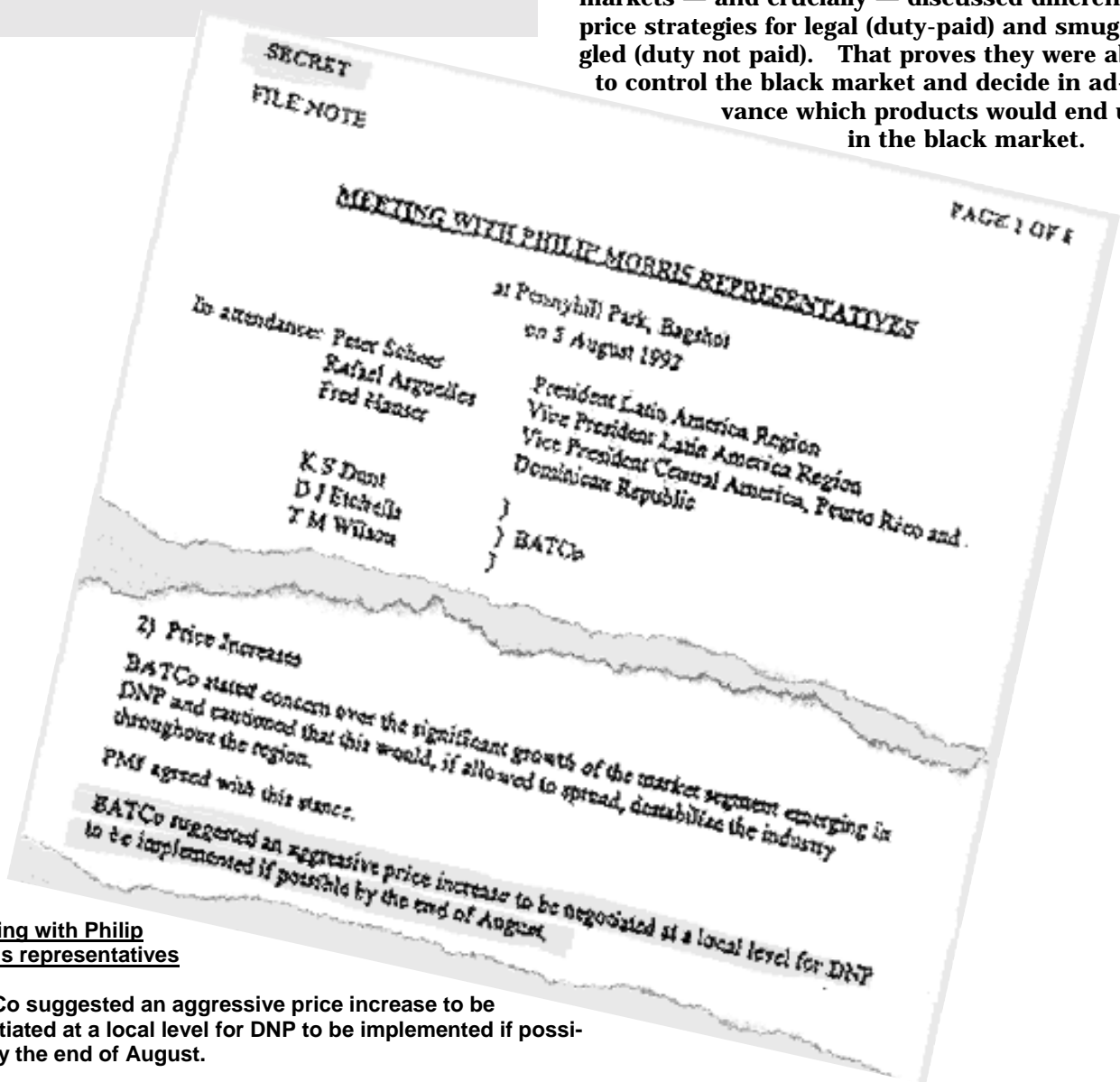
***“However, this is a problem that should be addressed through co-operation rather than litigation.”***

William S. Ohlemeyer,  
Philip Morris vice-president  
(BBC news 18 July 2001)

As in, ‘co-operation’ to make smuggling more profitable?

Not that long ago, at a comfortable hotel in Southern England, Philip Morris International was meeting with BAT to carve up the Andean markets in Latin America. BAT’s formerly secret notes of the meeting were released through litigation in the United States. This memo shows co-operation in action.

The two companies decided on prices for these markets — and crucially — discussed different price strategies for legal (duty-paid) and smuggled (duty not paid). That proves they were able to control the black market and decide in advance which products would end up in the black market.



## Meeting with Philip Morris representatives

BATCo suggested an aggressive price increase to be negotiated at a local level for DNP to be implemented if possible by the end of August.

# The new Chair's Text on illicit trade...

Article 15 of the new FCTC Chair's Text covers illicit trade in tobacco. We comment on some of the main provisions below under the headings used in the agenda of the ICITT.

Our overall evaluation: as now drafted, the Text ***falls far short of providing a co-ordinated and realistic international response to a multi-billion-dollar problem***. In particular, it is silent on the liability of manufacturers and large distributors.

## **Licensing**

**Chair's text:** 15.8. Each Party shall endeavour to adopt and implement further measures including licensing, where appropriate, to control or regulate the production and distribution of tobacco products in order to prevent illicit trade.

**Comments:** This should be sharpened to a mandatory requirement to establish a licensing system for wholesalers trading in large consignments of duty-not-paid tobacco products. The licensing system should be common to all parties and integrated globally. A mandatory licensing system for retailers is *not appropriate for the FCTC*, as many countries would find this excessively expensive and burdensome for little return.

## **Record-keeping**

**Chair's text:** 15.5 (d) adopt and implement measures to monitor, document and control the distribution and movement of duty-free tobacco products, pending their prohibition in accordance with Article 6.2(c).

**Comments:** This should be applied to ALL movements of tobacco products on which the full duties have not been paid. The vast majority of such movements are 'duty-suspended' wholesale shipments that should eventually be duty-paid in normal retail markets.

Suggested alternative wording would generalise the requirement to all duty-not-paid movements:

*(d) adopt and implement measures to monitor, document and control the distribution and movement of tobacco products on which the full import or excise duty has not been paid.*

This is potentially a substantial obligation and would require co-operation between parties; a common (computerised) system would have to be specified.

## **Labelling**

**Chair's text:** 15.3(b) carry the statement "Sales only allowed in (*insert name of the country, subnational, regional or federal unit where the product is to be placed*

*on the market*)" or carry any other effective marking which would assist authorities in determining whether the product is legally for sale on the market for which it is intended as a final destination.

**Our comments:** This is an important clause. The aim should be to identify the final market at the time of manufacture, something the tobacco industry already has to do for part of its production runs, because of requirements to print health warnings in national languages.

## **Tracking and tracing**

**Chair's text:** 15.3.(a) carry a marking in any appropriate manner in order to identify the origin and enable the tracking of the product, including the name of the manufacturer, the country of origin, the product and batch number and the date of production;

**Our comments.** Before embarking on discussions about this concept, delegates should agree on terminology. Different definitions of tracking and tracing are in use in the corridors. There is a great difference between being able to trace the original manufacturing plant, and the ability to trace the movement of the product through several distributors to the point where the product was diverted to the black market. These definitions were not included in the Chair's text, but we suggest....

**"Tracking"** is the systematic monitoring of the movement of tobacco products from the place of manufacture to the place where all relevant duties and taxes have been paid.

**"Tracing"** refers to the ability of competent authorities retrospectively to recreate the route taken by a tobacco product from the manufacturing plant through the distribution chain to the point where a product was diverted into the black market.

This would require, for example, a *unique identifier* on each pack, with some means of recording its movements once it left the manufacturing plant. Batch

number marking is likely to be ineffective — batches could be extremely large and be divided between dozens of customers making investigation of fraud impossible. We suggest the alternative:

(a) carry overt or covert markings that uniquely identify each packet and allow enforcement authorities to track and trace it from the point of manufacture through the entire chain of custody.

#### **Information sharing and mutual assistance**

**Chair's text.** 15.7. The Parties shall promote cooperation between national agencies, as well as regional and international intergovernmental organizations, as it relates to investigations, prosecutions and proceedings, in order to eliminate illicit trade in tobacco products. Special emphasis shall be placed on cooperation at regional and subregional levels to combat illicit trade of tobacco products.

#### **Our comments:**

This language is too vague. At some point a more precise text is needed. At INB-3, the World Customs Organisation produced a draft protocol on mutual administrative assistance with appropriately specific language. The main elements include:

- Definitions
- Scope of information exchange
- Surveillance of suspect movements
- Controlled delivery (sting operations)
- Arrangements for assistance
- Hot pursuit
- Joint operations
- Information exchange
- Recovery of Customs claims
- Exchange of expert witnesses
- Procedures for making requests of other parties
- Arrangements for visiting officials
- Confidentiality
- Exemptions
- Cost-sharing regime

## Contrôle de la contrebande à la source : le cas du Canada

Dès 1992, le Canada découvre l'efficacité des *taxes à l'exportation* pour prévenir la contrebande de cigarettes.

À l'époque, la contrebande ne cesse de gagner du terrain au Canada et provient presque exclusivement de la réimportation illégale de cigarettes canadiennes qui ont été exportées aux États-Unis. En effet, les fumeurs canadiens ont toujours opté (à plus de 98 %) pour les marques canadiennes.

En imposant une taxe à l'exportation, le Canada a donc pu priver les réseaux de la contrebande de leurs principaux fournisseurs. À tel point que les cigarettiers ont usé de leur influence considérable pour convaincre le gouvernement d'abolir la taxe à l'exportation. En contrepartie, l'industrie du tabac a promis sa pleine et entière collaboration dans la lutte

contre le trafic illégal.

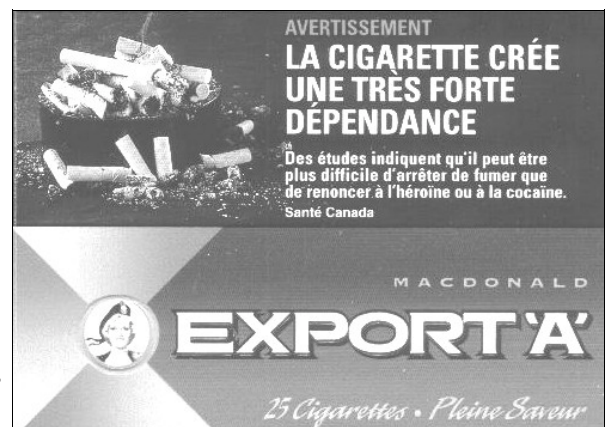
Les exportations massives vers les États-Unis ont recommencé, et avec elles, la contrebande, jusqu'à ce que le gouvernement cède de nouveau aux pressions de l'industrie et décide en 1994 de réduire ses taxes de façon draconienne.

Au même moment, le Canada a réintroduit une taxe à l'exportation, laquelle a été beaucoup renforcée en 2001 et de nouveau en juin 2002. Sont maintenant taxées toutes les exportations de cigarettes — y compris les livraisons aux boutiques hors-taxes — quelles que soient les quantités.

Un fabricant qui

décide d'exporter plus de 1,5 % de sa production à l'étranger (où la demande pour les cigarettes canadiennes est presque inexistante) est frappé d'une taxe de 35 \$ can. (21 \$ US) la cartouche de 200 cigarettes.

Cette taxe est remboursable dans la mesure où le fabricant peut prouver que les cigarettes ont été légalement réimportées et taxées par un autre pays.



En 1992-1993, RJR-Macdonald a réussi à accroître la part de marché de sa marque Export 'A' au Canada — en exportant massivement aux États-Unis, où la marque est inconnue des fumeurs...

# Luncheon Briefing Reminder

From 1 p.m. to 3 p.m. today, the Framework Convention is hosting a special luncheon briefing in the UN Private Dining Room 6/7/8, to which all government delegates are heartily invited.

Featured speakers include a trade expert (and former politician) and a prominent senior enforcement official from Europe. The full list:

Carlos Ronderos was Colombia's Minister of Foreign Trade from 1996 to 1998. Today he is a professor in the International Trade and Business Programme at the *Universidad del Rosario* in Colombia.

Austin Rowan currently serves as Head of Operations, Task Group Cigarettes, Directorate of Operations & Investigation, European Anti-Fraud Office (OLAF), European Commission. Before joining the Commission, he was in the Special Investigations Branch of the Irish Customs Service.

Clive Bates is Director of Action on Smoking and Health (ASH-UK), based in London, which provides information about all aspects of tobacco, and campaigns nationally and internationally to build support for policies and legislation that will reduce the harm caused by tobacco.

David Sweanor is Legal Counsel of the Smoking and Health Action Foundation in Canada. His primary area of work has been the interaction of law and economics as a determinant of public health, with particular recent emphasis on tax policy and contraband tobacco.

This will be a sit-down luncheon with a full menu of excellent food.

***"All smuggling to Ukraine is undertaken with full support of the 5 TTC (Philip Morris, Reynolds, Reemtsma, BAT, Rothmans). They could stop 90% of smuggling within 10 minutes if they wish to, because they know exactly their clients involved in smuggling."***

— From a 1996 report by tobacco import firm Duncan-Kiev. (Quoted in: Alcohol and Drug Information Centre—Ukraine, *Economics of tobacco control in Ukraine from the public health perspective.*)

## Tracking and tracing demonstration

The technology to track and trace tobacco products can be seen in action on a demonstration production line at U Thant Room, 2<sup>nd</sup> floor, UN Millennium Hotel, 1 UN Plaza, opposite the UN building. Contact details at SICPA stand on lower ground floor level exhibition booth.

## Dirty Ashtray Award

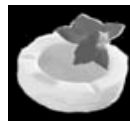
The duty-free lobby, for trying to convince delegates that an entirely unjustifiable tax concession to travelling smokers is somehow important to the economy.



## Creative Accounting

The Arthur Anderson prize goes to the US administration for claiming federal expenditure on tobacco control is US\$1 billion.

## Orchid Award



The World Bank, for exposing the role of the tobacco industry in smuggling and debunking its bogus arguments.