



FRAMEWORK CONVENTION  
**ALLIANCE**  
BUILDING SUPPORT FOR TOBACCO CONTROL

# BULLETIN

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## DEATH CLOCK

SINCE THE OPENING OF THE  
FIRST WORKING GROUP FOR  
THE FRAMEWORK CONVENTION  
ON TOBACCO CONTROL ON  
29 OCTOBER 1999

# 43,563,834

PEOPLE HAVE DIED FROM  
TOBACCO-RELATED DISEASES  
(AS OF 9AM ON 3 JULY 2009)

## DUE DILIGENCE: WHY IT MATTERS

Due diligence seems to be in deep trouble. Much confusion and some obstruction in Committee A is leading to a growing forest of brackets in Article 6, and there is a serious danger that INB-3 may see this vital weapon in the fight against illicit trade made largely useless or even thrown away altogether.

FCA appeals to Parties not to do this. We strongly support the principle that businesses involved in the tobacco industry should be made to conduct due diligence on those with whom they transact. It is absolutely unacceptable that the industry should be able to sell its products to dubious customers and then wash its hands of all responsibility for what happens next.

FCA believes that due diligence is a duty – and a cost – that properly belongs with the businesses themselves and not with government or a state agency. For governments to conduct due diligence would mean a nightmare of expensive bureaucracy, as hundreds of officials spent thousands of wasted hours checking millions of records. Therefore, businesses that manufacture tobacco products or the equipment used in manufacturing them, and those that trade in tobacco, tobacco products or the equipment used in manufacturing them, whether importing, exporting, brokering, or warehousing them, should know their customers. They should collect key facts, keep records, and report any transactions that they have good reason to think are suspicious. If the products they supply are found in illicit channels, they should have to prove that they have taken every reasonable step to stop that from happening.

It is important to see due diligence obligations as fitting logically and powerfully with other supply chain control measures: licensing, tracking and tracing, record-keeping, and other “security and preventive” measures. Taken together, they provide a set of tools to tackle illicit trade. Take any away, or weaken them, and the others are weakened too.

Some Parties have suggested that due diligence cannot be enforced. But it can. The threat is obvious. Government should say to business: “If we catch your products, or those of your customers, where they should not be, your records had better show that you conducted due diligence. If they don’t, your licence will be in doubt.”

There are plenty of examples of laws relating to due diligence, from weapons, to trade, to finance. Due diligence is a tried-and-tested regulatory measure, particularly for products and activities that can and do cause terrible harm.

FCA’s message to Parties is simple. Do not get confused about this vital but straightforward idea. Make the tobacco businesses do due diligence. If they fail to do so, take away their licences, or impose other penalties. Do not let Article 6 be nibbled away at by the weasel words “should” instead of “shall”, “when appropriate”, “should consider” or any of the other phrases that negotiators routinely use when they are trying to avoid taking action without actually saying so.

Due diligence matters a great deal. Please do not miss the chance to put it into practice.

# PUBLIC HEALTH AND PUBLIC PURSE WRACKED BY ILLICIT TRADE



A major new report released today details the extent of the illicit trade in tobacco in the MERCOSUR countries of Argentina, Brazil,

Paraguay and Uruguay. MERCOSUR is a regional free trade agreement concluded by the four countries in 1991.

The report, compiled by economist Alejandro Ramos, of Uruguay's Centro de Investigación de la Epidemia del Tabaquismo, brings together information gathered by experts throughout the MERCOSUR region. It estimates the total size of the illicit market in the region in 2007 as 45 billion sticks (cigarettes) every year. Most of the illegal production is centered in Paraguay, and about nine-in-ten illicit cigarettes are consumed in Brazil. In addition, another 30 billion cigarettes leave the MERCOSUR region for other countries, often through Panama or Aruba. If the total of illicit trade in cigarettes around the world is about 600 billion sticks a year, this would mean that about 12.5 per cent of this trade originates in the MERCOSUR region.

Paraguay, in particular, has seen sharp growth in the tobacco industry over the last 20 years. In 1993, there were only three tobacco companies in the country, by 2007 there were as many as 25 firms importing tobacco and cigarettes and 40 exporting. Total cigarette production is estimated at about 70 billion cigarettes in 2007, with a production cost of about five US cents a pack. A factory selling to smugglers might charge ten US cents a pack in cash for large orders. The cost of a pack of cigarettes legally traded in neighbouring countries would be about 50 US cents a pack.

In Brazil, the total market for cigarettes, both legal and illegal, is estimated to be about 140 billion sticks. The legal market is dominated by Souza Cruz (with approximately a 78 per cent share) and PMI (about 13 per cent). The illegal market has been estimated at about 30 billion cigarettes a year. In the 1990s, Souza Cruz cigarettes were frequently manufactured in Brazil, exported to neighbouring countries and then re-introduced illegally to Brazil, avoiding domestic taxes in a process called "triangulation". Cigarettes were also often produced for export but in fact sold in the domestic market. More recently, after struggles between the industry and the Brazilian government over export taxes on tobacco products, "triangulation" appears to have disappeared. But small producers have been prosecuted by the authorities for owning factories in Brazil and Paraguay, producing in Brazil, labelling products as coming from Paraguay, and then claiming that they had been illegally imported to Brazil by third parties.

Argentina has a domestic market of about 40 billion cigarettes, with PMI (Massalin Particulares) having about 70 per cent of the legal market and BAT (Nobleza Piccardo) about 26 per cent. Some small companies sell brands that are also produced in Paraguay, for example *Rodeo*. The small producers have also fought to avoid the tax system agreed with the major companies, which imposes a tax rate of 75 per cent of retail price on the best-selling brands. Small producers

compete mainly for market share in cheaper brands.

In Uruguay, the leading cigarette firm, Montepaz SA, is domestically-owned and has about 70 per cent of the legal domestic market. Montepaz exports both cigarettes and cut tobacco to Paraguay, where it also owns a factory. The cigarette brands exported are *Calvert* and *Broadway*, not sold in the domestic market. In 2006, Montepaz exported about 2.5 billion cigarettes, twice its domestic sales in Uruguay, and three million kilograms of tobacco raw material. It is likely that a substantial proportion of these exports are then resold to "operators" in Paraguay, who then move them to Brazil.

## TAXES ON ILLICIT CIGARETTE PRODUCTION IN PARAGUAY COULD YIELD AT LEAST US\$130 MILLION A YEAR

MERCOSUR country governments, with the governments of the associated countries of Bolivia, Chile and Peru, signed an agreement to fight brand counterfeiting and cigarette contraband in December 2004. A further agreement was substituted in 2006, but this contains fewer explicit commitments to action on illicit trade in tobacco products. The new agreement has not yet been ratified by most of the countries concerned.

The new report makes it clear that illicit trade in tobacco is damaging both the MERCOSUR economies and public health. For example, were taxes to be collected in Paraguay on what is produced illicitly, the government could expect to benefit by at least US\$130 million a year.

The report makes a series of recommendations to fight the illicit trade in the region, including stronger penalties for individuals and companies convicted of offences related to illicit trade, and for any government or public officials who are found to be involved. New offences related to organised crime are also recommended. The report calls for tougher regulations covering the transit of merchandise in free trade, transit and free ports, and for greater co-ordination and sharing of intelligence between customs bureaus and other law enforcement agencies. The report also calls for the establishment in MERCOSUR of a cross-border anti-fraud office.

### REFERENCE

Ramos, A. MSc. *Illegal trade in tobacco in the MERCOSUR countries*, Working Paper for CIET (Centro de Investigación de la Epidemia del Tabaquismo) Uruguay, funded by the Bloomberg Foundation

# EL COMERCIO ILÍCITO ARRUINA LA SALUD PÚBLICA Y EL ERARIO PÚBLICO



Un nuevo informe del Centro de Investigación para la Epidemia del Tabaquismo (CIET - Uruguay) que estudia en profundidad la extensión del comercio ilícito de tabaco en los países de MERCOSUR (Argentina, Brasil, Paraguay y Uruguay) será publicado en breve. MERCOSUR es un acuerdo de libre comercio que los cuatro países firmaron en 1991.

El informe, compilado por el economista Alejandro Ramos a partir de informes de expertos de la región de MERCOSUR, estima el volumen total del mercado ilícito en la región en 2007 en 45 mil millones de cigarrillos al año. La mayor parte de la producción ilícita se centraliza en Paraguay; cerca de nueve de cada diez cigarrillos ilícitos se consumen en Brasil. Además, otros 30 mil millones de cigarrillos salen de la región de MERCOSUR hacia otros países, a menudo a través de Panamá o Aruba. Si el total de cigarrillos ilícitos en todo el mundo es de 600 mil millones anuales, esto supone que el 12,5% del comercio proviene de la región de MERCOSUR.

La industria tabacalera de Paraguay ha experimentado un fuerte crecimiento en los últimos veinte años. En 1993 sólo existían tres empresas tabacaleras en el país; en 2007, había 25 empresas de importación de tabaco y cigarrillos y unas 40 exportadoras. La producción total de cigarrillos se estimaba en unos 70 mil millones en 2007, con un costo de producción de unos 5 centavos de dólar por paquete. Una empresa que venda a contrabandistas puede cobrar 10 centavos el paquete en los grandes pedidos. El costo de un paquete de cigarrillos en el mercado legal en los países vecinos sería de unos cincuenta centavos el paquete.

En Brasil, el mercado total de cigarrillos, legales e ilegales, se estima en unos 140 mil millones de cigarrillos. El mercado legal es dominado por Souza Cruz (con un 78% de la cuota de mercado) y PMI (con un 13%). Se estima que el mercado ilegal es de 30 mil millones de cigarrillos

al año. En la década de los 90, los cigarrillos de Souza Cruz a menudo se producían en Brasil, se exportaban a países vecinos y después se reintroducían ilegalmente en Brasil, evitando los impuestos nacionales en un proceso denominado "triangulación". Los cigarrillos se producían frecuentemente para su exportación, pero eran de hecho vendidos en el mercado nacional. Más recientemente, tras los enfrentamientos entre la industria y el gobierno brasileño sobre los impuestos a la exportación, la "triangulación" parece haber desaparecido, pero los pequeños productores han sido perseguidos por las autoridades por tener en propiedad fábricas en Brasil y Paraguay, produciendo en Brasil, etiquetando los productos como procedentes de Paraguay y alegando que habían sido importados a Brasil de forma ilegal por terceras partes.

Argentina tiene un mercado doméstico de unos 40 mil millones de cigarrillos. PMI (Massalin Particulares) tiene el 70% del mercado legal y BAT (Nobleza Piccardo), aproximadamente el 26%. Algunas empresas pequeñas venden marcas que también se producen en Paraguay, por ejemplo, Rodeo. Los pequeños productores han luchado también para evitar el sistema impositivo acordado con las grandes empresas, que establece una contribución impositiva del 75% del precio minorista para las marcas mejor vendidas. Los pequeños productores compiten sobre todo por la cuota de mercado de las marcas más baratas.

En Uruguay, la empresa líder de cigarrillos, Montepaz SA, es propiedad nacional y tiene cerca del 70% del mercado nacional legal. Montepaz exporta tanto cigarrillos como tabaco picado a Paraguay, donde también posee una fábrica. Las marcas de cigarrillos exportadas son "Calvert" y "Broadway", que no se venden en el mercado nacional. En 2006, Montepaz exportó unos 2,5 mil millones de cigarrillos, el doble que sus ventas nacionales en Uruguay, y tres millones de kilos de tabaco crudo. Es probable que una parte sustancial de estas exportaciones acaben siendo revendidas

a "operadores" en Paraguay, quienes las llevan posteriormente a Brasil.

Los gobiernos de los países de MERCOSUR, junto con los gobiernos de los países asociados de Bolivia, Chile y Perú, firmaron un acuerdo en diciembre de 2004 para combatir la falsificación de marcas y el contrabando de cigarrillos. Un acuerdo posterior se sustituyó en 2006, pero éste contiene muy pocos compromisos explícitos para la acción sobre comercio ilícito de productos del tabaco. El nuevo acuerdo no ha sido ratificado aún por la mayoría de los países.

El informe deja claro que el comercio ilícito de tabaco daña tanto las economías como la salud pública de MERCOSUR. Por ejemplo, si en Paraguay pudiesen aplicarse impuestos a la producción ilícita, el gobierno podría esperar beneficios de al menos 130 millones de dólares al año.

El informe realiza asimismo una serie de recomendaciones para combatir el comercio ilícito en la región, incluyendo sanciones más duras para individuos y empresas condenadas por delitos relacionados con el comercio ilícito y para cualquier gobierno o funcionario público que esté involucrado. También recomienda establecer nuevos delitos relativos a la delincuencia organizada. El informe hace un llamamiento para que se decreten regulaciones más duras que cubran el tránsito de mercancías en el libre comercio, tránsito y puertos francos y por una mayor coordinación e intercambio de información entre oficinas aduaneras y otras agencias policiales. El informe también solicita la creación de una oficina transfronteriza de lucha contra el fraude en MERCOSUR.

## REFERENCIA

Documento de Trabajo "Comercio Ilegal de Tabaco en los países de MERCOSUR", Alejandro Ramos MSc, para CIET Uruguay, financiado por la Fundación Bloomberg

## PHANTOM CIGARETTES: WHY WE NEED ARTICLE 9.6

Article 9.6 of the Chair's text requires Parties to prohibit the supply of tobacco products in amounts that exceed reasonably anticipated consumption or use in the intended market of use or retail sales. On Wednesday there was debate about whether this provision was necessary and what it would achieve. An example from the UK illustrates why it is essential.

Tobacco smuggling in the United Kingdom became a serious and rapidly growing problem in the 1990s, dominated by cigarettes exported to countries where almost no-one smoked them. In the year 2000, 16 billion illicit cigarettes were smuggled into the UK, half of them *Regal* and *Superkings*. These two brands had been exported in huge quantities to places where the intended market was "unclear", then were illegally re-imported by criminal networks back into the United Kingdom. Customs believes that, in 2000, as many as 65 per cent of the 12 billion *Regal* and *Superkings* exported by Imperial Tobacco were smuggled back into the United Kingdom. From 2000 to 2002, one-third of all *Regal* and *Superkings* were exported to five countries in which there was no reasonable demand for these brands.

These export practices came under scrutiny in the UK Parliament's Public Accounts Committee hearings in 2002. Members of the Committee questioned Gareth Davis, the chief executive of Imperial Tobacco. An excerpt from their exchange is quoted in the box, below. Pointed questioning highlighted how the industry had little justification for anticipated demand in those markets.



Smuggled *Regal* cigarettes among the green peppers

This example shows the necessity of making the industry account for its export practices. It is essential that the tobacco industry provides information, as required by Article 9.6, that its supply to any market is in line with legitimate demand in that market.

Luk Joossens  
FCA

*House of Commons Public Accounts Committee questions Gareth Davis, Imperial Tobacco CEO:*

*“Committee:* ... you said you believed you sold to legitimate consumers in Latvia, and in Latvia you sold 1.7 billion cigarettes in the year 1999–2000, and then the following year 1.4 billion cigarettes. Do you know the population of Latvia?

*Mr Davis:* I do not know the precise figure.

*Committee:* It is 2.3 million, which means each person, man, woman and child, including non-smokers, would have had to have smoked 722 cigarettes, which is 36 packets a year. When you were selling *Regal* and *Superkings* to this market, given it is a brand mainly sold in the UK, what did you think you were doing? Who did you think was buying these things and why did you think they were legitimate?

*Mr Davis:* I think you should understand that Latvia is a hub market, so the cigarettes were not just

consumed in Latvia but in other markets in Eastern Europe. ...

*Committee:* What I find puzzling is, if it is a hub market why did it suddenly completely collapse down to 1,290,000? I said 722 cigarettes per person, that is a drop from 1999 to 2001 from 722 cigarettes per person to half a cigarette per person, that is a fairly precipitous fall in the market. What happened?

*Mr Davis:* We discontinued supply.

*Committee:* Why?

*Mr Davis:* Because product was coming back into the UK. We made efforts to identify how that was happening and we could not guarantee that we would conform to our supply policy because product was coming back, so we ceased supply.

*Committee:* So you chose Afghanistan, the source of 98% of the world's heroin; you chose Moldova, the largest source of human

prostitution in terms of women being smuggled into Western Europe; you chose Kaliningrad, which is notorious as a crime-ridden enclave of the former Soviet Union and is notorious as being run by criminal gangsters. You chose some pretty odd locations. One comes to the conclusion that you are either crooks or you are stupid, and you do not look very stupid. How can you possibly have sold cigarettes to Latvia, Kaliningrad, Afghanistan and Moldova in the expectation that those were just going to be used by the indigenous population or exported legitimately to neighbouring countries, and not in the expectation they would be smuggled? You must know—you only have to read a newspaper every day, a member of the public could tell you—these are places which are linked to organised crime, that the drugs trade passes through all of these countries, that prostitution passes through all these countries. Did you not know that?”

## TOBACCO FIRMS PLEAD GUILTY TO SMUGGLING

Evidence abounds of tobacco industry complicity in the smuggling worldwide. However, the industry has consistently defended itself against having any involvement in illicit trade by stating it has never been convicted of any wrongdoing. Such a claim no longer holds true.

A C\$1.15 billion settlement was reached last year between Canada's two largest tobacco corporations, Imperial Tobacco of Canada and Rothmans, Benson & Hedges (RBH), and the Canadian government. The two companies are owned by British American Tobacco and Philip Morris International, respectively.

Canadian federal Revenue Minister Gordon O'Connor described the outcome as being the "largest criminal fines and civil settlements in Canadian history."

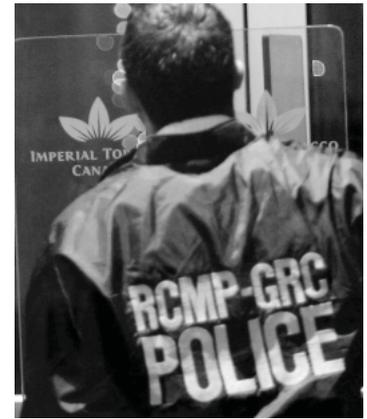
As part of the settlement, the two manufacturers pleaded guilty to a charge of "aiding persons to sell or be in possession of tobacco products manufactured in Canada that were not packaged and were not stamped in conformity with the Excise Act...". This settlement was reached after a decade-long investigation by federal authorities which included massive searches of both companies' head offices in 2002 and 2004.

The companies paid a total of C\$300 million in criminal fines and will disburse an extra C\$750 million in civil damages

over a period ranging between 10 and 15 years. They also each contributed an additional C\$50 million for a contraband enforcement strategy and will be required to comply with a series of contraband preventive measures such as "know your customer" rules.

Canada's third largest corporation, Japan Tobacco's Canadian subsidiary JTI-Macdonald, still faces a massive C\$10 billion civil lawsuit by federal and provincial governments. Many of its former executives are also facing criminal charges. Two of them have already pleaded guilty to lesser charges for their role in tobacco smuggling in exchange for testifying against their former colleagues. Discussions over reaching a settlement with JTI-Macdonald appear to be continuing.

These legal actions stem from the tobacco industry's involvement in the smuggling crisis which plagued Canada at the beginning of the 1990s. It arose in response to increases in tobacco tax introduced by federal and provincial governments to raise much-needed government revenues and lower tobacco consumption. In opposition, the tobacco industry engaged in a extensive disinformation campaign claiming that tobacco taxes did not work. At the same time, manufacturers exported massive shipments of cigarettes to free trade zones in the US where they were diverted and then smuggled back into



*Police raid Imperial Tobacco of Canada, November 2004*

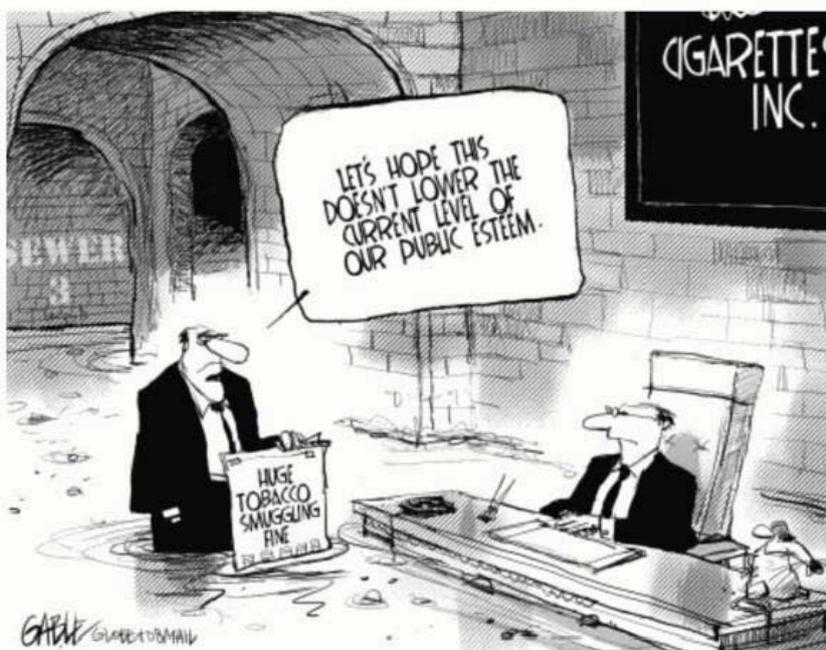
Canada. Unfortunately, the industry was successful in compelling the Canadian government and five provinces to drastically lower tobacco taxes in February 1994.

Admittance of guilt by Imperial Tobacco of Canada and Rothmans, Benson & Hedges was good news. Nonetheless, the health community and the media highlighted a number of failings of the settlement. First of all, no criminal charges were brought against former executives of either company. Second, it seems the penalties were based on industry profits rather than on losses of federal and provincial revenue prior to and following the 1994 tax rollback. Losses to the federal government alone were estimated at C\$15 billion. Nor did the penalties take into account the additional death and disease resulting from the availability of cheaper cigarettes.

In Canada, it took 15 years to bring the tobacco industry to account for its role in tobacco smuggling. The smuggling crisis was not necessarily generated by demand for cheaper tobacco products. Instead, it was the result of a failure to control the source of illicit supply; namely, the tobacco industry.

Effective measures can prevent such situations from arising but they require political will and allocation of resources. It is up to Parties here, at these negotiations, to demonstrate their solid commitment to dealing effectively with this public health scourge.

*François Damphousse, M.Sc.  
Non-Smokers' Rights Association, Canada*





# DIRTY ASHTRAY AWARD

To Parties more interested in pushing their own positions than listening to others and looking for consensus.



# ORCHID AWARD

To South Africa for moving Committee A forward by clarifying the debate on Article 6.



The Framework Convention Alliance (FCA) is a global alliance of NGOs working to achieve the strongest possible Framework Convention on Tobacco Control. Views expressed in the Alliance Bulletin are those of the writers and do not necessarily represent those of the sponsors.

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## ILLICIT TRADE AND OPEN BORDERS: NEPAL

Nepal shares a border with India extending over 1,100 km. Inhabitants of the border areas co-exist in cultural harmony. Although there is a designated 'no man's land' separating the two countries, for all practical purposes it does not exist. Every day, hundreds of thousands of people move back and forth across the border for shopping, healthcare, regular work and off-farm income.

A journalist posed the question of how illegal activities in the area could be controlled when the main gate of someone's house is facing Nepal and their window faces India. Trafficking in women is prevalent in the border region, with an estimated 7,000 girls being trafficked each year to India as sex workers. Smuggled goods include motorcycles and cars. Current political problems in Nepal have led to weak governance and an increase in encroachments from the Indian side. Most border posts are damaged and, compared to India, Nepal maintains no strong border security presence. There are abundant opportunities for illicit trade in tobacco.

India operates a strong Tobacco Control Law and has recently passed regulations on pictorial warnings. But there are hundreds of informally operated, unregistered local manufacturing companies producing and marketing low-grade, cheap tobacco products including Bidi (rolled tobacco) and Gutka

(pouched tobacco containing other harmful ingredients), which fall outside the present law.

The lack of tobacco control law in Nepal, together with political instability, makes the country a prime target for Indian tobacco producers and traders to intensify cross-border smuggling. Hundreds of small traders illegally import tobacco into Nepal every day, secreted among personal possessions, on bicycles or in hand luggage. There are fears that tobacco products lacking pictorial warnings will find their way into the country and that the Indian Tobacco Company may use Nepal as a marketing hub for other countries.

On the domestic front, marketing companies and local operators may pressurise the Nepal government into delaying the legal implementation process. And, as cigarette advertising in print media is yet to be banned in Nepal, the multinationals Philip Morris and BAT, and the Indian Tobacco Company, can exploit Nepali print media given that areas adjoining the border share the same culture and partly the same language.

Parties at INB-3 should address more specifically cross-border issues in relation to open borders within the illicit trade protocol.

*Shanta Lal Mulmi,  
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Nepal*

### NEGOTIOMETER

As INB-3 enters its sixth day, the proportion of the Chair's text on which there have been concrete discussions and alternative proposals have been tabled:

46% discussed

Elapsed time as a proportion of total time available:

70% elapsed

The average negotiating rate (ANR) took a beating yesterday as Committee B spent three hours considering the 80 words of Article 19.1. ANR for the first five days now stands at 170.8 words per hour. The required negotiating rate (RNR) for the coming days has risen to 467.4 words per hour, from 338.5 a day earlier.

### CLARIFICATION

Yesterday's Bulletin carried an overview of different track and trace systems. The EU/PMI legal agreement specifies carton markings at a future date. FCA understands that carton markings are in operation in some markets.