



BRIEFING PAPER:
**A PROTOCOL ON ILLICIT TRADE IN TOBACCO
PRODUCTS**

**Second Session of the Conference of the Parties to the WHO FCTC
Bangkok, Thailand
30 June - 6 July 2007**

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Key Recommendation

At the second session of the Conference of the Parties (COP) to the WHO Framework Convention on Tobacco Control (FCTC), the Parties should decide to establish a negotiating body that is mandated to develop a protocol on the elimination of illicit trade in tobacco, to be submitted to the COP for adoption. The negotiating body should report to the third session of the COP on the status of its work and should endeavour to complete its work as early as possible in 2010, with a view to the COP adopting the results during 2010.

Executive Summary

Parties to the FCTC recognize, in Article 15.1, that ‘the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting’ is an essential component of global tobacco control. This is because illicit trade: makes cigarettes available at lower prices, leading to higher consumption, particularly among young people; deprives governments of billions of dollars in taxation, thereby reducing the funding available for public health and other policies; and leads to the evasion of tobacco control laws, thereby undermining the effectiveness of measures implemented by Parties under the FCTC to protect their citizens from the devastating health, social, environmental and economic consequences of tobacco consumption.

The FCA estimates that the global illicit cigarette trade represents approximately 10.7% of global sales, or 600 billion cigarettes annually, and that losses to government revenue as a result of illicit trade in tobacco products total approximately \$US 40 to 50 billion annually. Given the scale of the problem, it is important that illicit trade in tobacco products be effectively addressed by Parties to the FCTC as soon as possible.

At its first session, the Conference of the Parties to the FCTC established an expert group to prepare a template for a protocol on illicit trade in tobacco products. A protocol to the FCTC is necessary because the elimination of illicit trade requires the implementation of a comprehensive system of international cooperation which includes obligations and measures additional to those specified in Article 15.

The template prepared by the expert group recommends the adoption of a protocol that includes a comprehensive set of measures including: an international system of tracking and tracing; control of the supply chain; criminalization of certain activities; strong enforcement measures; measures to eliminate money laundering; and technical assistance to aid implementation. The FCA supports this template.

Much work has already been undertaken in this area and a comprehensive template has been prepared. There is no further preparatory work that needs to be done before negotiation of a protocol can commence. At its second session, the COP should establish a negotiating body that is mandated to develop the draft text of a protocol, to be finalized and submitted to the COP as early as possible in 2010 for consideration and adoption by the COP during 2010.

Background

At the first session of the Conference of the Parties to the WHO Framework Convention on Tobacco Control in February 2006, the Parties to the Convention decided to establish an expert group to prepare a template for a protocol on illicit trade.¹ They did so recognizing ‘that international collaboration for the control of illicit trade is an important area of tobacco control’. The report of the expert group was released on 19 April 2007,² and will be considered by the COP at its second session, to be held in Bangkok, Thailand from 30 June – 6 July 2007.

Why illicit trade in tobacco products is a problem

Illicit trade in tobacco products is a significant problem for the following reasons:

- smuggled and counterfeit cigarettes are sold at lower prices, making cigarettes available cheaply, thereby increasing consumption and undermining efforts to keep young people, in particular, from smoking;
- illicit trade in tobacco products deprives governments of billions of dollars in taxation, reducing the funding available for public health and other policies;
- illicit trade in tobacco products undermines high tobacco taxation policy, which evidence shows is one of the most effective ways to reduce tobacco consumption;³
- illicit trade in tobacco products makes top international brands available at affordable prices to low-income consumers, and to image-conscious young people who often regard such products as sophisticated and stylish; and
- illicit trade in tobacco products leads to the evasion of tobacco control laws, such as prohibitions on selling to minors, packaging and labelling requirements, and regulation of contents and disclosure, thereby undermining the effectiveness of measures implemented by Parties under the FCTC to protect their citizens from the devastating health, social, environmental and economic consequences of tobacco consumption.

It is for these reasons that in Article 15.1 of the FCTC ‘[t]he Parties recognize that the elimination of all forms of illicit trade in tobacco products, including smuggling, illicit manufacturing and counterfeiting, and the development and implementation of related national law, in addition to subregional, regional and global agreements, are essential components of tobacco control’.

¹ ‘Elaboration of protocols’ (World Health Organization, Conference of the Parties to the WHO Framework Convention on Tobacco Control, first session, decision FCTC/COP1(16)). Article 1(a) of the FCTC defines ‘illicit trade’ as ‘any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase including any practice or conduct intended to facilitate such activity.’ Article 15(1) recognises various forms of illicit trade including smuggling, illicit manufacturing and counterfeiting.

² ‘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), available online at http://www.who.int/gb/fctc/PDF/cop2/FCTC_COP2_9-en.pdf.

³ See FCTC Article 6.1. On the effectiveness of taxation see generally Frank J Chaloupka, Teh-wei Hu, Kenneth E Warner, Rowena Jacobs, and Ayda Yurekli, ‘The Taxation of Tobacco Products’, in Prabhat Jha and Frank J Chaloupka (eds), *Tobacco Control in Developing Countries* (OUP: Oxford, 2000) 237-272, available online at <http://www1.worldbank.org/tobacco/tcdc/237TO272.PDF>; World Bank, *Curbing the Epidemic: Governments and the Economics of Tobacco Control* (Washington, DC: World Bank, 1999), available online at http://www1.worldbank.org/tobacco/reports_pdf.asp.

In addition to being a major health problem, there is evidence that illicit trade in tobacco products is carried out by organised transnational criminal groups, and so poses a threat to the maintenance of law and order.⁴ Of particular concern is the fact that money gained from illicit trade in tobacco is laundered and used for other serious criminal enterprises. The United States General Accounting Office has reported that illicit trade in cigarettes is one means by which a number of terrorist groups finance their operations.⁵

Why illicit trade is a problem for all FCTC parties

Illicit tobacco products give rise to significant problems for Parties wherever such products enter, emanate from, or pass through their territory. As noted above, the presence of smuggled or counterfeit tobacco products deprives governments of revenue and undermines the effectiveness of tobacco control measures. The use of a Party's territory as a staging ground for illicit trade in tobacco products may also undermine relations with other Parties attempting to eliminate illicit trade.

Notwithstanding the inherent difficulty of assessing the exact amount of illegal activity in a country's territory, there may be some FCTC Parties in which illicit trade in tobacco products is not prevalent. Nevertheless, illicit trade in tobacco products also poses a threat to these Parties, and it is in their interests to participate in the development of a robust international system so as to ensure that illicit trade in tobacco products does not reach their territory. Suppression of the financing and growth of transnational organised criminal activity is also in the interests of all Parties.

The size of the problem

In 2000 a report commissioned by the World Bank estimated that between 6% and 8.5% of global cigarette consumption was smuggled.⁶ The 6% estimate was based on both import and export statistics and represented mainly an estimate of large-scale smuggling. The 8.5% estimate was based on estimates of smuggling (both bootlegging and large-scale smuggling) as a percentage of 1995 domestic sales, using a combination of expert sources.⁷

Given the nature of illicit tobacco trade as illegal conduct, estimates of the size of the trade are seldom precise and some caution is necessary. The Framework Convention Alliance (FCA) has collected the most recent estimates of illicit tobacco trade from a number of countries around the world. Based on that data, the FCA estimates that the

⁴ See generally United States General Accounting Office, 'Terrorist Financing: US Agencies Should Systematically Assess Terrorists Use of Alternative Financing Mechanisms', Report to Congressional Requesters GAO-04-163 (November 2003), available online at <<http://www.gao.gov/new.items/d04163.pdf>>.

⁵ Ibid.

⁶ David Merriman, Ayda Yurekli & Frank J Chaloupka, 'How Big is the Worldwide Cigarette Smuggling Problem?', in Prabhat Jha and Frank J Chaloupka (eds), *Tobacco Control in Developing Countries* (OUP: Oxford, 2000) 365-392, available online at <<http://www1.worldbank.org/tobacco/tcdc/365TO392.PDF>>.

⁷ Ibid.

global illicit cigarette trade represents approximately 10.7% of global sales, or approximately 600 billion cigarettes annually.⁸

The losses in government revenue as a result of illicit trade

The losses in government revenue as a result of illicit tobacco trade are enormous, but vary widely among countries. Taxes (excise duties and VAT), for instance, on a pack of Marlboro on 1 January 2007 varied. For example, taxes of approximately \$US 0.85 were imposed in China and Brazil, \$US 2.30 in Turkey and \$US 8 in the United Kingdom.⁹ Taxes are not limited to excise duties or VAT. Countries with low excise duties can have high import duties of 100% or more. According to the European Anti-Fraud Office (OLAF) the average loss for a container of 10 million cigarettes (500,000 cigarette packs) in the EU is €1.5 million euro or \$2 million (\$US 4 for each cigarette pack of 20 cigarettes).¹⁰

The variability of tax rates between countries and the difficulty of quantifying the exact level of illicit trade in individual countries combine to make it impossible to precisely calculate global revenue losses. Nevertheless, a range of likely estimates can be offered.

Based on an estimate of the loss in revenue of \$US 4 per pack (VAT, excise and import duties) in high income countries (mainly Europe and North America: 100 billion illicit cigarettes / 5 billion packs), the loss in high income countries would result in a revenue loss of \$US 20 billion. Losses are lower – in monetary terms – in other regions of the world, though they may be even more consequential in terms of impacts on government revenues. An estimate of the loss in revenue of \$US 0.60 to 1.00 per pack (VAT, excise and import duties) in low and middle income countries (500 billion illicit cigarettes / 25 billion packs) would represent an annual loss of approximately \$US 15 to 25 billion. On these figures, the global loss of revenue would be approximately \$US 35 to 45 billion. This figure does not take into account the losses of revenue as result of illicit trade in other tobacco products, such as hand rolling tobacco or bidis. UK Customs & Excise, for instance, estimates the loss of revenue of hand rolling tobacco in 2004-5 in the UK alone to have been \$US 1.6 billion.¹¹

Overall, loss of government revenue due to illicit tobacco trade could amount to \$US 40 to 50 billion annually.¹²

⁸ Framework Convention Alliance, *How big was the illicit tobacco problem in 2006?* (Geneva, 2007).

⁹ European Commission, Excise Duty Tables: Part III – Manufactured Tobacco (Directorate General Taxation and Customs Union, Brussels: January 2007); Philip Morris International, Marlboro Price in January 2007 for selected countries, Total Tax in January 2007. Unpublished data.

¹⁰ Personal communication, L Joossens with A Rowan, Head of Operations, Task Group Cigarettes, European Anti-Fraud Office (OLAF) (7 May 2007).

¹¹ HM Revenue & Customs, *Annual report 2005-06* (London, 2006) 76, available online at <<http://www.hmrc.gov.uk/about/reports.htm>>.

¹² Framework Convention Alliance, *How big was the illicit tobacco problem in 2006?* (Geneva, 2007).

The need for international cooperation

International cooperation is essential to the suppression of illicit trade in tobacco products. First, illicit trade in tobacco products is an international enterprise involving the movement of goods and individuals between jurisdictions. As such, jurisdictional complications arise with respect to the investigation and prosecution of those involved. A protocol would facilitate international cooperation and technical assistance with respect to law enforcement on matters such as the investigation of cross-border offences, the exercise of jurisdiction and the extradition of alleged offenders.

Second, the implementation of a coordinated international tracking and tracing system for tobacco products is preferable to the implementation of numerous domestic tracking and tracing systems. A coordinated international system would permit the provision of information to law enforcement officials in a timely manner. An international system would also function as a process of standardisation, preventing the proliferation of diverse systems that unnecessarily increase complexity from the perspectives of both law enforcement and trade.

Why a protocol is necessary

The adoption of a protocol is necessary if Parties are to be able to collaboratively deal with illicit trade in tobacco products. While guidelines are likely to be developed to assist Parties to implement their obligations under other Articles of the FCTC, they would not be sufficient to enable Parties to eliminate illicit trade in tobacco products. Indeed, this was acknowledged in the negotiation of the Convention, with Article 15 not being listed (in Article 7) as one of the Articles on which the COP is required to propose guidelines. It was also acknowledged by the Parties at the first session of the COP, where ‘the need to further develop the obligations set out in Article 15 in an internationally binding legal instrument’ was noted,¹³ and the decision to establish an expert group to prepare a template for a protocol on illicit trade was reached.

The elimination of illicit trade in tobacco products requires the implementation of a comprehensive system of international cooperation that is not provided for in Article 15. In order to implement such a system, Parties would have to commit to obligations additional to those in Article 15. These proposed obligations relate to matters including:

- the tracking and tracing of tobacco products;
- licensing or other requirements to ensure the bona fides of participants within tobacco supply and distribution chains;
- enhanced law enforcement capacity and international cooperation;
- the creation of a strict liability and compensation system whereby the producer of tobacco products is made financially liable for all the taxes and duties until the products reach the final destination and all due taxes are properly paid;
- the exercise of criminal jurisdiction;

¹³ ‘Second report of Committee A (Draft): Additional matters identified in the Convention for consideration by the Conference of the Parties’ (World Health Organization, Conference of the Parties to the WHO Framework Convention on Tobacco Control, first session, agenda item 5, A/FCTC/COP/1/10, 17 February 2006) 2, available online at <http://www.who.int/gb/ctc/PDF/cop1/FCTC_COPI_10-en.pdf>.

- extradition arrangements; and
- mutual legal assistance.

Since the proper role of guidelines is to assist with the implementation of obligations already agreed to by Parties, guidelines are not an appropriate vehicle through which to assume new obligations of the kind that are necessary to create a comprehensive international system to combat illicit trade.

The Report of the WHO FCTC Expert Group on Illicit Trade

The report of the expert group on illicit trade established by the COP recommends the adoption of a comprehensive and cooperative multilateral approach to combat illicit trade in tobacco products. The measures recommended for inclusion in a protocol on illicit trade include:

- licensing schemes for participants in the tobacco business;
- measures to eliminate money laundering;
- the development of an international system that enables the tracking and tracing of tobacco products;
- the implementation of laws governing record keeping and internet sales of tobacco products;
- the criminalization of participation in illicit trade in various forms;
- obligations for tobacco manufacturers to control their supply chain with penalties for those that fail to do so;
- programs to increase the capacity of law enforcement bodies; and
- programs to increase cooperation and technical assistance with respect to the investigation and prosecution of offences and the sharing of information.

Why negotiations should commence as soon as possible

The report of the expert group on illicit trade provides a template from which parties are able to negotiate a protocol. The template sets out a range of recognised measures that are available to combat illicit trade. Many aspects of the template are modelled on other framework conventions and their protocols. As such, it can be expected that negotiation of a protocol will be made easier by the adaptation of existing precedents in international law to the circumstances of illicit trade in tobacco. There is no further preparatory work that needs to be done before negotiation of a protocol can commence.

Measures to combat illicit trade in tobacco products have been discussed in international fora for at least eight years. The development of an international agreement on the issue was contemplated in early negotiations on the FCTC: raised in a technical briefing for negotiations in 1999,¹⁴ and subsequently discussed by FCTC working groups in 1999 and 2000.¹⁵ In 2002, 142 member states of the WHO attended

¹⁴ L Joossens, 'Improving public health through an international framework convention on tobacco control' , Framework Convention on Tobacco Control Technical Briefing Series WHO/NCD/TFI/99.2 (1999) 21-24, available online at <http://whqlibdoc.who.int/hq/1999/WHO_NCD_TFI_99.2.pdf>.

¹⁵ See, for example, 'Subjects of possible protocols and their relation to the Framework Convention on Tobacco Control' (World Health Organization, First meeting of the working group on the WHO Framework Convention on

the International Conference on Illicit Tobacco Trade in New York, which was devoted to the identification of regulatory interventions to eliminate illicit trade.¹⁶ In 2003, the FCTC was adopted, with Article 15 outlining a range of measures required to combat illicit trade in tobacco products. A footnote to the 2003 text approved by the WHO noted that there was ‘considerable discussion throughout the pre-negotiation and negotiation process concerning the adoption of an early protocol on illicit trade in tobacco products’, which was expected to be initiated either ‘by the INB immediately following the adoption of the FCTC, or at a later stage by the Conference of the Parties’. At the first session of the COP, the Parties again noted ‘the need to further develop the obligations set out in Article 15 in an internationally binding legal instrument’.¹⁷

It is important that negotiations be commenced, and a protocol be adopted, as soon as possible. The health and economic harms of illicit trade in tobacco products require urgent action. In addition, with the negotiation of a protocol on illicit trade in tobacco products now clearly on the agenda of the COP, there is the possibility that Parties will delay the implementation of domestic measures until a protocol has been adopted, not wanting to implement measures that may conflict with, or fall short of, what is ultimately agreed in a protocol.

Why the FCTC is the most appropriate forum

Because illicit trade in tobacco products undermines the objective of the FCTC and the international tobacco control infrastructure created by the FCTC, the FCTC is the most appropriate forum through which to negotiate a protocol to combat the problem. Parties to the FCTC have recognised their role in combating illicit trade in tobacco products through the inclusion of Article 15 in the Convention and through their decision at the first session of the COP to establish an expert group to prepare a template for a protocol.

It should be noted that the negotiation of a protocol under the auspices of the FCTC does not preclude the involvement of other international organizations possessing relevant competencies. The FCTC encourages coordination and cooperation with relevant international and intergovernmental organizations (Articles 24.3(e) and 25), and the Rules of Procedure of the COP allow for the participation of intergovernmental organizations as observers. In accordance with these provisions the World Customs Organization (WCO) was present as an observer at the second meeting of the expert group on illicit trade in tobacco products.

Tobacco Control, provisional agenda item 8, A/FCTC/WG1/3, 3 September 1999), available online at <<http://www.who.int/gb/fctc/PDF/wg1/e1t3.pdf>>; ‘Possible subjects of initial protocols: Elaboration of technical components of three possible protocols’, (World Health Organization, Second meeting of the working group on the WHO Framework Convention on Tobacco Control, provisional agenda item 6, A/FCTC/WG2/4, 15 February 2000), available online at <<http://www.who.int/gb/fctc/PDF/wg2/ef24.pdf>>.

¹⁶ See the Co-Chairpersons Report on the International Conference on Illicit Tobacco Trade, United Nations, New York City, 30 July – 1 August 2002, available online at <www.who.int/entity/tobacco/framework/support/en/icittfr_english.pdf>.

¹⁷ ‘Second report of Committee A (Draft): Additional matters identified in the Convention for consideration by the Conference of the Parties’ (World Health Organization, Conference of the Parties to the WHO Framework Convention on Tobacco Control, first session, agenda item 5, A/FCTC/COP/1/10, 17 February 2006) 2, available online at <http://www.who.int/gb/fctc/PDF/cop1/FCTC_COP1_10-en.pdf>.

Recommendations

At the second session of the Conference of the Parties to the WHO Framework Convention on Tobacco Control, the Parties should decide to:

- **establish a negotiating body that is mandated to develop a protocol on the elimination of illicit trade in tobacco, to be submitted to the COP for adoption;**
- **authorise this negotiating body to adopt any necessary modifications to the Rules of Procedure of the COP insofar as they apply to its proceedings in order to allow it to exercise its functions in the most efficient and effective manner;**
- **request the Convention Secretariat to prepare a provisional agenda for the first meeting of the negotiating body based upon the issues raised in the report of the expert group on illicit trade established under decision FCTC/COP1(16) (Elaboration of protocols) and presented to the second session of the COP (A/FCTC/COP/2/9); and**
- **mandate the negotiating body to begin the process of developing a protocol without delay and to conduct the process as a matter of urgency. The negotiating body should report to the third session of the COP on the status of the process and should endeavour to complete its work as early as possible in 2010, with a view to the COP adopting the results during 2010.**