



**FURTHER INFORMATION
ON A PROTOCOL ON ILLICIT TRADE IN TOBACCO
PRODUCTS**

**Supplement to the FCA Briefing Paper:
A Protocol on Illicit Trade in Tobacco Products**

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BENEFITS AND COSTS OF A PROTOCOL

What will be the relative benefits and costs of negotiating and implementing a protocol on illicit trade?

There will be costs associated with the negotiation and implementation of a protocol on illicit trade in tobacco products. These costs are, however, likely to be massively outweighed in both the short and long term by gains to government revenue through increased compliance with taxation laws. As set out in the FCA document 'How big was the illicit tobacco problem in 2006',¹ losses of revenue from illicit tobacco trade could represent a global loss to government revenue of \$US 40 to 50 billion annually. The cost of negotiating a protocol will be minuscule compared to the likely savings to government revenue, and, at the implementation stage, an effective protocol will allow Parties to act to ensure that the tobacco industry bears the costs of securing the distribution of its products.

The experience of the state of California is one example that demonstrates that measures that combat illicit trade result in overall gains to government revenue. In January 2004 the state of California introduced the Cigarette and Tobacco Products Licensing Act, which required all entities engaged in the sale of tobacco products within the state to be licensed. In addition, in January 2005, the state required the attachment to tobacco products of tax stamps containing coded information that were more difficult to counterfeit than the stamps previously used. The Californian Board of Equalisation calculated that the two requirements resulted in an increase in tax revenues between January 2004 and March 2006 of approximately US \$75 million.² The Board estimated that the cost of enforcing the licensing component of the laws in the fiscal years 2003-2004 and 2004-2005 was approximately US \$9 million, the majority of which was spent on staff salaries and benefits.³

In addition to increased compliance with taxation laws, an effective protocol would reduce problems relating to law and order in general. For example, the United States General Accounting Office has reported that the proceeds of illicit trade in tobacco products are used for other criminal purposes, including the funding of terrorist groups.⁴ Thus, combating illicit trade would also restrict the financing of other illicit conduct.

¹ Framework Convention Alliance, *How big was the illicit tobacco problem in 2006?* (Geneva, 2007).

² Bureau of State Audits, California State Auditor, *Board of Equalization: Its Implementation of the Cigarette and Tobacco Products Licensing Act of 2003 Has Helped Stem the Decline in Cigarette Tax Revenues, but It Should Update Its Estimate of Cigarette Tax Evasion* (29 June 2006, Report no 2005-034), available online at <http://www.bsa.ca.gov/pdfs/reports/2005-034.pdf>.

³ Ibid.

⁴ 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>.

MEASURES TO COMBAT ILLICIT TRADE

Is tracking and tracing an effective means of combating illicit trade?

The contribution a comprehensive international tracking and tracing system would make to the successful elimination of illicit trade in tobacco products is recognised in Article 15.2(b) of the FCTC, under which Parties agree to ‘consider, as appropriate, developing a practical tracking and tracing regime that would further secure the distribution system and assist in the investigation of illicit trade’. The expert group established by the COP to prepare a template for a protocol on illicit trade concluded that an international tracking and tracing system would be effective in combating illicit trade in tobacco products.⁵ It identified three primary ways in which it would do so. First, it would permit the identification of illicit goods through the scanning of secure electronic codes placed on product packaging. Second, it would permit authorities to track the movement of a good while it is in the distribution chain, allowing them to identify the point at which a good should be in the distribution chain. Third, it would permit authorities to trace the movement of a seized good so as to identify the point at which the good left the legitimate distribution chain.

However, in combating illicit trade, one measure is rarely effective when implemented in isolation. Tracing and tracking should be implemented in combination with other measures such as licensing and a strict liability and compensation system.

Are licensing requirements feasible in low- and middle-income countries?

Licensing of participants in different stages in the production and distribution of tobacco products is, as recognised by the expert group established by the COP to prepare a template for a protocol on illicit trade, a ‘key measure’ for securing the tobacco products supply chain.⁶ In the negotiation of Article 15 of the FCTC, the feasible scope of licensing requirements in developing countries that have large numbers of street vendors was discussed. The outcome of that discussion was Article 15.7, which obliges parties to ‘endeavour to adopt and implement further measures including licensing, where appropriate’. Similarly, the report of the expert group acknowledges that licensing laws may be difficult to implement with respect to small-scale tobacco growers and in circumstances where there are a large number of street vendors.⁷ In light of this acknowledgement, it should be expected that negotiations on a protocol on illicit trade will address the question of how extensive any licensing obligations should be with respect to groups that may be more difficult to license, such as tobacco growers and street vendors.

⁵ ‘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 online at http://www.who.int/gb/fctc/PDF/cop2/FCTC_COP2_9-en.pdf.

⁶ Ibid, 6.

⁷ Ibid, 7.

Are the measures recommended by the expert group restrictive of trade?

International trade theory weighs heavily in favour of the adoption of an international system to eliminate illicit trade in tobacco products. In particular, a standardised international system imposing consistent requirements upon tobacco products in different jurisdictions is likely to be less burdensome to international trade than approaches to the problem that differ by jurisdiction.⁸

Economic theories of international trade also support the implementation of measures to combat smuggling in the case of goods with negative externalities such as tobacco products. International trade in goods with negative externalities may result in losses for an economy, and economic theory suggests that these losses should be internalised in the cost of the good through taxation.⁹ Given that illicit trade undermines the collection of taxation, economic theories of trade support the imposition of measures to eliminate illicit trade in tobacco products.

In considering the relationship between trade agreements such as the WTO Agreement¹⁰ and a protocol on illicit trade in tobacco products, it should be noted that there are numerous multilateral treaties that oblige parties to implement measures that are trade restrictive. For example, Article 10 of the Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition, supplementing the United Nations Convention against Transnational Organised Crime¹¹ imposes import and export licensing requirements that are contrary to Article XI (quantitative restrictions) of the General Agreement on Tariffs and Trade (GATT).¹² Similarly, the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES)¹³ imposes a number of restrictions upon trade in endangered species that are contrary to Article XI of the GATT. The inclusion of trade restrictive terms in these treaties is premised upon the assumption that exceptions such as the health and environmental exceptions in Article XX of the GATT extend protection to the measures.

Why shouldn't illicit trade be addressed through voluntary agreements with the tobacco industry?

Illicit trade should be addressed through laws and regulations rather than voluntary agreements with the tobacco industry. The tobacco industry has a long history of evading effective regulation through voluntary agreements. This reality is reflected in Article 5.3 of the FCTC, under which Parties agree that '[i]n setting and

⁸ Relative uniformity in technical regulations reduces the transaction costs associated with exportation.

⁹ See generally Jagdish N Bhagwati, Arvind Panagariya, and TN Srinivasan, *Lectures on International Trade* (MIT Press, 2nd edition, 1998).

¹⁰ *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995).

¹¹ GA Res 255, UN GAOR, 55th sess, UN Doc A/RES/55/255 (2001).

¹² *Marrakesh Agreement Establishing the World Trade Organization*, opened for signature 15 April 1994, 1867 UNTS 3 (entered into force 1 January 1995), annex 1A (*General Agreement on Tariffs and Trade*) 1867 UNTS 190. 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).

¹³ *Convention on International Trade in Endangered Species of Wild Fauna and Flora*, opened for signature 3 March 1973, 993 UNTS 243 (entered into force 1 July 1975).

implementing their public health policies with respect to tobacco control, [they] shall act to protect these policies from commercial and other vested interests of the tobacco industry in accordance with national law.’

The use of voluntary agreements is clearly a problematic means of regulating the entire tobacco industry. Voluntary agreements with tobacco companies would presumably differ in their terms depending upon the negotiating positions taken by individual tobacco companies. Such inconsistent regulation would not only increase the transaction costs associated with policing illicit trade but would also result in differential treatment of different tobacco products. Voluntary agreements would also be likely to reflect compromises between effective regulation and the interests of the tobacco industry.

An important benefit of the adoption of strong legal obligations at the international level is that, having committed to binding international standards, governments may find it easier to oppose attempts by the tobacco industry lobby to undermine the development and implementation of domestic tobacco control policy.

Do measures recommended by the expert group address counterfeit?

The measures recommended by the expert group address counterfeit tobacco products in a number of ways. Laws requiring tobacco manufacturers to include covert markings on packaging are one means of assisting authorities in the identification of counterfeit tobacco products. Similarly, the implementation of a comprehensive tracking and tracing system should permit authorities, at the time of seizure, to distinguish between tobacco products that are legally manufactured and products that are illegally manufactured. It would also be expected that aspects of a protocol relating to the criminalisation of particular conduct, and to cooperation in investigation and prosecution, would apply to counterfeit tobacco products.

Will the use of safe havens undermine a protocol?

It is possible that those involved in the illicit tobacco trade will use the territories of non-Parties to a protocol as ‘safe havens’. While this problem is to some extent unavoidable, an effective protocol would enable Parties to minimise the opportunities to do so. Measures such as a tracking and tracing system that permit the identification of the point at which products are diverted into illegitimate channels should assist law enforcement authorities in the identification of safe havens. Evidence collected in accordance with such investigations could then be used in diplomatic consultations.

The use of safe havens could also be limited by a strict liability and compensation system whereby the producer of tobacco products is financially liable for all applicable taxes and duties until its products reach the final destination and all due taxes are properly paid.¹⁴ In accordance with this approach, tobacco manufacturers would be responsible for tax losses where products are diverted from the legitimate supply chain into or through safe havens.

¹⁴ Measures of this nature are referred to in the report of the expert group: see ‘Elaboration of a template for a protocol on illicit trade in tobacco products’, above n 4, 10.

THE PROCESS OF DEVELOPING A PROTOCOL

What should be the mandate, objectives and duration of a negotiating body established to develop the text of a protocol on illicit trade?

Article 23.5(f) of the FCTC enables the COP to ‘establish such subsidiary bodies as are necessary to achieve the objective of the Convention’. Rule 25.2 of the Rules of Procedure¹⁵ of the COP provides that the COP shall determine the mandate, objectives, duration and budget of any such subsidiary body.

Article 33 states that the COP may adopt protocols to the FCTC, a protocol may be proposed by any Party to the Convention, and that such proposals will be considered by the COP. In practice, protocols to multilateral treaties are usually developed by a negotiating body – often referred to as a ‘working group’ – established and given its terms of reference by the COP. The negotiating body develops the text of a proposed protocol, usually within a timeframe set by the COP, and then submits the text to the COP for its consideration. A protocol may then be adopted by the COP and signed and ratified by Parties to the treaty wishing to become Parties to the protocol.

The COP should establish a negotiating body that is mandated to develop a protocol on illicit trade. The negotiating body should be required to develop a comprehensive protocol that includes both domestic and international measures. Its mandate should be sufficiently flexible to ensure that it is able to perform its work in a results-oriented way, without needing to request changes to its mandate to accommodate any new ideas falling within its objectives that may arise as it performs its work. The negotiating body should report to the third session of the COP on the progress of its work and should endeavour to complete its work as early as possible in 2010, with a view to the COP adopting a protocol during 2010.

How should the Rules of Procedure apply to the negotiating body?

Rule 25.3 of the Rules of Procedure of the COP states that, except as provided in Rules 26-28, the Rules shall apply *mutatis mutandis* ‘to the proceedings of any subsidiary bodies, subject to any modifications decided by the Conference of the Parties.’

While it would be expected that the Rules of Procedure of the COP would apply to the proceedings of a negotiating body established to develop a protocol to the FCTC, it would be appropriate for the COP to vary Rule 27 of the Rules insofar as it applies to the proceedings of the negotiating body. Under Rule 27.1, the COP is to ‘decide the dates and venue of the sessions’ of subsidiary bodies. The application of this Rule could unnecessarily inhibit the ability of the negotiating body to perform its work in the most efficient and effective way.

¹⁵ ‘Rules of Procedure of the Conference of the Parties to the WHO Framework Convention on Tobacco Control’, adopted by the Conference of the Parties to the WHO Framework Convention on Tobacco Control in Decision FCTC/COP1(8) at its first session (Geneva, 6-17 February 2006).

A negotiating body tasked to develop the text of a protocol will need to meet more frequently than the COP in order to carry out its mandate in the timeframe established for its work. For example: the working group which developed the text of the Kyoto Protocol to the United Nations Framework Convention on Climate Change met 6 times over a 2½ year period during which 2 sessions of the COP were held; and the working group which developed the text of the Cartagena Protocol on Biosafety to the Convention on Biological Diversity met 8 times over a 3½ year period during which 3 sessions of the COP were held.

If the negotiating body, during the course of its work, were to decide that it needed to meet at a time or times not foreshadowed at a session of the COP, and if there were funding available for such a meeting or meetings, the negotiating body should be able to convene such a meeting or meetings without having to wait for another session of the COP to authorise such a meeting or meetings. Any safeguards that may be required by the COP in relation to such decisions of the negotiating body would be ensured by the negotiating body being open to all Parties to the FCTC, and could be further strengthened by requiring consultation between the negotiating body and the Bureau to the COP and ensuring that any relevant decision of the COP would prevail over a decision of the negotiating body.

In its decision establishing a negotiating body, the COP should include the following paragraph:

‘Notwithstanding Rule 27.1 of the Rules of Procedure of the Conference of the Parties to the WHO Framework Convention on Tobacco Control, the [negotiating body / working group] established by this decision shall be permitted to decide the dates and venue of its sessions in consultation with the Bureau, except to the extent that any such decision is inconsistent with a decision of the Conference of the Parties with respect to the sessions of the [negotiating body / working group].’