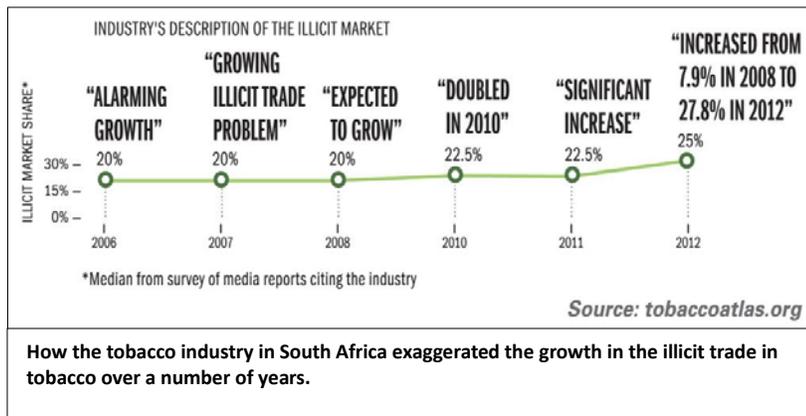


Tax increases don't need to wait for the Illicit Trade Protocol

If smuggling is a concern, start with national illicit trade control measures

The main reason governments don't raise tobacco taxes more frequently is the fear of smuggling, a fear the tobacco industry works very hard to feed.

Substantial progress has been made in negotiating global controls on illicit trade in tobacco, and governments may be tempted to wait until these controls are in place before improving their tobacco tax policies. This would be a mistake, in two respects. First, even where illicit trade is present, better policies – which usually start with tobacco tax increases – almost always lead to higher revenues and higher prices, and a corresponding drop in tobacco use.



Second, there is absolutely no reason to wait for the Protocol to Eliminate the Illicit Trade in Tobacco Products (more commonly known as ITP, for Illicit Trade Protocol) to come into effect before taking action to curb tobacco smuggling. A number of countries, including the United Kingdom, Brazil, Turkey, Kenya, Canada and Spain, have successfully reduced illicit trade through national measures.

Moreover, the cornerstone of ITP implementation is *national* action. Individual countries can and should enact many of the ITP's measures ahead of the protocol's entry into force. These measures will of course have a bigger impact when many countries are implementing it – but can still be effective immediately.

The key thing to remember is that preventing tobacco smuggling doesn't mean detecting and apprehending every single person or group engaged in smuggling (or in purchasing untaxed product). Rather, authorities can concentrate on raising the costs and risks of smuggling until illicit trade becomes impractical or unprofitable for larger players. Some examples follow.

Licensing (Article 6)

The first step to controlling the supply chain of tobacco products is licensing – at a minimum licensing manufacturers and importers. This provides basic information, such as names and addresses, about the players that are (legally) active in the national market. More importantly, it means these key players have something to lose if they misbehave: their licence to produce or import tobacco products (or manufacturing equipment).

It is generally much simpler and quicker to suspend or revoke a licence than to convict a person or company of a criminal offence – at least if the licensing system is properly set up. (Art. 6.3(a) specifies that there must be a designated authority that can "issue, renew, suspend, revoke and/or cancel licences".)

Due diligence (Article 7 – also known as “Know-your-customer” obligations)

Licensing is also the foundation for another important provision of the Protocol: due diligence. This means that the main players in the tobacco trade must run some basic checks on prospective buyers or suppliers of tobacco, tobacco products or manufacturing equipment. A key requirement is that they should deal only with licensed companies or persons.

These “know-your-customer” rules further require persons in the supply chain to check on their business partners: whether they have criminal records, what their bank accounts are, whether they are registered with tax authorities and so on.

“Know-your-customer” obligations work best in conjunction with “know-your-market” obligations (see Article 10 of the ITP – *Security and preventive measures*). That is, manufacturers and others should not be allowed to sell vast quantities of product in countries where they must know that domestic demand cannot possibly absorb them.

For example, a number of tobacco companies used to ship large quantities of cigarettes to Andorra, a tiny country with a population of less than 100,000. They had to know that most, if not all, of these cigarettes would end up on black markets in other, larger countries. This type of transaction should be illegal.

Tracking and tracing (Article 8)

The flagship measure in the Protocol is the establishment of a global tracking and tracing regime – made up of national and/or regional systems that talk to each other via a “global information-sharing focal point”.



A tax stamp on a cigarette pack in Turkey

The logic is simple: when product that is suspected of being untaxed (or illegal in some other way) is discovered, authorities want to know where it came from, and in particular where it was first diverted from legal into illegal channels. (This is *tracing*.) And when they suspect a manufacturer, importer or wholesaler of selling into the black market, they want to be able to follow a particular shipment from start to finish in hopes of catching people in the act of diversion (this is *tracking*.)

To achieve this, Parties need to require “unique, secure and non-removable identification markings” (such as tax stamps with security features, like those on bank notes, to prevent copying/counterfeiting). These markings need to include, or be linked (via a database of some kind) to information about the manufacturer and shipment. Ideally, the

The Illicit Trade Protocol to the FCTC

- ✓ The WHO Framework Convention on Tobacco Control (FCTC), which came into effect in 2005, includes an article, Article 15, about controlling illicit trade. This already requires “effective” measures to ensure that all tobacco product packaging is marked, which will to Parties to figure out where the products are from.
- ✓ Because of the complexity of illicit trade, Parties decided to negotiate a protocol, or sub-treaty, specifically on the topic. Formal negotiations lasted from 2008 to 2012, leading to the ITP, which was adopted by the FCTC Conference of the Parties in November 2012.
- ✓ 54 FCTC Parties signed the Protocol; at last report, 7 had become Parties to the Protocol (by ratification).
- ✓ The ITP will come into effect 90 days after there are 40 Parties.
- ✓ The first Meeting of the Parties to the Protocol is to be held immediately before or after the first session of the FCTC Conference of the Parties that falls after the Protocol comes into effect.

markings are affixed to cigarette packs, cartons and master cases at point of manufacture, via machines that are under the government's control and surveillance. (Authorities must ensure that manufacturers cannot run 'ghost shifts', with the marking machines turned off, to create product for the black market.)

If this works properly, when authorities examine a suspect shipment of cigarettes, they can rapidly find out where they were manufactured, what market they were officially destined for, and who they were originally sold to (or supposed to be sold to). Clearly if illegal product is frequently found to have originated from a particular warehouse, that warehouse will become a priority target for further investigation.

A strictly national tracking and tracing system is particularly effective at preventing tax-free export and illegal re-import of domestically manufactured product – the type of contraband that has historically been prevalent in a number of countries at various times (e.g. Canada and Brazil.)

Countries that have implemented elements of a national tracking and tracing systems have made surprising discoveries. For example, Brazil has a long-standing problem with cigarettes manufactured in Paraguay and imported illegally and tax-free into Brazil. However, thanks to their system (and to extensive investigations) they discovered that *Brazilian* manufacturers were also producing cigarette packs designed to look as if they were from Paraguay – complete with Spanish-language product markings and Paraguayan health warnings. Those manufacturers had presumably assumed that authorities would attempt to block trade in their illicit brand via increased border controls, rather than inspections in Brazilian factories hundreds of kilometres from the border.

Unlawful conduct/offences (Article 14)

One frequent complaint of police forces investigating illicit trade in tobacco products is that courts still perceive such trade to be a 'victimless crime' and impose at most symbolic fines.

Sometimes it is worse than that: police are convinced that a person or company is involved in the illicit trade, but their particular role in tobacco smuggling isn't technically illegal under existing law. For example, it may be illegal to *produce* cigarettes without buying a corresponding quantity of tax stamps, but if it is not illegal to be in possession of unstamped cigarettes, it may not be possible to charge transport companies that link overseas factories with local black markets.

Article 14 of the ITP includes a long list of acts and omissions that all governments should make illegal. (According to 14.2, it is up to individual governments to decide which ones should be treated as criminal offences and which as less serious matters, such as administrative violations.)

Governments who feel their country is experiencing, or could soon experience, substantial levels of illicit trade in tobacco would be well advised to review their legislation in light of Article 14, to see what conduct is not yet illegal in their country.

Conclusion

The Illicit Trade Protocol is a complex document with many other useful provisions. Authorities who are hesitating about tobacco tax increases because of fears of illicit trade should treat the ITP – which was negotiated by all Parties to the FCTC – as a template for immediate national action.

Keeping tobacco taxes low, as the tobacco industry and its allies suggest governments should do, is the worst possible policy to control illicit trade. There is already an international consensus on the specific, evidence-based measures governments should take to reduce tobacco smuggling: the ITP.

