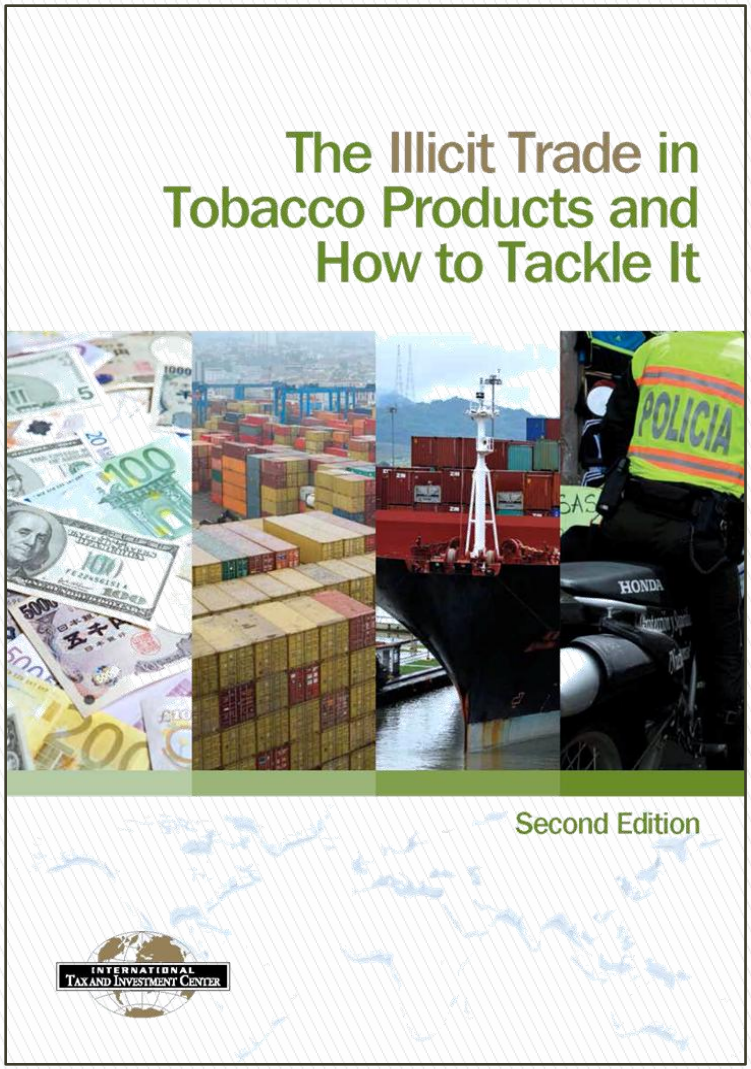

Combating Illicit Trade in Tobacco Products

Elizabeth Allen

International Tax and Investment Center July 2014

www.iticnet.org

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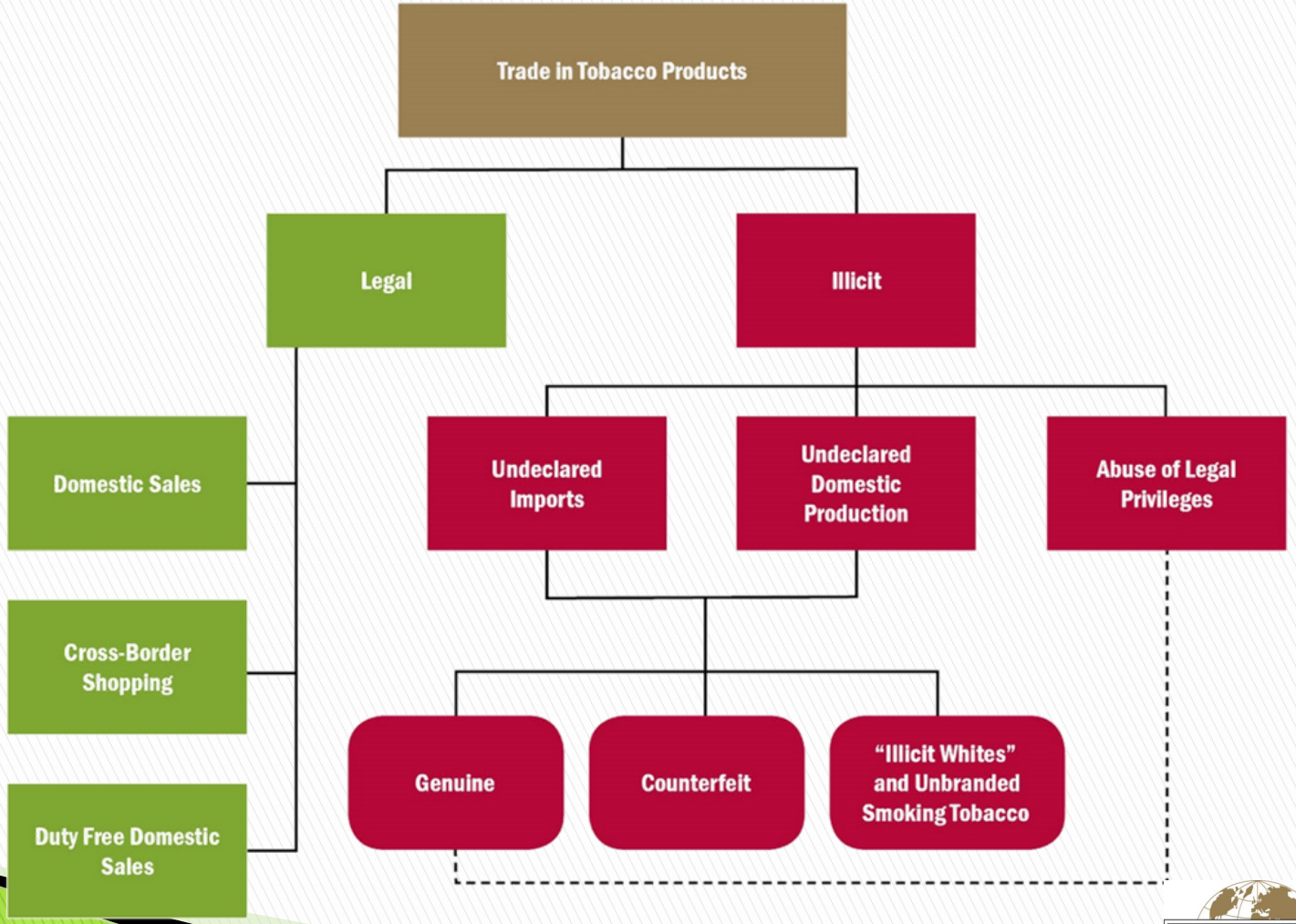
TRADE IN TOBACCO PRODUCTS



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ILLICIT TRADE IN TOBACCO PRODUCTS

- WHO FCTC *"any practice or conduct prohibited by law and which relates to the production, shipment, receipt, possession, distribution, sale or purchase including any practice or conduct intended to facilitate such activity."*

Main categories are:

- Illicit Imports
- Illegal Domestic Production

WHY CIGARETTES?

SUPPLY

- Economic drivers – profits for criminals:
- Protectionist policy measures
- Light and portable
- Inadequate enforcement including control of "Free Zones" and porous borders
- Corruption
- Inadequate legislation and penalties
- Time-consuming prosecution process
- Not a political priority

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WHY CIGARETTES?

DEMAND

- Affordability for consumers
- Dramatic tax hikes
- Reliable suppliers with well organized distribution in areas of economic and social deprivation
- Restrictions on flavours, pack sizes etc.
- Not seen as a “crime” – resentment
- Sales to minors are illegal in most countries – forbidden fruit!

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HOW BIG IS THE PROBLEM?

Euromonitor International 2012

"Illicit trade in cigarettes is the biggest illegal trade in a legal product in terms of value and second only to illegal drugs in terms of revenue generated by smugglers"."

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ESTIMATING THE SIZE OF THE PROBLEM AND REVENUE IMPACT

- KPMG Project Star estimates illicit cigarettes in the EU in 2012 at 11.1% - or 65.5 billion cigarettes - resulting in Euro 12.5 billion in lost tax revenues to Member States.

- Euromonitor International 2012 estimates 600 billion cigarettes - 10% of all cigarettes consumed worldwide - are illicit. Governments lose between US$40 and 50 billion tax a year.

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MEASUREMENT

- **Seizures** may be only a small proportion but provide useful information on trends/routes etc.
- **Street prices of illicit goods** indicate the effectiveness of enforcement.
- **Market and consumer research** utilising robust methodologies relevant to the type of tobacco market
- **Econometric estimates** repeated at regular intervals provide a baseline to indicate whether illicit trade is increasing or decreasing and a useful tool in persuading Ministers to fund essential resources.

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NATURE OF THE PROBLEM

- **Illicit imports - smuggled across borders**
  - "Cheap" or "illicit" whites - Products produced legally or "off record" in another country – sometimes specifically for smuggling
  - Genuine legal products
  - Counterfeit products
- **Illicit domestic production - evading local taxation**
  - Off record production either by poorly controlled but licensed excise taxpayers or by completely off record producers

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DRIVERS AND FACILITATORS

- **STEEP TAX HIKES – Ireland, Malaysia, Turkey and Singapore**
- Relaxed customs controls in Free Zones
- Corruption – Australia “Operation Heritage”
- Ineffective domestic controls on manufacture , inputs to manufacture e.g. acetate tow and onward supply
- Very small (1 to 2%) percentage of containers scanned/physically examined
- Display bans provide legitimate retailers with opportunities to sell illicit goods to regular customers
- Inadequate consultation
- Gaps in legislation – e.g. ability to seize and destroy products and equipment

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IMPACT ON SOCIETY

- Organized crime – money laundering
- Terrorism – impact on global security
- Undermines respect for the rule of law
- Undermines public health and tobacco control initiatives
- Has most impact on young people and on those in reduced economic circumstances
- Lost Government revenues
- Financial loss to legitimate industry and associated businesses

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OTHER IMPACTS

- Consumers of illicit products predominantly come from lower income groups who find the legal prices unaffordable or young people who are unable to buy the goods from a legal retail outlet.
- Counterfeit cigarettes can contain cadmium levels five times higher and lead levels six times higher than in genuine cigarettes.
- Customs officials at risk because of methods of concealment of illicit tobacco products.
- Contents of some illicit products have contained pesticides, arsenic, rat poison and human faeces.

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HOW TO TACKLE IT?

A COMPREHENSIVE STRATEGIC APPROACH :

- **Top level ongoing political commitment**
- Understand and monitor the size and nature of the problem.
- A balanced tax policy and effective tax collection
- Zero tolerance of corruption and nepotism
- Ensure that official controls on manufacturing and export controls, free zones and transit are appropriate and effective
- Ensure legislation and regulations work and that penalties act as a deterrent
- Raise awareness of the judiciary so that appropriate penalties are imposed
- Educate the public – tackle demand as well as supply
- Implement the ITP consistently (across nations) and effectively
- Build/strengthen national and international partnerships
- **Robust enforcement**

See – www.customs.hmrc.gov.uk**.**

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STRONG REVENUE /CUSTOMS CONTROLS ESSENTIAL

- *Producing, storing, operating on and transporting excise goods tax-unpaid MUST be regarded as a privilege not a right with appropriate licences controlled robustly and controls applied consistently across those licensed.*
- Risk and intelligence based controls need to detect illicit “underground” production and distribution and undeclared production by licensed producers.

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LEGISLATION

Ensure legislation enables you to:

- Destroy seized illicit products, raw materials, and manufacturing equipment quickly;
- Seize the means of transport of illicit goods;
- Control tobacco related activities in Free Zones;
- Require all transporters of tax-unpaid goods to hold an appropriate excise licence; and
- Impose robust supply chain controls and interventions across manufacturing, tax free movements and on wholesale/retail sales and include key manufacturing inputs e.g. acetate tow.

NATIONAL ENFORCEMENT

ENFORCEMENT

- A cross-government enforcement strategy. All national and local enforcement agencies need the powers, skills, resources and tools to act effectively.
- Ensure accuracy and easy interchange of data with partners.
- Analyse trends, use risk assessment, intelligence and mutual assistance to target illicit movements and smugglers.
- Effective channels for co-operation with WCO , Interpol and with other countries and legitimate industry.
- A robust comprehensive anti-corruption strategy **AND ACTION.**
- Enforcement authorities **must** be involved in policy discussions on tobacco regulation.

UK – Collaboration with public health organisations

- Understanding the impact on the illicit market of any health-related policy initiatives
- Regional programmes to tackle illicit tobacco Cross-government approach to illicit tobacco marketing & communications
  - to shift public behaviour and attitudes to illicit tobacco and reduce demand
  - drawing on expertise across the public sector
  - how/when to target common audiences
  - achieving wider reach through pooled resources
- Help to keep tackling illicit tobacco on the local authority agenda

PUBLIC AWARENESS

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PUBLIC AWARENESS

UK research shows that:

- 70% of illicit cigarette consumers obtain their supplies from a known source – friend, family member or work colleague
- The message around illicit that has greatest impact on the UK public– especially parents – is that illicit trade encourages or makes it easier for children to smoke.

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WHY WORK WITH TRADE?

- Policy makers and regulators need to build a comprehensive understanding of the legal & illegal trade in tobacco products
- Collecting & collating reliable and comprehensive data on the global size and scale of this trade is challenging
- International “best practice” conventions, guidelines & standards on trade compliance & facilitation all encourage close public / private partnership

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WHY WORK WITH TRADE?

- Global supply chains are increasingly complex with highly complicated transport routes
- Industry is always best placed to know trade practices and international marketplaces–tobacco is no exception

So, maintain an ongoing dialogue between regulators and all involved in the legal production, carriage, storage and distribution of tobacco products.

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HOW TO WORK WITH TRADE

- **Transparency and integrity** essential on both sides
- **Consultation** on policy/legislative change enables government to understand the full implications of proposals and industry to work with government to ensure changes support economic development
- **Collaboration** in information sharing, designing auditable business processes, record keeping & technology development

WORKING WITH PARTNERS INTERNATIONALLY

- The illicit trade in Tobacco Products is “global” – but often addressed regionally or nationally
- Trans National Criminal Networks know no borders or boundaries
- Criminal networks operate across products - in other transnational crimes and money laundering
- International exchange of information & intelligence across government agencies is critical to understanding & suppressing this trade

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THE PROTOCOL TO ELIMINATE ILLICIT TRADE IN TOBACCO PRODUCTS

- The Protocol is a legally binding instrument; once in force, it will have significant implications for Customs enforcement operations
- Customs & other border agencies are encouraged to make the implementation of this Protocol an opportunity to strengthen their statutory powers, which may also then be used to counter other smuggling and fraud

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THE PROTOCOL TO ELIMINATE ILLICIT TRADE IN TOBACCO PRODUCTS

Opportunity to secure the supply chain of legitimate products:

- Licensing
- Due diligence
- Record keeping
- Track & Trace; and
- International cooperation in information, administration and enforcement

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KEY ISSUES TO BE ADDRESSED – LICENSING

- **Who** should be licensed in the supply chain?
- **Which agency** (agencies) should issue licences?
- **What criteria or standards** should determine who is 'fit and proper' to hold a licence?
- **What administrative guidelines** need to be devised to support licensing agencies?
- **How** will licence details be kept and updated to enable use in international enquiries and ensure non-compliant operators cannot move operations to start again in other jurisdictions?
- **New offences and penalties** may be needed for non compliance or for dealing without a licence.

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KEY IMPLEMENTATION ISSUES – DUE DILIGENCE

- **How** will this be monitored?
- **What guidelines** will be provided to industry on what to look for?
- **How** will non-legitimate customers or sales be reported and acted on?
- **New offences and penalties**

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KEY IMPLEMENTATION ISSUES – TRACK AND TRACE

- **How** do you identify the most appropriate technology to support?
- **How** do you ensure that the technology you approve will facilitate mutual assistance across borders?
- **Should** customs authorities seek to devise guidelines to ensure that technologies adopted and datasets used meet a set standard so that data can be exchanged quickly and easily across borders or is there an international standard that can be used?

AND, track and trace technology will not be applied to counterfeit products!

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KEY IMPLEMENTATION ISSUES

- **What** records are kept today for commercial purposes and for how long?
- **What** records are required today for tax purposes and for how long?
- **What** changes will be needed in law and in practice?

KEY IMPLEMENTATION ISSUES – INTERNATIONAL CO-OPERATION

- **Which authority shall be designated** with responsibility and power to receive requests and either execute or transmit them to their respective competent authorities for speedy and proper execution.
- **How** can speedy and accurate responses by ensured to queries from another authority?
- **How** can data quality and security be assured for global exchanges of information critical to investigations and prosecutions?
- **How** will the comprehensive international approach and close cooperation among Countries emphasized by the Protocol be achieved?

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IMPLEMENTATION ISSUES – SANCTIONS

Article 14 provides a list of unlawful conduct

- **How** will countries determine which core conduct should be criminalised?
- **What** guidelines should there be as to which provisions should be criminal offences and which administrative offences?

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OTHER IMPLEMENTATION ISSUES

What Customs procedures are needed for:

- Free zone management of tobacco operations
- Under-bond movements
- Exports, including movements to point of export

What resources and skills will be needed?

CONSISTENCY OF APPROACH WILL BE KEY TO SUCCESSFUL IMPLEMENTATION WORLDWIDE

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THANK YOU

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