

Combating Illicit Trade in Tobacco and Alcohol Products

The Illicit Trade in Tobacco Products and How to Tackle It



Second Edition



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ILLICIT TRADE IN TOBACCO (AND ALCOHOL) 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 AND ALCOHOL?

SUPPLY

- Economic drivers – profits for criminals:
- Protectionist policy measures
- Cigarettes - 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

WHY CIGARETTES AND ALCOHOL?

DEMAND

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

HOW BIG IS THE TOBACCO 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”.“

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.

NATURE OF THE GLOBAL PROBLEM

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

DRIVERS AND FACILITATORS

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

IMPACT ON SOCIETY

- ▶ Organized crime – money laundering
- ▶ Terrorism – impact on global security
- ▶ Lost Government revenues
- ▶ Undermines respect for the rule of law
- ▶ Undermines policies on health and sales to minors
- ▶ Has most impact on young people and on those in reduced economic circumstances
- ▶ Financial loss to legitimate industry and associated businesses – especially small retailers

THE SADC REVIEW OF ILLICIT EXCISE TRADE -2010/11

TERMS OF REFERENCE

Briefly:

“to evaluate the extent of and provide recommendations for solutions for combating the illicit trade in excisable products in the SADC region, with particular emphasis on the illicit trade in alcoholic beverages and tobacco products.”

FINDINGS - CIGARETTES

- ▶ **Illicit trade in cigarettes** was a **significant problem** resulting in considerable leakage of tax revenue across SADC potentially a minimum of approximately **US\$350 million a year**
- ▶ The amount of revenue leakage for cigarettes in South Africa alone was estimated at **US\$323 million** or **23%** of total consumption (6.3 billion sticks)

ESTIMATES (BY INDUSTRY) OF ILLICIT TRADE IN OTHER COUNTRIES VISITED

Cigarettes

- ▶ 12% to 15% of total consumption in Namibia
- ▶ 10% to 13% of total consumption in Zambia
- ▶ 10% to 12% of total consumption in Swaziland
- ▶ 1% to 2% of total consumption in Mozambique
- ▶ Minimal proportion in Zimbabwe

NATURE OF ILLICIT TRADE - SADC

Cigarettes

- ▶ Main source countries in region were Zimbabwe and, to a lesser extent, South Africa, Mozambique and Malawi.
- ▶ Some counterfeit and contraband from Dubai and counterfeit from China
- ▶ Destination country – mainly South Africa but illicit cigarettes found their way into all countries
- ▶ Transit countries – Namibia, Botswana, Swaziland, Mozambique, Zambia, Tanzania.

FINDINGS - ALCOHOL

- ▶ **Illicit trade in alcohol for most of the countries visited was a significant problem** resulting in considerable leakage of tax revenue across SADC potentially a minimum of approximately **US\$115 million a year.**
- ▶ The amount of revenue leakage for alcohol in South Africa alone was estimated at about



ESTIMATES (BY INDUSTRY) OF ILLICIT TRADE IN OTHER COUNTRIES VISITED

Alcohol

- ▶ Swaziland - no estimate available - one importer estimated legitimate sales had decreased by 40% in 2010.
- ▶ Mozambique - estimate 50% of nationally produced spirits and over 50% of imported spirits are illicit.
- ▶ Namibia - industry's rough estimate was "less than 10%" illicit but growing.
- ▶ Zambia - unofficial estimate of excise loss of about K15bn a year (over \$3 million) excluding opaque beer.
- ▶ Zimbabwe - industry estimate of illicit alcohol was between 100,000 and 150,000 litres a month and growing.

NATURE OF ILLICIT TRADE

Alcohol

- ▶ Source countries for finished products - South Africa and Europe (via South Africa and Namibia), Mozambique and Zambia.
- ▶ Source countries for bulk spirits - S. Africa, Swaziland, Zimbabwe and Malawi.
- ▶ Destination countries for finished products - Mozambique and Zambia. Particular concern - small plastic sachets of fruit-flavoured high strength spirits and small plastic bottles of spirits.

AREAS FOR IMPROVEMENT

- ▶ **A strategic approach to tackling the illicit trade in alcohol and tobacco products was advocated including:**
- ▶ Zero-tolerance of corruption
- ▶ A balanced evidence based tax policy leading to specific duty structure with the long-term aim of tax harmonisation
- ▶ Reliable and complete data
- ▶ Understand the size and nature of the illegal trade
- ▶ Targeted enforcement strategy and action plans across all enforcement agencies
- ▶ Implement regional customs transit system
- ▶ Investment in one-stop-border posts, training, more scanners, sniffer dogs and better examination facilities

AREAS FOR IMPROVEMENT

Continued

- ▶ Clear, straightforward and appropriate excise administration policies and legislation
- ▶ Appropriate offences, penalties and a judiciary aware of the seriousness of excise fraud and smuggling
- ▶ A national professional focus on excise control
- ▶ Supply chain controls on products and on wholesale and retail outlets
- ▶ E-filing and inclusion of excise in modernisation programmes
- ▶ Raise capacity and capability of officials
- ▶ Mutual assistance between Member States

HOW TO TACKLE ILLICIT TRADE?

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.



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.

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 excise operators to practice zero-tolerance of corruption;
- ▶ 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 including key manufacturing inputs.

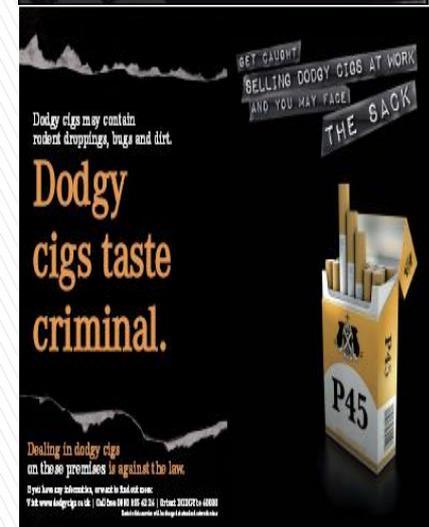
NATIONAL ENFORCEMENT

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 health policy driven regulation.

TACKLING DEMAND FOR ILLICIT TOBACCO PRODUCTS – UK

- Critical is understanding the impact on the illicit market of any health driven regulations
- Development of research based 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



UK – PUBLIC AWARENESS ADVERTISING



UK RESEARCH SHOWS

- ▶ 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.

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 and alcohol 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

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

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

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.

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**

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!

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 be 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?

SOME OTHER ISSUES

- ▶ **What** records are required today for tax purposes and for how long and what changes will implementation of the ITP require?
- ▶ **How** best to control the supply chain for alcohol products? – One size doesn't fit all!
- ▶ **How** will countries determine which core conduct should be criminalised for the ITP?
- ▶ **What** guidelines should there be as to which provisions should be criminal offences and which administrative offences for the ITP?

SOME OTHER ISSUES

What Customs procedures are needed for:

- Free zone management
- Under-bond movements including movements between tax warehouses nationally and within a customs union
- Exports, including movements to point of export.

What resources and skills are needed?



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