

FCA Briefing paper setting out why COP-1 should prioritise starting a process to develop a protocol to combat the illegal tobacco trade

Summary and Recommendation

Article 15 of the WHO FCTC contains obligations for countries to reduce the illegal tobacco trade, but is not detailed and specific enough to be fully effective. COP 1 should prioritise starting a process to develop a protocol to control the illegal trade of tobacco products. This should be based on similar conventions such as the Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition, supplementing the United Nations Convention against Transnational Organized Crime. It should contain at a minimum the same obligations as the agreement between Philip Morris International (PMI) and the European Commission.

Introduction

During FCTC negotiations, countries recognized the importance of a protocol on illicit trade. The following footnote to Article 15 (illicit trade) was included with the text of the FCTC approved by the World Health Assembly in 2003 (the footnote has not been included in the reprinting of the FCTC):

“There has been considerable discussion throughout the pre-negotiation and negotiation process concerning the adoption of an early protocol on illicit trade in tobacco products. The negotiation of such a protocol could be initiated by the INB immediately following the adoption of the FCTC, or at a later stage by the Conference of the Parties.”

Set out below are some Questions and Answers to give more detailed background to the recommendation that COP-1 should prioritise the development of a smuggling protocol for the Framework Convention on Tobacco Controlⁱ

1. Why is the illegal tobacco trade a health problem?

The illegal tobacco trade is a major health concern for the following reasons:

- It undermines a high tobacco taxation policy, which evidence shows is one of most effective ways to reduce consumptionⁱⁱ as well as an effective method of raising revenue.
- Smuggled cigarettes are sold at a lower price, making cigarettes available cheaply, thereby increasing consumption and undermining efforts to keep youngsters from smoking.
- Smuggling makes top international brands available at affordable prices to low-income consumers, and to image-conscious young people who regard such products as sophisticated and stylish. This is also a growing problem in developing countries.
- Smuggled cigarettes evade health regulations, such as prohibitions on selling to minors, package warnings and other labelling requirements.

2. Are there additional reasons to combat the illegal tobacco trade?

Terrorist groups and other criminal organizations are involved in the illegal tobacco trade.ⁱⁱⁱ Many governments are concerned by the link between tobacco smuggling and criminal and terrorist organisations by providing these organisations millions of dollars through the diversion of large consignments of cigarettes.^{iv} Smuggling is mainly caused by cigarettes which are duty suspended under the transit regime and which disappear during their international transport. They can be sold on the illegal market without taxes. A container load of 10 million cigarettes can be bought in transit for 200 000 euros, but is worth 5 to 10 times more. Transit is a concession system aimed at facilitating trade. Its essence is to allow the temporary suspension of customs duties, excise and VAT payable on goods originating from and/or destined for a third country while under transport across a defined customs area. Missing containers which end up in the illegal tobacco trade are an important source for financing of organised crime and terrorist organisations. The current relative lack of controls on cigarette containers under transit makes it easy for terrorist organisations to finance their activities, as smuggling cigarettes is much less risky than smuggling illegal drugs but is still highly profitable (and is a convenient way to launder drug money).^v

3. Why don't the cigarette companies do more to prevent and reduce the illegal trade of tobacco products?

Tobacco manufacturers profit from the illegal trade of their own products because it increases overall sales. It does this both by reducing the prices paid by consumers (without reducing the prices paid to the manufacturers), which increases consumption levels, and by facilitating transport of the manufacturers' tobacco products into otherwise closed or restricted markets. Legal manufacturers lose profits, however, when consumers purchase counterfeit versions of the manufacturers' tobacco products instead of their own products, thereby reducing the manufacturers' sales and revenues. Accordingly, some of the major tobacco companies have actually supported or facilitated the illegal diversion of their own tobacco products into illegal trade and illegal sales;^{vi} but some have also taken steps to reduce the illegal trade in counterfeit tobacco product (see Question 4, below).

4. What other recent developments have been important in the fight against the illegal tobacco trade?

Prompted by a lawsuit filed against PMI for smuggling cigarettes into the EU, in July 2004 PMI concluded an anti-contraband and anti-counterfeit agreement with the European Community and 10 EU countries. For years the industry has been saying that the cause of smuggling was high cigarette prices. However, the agreement stresses the importance of controlling the supply chain and export practices in order to effectively control smuggling. Smuggling is a supply driven process, fed by the industry which supplies the duty suspended cigarettes. The payments set out in the agreement are of crucial importance. For each seized container of 10 million PM cigarettes in the ten countries -which are part of the deal – PMI has to pay 1, 5 million euros. When 90 million PM cigarettes in ten countries have been seized, PMI has to pay 5 times as much or 7, 5 million euro for each seized 10 million cigarettes container. The agreement is in line with the principle that "The key to controlling cigarette smuggling is to control tobacco manufacturing and its exporting practices."^{vii} Currently this agreement only applies to PMI and the European Community. This agreement

is very detailed and far reaching, but lacks transparency. No information has been made public by the two parties since the agreement was signed in July 2004. It could provide a baseline for the protocol on smuggling required under the Framework Convention on Tobacco Control. As a minimum, an FCTC protocol on smuggling should contain the provisions of the PMI-EU agreement applied to all tobacco product manufacturers and countries (but with more public access to information related to enforcement efforts and results).

5. What is the attitude of the other tobacco companies?

Other tobacco companies have not been keen to accept the obligations of the agreement between Philip Morris International and the European Community. British companies, such as Imperial Tobacco and Gallagher prefer Memoranda of Understanding (MOUs), which are generally vague, short, without penalties and not legally binding in the same way as the PMI-EU agreement^{viii}. British American Tobacco (BAT) prefers also non binding agreements and has concluded more than thirty MOUs with governments in different parts of the world. BAT is not willing to accept the obligations of the PM agreement, but has made proposals to accept an export bond system which would require that any person wanting to move tobacco manufactured products in commercial quantities from one country to another, has to post a bond in the form of a bank guarantee or similar instrument in approved form and provided by an approved institution. While the proposal of BAT is not legally binding as the PM agreement is, it acknowledges financial responsibility for control of the export of their cigarettes.

6. Why is a protocol needed? Isn't article 15 of WHO FCTC sufficient to resolve the problem of the illegal tobacco trade?

Article 15 of the WHO FCTC contains obligations for the countries to reduce the illegal tobacco trade, but is not detailed and specific enough to be fully effective. What is needed is a protocol which controls the illegal trade of tobacco products. This should be based on similar conventions such as the Protocol against the Illicit Manufacturing of and Trafficking in Firearms, Their Parts and Components and Ammunition, supplementing the United Nations Convention against Transnational Organized Crime and should at least contain the same obligations as the agreement between PMI and the EC.

7. How can a protocol on illicit trade be prioritised by the COP?

The need for the development of a protocol on illicit trade will have to be raised by a Member State(s) during the course of the discussion under agenda item 5.3 on the elaboration of protocols.

8. Are counterfeit cigarettes not the real problem and if so how would a protocol help?

A relatively new phenomenon is counterfeit cigarettes. In the UK, 25% of the illegal cigarette market and 54% of the seized illegal cigarettes in 2003-4 were counterfeit cigarettes. The control of counterfeit cigarettes is even more difficult than the control of "normal smuggled cigarettes". The origin of smuggled cigarettes can be detected, but the origin of counterfeit

cigarettes can only be discovered through close collaboration with the country in which counterfeit cigarettes are produced. An estimate of counterfeit trade is difficult to make, but it is certain that the market share of counterfeit cigarettes is rising in many countries, not just the UK. The recognition of counterfeit cigarettes at time of seizure is an additional problem. Most counterfeit cigarettes have health warnings or tax stamps on the pack and are not recognised as fake by smokers. In most countries customs authorities rely on the tobacco industry to determine whether a product is genuine or counterfeit, which can take considerable time and impedes effective control of counterfeit trade. The need for independent identification of counterfeit cigarettes is self evident. California, Malaysia and Brazil for instance require markings on the pack which allow enforcement officials to detect easily counterfeit cigarettes. A protocol is needed to effectively control the worldwide trade in both “normal smuggled cigarettes” and counterfeit.

9. What are the key provisions of a WHO FCTC protocol on illegal tobacco trade?

A. Anti-money laundering provisions.

Anti-money laundering measures are essential in combating the smuggling of tobacco products as payments for smuggled cigarettes are normally made in cash in order to hide the identity of the traders and disguise the illegal sources of the payments. In addition, there is a significant risk that proceeds of smuggling can be used to finance criminal activities such as terrorism. In line with article 15.4.e of the FCTC, specific measures should be adopted to enable the confiscation of proceeds derived from the illicit trade in tobacco products.

B. A tracing and tracking system.

In order to enable authorities to trace tobacco products and detect illegal trade, markings and codes on the packs, cartons and master cases must be made mandatory. A tracking system would allow authorities to monitor the movement of tobacco products around the world in order to avoid their diversion into illegal markets. The ability for authorities to follow the products is key to identify the point of diversion and hold those responsible accountable. Any prospective system needs to allow for some flexibility to cope with progress in technology but still be unified in order to avoid having different countries with different and non compatible tracking and tracing systems. Tracing and tracking systems have already been put in place in Brazil and California.

C. Record-keeping

Linked to a tracking/tracing system and the use of machine scannable codes and markings, authorities must keep computerised records of all shipments, including the country of export, the country of import, transit countries, date of issuance and of expiry of licenses, final destination, amounts of tobacco products traded, etc.

D. A strict liability and compensation system

A strict liability and compensation system should be put in place 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. Payments are an essential part of the agreement between Philip Morris and the EC and a system of posting bonds has been proposed by BAT. If the two biggest international tobacco companies already accept a system of financial liability, it can certainly be a key element of an FCTC protocol.

E. **Criminalisation** of counterfeiting of and contraband in tobacco products, as well as the removal and alteration of markings is key to deterring illicit activities. Currently the penalties for tobacco smuggling are minor compared to the profits that accrue from it.

Recommended reading:

- Ligue Nationale Contre Le Cancer, Seminar on a FCTC Smuggling Protocol, 27th January 2005, Paris.
- Framework Convention Alliance for Tobacco Control, Fact sheet 8, Tobacco smuggling, 2005. <http://fctc.org/factsheets/8.pdf>

ⁱ The recommendation for a protocol on illegal tobacco trade arose from the policy development group held during the UK Presidency of the EU summit on Health Inequalities in London in October 2005, and these Questions and Answers are taken from the presentation to that event made by Luk Joossens, Advocacy Officer at the Association of European Cancer leagues.

ⁱⁱ World Bank. Tobacco control at a glance , Washington DC, 2003, www.worldbank.org/tobacco

ⁱⁱⁱ See, e.g., Horwitz S, Cigarette smuggling linked to terrorism, Washington Post, June 8 2004. U.S. General Accounting Office, *Terrorist Financing: U.S. Agencies Should Systematically Assess Terrorists' Use of Alternative Financing Mechanisms*, GAO-04-163, November 2003, <http://www.gao.gov/new.items/d04163.pdf>.

^{iv} The European Community against RJ Reynolds Tobacco Company, Civil money laundering action, 31 October 2002, U.S. District Court, New York, 146 pages.

^v See, e.g., Farah, D., “Money Cleaned, Colombian Style; Contraband Used to Convert Drug Dollars,” *The Washington Post*, August 30, 1998.

^{vi} See, e.g., Campaign for Tobacco-Free Kids, *Illegal Pathways to Illegal Profits: The Big Cigarette Companies & International Smuggling*, 2001, <http://tobaccofreekids.org/campaign/global/framework/docs/Smuggling.pdf>.

^{vii} Joossens, L. & M. Raw, “How can cigarette smuggling be reduced?,” *British Medical Journal* 321:947-950, 14 October 2000, <http://bmj.com/cgi/content/full/321/7266/947>.

^{viii} <http://www.ash.org.uk/html/press/040709brief.html>