

Smuggling: what the FCTC could do...

Clive Bates, Action on Smoking and Health, London
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Why is smuggling a health problem?

Roughly one third of internationally traded cigarettes (350 billion per year) are eventually sold illegally with the avoidance of duty. This reduces the price, increases demand, undermines national tobacco tax policies and – as a result harms health by increasing tobacco use. Tobacco smuggling is also linked to organised crime, money laundering, and racketeering. Philip Morris and BAT face racketeering (RICO) charges over their involvement in tobacco smuggling in Latin America.

Who benefits?

Organised crime and petty criminals clearly benefit. The tobacco companies benefit because average tobacco prices are reduced and hence demand increased and cheap smuggled cigarettes may keep people smoking who otherwise would quit. High levels of smuggling can also result in governments reducing tobacco taxes in an effort to deal with the problem. This keeps prices lower and demand higher in the *legal* market – again the tobacco companies benefit. The World Bank has identified price as a key health and economic policy in tobacco control, and smuggling undermines the effectiveness of this policy.

Tobacco smuggling as a commercial activity.

Tobacco companies have used smuggling as a distribution channel to launch new brands, to enter new markets and fight price wars with their competitors. Once one company is involved, the others risk losing market share if they do not effectively 'compete' to have their brands represented in illegal markets. The major companies seek to maximise their performance in the whole system – legal and illegal.

Is smuggling caused by high taxes?

Yes and no. But mostly no. The difference in duty levels between neighbouring states is only a MINOR driver of smuggling. The economic driver of most smuggling is the difference between the duty paid and duty not paid price. Most smuggled cigarettes have never had duty paid in any country and are smuggled by diversion from the transit trade. The level of cigarette smuggling in the UK has recently reached about 25 per cent of the market – but 80 per cent of this is large scale container fraud involving consignments of 10s of millions of cigarettes on which duty has not been paid anywhere.

Key fact

Even if all countries levelled exactly the same level of taxes and had identical prices, smuggling would still continue at a large scale. In Europe until recently the highest levels of smuggling were found in countries with some of the lowest taxes (Spain and Italy). This pattern is reflected around the world.

What drives smuggling?

Smuggling is *based on* tax avoidance, but it is *driven by* commercial activities of tobacco companies and organised crime and the extent to which law enforcement creates costs and risks as a disincentive to smuggling. The success of the FCTC will depend on how it improves law enforcement and how it changes the business practices of tobacco companies.

- Without tobacco taxes there would be no smuggling, but that does not mean reducing tobacco taxes will reduce smuggling – unless taxes were eliminated. But even this measure would simply stimulate smuggling into neighbouring countries.
- Extensive evidence now exists showing that tobacco companies act to facilitate smuggling and treat smuggling as a normal distribution channel in which they act through third parties. For example by: (see www.ash.org.uk/smuggling for more detail)
 - Adopting an approach to business planning and sales target setting which treats the various

ordered by customers etc.

The FCTC response to smuggling

The strategic response must be to:

- Secure the distribution chain – in no other industry could one-third of traded goods enter the black market.
- Create a liability regime – in which producers and distributors are accountable for onward sales to legitimate dealers. This ‘duty of care’ approach is a major component of the Basel Convention on the transboundary trade in hazardous wastes and could be applied to trade in tobacco.
- Reorganisation of distribution to ensure that products can be tracked and traced, to facilitate identification of smugglers and the point where tobacco enters the black markets.

The FCTC should contain anti-smuggling measures in BOTH the Convention itself and in a detailed smuggling protocol. In the **Framework Convention** basic anti-smuggling measures should be developed. These would have benefits in their own right and create a basis for building a protocol. Such measures could include (but not limited to):

- Labelling every pack with its origin (manufacturer) and destination (country). This means that the manufacturer must know where the product will be sold at the time of manufacture and therefore must know the distribution chain.
- Requiring warnings in the language of the destination market
- Ban duty free sales (already achieved within the European Union)
- Require manufacturers to mark packs and to be able to identify which wholesaler they sold a particular pack to on the basis of the marking.
- Require co-operation between law enforcement bodies.
- Commit to meaningful penalties to introduce a disincentive to smuggling.

In the **Smuggling Protocol**, the FCTC should develop a secure regime for the legal sale of tobacco. This would involve:

- A liability regime in which producers and wholesalers would be liable for damages or penalties if they sold to smugglers – or sold to someone that subsequently sold to smugglers. This applies a ‘duty of care’ each participant and to ensure that they take proper care to ensure their products do not enter the black market. At present the opposite
- A duty of care, with a view to creating a secure custody chain for tobacco.
- Licensing of participants in the distribution chain – with the threat of the loss of license if they fail to discharge their duty of care.
- Consider the possibility that tobacco products should move in transit with duty paid or with a bond redeemable at the point of legal sale.