

## Smuggling: Our View

- **British American Tobacco companies do not smuggle. We do not condone smuggling, and we do not encourage or collude with others to smuggle on our behalf.**
- **Smuggling is caused by tax differentials, weak border controls, and import restrictions and bans.**
- **Smuggling damages our business. We would make more money in the long term if it could be eliminated. We would like every market to be entirely rid of it.**
- **Only governments can tackle smuggling effectively. No international business operating through distributors can control every subsequent link in diverse and myriad secondary supply-chains.**
- **We work actively with governments and customs and excise authorities around the world to help them eliminate smuggling and to ensure that we can compete fairly and openly.**
- **Smuggling is a major global problem for manufacturers of many goods, including computers, electrical goods, cars, watches, wines and spirits, mobile phones, toys, perfumes, even soaps and detergents. It is invidious to single out the tobacco sector, or one tobacco company, as if to suggest that no other industry or company faces equally difficult issues.**
- **The British American Tobacco group employs almost 90,000 people and contributes about £13 billion a year to governments around the world through duties and taxes, well over ten times more than the group's profit after tax. The vast majority of the 180 markets where we operate are orderly.**

### Causes of smuggling

Smuggling is caused by high tax differentials between neighbouring areas, weak border controls, and import restrictions and bans - often to protect state monopolies - on goods which are in high consumer demand.

It is not caused by companies such as those in the British American Tobacco group, which invest heavily in well-managed distribution networks and seek orderly, transparent markets for their goods.

Where governments are not prepared to address the causes of smuggling, it can rapidly spiral to overwhelm an orderly market and will frequently be penetrated by organised crime.

For centuries, smuggling has been exacerbated by bans and excessive taxes imposed on political or 'disapproval' grounds which are not welcomed or endorsed by the majority of consumers.

### Bans and import controls

During Prohibition in the USA in the 1920s, bans on both the importation and use of alcohol did not prevent consumption. Smuggling increased dramatically, with heavy involvement of organised crime.

In the UK, some of the earliest government attempts to control tobacco were in the 17<sup>th</sup> century, soon after tobacco first arrived. King James I, a powerful opponent of smoking, imposed a five-fold tax increase, which did not stop tobacco consumption increasing. When he restricted imports, smuggling increased. Sizeable revenues were lost and the government had to allow wider importing.

In recent years, Canada and Sweden have reduced tobacco duties to combat smuggling. Overall consumption in these markets has remained stable,

smuggling has reduced, and government revenues have stabilised.

People choose to smoke for many social, cultural and personal reasons. Just as adults make informed choices about smoking, adult smokers make informed choices about brands. Even in relatively undeveloped markets, there is strong consumer demand for international cigarette brands. If they are not manufactured locally and a local monopoly favours domestic products, consumer demand for international brands stimulates smuggling and counterfeiting.

### Smuggling damages our business

British American Tobacco companies manufacture around the world for domestic markets and for export.

In various markets, we sell on standard terms and conditions to wholesalers who often also re-sell many other companies' products.

In many of our principal markets, we invest in company distribution networks staffed by our own employees, delivering direct to retail outlets, as in Argentina, Australia, Brazil, Chile, Colombia, Mexico and Venezuela.

In countries where local restrictions prevent company distribution, we engage distributors under contract to provide the same service, for example in large parts of the Middle East.

Developing well-managed distribution networks requires major investment, which is undermined by smuggling.

Smuggling also corrodes market share and destroys the reputation and profitability of our brands - amongst any company's most important assets. It also facilitates the equally damaging problem of counterfeiting.

### **Counterfeiting**

There is significant global capacity to produce counterfeit cigarettes. Counterfeiters can undercut legitimate manufacturers' production costs with inferior materials and by breaching employment and other regulatory standards. Cigarette counterfeiting can be highly lucrative when a destination market has high duties.

Counterfeit cigarettes typically evade duty and taxes. They damage companies' market share for genuine brands, and the inferior quality significantly damages customers' brand perceptions.

Smuggling and counterfeiting damage our business. We would like every market to be entirely rid of them.

### **Diversity of supply**

The global tobacco market is characterised by diverse sources of supply. Tobacco is widely grown. The technology to make and package cigarettes is widespread and relatively inexpensive. There is vast available manufacturing capacity.

Alongside the major international manufacturers, who supply just over 40% of the world market, there are more than 200 producers in various countries, supplying some 60%. Many make local versions of international brands under licence.

There are multiple supply chains for tobacco products, including an active secondary market involving hundreds of brokers globally, and local spot markets in several countries which also involve the trade of hundreds of other commodities.

Where a market involves myriad and diverse secondary transactions, it is impossible for any manufacturer, however prudent in managing its primary distributors, to control all aspects of supply. Efforts to do so would not only be impractical but, from the point of view of competition and the efficient working of markets, almost certainly undesirable and in some markets illegal.

Smuggling and counterfeiting typically involve several separate buyers between an initial purchase and its eventual dispersal and disappearance from legitimate circulation. Intermediate changes of hands can take place almost simultaneously in diverse global locations, making identification of the buyers virtually impossible.

Where the causes of smuggling are not being addressed, demand for contraband will inevitably overcome any supply-side control efforts.

### **Only governments can tackle smuggling effectively**

Global businesses are not global law enforcement agencies. Only governments can control borders and excise strategies to ensure orderly markets.

If a company withdraws entirely from a market damaged by smuggling, consumers will either switch to its competitors' brands, or there will be a dramatic increase in counterfeiting.

Where governments are not prepared to address the causes of smuggling, businesses such as ours, producing highly taxed consumer goods, will inevitably find that their goods are being smuggled or that there is a noticeable increase in counterfeiting.

In these circumstances, British American Tobacco companies, like many other similar businesses, act within the law to sell goods for both duty-paid and duty-free markets, recognising that some of our brands will be found in certain markets, alongside those of our competitors, as a result of the activities of smugglers.

### **Company standards**

British American Tobacco employees are required to operate in accordance with our Standards of Business Conduct. These stipulate that all employees must observe the laws and regulations of any country where they operate, must act with integrity in conducting business, and must not sacrifice business integrity to results.

Our global Export Guidelines require all exports to comply with the law of the exporting country, and to be fully and accurately documented. Export managers are trained in a wide range of compliance issues including trade embargoes, avoiding third party money laundering and fraud and in conducting co-operative day to day liaison with customs authorities.

We operate rigorous selection procedures for distributors. Only a small number of the many applying to us are accepted. We will, and have, terminated contracts with distributors who have not complied with our own requirements or with legal requirements.

### **Business issues**

A major global business must balance many obligations, including obligations to employees, shareholders and business partners. It must protect market share, sustain the long term profitability of its brands, avoid unnecessary job losses and factory closures, honour supply contracts, protect the interests of its distributors in domestic markets, and meet customers' expectations of quality.

In assessing markets, whether orderly or disorderly, British American Tobacco companies have the right and responsibility to evaluate the entire market at the consumer level, and the performance of our own and competitors' brands, irrespective of source.

Opponents of tobacco will attempt to misrepresent our recognition that smuggling occurs, our efforts to understand its extent or explore solutions, or our lawful actions to protect brands and market share. They will not publicise the continuous efforts of a responsible tobacco business to work with governments and customs and excise authorities to eliminate smuggling wherever possible.

### **Co-operation with governments**

Our companies work actively with governments and customs and excise authorities around the world to help them to eliminate smuggling. They establish close day-to-day liaison, provide regular information and support practical steps to stamp out smuggling and counterfeiting.

For example:

**In the UK**, British American Tobacco companies:

- Provide regular contact and support to fiscal liaison officers in Belgium, Holland, Germany, Russia, Romania and Spain;
- Contributed to the UK Government Tobacco & Alcohol Fraud Review in 1997, to help the Government to identify the causes and scale of the problem and to provide support for solutions;
- Volunteered a Customs Director as an expert witness to the European Parliament's Committee of Inquiry into the Community Transit System;
- Distributed *Crimestopper* notices giving people a 'hotline' number to tell Customs & Excise about illegal sales, leading to many prosecutions;
- In 1999, provided over 25 witness statements to assist prosecutions of people charged with illegal importation.

**In Argentina**, Nobleza-Piccardo:

- Donates vehicles and radio equipment to the National Border Guard;
- Co-operates with police and judicial authorities in prosecutions of smugglers, counterfeiters and falsifiers of fiscal markers.

**British American Tobacco Vietnam:**

- Has been a key advocate for the adoption of new fiscal marking legislation, to take effect this April;
- Facilitated the visit by Vietnamese tax officials, customs officers and executives of the Vietnam National Tobacco Corporation to Thailand and Malaysia to meet customs and tax officials to help develop best practice.

**British American Tobacco Malaysia:**

- Carries out constructive monthly liaison with state customs directors;
- Produced 'information calling cards' for use by Malaysian customs officials, similar to the UK *Crimestopper* initiative.

**In China and Hong Kong**, British American Tobacco Hong Kong, as a member of the Hong Kong Trade Institute, has worked with Customs and Excise on the Informant Award scheme, including poster and radio advertising.

**British American Tobacco Ukraine** organised a visit of Ukrainian ministers, parliamentarians and customs officials to the UK and Germany to examine effective tax structures to combat smuggling. The delegation discussed with the German Ministry of Finance the successful record of British American

Tobacco Germany and other companies in the industry as a potential model. In the UK, they met with HM Customs & Excise, who advised that no technical measures were likely to succeed if there were significant cross border tax differentials.

**In Nicaragua**, Tabacalera Nicaraguense formed a working team with the national police, the Ministry of Finance and the General Director of Customs to break an Ecuadorean smuggling ring.

**In Venezuela**, CA Cigarrera Bigott Sucesores paid for a million pamphlets providing national guard phone numbers.

**British American Tobacco Uzbekistan** was formed in 1994. At that time it was estimated that only 10% of the market was supplied with locally manufactured cigarettes, with all other cigarettes smuggled. Lost revenue to the Uzbek government was vast and, without an orderly market, the operation of a legal, tax paying cigarette business in Uzbekistan would be impossible.

British American Tobacco and the Uzbek Government co-operated extensively in initiatives which, over 3 years to 1999, brought an increase in government tax revenues from US\$2 million to US\$14 million.

Initiatives included:

- Tax stamps, introduced in 1996;
- Dialogue and technical collaboration with state tax, customs, and statistical committees and the President's economic advisor;
- A company-sponsored communication system costing US\$350,000 to improve border controls;
- Company-sponsored information campaigns including TV, newspapers, radio, posters and point of sale;
- Government enforcement of anti-smuggling measures.

**British American Tobacco Colombia** has been actively co-operating with the government in its efforts to combat smuggling.

The company has invested heavily in a distribution network and marketing strategies to enable brands to reach areas previously only supplied by smugglers.

British American Tobacco Colombia has recently entered a formal co-operation agreement with the Colombian customs authority, DIAN, to strengthen its anti-smuggling efforts. New initiatives include Colombia licensing distributors, and the company holding training sessions with customs officials and police and liaising with the authorities to help them in monitoring the market.

### **Aruba**

Aruba is an overseas territory of the Netherlands, with a legal system based on Dutch law and final appeal to the Netherlands Supreme Court.

As an established government controlled duty free zone, it is a point of distribution for a wide range of

consumer goods in the region, including to government controlled duty free zones in Colombia.

Our exports have been sold legally to an independent distributor in Aruba who had all the necessary permits and authorisations, and who had responsibility for any further transactions.

In 1999, the Netherlands Supreme Court, on the application of British American Tobacco as a trademark owner, granted powers to the local customs authorities to seize counterfeit tobacco goods in the duty-free zone, thus extending the local customs authorities' powers.

### **UK exports**

We currently export from three UK factories. The largest, at Southampton, manufactures almost exclusively for export.

All our export procedures are controlled, monitored and approved by HM Customs & Excise, and comply with all UK and European regulations.

Company managers maintain contact with fiscal liaison officers to help identify illegal activity. This has resulted in successful seizures of smuggled and counterfeit goods.

Our export procedures are regularly audited by HM Customs & Excise. Since 1992, they have implemented 'audit-based' compliance checks, carrying out between 2 and 5 'walk-in' operational audit visits a year, with teams of up to five officials, in a programme predetermined by HM Customs & Excise. There are also between 8 and 10 'ad hoc' visits a year, for example to substantiate values or check proof of exports.

A key compliance measure is the level of any revenues or fines a company has paid as a result of any failings.

The Southampton factory alone exported 4,000 containers in 1999, representing potential duty liabilities of over £4 billion. In 10 years, Southampton can recall only one demand for £3,000, as a result of a pricing error.

We constantly review and update our procedures to ensure the highest standards of compliance and seek prior Customs & Excise approval for any changes of procedure. We also work closely with the relevant authorities in contributing to policy formation.

### **Smuggling in the UK**

While exports of tobacco products from the UK are well regulated and efficient, the UK is now one of the

significant disorderly markets of the world for tobacco imports.

Smuggling of tobacco to the UK is growing rapidly, as a direct result of a government policy of imposing far higher - and rising - taxes than those in neighbouring European countries, coupled with open borders to mainland Europe. UK smugglers can buy products in continental Europe at retail outlets - tax and duty paid - and still make large profits in the UK.

The UK now has a worse tobacco smuggling problem than Colombia, with smuggled tobacco goods estimated at some 25%, and rising, of the UK market compared to less than 10% in Colombia.

The UK Government is believed to be losing tax revenue of some £3 billion a year to tobacco smuggling. The Tobacco Alliance, representing 26,000 UK retailers, estimates that in 1999 alone each of its members lost an average of £42,000 to smuggling.

UK tobacco smuggling now appears to be attracting organised crime and gangs dealing in illegal hard drugs.

Policies of raising tobacco duties to excessive levels, often driven by anti-tobacco activists, can only exacerbate the situation.

It has been revealed that the UK Government's own 'Smuggling Tsar', Martin Taylor, recently warned the Chancellor of the Exchequer that other measures to curb tobacco smuggling would fail unless the duty on cigarettes was reduced in line with other European countries.

### **Considerations for the UK Health Committee**

It is difficult to see how a UK Parliamentary Health Committee can make recommendations in respect of international trade, particularly on issues which can only be solved - and in many cases are being actively addressed - by sovereign governments and customs authorities overseas.

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**British American Tobacco**

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